

May 12, 2017

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision

Mr. Jürgen Janssens
Deputy Advisor
Prudential Policy
National Bank of Belgium

Ms. Li Wenhong
Deputy Director General
Policy Research Department
China Banking Regulatory Commission



Sent by email to: william.coen@bis.org; jurgen.janssens@nbb.be; liwenhong@cbrcc.gov.cn

Re: NSFR Future Funding Risk Alternatives

Dear Mr Coen, Mr. Janssens and Ms. Wenhong:

The Institute of International Finance (the “IIF” or the “Institute”) appreciates the close continuing attention on the part of the Basel Committee on Banking Supervision (“Basel Committee” or the “Committee”) and national authorities to the appropriate implementation of the Net Stable Funding Ratio (“NSFR”)¹. The IIF has long endorsed the goals of the Basel Committee in creating the NSFR to foster the better assessment of funding risks and promote funding stability.² However, the IIF believes there is ongoing need for cross-border dialogue regarding implementation alongside review of certain aspects of the framework on a global basis.

Specifically, the IIF, in concert with other organizations, has expressed to the Committee and national jurisdictions very significant continuing reservations regarding the impact of the NSFR on capital markets and other banking activities. After the 2014 consultation, the Committee introduced new provisions in the final published standard on which it did not consult and on which it has acknowledged that it did not have sufficient data to analyze.³ It is important, therefore, that the Committee continues to work with the industry to fully understand the implications of the standard on banking activity and examine the possibility of updating the framework to address outstanding issues.

In this regard, we continue to be particularly concerned by the 20% Required Stable Funding (“RSF”) add-on that applies to gross derivatives liabilities before the netting of posted collateral or derivatives assets.⁴

¹ Basel Committee on Banking Supervision, *Basel III: The Net Stable Funding Ratio*; October 2014

² IIF, GFMA, ISDA, TCH, ICMA Submission: *Consultative Document: Basel III, the Net Stable Funding Ratio*, April 11, 2014

³ Basel III Monitoring Report issued March 2015: “revisions adopted in the revised standard have not yet been incorporated into the NSFR data collection exercise”

⁴ As has been noted in previous correspondence, this measure was not included in any Basel NSFR consultative document prior to appearing in

We believe that it does not address some key elements of derivative pledge sensitivity and therefore cannot be practically translated into product pricing and trading actions. The size of a gross payable on a bank's balance sheet is not a good indicator of a firm's possible contingent funding requirements in a stress event, as it does not take into account either the collateral a firm is required to post to secure its derivative liabilities or the rehypothecable cash and liquid securities collateral a firm receives from other counterparties to secure its derivative assets. This will likely translate into an additional and sizeable funding burden that will ultimately impact end-users.⁵

Given the 20% RSF measure has never been fully assessed and impact tested, we believe it would be more appropriate to explore the possibility of adopting a measure that is more sensitive to future funding risk. As you will be aware, the industry has recently carried out a Quantitative Impact Study ("QIS") on potential alternatives to the 20% RSF add-on to assist in this analysis.⁶ In order to test alternative approaches, the QIS collected data on two different types of approaches for measuring future funding risk – modified versions of the Standardised Approach for Counterparty Credit Risk ("SA-CCR") and Historical Look-Back Approaches ("HLBA") – and compared the results against the Basel Committee measure based on a percentage of gross derivative liabilities.

The IIF agrees these different alternatives present strengths and weaknesses which require due consideration and these are outlined in detail in the attached QIS report (the "report"). As a result of the findings, using SA-CCR – an exposure measure designed for capital purposes – would not be appropriate for calculating future funding requirements for derivatives portfolios without substantial modifications and a substantive observation period. At the same time, HLBA with a high confidence interval is not consistent with the milder stress scenario of the NSFR compared to the Liquidity Coverage Ratio ("LCR") – as the NSFR is not a one-year LCR.

When considering an alternative methodology, we concur with the report that careful attention should be given to ensuring that alternative is non-volatile and predictable, as the long term funding strategy cannot be adjusted often. It should also be risk sensitive, proportionate to expected funding requirements and easily implemented in a manner consistent with the existing liquidity risk framework. The QIS makes clear that more work needs to be done in this regard to ensure the appropriate alternative is achieved.

Given the potential substantial impact this measure can have on derivative activities and end users, we encourage the Basel Committee to carefully review the findings of the QIS as an initial step. We also ask that the Committee continue their full engagement with industry on exploring additional alternative approaches for measuring future funding risk so the best result can be found to ensure well-functioning and liquid markets are maintained. Furthermore, we believe that these approaches should be further tested and monitored over sufficient time and open to public comment before they are adopted by the Basel Committee and at jurisdictional levels.

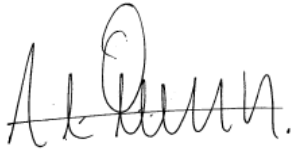
the final global standard and the industry did not have an opportunity to provide comment on it or review its potential impact.

⁵ According to an IIF, GFMA and ISDA NSFR QIS from 2015, the measure will result in an additional industry-wide funding requirement of €340 billion (\$377 billion) to be allocated to derivatives portfolios and will not only require unjustifiably large additional funding requirements, but an increased relative funding cost as the additional funding will need to be longer term and thus more expensive.

⁶ The QIS was prepared by the International Swaps and Derivatives Association ("ISDA") and the Global Financial Markets Association ("GFMA") and presented to the Basel Committee Secretariat and the Basel Committee Working Group on Liquidity on May 8, 2017. The QIS report is attached to this letter for ease of reference.

We look forward to further dialogue with you on this going forward. Should you have any questions, please do not hesitate to contact myself or Matthew Ekberg (mekberg@iif.com).

Very truly yours,

A handwritten signature in black ink, appearing to read "Andres Portilla". The signature is written in a cursive style with a large, prominent initial "A" and "P".

Andres Portilla