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Basel Committee on Banking Supervision
Basel Committee of International Settlements
Basel, Switzerland

Basel 3 framework: outstanding issues on Basel III standards and processes

1. Opening remarks

1.1.1. The Global Financial Markets Association ("GFMA") members support the efforts of the Basel Committee on Banking Supervision ("the Committee") to establish a macro- and micro-prudential framework that details global regulatory standards on bank capital and liquidity. We acknowledge that the new standards will help protect financial stability and promote market confidence.

1.1.2. The publication of the global regulatory standards on bank capital adequacy - *Basel III: A global regulatory framework for more resilient banks and banking systems* ("BCBS 189") - and liquidity standards - *Basel III: International framework for liquidity risk measurement, standards and monitoring* ("BCBS 188") - on 16 December 2010 and the Annex to BCBS 189 on 13 January 2011 (together "Basel III package") helps to provide some more certainty for banks and their stakeholders. It will also serve as a platform for the supervisory and banking communities to take the necessary steps towards realising consistent and rigorous new capital and liquidity regimes.

1.1.3. We would like to use this opportunity to offer our remarks on the emerging prudential framework in relation to the Basel III package – Section 2 - and highlight where we are seeking clarity on the issues relating to the new Basel III measures and processes – Section 3.

1.1.4. Our remarks are supported by four detailed Annexes. GFMA members have been tracking the progress of the Committee's work and have analysed, for clarity of content and process, the Basel III package against the issues we have been monitoring. The outcome of this analysis is an updated list of industry issues in relation to the Basel III package. This list is provided in Annex 1 in the form of tables. Annex 2 provides further detail on the questions we have on the calculation of the Liquidity Coverage Ratio ("LCR"), while in Annex 3 we return to the outcomes of the Net Stable Funding Ratio ("NSFR") that we have already raised with the Committee in our previous letters. Annex 4 provides a view of some of the regulatory initiatives that will inform the emerging prudential framework.

1.1.5. GFMA members would also welcome clarification on any further work that the Committee is planning to undertake in relation to the Basel III package. It is unclear whether and to what extent the Committee will be developing more detail on the standards. We support and encourage the Committee to stay closely involved with the Basel III package as it is implemented to ensure international consistency. Although the main elements of the package have been finalised by the Committee, banks need clarification on important points of detail – in consultation with the industry as necessary - before Basel III enters into local legislative processes where interpretation may lead to divergences in

international application. In a similar vein, we also encourage the Committee to publish its response to the issues raised by GFMA in the attached Annexes in a dedicated FAQ section on its website, consulting with the industry as necessary.

1.1.6. We would like to work with the Committee on the continued development of the Basel III standards, particularly where these are being monitored before implementation.

2. Clarifying the emerging prudential framework

2.1.1. The work to introduce minimum global standards for measuring and controlling liquidity risk; raise the quality of the capital base; build greater buffers into the banking sector to withstand severe shocks; and ensure that high quality capital is present to absorb losses, has been completed. However, the Basel III package, albeit an important element, is only one of several elements of the Committee's overall reform programme.

2.1.2. Elements of the Committee's overall reform programme are still in progress and the end goal is unclear to the industry. The reform package includes initiatives relating to CCPs and the development of a macro prudential tool kit. There are also a number of initiatives aimed at the regulation and supervision of systemically important banks, where the Committee (in coordination with the FSB and other bodies – as summarised by Annex 4) is reviewing the appropriate capital and liquidity treatment of systemic banks, including whether an additional SIFI buffer is required. Also on-going is the work on permitting the countercyclical buffer (or any wider SIFI buffer) to be met with other fully loss absorbing capital beyond Common Equity Tier 1 and the form it would take (i.e. contingent capital in its broadest sense[1]). Our members are still debating the contribution contingent capital can make, although we are aware that a number of national regulators believe that there is indeed scope for such instruments. We would therefore urge the Committee to engage with the industry on this, which in turn should help to clarify the uncertainty concerning the components of non-qualifying Tier 1 and Tier 2 capital when the rights of conversion are exercised: potentially significant components of a bank's regulatory capital structure remain unclear, as does the operation of that structure[2].

2.1.3. Our members are concerned that a holistic approach to the creation of an overall prudential framework, in which the initiatives being brought forward will dovetail, is not being actively pursued by the regulatory community. The package of measures that will together form the overall prudential framework has a number of moving parts, so its cumulative impact is yet unknown. Absence of a prudential framework that takes into consideration prudential implications of other parts of the Committee's reform programme has the potential to hamper the efficient functioning of banks and the markets with which they interface and to foster further uncertainty at early stages of economic recovery.

2.1.4. Of particular concern to our members is the lack of any clarity regarding the interaction of the proposed reforms to the treatment of exposures to central clearing counterparties, contained in *BCBS 190 Capitalisation of bank exposures to central counterparties ("CCPs")*, with those supervisory regimes that have Pillar 1 or Pillar 2 requirements and limits for large exposures. Our members believe that

[1] We suggest that there is a need to adopt a common language to ensure that the industry and the regulators avoid any confusion when discussing financial instruments with contingent features

[2] Although our members may not agree with many points of detail of the 30 September 2010 *Swiss Final report of the Commission of Experts for limiting the economic risks posed by large companies,* the document offers a clear view of how instruments with contingent capital features might be considered within a bank's regulatory capital structure - the basis on which a bank (or indeed other financial and non-financial firms) may be deemed systemic - and how that structure operates

banks' concentrated exposures to CCPs (such concentration resulting from various legal and regulatory initiatives) should be permanently exempt from the large exposure limit and concentration risk capital requirements, so long as the applicable CCP is a Qualifying CCP and thus complies with the current and forthcoming CPSS-IOSCO recommendations for CCPs. Failure to adopt such an approach in the treatment of large exposures to CCPs would undermine the incentive effect that is otherwise being pursued. Given this public policy direction, it is an important component of the incentive structure that market participants should be able to rely upon CCPs and not be constrained by regulatory dictated limits on their necessarily concentrated exposures to them in such a way as to constrain their use.

2.1.5. There are also unanswered questions in relation to how large institutions will be regulated on a cross border basis, and the resolution frameworks that will apply to them, as well as how the Committee will link these with current work being undertaken in the US and in the EU on crisis management.

2.1.6. We therefore urge the Committee to provide further clarity on the work that is still being carried out by the Committee and other bodies (such as the FSB), as well as the broader framework in which this work is just one, albeit key, part. At this time, members would also welcome an assessment of the Basel III package in the context of the initiatives for wider reform so as to take account of the *total impact* on liquidity and capital requirements.

3. Clarification of key capital framework issues

3.1 Opening remarks

3.1.1. This section focuses on key capital issues that we wish to highlight as a result of our analysis of the Basel III package. We concentrate here on selected issues that are particularly important to the industry. Details relating to these and associated issues are itemised in Annex 1 (Table 1).

3.2. Definition of capital

Grandfathering

3.2.1. BCBS 189, in reference to the definition of capital, makes a number of important clarifications. Of particular importance are the grandfathering arrangements agreed for regulatory capital instruments. Although this clarification helps to create some certainty for banks, we remain unclear of the implications of the agreed arrangements and their interaction with parallel regulatory regimes at the national level. This is an area where we would like to see the Committee promote consistency.

Loss absorbency at the point of non-viability

3.2.2. We welcome the Committee's 13 January 2011 Annex, which is aimed at ensuring that non-common Tier 1 and Tier 2 instruments are loss absorbing. However, we seek clarity on the two alternative scenarios the Committee seeks to describe in paragraph 1 (*scope and post trigger instrument)* of the Annex.

3.2.3. Under one of the scenarios ("Scenario 1"), non-common Tier 1 and Tier 2 regulatory capital instruments issued are not required to include a contractual provision - that requires the instrument, at the option of the relevant authority, to be written o*ff or converted due to trigger eve*nt - because the governing jurisdiction of the bank has the requisite laws in place that ensure that (i) these instruments will be written off at the point where the firms is non-viable; or (ii) these instruments are required to fully absorb losses before taxpayers are exposed.

3.2.4. The alternative scenario ("Scenario 2") refers to those instances where contractual provisions in regulatory instruments are required because the requisite laws (described above) are not in place.

3.2.5. However, given that Scenario 2 requires the relevant authority to have the authority to exercise the option embedded in the contractual provision, it would appear that it effectively requires the relevant authorities to have the same powers as the authorities in Scenario 1.

3.2.6. It is important that the distinction the Committee wishes to draw between the two scenarios is clarified. This will help to enable banks identify which scenario applies to them.

3.2.7. In addition, further engagement with the industry will be important on how and by who 'peer group reviews' would be undertaken to confirm that a jurisdiction has in place the necessary laws. We assume that the peer review process referred to in the 13 January 2011 Annex is linked to the FSB's resolution initiatives identified in Annex 4.

3.3. Leverage ratio (LR)

3.3.1. The Committee's measure of leverage risk is just one method of measuring this risk. We support the transitional arrangements the Committee has put in place to assess the currently proposed design and calibration in reference to the full business cycle and different business models. We would encourage the Committee to treat leverage risk as a Pillar 2 risk to help minimise the effects of perverse incentives, which are inherent to a risk sensitive measure, and promote an informed dialogue between banks and supervisors on the nature of leverage risk.

3.3.2. Our members are concerned that disclosure of the leverage ratio is to be required before the parallel run is complete. We are concerned that any changes in a bank's leverage ratio associated with changes in the design and / or calibration, or indeed changes in bank specificities, introduced over the parallel run, may not be well understood by the market and other stakeholders. Disclosure may also in practice have the effect of restricting the capacity to make any changes considered to be necessary given lessons learnt in the parallel run: this would clearly be undesirable.

3.4. Counterparty measures - CVA

3.4.1. We acknowledge that the treatment of CVA has been clarified for the purposes of the Basel III standards, and we are aware that CVA is being discussed as part of the wider trading book review being undertaken through the Committee's working groups. We therefore seek clarification as to the process for implementing any changes and for taking into account the cumulative impact of the trading book review. In Annex 1 we list some of our CVA specific issues noting that this work is being led by ISDA.

3.5. Capital buffers

3.5.1. We welcome the Committee's clarification on the operation and timelines with respect to the capital conservation buffer (as per BCBS 189), as well as the publication of a separate *Guidance for national authorities operating the countercyclical capital buffer*. The latter clarified a number of questions in relation to the countercyclical buffer's objectives and release, and set out principles aimed at ensuring international consistency of its operation.

3.5.2. We note the Committee's view that the countercyclical buffer is only one in the suite of macro-prudential tools. However, our members would welcome further articulation of the full range of macro-prudential tools and how they would be

used, including the possible use of additional buffers for SIFIs and the use of contingent capital. We believe that more work needs to be done to evaluate alternative tools and the interaction of the countercyclical buffer with these tools.

3.5.3. We would like further clarification and assessment of the interaction between the countercyclical buffer and other parts of the Basel III framework (in particular but not limited to forward looking provisioning, use of through the cycle and downturn parameters in credit and market risk models in Pillar 1). Whilst we support the Committee's desire to protect the banking system from potential future losses by providing it with an additional buffer of capital we are nevertheless concerned about potential duplication of capital requirements.

3.5.4. We seek further clarity on the manner in which credit exposures are to be aggregated. Any approach adopted will give rise to potentially significant infrastructure requirements for banks (please see Annex I for further details), which may be unnecessary given other changes being introduced to address the procyclicality issue.

4. Clarification of key liquidity framework issues

4.1. Opening remarks

4.1.1. This section focuses on key liquidity issues that we wish to highlight as a result of our analysis of the Basel 3 standards. Again, as in section 3, these issues are only a short list of selected issues that are particularly important to the industry. Details relating to these and associated issues are itemised in Annexes 1 (Table 2), 2 and 3.

4.1.2. We recognise that the Committee has taken steps to address several of the issues we have raised in our letters to the Committee over the past year. Notable among these is a definition of liquidity lines and the inclusion - for a further 30 days - in the liquidity buffer of those assets that become ineligible owing to, for example, a ratings downgrade. We also appreciate the inclusion of transitional arrangements for the standards.

4.1.3. However, given the number of open issues we highlight below and in Table 2 - some of which are new and some of which remain unclear to us - we hope that the Committee will use the observation period to engage with the industry on these liquidity issues.

4.2. Liquidity Coverage Ratio (LCR)

4.2.1. Our members have arrived at an understanding of how to compute the LCR both in terms of the calculation of the buffer in relation to the cap on the buffer and net outflows. A detailed exposition is contained in Annex 2 and central to this exposition is an understanding that (i) the computation of the cap is independent of the buffer calculation; (ii) the computation of the buffer is based on assets that can be realised on 'day one'; and (iii) computation of the net outflows is based on the sum of these flows over the next 30 days. If our interpretation of the relevant BCBS 188 text is correct we would like to further discuss with the Committee what (as per Sections 2 – 4 of Annex 2) behaviours may arise as a result of the LCR's design, the treatment of collateral swaps and the deterioration of the market value under asset received as collateral under a reverse repo.

Implications of the LCR for non-level 1 and non-level 2 assets

4.2.2. We are keen to understand the Committee's views on the potential economic impact of not recognising the marketability of assets such as equities or gold as part of the LCR's liquidity buffer (LCR's numerator) or their contribution to a firms liquidity as inflows particularly that a cap has been put in place on inflows. The current approach implies that for all assets outside the narrow liquidity buffer, as currently defined, it is not possible to generate any liquidity value within a 30 day time horizon, and that any associated financing requirements (e.g. equity repo) would have to be fully covered by liquidity buffer eligible assets. Our members are concerned that BCBS 188 treatment might drive the funding of such assets outside the banking sector, and reduce market liquidity in these asset classes.

Liquidity buffer operational requirements

4.2.3. We also request clarification from the Committee that where high quality assets are held by a trading business, but do not necessarily satisfy the additional operational requirements for the liquidity buffer, then inflows from such assets could be recognised to offset any associated funding outflows. An example would be where a government security is held to hedge an interest rate position, but such security could be financed on a secured basis without any adverse impact on the market risk hedge.

4.2.4. One of the implications of the operational requirements that has become clear to us is that a much greater proportion of corporate deposits will fall in the 75% run-off category than those that are typically managed by professional treasurers. This definition of operational relationship seems to relate to a disintermediated (banking) model and does not correspond to the way the banking industry engages with corporates in many jurisdictions. Moreover, the 50% roll-over rate for credit becomes inconsistent with a 75% run-off rate for deposits. We ask the Committee to let us know whether this difficulty is something that has been identified.

Cap on inflows

4.2.5. A new feature of the LCR is the cap on the inflows a bank can use to offset the outflows in the LCR's denominator. It is stated that the aim of the cap restricts banks from relying solely on anticipated inflows to meet their liquidity requirement (BCBS 188 para 107). We would like to understand why inflows are not regarded as having the same liquidity value as the ability to transform certain assets in cash and why such a low limit (75% rather than, say, 90%) was placed on the reliance on inflows.

4.2.6. Moreover, we suggest that some transaction types should be excluded from this rule, such as project finance and other kinds of business.

4.3. Net Stable Funding Ratio (NSFR) design and calibration

4.3.1. We appreciate that the transitional arrangements applying to the NSFR (with final revisions to be implemented by mid-2016) will allow the Committee time to adjust the NSFR's design so that this standard addresses the Committee's objectives and concerns but also gives a fair representation of the funding requirements of a bank's assets and funding provided by its liabilities. We ask the Committee to engage with industry on the design and calibration of the NSFR in a manner similar to that adopted by the Committee's Risk Management Measurement Group (RMMG) when it engaged with the industry on Credit Valuation Adjustment (CVA).

4.3.2. We are encouraged that the Committee will be addressing the cliff effects associated with the NSFR and evaluating the issues of matched term funding and providing incentives for term funding within a year. We continue to be concerned with the treatment of secured funding. For example, consider covered bonds when the available funding provided by these bonds drops to zero from 100% once the covered bond falls below one year, but the Required Stable Funding (RSF) for underlying mortgages require 65% - 100% funding. We seek confirmation that in the case of highly liquid assets used as collateral, as in the case of a public covered bond, with a maturity of less than a year, they would require an RSF of 5-20%. These issues are included in Annex 1 (Table 2) along with a number of design issues relating to the treatment of derivatives, repos and reverse repos under the NSFR.

4.3.3. On the issue of unintended consequences arising from the NSFR's design, we note that BCBS 188 continues to produce the same outcomes we discussed under the GFMA / BBA / ISDA Joint Industry response to BCBS 165. These examples and outcomes are illustrated in the attached Annex 3.

4.4. Harmonised liquidity reporting framework

4.4.1. GFMA continues to suggest that an international liquidity framework should be based on the development of a harmonised liquidity reporting framework. This is of particular concern given the same is implied for other liquidity monitoring tools presented in BCBS 188 and multiple reporting templates for multiple monitoring tools across multiple jurisdictions.

5. Concluding remarks

5.1.1. Our membership would welcome the opportunity to discuss with the Committee any of the issues highlighted in this letter. Our members continue to analyse and discuss the Basel III package, so we expect further issues to be identified as our work and thoughts progress. We hope to have a constructive dialogue on these as well.

Yours sincerely,

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The Global Financial Markets Association (GFMA) joins together the common interests of hundreds of financial institutions across the globe. GFMA's mission is to develop policies and strategies for global policy issue in the financial markets, thereby promoting coordinated advocacy efforts across its partner associations. GFMA is partnered with the Association for Financial Markets in Europe (AFME), the Asian Securities and Financial Markets Association (ASIFMA), and, in the United States, the Securities Industry and Financial Markets Association (SIFMA).

Annex 1: GFMA Position table on Basel III issues updated for BCBS 188 and 189

The Global Financial Markets Association ("GFMA") is pleased to attach our latest position tables updated for the Committee's 10 December 2010 publication of *Basel III: A global regulatory framework for more resilient banks and banking systems* ("BCBS 189"); *Basel III: International framework for liquidity risk measurement, standards and monitoring* ("BCBS 188"); and the 13 January 2011 Annex to BCBS 189.

The order of the tables in Annex 1 is as follows:

- Table 1: Positions on capital
- Table 2: Position on liquidity

Annex 1

Table 1: GFMA Basel III Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)				
Priority Rating (H / M / L)	**Issue name**	**GFMA position**	**Issue status**	**Cross reference Cross reference to previous correspondence**
		Systemic Risk and Interconnectedness		
H	1. Introduction of regulatory initiatives to define capital structures	• Seek clarity on how various regulatory initiatives relating to systemically important firms and recovery and resolution will, together with Basel 3, come together to inform how firms define their regulatory capital structures (and indeed their total capital structures) (BCBS 189 para 32 – 33)	• Open	• Section 2 (above)
		Cyclicality of Minimum Requirements		
H	2. Interaction of further micro prudential measures within the Basel 3 framework	• Seek clarity as to whether the Committee will consult further on how the capital conservation buffer and countercyclical buffer interact with micro prudential measures that address cyclicality through adjustments to the probability of default in the Internal Ratings Based approaches, Stressed Var and Stressed EPE	• Open	• Section 2 (above)
		Forward Looking Provisioning		
M	3. Forward looking provisioning: Valuation	• Note that IASB/FASB recently issued 'Financial Instruments: Impairment', a supplement to the exposure draft on amortised cost and impairment. Would be interested to know the extent to which the treatment proposed meets the Committee's aims in the area of provisioning	• Open	• No previous reference

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
M	4. Forward looking provisioning: Incentives	• Seek clarity on the incentives the Committee is addressing to support stronger provisioning in the regulatory framework (BCBS 189 para 23- 25)	• Open	• GFMA 16 April 2010 response to BCBS 164 (page 55)
Definition of Capital				
H	5. Capital: Non-Viability triggers - Non-Common Tier 1 and 2 instruments	• Seek clarity (in regard to the 13 January 2011 Annex published by the Committee) on the distinction the Committee is seeking to describe in regard to the powers of the authorities outlined. The first of these scenarios being where the governing jurisdiction of the bank has sufficient powers to write down non-common Tier 1 and 2 instruments. The second of these being where these powers are not deemed sufficient and contractual provisions (that amount to an embedded option that is to be triggered by the relevant authority) are required in these instruments. The ability of the relevant authority to exercise an embedded option in a regulatory instrument also requires that they have the authority to do so. The powers required in the second scenario appear to be no different from the first	• Update	• AFME 1 Oct 2010 response to BCBS 174 (highlights the key issues relating to regulatory capital instruments with non-viability triggers and in particular see para 13 to 17) • Section reference 3.2
H	6. Capital: Non-viability	• Need for information on how and by who peer group reviews will be undertaken to confirm that a jurisdiction has the necessary laws in place to allow the recognition of non-common Tier 1 and Tier 2 instruments (BCBS's 13 January 2011 Annex, para 1 (b))	• New	• Section reference 3.2
H	7. Capital: Grandfathering	• Need for clarity on how the provisions relating to the phasing out of instruments no longer qualifying as	• Open	• GFMA 6 Sept 2010 letter (para 2.1.3 and footnote 2)

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		non-common Tier 1 or Tier 2 (BCBS 189 para 94 g) interact with current provisions in other jurisdictions. • For example, the grandfathering provisions being envisaged for CRD 4 given that the grandfathering provisions in CRD 2 provisions extend to 31 Dec 2040 in respect to instruments issued before 31 Dec 2010		
H	8. Capital: Grandfathering - Cut-off date	• Additional Tier 1 or Tier 2 will be phased out from 1 Jan 2013 (BCBS 189 para 94 g and Jan 2011 Annex)	• Closed	• GFMA 15 Oct 2010 letter (para 8)
H	9. Capital: Capital amortisation of non-conforming Tier 2 instruments	• Seek clarification as to whether the reduction in the cap on non-qualifying capital should be calculated on a straight-line basis or using a different approach (BCBS 189 para 94 (g))	• New	• GFMA 1 Oct 2010 letter (para 27)
H	10. Capital: Capital grandfathering of former deductions from capital	• Seek clarification as to whether grandfathering will apply to 1250% risk weight treatment for items (including certain securitizations) that under Basel II were deducted 50% from Tier 1 and 50% from Tier 2 (BCBS189 para 90)	• New	• No previous reference
M	11. Capital: Minority interest	Seek: • An extension of the simple illustrative example on the treatment of minority interests. The treatment of minority interests (BCBS 189 para 62 – 65) is complex, so more complex examples would be helpful. Such examples should include the treatment of other legal entities in the group (including non-banks and those which are not regulated on a stand-alone basis but are still subject to consolidated supervision as part of the wider group), recognition of capital surpluses between subsidiaries (i.e. subsidiaries at the local level), and where the subsidiary is incorporated	• Update	• GFMA 6 Sept 2010 letter (para 2.2.1 – 2.2.2 page 3)

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		in a jurisdiction which has not implemented the Basel III standards		
M	12. Capital: Investments in financial institutions – Underwriting exposures	• Underwriting positions held for five working days or less (regardless if the bank owes more than 10% of the issued common share) are excluded (BCBS para 80 and 84)	• Closed	• GFMA 6 Sept 2010 letter (para 2.2.2, page 4)
M	13. Capital: Investments in financial institutions – Own shares	• All bank's investments in its own common shares will be deducted, (BCBS 189 para 78), although we note that no reference is made to synthetic positions so it is assumed that the treatment of these positions will be left to the local supervisor	• Closed	• GFMA 6 Sept 2010 letter (para 2.2.3)
M	14. Capital: Investments in financial institutions - Holdings in banking book and traded book	• Overall, the standards are now specified but we believe they are now overly complex and should be simplified • Furthermore, until additional clarity is provided, the rules may represent a material change to the December 2009 package. We question whether this was the intention of the Committee and believe an additional QIS exercise may be warranted to understand the impact, depending on the clarity provided. • In particular, we seek clarity relating to: - The extent to which long and short positions can be netted for the purpose of computing the regulatory adjustments applying to investments in banking, financial and insurance entities both where the bank does not own more than 10% and where it does own more than 10% (BCBS 189 para 80 and 84) - Can short positions in indices that are hedging long	• New	• No previous reference

Table 1: GFMA Basel III Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)				
Priority Rating (H / M / L)	**Issue name**	**GFMA position**	**Issue status**	**Cross reference Cross reference to previous correspondence**
		cash or synthetic positions be decomposed to provide recognition of the hedge for capital purposes? What value should be attributed when looking through a synthetic or an index security, for the purposes of calculating with the long or short component of the "net long position". For example, should delta-equivalents be used for non-linear products? - Whether CDS and TRS as synthetic positions count as the same amount of holdings in capital instruments as outright cash positions? Market value of notional to be used? Which of the following should be used: market value of notional, contract notional, contract notional adjusted for mark-to-market moves of the contract or other? - How to determine maturity of short position where short position is funded by rev repo? Is maturity settlement period (e.g. T+3) or the term of the rev repo or something else? - Cash equity position has indeterminate maturity so how can a short position have the same maturity such that offset can be achieved?		
M	15. Capital: Investments in financial institutions – Market making	• Seek an exemption for positions in financial entities that are held temporarily for market making	• Closed	• GFMA 6 Sept 2010 letter (para 2.2.4)
M	16. Capital: Investments in financial institutions – Computation of deductions	• Two limited recognition caps on threshold deduction items have been put in place • Both caps operate on (i) significant investments in common shares of unconsolidated financial institutions, as well as (ii) mortgages servicing rights,	• Closed	• GFMA 6 Sept 2010 letter (para 2.2.5 – 2.2.6)

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		and (iii) deferred tax assets that arise from temporarily differences. The first cap set at 10% of a bank's CET1 provides for limited recognition of the above three items. The second cap concerns the deduction that applies when in aggregate the three items exceed 15% of its CET1. The amount of the three items not deducted from CET are risk weighted at 250% (BCBS 189 para 87 – 89)		
M	17. Capital: Investments in financial institutions – 15% common equity limit	• Welcome the clarification of the limit structure (BCBS 189 para 87 – 89) but seek - Further clarification of the rationale of the cap of 15% (BCBS 189 para 88) that applies to three unconnected items – investments in unconsolidated financial institutions, mortgage service rights and deferred tax assets - - Confirmation of our understanding (BCBS 189 para 94c) that this aggregate amount above the 15% is to be deducted from CET1 by 1 January 2018 - Further clarification on the proportions required to be deducted in the event that the aggregate 15% has been exceeded but individual components are less than 10% (e.g. 9% DTA and 8% MSR) • Seek from the Committee further examples with different permutations to minimise possible interpretations of the text	• Update	• GFMA 6 Sept 2010 letter (para 2.2.7)
Leverage Ratio (LR)				
H	18. LR: Incentivising better risk management	• The BCBS measure of leverage risk is just one method of measuring this risk (BCBS 189 paras 153-167). We support the transitional arrangements the Committee	• Open	• GFMA 6 Sept 2010 letter (para 4.1.1 – 4.1.3)

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		has put in place to assess the currently proposed design and calibration in reference to the full business cycle and different business models. • Seek clarification as to whether the Committee will be reviewing the LR measure as one possible measure of leverage risk in a Pillar 2 context. A • Ask whether the Committee is reviewing the migration of the LR measure to Pillar 1 in 2018		
H	19. LR: Exposure measure - Regulatory balance sheet	• Note that BCBS states that the exposure measure for the leverage ratio should "generally follow" the accounting measure of exposure (BCBS 189 para 157), and (i) seek clarification regarding the treatment of items where accounting treatment is not possible (e.g. off balance sheet items) (ii) suggest that the approach be closely monitored during the transition period for any unintended consequences • Linked to issue #26	• Update	• GFMA 6 Sept 2010 letter (para 4.1.3)
H	20. LR: Exposure measure – Netting of loans and deposits	• Seek clarification of the rationale of not allowing the netting of loans and deposits (BCBS189 para 157) whilst allowing netting for derivatives (BCBS para 161) and repurchase agreements and securities finance (BCBS 189 para 159)	• New	• No previous reference
H	21. LR: Exposure measure – Netting of repo and reverse repos	• Seek clarification as to how repo netting should be calculated for the purposes of the leverage calculation • The standards indicate that accounting measures of exposure should be used to which netting rules based on Basel II should be applied (BCBS 189 para 159) • Seek clarification as to whether this includes the credit risk mitigation rules (i.e. that allow banks to offset a single repo's cash and securities legs), or can	• New	• No previous reference

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		banks only net the cash leg of one repo against the cash leg of another reverse repo, where both are covered under a single netting agreement with that counterparty? • Seek clarification whether this means repos where both legs are securities are ignored in the leverage ratio		
H	22. LR: Own funds measures - Calibration trade-off	• Welcome the clarification that the definition of own funds is based on the new definition of Tier 1 capital (BCBS 189 para 154) paras 52-56) and that data will be collected by the Committee during the transition period to track the impact of using total regulatory capital and CET1	• Closed	• GFMA 6 Sept 2010 letter (Annex 1 para 1.2.7)
H	23. LR: Linkages to other elements of the framework	• Recommend that the framework takes into account interlinkages and that: - The exposures to central counterparties and liquid assets in the numerator of the LCR be excluded from the leverage ratio	• Update	• GFMA 6 Sept 2010 letter (para 4.1.7)
H	24. LR: Disclosure and basis of calculation	• Welcome clarification has been provided on disclosure, processes and timelines (BCBS 189 para 166), but continue to underline that disclosure should not be required before the end of the parallel run. • Remain concerned that any changes in a bank's leverage ratio associated with changes in the design and / or calibration, or indeed changes in bank specific arrangements, introduced over the parallel run may not be well understood by the market and other stakeholders	• Update	• GFMA 6 Sept 2010 letter (para 4.1.6 and Annex 1 1.2.9) • GFMA 15 Oct 2010 letter (para 15)
M	25. LR: Repos and secured transactions	• Welcome the clarification on the regulatory netting for repos and secured transactions (BCBS 189 para	• Closed	• GFMA 6 Sept 2010 letter (Annex 1 para 1.1.1)

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		159)		
M	26. LR: Client money and assets	• Continue to seek clarification that client money or assets are excluded as these are ring fenced assets and would be returned to their owners in the event of failure (in the event that the LR exposure computation is based on an accounting balance sheet)	• Open	• GFMA 6 Sept 2010 letter (Annex 1 para 1.1.4)
M	27. LR: Securitisation	• Suggest that it is inappropriate to bring all securitisation transactions back on the balance sheet in the event that the LR exposure computation is based on an accounting balance sheet) • Note that the accounting and regulatory treatments for securitization are different in Europe but the same in the US (in reference to BCBS 189 para 159 which does not mention securitizations)	• Open	• GFMA 6 Sept 2010 letter (Annex 1 para 1.1.5)
M	28. LR: Clarification on the application of regulatory netting of derivatives	• Welcome the clarification on the application of regulatory netting of derivatives (BCBS 189 para 161)	• Closed	• GFMA 6 Sept 2010 letter (Annex 1 para 1.2.1 – 1.2.6)
M	29. LR: Off balance sheet credit conversion factors ('CCF')	• Note that for the purpose of calculating the leverage ratio BCBS states that a 100% CCF should be applied to off-balance sheet items and a 10% CCF should be applied to unconditionally cancellable items (BCBS 189 para 162 – para 164) • Seek clarification as to why a broader range of CCFs have not been included along the lines of the CCFs set out in BCBS107 (Basel II) paras 82-87 • Question the appropriateness of 10% CCF for commitments that are unconditionally cancellable at any time and recommend that the Committee revise the CCF in line with the treatment under Basel II	• Update	• GFMA 6 Sept 2010 letter (Annex 1 para 1.2.8)

Table 1: GFMA Basel III Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)				
Priority Rating (H / M / L)	**Issue name**	**GFMA position**	**Issue status**	**Cross reference Cross reference to previous correspondence**
		(BCBS107, para 83)		
Counterparty Risk Measures				
M	30. Cpty risk: CVA – Choice of models	• The Basel III CVA standards do not provide scope for firms using PD models to calculate CVA: the published CVA charges for each counterparty are based on one of the two formulae. The first (BCBS 189 para 98) applies to banks with the necessary regulatory model approvals and the second (BCBS 189 para 104) applies to all other banks. The former includes EE, credit spread and LGD parameters based on market instruments while the later includes EAD and external ratings • Given that CVA is being discussed under the wider trading book review, we ask whether the accommodation of PD models will be considered	• Open	• No previous reference
M	31. Cpty risk: CVA – Diversification benefit	• As part of the wider trading book review, recommend that further consideration is given to calculating diversification benefits in calculating the CVA market risk charge and that CVA charges are not calculated on a stand-alone basis	• New	• No previous reference
M	32. Cpty risk: CVA – Impacts on corporate exposures	• As part of the wider trading book review, recommend further consideration of the impact of CVA on corporates given that: – Regardless of the whether corporate exposures are hedged or not, the increased capital charge will result in increased costs to the corporate client – The impact of CVA is more pronounced for mid-size corporates and SMEs as they are not able to put up collateral to the same extent as large financial firms	• Open	• Currently under discussion with the Basel Committee's Risk Management Modelling Group (RMMG) • AFME 10 December 2010 letter to the Commission issue xxxi

Table 1: GFMA Basel III Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)				
Priority Rating (H / M / L)	**Issue name**	**GFMA position**	**Issue status**	**Cross reference Cross reference to previous correspondence**
M	33. Cpty risk: CVA – Max loss cap	• Similar to the max loss concept adopted in Basel 2.5, for clarification purposes we recommend specifically incorporating a cap to counterparty credit risk capital requirements such that the required cap does not exceed maximum loss	• New	• No previous reference
Capital Buffers				
H	34. Capital buffers: Capital conservation buffer - Operation	• Welcome the clarification of the operation of the capital conservation buffer (BCBS 189 para 129 – para 131)	• Closed	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 16)
H	35. Capital buffers: Countercyclical buffers – Level of cyclicality	• Welcome the transitional arrangements put in place for the countercyclical buffer regime although arguably the nine year transition period falls short of a full business cycle on which the countercyclical buffer should be calculated (BCBS 189 para 150)	• Closed	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 2)
H	36. Capital buffers: Countercyclical buffers – Macro-prudential toolbox	• Welcome the separate document "*Guidance for national authorities operating the countercyclical capital buffer*" (BCBS187 page 5) and in particular Principle 5 that highlights that the countercyclical buffer could be deployed in tandem with other macroprudential tools • Require further clarity on the interaction with and operation of additional macroprudential tools at disposal to the regulators	• Update	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 2)
H	37. Capital buffers: Countercyclical buffers – Interaction with other parts of the framework, including Pillar 2	• Continue to recommend that an assessment be undertaken of how countercyclical buffers will operate in conjunction with other microprudential measures being considered (e.g. forward looking provisioning, through the cycle and down turn	• Open	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 2)

Table 1: GFMA Basel III
Positions on Capital (updated for BCBS 189 and 13 Jan 2011 Annex)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference Cross reference to previous correspondence
		parameters in credit and market risk models in Pillar 1)		
H	38. Capital buffers: Countercyclical buffers – International consistency	• Welcome the statement that the aim of the countercyclical buffer (BCBS 187, page1 section 2) is to ensure that the banking sector in aggregate has the capital on hand to help maintain the flow of credit in the economy • Question the degree of its effectiveness as a moderating effect on the credit cycle, given that the operation of the buffer does not manage demand and banks are not the only providers of credit	• Update	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 3)
H	39. Capital buffers: Countercyclical buffers – Practicality / application	• Seek further clarity on the manner in which credit exposures are to be aggregated. Any approach adopted will give rise to potentially significant infrastructure requirements for banks. Consider a UK bank lending through its Paris branch to an Irish borrower to fund the purchase of a house in Spain. Is it envisaged that (BCBS 189 para 138) the exposure will be considered, for example, to arise in Spain where the property is located, or in Ireland where the borrower derives their income or in Paris where it is booked or the UK where regulatory capital requirements are applied	• Update	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 3)
H	40. Capital buffers: Countercyclical buffers – Release of the buffer	• Welcome the inclusion of Principle 4 in BCBS 187 (page 4) and note that it states that promptly releasing the buffer in times of stress can help to reduce the risk of the supply of credit being constrained by regulatory capital requirements	• Closed	• AFME / ISDA 25 November response to EU Consultation on countercyclical buffers (page 3)

Annex 1 (continued)

Table 2: GFMA Basel III
Positions on liquidity (updated for BCBS 188)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference to previous correspondence
Common Issues to Both Standards and/or One or More Monitoring Tools				
H	41. Reporting in the observation period: Basis	• Seek confirmation that reporting for the LCR and NSFR (BCBS 188 para 197) is to be, like the QIS, on a 'best efforts' basis, rather than on a 'materially accurate' basis. Our members accept that they will need to make significant investment firms in their reporting systems, but are concerned about the need to invest in continually changing templates over the monitoring period. Furthermore: – ask if the Committee might produce an official Basel III template that goes beyond the line items of the QIS – continue to suggest that the creation of a cross-border supervisory framework for liquidity risk should be based on the development of harmonised liquidity reporting framework	• New	• No previous reference
H	42. Reporting in the observation period: Frequency of reporting	• Seek clarity on the frequency of reporting in the observational period for the LCR and NSFR and whether it is expected that the LCR is to be reported monthly (or even daily in stressed situations) and the NSFR quarterly (BCBS 188 para 186) over the observational period • Given the trade-offs that arise between frequency and accuracy; we would like to understand the Committee's views on this trade-off in relation to reporting requirements	• New	• No previous reference
Liquidity Coverage Ratio (LCR)				
H	43. LCR: Central bank eligibility criteria	• Recognize that the BCBS wishes to avoid standards that put central banks in the position that they are lenders of first resort, but nevertheless note that the BCBS has stated that high quality assets should also ideally be central bank eligible for intraday liquidity needs	• Closed	• Update to GFMA 16 April 2010 response to BCBS 164 and 165 (page 75)

Table 2: GFMA Basel III
Positions on liquidity (updated for BCBS 188)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference to previous correspondence
		and overnight facilities in addition to being liquid in markets in stressed periods (BCBS 188 para 20 (a) para 38 and footnote 8) and, as such, central bank eligibility does drive liquidity in certain instruments		
H	44. Calculation of the LCR: Computation of liquidity buffer vs. computation of adjusted Level 1 and Level 2 assets	• In reference to Annex 2, seek confirmation of our understanding of how to compute the LCR both in terms of the calculation of the buffer in relation to the cap on the buffer and net outflows: – Seek confirmation that (i) the computation of the cap is independent of the buffer calculation; (ii) the computation of the buffer is based on assets that can be realised on 'day one'; and (iii) computation of the net outflows is based on the sum of these flows over the next 30 days – If the Committee can confirm the above, would like to discuss the behaviours that may arise as a result of the LCR's design, the treatment of collateral swaps and the deterioration of the market value under assets received as collateral under a reverse repo	• New	• No previous reference
H	45. LCR: Definition of the buffer – Level 1 vs. Level 2 liquid assets	Seek clarity on: • the process the Committee will be adopting over the observation period to test the ratings criteria and qualitative and quantitative criteria that is be applied to Level 2 assets (BCBS 188 42 - 43); • the process being adopted to further define subjective Level 1 criteria, particularly 'traded in deep and active repo or cash markets characterized by a low level of concentration' is also fairly subjective (BCBS 188 40 c); • whether the analysis of (i) and (ii) and/or designation of Level 1 and Level 2 assets will be undertaken by the Committee in conjunction with local supervisors; or solely regional and / or national supervisors; and /or whether third parties will be invited; and / or if banks will be asked to undertake the assessment of (ii)	• Update	• GFMA 3 Sept 2010 Annex

Table 2: GFMA Basel III
Positions on liquidity (updated for BCBS 188)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference to previous correspondence
H	46. LCR: Recognition of a wider range of assets	• Remain disappointed that the Committee has not allowed a wider range of assets [with proven liquidity] (e.g. gold and equities) in the liquidity buffer beyond the Level 1 and Level 2 assets identified in BCBS 188 or allow them to be recognized in the computation of net outflows • Keen to obtain clarity on the Committee's views on the potential impact of this exclusion of a wider range of assets in the liquidity buffer given the (i) impact this exclusion might have on these assets in terms of driving their funding outside of the banking sector and (ii) the requirement (BCBS 188 para 41) that any institution should be well diversified in terms of assets, type of issue, and specific counterparty or sector	• Update	• GFMA 16 April 2010 response to BCBS 164 and 165 (recommendation x, page 75 - 80)
H	47. LCR: Level 2 liquid assets and covered bonds	• Remind the Committee of our proposed approach for assessing liquidity of covered bonds (as outlined the GFMA 3 September letter to the GHOS). It is similar to the approach used by the ECB and we would extend the definition of covered bonds to structured covered bonds • Note that the inclusion of Fannie Mae and Freddie Mac paper in the definition of PSE, as a Level 1 asset, gives support to the US mortgage market. In contrast, the EU covered bond market is only recognizes as a Level 2 asset so it is not supported in equivalent manner • As a further remark in relation the definition of PSE, we understand the definition of PSEs to be as covered by BCBS 107 para 58 – 58 and footnotes 22 – 23 and seek confirmation that this definition will apply to the Basel III framework	• Update	• GFMA 3 Sept 2010 letter (para 2.3.3 – 2.3.5 and Annex 1 including recommendation box at the end of para 1.2.10)
H	48. LCR: Asset held as funding at less than 30 days	• Seek clarification, with reference to BCBS 188 para 85, whether for the purposes of the LCR - (as it appears to be the case for the NSFR (BCBS 188 para 132) although defined in terms of less than a year) - that when the residual maturity on a public covered bond (or similar secured funding transaction on a pool of collateral assets in the form of traded securities) drops to less than 30 days (counting as an outflow	• New	• No previous reference

Table 2: GFMA Basel III
Positions on liquidity (updated for BCBS 188)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference to previous correspondence
		under the LCR), that the assets held as collateral in the covered pool can be included in the liquidity buffer subject to the factors given in BCBS 188 para 87, and that the assets satisfy the criteria in BCBS para 40 and 42 respectively. In the case of other assets held as collateral (e.g. mortgage loans collateralising a mortgage covered bond) we assume that inflows are considered in the denominator as per para 105, considering the respective roll-off factors given by BCBS 188 para 113 - 114		
H	49. LCR: Operational requirements – restrictions	• Welcome the clarity on the operational requirements relating to the LCR but remain disappointed by the restriction that 'the stock of liquid assets should not be co-mingled with or used as hedges […] and should be managed with the clear and sole intent for use as a source of contingent funds" (BCBS 188 para 26, 28 and 33). The apparent implication of this restriction is that unencumbered assets in the trading book at day end are not eligible for inclusion in the buffer (or even as in the LCR denominator) and we would like confirmation that this is the case • Seek clarification that the roll-over assumptions for assets financed on a secured basis are determined with reference to the underlying asset quality only, and not additionally linked to the broader operational requirements of the liquidity buffer (e.g. a sovereign bond repo that is part of the trading business) • Welcome the clarification that a bank is permitted to hedge price risks associated with the stock of liquid assets and while we recognise that the cash outflow associated with a hedge should be taken into account, we seek clarity as to that the inflows from the hedge can be counted (BCBS 188 para 28)	• Update	• GFMA 3 Sept 2010 letter (para 2.3.1 – 2.3.2)
H	50. LCR: Operational requirement	• Express concern that one of the implications of the operational requirements is that a much greater proportion of corporate deposits will fall in the 75% run-off category than those that are typically	• New	• No previous reference

Table 2: GFMA Basel III
Positions on liquidity (updated for BCBS 188)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference to previous correspondence
	s - corporates	managed by professional treasurers. This definition of operational relationship seems to relate to a disintermediated (banking) model and does not correspond to the way the banking industry engages with corporates in many jurisdictions. Moreover, the 50% roll-over rate for credit becomes inconsistent with a 75% run-off rate for deposits		
H	51. LCR: Cap	• Seek clarity as to why inflows are not regarded as having the same liquidity value as the ability to transform certain assets into cash and why such a low limit (75% rather than, say 90%) was placed on the reliance on inflows (BCBS 188 para 50) • Suggest that some transaction types should be excluded from this rule, such as project finance and other kinds of businesses	• New	• No previous reference
H	52. LCR: Treatment of liquidity lines	• View as unrealistic the 100% drawn factor to be applied to undrawn committed liquidity facilities to non-financial corporates and are concerned about the impact on the capacity of these corporates to refinance • Continue to monitor how definition of the liquidity line (which we welcome) will operate in the observational period (BCBS 188 para 93 – 95)	• Update	• GFMA 3 Sept 2010 letter (para 2.2.6 – 2.2.10)
M	53. LCR: Treatment of operational balances	• Note the asymmetric treatment of operational balances (25% outflow factor applied to deposits and 0% inflow assumption for the depositing bank), and welcome the accommodation of deposits with service providers in the framework, and seek clarity on how the determination of service providers will be made (BCBS 188 para 72 – 78*)*	• Update	• GFMA 3 Sept 2010 letter (para 2.2.2)
L	54. LCR: Jurisdictions without sufficient level 1 assets	• Welcome the 26 July 2010 announcement that the Basel Committee would be developing standards for jurisdictions with insufficient Level 1 assets • In order to keep level playing field across jurisdictions and to avoid the multiple side effects of the building of huge government bond portfolios in bank balance sheets, we encourage the Committee to	• Update	• GFMA 3 Sept 2010 letter (para 2.3.4)

Table 2: GFMA Basel III
Positions on liquidity (updated for BCBS 188)

Priority Rating (H / M / L)	Issue name	GFMA position	Issue status	Cross reference to previous correspondence
		adopt Option 1 (BCBS 188 para 47)		
Net Stable Funding Ratio (NSFR)				
M	55. NSFR design: Counter-intuitive outcomes	• Continue to seek engagement on the design and calibration of the NSFR noting that that BCBS 188 (see Appendix III) does not address the counter intuitive outcomes produced by the Committee's December 2010 proposal BCBS 165	• Open	• GFMA 3 Sept 2010 letter (para 3.1.2 – 3.2.5) • GFMA 16 April 2010 response to BCBS 164 and 165 (page 85 and 86) • Annex 3
M	56. NSFR design: Cliff effects	• Although the Committee is seeking to evaluate the treatment of match funded assets and liabilities and is seeking to provide incentives for term funding within a year (BCBS 188 para 134), the cliff effects associated with the NSFR remain a concern for our members • Seek confirmation that in the case of highly liquid assets used as collateral as in the case of a public covered bond, with a maturity of less than a year, they would require an RSF of 5-20% (BCBS 188 para 132)	• Update	• GFMA 3 Sept 2010 letter (para 3.2.2)
M	57. NSFR design: Treatment of repos and reverse	• Seek clarity on the treatment of repos and reverse repos. It would appear that repos will attract an RSF of the underlining asset received at the maturity of the transaction while reverses will attract 0% as cash is received (BCBS 188 para 131)	• Open	• GFMA / BBA / ISDA joint industry response to BCBS 164 and 165 (page 88)
M	58. NSFR design: Loan secured by a reverse repo	• Seek clarity (in relation to the components of the 0% RSF factor) as to the meaning of 'unencumbered securities held where institution has an offsetting reverse repurchase transaction when the security on each transaction has the same unique identifier (BCBS 188 Table 2)	• New	• No previous reference
M	59. NSFR design: Treatment of derivatives	• Seek clarity on the treatment of derivatives and suggest that any review of the design of the NSFR requires a full discussion – It would appear that under the NSFR derivatives fall into the 'all other liabilities' 0% ASF bucket and 'all other assets' 100% RSF bucket implying that they have no value as a source of stable	• Open	• GFMA / BBA / ISDA joint industry response to BCBS 164 and 165 (page 88)

Table 2: GFMA Basel III Positions on liquidity (updated for BCBS 188)				
Priority Rating (H / M / L)	**Issue name**	**GFMA position**	**Issue status**	**Cross reference to previous correspondence**
		funding and require 100% support – Suggest that there is a need to differentiate between different types of derivative transactions – Seek clarity as to whether the full netting of market values is allowed as indicated in the Committee's 18 May 2010 *Frequently asked questions on the quantitative impact study* and allowed under the LCR (BCBS 188 para 88)		
M	60. NSFR design: New counterparty groups	• Seek clarity in relation to the additional counterparties that are now included in the RSF category of 50% whether overnight deposit facilities will attract a 50% RSF (BCBS 188 Table 2)	• New	• No previous reference
Monitoring Tools				
M	61. Contractual mismatch: Capturing net outflows > 30 days and < 1 year	• Seek clarity as to whether the Committee will recommend time bands for which contractual mismatch information is reported that considers potential bank outflows occurring between 30 days and under 1-year (i.e. the LCR already takes into account outflows LCR under 30 days and the NSFR is concerned with changes in funding 1-year and beyond)	• New	• No previous reference

Annex 2: Computation of the LCR and issues arising

The Global Financial Markets Association ("GFMA") is pleased to attach examples illustrating our understanding of how the Liquidity Coverage Ratio ("LCR") is to be computed. These examples raise a number of issues and are based on our interpretation of the Committee's 10 December 2010 *Basel III: International framework for liquidity risk measurement, standards and monitoring* ("BCBS 188").

Annex 2 is organised as follows:

- Introduction to Sections
- Section 1: Interpretation of LCR and cap calculations applying to repo / reverse repos on a case-by-case basis
- Section 2: Interpretation of LCR and cap calculations applying to repo / reverse repos on a portfolio basis
- Section 3: Interpretation of LCR and cap calculations applying to repo / reverse repos for collateral swaps
- Section 4: Interpretation of the treatment of a deterioration in the market value of an asset received as collateral under a reverse repo

Annex 2

Introductory remarks – overview (following comments in Annex 1 Issue #43)

Based on our interpretation of BCBS 188 GFMA has constructed a series of examples that look at the computation of the LCR. All paragraph references in this Annex refer to BCBS 188 unless stated otherwise.

We have used a building block approach to help illustrate the calculations that require confirmation and also outline questions we would like to raise directly with the Committee for discussion. Our simple illustrative calculations are embedded within this Annex and split into four sections. In general terms:

- Section 1 looks at sixteen independent repo and reverse repo computations and the calculation of the LCR (in terms of its components and the cap on the buffer).
- Section 2 utilises the cases identified in Section 1 and considers the LCR in terms of a changing portfolio of assets
- Section 3 again utilising the cases set out in Section 1 considers the treatment of collateral swaps
- Section 4 looks at the particular question of how to deal with the deterioration of an asset received as collateral under a reverse repo for a secured funding transaction of less than 30 days

Section 1 – in detail

Example repo, reverse repo and collateral swap calculations in terms of the Liquidity Buffer and Liquidity Buffer Cap

Column A	Column B	Column C	Column D	Column E	Column F	Column G	Column H	Column I	Column J	Column K	Column L	Column M	Column N	Column O	Column P
					Counterparty A (original owner of 'asset pledged as collateral')						Counterparty B (original owner of 'asset received')				
case	mirror case	Asset received by CP A	Asset pledged as collateral to CP B		Liquid Buffer Asset (before Transaction) assume asset is term funded	Liquid Buffer Asset (after Transaction)	Cash Inflow (+ve)/ Cash Outflow (-ve)	Adjusted Level 1	Adjusted Level 2		Liquid Buffer Asset (before Transaction) assume asset is term funded	Liquid Buffer Asset (after Transaction)	Cash Inflow (+ve)/ Cash Outflow (-ve)	Adjusted Level 1	Adjusted Level 2
						used for LCR ratio		used for cap calulation only				used for LCR ratio		used for cap calulation only	
1		100 Cash	100 Level1		100 Level1	100 Cash	0	100	0		100 Cash	100 Level 1	0	100	0
2	9	100 Cash	100 Level 2		85 Level 2	100 Cash	-15	0	85		100 Cash	85 Level 2	15	100	0
3		100 Cash	100 illiquid (CP=PSE)		none	100 Cash	-25	0	0			role of counterparty B not applicable for banks			
4	13	100 Cash	100 illiquid		none	100 Cash	-100	0	0		100 Cash	none	100	100	0
5		100 Level 1 Asset	100 Cash (Level1)		100 Cash (Level1)	100 Level 1	0	100	0		100 Level 1 Asset	100 Level 1	0	100	0
6	9	100 Level 1 Asset	100 Level 2		85 Level 2	100 Level 1	-15	0	85		100 Level 1 Asset	85 Level 2	15	100	0
7		100 Level 1 Asset	100 illiquid (CP=PSE)		none	100 Level 1	-25	0	0			role of counterparty B not applicable for banks			
8	13	100 Level 1 Asset	100 illiquid		none	100 Level 1	-100	0	0		100 Level 1 Asset	none	100	100	0
9	2	100 Level 2	100 Cash (Level1)		100 Cash (Level1)	85 Level 2	15	100	0		85 Level 2	100 Level 1	-15	0	85
10		100 Level 2	100 Level 2		85 Level 2	85 Level 2	0	0	85		85 Level 2	85 Level 2	0	0	85
11		100 Level 2	100 illiquid (CP=PSE)		none	85 Level 2	-10	0	0			role of counterparty B not applicable for banks			
12	14	100 Level 2	100 illiquid		none	85 Level 2	-85	0	0		85 Level 2	none	85	0	85
13	4	100 Illiquid	100 Cash (Level1)		100 Cash (Level1)	none	100	100	0		none	100 Level 1	-100	0	0
14	12	100 Illiquid	100 Level 2		85 Level 2	none	85	0	85		none	85 Level 2	-85	0	0
15		100 Illiquid	100 illiquid (CP=PSE)		none	none	0	0	0			role of counterparty B not applicable for banks			
16		100 Illiquid	100 illiquid		none	none	0	0	0		none	none	0	0	0

Section 1 covers sixteen independent case studies developed to obtain confirmation from the Committee of our understanding of the LCR calculation (in terms of its components and the cap on the buffer) in relation to simple repo and reverse repo transactions.

Section 1 looks at the calculation of the:

- Assets in liquidity buffer that can be realised on day 1 (para 39 – 42);
- Cumulative net cash flows over next 30 days (para 85- 87 and para 108 - 109);
- Adjusted level 1 and level 2 assets determining the calculation of the cap (para 35 – 37 and para 41).

Each case study is numbered in column A and, as mentioned above, is independent of the other. All sixteen cases, however, are conceptually the same and follow the same approach so we only take a close look at case 1 (and a high level view of case 2) noting that, where it is relevant, column B identifies the corresponding mirror case (where appropriate); for example, the mirror of case 2 is case 9.

Case 1 – Counterparty A:

- The buffer computation
  - At the start, counterparty A has 100 units of level 1 assets on its books
  - Then on day 1, counterparty A enters into a repo agreement under which it receives 100 units of cash (Column C) and delivers level 1 assets worth 100 to counterparty B (Column D)
  - In terms of the buffer, prior to this transaction, Counterparty A level 1 assets of 100 (Column F, as per para 40) and after the transaction this is replaced with 100 of cash (Column G – numerator). This post-transaction amount is what will be included in the numerator of the LCR calculation
- Net cash outflows:
  - Over the next 30 days the cash outflows amount to zero (Column H – denominator) as the repo is in relation to a level 1 asset (i.e. 100 x 0% is added to the cash outflows as per para 86 and 87)
- Adjusted level 1 and level 2 assets:
  - If the transaction was unwound, then counterparty A would be left with 100 units of level 1 assets as recorded in Column I. Columns I and J track adjusted level 1 and level 2 assets used in the calculation of the 40% cap (para 36 – 37) but not the buffer

Case 1 – Counterparty B:

- Columns L, M, N, O and P show the corresponding position for Counterparty B in relation to the liquid buffer asset, total net cash flows over the next 30 calendar days (para 108–109) and adjusted level 1 and 2 assets (para 37)

Case 2 – Counterparty A

- Case 2 is like Case 1 except that counterparty A starts with 100 units of level 2 assets on its books. This leaves it with a buffer (Column F) of 85 (para 42) to start. On day 1 it then repos out the level 2 assets for cash, leaving it with a buffer of 100 (Column G). Net cash outflows amount to 15 over 30 days on the returning level 2 asset (para 86 - 87). The adjusted level 2 assets is 85 (para 37) and the haircut applied under para 42

Cases 3,7,11 – roll-over assumptions

- We draw your attention to cases 3, 7 and 11. Currently the adjusted level 1 and 2 assets (Columns I and J) for these cases are shown in our example as being zero because we were unclear on the roll-over assumptions applying for the purposes of calculating the cap
- We would like to discuss the underlying treatment with the Committee

Section 2 – in detail

Example calculation of Buffer Assets and Buffer Cap and LCR

Bank's position as CP A:

	Asset received by CP A	Asset pledged as collateral to CP B	Liquid Buffer Asset (used for LCR ratio)		Cash Inflow (+ve)/ Cash Outflow (-ve)	Adjusted Level 1 (used for cap calulation only)	Adjusted Level 2	
Cashoutfows	any deals				-1600			
Cashinflows	any deals				1300			
Outright	100 Illiquid		none		0	0	0	
Outright	200 Level1		200 Level 1		0	200		
Outright	100 Level 2		85 Level 2		0	0	85	1875
Case 9	100 Level 2	100 Level 1 Asset	85 Level 2		15	100	0	1200
				370	-285	300	85	93%
		LCR (without inflow cap)			130%			
		LCR (with 75% inflow cap)		LCR in Breach !	93%			
		Cap = Adj(L2) / [(Adj(L1) + Adj(L2)]					28%	

Repo out the illiquid security vs a level 1 asset:

	Asset received by CP A	Asset pledged as collateral to CP B	Liquid Buffer Asset		Cash Inflow (+ve)/ Cash Outflow (-ve)	Adjusted Level 1	Adjusted Level 2	
Cashoutfows	any deals				-1600			
Cashinflows	any deals				1300			
Case 8	**100 Level 1 Asset**	**100 Illiquid**	**100 Level 1**		**-100**	**0**	**0**	
Outright	200 Level1		200 Level 1		0	200		
Outright	100 Level 2		85 Level 2		0	0	85	1875
Case 9	100 Level 2	100 Level 1 Asset	85 Level 2		15	100	0	1200
				470	-385	300	85.2833333	118%
		LCR (without inflow cap)			122%			
		LCR (with 75% inflow cap)		LCR in Line !	111%			
		Cap = Adj(L2) / [(Adj(L1) + Adj(L2)]					28%	

Section 2 now looks at the LCR and its cap in terms of a portfolio of assets and changes to that portfolio, whilst bringing in Cases 8 and 9 outlined in Section 1 in conjunction with outright positions and deals on the existing book.

The purpose of this section is to show the potential inconsistent treatment of assets in the LCR stand-alone computation and the cap.

Initially, Case 9 is combined with deals on the book and outright positions of 100 units of illiquid assets, 200 units of level 1 assets and 100 units of level 2 assets.

The portfolio is modified by bringing in Case 8: bank enters into a repo transaction using stock of illiquid assets it holds outright on the balance sheet.

The impact of repoing out the illiquid securities for a level 1 asset is an increase in liquidity buffer of 100 and cash outflow of 100. This results in the liquidity buffer increasing to 470 (from 370) and net cash outflows increasing to 385 (from 285) resulting in LCR improving to 111%, bringing it in line with the regulatory standard from the position of breach of 93%. This advantageous treatment has occurred as changes to the numerator and denominator do not have an equal impact on this ratio. However, the cap - at 28% - remains unchanged with the addition of Case 8 to the portfolio.

Section 3 – in detail

Treatment of Collateral Swaps can be derived as the sum of the breakdown into single repo/reverse repo legs versus cash, however, the cash leg of second transaction needs to be substracted to derive meaningful results

Example 1:

			Liquid Buffer Asset	Cash Inflow (+ve)/ Cash Outflow (-ve)	Adjusted Level 1	Adjusted Level 2	
original position	100 Level 2		85 Level 2			85	
Collateral Swap case 6	**100 Level 1 Asset**	**100 Level 2**	100 Level 1	-15	0	85	
equals: Repo case 2	100 Level 2 100 Cash	100 Level 2	100 Cash	-15	0	85	same
Reverse Repo case 5	100 Cash (<- this cash does not exist, therefore must be subtrac 100 Level 1	100 Cash	-100 cash 100 Level 1	0	-100 100	0	
sum			100 Level 1	-15	0	85	

Example 2:

			Liquid Buffer Asset	Cash Inflow/ Cash Outflow	Adjusted Level 1	Adjusted Level 2	
original position	100 Illiquid			0			
Collateral Swap case 12	**100 Level 2**	**100 Illiquid**	85 Level 2	-85	0	0	
equals: Repo case 4	100 Illiquid 100 Cash	100 Illiquid	100 Cash	-100	0	0	same
Reverse Repo case 9	100 Cash (<- this cash does not exist, therefore must be subtrac 100 Level 2	100 Cash	-100 cash 85 Level 2	15	-100 100	0	
sum			85 Level 2	-85	0	0	

Section 3 considers the treatment of collateral swaps. BCBS 188 does not explicitly discuss how to treat collateral swaps, although they appear to be allowed (para 85). The table above sets up the treatment of a collateral swap transaction involving two assets as two economically equivalent 'plain vanilla' secured lending transactions (Examples 1 and 2). Once split into these transactions, we refer to how they are computed under Section 1 (Cases 2, 4, 5, 6, 9 and 12). We seek confirmation that this approach is correct.

Section 4 – in detail

Treatment of fall in market value of received collateral

Do we need to consider market value or cash value in repo transactions ??

Reverse Repo done at par (100 L1 vs 100 Cash), where market value of asset fall to 90

	Asset received	Asset pledged as collateral	Liquid Buffer Asset	Cash Inflow	Adjusted Level 1	Adjusted Level 2
At inception						
	100 Level 1	100 Cash	100 Level 1	0	100	0
After fall in market price	**Asset received**	**Asset pledged as collateral**	**Liquid Buffer Asset**	**Cash Inflow**	**Adjusted Level 1**	**Adjusted Level 2**
Alternative 1	90 Level 1	100 Cash	90 Level 1	0	100	0
	- or -					
Alternative 2	90 Level 1	100 Cash	90 Level 1	10	100	0
	- or -					
Alternative 3 (CSA Margin agreement)	90 Level 1	100 Cash	10 Cash (margin call) 90 Level 1		100	0

Finally, Section 4 deals with deterioration in the market value of an asset received as collateral under a reverse repo during the lifetime of a secured lending transaction (less than 30 days).

We have identified three possible alternatives to account for this deterioration in the assets:

1) Write down the liquid asset buffer (10% haircut) by the amount of the deterioration in the asset received
2) Write down the liquid asset buffer (10% haircut) by the amount of the deterioration in the asset received, but also recognise the net cash-flow that will occur on the maturity of the transaction
3) Represents an arrangement whereby the counterparty is able to call margin to cover the deterioration in the market value of the asset, and this margin is added to the reduced level of the liquid asset buffer.

We would like to discuss these alternative treatments with the Committee.

Annex 3: NSFR outcomes

The Global Financial Markets Association ("GFMA") is pleased to attach several examples of outcomes produced by the design of the Net Stable Funding Ratio ("NSFR"), as published in the Committee's 10 December 2010 *Basel III: International framework for liquidity risk measurement, standards and monitoring* ("BCBS 188").

Annex 3

In the GFMA / BBA / ISDA 16 April 2010 joint industry response we drew the Committee's attention to several outcomes produced by the proposed design of the NSFR that we questioned.

Our review of BCBS 188 indicates that these outcomes remain.

In reference to Tables 1, 2, 3 and Annex 2 of BCBS 188, we reiterate these examples, updating as appropriate and clarifying where we thought it was helpful.

1. A corporate bond rated AA and financed with a three month commercial paper sold to a non-financial corporate has an NSFR of 250% (50% available stable funding (ASF) for commercial paper/ 20% RSF for the corporate bond), while the same asset financed with a nine month repo has an NSFR of 0% (0% /20% RSF for the corporate bond). Consequently, the NSFR makes it more advantageous for a bank to finance an AA-rated corporate bond with the sale of three month commercial paper than nine month securities repo, while the commercial paper can be sold back and the repo cannot be unwound early. It is counter-intuitive that locked-in funding is treated more harshly.

2. A blue chip equity security requires more stable funding (50% for non-financials 100% for financials) than an equivalently sized unsecured nine month loan to a hedge fund (0%). This result is counter-intuitive as the treatment appears unaligned to the risks associated with these assets.

3. A renewable nine month unsecured loan to a hedge fund (which the bank has an irrevocable right to call) is assigned a 0% RSF while an identically termed loan secured with blue chip equities attracts either a 50% RSF or 100% RSF (depending on whether they are a non-financial or a financial firm). As a consequence of the treatment of collateral, a financial services firm may find that it prefers to extend the loan to the hedge fund over the secured loan, although a secured loan is more prudent from a credit and financing risk management perspective.

4. It appears that secured borrowings of less than one years (i.e. repos) are penalised attracting an ASF of 0% (for the cash borrowed by the firm) and an RSF ranging from 5% (for governments, i.e. level 1 assets), to 20% for qualifying corporate and covered bonds, i.e. level 2 assets, to 100% (for most non-government assets, i.e. non level 1 and 2 assets) for the securities lent to finance the borrowing. This treatment could mean the end of secured borrowing of less than one year as it ignores the true stability of funding offered by certain types of secured borrowing and overstates the stickiness of many assets that are regularly liquidated in the normal course of business.

5. Unencumbered marketable securities (representing claims or governments or alike) with residual maturity of 1 year or more attracts a required stability factor (RSF) of 5%, whereas a mortgage with say 7 years left on it would attract a 100% RSF (as it would fall into the 'all other assets category'). Thus, it appears that the securities dealing business is favoured over straight retail lending which requires more stable funding. The result is the same for commercial

lending where the securities dealing business also appears to be favoured. This indicates to us that precise calibration is important and required.

The examples above point to a number of possible outcomes. Namely, funding will be available from fewer sources/counterparties; less prudent credit activity will be incentivised; secured borrowing could disappear; and, in some instances investment banking will be encouraged over retail or commercial banking although retail deposits are favoured from a stability of funding perspective (i.e. as retail deposits of < 1 year are treated more favourably than wholesale funding).

Annex 4: FSB, BCBS and related regulatory initiatives timeline

The Global Financial Markets Association ("GFMA") is pleased to attach a timeline representation of Financial Stability Board (FSB), BCBS and related regulatory initiatives that will inform the emerging prudential framework.

logo: gfma — afme / asifma / SIFMA

Annex 4

	2010 Q4	2011 H1	2011 H2	2012
Capital / Liquidity / Loss Absorbency	End 2010: FSB / BCBS – Macroeconomic impact assessment using Basel 3 framework (final report)	June: EC – CRD4 proposal expected	Mid-2011: BCBS – Study on additional loss absorbency Mid-2011: FSB / Members – Assessment of issues relating to contractual and statutory bail-ins Dec: FSB / BCBS – Recommendations on additional degree of loss absorbency and instruments	
Resolution		March: FSB Members – Assessment of SIFI resolvability and needed legal and regulatory reforms Mid-2011: FSB / Others – Formulation of resolvability criteria and key attributes of effective resolution regimes Mid-2011: FSB Working Group – Recommendations on the legal / operational aspects of contractual and statutory bail-ins	End 2011: FSB Members – Assessment on the basis of resolvability criteria and key attributes of needed changes of national resolution regimes and policies End-2011: Home / Host G-SIFI authorities – Institution-specific cross-border cooperation agreements for G-SIFIs End-2011: FSB CBCM – Report on progress on institution-specific recovery and resolution plans for G-SIFIs	Dec: FSB / BCBS CBRG – Thematic peer review on key attributes of effective resolution regimes
Strengthening SIFI Supervision		Mid-2011: FSB Members – Self-assessments against relevant ICPs on effective supervision	End-2011: FSB – Status report on implementation of SIFI supervisory Intensity and Effectiveness Recommendations	Early-2012: FSB Members – Self assessments against relevant ICPs on effective supervision End-2012: BCBS / IAIS / IOSCO – Review of relevant core principles relating to supervisory powers, mandates and consolidated supervision End-2012: BCBS / IAIS / IOSCO – Report on improvements of supervisory colleges
Strengthening Core Financial Market Infrastructures		Early 2011: CPSS / IOSCO – Review of standards for financial market infrastructure (consultative report) March: FSB OTC Derivatives WG – Assessment of progress on implementation of FSB OTC Derivatives WG Recommendations	End 2011: CPSS / IOSCO – Review of standards for financial market infrastructure (final report)	
Peer Review of G-SIFI Policies	Dec: BCBS – Provisional methodology for assessing systemic importance (draft)	Early 2011: BCBS – Provisional methodology for assessing systemic importance (finalised)	Mid-2011: FSB / National authorities / Others – Determination of those institutions to which FSB G-SIFI recommendations will initially apply End 2011: FSB / Standard setters – Evaluation framework for G-SIFI policies End 2011: FSB – Establishment of Peer Review Council (PRC)	Dec: FSB PRC – Initial assessment of G-SIFI policies

Source: FSB "Reducing the moral hazard posed by systemically important financial institutions"