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August 5, 2016

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC—2104—0029; RIN 1557—AD97

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064—AE 44

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Robert deV. Frierson, Secretary
Docket No. R—1537; RIN 7100 AE-51

Re: Notice of Proposed Rulemaking – Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements

Ladies and Gentlemen:

The Institute of International Finance (the "IIF" or the "Institute") is grateful for the opportunity to provide feedback on the joint notice of proposed rulemaking of the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency (the "OCC") and the Board of Governors of the Federal Reserve System (and collectively, the "Agencies") which seeks to implement a net stable funding ratio ("NSFR") requirement in the United States ("the proposed rule").[1]

The IIF has long endorsed the goals of the Basel Committee on Banking Supervision (the "BCBS" or the "Committee") in creating the NSFR[2] to foster the better assessment of funding risks and promote funding stability.[3] Now that the NSFR is being implemented globally, the IIF continues to support its underlying policy objectives, including requiring banks to develop and maintain sustainable funding structures.

[1] 81 Fed. Reg. 35124 (June 1, 2016).

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

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

However, the IIF, in concert with other organizations, has expressed to the BCBS, the European Commission and other authorities very significant continuing reservations regarding the NSFR and its impact on capital markets and other banking activities. After the 2014 consultation, the Committee introduced a number of 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.[4] In this context, it is important that the Agencies carefully examine several issues of the NSFR as set out in the proposed rule if they do move forward with adoption of a longer term funding measure in the United States ("US").

First, in line with other commentators on this topic, the IIF believes that it is important that the NSFR – which is a new and untested regulatory standard – be subject to an appropriate monitoring and review period and should be carefully evaluated for its impact on activities and transactions where it would likely have excess effects or significant unintended consequences.[5] As part of this, we recommend that the Agencies undertake a comprehensive analysis to consider how banks allocate regulatory capital, funding and liquidity costs internally within their organizations, as required by BCBS standards.[6] NSFR deficits are more likely to arise in connection with capital markets activities than with commercial banking activities and, as a consequence, there is potential for the NSFR to contribute to further contraction of financial markets activity and increased financial market volatility. If the cumulative effects of NSFR and other requirements are not manageable, a bank will reduce its inventories, thereby contributing to impaired market liquidity. Less-liquid markets in turn will reduce issuers' access to investors through reduced participation, reduced efficiencies and increased costs.

The NSFR also cannot be read in isolation. As a single change in one rulemaking has knock-on implications throughout the regulatory framework, it is vital for all factors to be considered as the Agencies contemplate a major change to regulatory liquidity standards in the US. A holistic assessment of these interactions needs to be undertaken before new reforms are finalized.

Second, in order to mitigate potential negative impacts on capital markets, the IIF believes the Agencies should carefully review and rectify issues in the proposed rule for, *inter alia*, derivatives funding, securities hedging, securities market making, the asymmetrical treatment of repo and reverse repo, client and firm short coverage, segregated client assets, and off-balance sheet collateral swaps. We discussed specific recommendations for these types of transactions as they relate to the NSFR in our recent joint

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[4] Basel III Monitoring Report issued March 2015: "revisions adopted in the revised standard have not yet been incorporated into the NSFR data collection exercise"

[5] We specifically reference comments submitted on this notice of proposed rulemaking by The Clearing House ("TCH") and the Securities Industry and Financial Markets Association ("SIFMA") which contain recommendations on some of the most important technical areas for consideration by the Agencies as they review possible implementation of the NSFR in the United States.

[6] Basel Committee on Banking Supervision, *Principles for Sound Liquidity Risk Management and Supervision* (Sept. 2008), Principle 4, ('a bank should incorporate liquidity costs, benefits and risks in the internal pricing, performance measurement and new product approval process for all significant business activities (both on and off balance sheet), thereby aligning the risk taking activities of individual business lines with the liquidity risk exposures their activities create for the bank as a whole').

submission to the European Commission on its consultation for implementation of the funding standard in the European Union ("EU"). [7]

For example, owing to the punitive treatment of derivatives under the proposed rule, banks will likely be faced with billions of dollars in additional funding costs, which may impact the liquidity of derivatives markets. Asset managers, corporates and sovereigns could see costs associated with vital derivatives for risk management purposes increase significantly as a result of a higher funding requirement for banks.

In particular, the de-recognition of cash variation margin received (due to the look-through the leverage ratio netting criteria) for derivatives may force some end-users to rely on repo markets to create cash collateral, potentially increasing linkages and systemic risk, while exposing these end-users to unwanted liquidity risks. Moreover, diminished liquidity will also make it much more difficult for the market to absorb derivatives flow without leaving sizeable footprints.

In this regard, we are 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. The measure was not included in any BCBS NSFR consultative document prior to appearing in the final global standard and the industry did not have an opportunity to provide comment on it. We are uncertain how the BCBS developed the requirement and whether its impact is fully understood. 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.

We therefore believe it would be more appropriate to explore the possibility of adopting a measure that is more sensitive to future funding risk. Given the 20% RSF measure has never been fully assessed and impact tested, nor have any alternatives been adequately evaluated, we believe it is important that the Agencies defer the adoption of a measure until they have been able to fully assess and observe the potential impacts of different alternatives.

The proposed rule also impacts the ongoing viability of repo transactions, which play a vital role within the financial system and underpin the functioning of primary and secondary capital markets, in addition to the shorter-term money markets. More broadly, the repo market promotes the more efficient use of available tradeable stock for collateral management. Owing to the size of the repo market, small asymmetries in Available Stable Funding ("ASF") and RSF factors (e.g. 10- 15%) will have a very large impact.

[7] IIF,ISDA, GFMA Submission: *European Commission DG FISMA Consultation Paper on further considerations for the implementation of the NSFR in Europe,* June 24, 2016: https://www.iif.com/publication/regulatory-comment-letter/iifisdaafme-response-european-commission-consultation-nsfr

Lastly, the proposed rule impacts situations where banks facilitate client activities for key transactions, which in addition to derivatives include short facilitation (short proceeds receive 0% ASF but reverse repo coverage attracts 10—15% RSF), client clearing transactions and the holding of segregated client assets. The increased costs would challenge the economic viability of many client facilitating trades and introduce additional volatility.

The IIF believes that these areas should be carefully considered by the Agencies in their rulemaking process. In addition to the specific recommendations we have made to the Basel Committee and the European Commission on these points (as referenced above), we recommend the Agencies also carefully consider the detailed comments of TCH and SIFMA on the current notice of proposed rulemaking for options to address these issues in the proposed rule.

Third, we believe that implementation of the NSFR cannot be handled in isolation on a jurisdictional basis. International consistency remains vital. We encourage the US, as a member of the BCBS, to take the changes that result from the Agencies final analysis back to the Basel Committee to obtain the necessary revisions of the Basel NSFR so that a sensible NSFR that is appropriately targeted to its purposes can be implemented consistently on a global basis. Liquidity standards are very new compared to the approaches to capital requirements. We believe it is important that they be adjusted where necessary to find methods that are more reflective of the liquidity and funding risks that the international liquidity standards are attempting to address.

We thank the Agencies for considering our comments and the comments of other industry stakeholders in this process. We look forward to continued dialogue on these issues going forward. Should you have any questions, please do not hesitate to contact me or Matthew Ekberg (mekberg@iif.com).

Very truly yours,

David Schraa