POSITION PAPER

WSBI-ESBG COMMON RESPONSE TO THE BASEL COMMITTEE REVISION TEXT ON THE NSFR

WSBI (World Savings and Retail Banking Group)
ESBG (European Savings and Retail Banking Group)
Rue Marie-Thérèse, 11 - B-1000 Brussels

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WSBI ESBG

WSBI-ESBG would like to welcome the opportunity to contribute with our views to the debate on the implementation of the Net Stable Funding Ratio (NSFR). We also welcome the efforts made by the Basel Committee to strengthen financial stability in the banking system.

With regards to the proposal on the Net Stable Funding Ratio (NSFR) we would like to convey our support to the policy goals the Basel Committee is aiming to achieve with this initiative, including limiting banks' overreliance on short-term wholesale funding, encouraging banks to better assess funding risk across all on- and off-balance sheet items, and promoting funding stability within the banking sector. However, we would like to stress the fact that from an analysis of global banks' funding practices since the financial crisis we can draw the conclusion that less reliance on short-term wholesale funding and a greater focus on long-term stable funding sources is happening.

We also appreciate that the Basel Committee has designed the NSFR as a simple, easy-to-implement funding and liquidity metric that can be applied across a wide variety banking models. The advantage of this approach is that it permits supervisory authorities (and, ultimately, the marketplace) to compare the stability of different banks' funding sources and requirements, which might be more difficult if the NSFR included a large number of complicated, business line-specific exceptions to the general framework. However, we think that clarity is lacking in a number of issues such as the treatment of CCPs and collateral with CCPs. Although the latest Basel Committee revision of the NSFR has refined the proposal especially by reaching an alignment with the LCR we would like to draw the attention to some specific concerns and potential problems that can stem from the current proposal. In particular, we are concerned by potential imbalances that can lead to deleveraging in the short term, the treatment of covered bonds, reverse repos, derivatives and CCPs and non-financial deposits.

As outlined above, we welcome the alignment of the NSFR with the LCR, in particular with regards to the definition of the NSFR from a 1 year long stress test to a structural liquidity risk metrics. This complements the Liquidity Coverage Ratio (LCR) that is based on an extremely severe liquidity stress scenario, with a more sustainable business-as-usual approach in the long term.

Finally, we would like to draw your attention to the potential drawbacks for the maturity transformation role of banks that the current formulation of the Available Stable Funding (ASF) and Required Stable Funding (RSF) may cause in the future. Indeed, the liquidity maturity transformation is needed for the economy since there is a structural discrepancy between liquidity providers and liquidity takers. Hence, the NSFR should reflect the extent of the acceptable sustainable liquidity maturity transformation, and the sources of this maturity transformation.

Furthermore, we have a number of specific concerns with regards to the current formulation of the NSFR on which we would like to further elaborate. Please find below our comments.

1. *Specific Comments*

a) *Reverse repos*

The current NSFR rules for reverse repos are currently not symmetrical with the ASF from repos and neglect the funding potential from received HQLA collateral from reverse repos. It is impossible to migrate excess NSFR between banks by reverse repos on HQLA collateral, but 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 >1year, 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 of not taking into account the underlying collateral, and adds new inconsistencies:

- It differentiates banks from other financial institutions when looking at the counter-party.
- 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 penalise non-banking financial institutions as counterparty for the transactions.

While the Basel Committee proposal reflects correctly the encumbrance of securities due to the repo business, it ignores the re-usability of the received collateral from reverse repos.

This asymmetrical treatment of repos and reverse repos punishes the repo business above 6 months with any counterparty (banks and non-banks). It hinders the transfer of secured funding between banks as well as the secured financing of the real economy. Finally, the volume of secured funding above 6 months will decrease significantly and the price will increase without any economical reason.

b) *Loans maturing < 6 months (Par. 32 e)*

All unencumbered loans maturing <1year (excluding those to banks) require 50% stable funding. On the other hand, wholesale funding is only considered as ASF if it has a maturity >6 months. This

implies that loans maturing <6 months have to be prefunded at 50% with funding maturing >6 months. Thus, prefunding means a negative maturity transformation.

The required pre-funding > 6 months for (the rollover of) corporates, mortgages and other retail loans maturing < 6 months seems to be justified to allow future lending. By prefunding the rollover of loans maturing within 6 months, future deleveraging is apparently avoided.

The unintended consequence is nevertheless the current deleverage: the funding required for loans maturing up to 1 year drains funding for present lending. Therefore lending today is impaired by the possibility of lending tomorrow.

Moreover, the liquidity held for the prefunding can never be actually used in the future. As loans mature in the coming 6 months, loans that were beyond the 6 months horizon will fall into this bucket. Their matched funding (<6months) will not be considered stable anymore, so they will require new stable funding. Thus the previous pre-funding cannot be used for new lending, but has to remain to prefund the future rollover of the loans that have fallen in the horizon.

c) Covered bonds

One of the key issues that we have of the new NSFR is that it still doesn't acknowledge the stability and liquidity of covered bonds as funding source and penalises mortgage loans backing the covered bonds, having them attached with a 100% RSF if encumbered. It would, with the current new proposal, still be beneficial to fund mortgage loans with senior unsecured funding instead of the well-developed covered bond market which already has a specific regulation in place. The treatment of senior unsecured funding should at least be aligned with covered bonds by shortening the maturity which would also reduce price of funding and level it with covered bonds

d) Non-financial corporate-deposits

Another of our main concerns is the 50% ASF-factor on non-financial corporate deposits. The stability of non-financial deposits suggests a higher ASF which is supported by empirical evidence. In order to bolster the well-functioning of the NSFR this should be taken into account. Even under stressed situations corporate deposits have been resilient due to strong underlying business relationships.

e) Paragraph 17

We are also concerned by Paragraph 17 which establishes that "When determining the maturity of an equity or liability instrument, investors are assumed to redeem a call option at the earliest possible date." This assumption to calculate the amount of ASF seems to be very demanding and not adjusted to an institution's reality. We consider that the Basel Committee should explain the empirical review developed to reach this assumption and calibrate it in order to reflect real investors' behaviour.

f) Treatment of derivatives

Even if the regulation has still not been definitively finalised, from an NSFR perspective we want to point out some remarks on the treatments of derivatives positions and related cash collateral paid/received as initial and/or variation margins.

We have also identified a lack of clarity concerning the treatment of certain counterparties as it is the case for CCPs. CCPs do not have a specific treatment in the NSFR and we have difficulties to understand whether they would be treated as any other financial institution. If they were not treated as banks any investment in CCPs with a maturity of less than 6 months would receive a weight of 50% of RSF, whereas if treated as banks they would receive a 0% weight. However, a repo contract with a CCP as a counterparty would be assigned with a 0% of ASF and therefore, the treatment would be asymmetric and imbalanced although the position would be ensured from the point of view of the liquidity risk.

For example, take a derivative margining set that reports a negative mark-to-market (MTM) backed by cash collateral (given to a specific counterparty). In financial statements this negative MTM is reported on the liabilities side, while on the contrary the cash collateral is reported as a loan on the asset side. It is not then clear where the "cash collateral given" should be allocated in the NSFR. If it is reported between "other assets", it should be assigned an ASF factor equal to 100%, and then be fully funded by "stable funding", even if the contracts included in the margining set had maturities potentially lower than one year (e.g. Overnight Index Swap). On the other hand, the same problem could occur for a derivative margining set with a positive MTM backed by "cash collateral received", then weighted by an RSF factor of 0%.

It is not clear, in our opinion, if the current approach has yet to be better defined with regard to the treatment of cash collateral paid/received as initial and/or variation margins, or whether these cash positions should be funded/invested on a long-term horizon. In the latter case, it should be noted that the market standards (based on the NPV/OIS discounting) consider these items as very short-term positions consistently with the remuneration paid by the CCP.

About WSBI (World Savings and Retail Banking Institute)

WSBI brings together savings and retail banks from 90 countries, representing the interests of approximately 7,000 banks in all continents. As a global organisation, WSBI focuses on issues of global importance affecting the banking industry. It supports the aims of the G20 in achieving sustainable, inclusive and balanced growth and job creation around the world, whether in industrialised or less developed countries. WSBI favours an inclusive form of globalisation that is just and fair, supporting international efforts to advance financial access and financial usage for everyone. It supports a diversified range of financial services that responsibly meet customers' transaction, saving and borrowing needs. To these ends, WSBI recognises that there are always lessons to be learned from savings and retail banks from different environments and economic circumstances. It therefore fosters the exchange of experience and best practices among its members and supports their advancement as sound, well-governed and inclusive financial institutions.

WSBI represents more than 6,150 financial institutions from 82 countries. At the end of 2011, these institutions operate through more than 227,000 branches and outlets, employ more than 2.2 million people and serve more than 600 million customers. Assets of member institutions amounted to more than US $15.6 trillion at the end of 2011.

World Savings and Retail Banking Institute - aisbl
Rue Marie-Thérèse, 11 ■ B-1000 Brussels ■ Tel: +32 2 211 11 11 ■ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ■ www.wsbi.org

About ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,300 billion, non-bank deposits of €3,480 billion and non-bank loans of €3,950 billion (31 December 2012).

European Savings and Retail Banking Group – aisbl
Rue Marie-Thérèse, 11 ■ B-1000 Brussels ■ Tel: +32 2 211 11 11 ■ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ■ www.esbg.eu

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