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

Dear Sir/Madam:

**Re: CBA[1] comments on BCBS consultative document: Haircut floors for non-centrally cleared securities financing transactions**

The Canadian Bankers Association (CBA) is pleased to provide its comments on the BCBS's consultative document entitled, "Haircut floors for non-centrally cleared securities financing transactions".

While the CBA supports efforts to strengthen oversight and regulation of shadow banking, we do not believe that the haircut floors proposed by the BCBS in this consultative document should apply to trades involving banks, and their related affiliates, that are already subject to prudential capital and liquidity regulation. As heavily regulated entities in Canada, banks are already subject to Basel III capital and liquidity requirements, which we believe are sufficient to address the concerns over excess leverage and minimum haircut floors identified in this document.

We also note that haircut floors may have the unintended consequence of shifting focus away from a bank's own risk analysis and practices. Introducing a set of regulatory minimums has the potential to lead to a "race to the bottom" in actual haircuts used in market transactions. Banks' negotiations of haircuts for securities financing transactions (SFTs) with their non-bank counterparties now risk being cast in the context of regulatory minimums, with banks' counterparties exerting downward pressure towards these floors. This could result in a convergence towards haircut floors.

Further, we would like to express our opposition to the proposal to treat SFTs as unsecured loans in calculating capital requirements in cases where minimum haircut floors are not applied. We believe such capital treatment would be punitive and not proportional to the corresponding

[1] The Canadian Bankers Association works on behalf of 60 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

risk incurred. Instead, we would suggest that any capital requirements imposed on SFTs that do not meet minimum haircut floors be commensurate with the incremental risk incurred by the discrepancy between the minimum and actual haircut. The CBA believes that the proposal to treat SFTs as unsecured loans is not necessary to achieve the objectives identified by the BCBS in this consultative document.

There are also significant operational hurdles to implementing the BCBS proposal in its current form. Implementation would be difficult as the determination of whether the SFT is subject to a haircut floor is dependent on certain criteria that are subjective, difficult to implement within systems' logic, and not easily observable by a bank subject to the proposals. For example, cash-collateralized securities lending transactions are exempt based on a number of conditions with respect to the non-bank (or its agent's) reinvestment of cash collateral. These conditions would conceivably give rise to a need for additional legal representations between counterparties that are impractical and not justified by the underlying policy rationale of the SFT proposals. A more direct avenue would be to regulate the cash collateral reinvestment activities of non-banks, as necessary.

Finally, we would like to note that not all jurisdictions have a central counterparty facility for equities so the impact of the proposals could be uneven across markets.

Our more detailed comments on the consultative document are set out in the attached Annex.

We would be pleased to discuss these comments with you further at your convenience.

Sincerely,

Attachment

**ANNEX**

| CBA's Detailed Comments on BCBS Consultative Document |
|---|
| **Q1. Are there any weaknesses or further improvements to the proposals that the Committee should consider?** |
| • The additional mitigation/disclosure requirements in Appendix 1 for cash collateral re-investment could act as a deterrent to market liquidity if applied to prudentially regulated banks.<br><br>• As Canadian broker-dealers are regulated by the Investment Industry Regulatory Organization of Canada (IIROC) and subject to its prescribed margin requirements for SFTs, the CBA seeks clarity on how the discrepancy between any BCBS and IIROC haircuts would be treated.<br><br>• At the margin, the implementation of haircut floors may impact liquidity and market efficiency due to higher costs to users of SFTs. As well, it may force the exit of certain players in the market as their use of leverage becomes economically unfeasible.<br><br>• We note that banks have no way to enact enforcement or to ensure that the representations made by counterparties are truthful and accurate. |
| **Q2. Are there any specific implementation challenges with the proposals?** |
| • As systems development would be required, there would be a significant operational and technology effort to implement these proposals, which may be computationally intensive.<br><br>• Implementation would be difficult as the determination of whether the SFT is subject to a haircut floor is dependent on certain criteria that are subjective (e.g., "intent" of the trade, "long" maturities, "short" maturities, "supervised by a regulator").<br><br>• In addition, the proposal would require monitoring of all transactions, as well as a review of all legal agreements (and potentially amending existing agreements), notwithstanding the fact that the bank may have very few transactions subject to the haircut floor. |
| **1. Proposed haircut floors** |
| • The haircut floors for "Main index equities" appear to be high, as these assets benefit from on-exchange price transparency. |
| **2. Scope of application** |
| • The CBA seeks clarity on several terms used in the consultative document, such as:<br><br>o "non-banks" (Are broker-dealers considered "non-banks"?);<br><br>o "sovereign debt" (What exactly does this encompass?); |

- “short” and “long” (These terms can be open to interpretation.);
- “Main index equities” (As this term may be defined differently by the BCBS and local regulators, the CBA requests clarification on which definition would apply.);
- “Corporate and other issuers” (Would this include Canadian provincial and municipal issuers?);
- “Securitised products” (Are US agency MBS, Canada Mortgage and Housing Corporation MBS, and other securities with guarantees included?).

- We also seek clarification on the impact of non-rehypothecation and whether haircut floors are applicable to collateral upgrade trades where a bank does not have the intention or ability to rehypothecate the collateral received.

- While the consultative document states that “the framework of numerical haircuts floors is intended to apply to transactions where the primary motive is to provide financing, rather than to borrow or lend specific securities”, we believe that the mechanism proposed to carve out “for purpose” borrowings is not sufficient. Brokers who are required to cover shorts of their clients may have to borrow securities from non-banks even if their counterparties cannot provide the representations proposed in the document. Given the current practice of posting over 100% collateral for purpose trades, such borrows will have a significant capital impact, particularly given the proposed punitive capital treatment of such transactions. We believe that an additional carve out for borrows by a covering firm or client short position is required.

**3. Key principles considered in the development of the proposed rules**

- We suggest that the FSB consider only applying the portfolio level treatment to non-bank to non-bank transactions given the current haircut levels already in place at the trade level for regulated banks.

- The CBA is concerned that this proposal places greater requirements on banks to monitor shadow banking activities.

**4. Possible arbitrage opportunities highlighted by the FSB**

- We note that for the transaction described in point (ii) of Section 4 (arbitrage opportunities), such an arbitrage opportunity would also exist if the counterparty transacted with two separate banks for each leg (i.e., sovereign vs. corporate with Bank 1, and cash vs. sovereign with Bank 2). As each bank would not know what was being executed on the other end, the trade would not be captured on a net basis.

**5. Proposed higher capital requirements for in-scope SFTs**

- As noted in the cover letter, the punitive capital treatment contained in this proposal would create a “cliff effect” that is not consistent with the capital approach in other areas of the Basel capital framework. For example, if the proposed haircut floor is 5% and the actual haircut is 4.99%, the proposal would require capital treatment as an unsecured loan. On the other hand, if the actual haircut is 5.01%, the collateral would be fully recognized. The proposed approach does not accurately reflect the difference in risk of the two transactions.

A more appropriate approach would be to treat only the difference between the minimum and actual haircut as an unsecured loan.

- The CBA seeks clarification on the netting calculation (exactly what should be included and whether it covers cross-product arrangements (or how it captures them)).

- We also seek clarification on how the haircut floors are calculated if there is a cross-currency element involved between collateral taken in vs collateral lent out.

**6. Proposed rules text**

- We believe that the formula described in paragraph 143(x) is excessively complex and pushes implementation costs higher. In addition, it is not clear why the simpler portfolio level formula in paragraph 143(xi) may not be used instead.

**Appendix 1: High-level principles**

- As banks are to rely on securities lender representations that they are in compliance with minimum standards, we seek clarity on whether a standard letter would be provided to banks.

**Appendix 1: Mitigating liquidity, credit, and other risks associated with cash collateral reinvestment**

- We believe the requirements below are punitive to repo trading for a prudentially regulated bank:
    - Monitoring maturity mismatch of a security bought with cash collateral against the maturity of the security lent and ensuring the assets are sufficiently liquid/low risk
    - Limits on weighted average maturity and minimum maturity requirements
    - Ensuring a buffer is in place to guard against stress scenarios

**Appendix 1: Stress tests**

- A stress testing requirement could prove to be an operational burden for regulated banks when acting in the capacity of lender and/or agent lender.