NOMURA

Basel Committee on Banking Supervision

Centralbahnplatz 2
4051 Basel
Switzerland

11 April 2014

RE: Basel III: The Net Stable Funding Ratio – Consultative Document January 2014

Dear Madam/Sirs,

Nomura Holdings, Inc. ("**Nomura**"), a Basel compliant global investment banking group headquartered in Tokyo, Japan, appreciates the opportunity to comment on the Basel Committee on Banking Supervision's ("**BCBS**") Net Stable Funding Ratio ("**NSFR**") consultative document issued in January 2014.

In response to the lessons we have learned from the 2008 financial crisis and all the liquidity events leading up to the crisis in particular, it is now especially evident that a globally coordinated regulatory reform is an essential effort to pursue for addressing any structural weaknesses in the financial system and promoting global financial stability. In this respect, we would like to appreciate very much the series of great support and efforts made by the BCBS to properly address these issues including development of new Basel III capital and liquidity standards. Nomura strongly believes that a prudent and conservative liquidity risk management as one of key foundations for the successful and sound operation of our business and objective of NSFR is in line with our overall liquidity management philosophy.

While we are generally supportive of the NSFR framework proposed by the BSBS, we do have reservations around some specific calibrations of risk factors and methodology. The remainder of this letter sets forth our analysis and thoughts regarding calibration of the risk factors and methodology proposed by the BCBS. We have also noted areas of the proposed rules that would benefit from additional clarification.

<u>Required Stable Funding (RSF) Factors</u>

We understand that resilient credit creation, bank behavior, asset tenor and quality are the key criteria used by the BCBS to determine the RSF factors for various assets. Although we have no strong objection against the concept of simplicity in creating the standards, a preference for

simplicity should be balanced with due attention to a situation where market evidence and experience clearly warrant lower RSFs as a sensible standard to be applied.

As a primary and secondary market maker in wide variety asset classes including sovereign debt, municipal bonds, corporate bonds and equities, for better serving our clients and the economy as a whole, we play a critical role in providing liquidity to the relevant market. While our internal assessment of term liquidity requirements to support unencumbered long inventory positions is generally in line with the views of the BCBS, we believe that some further calibrations of RSF factors are required to recognize objective differences of asset liquidity characteristics in the market scenario NSFR assumes.

Our analysis, based upon price volatility during the assumed turnover period, indicates RSF factor levels should be lowered as follows;

1. Corporate Bonds:
    a. rated A or higher to 10% and
    b. rated BBB to 25%
2. Listed Equity: Our analysis of major stock indices indicates 50% or 85% RSF factors for listed equity would be too conservative. We recommend 20% RSF factor for non-financial corporate and 30% for financial corporate.

We believe that any detailed quantitative analysis of corporate bond market and equity market in relation to our recommendation will be useful for the BCBS's consideration in these regards.

There could be various methodologies to measure the price volatility and assess adequate RSF level and the level of adequate granularity is worthwhile debating. We recommend the BCBS organizes a globally aligned process among the supervisors and the industry to facilitate proper RSF calibration. Global implementation of a transparent data-driven quantitative mechanism to assess asset liquidity characteristics across jurisdictions, security types and credit quality would substantially benefit all stakeholders in the wider financial system. Regular, global surveys of industry market participants and periodic RSF reviews incorporating observable market data such as historical asset price behavior and secured financing haircuts as useful inputs for RSF calibration methodology will create more transparency and avoid any unintended market consequences due to overly severe stable funding requirements for certain assets. Continuous liquidity monitoring under such framework should enhance overall liquidity management across the industry as well.

Treatment of Unsecured/Secured Lending to Non-bank Counterparty

Current BCBS proposal disregards existence and quality of collateral through an application of 50% haircuts to all lending to non-banks, including secured lending transactions, this could bring excessive costs into market making activities for Level 1 and HQLA products and eventually impact primary/secondary markets. We believe that any quantitative analysis of potential impact on Japanese government bond market will be useful for the BCBS's consideration in these regards.

We urge the BCBS to consider the following points for RSF factors applying to secure lending to non-bank counterparty.

1. Distinguish unsecured lending from secured lending.
2. For secured lending transactions, quality of underlying assets is a key factor in determining the required stable funding. We recommend 0% for Level 1 assets, RSF factors for other assets in the assumptions that current RSF factors are to be re-calibrated as suggested in prior sections.
3. The following institutions should be treated in the same way as a "bank" is excluded from the calculation.
    a. QCCP's
    b. Central banks
    c. Primary dealers or trading counterparties for central banks, which support monetary policy operations
    d. Non-bank financial entities, subject to Basel regulations and/or prudential supervision where robust liquidity management is required

Given the potential impact on the market, we would strongly advocate for careful consideration even for market participants who may not be in the categories above, but, play critical roles in supporting liquidity in the stable secured funding market, particularly in HQLA markets. Diverse range of market participants is an essential element to ensure deeper and active repo markets.

Tenor of Structured Liabilities with Embedded Options

The current language in paragraph 17 of BCBS 271 NSFR Consultative Document is overly restrictive as it assumes a worst case for all liabilities with early repayment options. Demonstrating banks would not exercise options to early terminate "under any circumstance" would not be practical for most of the liabilities with embedded options.

We recommend an approach similar to the BCBS's suggested treatment among banks and supervisors in BCBS 238 LCR (Paragraph 86):

86. The wholesale funding included in the LCR is defined as all funding that is callable within the LCR's horizon of 30 days or that has its earliest possible contractual maturity date situated within this horizon (such as maturing term deposits and unsecured debt securities) as well as funding with an undetermined maturity. This should include all funding with options that are exercisable at the investor's discretion within the 30 calendar day horizon. For funding with options exercisable at the bank's discretion, supervisors should take into account reputational factors that may limit a bank's ability not to exercise the option. In particular, where the market expects certain liabilities to be redeemed before their legal final maturity date, banks and supervisors should assume such behavior for the purpose of the LCR and include these liabilities as outflows.

Derivatives

We recommend BCBS to provide further guidance; specifically addressing

1. Netting collateral received and posted with assets and liabilities
2. Treatment of cash collateral received and posted
3. Treatment of securities collateral received and posted with clarification on how BCBS intends to treat re-hypothecated, re-hypothecable but not re-hypothecated and segregated collateral
4. Treatment of initial margin

Linked Assets and Liabilities

While we support the BCBS's approach to look at assets and liabilities separately, completely ignoring the underlying relations can lead to an overly conservative approach. We understand it would not be practical to implement a model that considers all the underlying relationships and, in many cases, these relations cannot be illustrated explicitly as per given financial accounting rule.

As an alternative, we recommend implementing NSFR neutral treatment where assets and liabilities can be clearly demonstrated to be linked each other legally and / or operationally and the transaction as a whole has fully offsetting cash flows (liquidity risk neutral) in all scenarios.

We recommend the BCBS to lay out broad principles to use this treatment; and banks should be able to demonstrate to the satisfaction of their national supervisors that they have established appropriate policies and operational processes to ensure compliance with the principles recommended by the BCBS.

Some examples of linked transactions include;

1. Delta 1 notes: Proceeds from note issuance are used to buy the hedges and hedges will be unwound when the note is redeemed.
2. Reverse repo transactions to cover firm/client short positions.
3. Liability driven transactions like reserves held in segregated accounts to offset client liabilities. When client liabilities reduce, balances in segregated assets reduce to offset the cash flow.

Other Assets and Liabilities

We believe the BCBS's proposal to assign 0% ASF and 100% RSF factor for liabilities and assets not specifically covered in the proposal is too conservative and majority of these assets can be funded with offsetting liabilities.

1. As a part of our market making activity, we buy and sell securities in our own name. In most cases these transactions settle two or three days after the transaction date. From transaction date to the settlement date of the security, we have receivables before settlement date (sale) and payables before settlement date (purchase). Payables would fund receivables and should receive similar ASF and RSF factors (0%).
2. Fail to Deliver and Fail to Receive are similar in nature to the Receivable and Payable before settlement date.
3. Where we act as an agent for client's exchange-traded derivatives, any collateral received from clients and the collateral posted to exchanges can be netted. As these assets and liabilities move together, 100% RSF factor and 0% ASF factor applied for these assets and liabilities would be too conservative.

Relationships across multiple regulations

In seeking best methodologies and practice with regards to the NSFR and other regulatory initiatives, we should consider the regulatory framework holistically and establish clear relationships among its components. For example, application of a 50% RSF to reverse trades with non-bank counterparties could potentially lead to contractions in sound repo markets, potentially jeopardizing the legitimacy and value of HQLA assets, an effect which seemingly contrasts with the LCR's encouragement of banks to hold HQLA as a good liquidity backstop and the requirement of repo market depth as HQLA eligibility criteria.

Regulatory initiatives seem to have built multiple layers of protection out of concern for secured funding transactions. When aggregated, the results could translate into excessive costs for the industry and wider markets if each regulatory stream is not well aligned. For example, it could be excessive protection if an institution holds a long term liquidity backstop discretely under the NSFR while a minimum haircut is to be exchanged across the markets as per separately-discussed shadow banking regulation.

We hope that our comments delivered to the BCBS hereunder will be useful for the BCBS to ensure a sensible regulatory framework around NSFR standards which benefits both soundness of banking operations and activities in the wider financial markets with sufficient liquidity, a vital source of economic growth and financial stability. Should you have any further queries, we Nomura are always happy to have an effective interaction with the BCBS and its member regulators, where necessary, to contribute successful completion of implementation of Basel III framework.

Sincerely yours,

Shigesuke Kashiwagi

Shigesuke Kashiwagi

Executive Managing Director
Chief Financial Officer
Nomura Holdings, Inc.