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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Ms. Carolyn Wilkins
BCBS Working Group on Liquidity
Senior Deputy Governor of the Bank of Canada
Bank of Canada

**Re: Comment on the Net Stable Funding Ratio consultative document
Additional Comment on the Treatment of Equities, Repos, and Corporates**

Dear Ms. Wilkins:

The Asset Management Group ("**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") is writing to express our members' substantial concerns with the potential market impact of *The Net Stable Funding Ratio*[2] ("**Revised NSFR**") outlined in the January 2014 Consultative Document. As it considers the Revised NSFR, AMG appreciates the consideration by the Basel Committee on Banking Supervision ("**BCBS**") of the comments in this letter and in the letter provided by SIFMA's global affiliate, The Global Financial Markets Association ("**GFMA**"), together with other trade associations (collectively, the "**Associations**") on April 11, 2014 (the "**Associations' letter**"), the Supplemental Comment Letter of GFMA and the Institute for International Finance on August 29, 2014 (the "**Associations' supplemental letter**") and the market impact study conducted by Oliver Wyman that was attached to the Associations' supplemental letter (the "**market impact study**"). AMG requests that the BCBS consider the impacts that the proposal will have on all potential participants in the markets for equities, repurchase agreements ("**repos**"), and corporate debt, including the funds and clients that AMG members manage.

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[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion.

[2] BCBS, Basel III: The Net Stable Funding Ratio (January 2014), available at: http://www.bis.org/publ/bcbs271.pdf.

In this regard, AMG recommends that the BCBS conducts a Quantitative Impact Study ("**QIS**") and adopt a revised framework for RSFs that accords with the approach set forth in the Associations' letter.

I. AMG's Perspective As The "Buy Side" In Market Interactions With Bank Counterparties That Will Be Subject To The Revised NSFR.

The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector pension funds, and private funds such as hedge funds and private equity funds. As such, the asset managers that are members of AMG represent the "buy side" in the markets for securities and securities financing transactions. AMG's members' counterparties to these transactions are nearly always banks or other organizations that will be covered by the Revised NSFR. Accordingly, AMG has a strong interest in the proposal, and this letter provides our members' perspective regarding how they and the funds and clients that they manage would be impacted if the proposal were finalized in its current form.

As the Financial Stability Board (FSB) has observed, liquid securities financing markets are critical to the functioning of cash, bond, securitization, and derivatives markets.[3] Liquid repo and securities lending markets are critical to the proper functioning of cash markets. Repo and securities lending are deeply connected to a significant portion of transactions that occur in the bond and equity markets. For example, they a) provide banks and broker-dealers with the ability to quote two-way prices (i.e. to make markets) in reasonable size and without carrying inventory in every security (in itself a significant risk-management consideration); b) allow all participants to finance positions; c) are critical in avoiding settlement delivery failure; and d) provide the ability to hedge against credit- or market-risk exposures arising from other business activities, such as participating in government bond auctions, underwriting corporate bonds, and trading in cash instruments and derivatives. AMG's members rely on the repo and securities lending markets to facilitate transactions for their clients in the equity and bond markets and to deliver access to capital markets with low transaction costs that allow these end-users to achieve their investment objectives.

To be sure, AMG supports the policy goals underlying the Revised NSFR, which include limiting banks' overreliance on short-term wholesale funding, encouraging better assessment of funding risks across all on- and off-balance sheet items, and promoting funding stability.[4] As proposed, we do not believe that the Revised NSFR properly balances these regulatory goals against the costs it will impose on investors and borrowers. AMG recommends adopting an approach to achieve these policy goals without causing unnecessary disruptions to healthy and

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[3] *See* Financial Stability Board, Securities Lending and Repos: Market Overview and Financial Stability Issues, April 2012, http://www.financialstabilityboard.org/publications/r_120427.pdf.

[4] *See* Revised NSFR, ¶ 1.

vibrant equity, repo, and corporate debt markets. It is essential that the approach adopted assures critical access to liquidity and other services provided by banking organizations in order to preserve efficient and cost-effective trading. This balance should be achievable without significant compromise of the BCBS's prudential goals because many of the activities in question do not entail short-term funding of longer-term exposures.

II. The BCBS Should Consider The Impact Of The Revised NSFR On End-Users.

AMG urges the BCBS to take into account the effects that the Revised NSFR will have on markets, market participants, including end-users, and on market liquidity. Specifically, before finalizing the Revised NSFR, AMG requests that the BCBS take into account market and liquidity effects with regard to the following market segments, and the end-users of these segments, as discussed more fully below:

- Securities lending markets;
- Index rebalancing activities in the mutual fund and ETF markets;
- Repo markets; and
- Corporate debt markets.

A. Effects On End-Users in Securities Lending Markets

AMG supports the comments and recommendations made in the Associations' supplemental letter and the market impact study. As outlined in those materials, the potential impact of the Revised NSFR on securities lending could be high – raising the carry costs of these transactions up to five times the current levels.[5]

These costs may then be passed on to end-users, thereby substantially reducing their returns. AMG members are concerned that such increased costs, moreover, could cause dealers to pull back from the securities lending market, which would result in significantly reduced market liquidity and pricing efficiency while increasing settlement risk for their clients.

In other words, not only would end-users suffer through reduced returns and less liquid markets, but, overall, the systemic risk of the securities lending markets themselves could be increased. AMG strongly urges the BCBS to consider this impact and the requests set forth in this letter, and the Associations' letter and supplemental letter.

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[5] Market impact study, p. 8.

B. Effects On Index Rebalances by End-Users

As shown in the market impact study, AMG believes that the Revised NSFR may cause dealers to reduce support for index rebalances or increase the costs of doing so through higher bid-offer spreads.[6] This presents a considerable problem for all of our members, particularly those that that manage mutual funds and ETFs that track major indices, as it could reduce liquidity for these funds and could lead to a spike in pricing volatility. The typical investors in these relatively low-cost products tend to be retail investors and savers for retirement.

The market impact study set forth the potential costs of such actions, which it estimated, conservatively, to be at least $1.2 billion in lost returns to investors annually.[7] AMG is concerned that such increased costs will be passed along to the funds and clients managed by AMG member, which include, among others, pension plans, state and local governments and municipalities, and registered investment companies. These costs would directly impair the ability of AMG's members to invest on behalf of these clients. The effect on the real economy could be lost jobs, less wealth creation, and less disposable income for consumers, as well as a drag on already deeply underfunded public and private defined-benefit programs.

C. Effects On The Liquidity And Clearing Of The Repo Markets

Wholesale funding allows dealers to provide liquidity to the markets, lowering financing costs for corporate and government borrowers. The asymmetry introduced by the Revised NSFR – which introduces a 0 percent available stable funding factor ("**ASF**") for most short-term repo borrowing but requires the use of a 50 percent required stable funding factor ("**RSF**") for short-term lending – poses a number of potential risks to the financial markets.[8]

Dealers would have decreased incentives to participate in the repo markets, which would, in turn, reduce the liquidity of the government and corporate bond markets. The market for government bonds would be impacted most, as the majority of repo transactions use government bonds as collateral.

[6] *See id.* pp. 17-20.

[7] *See id.* p. 17.

[8] We understand that the BCBS intended to introduce asymmetry between reverse repos and repos with maturities of less than 6 months in order to account for the possibility that a bank may choose to roll certain otherwise maturing client transactions. We agree that the rule should take that possibility into account. However, we think that applying a blanket asymmetrical treatment across reverse repos is likely to adversely affect the government bond and corporate debt markets in significant ways including reduced liquidity leading to higher borrowing costs for corporate borrowers and much increased transactions costs. These costs will ultimately be borne by the consumer, including investors in the funds and accounts managed by AMG members.

In addition, as banks' costs of borrowing bonds increase because term financing would be required in order to meet the bank's 50 percent RSF requirement, market making to support primary dealerships may be reduced. As a result, the bond market could be significantly disrupted.[9] Terming out financing would also be disruptive to certain investors managed by AMG members that have shorter-term holding requirements for their investments such as money market funds.

AMG believes that these potential impacts on the repo markets, as well as the potential effects such market impacts would have on end-users, should be considered before finalizing the Revised NSFR.

D. Effects On The Liquidity Of Corporate Debt Markets

Corporate bond markets bring together real economy borrowers and lenders. With nearly $10 trillion[10] in corporate debt outstanding and nearly $5 trillion in annual volume,[11] the US corporate bond market represents a significant portion of Americans' college and retirement savings investments managed by AMG members. Bond investors, including clients of AMG members, rely on the ability to buy and sell bonds in the open market.

The Revised NSFR, by requiring a 50 percent RSF factor for most corporate bonds, will mean that dealers would need to term out funding substantially, thereby increasing funding costs significantly. We understand that the Revised NSFR would greatly increase funding costs for holding investment grade corporate bonds. That would translate into a substantial increase in transactions costs and a meaningful increase in borrowing costs for corporate issuers.

These costs will likely be absorbed by investors through a combination of higher transaction costs and less robust dealer participation in the markets. The net result would be reduced returns to investors, including those investing in funds and accounts managed by AMG members, as well as slower economic growth through reduced availability of low-cost capital to the real economy.

[9] To the extent that banks are required to finance these types of transactions via longer term borrowings, it will fundamentally change the economics of banks' participation in corporate, government and other short-term markets. There is little market for funding over six months against many government bonds; the present 50 percent RSF for non-bank transactions would require USD or EUR 500 million of term funding of a tenor greater than 365 days for every USD or EUR one billion of transaction. Such a result clearly changes the attractiveness of engaging in low-risk and economically beneficial transactions and may cause a substantial change of business and pricing patterns where the requirement of term financing over six months imposes constraints. In turn, this could substantially reduce market liquidity in affected markets.

[10] *See* http://www.sifma.org/research/statistics.aspx.

[11] *Id.*

III. The BCBS Should Conduct A QIS Before Adopting The Revised NSFR And Should Adopt Revised RSF Factors That Mitigate The Proposal's Impact On End-Users.

In light of our concerns, AMG respectfully requests that the BCBS conduct a QIS that measures the impact of the Revised NSFR on all of the potential participants in, and beneficiaries of, the markets discussed above. In any event, AMG believes the BCBS should adopt revised RSF factors using a framework such as the one advocated in the Associations' letter.

A. The BCBS Should Conduct A QIS Before Adopting The Revised NSFR.

AMG urges the BCBS to conduct, before finalizing the Revised NSFR, a QIS, accompanied by additional research, of the potential impacts on global equity, repo, and corporate debt markets. This important empirical step would help avoid overly conservative calibrations that might weaken the liquidity of markets and harm investors in the funds and accounts managed by AMG members.

In this regard, we are concerned with the aggregate impact of other regulations that impose requirements that are intended to address similar concerns. We accordingly urge the BCBS to analyze how the effects of the Revised NSFR are intended to interact with the effects of the Supplemental Leverage Ratio and the Liquidity Coverage Ratio, among other requirements, so that the NSFR does not become an overly punitive constraint, resulting in a significant reduction of the number of dealers providing liquidity to investors.

B. The BCBS Should Adopt A Revised Framework For RSF Factors Such As The One Discussed In The Associations' Letter.

The most recent impact study identified an NSFR shortfall of EUR 2 trillion, before the Revised NSFR was proposed.[12] Given the more restrictive criteria in the January 2014 proposal, particularly for banks with large capital markets portfolios, this shortfall is only likely to increase. Because there is a plausible scenario in which banking entities are simply unable to raise the required funds at prices that would allow them rationally to continue their capital markets activities, it is possible that there would be a further withdrawal from the market of businesses critical to the proper functioning of the global capital markets. This in turn would reduce liquidity, result in higher borrowing costs, lower returns for investors, and result in reduced economic growth.

With these concerns in mind, AMG urges the BCBS to adopt revised RSF factors for transactions in the markets discussed above using a framework such as the one advocated by the Associations in the Associations' letter. Specifically, AMG asks the BCBS to adopt RSF factors

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[12] *See Basel III Monitoring Report*, Sept. 2013, available at http://www.bis.org/publ/bcbs262.pdf.

that more realistically align with funding and liquidity risks that are evident in the marketplace, including adjusting the RSF factors based on the quality of the collateral involved.[13]

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We appreciate the BCBS's consideration of this letter; we stand ready to provide any additional information or assistance that the BCBS might find useful. Should you have any questions, please do not hesitate to contact Tim Cameron at +1.212.313.1389 or Matt Nevins at +1.212.313.1176.

Sincerely,

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Timothy W. Cameron, Esq.
Managing Director and Head,
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Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel,
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cc: William Coen, Secretary General, BCBS

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[13] *See, e.g.*, Associations' letter, pp. 42-54.