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Via Electronic Submission to: baselcommittee@bis.org
Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

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

Ladies and Gentlemen:

JPMorgan Chase & Co ("JPMC") is pleased to provide comments on the Consultative Document (the "Proposal") regarding revisions to the Net Stable Funding Ratio ("NSFR"). JPMC supports the goals of the NSFR to limit overreliance on short-term wholesale funding markets, encourage a better assessment of funding risks across all on and off balance sheet assets and promote funding stability and resiliency to banks.
We appreciate the significant review that the Basel Working Group on Liquidity ("BWGL") has done on the Proposal as well as the material revisions that have been made to the Proposal since its origination. We believe that the revised NSFR attempts to maintain an appropriate balance between the structural liquidity risk in a firm's balance sheet and off-balance sheet activities versus the amount of maturity transformation performed by banks that is a crucial part of financial intermediation.

Our comments are meant to help ensure that the NSFR accurately and realistically recognizes structural liquidity characteristics of bank assets and liabilities and the relationships between them as well as act as a complement to Basel's Liquidity Coverage Ratio ("LCR"). JPMC has a few key concerns and recommendations on sections of the Proposal where the calibration of the factors does not appropriately capture the funding and liquidity characteristics of particular assets. We hope the BWGL finds these recommendations helpful in accomplishing their objectives.

<u>Liability driven reverse repo and securities borrow transactions should receive symmetric factor treatment[1] in the NSFR calculation.</u>

- The Proposal requires 50% Required Stable Funding ("RSF") to be held against secured loans with a tenor of less than one year. Subsequent guidance classifies reverse repurchase agreements ("repo") and securities borrowed transactions into the secured loan category.
- Reverse repo and securities borrowed transactions are entered into for many purposes other than client financing activities. A significant portion of these transactions used for risk management purposes to cover short positions or optimal deployment of excess cash.
- Certain reverse repo and securities borrowed transactions are self-funding in nature yet the Proposal requires 50% RSF treatment.
- The self-funding nature of the types of transactions referenced above is explained as follows:
    - Customer / Firm Shorts

[1] Same ASF and RSF factors

- When a firm or its customer sells a security short, settlement of the trade often requires a reverse repo or securities borrow transaction to deliver the necessary securities. The cash proceeds from the short sale are used to secure the borrowed collateral. When the firm or its customer closes out their short position by purchasing the security, the security is returned to the third party lender and the cash is received back. These types of shorting strategies are normal course risk management practices and are conducted in accordance with applicable legal and regulatory requirements.
- Therefore, the NSFR calculation should exclude these transactions or at a minimum apply symmetric factor treatment to both legs of the transaction for the following reasons:
    - These two transactions are linked. The purpose for booking the reverse repo or securities borrow was specifically tied to the client or firm short position.
    - These back-to-back, offsetting transactions are typically short-dated and are highly regulated (Reg. T purpose rule: "borrow for a purpose").
    - Once the client or firm purchases the security and closes out the short position, the firm will close out the linked reverse repo or securities borrow.

- Collateralized Deposits
    - As recognized in the Federal Deposit Insurance Act (the "FDIA"), the laws of various states require that the deposits of certain municipalities and other PSEs must be "secured or collateralized" by the insured depository institution which holds such deposits.
    - Banks may meet this collateralization requirement through a reverse repo transaction to acquire the high quality collateral.
    - Should the municipality or PSE withdraw their deposit, these high quality assets would no longer be required and the reverse repo transaction would be unwound.
    - NSFR should consider equivalent treatment for ASF/RSF factors related to these transactions. Similar to other liability driven transactions, NSFR should apply symmetric factors for the municipal deposit and the reverse repo for the following reasons:
        - Offering these types of secured deposit arrangements is critically important to municipalities and PSEs.
        - Municipal deposits are significantly different in nature than other types of secured funding transactions where banks, at their discretion, seek funding to finance their securities inventory in the wholesale funding markets. Discouraging banks from providing secured deposit services to U.S. municipalities and PSEs would be contrary to public policy goals.
- Excess Cash Deployment
    - A firm's excess cash balances can be deployed into high quality liquid assets ("HQLA") via reverse repo as part of the management of the bank's liquid asset buffer. Such transactions are entered into to diversify the liquidity pool and to manage regulatory requirements.
    - If the reverse repo is unwound, the firm would receive the deployed cash back.

- We believe the NSFR calculation should exclude these transactions or at a minimum apply symmetric ASF and RSF factors to both legs of the transaction. JPMC believes that it would be possible to establish auditable and observable purpose tests where the bank could demonstrate that the specific securities obtained via reverse repo or securities borrow are performed for a purpose, i.e. to cover a specific firm or customer short, collateralize a deposit, or deploy excess cash into HQLA, symmetric ASF/RSF treatment would be applied up to the amount of the demonstrable self-funded liability. Any securities financing transactions in excess of this amount for that particular security would then be subject to the ordinary RSF/ASF treatment.

Credit quality and liquidity of collateral securing reverse repo and securities borrowed transactions should be incorporated into the factors for the NSFR.

- The Proposal seeks to create RSF factors that are based on broad characteristics of the liquidity risk profile of a firm's assets and off-balance sheet exposures, and JPMC generally agrees with this approach.
- We believe that maturity of the transaction should be a key consideration. However, we also acknowledge the potential that asymmetric unwind could create unexpected financial risk.
- Even contemplating asymmetric risk, collateral quality securing a transaction is a significant characteristic of a bank's liquidity profile and it is not fully accounted for in the RSF factors outlined in the Proposal.
- To the extent that regulations require stable funding against reverse repo or securities borrowed transactions with tenors less than 1 year, JPMC believes that the NSFR should apply tailored ASF and RSF factors that reflect the quality of the collateral and thereby distinguish between Level 1, Level 2A and Level 2B assets for transactions secured by these assets.
- Secured funding transactions should not attract a higher RSF factor than the factor that would apply if a firm owned the security in inventory.
- Secured funding transactions have structural and legal protections to substantially mitigate liquidity and credit risk such as:
    - Posting daily marked- to-market margin
    - Contractual maturity
    - Special bankruptcy protections that allow immediate access to the collateral without the risk of automatic stay
- JPMC supports an RSF factor calculated as follows for secured funding transactions in an effort to appropriately account for underlying collateral quality.
    - A bank would take the 50% RSF for unsecured loans and multiply this by the RSF of the underlying asset as if it was unencumbered in recognition of the fact that bank has two liquidity resources: (a) repayment of cash by the counterparty and (b) use or liquidation of the collateral. This treatment should only apply where the bank has re-hypothecation rights with respect to the collateral received; otherwise, a flat 50% RSF would apply.
    - For example, a reverse repo secured by a Level 1 asset would have an RSF of 2.5% (50% unencumbered factor multiplied by 5% factor for Level 1 assets) and a reverse repo secured by equities would have an RSF of 42.5% (50% multiplied by 85% factor for equities).

Reverse repo and securities borrowed transactions executed with the same counterparty, same end date, and same settlement system should be permitted to be netted against one another.

- The Proposal does not allow for the netting of securities financing transactions executed with the same counterparty, end date and settlement date.
- These secured funding transactions, by definition, are structurally matched and allow for legal offsetting. As such, these transactions do not create liquidity risk to the extent they are nettable.
- A bank would not allow the unwind of a repo without the simultaneous unwind of the reverse repo with the same counterparty.
- For example, if a firm reverse repos a long dated U.S. Treasury in from a specific counterparty to a specific end date and repos a short dated U.S. Treasury to the same counterparty to the same end date as part of a trade facilitating the location and financing of long and short positions, both transactions are legally nettable from a credit risk and balance sheet perspective. It would not be expected that the reverse repo leg of the trade would continue on the same terms if the offsetting repo transaction were to mature, and therefore should require no stable funding.
- We therefore recommend that netting of these transactions be permitted within the framework of the NSFR.

The NSFR should distinguish between counterparties.

- The Proposal specifies treatment for repo and reverse repo transactions dependent on the counterparty in the transaction.
- When executed with a prudentially regulated institution, i.e. a bank, these transactions are subject to a 0% RSF factor, while the same transactions performed with non-bank counterparties receive a more punitive 50% RSF factor.
- JPMC understands that Central Banks were unintentionally omitted in the definition of a bank, and that this will be corrected in the final rule.
- The Proposal does not detail specific treatment for repo and reverse repo transactions with a Qualified Central Counterparty ("QCCP"). The majority of QCCPs are not organized as banks.
- Pursuant to paragraph 29(c) of the Proposal, repo and reverse repo transactions with a "non-bank" QCCP would then be subject to a 50% RSF factor, resulting in more punitive treatment compared to bilateral, non-centrally cleared repo or reverse repo with a bank which would be subject to a 0% RSF factor.
- This treatment will incentivize market participants to execute repo and reverse repo transactions on a bilateral basis, and strongly disincentivize central clearing of repo and reverse repo transactions, which is at cross purposes with regulators' and policy makers' goal to promote the standardization and resilience of markets through the establishment of central clearing counterparties that are subject to regulation and supervision.

Treatment of margin lending balances should be treated on a net basis.

- Although the rules do not specifically address the treatment of margin lending balances, JPMC believes that securities margin accounts represent single units of account per client and therefore should be carried at balance sheet value for the purposes of the NSFR calculation.
- The balance sheet value reflects the net extension of credit to the counterparty, and is therefore the appropriate basis on which to evaluate the stable funding position.

- Securities margin accounts are effectively securities financing transactions, and therefore we recommend similar treatment as that proposed for client financing reverse repo and securities borrow transactions in terms of collateral quality and tenor.
- We believe that because client accounts are managed at a portfolio basis and not on a transactional basis, we also recommend applying RSF's that are in line with the average asset composition of the portfolio. Similarly, simplifying assumptions should be permitted regarding the quality of the collateral so long as the bank can demonstrate the average quality of the portfolio to be consistent with the applicable RSF.

Netting parameters for derivatives payables and receivables should be amended to reflect their true funding and liquidity characteristics.

- Pursuant to paragraph 22(c) in the Proposal, banks must deduct any net payable from any net receivable (prior to netting down for cash) and the outcome is allocated 100% RSF factor if it is a net receivable or 0% ASF factor if it is a net payable position.
- Although this balance sheet approach does have merit, we believe that adjustments to this approach are necessary to appropriately capture the true funding and liquidity characteristics of derivatives.
- First, we believe that the same logic that led to the recognition of a derivative payable fully offsetting a derivative receivable should apply to a derivative payable independent of a receivable as the payable has liquidity value on a standalone basis as well.
- In addition, it is important for liquidity purposes to net collateral received or pledged against these cash flows as well as net the mark-to-market and credit exposures (important for balance-sheet and capital management).
- JPMC believes, at a minimum, that cash variation margin ("VM") received under an agreement that provides for daily margining should be recognized within the NSFR as it provides an ideal source of stable funding due to its perfect tenor and notional match with the underlying derivative.
- Finally, we believe that VM received as securities that are able to be re-hypothecated, should also be given credit within the NSFR. These securities are a source of funding as they provide a refinancing option for the receiving bank.
- We acknowledge that this is a more complex topic that may require further analysis in order to ensure comfort. We look forward to working with the regulators to avoid any unnecessary negative implications that may be caused by the lack of recognition of this margin.

A bank's intermediary activities between clients and Central Counterparties ("CCPs") should be excluded from the NSFR derivatives framework.

- The Proposal would capture IM posted to CCPs on behalf of a bank's client. We believe these activities should be excluded from the NSFR derivatives framework.
- IM posted to CCPs is fully funded by a bank's client. It appears on the bank's balance sheet as a receivable, while IM received from a client shows up as a customer payable, but does not create liquidity risk for the intermediary bank.
- Given the self-funding nature of this activity, collateral posted to CCPs on behalf clients and excess customer collateral, which are both part of accounting assets, should be given a 0% RSF, and that customer payables funding these assets should be given 0% ASF.

Operational Deposit ASF should be increased.

- The Proposal requires a 50% ASF factor for all operational deposits.

- While we appreciate the Proposal's revision in ASF factor from 0% to 50%, we believe it is inappropriate for the NSFR to apply less stable funding value to operational deposits than the LCR, a 30-day idiosyncratic severe stress.
- From a structural liquidity perspective, client operating relationships and their average deposit balances are stable over time.
- At a minimum, we believe the more appropriate ASF factor would be 75%. We would look forward to providing analysis to support the higher level of stability for operational deposits.

We appreciate the opportunity to comment on this Proposal and wish to thank the Committee for their consideration and concern for the views expressed in this letter. If you have any questions or need additional information, please feel free to contact Adam Gilbert at 212-270-8928 to discuss the contents of this letter at your convenience.

Respectfully yours,

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