

April 11, 2014

Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Dear Basel Committee members:

**Re: CBA¹ Comments on consultative document:
“*Basel III: The Net Stable Funding Ratio*”**

The Canadian banking industry appreciates the opportunity to review the consultative document, *Basel III: The Net Stable Funding Ratio*, dated January 12, 2014. We understand that this proposal updates the Net Stable Funding Ratio (NSFR) framework outlined in the December 2010 proposal, and through this revision the Basel Committee is seeking to reduce cliff effects with the measurement of funding stability, improve its alignment with the Liquidity Coverage Ratio (LCR), and alter the NSFR calibration to focus greater attention on short-term, potentially more volatile funding sources.

The confirmation that the NSFR is intended to be a structural liquidity ratio and not a one-year idiosyncratic stress test will be beneficial to the industry as we make plans to ensure compliance with the guidelines. We were also encouraged by the Basel Committee's response to the industry's concerns through the positive changes to some of the assumptions and calibration of the NSFR (e.g. higher stable ratios for retail and small-and-medium enterprise (SME) deposits, some recognition of operational deposits and wholesale debt maturities under 1 year; and improvements of some required stable funding (RSF) factors). Notwithstanding, we are concerned that certain available stable funding (ASF) and RSF factors remain overly conservative, and note that more quantitative impact analyses will be required before the industry can assess the impact of the revised NSFR calibration, particularly for the products we have highlighted with our comments.

¹ The Canadian Bankers Association works on behalf of 59 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

The industry offers our comments on the consultative document below and in the attached detailed appendix. The key sections in this comment letter can be summarized as follows:

- **Non-Risk Based Measure** – The NSFR applies the same liquidity factors to all banks and is no longer described as a crisis scenario. Some of the factors differ materially from current industry practices. Therefore, it is important that the factors be carefully calibrated, taking into account the impact on market liquidity, leverage ratios, and economic growth.
- **Simplicity** – The Basel Committee’s desire for simplicity has led to some additional conservatism by treating products of different liquidity value within one category with a single factor that seems to be calibrated to the “worst case”, not average, of the applicable products.
- **LCR/NSFR Inefficiency** – The current calibration of the NSFR will lead to difficulties in managing concurrently and efficiently to the LCR (and leverage ratio). One example is wholesale funding between 1 month and 6 months, which will have no value in the NSFR and require holding more HQLAs than the LCR suggests. We recommend a closer examination of this effect, in particular as it relates to wholesale funding of HQLA portfolios and overall calibration.
- **Long Term Collateralized Funding** – Long-term matched-term collateralized funding, such as covered bonds and mortgage-backed securities, have a punitive treatment to the assets they are funding when there is less than 6 months to maturity. No distinction is made between secured and unsecured funding. We recommend a better alignment of the RSF and ASF factors of secured funding to recognize this as a more likely stable source of funding.
- **Inconsistency between the ASF and RSF Factors** – There is an asymmetric treatment of products, in particular reverse repos, executed with banks versus other counterparties that will lead to unintended consequences in the market. We recommend the nature and quality of the underlying asset and counterparties be given further consideration.
- **RSF Factors and Liquidation of Assets** – The treatment of HQLA and non-qualifying securities and precious metals is too closely related to the LCR treatment over a 30-day stress, particularly given the time horizon of 1 year. We recommend a stronger connection and consideration to their market liquidity in the NSFR.

Non-Risk Based Measure

We note that the NSFR is no longer described in terms of an extended firm-specific crisis scenario. In addition, specific triggers and a risk-based methodology are not provided to support the proposed ASF and RSF factors (e.g. credit rating downgrade). The ASF and RSF factors are the same for any bank, irrespective of its financial strength, business model, and market footprint. While we are not advocating for more country- or bank-specific factors, we believe that this background lends support to the ASF and RSF factors that are not calibrated too stringently, both on a consolidated bank basis and, just as importantly, for any key banking products relative to current industry practices for 1-year horizon metrics. The greater the

difference between the ASF and RSF values currently applied by banks in their internal models and with those proposed by the Basel Committee, the more banks will have to alter their funding profile and pricing for these products. While we appreciate that some of this impact is intended, where applicable, we stress the importance of ensuring that the impact of materially more stringent factors on market liquidity, product pricing and availability, financial stability, the leverage ratio and economic growth are well understood, analysed and debated before calibration is finalized and the proposal implemented. The QIS results over the next few years, together with projected changes in bank behaviours, will be a key resource to use in right-sizing the NSFR. While we understand why the Basel Committee is keen to finalize its post crisis regulatory reforms by the end of this year, we think it should leave the door open for changes to the NSFR calibration over the next few years as warranted.

Simplicity

We support the Basel Committee's intention to keep the NSFR rules simple. But we are concerned that this approach may, in some instances, have led to additional conservatism. For example, where assets or liabilities with somewhat different liquidity values have been combined into one category, we recommend using the average of liquidity values of all assets or liabilities, not the most conservative liquidity value of any assets or liabilities for calibration. More specifically, we recommend that the RSF for Other Assets at 100% and the ASF for Other Liabilities at 0% should be reviewed. Some of these assets and liabilities are linked and do not, when considered together, result in structural liquidity gaps of 100% of their balance sheet value. Some of these assets and liabilities should also be netted before a factor is applied.

LCR/NSFR Inefficiency

It is important to highlight that the NSFR, as it is currently constructed, may result in banks running a significantly higher LCR than required to comfortably exceed the 100% minimum. As an example, applying a 0% ASF factor to wholesale funding maturing in 6 months or less will result in banks pre-funding these maturities and investing the proceeds in Level 1 assets to avoid additional RSF. Therefore, all banks may have to carry extra liquidity than what is required by the LCR for an additional 5 months, which will result in elevated LCR levels. The proposed approach attributes limited funding value to a deep segment of the money markets (e.g. 3-month and 6-month original term funding) given the RSF factors that are applied to highly liquid assets (e.g. level 2A and 2B assets and other non-HQLA); this may affect bank product offerings and market-making activities and reduce broad market liquidity. This excess liquidity will also lead to a deterioration in leverage ratios. The extra costs banks will face will to a large extent be passed on to their clients and may also impact product availability, with obvious potential impacts on the broader economy. We recommend that the Basel Committee further evaluate the alignment of the LCR and NSFR and consider changes to the RSF and ASF factors to better align the liquidity value of non-level 1 HQLA with wholesale market funding availability. We further believe that this evaluation should not be based on current QIS data, which may not be reflective of a bank's post-NSFR implementation balance sheet, but rather on data that is based on projected NSFR- and LCR-driven behaviors after the standards are effective.

Treatment of long-term collateralized/securitization funding

We understand that the intent of the NSFR is to encourage long-term/matched funding; however, by setting all wholesale funding maturing below 6 months uniformly at 0% ASF, the NSFR discredits maturing long-term collateralized funding (covered bonds) and securitizations (mortgage backed securities) as much as short-term unsecured funding, even though the former are over-collateralized by or are a direct-pass through of maturing retail loans, and thus are more likely to roll over. On the other hand, the NSFR assumes these encumbered loans will renew and therefore will require 50% (mortgage, paragraph 27) to 65% (Home Equity Line Of Credit, paragraph 27, 35(a)) RSF as they mature. To manage this asymmetry, a bank will resort to other forms of funding 6 months ahead of covered bonds or MBS maturity, as loans backing these structures have not been freed up for reuse. This forced reduction in collateralized funding/securitization capacity will negatively impact banks' funding mix. This asymmetry implies that the NSFR does not differentiate roll-over risk of collateralized and securitization funding from unsecured funding, even though investors have direct claims to the underlying assets and thus have better protection than do unsecured creditors. The protection is strengthened by the overcollateralization requirement on covered bonds, and in Canada, by CMHC insurance and government guarantees on mortgages backing MBS and reflected in the pricing of these instruments.

We recommend that the NSFR recognize the lower roll-over risk of collateralized/securitization funding, and reduce the ASF/RSF asymmetry. This could be achieved by lowering the RSF factors on retail loans encumbered in these structures (e.g. from 50% - 65%, to 25% range) or by raising the ASF for this type of funding (e.g. from 0% to 25 – 40%).

Inconsistency between the ASF and RSF Factors

It is our opinion that the net structural liquidity risk measured by the NSFR for various combinations of products and counterparties described in three paragraphs (i.e. 22(a-b), 29(c) and 32(e)) will be materially overstated. The combined impact of these ASF and RSF factors will, for selective products, securities and counterparties, result in unwanted consequences, unless the asset is booked with a bank. Broadly speaking, there should be no material differences in the NSFR risk profile of many of these combinations of transactions across products, securities and client types - the resulting NSFR gap should be nil or very small, and not 50% (as in some cases).

We understand that the driver for this material change from the original proposal was a concern raised by a few jurisdictions about over-reliance on certain forms of short-term secured funding and lending transactions conducted between selective types of counterparties for particular types of securities and maturities in their domestic markets.

We believe that this concern has merit for a defined scope of transactions in some markets, but that applying such a broad-based (rather than selective) response will adversely and unduly affect many markets and related transactions globally.

We cite a number of reasons for modifying the proposed NSFR treatment:

- Many types of short-term funding and lending transactions against securities serve valuable purposes, both for banks and the broader market place. Where this is the case, they should not be discouraged (see examples below). The need to term fund 50% of many of these

transactions would result in economics that would effectively eliminate or unduly reduce secured funding activities with non-prudentially regulated banks.

- The NSFR is a structural non-stressed liquidity metric, and therefore should not be used to address a concern related to short-term secured funding transactions in a stressed environment. The Leverage Ratio addresses balance sheet build up, the LCR minimizes the possibility of mismatches between maturities and types of securities for up to 30 days, RWA limits ensure that adequate capital is held against these exposures, and credit limits ensure appropriate counterparty diversification.
- The proposed NSFR rules are inconsistent with the treatment of HQLA-eligible secured funding and lending transactions in the LCR where limited or no liquid asset buffers are required for secured lending and funding transactions against most HQLAs. Major inconsistencies in the treatment of the same product across different regulatory metrics will present significant pricing challenges and inefficiencies that will adversely affect all market participants.
- These new NSFR rules will favour interconnectivity between banks. The LCR does the opposite and the spirit of Basel III reforms has been to reduce interconnectivity between banks.
- The NSFR rules could negatively impact market liquidity (e.g. reduce funding available to non-bank buyers of government bonds, as well as increasing their funding costs, likely shrinking the number of buyers of government debt and thereby increasing concentration risk in the number of potential buyers of government debt).
- The NSFR is a balance-sheet-based metric and differences in accounting treatment for (i) CCP-cleared secured funding transactions and (ii) balance sheet netting in bilateral trades with the same counterparty could lead to material differences in term funding requirements across different banks in different countries for the same set of secured funding transactions.
- Banks will be incented to do bilateral reverse repos with other banks rather than centrally cleared reverse repos with CCPs, if the CCP is not classified as a bank.

We provide four examples to better illustrate our concerns:

- **Matched book secured funding transaction:** There is material asymmetry between the treatment of certain types of short-term secured funding (liability) and lending (asset) transactions even for the same product, security, and tenor. For example, if a bank does an overnight short-term repo and an overnight reverse repo underpinned by Level 1 HQLA with two different clients, irrespective of the counterparty with which the bank books the repo, paragraph 22(a-b) applies (0% ASF). If the offset trade is booked with a bank, paragraph 29(c) applies (0% RSF), leading to a neutral (and reasonable) NSFR position between the two trades. However, if the counterparty on the reverse repo is not a bank, paragraph 32(e) applies (50% RSF), leading to a NSFR gap of 50% for the notional amount of the transaction when it is a short-term matched book transaction of the highest quality.
- **Short position:** Short liquid asset positions will be treated as per paragraph 22(b). If the short position is covered with a bank counterparty, paragraph 29(c) applies, leading to a neutral NSFR position. However, if the reverse repo is done with any other counterparty, the same issue as above arises. Shorting HQLAs to manage interest rate risk in fixed income portfolios should not be discouraged by the Basel Committee. This would otherwise lead to increased usage of derivatives to hedge market risk and reduced market liquidity in bond markets.

- **Short term investments of capital and long-term debt proceeds and surplus core deposits:** If a bank's treasury department chooses to invest surplus cash in a short-term reverse-repo transaction collateralized by Level 1 assets with a non-bank counterparty, an RSF factor of 50% will apply but a 0% RSF factor will apply to an uncollateralized loan to a bank. This rule would eradicate half of the ASF factor of 100% associated with long-term debt or capital funding. Given that the bank's unsecured and secured risk appetite for other banks is limited, unless the rule is changed, banks will be provided with an incentive to buy short-term HQLAs instead of doing reverse repos of HQLAs, when we believe the Basel Committee should be indifferent between either choice from a liquidity management perspective.
- **Liquid Assets maturing under 1 year:** Where short-term transactions are booked with, or issued by, counterparties like non-bank financial institutions, central banks (other than reserves) and PSEs for which there is no reputational risk not to renew these assets as they mature, an RSF factor of 50% per paragraph 32(e) is not appropriate. The short-term money markets for non-banks and certain central bank programs (e.g. the Federal Reserve Board (FRB) Reverse Repo facility) will be materially affected if term funding has to be raised against these assets. Consistent with the changes recommended below to paragraph 29(c) and the original 2010 NSFR proposal, a 0% RSF factor should apply to any money market assets or securities maturing within one year, and to any loans (assets) to central banks maturing under 1 year unless encumbered.

We reiterate that future QISs should be used to quantify the potential impact of this proposal on various subsets of secured funding and lending transactions underpinned by liquid assets.

For balance, we also provide one example where the outcome of the new NSFR rules would in our opinion overstate a bank's liquidity:

- **Long-term repo and short-term reverse repo:** Where a term repo (e.g. against government bonds) with a maturity greater than 1 year is conducted with one client and a short-term reverse repo with a maturity under 6 months is conducted with another client, the ASF factor per paragraph Para 18(c) would be 100% while the RSF factor would either be 0% for a bank counterparty per paragraph 29(c) or 50% for other counterparties per paragraph 32(e). This would leave the bank with an NSFR surplus when we believe the NSFR should be neutral. The need to rollover the reverse repo to cover the short position that would otherwise arise is not captured in paragraph 28 because the focus is on the cash not securities leg of these transactions (unlike the LCR).

As already discussed, we expect that the above unfavourable treatment of Level 1 assets reversed in from non-bank counterparties will have a detrimental impact on both repo market liquidity and liquidity in the underlying cash assets. This would clearly be a negative unintended consequence, as it is essential that Level 1 assets retain highly liquid characteristics, including both repo and cash markets, in order to maximize their effectiveness as a liquidity buffer. We note that a number of major investors have already expressed concerns regarding the prospect of a significant reduction in market liquidity in the secured funding markets as a result of the proposal.

In its simplest/shortest form we recommend that the Basel Committee amend paragraph 29(c) as follows: "All *unsecured* unencumbered assets to banks subject to prudential supervision (including interbank placements and money market instruments), *all secured lending transactions against securities (e.g. reverse repos, securities borrowing) and liquid money market and fixed income assets (e.g. Commercial Paper) issued by counterparties with whom*

there is no contractual or reputational requirements to rollover, with residual maturities of less than six months.”

A less simple yet not overly burdensome approach for transactions covered by Paragraph 29c (or subsequent paragraphs) would be to consider more granular rules for assigning RSFs to secured lending transactions against securities as follows:

- An RSF factor of 0% for any secured lending transactions against any type of collateral conducted with performing banks, broker dealers, insurance companies and any other types of counterparties the Basel Committee deems subject to prudential supervision, including any transactions with Central Clearing Counterparties and Central Banks. Many other mechanisms protect these transactions against loss of liquidity value, for example, capital and margin requirements. They should not be treated more harshly than unsecured loans with banks.
- RSFs of 0% for Level 1 HQLA secured lending transactions with any counterparties (similar reasons as immediately above).
- Any secured lending transactions to cover short securities transactions should also be assigned a 0% RSF.
- Institute RSFs for the remaining types of transactions, counterparties and securities not covered above that would take into consideration the quality of collateral and other important features of these transactions, including i) that liquidity value is not only supported by the quality of the collateral but by the obligation of the counterparty to repay these loans, irrespective of the value of the collateral, which is frequently topped off as necessary if their mark to market value deteriorates (see more details in Detailed Document on discussion of Para 29(c) and 32(e)) and ii) that some of these transactions are often over-collateralized.

Finally, we believe that any regulatory concerns with specific types of business strategies, counterparty types, securities types or mismatched maturities in a specific jurisdiction for secured lending transactions supported by securities should be approached as an exception to these revised rules by the national regulator, and not be driven by global rules.

RSF Factors and Liquidation of Assets

In setting the RSF factors at similar levels to the LCR haircuts for various liquid assets, due consideration was not given to:

- The different time horizons (12-months NSFR vs. 1-month LCR);
- The severity of the scenario under consideration (the NSFR is not a stress metric while the LCR is an acute stress test), even if there was a small concession for some Level 3 assets with an 85% RSF factor (versus 100% illiquid in the LCR) and the removal of the caps for Level 2 assets, which is of no current benefit on a consolidated basis to Canadian Banks polled;
- The Basel Committee’s own January 2014 paper on Guidance for Supervisors on Market-Based Indicators of Liquidity, where it is stated on page 1 that “The liquidity value of asset depends on the underlying stress scenario, the volume to be monetized and the timeframe considered”; and
- The linkages that exist between HQLAs and liabilities and/or derivatives transactions in many business strategies, which, taken together, materially reduce the net NSFR risk of these ‘linked’ transactions in the normal course of business since they include (i) self-liquidating mechanisms that assure that both sides of the transactions would be taken off

the balance sheet concurrently; and/or (ii) exchange of initial/daily variation margins that mostly or fully neutralizes the potential loss of liquidity value in the HQLAs. For example, total return swaps against equities and structured notes hedged in part or in full with securities.

This approach is particularly punitive for Level 2B and 3 assets. For example, assuming that 50% of qualifying non-FI equities and 85% of non-HQLA qualifying exchange traded equities and gold, cannot be monetized within 1 year is extreme for a metric seeking to strike a proper structural balance in a non-stress environment, especially where these assets are linked to other transactions that reduce their net liquidity risk. The alignment that the Basel Committee is seeking between the LCR and the NSFR for the scope of eligible HQLAs and their applicable haircuts is questionable since the universe of securities that can be liquidated over a one-year time horizon in a non-stress environment is far greater than in a 30-day severe stress. There is widely available public data to support that view and the industry has shared this with Basel Committee during the LCR deliberations.

Keeping the RSF factors of some securities too high relative to their expected market liquidity under the NSFR scenario will materially change their “cost of carry” relative to non-bank market participants not subject to Basel III, impacting, for example, how derivative products sold to bank clients and linked to these products can be priced. This could cause a shift of this business to the ‘shadow banking’ sector. The materiality of the impact will depend on firms’ respective funding curves; however, we see incremental funding costs of at least 25-50 basis points (bps) for well-rated firms based on an estimate of the percentage of funding that would have to move from a “greater than 30 days” to a “greater than 365 days” tenor to neutralize the NSFR risk and current price differentials between different parts of the yield curves. This will likely cause banks to deleverage securities with high RSF factors, possibly reducing their market liquidity.

The current calibration of HQLAs has been described by some Basel Committee members as a compromise between those advocating for a 100% RSF for all HQLAs and those willing to consider less stringent RSFs than the LCR scenario due to the longer scenario period and reduced severity of NSFR. The argument for a 100% RSF is that banks will have to hold HQLAs at all times, and they should be term funded for tenors longer than 365 days. We believe this current compromise is between two views of *unequal merit*. A 100% RSF would have created serious liquidity management challenges, including double counting of risk, for some key banking products and caused inconsistencies in the concurrent management of the NSFR and the LCR, causing the LCR and the NSFR to be at odds with rather than complement each other. This is demonstrated in more detail in Appendix 1.

We believe the Basel Committee should consider a more reasonable compromise, that is, one between the current proposed RSFs and those that would arise if the NSFR was calibrated to a longer and non-stress scenario. We also believe that the RSFs of HQLAs should be calibrated based on their market liquidity and availability, not their projected holding periods.

It is somewhat challenging to propose specific RSF factors supported by detailed analysis by types of HQLAs to counter the current NSFR proposal, since we have no detailed explanations on the methodology used by the Basel Committee to arrive at the current RSFs, including the triggers and shocks considered. However, at a minimum, we believe that due consideration of the arguments made above and in the appendix should lead to a material reduction (e.g. at least 50%) in each RSF factor for eligible/ineligible HQLAs maturing past 1 year and a 0% RSF for those maturing within 1 year.

We thank you for taking our comments into consideration and look forward to future discussions on these issues.

Sincerely,

A handwritten signature in black ink, appearing to read "Dave Hamel". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Attachments: Appendix and Detailed comments

cc: Brad D. Shinn, Acting Managing Director, Bank Capital, OSFI
Brian Rumas, Senior Analyst, Capital Division, OSFI
Carolyn Wilkins, Adviser to the Governor, Bank of Canada
Chris Graham, Principal Researcher, Financial Stability
Department, Bank of Canada

Appendix on calibrating RSFs for HQLAs

This appendix outlines the issues that would have arisen if the Basel Committee had adopted a 100% RSF for all HQLAs.

Banks buy HQLAs for different reasons by types of products (e.g. on- vs. off-balance sheet exposures). These differences should affect views on their minimum funding tenors (or RSFs), and how these minimum funding tenors should be achieved through RSFs assigned to banking products or HQLAs.

A 100% RSF for HQLAs would have caused the NSFR to significantly diverge from other regulatory and industry liquidity metrics, including the LCR, in the application of the following key liquidity management principles:

1. Banks should always be able to fully or mostly neutralize the liquidity risk of deposits assigned a 100% cash outflow inside the minimum time horizon of a liquidity metric (an ASF of 0% for the NSFR) by holding top HQLAs (or other low risk assets). If not, they can't price these deposits in an effective manner.

Example: The liquidity risk of a deposit with a 100% outflow in the LCR and a 0% ASF in the NSFR can be neutralized in the LCR by buying a Level 1 HQLA or doing a reverse repo underpinned by a Level 1 HQLA. However, in the NSFR, had all HQLAs attracted a 100% RSF or should the reverse repo as currently proposed be conducted with a non-bank counterparty, a material NSFR shortfall arises. Conversely, under the NSFR, an unsecured money market loan to a bank with a maturity of 1 day would neutralize the structural risk but it would not do the same under the LCR due to the 75% cap on inflows.

2. Banks should always be able to fully or mostly neutralize the liquidity risk of client deposits assigned a fixed run-off factor by holding top HQLAs (or other low risk assets) against the run-off portion. Banks should not have to raise incremental term funding to neutralize this risk if willing to buy the most liquid assets.

Example: Where banks buy HQLAs to invest the portion of their retail deposits not getting term value past 30 or 365 days (e.g. 10% outflow), buying Level 1 assets (10% of the deposit) allows banks to mitigate their LCR risk and invest 90% of the deposit in illiquid assets. An RSF factor of 100% for HQLAs would have created an NSFR shortfall of 10% and required banks to raise additional term funding > 365 days to try to fix this shortfall. However it would have still been difficult to close this NSFR gap since banks could not have invested this new term funding in more HQLAs due to the 100% RSF factor. The only possible assets would have been those covered by Paragraph 29 (not Paragraphs 30 or beyond) assuming the 100% HQLA factor would not have been applied to Paragraph 29 assets.

3. The minimum funding tenor for HQLA mitigating the liquidity risk of off-balance sheet products (e.g. undrawn commitments) should only be driven by the RSF assigned to that product not, in addition, through the risk factor applied to HQLAs, especially top HQLAs. Otherwise the same risk would be mitigated twice.

Example: Where a bank buys HQLAs to mitigate contingent risk (e.g. undrawn commitments), it is reasonable to debate the tenor of the funding that should underpin these HQLAs (e.g. greater than 30 days (LCR) or 365 days (NSFR)).

But the desired tenor should not be achieved through an RSF applied to HQLAs, rather through the RSF applied to the categories of products to which HQLA requirements apply. For example, currently, an RSF of 5% of the notional amount of undrawn commitments requires HQLAs term funded past 365 days. The remaining HQLAs can be funded for terms past 30 days to conform to the LCR requirements. Applying an RSF factor of 100% to the HQLA supporting the 5% RSF for undrawn commitments would have resulted in 'double mitigation' of the same exposure.

4. Banks should always be able to close liquidity gaps by raising term funding and investing the proceeds in HQLAs (or other low risk assets).

An "across the board" RSF factor of 100% for HQLAs would have breached all of the above principles.

CBA comments on Basel Committee consultative document: *Basel III: The Net Stable Funding Ratio*

CBA Members' Comments and Requests for Clarification

INTRODUCTION *(Pages 1 - 2)*

DEFINITION AND MINIMUM REQUIREMENTS *(Pages 2 – 10)*

A. Definition of available stable funding *(pages 3 - 6)*

- The chart located at the end of this document details the discrepancy in the treatment of secured funding of Canadian mortgages between the ASF and RSF for securitizations and covered bonds.
- [Para 13]: While we accept that franchise risk is an important consideration in determining the funding profile of products for which continued supply is important to protect financial stability and the real economy, there should also be a recognition that the higher funding costs that come with longer funding tenors may at some point affect their supply by banks, especially if these increased costs cannot be passed on, ultimately defeating the original purpose of protecting their availability.
- [Para 17]: The NSFR proposal assumes worse case assumptions for all liabilities with callable/puttable early repayment options, including those where the bank is long the option or the option is dependent on movements in the price of foreign exchange, equity, interest, credit or commodity rates and not the decision of issuers or investors. In some cases, this rule implies that banks will make irrational decisions from an economic and liquidity perspective, for example, by calling in good liabilities at a time the bank is unable to rollover any debt maturing within six months. Could the Basel Committee provide some rationale for this decision, especially for liabilities where the bank owns the call option embedded in the structure? We believe that it is not reasonable to ask banks to demonstrate they would not exercise an option under any circumstances when the NSFR is not underpinned by a specific scenario. We believe that probabilistic models assessing average expected life of each liability with options should be used to assess ASF values.

CBA Members' Comments and Requests for Clarification**Liabilities receiving a 95% ASF factor (page 4)**

- Should accrued interest be included here or in liabilities receiving a 0% factor?

Liabilities receiving a 50% ASF factor (page 4)

- [Para 21(b)]: The ASF value on stable and non-stable retail deposits has been harmonized between LCR and NSFR, but this is not the case for operational deposits. Operational deposits receive a 25% runoff in the LCR, but an ASF of 50% in NSFR. We believe that empirical evidence supports a better ASF than 50% for operational deposits relative to other deposits in that category, which is recognized in the LCR rules. Shouldn't operational deposits from sovereigns, Public Sector Entities (PSEs), and Multilateral Development Banks (MDBs) receive a higher ASF factor than non-operational deposits from the same sources because they are stickier (i.e. > 50%)? While we accept that the risk that the providers of operational deposits tied to specific services could move their business somewhere else is less over 30 days (LCR) than 1 year (NSFR), we believe that this argument can be countered by the fact that NSFR is not a stressed scenario, unlike LCR. We also urge the Basel Committee to consider that any core value taken away from these operational deposits relative to their current internal models will force banks to increase the amount of their wholesale funding with maturities greater than one year, which increases their reliance on this market and their leverage ratio, both outcomes which are not favoured by most supervisors, or will cause banks to reduce their illiquid assets. Either way, the potential impact of the calibration of this ASF should be understood before it is finalized. Would the Basel Committee please provide clarification on why the LCR and NSFR factors are so far apart?
- [Para 21]:
 - Would the Basel Committee confirm if a bank's unsecured and/or sub-debt securities fall in this category. As per paragraph 21, a bank should be able to distinguish its funding counterparty to be a non-financial corporate customer [Para 21(a)], sovereign, public sector entity, multilateral banks [Para 21(c)]. In the previous NSFR template, a bank's unsecured and/or sub debt securities were reported in the single line. In the new QIS template, there are Lines 16, 23, 28, 35 that represent unsecured, non-deposit funding from different counterparty types. Our concern is that securities issued are market traded, and a bank is unable to trace current debt holders to determine the type of a funding counterparty. How should a bank report its unsecured and/or subordinated debt securities? What criteria will the Basel Committee set for tracing buyers of marketable securities?

CBA Members' Comments and Requests for Clarification

- Funding for <1 year from Non-financial Corp (50% ASF); Financial; 0% ASF for <6 month, 50% ASF for over 6 month. Bearer deposit notes (BDN) and bankers' acceptances (BA), and deposit notes under a year are traded securities, which are mostly held by Corporates; however, we cannot tell if some are owned by banks. We believe that these should be considered "Corporate". Would the Basel Committee please confirm.
- [Para 21(a) and (d)]: there is no distinction between secured and unsecured funding, and more specifically no value is given to the collateral underlying secured funding. For example, in times of stress, in the extreme case that covered bonds do not get rolled over, the mortgage collateral can be redeployed to access funding (i.e. in government support programs). Secured funding should receive a higher ASF factor than unsecured funding.

Liabilities receiving 0% ASF factor (pages 4 - 5)

- [Para 22(a)]: Should this be the balancing number to ensure the totals reconcile to the total on-balance sheet liabilities?
- [Para 22(c)]: A net asset derivative position should not be assigned a 100% RSF unless net contractual inflows have a maturity date past 1 year. RSF should be reflective of contractual obligations. It is a similar argument for net derivatives payable position where it should not default to ASF of 0% but be driven by contractual obligations.
 - Paragraph 22 grants 0% ASF to a net derivative liability, whereas paragraph 35 specifies 100% RSF for a net derivative assets. What is the justification for the worst-case asymmetric treatment afforded to net derivatives? Given the 1 year time horizon of the NSFR, a much lower RSF factor for a net derivative asset is justified by the fact that a book of business could be sold or assets positions novated over such a time horizon.
 - How are associated derivative collateral inflows and outflows captured? We believe that derivatives receivable positions should be considered net of collateral. Would the Basel Committee confirm.
- [Para 23]: Can three-month Commercial Paper issued by a bank and sold to a non-FI corporate qualify for 50% RSF because it is 'funding' sold to a non-FI, or does it only qualify as 0% because it is 'other liabilities' maturing under six months? If the latter, can the Basel Committee clarify how banks will be expected to trace the ownership, especially in the secondary market?

CBA Members' Comments and Requests for Clarification

- [Para 23]: What is the definition of pension plans? Are pension plans of provincial, state, municipalities considered “PSEs” for the purpose of counterparty classification as they are funded by PSE’s or other government entities? Are pension plans of universities and other public services (hospitals, police, fire, schools) considered PSEs for the purposes of counterparty classification as they are publicly funded by PSEs or other government entities?

B. Definition of required stable funding for assets and off-balance sheet exposures (pages 6 -11)

- Clarification is required for the treatment of non-maturity (open maturity) loans (e.g. HELOC, credit cards, ODP etc.).
- Would the Basel Committee confirm the treatment for asset-backed securities (ABS) backed by financial assets (loans to banks over 6 months get 50%). Also, what is the treatment for callable demand loans with no maturity date?
- [Para 25]: Paragraph 25 notes that RSF factors are intended to approximate the amount of particular asset that would have to be funded, either because of expected rollover or inability to monetize via sale or secured funding over the course of one year without significant expense. Where non-HQLA long cash securities are held as hedges against (or linked to) synthetic short positions (such as Total Return Swaps), and the contractual provisions of the synthetic grant the institution the unfettered right to terminate the position with full settlement of cash flows within the one-year NSFR horizon, the RSF factor should be capped at 0%. While the LCR does not recognize contingent inflows, this is in the spirit of substantial work and dialogue with the regulator that informed the acceptance of “hedged equities” as Level 2B in the presence of appropriate contractual termination rights. Similar examples could be provided for other self-liquidating trades such as exchangeable ETFs vs. short sales or securities held that are hedged by forwards where delivery is required by the forward.

Secured financing transactions (page 6)

- [Para 28]: In determining the balance to report as unencumbered security assets, the NSFR definition appears inconsistent with the LCR definition of net unencumbered assets. The calculation of net unencumbered assets under the LCR includes off-balance sheet pledging and collateral swaps, as well short sale of securities. The “on-balance sheet” approach under the NSFR appears to instruct banks to report their stock of long securities assets, less repo and securities lent against cash – is that how Paragraph 28 should be interpreted?

CBA Members' Comments and Requests for Clarification

[Para 28]: This paragraph sets out the basic principle of following balance sheet and accounting treatment. Collateral swap impacts are excluded being off balance sheet. The paragraph is silent on non-cash derivative and other collateral pledges in and out. Is inbound / outbound non-cash collateral excluded / included in the banks' assets respectively by virtue of being off balance sheet?

Assets assigned a 0% RSF factor (page 7)

- [Para 29(c) and 32(c)]: What is the definition of “prudential supervision”? Under which category do Financial Markets Intermediaries or central clearing houses (i.e. Canadian Derivatives Clearing Corporation (CDCC), Fixed Income Clearing Corporation (FICC)) fall under? Are broker / dealer subsidiaries that are fully or partially owned by a parent bank who are prudentially regulated considered to fall under the category “banks subject to prudential regulation”? Are mutual funds managed and issued by banks that are prudentially regulated considered to fall under the category “banks subject to prudential regulation”?
- Para 29(c) and 32(e): If the Basel Committee decided to implement a recommendation along the lines proposed in our cover letter (i.e. broaden the type of counterparties subject to Para 29(c) and give consideration to the type of transactions and collateral underpinning secured lending transactions to set RSFs), the following comment should also be considered:
 - For secured lending transactions maturing under 6 months not assigned a 0% RSF, the dual ‘protection’ embedded in these transactions (borrower has obligation to repay banks and banks have collateral) should justify materially lower RSFs than those applicable to HQLAs held on balance sheet. For example, the current proposal in Para 32(e) would apply a 50% RSF to a secured lending transaction to counterparties not eligible in Para 29(c) irrespective of collateral. For a counterparty deemed not subject to prudential supervision to which cash is lent against non-Level 1 assets, we believe this should result in a RSF that is between one quarter and one half of the RSF factor applicable to the eligible/ineligible HQLA in paragraphs 30 - 35 with a RSF cap of 25% for any secured lending transactions against eligible/ineligible securities. We believe this would be reasonable based on preceding arguments in this section and the cover letter and the maturity of these transactions. The remaining minimum funding tenor for these transactions would be driven by LCR rules.

Assets assigned a 5% RSF factor (page 7)

- Level 1 HQLA receive a 5% RSF factor regardless of their maturity. This means that an unencumbered three-month T-bill would receive a 5%

CBA Members' Comments and Requests for Clarification

RSF, while the associated six-month unsecured funding would receive only 50% ASF. This asymmetry between funding ASF and unencumbered liquid assets RSF means that it will be difficult for banks to hold unencumbered HQLA with maturities shorter than one year. We believe that the RSF factor for all HQLA that mature within one year should be assigned 0%, which was the original treatment in the NSFR rules from December 2010.

Assets assigned a 50% RSF factor (pages 7 - 8)

- [Para 32(a)]: Can the Basel Committee comment on the seemingly inconsistent funding requirement of equities under the NSFR as compared to the LCR? The LCR provides a 50% factor for non-FI qualifying equities, which implies 50% of such equities must be supported by > 1 month funding. In the NSFR rules, these same equities have a 50% RSF factor, which now implies that these equities need to be supported by > 1 year funding. Similarly, all other non-qualifying equities under the LCR require > 1 month funding, but under paragraph 34(b), 85% of these equities would require > 1 year funding.
- [Para 32(a)]: Equity TRS typically have contractual original terms of 1 year or less with binding cancellation clauses in all cases <3 months. This cancellation clause appears not to be relevant in the NSFR as equities would be subject to a 50% RSF (non-FI exchanged traded equities) and 85% RSF (FI exchange traded equities) under paragraphs 34(b). There is a similar point for fixed income TRS. Could the Basel Committee please confirm if we can look to the cancellation date of the TRS to assign RSF factors for these equities or fixed income securities?
- Would the Basel Committee please confirm if “*exchange traded common equity shares*” include Exchange Traded Funds (ETFs)?
- [Para 32(e)]: What's the difference between a financial institution and a financial corporate client?
- [Para 32(e)]: A lot of assets are included in this paragraph. The NSFR updated template should probably provide a different line to distinguish between Non-FI loans, Retail/SME loans and Sovereigns/Central banks etc.
- [Para 32(e)]: The proposal is very punitive for short-term money market instruments issued by non-bank FIs and held as assets on balance sheet. Although maturing within 1 year, they will need to be term funded 50% past 1 year. No consideration is given to the fact that they can be monetised or secured funded per criteria in paragraph 25. We believe that non-bank FI short-term liquid assets such as commercial paper should get the same treatment as bank assets less than six months, which is 0% RSF.

CBA Members' Comments and Requests for Clarification**Assets assigned a 65% RSF factor** *(page 8)*

- [Para 33(a)]: Can the Basel Committee comment on the intended seemingly inconsistent treatment of residential mortgages and installment secured home equity lines of credit with less than 1 year to maturity, which receive a 65% RSF factor compared to other loans that receive a 50% RSF factor under paragraph 32.
- [Para 33(a)]: Would the Basel Committee please provide clarification for the treatment of residential mortgages maturing within a year, since this paragraph only provides guidance on residential mortgages with a residential maturity of one-year or more.
- Do CMHC-insured mortgages fall into this category?

Assets assigned a 85% RSF factor *(page 8)*

- [Para 34(c)]: Why is gold now getting an 85% RSF factor vs. 50% as in previous versions of the NSFR? Physical commodities and exchange traded equities were at 50% in the last QIS template but are increased to 85% RSF. This will include financial equities and non-index equities. We believe that this is far too punitive. Would the Basel Committee please reconsider and apply 50% RSF factor for gold.
- [Para 34 (c)]: Gold holdings related to gold deposits should be treated in a symmetrical manner. This activity is analogous to holding cash in a vault against the demand deposits (i.e. the bank should be liquidity neutral where gold is held against deposit liability).

Off-balance sheet exposures *(pages 9 - 10)*

- Unconditionally revocable “uncommitted” credit and liquidity facilities are divided between retail and SME and all other customers in the LCR. Retail and SME receive a lower weighting. Should we distinguish between the two in the NSFR?

ANNEX 1 – KEY CHANGES FROM THE NET STABLE FUNDING RATIO PUBLISHED IN DECEMBER 2010 (Page 11)

Transaction Type	Description	ASF/RSF	Factor <6 month	Factor ≥ 6 months to < 1 year	Factor ≥1 year	Comment	Paragraph
1. MBS sale	MBS pass-through	ASF	0%	50%	100%	Term matched maturity	22(a), 21(d), 18(c)
	Mortgage	RSF	50%	50%	100%		27
2. CHT/IMPP	MBS pass-through	ASF	0%	50%	100%		22(a), 21(d), 18(c)
	CHT Sale	RSF	50%	50%	100%	Sale is term matched	27
	CHT Repo	RSF	→	→	100%	MBS repo is ≥1 year	35(a)
	T-bill Repo	RSF	5%	50%	100%		30, 32(b), 35(a)
3. Covered Bond	Liability	ASF	0%	50%	100%		22(a), 21(d), 18(c)
	HELOC	RSF	65%	65%	100%	If HELOC is matched to covered bond maturity	27, 35(a)
4. Covered Bond	Liability	ASF	0%	50%	100%		22(a), 21(d), 18(c)
	HELOC	RSF	→	→	100%	If HELOC remains in the ≥1 year bucket	35(a)

**RSF
overstatement**

- We believe that the mismatch between the treatment of long-term funding and long-term assets under one year is unduly penalizing; however, a bank with a match-funded profile throughout will not stay onside with NSFR rules unless it pre-funds against its long-term debt maturities at least five months ahead of time. Securitization funding is an example – given the pass through structure and/or credit enhancements, we believe that it is overly conservative to assume the same roll over risk for these funding structures (e.g. Canada Mortgage Bonds (CMB)) as unsecured short-term debt.
- The MBS pass-through on the ASF vs. the treatment of the encumbered mortgages on the RSF results in an RSF overstatement in ≤1 year depending upon the type asset supporting the liability (see examples 1 & 2 above).
- The mismatch between the treatment of the covered bond liability on the ASF vs. the treatment of the encumbered HELOC on the RSF results in a RSF overstatement in ≤1 year depending upon the assumption used to for the HELOC asset (see examples 3 & 4 above).