

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

EBF response to the Basel Consultative Document Basel III: The Net Stable Funding Ratio (BCBS CD271)

We welcome the change to the definition of the Net Stable Funding Ratio (NSFR) from a one year long stress test to a structural liquidity risk metric. 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.

The Available Stable Funding (ASF) 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. 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.

In doing so, the NSFR should also take into account the huge regulatory changes that have been and are being implemented in the financial sector, notably the Basel III - related components for the banking industry, which will make the financial industry far more resilient to future shocks.

In terms of decision process, the EBF is concerned that the BCBS will not have the time to use the data from the Quantitative Impact Study (QIS) to be factored in its updated revised recommendation for NSFR that is expected early 2015. The EBF urges the BCBS to adopt a timeline that will enable it to have an informed decision process.

The BCBS should also be aware that its recommendation designed for the consolidated level are applied at entity, branch or country level in some jurisdictions. Considering the experience of the implementation of the Liquidity Coverage Ratio, the BCBS should make it clear that the application of the NSFR at the sub consolidated level would require local regulators to adapt its assumption set.

Similarly, BCBS should make clear that local specificities should be factored in by local regulators in their local application of the NSFR.

Key Messages

The EBF supports:

- Modifying the NSFR treatment of repos and reverse repos.
- A widening of the definition of high quality liquid assets and a lowering of RSF factors for liquid assets to reflect the longer time horizon available to liquidate assets in markets.
- An improved treatment of derivatives and its collateral.
- Debt repayment based on expected maturity
- Netting of other assets and other liabilities (including accruals)
- A higher ASF factor and simpler definition for operational deposits
- Lower RSF for Trade Finance and Factoring
- Mitigating the NSFR disincentives for wholesale secured funding.

EBF Members further seek clarification on the treatment of:

- Guaranteed residential mortgages
- Expected loan prepayment
- SME as retail deposits

General Comments and Recommendations

EBF Members note the following observations and recommendations for adjustments:

Repos and Reverse Repos

- The NSFR treatment of transactions with financial counterparties is asymmetric for no reason connected to, or consistent with the NSFR.
 - A loan granted to a non-bank-financial institution with a maturity of less than 6 months gets assigned a 50% RSF, while the same loan with a maturity of less than 6 months *received from* a non-bank financial institution gets an ASF of 0%. Hence, a perfectly match-term position is not NSFR-neutral, which is not consistent.
 - As the revised NSFR does not segregate between secured and unsecured lending/borrowing, the above example applies to a less than 6 month reverse repo and a 6 month repo and leads to a requirement of stable funding for a position that is fully matched.
 - As the NSFR assumption set does not consider the *securing* assets, the treatment of secured lending and borrowing is inconsistent, even with its own premises.¹
 - In this case, as is, the NSFR would have very detrimental consequences for market making activities, including for sovereign debt market making. This is at odds with the necessity in Europe to strengthen capital markets to support bank financing that has been lowered by the regulatory environment. Repo and reverse repos are vital for this process.
- *The EBF recommends that*
 - *As a general principle, NSFR should be made compatible with the LCR. As an illustration, where a repo and reverse repo would be matched (security-wise and term wise) to be LCR-neutral, they should be NSFR-neutral as well.*
 - *Symmetry should apply to:*
 - *all counterparties as long as the reverse repo and other secured funding transactions is subject to prudentially applicable daily margining.*
 - *regulated entities such as CCP and insurance companies.*
 - *Secured lending/borrowing transactions (e.g. reverse repos/repos) are isolated from unsecured lending/borrowing transactions so as to avoid creating inconsistencies in ignoring the securing asset (collateral) and the treatment for secured transaction presented below should apply:*
 - *RSF/ASF for secured lending / borrowings are derived from multiplying RSF/ASF for unsecured lending/borrowing by the RSF of the underlying collateral.*

¹ BCBS271§25. The RSF factors assigned to various types of assets are parameters intended to approximate the amount of a particular asset that would have to be funded, either because it will be rolled over, or because it could not be monetised through sale or used as collateral in a secured borrowing transaction over the course of one year without significant expense. Under the standard, such amounts are expected to be supported by stable funding.

Hence, reverse repos (resp. repo) with residual maturities shorter than 6 months, between 6 to 12 months and greater than 12 months should receive RSF (resp. ASF) respectively of: 0%, 50% x collateralising asset RSF and 100% x collateralising asset RSF.

- *RSF for encumbered assets are unchanged (since the adjustment is applied to the encumbering instruments). Short positions are netted out of the reverse repos they originate from (by ISIN)*
- The 50% RSF for deposits and initial deposits made notably to Central Clearing Counterparty (CCP) is not consistent when these deposits relate to short term transactions or when the bank acts as an agent.
 - *The EBF recommends that those deposits should be allocated a maturity consistent with the maturity of the transactions they relate to. Hence, if all related transactions were shorter than 6 months, deposits should receive a 0% RSF.*
 - *When the bank acts as an agent, intermediating the access to CCP for its customers, the deposits received from the customers and the related deposits to the CCP should be netted out.*

Market Liquidity

- The asset market-liquidity is not sufficiently recognised in the NSFR which is a structural ratio:
- Market liquid securities require as much as loans: 85% RSF for longer than 1 year non-HQLA securities, and even shorter than 1 year securities require stable funding.
- All LCR level 2B assets should receive RSF factors that are commensurate to the fact that these are market liquid instruments. For funding instruments secured by mortgages, the gap between the RSF factors for covered bonds (15%) and LCR eligible RMBS (50%) is too large, given that the underlying assets are similar and both instrument types are market liquid.
 - *The EBF recommends a wider definition of liquid assets for the NSFR to reflect market liquidity:*
 - *RSF for market liquid securities should be no greater than 25% including for Level 2B assets;*
 - *Market Liquid Assets should be defined as all securities that are actively traded on recognised major markets;*
 - *The EBF recommends that the maturity of the securities should be considered:*
 - *Shorter than 6 months Liquid Asset should receive a 0% RSF;*
 - *assets whose residual maturity is between 6 and 12 months should be applied 50% of the RSF that applies to this asset category.*
 - *The EBF recommends that assets, whether HQLA or non-HQLA, that are held to hedge market risk exposures should be allocated the maturity of the underlying risk exposures which they hedge.*

By way of example, an asset that is held to hedge a derivative with less than 6 month maturity should be applied a 0% RSF. Where the derivative has a residual maturity of between 6 and 12 months, the corresponding hedging asset should have an RSF of 50% of the RSF of the asset; and for derivatives of greater than 12 months the asset would attract 100% RSF of the asset.

Derivatives

We welcome that BCBS is considering changes for dealing with derivatives and other assets/liabilities as the current suggested NSFR treatment of derivatives is not appropriate. The vast majority of centrally cleared and OTC derivatives are margined on a daily basis. This collateral significantly enhances the liquidity value of the transactions and, from a funding perspective, helps to keep the positions fully self-funded. In view of this prudent risk management of derivatives and impending regulations with respect to collateral management the EBF recommends the following treatment with respect to variation margin:

- *Step 1: calculate the net derivatives payables and net derivatives receivables in accordance with ISDA agreements (or similar) where possible*
- *Step 2:*
 - *2a: calculate the net residual derivative payables amount by deducting the fair value of any variation margin posted from the payables amount calculated in step 1.*
 - *2b: calculate the net residual receivables amount by deducting the fair value of rehypothecable variation margin received from receivables amount calculated in step 1.*
- *Step 3: The amounts calculated in step 2a shall be subtracted from the amount calculated in step 2b*
 - *For residual net derivative payables, a 100% ASF factor should apply*
 - *For residual net derivative receivables, a 100% RSF factor should apply*

Initial Margin should be recognised symmetrically (e.g. equal ASF/RSF assumptions), depending on the maturity of the transactions they relate to:

- *0% RSF/ASF for transactions with a maturity below 6 months*
- *50% RSF/ASF for transactions with a maturity between 6 to 12 months*
- *100% RSS/ASF for transactions with residual maturity beyond 12 months.*
- *if the received initial margin is not re-hypothecable, ASF is set to 0%*

Finally, excess collateral should be considered specifically:

- *collateral that is in excess of contractual agreements should receive a 0% RSF/ASF*

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^[1]. Moreover, it is impossible for banks to

^[1] BCBS271§17 “When determining the maturity of an equity or liability instrument, investors are assumed to redeem a call option at the earliest possible date. For funding with options exercisable at the bank’s discretion, banks should assume that they will be exercised at the earliest possible date unless the bank can demonstrate to its supervisor’s satisfaction that the bank would not exercise this option under any circumstances. For long-dated liabilities, only the portion of cash flows falling at or beyond the six-month and one-year time horizons should be treated as having an effective residual maturity of six months or more and one year or more, respectively.”

demonstrate that they would not exercise an option under “any circumstances” (as required by Paragraph 17).

- *The EBF recommends that 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), redeemable debt should be considered for their expected maturity considering reputational factors that may limit a bank's ability not to exercise the option should be taken into account.*

Other Assets and Other Liabilities:

- Numerous balance sheet items are not explicitly mentioned in the NSFR and consequently are considered other assets with a 100% RSF and other liabilities with a 0% ASF, which makes the default treatment extremely penalising for no reason. Most probably, this is unintended by the BCBS.
 - *The EBF recommends that a principle is clearly articulated in the NSFR so that balance sheet items that fall in other assets and other liabilities categories are netted out, and tenorised in 0-6 month, 6-12 month and greater than 12 month time bucket. As an illustration, accruals on both assets and liabilities should be netted out before being applied the relevant RSF/ASF.*

Deposits

- The EBF welcomes that the portion of non-retail deposits that are considered stable is increased.
 - *The EBF recommends that operational deposits (custody, clearing, cash management) should be recognised a higher ASF (e.g. 75%).*

Indeed, the operational deposits represent only a portion of the total deposits since they are subjected to an extremely demanding identification process (excess balances are filtered out). Allocating a 50% ASF does not recognise the first filter those deposits results from.
 - *The EBF welcomes the ongoing work in BCBS to articulate definition of operational deposits is simple and based on easily available criteria. A definition is proposed in our detailed comment section.*
 - *However, the EBF considers that deposits from non-financial customers could be allocated a higher ASF to better reflect the actual stability of those deposits in a normal environment.*
- In the proposed framework, the funding (i.e. outside of monetary policy operations) from central banks having a residual maturity of less than 6 months is weighted at 0% ASF, as if central banks were considered as financial institutions, whereas they are considered as non-financial institutions for deposits in the LCR.
 - *The EBF recommends that unsecured funding from Central Banks is considered in the same way as funding from non-financial institutions in the NSFR.*

Trade Finance and Factoring

- As the underlying trade/factoring transactions of trade/factoring loans are discrete, short term, low risk, self-liquidating events, we believe that a 50% RSF is inappropriate and will increase the cost - and reduce the availability - of this vital source of finance for economic growth.
 - *The EBF supports an RSF factor in the range of 0-10% for on-balance sheet trade finance and factoring lending with residual maturity below 6 months and a 15-25% RSF factor range for drawn trade finance and factoring transactions between 6-12 months in duration.*

- *We support a 0% RSF Factor recommendation for off-balance sheet trade finance products covered under Table 3 of the consultative proposal.*

Wholesale funding (secured or unsecured) maturing between 6-12 months are 50% ASF

- The EBF welcomes the introduction of a 6 to 12 month time bucket to mitigate cliff effect, notably for wholesale funding that are allocated a 50% ASF when their residual maturity is between 6 and 12 months. However, as the NSFR does not breakdown secured from unsecured wholesale funding, the EBF considers that the regulatory environment would become overly detrimental to secured wholesale funding.

Indeed, it should be reminded that European banks will be subject to detailed public disclosure on their asset encumbrance (cf Asset Encumbrance Disclosure), which gives a strong incentive to discipline asset encumbrance (even though European financial markets require banks to bear asset encumbrance in their balance sheet while other jurisdiction offer official sector-supported entities to bear this encumbrance).

In the NSFR, encumbered asset are allocated a higher RSF than when unencumbered (e.g. 100% when encumbered for longer than 12 months), which significantly mitigates the benefit of term secured funding those assets. Hence a 2 year long asset with a 65% RSF would require either 100% secured longer than 1 year term funding or 65% unsecured longer than 1 year term funding. Actually, this would be even worse due to the excess collateral required for secured funding. Even asset that are encumbered for 6 to 12 months are allocated a higher RSF.

The EBF considers that the NSFR treatment of secured funding is overly detrimental.

- *The EBF recommends mitigating the NSFR disincentives for secured funding, with one or a combination of the below described NSFR treatment:*
 - *The RSF of asset that are encumbered for less than 12 months should be unchanged*
 - *Higher ASF for secured funding with residual maturity lower than 12 month.*
 - *Pass through secured funding should be neutral for NSFR*

Some clarifications are needed:

Guaranteed residential mortgages

- The RSF for assets that can be sold or give access to secured-funding thanks to their high credit quality (65% RSF).
 - *We believe the treatment in the NSFR of the residential loans secured by a guarantee should be clarified as equivalent to mortgages.*

Indeed, these loans are of the same high credit quality as the residential mortgages and the EBF strongly supports that they benefit from the same RSF (i.e. 65%). If the 65% RSF factor is not recognised for these loans, the impact on the NSFR of the concerned banks is significant, introducing a level playing field issue.

Expected loan prepayment

- Other unencumbered performing loans (with risk weights greater than 35% and residual maturities greater than 1 year) require a 85% RSF based on the contractual cash flows expected beyond one year (34. (a) in the BCBS CD on NSFR). The contractual amortisation schedule may overstate the asset tenors since early prepayment of retail and corporate loans would be ignored. Such early

prepayments typically are analysed regularly and taken into account cautiously in building the liquidity ladder of banks.

- *The EBF recommends clarifying that expected maturities are considered rather than contractual maturity, notably to take into account prepayment on loans that are expected in the next 12 months (note that the portion of the expected prepaid loans would fall in the lower than 6 month or between 6 to 12 months category, that are subject to positive RSF).*

SME Deposits

- The EBF welcomes that retail deposits are considered stable funding sources with a higher ASF than in the previous NSFR.
 - *The EBF recommends clarifying that all SME deposits are considered retail deposits without considering the €1mm cap that applies in LCR.*

The following Annex give additional detailed comments and examples to the EBF recommendations described above.

The EBF welcomes an ongoing dialogue with BCBS and stands ready to complement this response with additional material and input.

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Annex – Detailed Comments

I. Repo/Reverse Repos Asymmetry

Detrimental Impact on Market Making

In their role of market making of securities, notably sovereign debt, banks commit to buy or sell securities to their clients, when they bid for the amount they wish.

To meet this commitment, banks have to maintain an inventory of securities to meet buy orders. Before receiving buy orders, banks need to fund the inventory. As their unsecured funding capacity is limited, banks mostly fund their market making inventory with secured funding. As the timing and magnitude of the buy orders are not known, banks are led to fund their market making inventory through short term repo.

To the extent that buy orders exceed the amount or security available in their own inventory, market making banks need to be able to buy the security they receive buy orders on. In such a case, either they buy the security, or they borrow them through reverse repo to deliver the security quickly to their clients, and the term of the reverse repo gives time for the banks to buy the security.

Hence, repos and reverse repos are fundamental in delivering their market making commitment to their customers (including commitment to the sovereign for market making sovereign debt).

Reverse repos are executed with counterparts that own the security in their own inventory: insurers, asset managers and to a low extent banks are natural provider of securities as they are structurally long those securities.

Repos are executed with counterparts that are cash long and are willing to lend secured to banks, which is notably money market funds, and to a lower extents banks.

The suggested asymmetrical treatment for repos and reverse repos with non-bank counterparties, would have a direct detrimental impact on market making activities, including sovereign debt.

Indeed, the NSFR would act as a disincentive to enter into reverse repos with non-banks (i.e.: insurers and asset managers) which would limit their responsiveness to meet buy orders.

The repos and reverse repos are executed with very few basis points over short term index (OIS+x bp). Should NSFR apply, unsecured term funding would be needed, with funding costs in dozen of basis points over OIS, for the very same activity, far in excess of the profitability of the market marking activity: market making would hence no longer be sustainable in banks.

Addressing the risk of fire sales by non-banks with asymmetric treatment in NSFR

Given the speech from Jeremy C. Steins from the US Federal Reserve of October 2013² we assume that by making NSFR asymmetric it is the intent of regulators to address the risk of fire sales:

A conceptually similar way to get at matched-book repo would be to modify liquidity regulation so as to introduce an asymmetry between the assumed liquidity properties of repo loans made by a broker-dealer, and its own repo borrowing. For example, in the context of the Net Stable Funding Ratio (NSFR), one could assume that a dealer's repo loans to a hedge fund roll off more slowly than do its own repo borrowings from the triparty market. This assumption would create a net liquidity exposure for a matched repo book, and would thereby force the dealer to hold some long-term debt or other stable funding against it.

² "The fire-sales problem and securities financing transactions," Speech by Jeremy C Stein, Member of the Board of Governors of the Federal Reserve System, at the Workshop on "Fire Sales" as a Driver of Systemic Risk in Tri-Party Repo and Other Secured Funding Markets, Federal Reserve Bank of New York, New York City, 4 October 2013.

Although the implementation is different, the end result is quite close to that obtained with the capital-surcharge approach: in one case, there is a broad stable funding requirement for intermediaries against a matched repo book. In the other case, there is an equity requirement. It follows that, whatever its other advantages, going the modified-NSFR route does not eliminate concerns about disintermediation and regulatory arbitrage.

EBF Members believe that the objective to internalise the risk of fire sales in micro-prudential framework such as the NSFR is misplaced and should be dealt with macro-prudential supervision.

LCR framework is designed to address the survival of individual institutions subject to this regulation. Securing individual institutions from a liquidity perspective (i.e. micro approach based on micro analysis of the balance sheet, including off Balance Sheet) is thought to secure the global regulated system (i.e. impact at macro level). The goal is achieved and LCR regulation actually secures the liquidity position of regulated institutions within the regulated area.

It is not designed to deal with negative externalities such as fire sales risk having an impact on entities inside and outside of the liquidity regulated area. Using the LCR/NSFR regulation in order to address this externality might address partially the issue but at a very high cost for the economy.

First the issue will be only partially addressed as it is very likely that the intermediation role currently ensured by banks and brokers-dealers will be ensured by other parties or means, such as opening direct relationships between hedge funds and MMF for instance, hence growing the shadow banking area.

As the current proposal does not discriminate between the nature of the securities used as collateral in SFT, unlike the LCR, such asymmetry will lead to the extinguishment of the market making on sovereign debt which must be seen as an important negative externality but within the regulated area. Therefore trying to address a macro issue impacting all economic actors through a regulation meant for only a part of the participants is not a sensible approach. The Stein speech is fully aware of such drawback and explicitly mentions that NSFR is not the right tool to address the fire sale issue. The very relevance of the “run on repo” described by Gorton and Metrick (2010) in explaining the steep fall of aggregate funding conditions in 2008 is challenged by some recent papers: Khrishnamurthy and Nagel (2013) warn against the evidence of large unmeasured entities (i.e. shadow banking players) outside the categories captured by the Flow of Funds (commercial banks, broker/dealers) who play a significant role in the US repo market. Khrishnamurthy, Nagel and Orlov (2012) also show that rather than increasing haircuts, market users initially responded to the crisis by reducing or withdrawing credit lines, shortening the terms for which they were willing to lend and narrowing the range of eligible collateral. The conclusion is that repo was not key to the funding of shadow banking and had a modest impact on changes in aggregate funding conditions.

More precisely, if the fire sales issue is the risk to be addressed, it must be explained as such and a proper regulatory answer must be brought.

If this is a risk linked to the type of the counterpart, i.e. not renewing secured financing because of fear on the credit quality of the counterpart, it is already dealt with through capital ratios. It can be adjusted but this is not a liquidity issue to be addressed in either LCR or NSFR that do not consider credit in the approach.

If this is a risk linked to the nature of the asset, it is paramount that the approach chosen is fully consistent. LCR/NSFR address liquidity issues within the regulated area. LCR assumes that L1 assets do not suffer any loss in liquidity value in a market stress. This assumption allows banks to fulfil their

intermediary role in the economy and especially in intermediating offer and supply in sovereign debt which accounts for a very large part of matched book activity. The NSFR shall maintain a consistent approach. The current proposal creates an asymmetry in repo and reverse operations that is independent of the nature of the asset. Even if it might address partially the fire sale issue, it will more importantly lead banks to stop an activity that will require otherwise to hold very large amounts of above 1 year stable funding and push it to non-regulated area. Therefore the fire sale issue will not have been properly addressed but a very large negative externality within the regulated sector will have been created at the expense of sovereign debt financing.

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 > 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 of not taking into account the underlying collateral but adds new very material 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 penalise non-banking financial institutions as a counterparty for the transactions.

Consider the following illustration. ASF, RSF and NSFR are expressed in:

- absolute amount, with NSFR in the 'asset column' when there is an excess of RSF over ASF, and in the 'liability column' when there is an excess of ASF over RSF.
- Percentage ratio in bracket (eg: (100%)).

Starting point, with Bank A and Bank B meeting the NSFR:

Bank A				Bank B			
Asset		Liability		Asset		Liability	
Level 1	100	5	Equity	Cash	100	5	Equity
		95	3m debt			95	3m debt
RSF	5	5	ASF	RSF	0	5	ASF
		0	NSFR (100%)			5	NSFR (>>>100%)

Bank A and Bank B enter into a 9 month repo for 100 cash leg secured by 100 Level 1 security leg. As it is a 9 month long repo/reverse repo, it is allocated a 50% RSF/ASF:

Bank A				Bank B			
Asset		Liability		Asset		Liability	
Level 1	100	5	Equity	Cash	0	5	Equity
Cash	5	100	9m repo	9m rev repo	100	95	3m debt
RSF	50	55	ASF	RSF	50	5	ASF
		5	NSFR (110%)	NSFR (10%)	45		

Bank B no longer meets the NSFR: it comes from the fact that the Level 1 collateralising asset that it gets access to by entering a reverse repo is denied any NSFR liquidity value.

With this very simple example, transactions that are inter-bank change the situation of the bank situation as a whole.

This asymmetrical treatment of repos and reverse repos circumvent 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 month will decrease significantly and the price will increase without any economical reason.

In our proposal, the RSF/ASF of the repo/reverse repo would be multiplied by the Level 1 RSF while the encumbered asset would have an unchanged RSF:

Bank A				Bank B			
Asset		Liability		Asset		Liability	
Level 1	100	5	Equity	Cash	0	5	Equity
Cash	5	100	9m repo	9m rev repo	100	95	3m debt
RSF	5	7.5	ASF	RSF	2.5	5	ASF
		2.5	NSFR (150%)			2.5	NSFR (200%)

The global NSFR of the two banks is unchanged (0+5 as starting point, 2.5+2.5 after entering into the 9 month repo). The individual NSFRs are affected to the extent of the regulatory RSF that is repo'ed.

NB: it is important to consider the combination of the encumbered asset (whose RSF is unchanged) and the funding secured by it whose ASF is mitigated by the RSF of the securing asset.

II. Liquid Assets

The uniformity of the treatment of level 2B RMBS

The proposed treatment of level 2B RMBS in the NSFR is punitive compared to the treatment in the LCR. When comparing the haircuts required for level 1, 2A and 2B assets, the gap between the haircut for all assets other than RMBS is 5% at a maximum, as shown in the graph below:

LCR Level:	LCR haircut	NSFR RSF (proposal)	Gap
1	0%	5%	5%
2A (Covered Bonds)	15%	15%	0%
2B (RMBS)	25%	50%	25%
2B (non-RMBS, e.g. corporate bonds & equities)	50%	50%	0%

However, for RMBS the gap is 25%. As the EBF advocates the consistency of the treatment of assets between the LCR and the NSFR, the required stable funding for RMBS should clearly be revised.

Treatment of Gold and Precious Metals

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.

Can the Basel Committee confirm its view on the treatment of gold (and other precious metals)? We believe that the 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.

Treatment of equities that cover derivative exposures

Most equity positions held in the trading book balance sheet of banks are held to cover market risk exposure from derivatives contracts. These equity positions are not directional positions, but mature concurrently with the related derivative contract and the impact of market price movements are compensated by opposite changes in the value of the relevant derivatives contracts.

Dealer banks do not typically carry significant directional market positions: if a derivative contract is sold, the bank will purchase the underlying asset in order to hedge its market risk. Symmetrically when the derivative contract matures, the hedging positions are liquidated (or delivered in the case of physically-settled contracts) concurrently so as to avoid exposure to a market risk.

In case in the event of market volatility, there is no price risk on the value of the asset: a decrease of the asset price will be compensated by an increase of the value of the derivative, either via collateral received on a regular basis through the margin call process or at the end of the contracts in case of derivatives without collateral contracts.

It should also be noted that these equity positions can act as a real available source of liquidity in a sustainable business-as-usual approach without significant franchise-erosion risks.

The current LCR and NSFR frameworks do not recognise this link. It is important to note that even in the event of market stress, there is no reason to take a haircut on assets held to hedge market risk exposures since the market value of the assets are offset by the derivative.

As a business-as-usual indicator, the NSFR should take account of this link and recognize that an equity has a maturity depending on the maturity of the underlying derivative portfolio.

Beyond equities, this applies to all securities that are held as hedge for market risk exposures that are lower than 1 year.

III. How Derivatives should be dealt with in NSFR

This section explains how derivatives should be dealt with in the NSFR. It is illustrated with swap but this applies to all types of derivatives.

1. Non-collateralised swap:

T0		T1		
Asset	Liability	Asset	Liability	
Swap	0	Swap	20	20 P&L

The swap market value is positive, perfectly offset by the P&L, and there is no actual cash flow for the bank: all is only accounting entries without cash movement.

Progressively, the swap value is recycled in cash since the value is simply the discounted value of the swap's cash flows:

T1+1y (swap cash inflow of 2)

Asset	Liability
Swap	18 20 P&L
Cash	2

On the liability side, P&L becomes cash *only* when distributing it in the form of tax, dividend... which is the choice of the bank. There is no obligation to distribute P&L in cash, and so, there is no funding need for a derivative asset.

Hence, if there is no P&L distribution, there would be no need for funding a derivative asset.

T1+1y+ (after no distribution)

Asset	Liability
Swap	18 20 Retained earnings
Cash	2

... and actually, the cash inflow from the derivative could be redeployed to fund long term asset (since it is not distributed).

Conversely, if there is an assumption that P&L is fully distributed, there would be a funding need at 1 year horizon to the extent of the derivative asset value *net of* cash inflow within the next year (those inflow would be fully used to distribute the P&L associated with the swap value).

T1+1y+ (after full distribution)

Asset	Liability
Swap	18 0 Retained earnings
Cash	0 18 Borrowing

If $\frac{3}{4}$ of P&L is distributed and $\frac{1}{4}$ is retained as capital. As there is only 3 available cash, the bank has to borrow the difference: $2 - \frac{3}{4} \cdot 20 = -13$ cash outflow that needs to be funded.

T1+1y+ (after full distribution)

Asset		Liability	
Swap	18	5	Retained earnings
Cash	0	13	Borrowing

What if the swap has a negative value?

T0		T1	
Asset		Liability	
Swap	0	20	Swap
		-20	P&L

Progressively, the swap value is recycled in cash since the value is simply the discounted value of the swap's cash flows:

T1+1y (swap cash outflow of 2)

Asset		Liability	
		18	Swap
		2	Cash
		-20	P&L

As the P&L is negative, it can't be distributed.

We need to consider the global P&L (ie not only the P&L of this derivative asset).

- If the global P&L remains *positive*:
 - If the P&L is assumed *not* to be distributed, there is a need for funding only to the extent of the derivative cash outflow over 1 year horizon (2 in our example)
 - If the P&L is assumed to be *fully* distributed, the negative P&L of the derivative reduces the need for funding to the extent of the derivative (negative) value netted out of cash outflow (=20-2)
- If the global P&L is *negative*, the P&L cannot be distributed, and actually the bank will need to eat a portion of its capital that is a long term funding source:

As the NSFR is a structural ratio, it is suggested that there is no changes in capital (neither through future retained earnings, nor through capital eaten which is covered by solvency prudential framework).

Hence:

- **the 1 year funding need from a derivative asset is the current positive value of the derivative netted out of expected cash inflow expected over the 1 year horizon;**
- **current derivative negative value netted out of expected cash outflows over the 1 year horizon *reduces* the funding needs over 1 year horizon.**

As the funding needs derive from P&L through which all derivatives' values go through, derivatives' funding needs should be considered by netting derivative assets and derivative liabilities and netting their cash inflows/outflows over the 1 year horizon.

2. Collateralised swap:

When the derivatives are collateralised, derivatives assets enable the bank to receive collateral (cash) that can be used for distributing the P&L, as illustrated below:

T1+1y (swap cash inflow of 2)

Asset		Liability	
Swap	18	20	P&L
Cash	20	18	Collateral received

T1+1y+ (after full distribution)

Asset		Liability	
Swap	18	0	Retained earnings
Cash	0	18	Collateral received

Case of Certificates

Certificates are financial instruments issued by financial institutions to replicate a particular underlying asset (e.g. equity, credit, commodities, foreign exchange).

For accounting purposes these products are classified as "derivative instruments"; however, as for liquidity monitoring, NSFR should clarify that they should be considered as "securities" in accordance with the substantial nature of the transaction

IV. Other Assets and Other Liabilities

This item includes all accruals that are recognised on the balance sheet. Accruals are due to:

1. the difference between trade and settlement date involving all type of transactions
 - a. settlement of securities purchase
 - b. benefits to be paid
2. difference between the cash flows statement and the P&L recognition
 - a. up-front fees that are accrued on the P&L
 - b. other income/charges

Under International Financial Reporting Standards, there is a clear difference between accruals and provisions. IAS 37 states:

Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

- a. *trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and*
- b. *accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.*

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

The EBF recommends that accruals are netted out of the following balance sheet items, applying a tenorisation process when possible as proposed in the FAQ of 18 May 2010:

p.20, question 32 “How should accruals be treated in the NSFR? In the current text, it looks like accruals to receive and to pay cannot be netted and accruals to be received should be funded for the entire amount by LT funding”

Response: « Please report accruals on a net basis with net accruals to be received on line 249 “other income generating assets (eg. Minority interests)” Net accruals to pay can be reported on line 18 “all other liabilities and equity not reported above »

ASSET SIDE	LIABILITY SIDE
CURRENT TAX ASSETS	CURRENT TAX LIABILITIES
PREPAID EXPENSES - EMPLOYEE BENEFITS	DEFERRED INCOME - EMPLOYEE BENEFITS
INCOME RECEIVABLE - EMPLOYEE BENEFITS	ACCRUED EXPENSES - EMPLOYEE BENEFITS
PREPAID COMMISSIONS - FINANCIAL GUARANTEE RECEIVED - CUSTOMERS	DEFERRED FEES ON FINANCIAL GUARANTEE GRANTED - CUSTOMERS
PREPAID COMMISSIONS - FINANCIAL GUARANTEE RECEIVED - BANKS	DEFERRED FEES ON FINANCIAL GUARANTEE GRANTED - BANKS
FEES RECEIVABLE ON FINANCIAL GUARANTEE GRANTED - CUSTOMERS	ACCRUED FEES ON FINANCIAL GUARANTEE RECEIVED - CUSTOMERS
FEES RECEIVABLE ON FINANCIAL GUARANTEE GRANTED - BANKS	ACCRUED FEES ON FINANCIAL GUARANTEE RECEIVED - BANKS
OTHER INCOME RECEIVABLE	OTHER ACCRUED EXPENSES
OTHER DEBIT ADJUSTMENT ACCOUNTS	OTHER CREDIT ADJUSTMENT ACCOUNT
SETTLEMENT ACCOUNT ON SECURITIES TRANSACTIONS (ASSETS)	SETTLEMENT ACCOUNTS ON SECURITIES TRANSACTIONS (LIABILITIES)
OTHER SECURITIES TRANSACTIONS (ASSETS)	OTHER SECURITIES TRANSACTIONS
RECEIVABLES/CLEARING HOUSES	AMOUNT OWED TO CLEARING HOUSE
GUARANTEE DEPOSITS PAID - SECURITIES TRANSACTIONS (ACCRUED OPERATIONS) AND OTHER DEPOSITS	GUARANTEE DEPOSITS RECEIVED - SECURITIES TRANSACTIONS (ACCRUED OPERATIONS)
GUARANTEE DEPOSITS PAID - OTHERS	GUARANTEE DEPOSITS RECEIVED - OTHERS
SUNDRY DEBTORS	SUNDRY CREDITORS

V. Deposits

Definition of Operational Deposits

The EBF recommends a higher ASF factor for operational deposits i.e. 75% recognising their inherent stability, the identification process that must be undertaken to identify such deposits and the criteria which must be met. Meanwhile we also suggest the Basel Committee adopts a more simplified definition of operational deposits as described below:

An operational established relationship is met for non-maturing deposits if BOTH of the following two criteria are met:

1. *There is an operational relationship defined as the customer having account(s) in the bank that meet one of the two below criteria:*
 - *The remuneration of the accounts is below the wholesale funding costs for similar term.*
 - *Accounts on which material transactions are credited and debited on a frequent basis. Ideally, banks should be able to decide on its factors as “Material transactions” and “on a frequent basis” might mean different things to different business models. Different payments systems / process in different member states might lead to different ways of viewing entries through the accounts.*
2. *There is an established relationship if one of the two below criteria are met:*
 - *A minimum relationship duration of 1 year, **or***
 - *A minimum of 2 active products: money transmission account, e.g.: loans or deposits, off-balance sheet commitments, guarantees or delegated portfolio, derivative transactions, etc.)*

Benchmarks, definition and process for the assessment of the above criteria should be agreed between firms and their supervisors based on international guidelines.

Deposits from non-financial customers

EBF believes that the calibration of the ASF for non-financial clients should be based on further empirical data. The ASF factor of 50 % on funding with a residual maturity of less than one year provided by non-financial customers is unwarranted. The factor should be set higher in order to be in line with the actual stability of the funding which is clearly supported by historic data. This should certainly be reflected in a NSFR that is primarily meant to be a structural measure reflecting normal operation and where banks should have sound incentives to keep well diversified funding structures combined healthy loan-to-deposit ratios. It should be added that even under stressed situations, such as the recent financial crisis, experience demonstrated that corporate deposits were resilient due to strong underlying business relationships. A substantial proportion of corporate deposits are associated with core businesses, such as payment and settlement and custodial accounts.

When reviewing the appropriate ASF for deposits from non-financial customers we note that the following jurisdiction provided arguments, some backed by empirical evidence, which support the case for assigning a higher ASF for corporate deposits:

American Bankers Association (April 2010 response to Basel III, Liquidity): Moreover, we believe the run-off rates proposed are unduly conservative, even taking into account banks’ experiences in the recent financial disruptions. In fact, available data demonstrates that the run-off rates actually experienced by banks immediately prior to failure are much lower than those proposed in the CP. Deposit trends from 121 bank failures from 2008 and 2009 show that deposits actually increased at banks in the third and fourth quarters prior to failure, decreasing by 1.3 percent in the second quarter prior to failure and 2.1 percent in the last quarter prior to failure. The greatest decline in deposits – that is, the greatest rate of run-off – of any bank in the last quarter prior to failure was 17 percent. In particular, the degree of deposit runoff assumed for custodial deposits, corporate deposits, and deposits from financial institutions with well established relationships are excessive. Experience during

the recent market disruptions demonstrates that custodial and corporate deposits were resilient due to the stable, long-term nature of custodial deposits and strong underlying business relationships. A substantial proportion of financial institution deposits are associated with core businesses, such as payment and settlement and custodial accounts.

German Banking Industry Committee (21.03.2013. regarding hearing on higher outflows on retail deposits): *The challenge in general is that all historic data available do not indicate any unexpected or unmanaged outflow of deposits, even through the recent financial crisis...In Germany overall deposits increased.*

Austrian National Bank, Financial Market Authority and Ministry of Finance (April 2010 response to Basel III, Liquidity): *The low weights assigned to retail and corporate deposits as well as to wholesale-funding (non-maturing or residual maturity < 1 year) are unwarranted; large shares of household financial wealth are invested with non-bank financial intermediaries. To curtail the access of the banking system to these sources could be inefficient for banks and non-bank financial intermediaries. The weights should be reconsidered after a cost-benefit analysis based on the QIS data.*

In Annexes I and II the assumed cash-outflows from retail deposits are too high. During the crisis funds flowed from mutual funds and other non-bank financial intermediaries to the banking sector. For insured deposits the run-off rate should be less than 5 percent in LCR; the run-off rate for uninsured retail deposits should be 10 percent; that of unsecured wholesale funding by non-financial corporates 25 percent and that of other legal entities 50 percent.

The experience in Finland based on ECB data showed an overall increase in non-FI wholesale deposits from February 2007 from EUR17.500 to EUR 27.172million in February 2014 (based on ECB data)..

Norwegian FSA and the Central Bank of Norway (April 2010 response to Basel III, Liquidity): *Again we wish to stress the importance of deposits as a source of financing for Norwegian banks. The available stable funding (ASF) factors, which capture the share of each financing source assumed available in a stressed situation, will have to be considered with care. We are concerned that the ASF factors for deposits are too conservative.*

The EBF recommends that the BCBS looks in further detail at banks average quarterly deposit volumes from non-financial corporates to ascertain a more appropriate ASF factor for non-financial corporates.

VI. Secured Funding

Central bank funding

Banks may obtain cash from central bank operations by securing assets non-classified as HQLA. Until these discrepancies remain, i.e. until a central bank affirms that for those types of assets markets are not efficiently functioning (in other words until the RMBS markets will recover), a phase-in mechanism for NSFR should be granted, waiting for an adjustment of the markets on a “normal” scenario.

Unencumbered loans to banks

Where 0% RSF factors apply under Paragraph 29 (c) to 'unencumbered loans to banks subject to prudential supervision (including interbank placements) with residual maturities of less than 6 months'.

Can the BCBS clarify whether Bank (subject to prudential regulation) issuance of ECP is captured under this description and secondly whether a minimum rating is implied? The terminology unencumbered loans and interbank placements suggests (to a front office) cash loans rather than paper purchases hence the request for clarification.

The question arises when reading paragraph 31 which outlines 15% RSF factors for 'corporate debt securities (including commercial paper)...' with a credit rating equal or equivalent to AA-'. Commercial paper is specifically mentioned in paragraph 31 but not in paragraph 29. Where Bank's subject to prudential supervision issue commercial paper can the BCBS confirm it is covered by paragraph 29?

The monitoring instructions for the NSFR (row 67) seem to prescribe that commercial paper issued by banks has to be reported under loans to bank. Can the BCBS verify this?

VII. Short Term Loans

Loans maturing < 6 months (Par.32 e)

The intent of Paragraph 32(e) is of course to require long-term funding for unencumbered loans maturing under one year, but EBF Members are concerned that it will create cross-currents that will be difficult for banks to manage and perhaps cause unintended consequences.

Two types of effects can be foreseen.

- The abrupt 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.

But a 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.

- 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.

The result appears to EBF Members as an unintended consequence at the core of an intended consequence. There will clearly be an adjustment hurdle, which will affect all banks somewhat unevenly because of mix-of-business issues. Retail oriented banks, especially in Europe, are 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.

Example: The following example illustrates how rolling over unencumbered loans (excluding loans to financial institutions) creates a liquidity pocket which will not be used for lending.

Assumption: Loans are all unencumbered performing loans higher than RW 35% under Basel II Standardised Approach for credit risk.

(1) Day 0

	Asset	RSF		Liability	ASF	
1.5 Y Loan	100	85	1.5 Y Senior Debt	100	100	170 RSF, 200 ASF; NSFR=118%
1.0Y Loan	100	85	1.0Y Senior Debt	100	100	

(2 a) 9 months later (d=0 +9m)

	Asset	RSF		Liability	ASF	
9m Loan	100	50	9m Senior Debt	100	50	100 RSF, 50 ASF; NSFR= 50%
3m Loan	100	50	3m Senior Debt	100	0	

(2 b) 9 months later (d=0 +9m) + Pre-funding for rollover to get back to NSFR>= 100%

	Asset	RSF		Liability	ASF	
9m Loan	100	50	9m Senior Debt	100	50	100 RSF, 100 ASF; NSFR=100%
3m Loan	100	50	3m Senior Debt	100	0	
Cash	50	0	1.5 Y Senior Debt	50	50	

(3a) 14 months later (d-0 +14m), (i.e. 5 months from (2), Rolling over 50% of the loan)

	Asset	RSF		Liability	ASF	
4m Loan 100	50	42.5	4m Senior Debt 100	0	92.5RSF, 50 ASF; NSFR= 54%	
Matured loan	0	0	Matured Debt	0	0	0
1.5 Y Loan	50	42.5	1.1 Y Senior Debt	50	50	

(3b) 14 months later (d-0 +14m), (i.e. 5 months from (2), Rolling over 50% of the loan)

	Asset	RSF		Liability	ASF	
4m Loan	100	50	4m Senior Debt	100	0	92.5RSF, 100 ASF; NSFR=108%
Matured loan	0	0	Matured Debt	0	0	
1.5 Y Loan	50	42.5	1.1 Y Senior Debt	50	50	
Cash	50	0	1.5 Y Senior Debt	50	50	

In month 14, when the prefunding is actually used, there appears a new need to prefund the maturing 4 months loans that were matched funded and have fallen into the <6m bucket. Considering a 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.

Specific framework for Factoring

The current framework doesn't take into consideration explicitly the specific features of factoring business and consequently it could not be applied "as-is" to the specialised factoring companies.

Factoring financing is provided against **the sale of receivables** thereby directly connected to the real economy in which goods and services are fluently traded. Therefore, its implementation "as-is" could lead not only to a misleading result in terms of enhancing the bank system response to shocks but even to a detrimental effect on domestic and European economy growth, thus a result diametrically opposed to the intended goal of the Regulators.

Factoring is a low risk short term activity. Factoring companies only provide financing against the sale of receivables: this means that the **financing maturity is directly linked to the receivables due date**, normally under a 90 day period. It also means that the source of liquidity is the asset purchased by the factor. The Factor, by contract, shall be indemnified by the seller in case of non-payment by the debtors in relation to the sold receivables. Thanks to this contractual framework, there is a **two layer guarantee** that the factor will be paid back.

Moreover, financing to the seller is contracted on a flexible basis, providing leeway for the Factor to stop purchases without any advice in a deteriorated financial condition scenario.

NSFR does not fit because:

- **Factors do not collect deposits**; they can only borrow on the wholesale market. This would mean that under the current liquidity framework almost all the funding (except for regulatory capital and a limited amount of more than 1 year deposits) **financing the purchase of short term receivables will be weighted at a 0% rate**. Furthermore for factors owned by banking group, any specific relaxed weight is provisioned in order to reflect the lower risk profile of funding from Parent Company in comparison with other external counterparties.
- **The 50% run-off rate required for assets** with residual maturity less than 1 year towards almost all counterparties (except for banks) does not reflect the true liquidity risk of factoring (**the average duration of lending delivered by factoring companies is actually a short term one**).

Therefore we recommend a lower RSF weight for on-balance sheet factoring lending with residual maturity below 6 months in the range of 0-10% and an RSF in the range of 15-25% for drawn factoring transactions between 6-12 months in duration.

VIII. Other Comments

Consolidated Group Calculation

The most recent publication on the NSFR outlines the calculation for an institution, it would be useful if clarification could be provided in respect of the Group calculation. In particular, confirmation that the Group calculation is the sum of all entities with no restrictions or clarification on restrictions.

In order to get an accurate liquidity position at the Group level, we recommend that the intra-group transactions benefit from symmetrical treatment. For instance, a repo (or a derivative) transaction traded between two institutions belonging to the same Group should be neutral for the Group NSFR.

Callable instruments related to changes in market parameters

Current Regulatory liquidity framework states that “when determining the maturity of an equity or liability instrument, investors are assumed to redeem a call option at the earliest possible date. [...]”³

We observe that this treatment does not distinguish the specificities of the so-called “auto-callable” instruments, for which the exercise dates of call/put options is not related to the behavioural choices of issuers/underwriters, but rather to changes in market parameters to which the performance of the option’s underlying is bound.

When determining the maturity of these instruments we deem appropriate to consider (even subject to the National Competent Authority approval) the expected maturity expressed by market valuations, given that neither the investor nor the issuer have the possibility to influence the life of the product.

Deferred Tax Asset

Article 478 of CRR assists the Bank’s capital base by allowing for the phasing in of the Deferred Tax Asset deduction (DTA). Similarly, consideration could be given to phasing in the funding factor to be applied to the DTA for NSFR purposes in a consistent manner. Would the BCBS consider the phasing of the NSFR funding factor to be consistent with the jurisdictional approach to DTA for capital purposes? Furthermore, paragraph 22 (b) and 35 (c) refer to deferred tax liabilities and deferred tax assets respectively, but raise the question whether the required treatments for DTLs and DTAs are supposed to be applied on a net basis, i.e. after accounting netting, using the carrying amount. Unlike for derivatives, no netting is mentioned.

In addition, there is an inconsistency between 22(b) and 35(c) in that 22(b) refers to DTLs due as being treated at the nearest possible date on which such liabilities could be realised, whereas the reference to DTAs in 35(c) is silent as to the date of DTAs. This asymmetry does not correspond to the way such items are normally treated and gives rise to doubt as to what “carrying amount” was intended to be used. The comment at page 105 of the QIS is also ambiguous as to such netting.

While the general rule for the NSFR is to refer to the accounting carrying amount, the ambiguities noted above create doubts. The Committee’s guidance as to the interpretation of this point would be appreciated.

³ “Basel III: The Net Stable Funding Ratio” (chapter II, point A, paragraph 17) - BCBS Consultative Document as of January 2014.