



*European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken*

**EACB Comments
On the BCBS Consultative Document on Net Stable
Funding Ratio**

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Introduction

The EACB welcomes the opportunity to comment on the revised text of the Basel III framework on the Net Stable Funding Ratio (NSFR) from January 2014.

We believe that in some ways the current calibration of the NSFR better reflects the stability of refinancing, due in particular to two principles:

- long-term refinancing operations have a higher stability than short term funding;
- deposits from retail and SME customers are more stable than wholesale deposits for the same duration.

However, we believe that the text does not fully reflect these principles in relation to the specific role played by central institutions of cooperative banking networks. The cooperative liquidity systems proved their soundness throughout the crisis, confirming the stability of their deposit base. In these systems, local banks deposit their excess liquidity at the network's central institution, which then ensures the liquidity within the network. In this context we have some concerns in relation to the following issues:

- we support the Basel approach for the treatment of internal deposits within cooperative networks but we find that it should be more explicit (not in a footnote).

In particular, the extent of supervisory appreciation should be extended and take into account not only the law but also statutory provisions;

- we believe that deposits with maturities up to six months placed by Central Banks should find more recognition as stable funding. In cooperative banking networks' central institutions often perform operations with the National Central Bank for the whole network, as local banks generally do not have direct access to the National Central Bank. In this context, Central Banks' deposits with maturities up to six months, are an important liquidity management tool and they do not find recognition under the proposed framework;
- we believe that covered refinancing transactions (REPO) should find more appropriate recognition, based on the collateral used, as a source of stable funding.

Furthermore, we believe that some specific ASF and RSF factors envisaged in the framework require further calibration, in particular to prevent a detrimental impact on retail business activities. Among other issues, we believe that a 50% RSF to securitisations of high quality residential mortgages is excessive and that a 65% RSF should be assigned to the residential loans secured by a guarantee.



1. Reporting

We appreciate that the review of the NSFR has been carried out in the awareness of possible unintended consequences arising from the introduction of the ratio on the economy, with particular regard to the following aspects (para. 7):

- The impact on the retail business;
- The treatment of shorter term financing;
- The analysis of assets and liabilities with maturities below one year.

We presume that also reporting requirements, and related notes, will be adjusted on the basis on the new consultation paper, as envisaged to some extent under the instructions for the Basel III monitoring exercise from March 2014 (see page. 89, footnote 37). In fact, many of the effects of the amendments introduced can only be evaluated and identified on the basis of actual reported data. In our opinion, only by appropriate reporting it would be clear what consequences would arise from the proposed changes for both institutions and the real economy.

2. Cooperative banking networks and NSFR calibration

2.1 Treatment of deposits from local cooperative banks at central institutions

In recent templates for the Basel III monitoring exercise, deposits from local banks in cooperative networks at their central institutions, with a maturity of less than one year, received an Available Stable Funding (ASF) factor of 50%. This treatment would allow to recognise at least partially the stable funding nature of such deposits for the central institution.

This has been partially taken into account in the NSFR text. While such deposits would generally qualify for a 0% factor, Footnote 7 clarifies that *"at the discretion of national supervisors, a possible exception to this treatment is for stable deposits from cooperative banks that are required by law in some jurisdictions to be placed at the central organisation and are legally constrained within cooperative banking network as minimum deposit requirements."*

We believe that this exception should be recognised also for minimum deposits which are placed to the central institution in virtue of statutory provisions and not only by law. In fact, also statutory provisions, especially when approved by supervisors, may be not less binding.

In fact, in cooperative liquidity systems, the minimum deposits that local institutions are demanded to place at their central institutions, are crucial to allow an orderly liquidity management of the network and are an effective liquidity tool. Competent authorities should be allowed to recognise cooperative networks' internal deposits as stable funding depending on the legal provisions, on the basis of the nature of statutory obligations, and on the terms and conditions governing such deposits.



2.2 Refinancing operations with the Central Bank

Central institutions of cooperative networks are not only managing the liquidity system of the network. In many countries they are also a platform for the access of local/regional banks to the National Central Bank and for supporting central bank transactions of those regional local banks, which do not access the National Central Bank directly.

Cooperative central institutions, when performing their liquidity adjustment function, engage in a high volume of refinancing operations with the National Central Bank, ensuring a flexible management of liquidity in the network. A great portion of these operations have a maturity band up to six months, being primarily designed to respond flexibly to short-term liquidity fluctuations in the network.

Under the current text, however, the refinancing operations with the National Central Bank, both covered and uncovered, would be severely limited. In fact, covered refinancing operations with the Central Bank with an original maturity up to six months, do not receive an ASF factor of 50%. They would instead qualify for an ASF factor of 0%.

This seems to indicate a view from the Basel Committee that covered refinancing would not be extended by central banks during a crisis. While we do not see the rationale behind such position, this also contradicts the approach followed in the LCR framework. In his paper from January 2013, the Basel Committee explicitly envisages a 0% run-off rate for covered refinancing with the National Central Bank. The Committee, therefore, assumes that central banks would extend the covered short-term funding during a crisis, not depriving banks of liquidity.

The experience shows that a great majority of covered refinancing transactions (repo) with central banks, have maturities of less than six months, being performed especially to cover the intraday liquidity needs. Assigning a 0% ASF factor to maturities up to six months would lead to a situation where almost all covered refinancing transactions with the National Central Bank would no longer stand available to any extent as stable.

We understand that funding from central banks should be differentiated according to their nature of operational and non-operational deposits, in accordance with the LCR framework (Para. 93-104). According to the current framework only operational deposits, or unsecured funding with maturities over six months at the national central bank will receive a 50% ASF factor, as a stable source of funding. While we welcome the possibility for "operational" deposits to receive a 50% ASF factor, we see no reason for assigning a 0% ASF to "non operational" deposits from Central Banks, which have the same degree of stability under the LCR.

In some cases, moreover, the distinction between "operational" and "non-operational" can be difficult to assess for transactions with the National Central Bank. Furthermore, under the current framework, all funding from the National Central Bank with maturities below six months would receive an ASF factor of 0%. As refinancing from central banks



are usually placed "until further notice", these operations would no longer be eligible as a stable source of funding .

The proposed framework would result in a major negative impact for all secured and unsecured refinancing operations with central banks. They would no longer be accounted for the NSFR as stable funding. We believe that this is an unintended outcome of the proposed text, and that this can not be the result of the analysis carried out by the Basel Committee on intra-year maturities of the liabilities. We therefore request that both covered and uncovered refinancing with central banks with a maturity below one year receive an ASF factor of 50%.

This would also have the advantage of consistency, as this would align the assumed stability of such counterparties under both the LCR and the NSFR framework (under the LCR, Central Banks are treated as Corporates rather than as financial institutions).

3. Secured refinancing

3.1 Secured refinancing

The recent liquidity crisis has shown that the liquidity provision in the interbank market strongly depends on mutual trust. A lack of confidence does not have to be related to a specific counterparty but may reflect a general sentiment of market distrust.

In this context, the secured funding operations play an essential role for the diversification of liquidity management and rebuilding of market confidence. While this trend towards collateralised operations seems to be generally welcomed, it should not be outweighed by unfavourable treatment within the NSFR.

We believe, instead, that the NSFR should envisage an ASF category for "Secured borrowing and liabilities from other legal entities (including financial corporates and financial institutions)" for a maturity band up to six months with a 50% associated ASF factor. When the operation is secured with good collateral we can assume that it will be easily rolled over also in short time frames.

As an alternative we propose to adopt a specular approach to the one envisaged for the LCR, in order to strengthen the consistency of the two measures. Within the LCR framework, secured transactions receive a run-off rate based on the quality of collateral (para. 112-115): operations collateralised with level 1 assets receive a 0% run-off rate; operations collateralised with level 2A assets receive a 15% run-off rate; operations collateralised with level 2B assets receive a 50% run-off rate. In the same manner, the NSFR should envisage stable funding factors (ASF) based on the type of collateral with three rates for example of 100%, 85%, 50%, reciprocal to the run-off rates used in the



LCR, or calibrated in a similar and consistent way, and regardless of the counterparty or the maturity of the operation.

3.2 Reverse REPOs

The current NSFR rules for reverse repos are currently not symmetrical with the ASF from repos and neglect the funding potential from received HQLA collateral from reverse repos. It is impossible to migrate excess NSFR between banks by reverse repos on HQLA collateral, but reverse repo transactions even lead in total to a loss of NSFR for both banks.

In previous versions of the NSFR, repo transactions with financial institutions received a symmetrical treatment between assets and liabilities. Secured lending and secured funding under one year had both a 0% weight. Transactions with a maturity > 1 year had a 100% weight. It lacked taking into account the liquidity of the underlying collateral, and only considered the maturity of the repo transaction. For reverse repos >1year, it resulted in a worse treatment of those assets if compared to LCR.

The ratio did not differentiate between banks and other financial institutions, and was symmetrical in the treatment of repos and reverse repos.

The revised NSFR framework has not solved the issue of not taking into account the underlying collateral, and adds new inconsistencies:

- It differentiates banks from other financial institutions when looking at the 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 penalize non-banking financial institutions as a counterparty for the transactions.

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

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



4. On the treatment of specific ASF and RSF factors

4.1 Impact on retail business activities

We strongly support the higher ASF factors for both stable and less stable non-maturity deposits from retail and SME customers. Through the banking crisis these categories of deposits from individuals provided stable funding, and, supported by other post-crisis measures, the position of retail depositors is even stronger than before, so we welcome further recognition of the extra stability that results.

However, given that the used definition of SME (footnote 7 of the text) dates back to 2006, we believe that an update of the definition of SME is necessary. The sales threshold of €50 million should be adjusted for inflation and labour productivity, and be accompanied by other drivers to be taken into account. We propose a revised sales threshold of €60 million.

On the other side of the balance sheet, we support the lower RSF factors for unencumbered loans to retail and small business customers that do not qualify for a 35% risk weight. The ready monetisability of such loans through use as collateral for secured borrowing has recently been underlined through developments including the pre-positioning and acceptance as collateral of these assets at the central bank.

We do not support the attribution of a 50% RSF to securitisations of high quality residential mortgages, which find recognition also under the LCR, especially in comparison with the 15% RSF attributed to higher rated corporate debt securities, some of which may be quite illiquid even if highly rated. With regard to covered bonds, whose performance and liquidity has generally been recognised in Europe through the crisis we support a 15% RSF for covered bonds, while 50% is much too high for top quality RMBS.

4.2 Analysis of some RSF factors

We believe that the asymmetric treatment for financial counterparties' loans with a maturity below six months should be eliminated. Such asymmetry would be very detrimental to the REPO/reverse matched book activities and short selling positions hedged by reverse REPOs. If such asymmetry is maintained under the final text, it will lead to a reduction of activities impacting the liquidity of debt markets (and, notably, of sovereign debt market). We would also ask to clarify whether the 50% RSF factor also applies to the security deposits placed at CCPs.

With regard to the 50% RSF factor applied to "trade finance", we find that such requirement is too high for such short-term activities. It should be re-calibrated, also in order to avoid adaptation of such activities.

With regard to a 50% RSF applying to short-term debt securities (previously 0%), we support an alignment of the weighting factors applying to interbank loans and CDs with a



maturity below 6 months, in order not to penalize the liquidity of the short-term bank securities market.

Furthermore, a 65% RSF should be assigned to the residential loans secured by a guarantee and not only to the residential mortgage loans if they are of the same high credit quality ($RWA \leq 35\%$ under BII). If the 65% RSF factor is not recognized for these loans, the NSFR might considerably impact concerned institutions, introducing a level playing field issue.

We do not support the proposed rule for the maturity of liabilities (para. 17). We believe that it would be hardly possible for institutions to demonstrate that *“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.”* Secondly, this rule is not in line with the one that applies in the LCR.

Finally, we would appreciate a clarification on rules regarding the netting of derivative positions. In our opinion, extensive netting of derivative positions should be allowed (including MtoM and margin calls).

4.3 Funding instruments with triggers or options of extendable maturity

The current wording of the framework is not explicit on how to treat funding instruments with embedded options to extend maturity. In essence, funding instruments with a conditional option to extend maturity by 1 year or more should be regarded as stable funding because the effective maturity of the instruments exceeds one year. These instruments include bonds with soft bullets or bonds with a regulatory trigger that by law automatically extends maturity in case the refinancing auction fails (e.g. short term Danish mortgage bonds). Accordingly, wholesale funding instruments with these characteristics effectively eliminate the risk that short term disruptions to a bank’s funding sources will erode its liquidity position.

4.4 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.

We invite the Basel Committee to confirm and clarify 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.

4.5 Treatment of equities

Whilst there is a slight improvement over the current regime, we still have some difficulties in understanding the rationale for assigning an 85% RSF factor to exchange-traded equities and a 100% RSF factor to non-exchange-traded equities. In the LCR, certain equities are eligible for recognition as Level 2 assets; the fluctuations in value are covered by a 50% haircut. Equity markets regularly remain highly liquid; whilst not limited to, this became particularly evident during the recent crisis.

4.6 Treatment of derivatives

Under the revised NSFR perspective we have some remarks on the treatments of derivatives positions and related cash collateral paid/received as initial and/or variation margins.

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

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



According to point 22 c), also the treatment of derivatives shall be defined in the NSFR. According to the QIS template instructions, derivatives shall be considered in the NSFR on the basis of the supervisory netting rules. There should be a clarification that the liquidity impact of derivatives has to be reflected in the NSFR; thus, at least the collateral obtained and granted can be integrated into the derivatives position.

4.4 Analysis of sub-one year buckets

We support the additional granularity now proposed for liabilities under one year, with a proposed 50% ASF factor for certain funding sources with residual maturities between six months and one year. To treat all funding below one year as making no contribution to stable funding was in our view a mistake – the revised proposal provides incentives to raise funding for more than six months, rather than two or three months. It is also helpful that when medium term funding (such as a three year fixed term retail deposit product) approaches the final year maturity, there is no longer a “cliff edge”, with ASF dropping from 100% to 0% overnight as the residual maturity falls below 365 days. Distinguishing 6-12 months from 0-6 months does in our view provide sufficient granularity without excessive complexity.