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Mr Stefan Ingves

Chairman

Basel Committee on Banking Supervision
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Dear Mr Ingves,

Re: Comments on consultative document: "Basel III: The Net Stable Funding Ratio"

We appreciate the opportunity to review the consultative document, Basel III: The Net Stable Funding Ratio (NSFR), dated 12 January 2014. We welcome the clarification that the NSFR is not intended to be a one-year idiosyncratic stress test, but a structural liquidity ratio. This definition is appropriate in providing a sustainable business-as-usual approach to long-term funding to compliment the Liquidity Coverage Ratio (LCR), which is based on an extremely severe short-term liquidity stress scenario.

The Available Stable Funding (AFS) and Required Stable Funding (RSF) factors should reflect this *sustainable business-as-usual* approach that is consistent with the role of the banking industry in the liquidity maturity transformation. The liquidity maturity transformation is needed for the economy since there is a structural discrepancy between liquidity providers and liquidity takers. The NSFR should reflect the extent of the acceptable sustainable liquidity maturity transformation, and the sources of this maturity transformation.

We appreciate and support the Basel Committee's recalibration of the NSFR, in recognition of significant potential unintended consequences that the previous NEFR calibration could arise.

Please find our comments on the consultative document below.

<u>RSF Factors and Liquidation of Assets</u>
In our opinion it should be once again considered if setting RSF factors for NSFR purpose at similar levels as LCR haircuts for various liquid assets is correct. The similar approach in NSFR and in LCR does not take into account some important factors which should differentiate attitude of regulator in this area. The most important factors are: the different time horizons (12-month in NSFR vs. 1-month

in LCR) and the severity of the scenario taken under consideration (NSFR is not a stress metric while LCR is an acute stress test).

Aligning HQLA definitions between the LCR and NSFR can be justified if we recognise that from a risk-based perspective the scope of securities that can be liquidated over one-year time horizon in a non-stress environment is not greater than in a 30-day severe stress. We recommend that the haircuts should be lower for NSFR to reflect this concept or the definition of liquid assets for the NSFR should be widened in order to reflect market liquidity. A shorter than 1 year security should receive a 0% RSF factor; assigning a 5% RSF factor of all level 1 government bonds until maturity is also inconsistent with the LCR and would be too high for shorter maturities.

Treatment of Operational Deposits and SME Deposits

While we welcome the incorporation, for the first time, of a stability factor for operational deposits (custody, clearing, cash management), we believe that the 50% ASF factor is too conservative for a structural measure of liquidity. This is especially true when one considers the requirements which govern the treatment of operational deposits, which have become progressively more stringent over time. This includes various qualification standards and the requirement to identify and exclude 'excess' deposits. As a result, the current definition of operational deposits produces a category of funding that is extremely stable, whether over a period of acute short-term stress or over a one year non-stress horizon. We believe that operational deposits should be assigned an ASF factor of 75%. This is consistent with the approach adopted for retail deposits, where the ASF factors are the same as the factors specified in the LCR. We recommend to continue work to simplify the definition of operational deposits based on easy criteria.

Reverse Repos

The suggested RSF weights for reverse repos are not symmetrical with the ASF weights for repos: they neglect the funding potential from received collateral from reverse repos (even when HQLA). It would become impossible to migrate excess NSFR between banks by reverse repos on HQLA collateral as reverse repo transactions even lead in total to a loss of NSFR for both banks.

In previous versions of the NSFR, repo transactions with financial institutions received a symmetrical treatment between assets and liabilities. Secured lending and secured funding under one year had both a 0% weight. Transactions with a maturity > 1 year had a 100% weight. It lacked taking into account the liquidity of the underlying collateral, and only considered the maturity of the repo transaction. For reverse repos with a maturity > 1 year, it resulted in a worse treatment of those assets, if compared to LCR. The ratio did not differentiate between banks and other financial institutions, and was symmetrical in the treatment of repos and reverse repos.

The new NSFR has not solved the issue and adds new inconsistencies:

- It differentiates banks from other financial institutions when looking at the counterparty
- Although it gives a symmetrical treatment to repos and reverse repos for transactions with banks, other financial institutions receive an asymmetrical treatment in the < 6 month bucket:

secured lending to other financial institutions require 50% stable funding, while secured funding < 6 months does not provide any ASF.

This asymmetrical treatment will deteriorate the repo markets, and especially penalize non-banking financial institutions as a counterparty for the transactions.

Short Term Loans

Loans maturing < 6 months (Par.32 e)

The intent of Paragraph 32(e) is clear - to require long-term funding for unencumbered loans maturing under one year. However, we are afraid that it will be difficult for banks to manage their liquidity risk and perhaps it can cause consequences which are intended for regulators as well. Two types of effects can be foreseen.

- The transition to the NSFR would require a substantial and permanent buffer of liquid assets from the entire banking sector that could never be used for real-economy lending. While paragraphs 6 and 13(a) incentivises deleveraging in the immediate term it creates a permanent cost burden on such lending for the future. This is contrary to the Basel Committee's intention to ensure a continual flow of long term loans to the real economy,
- The resulting extra funding causes grossing-up of balance sheets, which would also have a substantial effect on banks' management of their leverage ratios.

The reasoning is as follows:

All unencumbered loans maturing under one year (excluding those to banks) require a 50% RSF per 32(e). At the same time, wholesale funding is only given a maximum 50% ASF if it has a maturity over six months, per (21(d)).

- This implies that loans maturing under six months have to be prefunded at 50% with funding maturing over six months.

Bank cannot use this stable funding to support current lending. This is because stable funding will have to be allocated permanently to the proportion of loans that will mature in the coming six months. In our opinion:

- This permanent prefunding creates negative maturity transformation.
- As a result, the NSFR takes a part of generally available stable funding out of the financial system, making it permanently unavailable to support lending to the economy.
- Banks that are active in consumer finance (e.g. auto loans) or have a large commercial banking portfolios consisting of loans with 1-3 year tenors will often therefore de facto have to deleverage further as a result of the transition to the new NSFR, exacerbating the deleveraging already affecting some regional economies.
- Extra funding to meet the RSF for remaining lending activity must be balanced on the liabilities and assets sides, and the solution is likely to be to use LCR-eligible securities to manage the leverage ratio issues.

- The cost of carrying this additional amount of funding will of course have to be factored into the pricing of lending.

Such attitude will generate in our opinion an unintended severe consequence for banking activity. There will clearly be an adjustment hurdle, which will affect all banks somewhat unevenly because of mix-of-business issues. Retail oriented banks can be particularly concerned. The changed economics of retail lending in particular are hard to evaluate at this time, and individual banks will have to make their own competitive judgments, but it seems likely that some will reduce affected businesses. All banks will have to make pricing adjustments. Whether bank lending will remain competitive for relevant tranches of business (e.g. consumer lending, auto loans, etc.) will depend on local market circumstances, but it seems likely that some banks will curtail their activity and that in some cases non-bank competitors may gain an advantage. The Basel Committee is therefore asked to reconsider the trade-offs implicit in the current RSF provision.

Rolling over unencumbered loans (excluding loans to financial institutions) creates a liquidity pocket which will not be used for lending. Assuming that bank fulfills required NSFR norm at the initial stage of granting credit when the long-term assets (over one year) are totally financed by long-term liabilities (over 1 year), this norm cannot be fulfilled in near future without additional inflow of long-term liabilities. The changing residual maturity of old credit will diminish RSF factor from 1005 to 50%, but simultaneously the ASF factor will change. Unfortunately, the scale of change of RSF factor and ASF factor will be different. The negative result in NSFR will occur when remaining maturity of assets and liability will be lower than 6 months. Beginning from this moment the RSF factor for assets will be 50% but on liability site will be lowered to 0%. In this situation bank will have to collect additional long-term financing for part of its old assets which remain to repay. Having the same sums of assets and liabilities mismatched correctly at initial stage for NSFR purpose, this mismatch is not any longer correct if the residual maturity is shorter than 6 months. As the result, bank constantly has maturing loans, this means liquidity of equivalent size to a certain portion of the loan portfolio is stored within a bank, which would have been used for lending activities otherwise, unless the bank decides to allow substantial increase of its balance sheet.

Looking at this explanation we recommend to supplement the proposal by adding the distinct RSF factor for all other non-HQLA that have a residual maturity of less than six months.

<u>Treatment of Gold and Precious Metals</u>

The consultative document of the NSFR 2014 on page 11 under the heading "Additional granularity and lower RSF factors for certain other non-HQLA" reads:

> *Certain assets with risk weights greater than 35% under the Basel II Standardised Approach, including unencumbered performing loans with residual maturity of one year or greater, unencumbered non-HQLA securities not in default, physical traded commodities and exchange-traded equities have been moved to a category requiring an 85% RSF factor from a category requiring a 100% RSF factor in the 2010 NSFR*

This is true for all asset classes mentioned in his paragraph other than physical traded commodities including gold. Indeed, the 2010 NSFR proposal by the Basel Committee applied a RSF factor of 50% to gold which would mean, that the new proposal is a worsening of the initial proposal, where the phrasing in the 2014 proposal suggests, that it rather should be an easing of the funding requirement.

The Basel Committee should confirm its view on the treatment of gold (and other precious metals). In our opinion this treatment in NSFR 2014 should not lead to a worsening of treatment compared to the NSFR 2010 proposal unless there is a valid reason to do so. The new proposal does not give clear answer concerning the treatment of gold for NSFR purpose.

Treatment of bank deposit in central bank

The proposal of 0% RSF factor includes all central banks reserves (including the required reserves and excess reserves). The banks are not sure how will be treated bank deposit in central bank. These sums cannot be treated as excess reserves and they cannot be also treated as unencumbered loans to banks subject to prudential supervision. We recommend to create additional point in order to include the bank deposits in central banks as assets when 0% RSF factor should be applied.

Debt redemption

The assumption that debt are systematically redeemed at the earliest possible date, even when the option is at the discretion of the bank or when the option is dependent on movements in market parameters (not on decisions by issuers or investors) is extremely conservative and is inconsistent with a structural approach of the NSFR. This is particularly important for bank deposits where is the option to redeem at earlier date but the client has to bear the cost of earlier redemption. It is impossible for banks to demonstrate that they or the clients would not exercise an imbedded option under "any circumstances" (as required by Paragraph 17). We recommend to give the banks the possibility to present their evidence of historical redemption of deposits with the imbedded option of earlier redemption and after that process to establish the proper level of haircut depending on the type of option imbedded in debt.

Yours sincerely

Krzysztof Pietraszkiewicz

President