March 6, 2015

Basel Committee on Banking Supervision
Attn: Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Net Stable Funding Ratio Disclosure Standards, December 2014

Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to comment on the above-captioned Consultative Document of the Basel Committee on Banking Supervision ("BCBS" or "Committee").

BACKGROUND AND SUMMARY OF COMMENTS

The financial crisis of 2008 underscored the need for enhanced regulation of the liquidity risk in the global financial system. The financial stress conditions in which many banks found themselves were often caused by liquidity risk mismanagement and mispricing. In light of these events, the BCBS published its *Principles for Sound Liquidity Risk Management and Supervision* to provide specific guidance on management of funding liquidity risk.[2] Building on these principles, the Committee has since issued detailed guidance on the importance of establishing and maintaining adequate liquidity, identifying and measuring liquidity risk, and using stress tests and contingency funding plans.

As part of its effort to continually strengthen its liquidity framework, the Committee has developed two minimum standards for funding and liquidity: the Liquidity Coverage Ratio ("LCR") and the Net Stable Funding Ratio ("NSFR"). The NSFR and the LCR are intended to be used hand-in-hand to provide a complete picture of a bank's liquidity risk, and are key components of the BCBS's December 2010 Basel III reforms to strengthen liquidity management and promote a more stable banking system.

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[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking processes associated with domestic and international financial reform.

[2] Basel Committee on Banking Supervision, *Principles for Sound Liquidity Risk Management and Supervision* (Sept. 25, 2008).

The LCR, which aims to promote short-term resilience, measures short-term liquidity risk to ensure banks maintain sufficient high-quality liquid assets to survive a potential stress scenario lasting up to 30 days.[3]

To reduce funding risk over a longer time period, regulators have developed the NSFR. The NSFR, the subject of this Consultative Document, is defined as "the amount of available stable funding relative to the amount of required stable funding," and should be at least 100 percent.[4] Regulators would use the NSFR to ensure banks maintain a stable long-term funding profile to reduce the probability that a disruption could significantly erode a bank's liquidity and increase the risk of failure. Since its introduction in 2010, the NSFR has been through a number of revisions to focus on riskier types of funding and to improve alignment with the LCR, among other objectives.[5]

On December 9, 2014, the BCBS released a Consultative Document outlining Net Stable Funding Ratio (NSFR) disclosure requirements.[6] The Document supports the BCBS's continuing goal of ensuring adequate liquidity risk management by proposing guidelines for NSFR disclosure. The Document presents rules pertaining to the scope of application, implementation, and frequency of reporting, as well as the template in which NSFR data must be reported.

This comment letter supports the BCBS's effort to promote the transparency and utility of the measures and to ensure that market participants can accurately and consistently assess banks' funding risk. However, the letter encourages the BCBS to strengthen regulatory reporting frequency requirements for the global systemically important financial institutions. The letter reviews both the NSFR and the LCR measures, and the way they work together to ensure adequate liquidity risk management. The letter encourages the BCBS to increase the NSFR reporting requirements for large financial institutions to daily frequency, rather than quarterly. It further encourages BCBS to align the enhanced NSFR reporting frequency with the LCR reporting frequency for large institutions, by increasing LCR reporting from quarterly to daily as well.

The key point is that close to real-time monitoring of the liquidity positions at the largest banks is an essential measure to promote financial stability. Liquidity problems in large financial institutions spread risk contagion throughout the entire financial system. If regulators cannot rapidly detect deteriorating liquidity positions in banks, they will be unable to dynamically address the resulting vulnerabilities in the financial system, which could trigger another shock to the financial system, with potentially devastating consequences. Quarterly or semi-annual data about the liquidity conditions of the large

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[3] Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (Jan. 7, 2013).

[4] *Id.* at 6.

[5] Basel Committee on Banking Supervision, *Consultative Document: Basel III: The Net Stable Funding Ratio* (Apr. 11, 2014).

[6] Basel Committee on Banking Supervision, *Consultative Document: Net Stable Funding Ratio Disclosure Standards* (Dec. 9, 2015).

institutions would not allow dynamic monitoring or response by the regulators to the liquidity deterioration in those institutions.

COMMENTS

Daily frequency of calculation and reporting of the NSFR and the LCR for large financial institutions is a sound and conservative approach to liquidity risk management and supervision.

Because regulators will use the NSFR and LCR calculations hand-in-hand, strong and aligned regulatory reporting requirements for the NSFR and LCR are necessary to ensure accurate assessment of these measures and their ability to complement each other in liquidity management. That is especially important for the largest financial institutions, the liquidity shocks to which may spur a contagion risk through the global financial system.

Further, as the implementation of the LCR regime in national jurisdictions is underway, the NSFR reporting regime should be aligned with a strengthened, daily LCR regime. Moreover, the U.S. daily frequency of LCR reporting by large financial institutions should be adopted for NSFR reporting as well. The daily reporting regime represents an effective way to implement the NSFR and LCR as a combination of measures to regulate liquidity risk of large financial intuitions. The Federal Deposit Insurance Corporation, the Federal Reserve System, and the Office of the Comptroller of the Currency issued the final implementation rules for LCR on September 3, 2014.[7] The agencies mandated:

> daily liquidity reporting requirements, and the systems changes necessary to calculate the LCR accurately on a daily basis. . . . The agencies expect these largest, most complex firms [depository institution holding companies with $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody, and any depository institution that is a consolidated subsidiary of such depository institution holding companies] to have the most sophisticated liquidity risk monitoring procedures, commensurate with their size and complexity, and these firms are currently submitting daily liquidity reports.[8]

The BCBS should also adopt this approach, so that both NSFR and LCR are reported daily. With this approach, the two measurements will be properly aligned and can most effectively enable regulators to detect and address liquidity problems in the banking system in the real time.

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[7] Department of the Treasury, et. al., *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule*, 79 Fed Reg. 61440 (Oct. 10, 2014).

[8] *Id.* at 19.

In light of the historical mismanagement and mispricing of liquidity premiums, the daily reporting of NSFR and LCR by the largest financial institutions is the only prudent way to ensure safe and sound financial regulation.

History demonstrates that markets (and regulators) frequently underestimate or misunderstand the liquidity risks and liquidity premiums associated with assets. The IMF's December 2014 paper, "A Simple Macroprudential Liquidity Buffer," noted that:

> [T]he liquidity properties of assets and liabilities can change abruptly during crisis periods; information amplifiers may render illiquid assets that are normally close substitutes for cash, or subject even notionally long-term liabilities to "runs."[9]

Colleen Baker, Associate Professor at University of Notre Dame, addresses the same question from a liquidity pricing angle:

> Liquidity is not free. Liquidity risk is one of the fundamental risks in financial markets. All else being equal, liquid financial assets are less risky than illiquid ones and, therefore, worth more. Financial investors generally expect to receive a "liquidity premium" for illiquid financial assets. In the past, however, both economic and financial theories have sometimes treated liquidity as costless. And international financial institutions have long mismanaged and mispriced liquidity risk.[10]

In light of the historical mispricing of the liquidity premiums, members of the Basel Committee should have complete access to the current measures of asset liquidity at the largest financial institutions and, as a result, require daily reporting of the NSFR and LCR by those institutions. As most of those institutions are already subject to some version of liquidity reporting, the infrastructure and tools for such reporting should already be in place.

In the event of a financial shock, regulators need to know the current state of liquidity of the banks and not only the historical levels. Liquidity conditions can deteriorate rapidly and the ability of regulators to monitor and address liquidity shortages in real time is essential for mitigating the risk of a financial crisis.

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[9] Daniel C. Hardy and Philipp Hochreiter, *A Simple Macroprudential Liquidity Buffer* at 5, IMF Working Paper (Dec. 2014).

[10] Colleen Baker, *The Federal Reserve as Last Resort*, 46 U. MICH. J. L. REFORM 69, 78 (2012).

CONCLUSION

This comment letter supports BCBS's effort to promote the transparency and utility of the LCR and NSFR measures and to ensure that market participants can accurately and consistently assess banks' funding risk. However, the letter encourages the BCBS to strengthen regulatory reporting frequency requirements for the global systemically important financial institutions.

The letter reviews both the NSFR and LCR measures, and the way they work together to ensure adequate liquidity risk management. The letter encourages BCBS to increase NSFR reporting requirements for large financial institutions to daily and further encourages BCBS to establish daily reporting requirements for LCR, so the two metrics are aligned for such large institutions.

We hope these comments are helpful as the Committee continues work to ensure strong and resilient financial markets.

Sincerely,

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