BNY MELLON

April 11, 2014

BY ELECTRONIC SUBMISSION

Basel Committee on Banking Supervision
Bank of International Settlements
SH-4002 Basel
Switzerland

Re: **Consultative Document, Basel III: The Net Stable Funding Ratio**

Ladies and Gentlemen:

The Bank of New York Mellon Corporation ("**BNY Mellon**") appreciates the opportunity to comment on the Consultative Document, *Basel III: The Net Stable Funding Ratio* (the "**NSFR**"), issued by the Basel Committee on Banking Supervision ("**Basel Committee**").[1] We understand that the NSFR is intended to limit overreliance on short-term wholesale funding and to encourage stable sources of funding.[2]

BNY Mellon supports the Basel Committee's continued efforts to strengthen the resiliency of the banking sector by requiring banks to maintain a stable funding profile in relation to their on- and off-balance sheet assets under normal, business-as-usual conditions.[3] Our role as a global custodian and our deposit-funded business model provide us with a unique perspective on the ways in which the NSFR, as proposed, could achieve these goals and impact bank funding models. While we appreciate all the work that has been put into the NSFR to date, we believe that two modifications to the NSFR would better achieve the Basel Committee's goals:

- Increase the available stable funding ("**ASF**") factor for operational deposits to 75% to better reflect the actual, stable funding profile of such deposits; and

- Net balance sheet items in the "other assets" and "other liabilities" categories (e.g., net accounts payable and receivable, net failed trades payable and receivable) to remove the asymmetry between assets and liabilities and to better reflect the actual funding and liquidity profile of these linked items.

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1 Basel Committee on Banking Supervision, Consultative Document, *Basel III: The Net Stable Funding Ratio* (Jan. 2014).

2 *See id.* at ¶ 1.

3 *See id.*

I. Operational Deposits

The recognition of operational deposits in the NSFR is a welcome step toward improving the resiliency of the banking sector and encouraging stable sources of funding. We believe, however, that the proposed 50% ASF factor for operational deposits is too low given historical experience and understates the availability of operational deposits as a source of funding over a one-year time horizon. A 75% ASF factor more accurately reflects industry experience while remaining appropriately conservative.

BNY Mellon understands from conversations in industry forums that the 50% ASF factor assigned to operational deposits in the NSFR reflects two primary concerns: (A) the robustness of the current operational deposit classification criteria, and (B) the withdrawal behavior associated with such deposits over one year. We appreciate these concerns and respond to them below.

A. <u>Criteria for Operational Deposits</u>

The Consultative Document states that, for purposes of the NSFR, the definition of "operational deposits" will be the same as that for the Basel III Liquidity Coverage Ratio ("**Basel III LCR**").[4] The Basel III LCR first established the criteria for operational deposits generated by clearing, custody, and cash management functions in January 2013.[5] Since then, we understand that the Basel Committee has become concerned with divergent classifications of operational deposits as a result of the national implementation of the Basel III LCR. We also understand that some of the definitions are perceived to be insufficiently rigorous to capture only those deposits that are truly stable and operational.

In an attempt to address these concerns, BNY Mellon, together with the other Custody Banks,[6] proposes a uniform set of criteria to classify operational deposits in the Basel III LCR and NSFR. These criteria are intended to circumscribe the definition of operational deposits, increase uniformity across jurisdictions, and address what we understand to be the Basel Committee's fundamental concerns. They are also based, in part, on the operational deposit criteria proposed by the United States bank regulatory agencies, with some minor technical adjustments.[7] These definitions and criteria are attached in Appendix 1.

In addition to these criteria, national supervisors will have broad discretion to review a bank's categorization of operational deposits and to take additional measures as appropriate. As

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4 *Id.* at ¶ 21(b).

5 Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring* Tools ¶¶ 93-103 (Jan. 2013).

6 *See* Letter from The Bank of New York Mellon Corporation, Northern Trust Corporation, and State Street Corporation to the Basel Committee on Banking Supervision re: Consultative Document, Basel III: The Net Stable Funding Ratio (April 11, 2014).

7 Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring; Proposed Rule, 78 Fed. Reg. 71,818 (Nov. 29, 2013).

the Consultative Document states, "the NSFR must be supplemented by supervisory assessment work" as "a key component of the supervisory approach to funding risk."[8] Likewise, the Basel III LCR requires supervisory approval before a bank may use the operational deposit category.[9] Thus, to the extent supervisors have concerns with banks placing non-stable sources of funding in the operational deposits category, those concerns can be further addressed by supervisory means.

B. ASF Factor for Operational Deposits

Operational deposits provide a stable, predictable source of funding during normal and stressed financial market conditions, and we experience very low outflow rates for operational deposits. In this regard, we welcomed the adoption of a 25% outflow rate for operational deposits in the Basel III LCR to recognize this stable deposit profile. The 25% outflow rate is a conservative estimate of the run-off behavior of operational deposits, and the Basel Committee should adopt in the NSFR a commensurate 75% ASF factor. The proposed 50% ASF factor in the NSFR, by contrast, does not reflect our historical experience as one of the largest custody banks.

Operational deposits are a by-product of the core operational services, such as custody and asset administration, that BNY Mellon provides to our institutional clients. We provide these services pursuant to legally binding written agreements with strict notification requirements prior to termination. Our operational deposit balances remain very stable because clients need to maintain a base of funds to make payments and conduct other transactional activities on a day-to-day basis. Few clients move these critical services under normal, business-as-usual circumstances. Although BNY Mellon does lose clients, change is incremental rather than sudden because of the time, resources, and effort involved in establishing a new servicing relationship. Moreover, servicing changes occur with advance notice and take several months to complete, giving a bank sufficient time to manage the associated liquidity and funding risk. Our operational service agreements generally specify minimum notification periods of 30 days or more to terminate a contract, and transition periods to move services (and the accompanying deposits) can extend to one year or more.

Given this experience, it is surprising that the NSFR—a normal, business-as-usual measure—estimates a 50% outflow rate that is even more conservative than the LCR. And unlike other liabilities, operational deposits are subject to detailed requirements that have become quite stringent. For example, the Basel III LCR sets forth a list of qualifying criteria that spans eleven paragraphs. In addition, banks must both identify and exclude "excess balances" from the operational deposit category. As a result, the current classification of operational deposits results in a category of extremely stable funding, whether assessed over a period of short term financial market stress, or over the longer term NSFR horizon.

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8 Basel III NSFR, at ¶ 10.

9 *See* Basel III LCR, at ¶ 93.

Given this stable funding profile, we believe that a 75% ASF factor is an appropriate—yet still conservative—measure of the outflow behavior of operational deposits under normal, business-as-usual conditions.

II. Balance Sheet Items in "Other Assets" and "Other Liabilities"

The NSFR Consultative Document assigns a 100% required stable funding ("**RSF**") factor to all "other assets" and a 0% ASF factor to all "other liabilities."[10] "Other assets" include, for example, failed trades receivable and accounts receivable. "Other liabilities" include, for example, failed trades payable and accounts payable. Although these liabilities usually have payment schedules of less than one year, the liability accruals are replenished in the normal accounting cycle. From a funding and liquidity perspective, these payables are generally stable and continue to provide funding for receivables.

Rather than assign an asymmetrical 100% RSF factor to all "other assets" and a 0% ASF factor to all "other liabilities," we believe the NSFR should allow netting of such payables and receivables before applying ASF and RSF factors. For example, accounts payables should net against accounts receivables, and failed trades payables should net against failed trades receivables. If payables are greater than receivables, then the net amount would receive a 0% ASF; if receivables are greater than payables, then the net amount would receive a 100% RSF. This approach would better recognize the stable funding profile of these "other liabilities." It also would be a simple approach that is conceptually similar to the net derivatives payable and receivable approach that the Basel Committee already has adopted in the NSFR.[11]

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BNY Mellon appreciates this opportunity to comment on the Basel Committee's critical work to strengthen the resiliency of the banking system by encouraging stable sources of funding. We believe that operational deposits are a core source of stable funding and should be recognized as such in the NSFR. We also believe that netting would appropriately reduce the asymmetry between "other assets" and "other liabilities" and recognize the linkages between these balance sheet items. We would be happy to discuss any of these issues further. Should you have any questions or need any additional information, please contact Eli Peterson, Managing Director, Office of Public Policy and Regulatory Affairs, at (202) 624-7925 or eli.peterson@bnymellon.com.

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10 Basel III NSFR, at ¶¶ 22(a), 35(c).

11 *See id.* at ¶ 22(c).

Respectfully Submitted,

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Appendix 1

The Bank of New York Mellon, together with the other Custody Banks, [12] propose the following definitions and criteria to identify operational deposits for purposes of the Basel III LCR and NSFR to the extent the Basel Committee has concerns about the existing criteria. These recommendations are adapted from the Basel III LCR and the U.S. bank regulatory agencies' proposed implementation of the LCR.

Operational Deposits

Operational deposits mean unsecured wholesale funding that is necessary for a bank to provide operational services as an independent third-party intermediary, agent, or administrator to the wholesale customer or counterparty providing the unsecured wholesale funding.[13]

In order to recognize a deposit as an operational deposit, the following conditions must be met:

(1) The operational services to which the deposit relates are provided pursuant to a legally binding written agreement, the termination of which is subject to a minimum 30-day notice period or significant switching costs to be borne by the customer;[14]

(2) The deposit must be a by-product of the underlying services provided by the bank and must not be sought out in the wholesale market in the sole interest of offering interest income;[15]

(3) The deposit must be held in an account identified as an operational account;[16]

(4) The customer must hold the deposit at the bank for the primary purpose of obtaining the operational services provided by the bank;[17]

(5) The deposit account must not be designed to create an economic incentive for the customer to maintain excess funds therein through increased revenue, reduction in fees, or other offered economic incentives;[18]

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[12] *See* Letter from The Bank of New York Mellon Corporation, Northern Trust Corporation, and State Street Corporation to the Basel Committee on Banking Supervision re: Consultative Document, Basel III: The Net Stable Funding Ratio (April 11, 2014).

[13] *See* 78 Fed. Reg. 71818, 71858 (definition of "operational deposit"); Basel III LCR, at ¶ 94.

[14] *See* 78 Fed. Reg. 71818, 71859 (proposed § __.4(b)(1)); Basel III LCR, at ¶ 94.

[15] *See* Basel III LCR, at ¶¶ 94, 95.

[16] *See* 78 Fed. Reg. 71818, 71859 (proposed § __.4(b)(3)); Basel III LCR, at ¶ 95.

[17] *See* 78 Fed. Reg. 71818, 71859 (proposed § __.4(b)(4)).

[18] *See* 78 Fed. Reg. 71818, 71859 (proposed § __.4(b)(5)); Basel III LCR, at ¶ 95.

(6) The bank must demonstrate that the deposit is empirically linked to the operational services and that it has a methodology for identifying any excess amount, which must be excluded from the operational deposit amount and which must be conducted at a sufficiently granular level to adequately assess the risk of withdrawal of excess balance;[19]

(7) The deposit must not be provided in connection with the bank's provision of prime brokerage services; prime brokerage services are defined as a package of services offered by a bank under a contractual arrangement whereby the bank, among other services, clears, settles, carries, and finances transactions entered into by the client with the bank or a third-party entity (such as an executing broker), and where the bank has a right to use assets provided by the client, including in connection with the extension of margin and other similar financing of the client, subject to applicable law;[20] and

(8) The deposit must not arise out of a correspondent banking arrangement in which one bank (correspondent) holds excess amounts owned by other banks (respondents) in connection with payment and other services in order to settle foreign currency transactions (e.g., nostro and vostro accounts used to settle transactions in a currency other than the domestic currency of the respondent bank for the provision of clearing and settlement of payments).[21]

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19 *See* 78 Fed. Reg. 71818, 71859 (proposed § __.4(b)(6)); Basel III LCR, at ¶¶ 96-97.

20 *See* Basel III LCR, at ¶ 99 & n. 42; Financial Conduct Authority & Prudential Regulatory Authority Handbook, Glossary (April 2013) (definition of "prime brokerage services"), *available at* http://www.fshandbook.info/FS/html/handbook/; Letter from Brandon Becker, Director of the Division of Market Regulation, Securities and Exchange Commission, to Jeffrey C. Bernstein, Prime Broker Committee, at 2 (Jan. 25, 1994), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/pbroker012594-out.pdf.

21 *See* 78 Fed. Reg. 71818, 71859 (proposed § __.4(b)(8)); Basel III LCR, at ¶ 99 & n. 42.

Operational Services

Operational services means the following services, provided they are performed as part of cash management, clearing, or custody services:[22]

(1) Payment remittance and debt service payments;

(2) Payroll administration and control over the disbursement of funds;

(3) Transmission, reconciliation, and confirmation of payment orders;

(4) Daylight overdraft;

(5) Determination of intra-day and final settlement positions;

(6) Settlement of securities transactions and foreign currency transactions;

(7) Transfer of recurring contractual payments;

(8) Client subscriptions and redemptions;

(9) Scheduled distribution of client funds;

(10) Escrow, funds transfer, stock transfer, trustee and agency services, including payment and settlement services, payment of fees, taxes, and other expenses; and

(11) Collection and aggregation of funds;

(12) Administration of investment assets;

(13) Collateral management services; and

(14) Corporate trust services.

[22] *See generally* 78 Fed. Reg. 71818, 71858 (definition of "operational service"); Basel III LCR, at ¶¶ 101-03.