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Mr. Stefan Walter
Secretary General of the Basel Committee
On Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Mr Walter,

DB welcomes the Basel Committee's initiative to harmonize liquidity regulation on a global basis. The recent financial downturn exposed material weaknesses in the supervision of liquidity risk, and a lack of minimum standardised requirements for financial institutions. We value the opportunity to provide feedback on the proposals outlined by the Committee in CD 165. A detailed technical analysis is attached to this letter beginning with general observations and then setting out technical difficulties with the proposals.

Although we are responding to CD 164 and CD 165 separately, we would like to highlight that the proposals covered in both CDs cannot be read in isolation, as there are strong correlations in their impact.

Although DB in principle supports the conceptual design of the ratios, we have serious concerns about the calibration of parametres and limitation of eligibility of the current proposals. We believe that it would be impossible for even the most conservative business model to meet the proposed calibration. It is essential to achieve an appropriate calibration through dialogue between the industry and official sector. The liquidity rules have far greater potential to be procyclical in a crisis than the capital rules unless set at the right levels with appropriate discretion built in.

In our cover letter responding to CP164 we referred to the potential for financial stability to be threatened by a herd mentality in industry arising from overly granular and conservative rules. This is particularly true of the liquidity proposals. A liquidity event, unlike capital, can irreversibly damage an institution in a very short timeframe. The risks associated with every institution following the same strict and onerous rules are substantial.

Conservatism of proposals and impact on ability to conduct business: We are concerned that the nature of the proposals will significantly reduce banks' ability to perform maturity transformation which is a core function of the banking sector. A significant reduction in banks' maturity transformation will have repercussions on the efficiency of short-term interest rates as monetary policy instruments. Additionally, we expect the demand for term liabilities to increase leading to higher funding cost, which will eventually end in price increases charged to customers.

The Committee is proposing a narrow definition of buffer-eligible assets. In particular, it discriminates against long-term debt issuance by financial institutions and, due to the additional demand for sovereign paper, risks crowding out non-sovereign debt instruments in general. We therefore support more flexibility on the buffer-eligible assets.

Impact on markets and economy: The rules, if adopted as proposed, will have a broad impact on markets, pricing, and the economy as a whole. For example, increased competition for retail deposits will increase price sensitivity of depositors and erode the stable liquidity characteristics of this funding source.

As a result of the limitations on the liquidity buffer, banks will be forced to reduce and re-price their long-term lending to other sectors of the economy leading to further financial disintermediation. Corporate issuers will find it more expensive and difficult to issue paper, shifting demand for credit back to banks which at the same time will experience pressure on their lending activities to meet regulatory requirements.

Public disclosure requirements: Public disclosure of liquidity ratios could result in an outbidding competition, but could also trigger and increase the speed of a liquidity crisis in case of deteriorating ratios. Public disclosure will seriously impair the buffer function of a bank's liquid asset portfolio, because using the buffer will signal weakness to the market (self-fulfilling prophecy). On an ongoing basis market expectations that healthy banks will hold a buffer above the minimum requirements will add additional constraints given the already conservative calibration of the proposals. In addition, public disclosures would limit supervisory ability to allow an institution flexibility in stressed circumstances to avoid a sudden systemic shock.

Procyclicality: The NSFR pegs funding requirements to ratings, i.e. the higher the rating, the less the requirement. Given that in the corporate environment practically all ratings are BBB+ this means that the NSFR will increase as rating migrations increase. The procyclical impact of that effect could move more quickly than with capital. We would strongly recommend that liquidity rules should not under any circumstances be pegged to ratings.

Differences in implementation and competition: For the new liquidity regime to work, a global level playing field in implementation must be ensured. If not, those banks complying with the new proposals would have a material competitive disadvantage compared to their peers. To protect the integrity of the market, it will be fundamental that all Basel members, including the US, move ahead on an agreed timetable and take a coordinated approach. Differences in implementation may be minimised by having a longer implementation timetable as discussed below.

Implementation timeframe: We have serious concerns about the limited timeframe for implementation of rules which we believe may lead to material structural changes in the financial system. Whereas rushing implementation will exacerbate cyclicality, a longer roll-out would allow these changes to be put in place with less market disruption.

The timing of implementing the liquidity requirements should be viewed alongside the implementation of the proposed capital strengthening requirements. Implementation of the new liquidity and capital regime should only go ahead once there is a full understanding of the cumulative impact and likely knock-on effects on the broader economy.

Interaction between liquidity and capital elements of revised Basel rules: Once the final package of proposals is known, careful analysis will be needed of the interactions between the different elements. In particular, elements of the liquidity framework may impact on the leverage ratio requirements. For example, the European Commission has carved government bonds out of the leverage ratio in its CRD 4 proposals to avoid this inconsistency between the two parts and we believe that this approach should be followed by the Basel Committee.

QIS results: To a large extent, the results delivered in the QIS will be based on assumptions and estimates as the requested data granularity is not readily available in the reporting systems. The timeframe for the QIS is too tight to implement necessary system upgrades. QIS results, and final ratio specifications derived from it, will therefore depend too much on qualitative and possibly varying timeframe for the QIS is too tight to implement necessary system upgrades. QIS results, and final ratio specifications derived from it, will therefore depend too much on qualitative and possibly varying assumptions made by the participating banks. We would welcome a second QIS to refine the inputs and to allow for a better calibration of parameters.

We hope the Committee finds our feedback of assistance. In the meantime please do not hesitate to contact me if you would like to discuss our feedback.

Yours sincerely,

Andrew Procter
Global Head of Government & Regulatory Affairs
Deutsche Bank AG

1. General findings

Weaknesses of methodologies / Inconsistencies of definitions

- Equities are not recognized as liquid assets. Likewise, gold and other precious metals are not recognized as liquid assets. Given that these asset classes have proven to be very liquid over the last 2 years of crisis, this treatment seems too restrictive. The regulatory approach to liquidity should be justified by real experience in stressed conditions. Therefore, these assets should be recognized as inflows for the LCR and should not require term funding under the NSFR.

- The 0% RWA criteria for the determination of liquid assets is too restrictive and should be extended to 20% RWA. The 0% restriction, for example, excludes US agency debt (Fannie Mae/Freddie Mac) from liquid assets despite their explicit government guarantee. Moreover, this would mean, that corporate bonds and covered bonds rated A- and above can be included in the additional assets buffer whereas government bonds with equivalent rating level would be excluded.

- Lack of differentiation of wholesale deposits; Deposits from financial institutions, fiduciaries, etc receive a 100% run-off ratio for LCR purposes irrespective of whether they are money market or clearing balances. This ignores the operational nature and hence the relative stickiness of funds that banks receive in the course of their clearing and settlement business (clearing balances).

- Overly rigid quantitative requirements imposed by regulators will reduce incentives for banks to use and develop internal risk models and tools. This is contrary to the objectives of the Basel framework.

- LCR outflow parameters are crude and overly conservative. It is not clear to the financial industry how the parameters used in the proposed rules were derived, especially as they cannot be substantiated by experience during the crisis.

- In the LCR, a 100% outflow will apply on secured funding transactions (maturing within 30 days) backed by illiquid and less liquid securities. At the same time no liquidity value will be assigned to the underlying asset received out of the maturing secured funding transaction. This results in an inconsistent treatment of those assets that are generally eligible for inclusion into the additional assets buffer under section A2 of the LCR as it implies that they have no liquidity value. In contrast, however, they are being recognized as additional buffer asset and granted a liquidity value if funded on an unsecured basis. The rules should be reviewed in this regard to eliminate the apparent inconsistency.

- Rules are partially ill-conceived. For example, for NSFR purposes a covered bond issued by a bank will lose its eligibility as available stable funding once the remaining maturity is less than 1 year. At the same time the cover pool will continue to require stable funding, even though the cover pool assets may also mature within one year. To keep the NSFR stable this would imply that the cover pool assets would have to be refinanced twice for one year. A similar issue exists for loans that are refinanced by dedicated funding from agencies such as KfW on a fully matched basis.

- The NSFR further postulates an extreme situation for other assets and liabilities. Derivative-related assets are assumed to be totally illiquid (requiring 100% term-funding) while derivative-related liabilities are assumed to be immediate outflows (assuming 0%

term-liquidity value). The described treatment furthermore ignores the collateralisation of the positive and negative market values. This approach is at odds with the real economics of such transactions and basing the funding requirements on these assumptions will have very material consequences. The comparability of results will be further hampered, where different accounting standards or netting regimes are applied. A uniform interpretation of standards is required to ensure an international level playing field.

- In a number of instances the rules are asymmetric, such that the aggregate impact across the industry captures outflows, but fails to recognize that there will be corresponding inflows across the system. The final calibration of requirements needs to recognize this. (Example: Committed facilities extended to FIs receive a 100% run-off while facilities obtained from FIs receive 0% recognition as inflows.)

- The proposed rules represent a 'one-size-fits-all' approach, neglecting differences between institutions, their business mix, ratings and systemic importance. At the same time, the aim of international harmonization and comparison of institutions could be jeopardized by national discretion and room for interpretation of proposed rules.

Implementation issues

- Various clarifications of rules are required to avoid ambiguity and room for interpretation (e.g. treatment of intra-group funding lines, assessment of liquidity of assets in times of stress, effective deposit insurance scheme, early termination of savings deposits, gross versus net assessment of collateral and margin movements, etc.).

- The impact of different accounting standards on the proposed ratios (e.g. with respect to the netting of positions) needs to be considered to ensure comparability between financial institutions.

- A balance needs to be struck between increased granularity and effective management control. There will be a significant resource constraint on the liquidity risk management function because of the need to upgrade reporting systems/processes to obtain excessively granular data required to comply with proposed rules.

- We are also concerned that there is a mismatch between the requirements and the way that firms currently manage their liquidity risk. It is not clear whether the proposals are intended to provide a monitoring system for regulatory purposes (in which case the systems put in place to comply would not meet the use test) or whether they are supposed to be used for internal risk management purposes. If the latter is the case, we would have serious concerns about creating a herd mentality in the industry and the level of prescription places on individual bank models and strategy.

- The timing of implementing additional liquidity requirements should also be considered in the context of the proposed capital strengthening requirements to avoid excessively negative impacts on credit supply and knock-on effects on the real economy.

2. Liquidity Coverage Ratio - LCR

§35, 36, 37 (liquid assets)

- The definition of cash excludes amounts needed for operational purposes. It should be clarified what that means for cash balances maintained in branches or ATMs. Since these are the first balances to absorb withdrawals they should be included, even though they might be operational.
- The treatment of central bank liquidity reserves needs to be clarified. §34(c) in the CD165 leaves it to the discretion of the local regulator and central bank which of the central bank reserves can be included into liquid assets. This in turn will lead to a lack of comparability and regulatory arbitrage across locations.
- It is not clear whether the proposed 50% limit for corporate and covered bonds in the overall stock of the liquidity buffer should be applied before or after haircut.
- The haircuts on corporate and covered bonds are too conservative given market experience during the crisis. The requirements for market data (bid-offer-spread and price fluctuations) are difficult to fulfil given the lack of single data provider and lack of historical data over 10 years for certain instruments. This could lead to differences in interpretation.
- The rationale for applying a 20-40% haircut to bonds that have seen no price moves greater than 10% over the course of 10 years does not seem appropriate (also: how would bonds without a history of 10 years be treated?). Equities, gold and other precious metals are not eligible as liquid assets. This treatment is too restrictive and cannot be justified by experience during the crisis. These assets should be recognized as inflows.

§41, 42, 43, 44 (retail outflows)

- The classification of retail deposits leaves room for interpretation which will hamper the comparability of ratios across institutions and jurisdictions (e.g. definition of relationship based accounts, investor sophistication/definition of HNWI, etc).
- Run-off ratios prescribed by the BCBS only represent minimum ratios and are subject to the discretion of national supervisors (particularly where a classification of stable deposits is not possible).
- The definition of 'effective deposit insurance' needs to be more specific.

§46, 48, 49, 50, 51, 52, 53, 55, 56 (unsecured wholesale outflows)

- The definition of 'callable' funding should clarify that 'callable' only refers to a call right of the investor/depositor, but that a call right of the bank does not lead to a shortened maturity.
- The distinction between 'stable' and 'less stable' retail deposits leaves room for interpretation and creates comparability issues between institutions. Further clarity is needed to ensure consistent implementation.
- The definition of 'operational' balances and 'established cash management or other administrative funds relationship' requires clarification.

- The proposed rules specify a 100% run-off factor for deposits of FIs, fiduciaries, beneficiaries, conduits, SPVs. This ignores the operational nature and hence the relative stickiness of funds that banks receive in the course of their clearing and settlement business (clearing balances) and should be reviewed. It punishes transaction banking activities which are vital for any economy, not of a speculative nature, and have not played any destabilizing role in the recent crisis. The proposed treatment will significantly increase the cost of these services, could lead to a further concentration and increase systemic risk in the clearing and settlement industry.

- Certain fiduciary accounts, e.g. those maintained by a liquidator as part of the insolvency proceedings, are very sticky since the bank maintaining the account can only be changed through a defined legal process. Applying a 100% run-off to these balances would be overly conservative and would lead to higher cost in insolvency proceedings.

- The differing treatment of deposits (not covered by deposit insurance) from small business customers compared to non-financial corporate customers is not plausible. Furthermore the reasoning for imposing a EUR 1m cap on the total aggregate funding (on gross basis) for small business customers requires further clarification.

- A 100% run-off factor applies to own debt maturing within the 30d horizon unless the investor is known to be retail. It is not possible to determine with certainty whether the final investor in a retail debt instrument is in fact a retail customer (natural person) or not. Again, it needs to be clarified that own debt that is callable by the issuer does not fall in the scope of the LCR.

§63 (additional requirements, impact of valuation changes on pledged non-cash/sovereign collateral)

- A more explicit definition of collateral falling into this category is required. It further needs to be clarified whether the rule applies to collateral pledged by us, to us, or both.

§64 (loss of funding on ABCP)

- Assuming a liquidity drain of 100% of returnable assets implies that the assets underlying the ABCP have no liquidity value. Often, however, these assets are central bank eligible and could therefore be used to mitigate the arising funding demand. A more appropriate run-off factor should therefore be considered.

§66, 76 (Draws on committed credit and liquidity facilities, lines of credit)

- Differentiation of liquidity facilities and credit facilities is unclear. How are multi-purpose facilities seen in this context?

- The assumption that 10% of all credit facilities are drawn is not plausible.

- Committed facilities to financial institutions are assumed to be drawn by 100%. Lines of credit that the bank receives, however, do not receive any value. This asymmetric treatment is not plausible, as the flow of funds in the financial system will not add up. For group internal credit lines, this asymmetric treatment is also not plausible

§67, 68, 69 (Other contingent funding liabilities)

- Articles refer to a broad range of 'other contingent funding liabilities'. The assessment and treatment will be determined by the national supervisor and the bank and is currently unclear (scope includes uncommitted lines, guarantees, LCs and other trade finance instruments, but also potential requests for buybacks of own debt instruments, mutual funds and market making activities). The treatment of uncommitted lines should e.g. consider that these are often granted on accounts that usually show a positive balance (e.g. in retail banking) which needs to be drawn first, before the line will be utilized.

§71 (cash inflows)

- It is unclear whether overdrafts and until further notice facilities are to be included as inflows and whether this would include the drawn and undrawn amount of these facilities (e.g. most of the credit lines extended to clients can be revoked at the discretion of the bank and without further notice).

- Equities are not recognized as liquid assets. This treatment is too restrictive and cannot be justified by the experience made during the crisis. Likewise, gold and other precious metals are not recognized as liquid assets. These assets should be recognized as inflows for the LCR and should not require term funding under the NSFR.

3. Net Stable Funding Ratio - NSFR

§84 (Definition of available stable funding)

- It is unclear how open market operations (OMO) will be treated for the purpose of the NSFR calculation.

§86 (Definition of available stable funding)

- Liabilities with embedded options, which would reduce the expected maturity to less than 1 year, will not receive a 100% ASF Factor. As mentioned for LCR, it needs to be clarified that funding that is callable by the issuer does not fall in the scope of the NSFR.

- Capital as defined by the global capital standards of BCBS excludes goodwill and other capital deduction items. To avoid double counting, the same deduction items should also be excluded from the definition of total assets of RSF.

- It should be clarified whether the distinction between bonds issued to different investor groups (e.g. retail vs. institutional), as prescribed for the calculation of the LCR, also applies for the calculation of the NSFR.

§88 (Definition of required stable funding)

- For NSFR purposes a covered bond or securitization issued by a bank will lose its eligibility as available stable funding once the remaining maturity is less than 1 year. At the same time the cover pool will remain to require stable funding, even though the cover pool assets may also mature within 1 year. To keep the NSFR stable this would imply that the cover pool assets would have to be refinanced twice for one year. A similar issue exists for loans that are refinanced by dedicated funding from agencies such as KfW on a fully matched basis.

§89 (Definition of required stable funding)

- The definition of unencumbered asset is unclear.
- The rationale for the RSF factors applied to securities should be clarified. Examples include:
  - Fannie May / Freddie Mac securities are not 0% risk weighted under Basel II and therefore would receive a 20% RSF factor. This would significantly damage the agency-backed MBS market in the U.S. if introduced and the knock-on effects on home-owners is unlikely to be acceptable to the U.S. government.
  - Emerging market government debt is rated lower than AA. Clarification is needed on whether they attract a RSF factor of 100% or less.
  - What is the justification for a 20% RSF factor on AA or higher corporate and covered bonds, presumably including jumbo Pfandbriefe? If introduced this would drive up borrowing costs for these corporates and mortgage holders who will already be impacted by the capital requirements on securitisations and likely impact of increased capital on lending.
  - All corporate bonds lower than A- and minor index equities are given 100% RSF factor. What will be the impact on those corporates looking to issue long-term debt or equity in the market if banks need to fund these assets with term cash?
  - What is the justification for 50% RSF factor on major index equities and Aa- to A- corporates? There is a highly liquid repo market which did not go away during the crisis and securities traded on exchanges and can be easily liquidated within 3 days. This will drive up the costs of equity and debt capital markets activity for all corporates.
  - Gold is highly liquid and can be liquidated or swapped into USD within 2 days. What is the justification for a 50% RSF factor?
  - In the NSFR, minimum reserve requirements of the central bank attract 100% stable funding. This implies that reserve requirements remain unchanged over one year which is contradictory with the assumed decline of the deposits base. The reduction of liabilities would generally result in a reduction of minimum reserve requirements to be funded.
- Why are all commodities other than gold given 100% RSF factor, even when traded on highly liquid exchanges (e.g. silver, platinum, crude oil etc.)?
- ABS, MBS, CDO etc. – will also attract 100% RSF. This is likely to have a severe impact on the securitization market and knock-on impact on consumer lending including student loans, car loans etc.
- Applying a 50% RSF factor to loans maturing within 1 year for large non-financial corporate clients will inevitably lead to a rise in their short-term borrowing costs.

- All other assets – 100%. What is the treatment of self-funded structures / vehicles e.g. life assurance, mutual funds, and transactions where the asset and liability tenor is matched (e.g. total return swaps, B/S rental trades)?

- What is the treatment of balance sheet assets such as derivative MTM, deferred tax assets, margin and prime broker receivables, accrued interest, settlement / trade date balances, interim accounts (fails) etc.

- The impact of different accounting standards on the proposed ratios (e.g. with respect to the netting of positions) needs to be considered to ensure comparability between financial institutions.

§91 (Definition of required stable funding)

- Leaving the determination of the RSF factor of 'other contingent funding liabilities' by national supervisors is likely to result in differing treatments across jurisdictions that will hamper the comparability of results.

- What is the rationale for the 10% haircut on off B/S commitments?

4. Monitoring tools & application issues

§93, 96, 97, 99, 107 (Monitoring tools)

- National supervisors can impose tools and metrics in addition to the Basel proposal. This is inconsistent with the overall aim of harmonizing standards.

- The proposed rules specify that supervisors in each jurisdiction will determine the template for liquidity risk reporting. This might lead to an increased reporting burden for those banks that are active in multiple locations. Moreover, it will result in a lack of consistency and comparability across jurisdictions. We would welcome a more harmonized approach where supervisors agree on using one template (e.g. after discussion in supervisory colleges).

- The treatment of German savings deposits must be clarified (see §43) with respect to their 3M cancellation period vs. the common practice to allow early withdrawal under normal circumstances in exchange for a penalty interest.

- Liability cash flows should be reported according to their earliest possible date of outflow. It should be clarified that where call rights are in place, only those of the customer/investor should be regarded, whereas a call right for the bank would not necessarily trigger an early outflow.

- 'Significant counterparties' are defined as a percentage of the bank's total liabilities. How are liabilities defined in this context (accounting regime, incl. MtM, etc.)?

§132 (Application issues)

- The expected reporting frequency is challenging for internal reporting capabilities, respectively might not be feasible, especially where balance sheet data is required.

§133 (Scope of application)

- Applicability to all international banks needs to be ensured to maintain a level playing field. Exceptions like under Basel II (not applied by US banks) should not be possible.

§134 (Public disclosure)

- Public disclosure of liquidity ratios could result in an outbidding competition, but could also trigger and increase the speed of a liquidity crisis in case of deteriorating ratios. The public disclosure will seriously impair the buffer function of a bank's liquid asset portfolio, because using the buffer will signal weakness to the market (self-fulfilling prophecy).