HSBC

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

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HSBC comments to the Consultative Document on Basel III: The Net Stable Funding Ratio

Dear Sylvie and Carolyn,

HSBC welcomes the opportunity to comment on the above consultative document. HSBC considers that the NSFR is the most important of the entire suite of liquidity metrics recommended by the Basel Committee on Banking Supervision (BCBS), and correctly calibrated, it should significantly reduce the probability of a liquidity stress within a bank.

At HSBC we have utilised a similar structural funding metric for many years, which is similar to the NSFR and based upon the concept that illiquid or customer franchise assets should be funded by stable funding.

It is with the above in mind that we would like to comment on areas where it is either unclear from the text what the appropriate treatment of certain types of instrument should be, or where we believe the current calibration does not correctly reflect the risks in the financial market and we can see a number of possible unintended consequences that could be brought about by its implementation as proposed.

<u>Secured Financing Transactions (SFT's)</u>

We are concerned by the asymmetric treatment of SFT's with less than 6 months maturity. While there may be concerns around customer cash security financing, the calibration of reverse repo trades masks the three reasons for reverse repo transactions.

1. The use of reverse repo as a store of liquidity and more narrowly a source of HQLA to satisfy LCR.

2. The covering of short positions.
3. Customer securities cash financing.

In the first instance, any stable funding requirement will result in banks switching from reverse repo to Central Bank reserves and outright holdings of securities, reducing the depth of the repo markets. Deep and liquid repo markets are fundamentally required by the system as a whole in order for participants to be able to monetise liquid assets under stress, something the LCR framework relies upon.

In the second instance, as short sellers banks add significant liquidity to cash security markets, but this requires the use of reverse repo (stock borrow). Any stable funding requirement placed on reverse repo transacted for stock borrowing purpose will result in banks decreasing their short covering/short position capacity thereby reducing the depth of liquidity in cash security markets. Deep and liquid cash security markets are fundamentally required by the system as a whole in order for participants to be able to monetise liquid assets under stress, something the LCR framework relies upon.

In the third instance, regarding customer securities cash financing, we believe that the franchise risk should be taken into account, but only to the extent that the underlying collateral cannot be re-used by the cash provider to continue to finance the cash lent. To this extent, even in the most extreme case of an assumed constant franchise, it is only the stressed haircut on the collateral received that should be seen to require stable funding.

We would recommend the level of stable funding required for reverse repo using LCR HQLA assets to be set at the level of the haircut applied in the LCR, and for all other non-HQLA collateral, the level of stable funding required should be based on a similar approach through the definition of NSFR stressed haircuts. The approach should be consistent with the approach applied to long cash security positions.

We would recommend that a zero stable funding weighting be applied to reverse repo for surplus liquidity deployment, and short covering.

Cleared Reverse Repo

Another aspect of reverse repos that merits consideration is in situations when two banks contract over the counter repo but then choose to clear the trade across a Central Counterparty (CCP). Some CCP's are banks whereas others are non-bank financials. If a trade was conducted over a non-bank financial this would lead to a requirement for stable funding. This would clearly lead to banks reverting back to a bi-lateral repo, which is contrary to the regulatory push for further clearance of trades across CCP's. To resolve this problem we would like clarity that any Qualifying CCP's will be treated as a bank.

Long Cash Security Positions

We would recommend the use of the same haircuts as defined for HQLA in the LCR, and stressed NSFR haircuts defined for all other non-HQLA collateral, to determine the level of stable funding required for long cash security positions.

Funding from Central Banks and other international bodies

The funding from Central Banks and other international bodies, including the BIS, would currently seem to be caught in paragraph 21 (d). In normal circumstances these market participants conduct unsecured operations with banks that are outside the scope of monetary policy and not for emergency liquidity assistance. It does not seem appropriate to give these deposits zero ASF, and it would seem more appropriate to group them with paragraph 21 (c) .

Purchase of short dated CP or CD's issued by banks.

It is not entirely clear if the purchase of securities issued by banks with a residual maturity of less than 6 months is treated as part of 29 (c) - namely 0% RSF. Although this would not be a liquid asset for LCR, we believe this is the correct line as it is not a franchise trade for lending purposes and the counterparty could not realise any other available stable funding. Clarification on this issue would be helpful.

Derivatives

Much discussion has taken place around derivatives. We believe that with a lack of clarity over precisely how derivatives will be interpreted for LCR by bodies such as the EBA under the CRR, it is premature to implement an inconsistent regulation. There is a danger that much work, data mining and resources will be used up in delivering a reporting requirement around derivatives when the materiality of this number is likely to be small. The resources to achieve this are already running at a high capacity implementing the LCR requirements. Therefore until further work has been undertaken we agree with the current arrangement as proposed by the BCBS.

Balance sheet and Accounting Netting

The NSFR is seen as a balance sheet metric rather than a liquidity metric, however the terms regulatory netting are used in some of the guidance. We would like to see better clarity as to how the regulatory netting and accounting netting under different accounting standards are to be implemented to ensure comparability and level playing field standards and to try and ensure as much as possible the interaction with the leverage ratio is as consistent as possible.

Yours Sincerely,

M. S

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