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By email: baselcommittee@bis.org

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs

Consultative Document on Basel III: The Net Stable Funding Ratio (January 2014)

We refer to the consultative document on the Net Stable Funding Ratio ("NSFR") by the Basel Committee on Banking Supervision (BCBS) in January 2014. On behalf of our members, we set out in the attachment our comments on the proposals in the consultative document.

We would appreciate the BCBS's particular attention on the following views:

1. NSFR is a monitoring tool under a business as usual ("BAU") scenario which is different from the Liquidity Coverage Ratio ("LCR") in stress scenario. Both Available Stable Funding ("ASF") and Required Stable Funding ("RSF") factors in NSFR should be set under BAU scenario.

2. For particular areas which assets can be fully offset against liabilities, we consider a symmetrical treatment should be adopted for NSFR calculation.

We hope you would find our above comments useful. For any questions, please do not hesitate to contact Mr Timothy Tam of the Secretariat at (852) 2526 6080.

Yours faithfully

黃美嫦

Eva Wong
Secretary

c.c. Ms Karen Kemp, Executive Director (Banking Policy), Hong Kong Monetary Authority

Comments on "Consultation on Net Stable Funding Ratio (NSFR) & other recent announcements"

page number	paragraph number	quotation of extract from the consultation paper	HKAB's comments/counterproposal and supporting reason
2	12	The calibration reflects the stability of liabilities across two dimensions: (a) Funding tenor – The NSFR is generally calibrated such that longer-term liabilities are assumed to be more stable than short-term liabilities. (b) Funding type and counterparty – The NSFR is calibrated under the assumption that short-term (maturing in less than one year) deposits provided by retail customers and funding provided by small business customers is behaviorally more stable than wholesale funding of the same maturity from other counterparties.	**Stability of Operational Accounts** We agree that it is important to differentiate between the stability of different funding types (paragraph 12) and in line with the Principle 7 of the Sound Principles that it is important that banks maintain an effective diversification of the sources of funding and foster strong relationships with funds providers. Recognizing the stability of operational deposits is a positive step to meet these aims. However, we are concerned that the current calibration of NSFR reduces incentives for banks to seek out stable sources of funding within wholesale markets which would be contrary to the objective of the Sound Principles. In the same way that BCBS distinguishes stability of funding from within retail markets, we would suggest that it is prudent to distinguish between different types of funding from wholesale markets, in particular from different types of wholesale deposits. When banks identify operational deposit balances for the purposes of LCR they are required to only report balances from cash, clearing, and custody management where customers have a substantive dependency with the bank, and to strip out on a conservative basis any balances which are in excess of these requirements. The remaining core operational balance would display much higher stability in BAU and stress than a regular non-operational balance. If stress conditions were extended to up to a year it would be possible for funds to be withdrawn, however we must remember that the NSFR is looking at the BAU funding profile of a bank. In these conditions the core stable balance is more likely to remain due to the substantive dependency of the customer on the bank and the depth of relationship. For these reasons it would be in line with the Sound Principles to recognize a higher ASF (up to 75%) for operational deposit balances than non-operational balances in order to incentivise banks to build stronger relationships with wholesale depositors. This will ensure that banks are more resilient to a funding stress by having clear incentives to diversify wholesale funding and build funding relationships which provide a line of sight into the depositor's

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4	21	Liabilities receiving a 50% ASF factor (a) Funding (secured and unsecured) with a residual maturity of less than one year provided by non-financial corporate customers (b) Operational deposits (as defined in LCR paragraphs 93–104);	behavior. In light of the LCR framework, the operational deposits [item 21(b)] under the section of Available Stable Funding (ASF) of Basel III NSFR consultative document should deserve to receive a higher ASF factor than the unsecured funding [item 21(a)] on the ground that the LCR outflows rate of operational deposits (i.e. 25%) is much lower than the unsecured funding (i.e. 40%). At the moment, operational deposits and unsecured funding are assigned with the same 50% ASF factor.
3 8	13 32(e)	In determining the appropriate amounts of required stable funding for various assets, the following criteria were taken into consideration, recognising the potential trade-offs between these criteria: (a) Resilient credit creation – The NSFR requires stable funding for some proportion of lending to the real economy in order to ensure the continuity of this type of intermediation. (b) Bank behaviour – The NSFR is calibrated under the assumption that banks may seek to roll over a significant proportion of maturing loans to preserve customer relationships. (c) Asset tenor – The NSFR assumes that some short-dated assets (maturing in less than one year) require a smaller proportion of stable funding because banks would be able to allow some proportion of those assets to mature instead of rolling them over. (d) Asset quality and liquidity value – The NSFR assumes that unencumbered, high-quality assets that can be securitised or traded, and thus can be readily used as collateral to secure additional funding or sold in the market, do not need to be wholly financed with stable funding. Assets assigned a 50% RSF factor (e) All other non-HQLA not included in the above categories that have a residual maturity of less than one year, including loans to non-bank financial institutions, loans to non-financial corporate clients, loans to retails customers (ie natural persons) and **small business customers**, and loans to sovereigns, central banks and PSEs.	**Liquidity Value of Trade Finance** While we are in full agreement with the criteria for determining the RSF for assets set out in paragraph 13 we are concerned that the wide scope of paragraph 32e may have unintended consequences for short tenor trade finance loans used to support international trade. Trade finance lending have many characteristics that differentiate them from standard corporate loans. It aims to support international trade flows by helping customers meet their short term working capital needs. These type of trade finance related lending is typically short term with the average industry asset tenor less than 100 days. By setting an RSF of 50% for these short term assets we would be assuming that the same behavioral rollover assumptions as a maturing corporate loan with initial tenor above 1 year but usually it seldom matured beyond the 12 month. We should also consider that each trade finance loan is intrinsically linked to a trade. There is no automatic rollover as loans are considered on a transaction basis and all documentary proof of the underlying trade / shipment e.g. proof of shipment, proof of sale / purchase through invoices, quantity and quality certificates, warehouse receipts and other transactional documents, have to be provided for drawdown Due to its self-liquidating nature, the EU allows a 100% inflow in their calibration of LCR. Therefore, we opined that it would be appropriate to apply a 0% RSF for trade finance lending with residual maturity below 6 months. We would like to highlight that there will be adverse impact on this low margin business by adding an additional regulatory cost. It is imperative that the impact on real economy is adequately considered when setting RSF.

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4 5 8	19 20 23 32 e	Liabilities receiving a 95% ASF factor comprise "stable" (as defined in the LCR in paragraphs 75–78) non-maturity (demand) deposits and/or term deposits with residual maturities of less than one year provided by retail and **small- and medium-sized entity (SME) customers**. Liabilities receiving a 90% ASF factor comprise "less stable" (as defined in the LCR in paragraphs 79–81) non-maturity (demand) deposits and/or term deposits with residual maturities of less than one year provided by retail and **SME customers.** • Stable non-maturity (demand) deposits and term deposits with residual maturity of less than one year provided by retail and **SME customers** • Less stable non-maturity deposits and term deposits with residual maturity of less than one year provided by retail and **SME customers** All other non-HQLA not included in the above categories that have a residual maturity of less than one year, including loans to non-bank financial institutions, loans to non-financial corporate clients, loans to retails customers (ie natural persons) and **small business customers**, and loans to sovereigns, central banks and PSEs.	**Small and medium-sized entity (SME) customers** The term of "small- and medium-sized entity (SME) customers" is newly introduced in this consultation paper on NSFR, and has not been outlined in LCR paper. "SME customers" are present in paragraphs 19, 20 and 23, however "small business customers" is in paragraph 32(e). There is an inconsistency throughout the entire consultation paper. Also, should the scope of SME customers outlined in NSFR be consistent to the scope of Small business customers (SSE) in LCR? We would like to have more clarification on this.
5	22(a)	Liabilities receiving a 0% ASF factor comprise: (a) All other liabilities and equity categories not included in the above categories, including other funding with residual maturity of less than six months from central banks and financial institutions	**ASF for Central Bank Deposits** We agree that in the context of NSFR banks should not assume that secured funding from central banks should be expected to rollover. Banks should be incentivised to seek stable sources of funding from market participants to reduce the reliance on emergency support from central banks. However, where central banks act as market participants looking for institutions with which to place unsecured deposits as part of the money market management it would seem reasonable that the ASF is treated in line with counterparties with similar market behaviour e.g. Sovereigns, PSEs, and multilateral and national development banks. A 0% ASF for deposits from central banks would remove incentives for banks to hold these deposits. We ask that the standards differentiate between BAU unsecured and emergency secured funding transactions from central banks.

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			In this regard, we propose BAU unsecured funding from central banks applying the same ASF factor (i.e. 50%) as for sovereign, PSEs, and multilateral and national development banks according to paragraph 21(c) of the consultation paper, instead of 0% ASF factor according to paragraph 22(a).
5	22 (c)	Derivatives payable net of derivatives receivable if payables are greater than receivables. A bank will usually have both net derivatives liabilities (ie payables) and net derivatives assets (ie receivables) on its balance sheet. Banks should deduct any net payable from any net receivable and the outcome is allocated 100% RSF if it is a net receivable or 0% ASF if it is a net payable position. During the consultative period, the Basel Committee will continue to evaluate alternative treatments for derivatives within the NSFR	**Funding of Derivatives Transactions** We are against the use of any PFE requirements for derivatives in NSFR. The risks of stressed collateral calls are already covered in the LCR. The NSFR as a balance sheet metric should only focus on the structural position of the balance sheet during a business as usual scenario. In addition, we consider a symmetrical treatment should be adopted for derivative receivables and payables instead of requiring 100% RSF factor for net derivative receivables whilst only allowing 0% ASF factor for net derivative payables as proposed in paragraph 22(c) of the consultation paper. We also propose that there should be differentiation on tenors on derivative payables and receivables with lower ASF and RSF factors respectively applied to those with residual maturity less than one year.
7	32	Assets assigned a 50% RSF factor comprise: (a)Unencumbered Level 2B assets as defined and subject to the conditions set forth in LCR paragraph 54, including : • residential mortgage-backed securities (RMBS) with a rating of at least AA; • corporate debt securities (including commercial paper) with a credit rating between A+ and BBB-; and	**Funding of Level 2B Assets** Under LCR, 25% and 50% haircuts would be applied to residential mortgage backed securities and corporate debt securities respectively that are qualified as Level 2B assets. We consider it is penal for applying a standard 50% RSF factor for Level 2B assets for NSFR purposes. Furthermore, under BAU circumstance, the highest haircut level that would normally be accepted in the market would be around 20%. In this regard, we propose that RSF factor for Level 2B assets should be lowered to 25% vs. 50% as proposed in the consultation paper.
8	32	Assets assigned a 50% RSF factor comprise: (e) All other non-HQLA not included in the above categories that have a residual maturity of less than one year, including loans to non-bank financial institutions, loans to non-financial corporate clients, loans to retail customers (ie natural persons) and small business customers, and loans to sovereigns, central	**Funding of Non-HQLA Securities** We consider that there should be no differentiation of the RSF factors between those non-HQLA securities with residual maturity of less than one year and those with residual maturity of one year or more. The residual maturity tenor of the non-HQLA securities does not necessarily represent the length of period that a bank intends to hold that securities. The level of haircut

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	 34 35	banks and PSEs Assets assigned an 85% RSF factor comprise: (b) Unencumbered securities that are not in default and do not qualify as HQLA according to the LCR including exchange-traded equities Assets assigned a 100% RSF factor comprise: (a) All assets that are encumbered for a period of one year or more	for monetizing the securities (via outright sale or repo markets) would mainly relate to the nature and the credit rating of the securities, whilst the residual maturity is not the major factor. These haircuts should be applied in a manner consistent with market practice during business as usual. For this reason we think it is appropriate for haircuts to be limited to a maximum of 25%. This will also reduce the cliff effect for funding securities that do not qualify for either Level 1 or level 2A securities. Therefore, we propose the same RSF factor, i.e. 25%, should be applied to non-HQLA securities regardless of their residual tenors.
8 5	32 22	Assets assigned a 50% RSF factor comprise: (e) All other non-HQLA not included in the above categories that have a residual maturity of less than one year, including loans to non-bank financial institutions, loans to non-financial corporate clients, loans to retail customers (ie natural persons) and small business customers, and loans to sovereigns, central banks and PSEs. Liabilities receiving a 0% ASF factor comprise (a) All other liabilities and equity categories not included in the above categories, including other funding with residual maturity of less than six months from central banks and financial institutions	**Other Acceptance** According to our understanding, assets booked relating to other acceptance (with residual tenor normally less than 6 months) would be subject to 50% RSF factor according to paragraph 32(e) of the consultation paper, whilst the corresponding offsetting liabilities relating to other acceptance would be subject to 0% ASF factor according to paragraph 22(a) of the consultation paper. In this regard, we propose the BCBS to specify a symmetrical treatment to be adopted for both assets and liabilities booked relating to other acceptance as they are entirely offsetting with each other.
8 5	35 22	Assets assigned a 100% RSF factor comprise: (c) All other assets not included in the above categories, including non-performing loans, loans to financial institutions with a residual maturity of one year or more, non-exchange-traded equities, fixed assets, pension assets, intangibles, deferred tax assets, retained interest, insurance assets, subsidiary interests and defaulted securities. Liabilities receiving a 0% ASF factor comprise (b) Other liabilities without a stated maturity. This category may include short positions and open maturity positions. Two exceptions can be recognised for liabilities without a stated maturity: • first, deferred tax liabilities, which should be treated	**Assets Held for Backing Banknote Issuance and Bank Notes in Circulation** According to our understanding, assets held by note issuing banks for backing the issuance of banknote which is applicable to some jurisdictions, including Hong Kong, would be included as "other assets" and the corresponding offsetting liabilities, i.e. notes in circulation, would be included as "other liabilities" for NSFR purposes. According to paragraph 35(c) of the consultation paper, "other assets" would be subject to 100% RSF factor, whilst "other liabilities" would be subject to 0% ASF factor according to paragraph 22(b) of the consultation paper. In this regard, we propose the BCBS to specify a symmetrical treatment to be adopted for assets held for backing the issuance of banknote and the notes in circulation booked on the liabilities side as they are entirely offsetting with

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		according to the nearest possible date on which such liabilities could be realised, and • second, minority interest, which should be treated according to the term of the instrument, usually in perpetuity. These liabilities would then be assigned either a 100% ASF factor if the effective maturity is one year or greater, or 50%, if the effective maturity is no less than six months and less than one year	each other.

Other comments: **Adoption of Basel II Standardized Approach for Credit Risk in determining RSF factor**

The requirement of differentiating unencumbered loans that would qualify for a 35% or lower risk weight under the Basel II Standardized Approach for credit risk would pose an implementation challenge and cost for banks adopting Internal Risk Based Approach for credit risk ("IRB banks") as information relating to external credit ratings may not be readily availability in the reporting systems for IRB banks.