



Secretariat of the Basel Committee on Banking Supervision  
Bank for International Settlements  
CH-4002 Basel  
Switzerland  
[baselcommittee@bis.org](mailto:baselcommittee@bis.org)

January 11, 2019

Dear Sir/Madam:

**Re: *Revisions to Basel 3 and the treatment of securities financing transactions***

The IBFed<sup>1</sup> appreciates the Basel Committee on Banking Supervision (BCBS) efforts to revise the Basel 3 standards. The International Banking Federation (IBFed) has submitted numerous letters to the BCBS discussing various Basel 3 revisions and making recommendations for practical, and objective-focused ways those standards can be adopted. We anticipate that as domestic jurisdictions begin adopting the latest round of finalized standards, issues that were not previously anticipated or fully appreciated will present themselves. This letter addresses one of these specific issues, the minimum haircut floors for Securities Financing Transactions (SFTs), about which we have not previously commented.

We believe that the BCBS should revisit the minimum haircut floors for SFTs because certain aspects of the framework are overly broad and go beyond the stated objective “*to limit the build-up of excessive leverage outside the banking system, and to help reduce procyclicality of that leverage.*”<sup>2</sup> Moreover, we believe that the capital impact of the minimum haircut floors for SFTs is greater than necessary to achieve the stated policy objectives. Although the Financial Stability Board (FSB) conducted a study concluding that there would be a small impact,<sup>3</sup> the impact of minimum haircut floors for SFTs in the Basel 3 revisions was not separately tested through the regular Quantitative Impact Study (QIS) data collection by the BCBS. We would also highlight that not all banks may have consistently applied the same assumptions in their

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<sup>1</sup> The International Banking Federation (IBFed) was formed in 2004 to represent the combined views of our national banking associations. The IBFed collectively represents more than 18,000 banks, including more than two thirds of the largest 1000 banks in the world. IBFed member banks play a crucial role in supporting and promoting economic growth by managing worldwide assets of over 75 trillion Euros, by extending consumer and business credit of over 40 trillion Euros across the globe, and by collectively employing over 6 million people. The IBFed represents every major financial centre and its members’ activities take place globally. This worldwide reach enables the IBFed to function as a key international forum for considering regulatory and other issues of interest to the global banking industry. For more information visit: [www.ibfed.org](http://www.ibfed.org)

<sup>2</sup> FSB paper “Transforming Shadow Banking into Resilient Market-based Finance,” November 2015, See page 5, Available at: [http://www.fsb.org/wp-content/uploads/SFT\\_haircuts\\_framework.pdf](http://www.fsb.org/wp-content/uploads/SFT_haircuts_framework.pdf).

<sup>3</sup> FSB paper “Strengthening Oversight and Regulation of Shadow Banking” October 2014, see page 20, Available at [http://www.fsb.org/wp-content/uploads/r\\_141013a.pdf?page\\_moved=1](http://www.fsb.org/wp-content/uploads/r_141013a.pdf?page_moved=1).

BCBS QIS submissions in relation to SFTs due to the interpretations that were required. We do not believe the FSB study fully represents the impact, which banks believe could be material in certain respects. We encourage the BCBS to revisit the minimum haircut floors to cure the deficiencies.

Below we provide some high-level messages on the consultative document.

### **I. The minimum haircut floors for SFTs are overly punitive and inappropriately applied**

On December 7, 2017, the BCBS released the final Basel 3 revisions framework. Paragraphs 180 to 188 of the framework specify the capital treatment of certain non-centrally cleared SFTs with certain counterparties. Those specify the use of minimum haircut floors for SFTs intended to address systemic risks resulting from banks' provision of short-term funding to unregulated counterparties. These minimum haircut floors apply to certain transactions, including secured lending<sup>4</sup> transactions and "collateral upgrade"<sup>5</sup> transactions.

The treatment of SFTs is punitive in its application, specifically,

- It includes transactions with regulated entities;
- It includes transactions where the primary intent is not to provide financing; and
- It does not recognize collateral provided for in-scope transactions that do not meet the minimum requirements.

These imprecisions in the treatment of SFTs result in a significant, unfounded, increase in risk-weighted assets for specific institutions and specific transaction types.

This outcome is inconsistent with the FSB's objectives as articulated in the 2014 report on strengthening the oversight and regulation of shadow banking. We further note that a number of post-crisis rules already address risks posed by SFTs within the banking sector, including the supplementary leverage ratio, G-SIB capital buffer, and the liquidity coverage ratio, among others. These changes in regulation have made intermediation more costly through higher regulatory capital requirements, prompting banks to be less willing to undertake repo market intermediation compared with the pre-crisis period.<sup>6</sup> Application of minimum haircut floors for SFTs in the Basel 3 revisions framework could have further unintended detrimental impacts on the repo and securities lending markets.

We encourage the BCBS to revisit the issue and make the changes described in Section II. In the meantime, we do not believe minimum haircut floors for SFTs should be adopted in member jurisdictions.

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<sup>4</sup> Reverse repurchase transactions, securities borrowing, and margin lending transactions against non-government securities collateral with counterparties that are not supervised by a regulator that imposes prudential requirements consistent with international norms. Lending of cash transactions where 1) the counterparty attests to reinvest the cash at the same or shorter maturity than the security lent, or 2) the counterparty attests to reinvest cash in a fund or account subject to regulations, are not within the scope of the SFT haircut floor treatment.

<sup>5</sup> Where "a bank lends a security to a counterparty and the counterparty pledges a lower quality security as collateral" Paragraph 180 of Basel 3 revisions.

<sup>6</sup> See <https://www.bis.org/publ/cgfs59.htm>.

## **II. Negative unintended consequences of the haircut floor for SFT transactions should be mitigated**

The following adjustments to the minimum haircut floors for SFTs in Basel 3 revisions would better focus the provisions on the objectives sought:

*Narrow the range of in-scope counterparties by excluding regulated entities, such as regulated broker-dealers, regulated Mutual Funds, and Pension Funds*

The minimum haircut floors for SFTs are intended to target systemic risks resulting from the build-up of excess leverage outside the regulated sector. Therefore they exclude transactions by banks with certain regulated entities, such as other banks and central counterparties. However, many regulated entities that cannot contribute to the build-up of excess leverage outside the regulated sector are included as counterparties subject to the minimum haircut floors for SFTs, such as regulated broker-dealers, regulated mutual funds, and pension funds.

While regulated mutual funds are not subject to the same prudential regulations as banks, they are still highly regulated entities. Regulated mutual funds are required to disclose regularly and are limited in the amount of leverage they use. Such leverage limits mean that mutual funds are unlikely to contribute materially to the build-up of excess leverage, and the requirement to disclose makes it unlikely that any build-up of leverage can be hidden from the regulators who receive the disclosures. In addition to limits and disclosure requirements for leverage, mutual funds must also abide by a number of other regulations, including liquidity management, redemption requirements, and external oversight.

*Exclude securities borrowing transactions and borrow/pledge transactions that are used to facilitate client demand from the scope of SFTs subject to the minimum haircut floors*

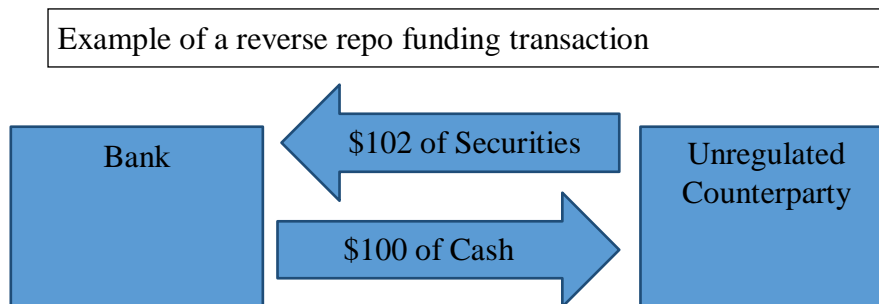
The FSB has recognized that not all SFTs are transactions with the intent to provide or receive financing. Specifically, the FSB noted that “*securities borrowing can be excluded if the borrower of the securities intends to use the received securities to meet a current or anticipated demand (e.g. delivery obligations, customer demand, segregation requirements).*”<sup>7</sup> Therefore, the FSB specifically proposed to exclude securities borrowing transactions from the minimum haircut floors if the intent of the transaction is not to provide financing, but is instead to meet current or anticipated demand for securities. While Basel 3 revisions do exclude certain transactions where the intent is not to provide financing, they do not go far enough. Furthermore, the rationale to exclude securities borrowing if the securities received are “*to meet a current or anticipated demand*” should also be extended to borrow/pledge transactions. We also note that the current classification of collateral upgrade vs. downgrade vs. purpose borrow (to meet client needs/demand) is not made a priori and all of the above may take place with the same client in the same master agreement simultaneously. The current exclusion logic therefore does not work well and negatively affects security vs. security (e.g. EQ vs. EQ) borrowing.

In a transaction where the bank intends to use the received securities to meet client demand, the bank will *provide* over-collateralization because the bank needs the security. The bank is therefore technically under-collateralized and will fail to meet the minimum haircuts. This is in

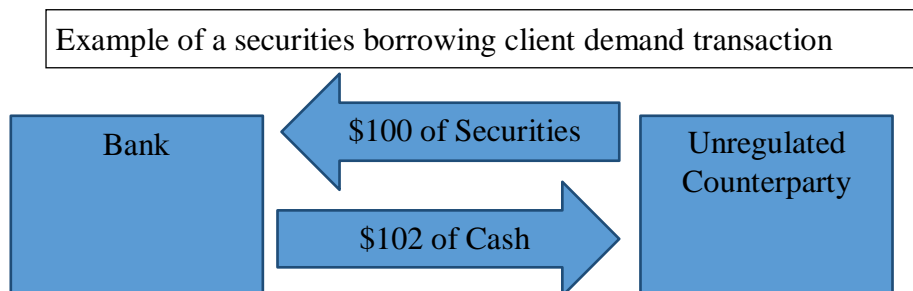
<sup>7</sup> “Regulatory framework for haircuts on non-centrally cleared securities financing transactions”  
<http://www.fsb.org/2015/11/regulatory-framework-for-haircuts-on-non-centrally-cleared-securities-financing-transactions-2/>.

contrast to a transaction where the intent is to provide financing. In these instances, the bank will *receive* over-collateralization because the counterparty needs the cash to fund its activities. The examples below illustrate this very idea.

In this first example, the counterparty will initiate the transaction in order to obtain financing to fund its business activities. To obtain that financing, the bank enters into a reverse repo and requires the cash to be over-collateralized.



However, in a securities-borrowing transaction, the primary purpose is to make the security available to a bank's client. As a result, the cash lent is not for funding purposes but is merely collateral so the bank can gain access to the security. In these transactions, the bank will initiate the transaction and will generally provide over-collateralization to access the security.



#### *Allow exemptions via supervisory review process*

The simplistic nature of the formulas for the minimum haircuts for SFTs might cause netting sets of SFTs or individual trades to fail to meet the minimums even if the transactions were prudently underwritten. A particular example of this is with cross-product netting agreements across derivatives and financing transactions. IBFed recommends permitting supervisors to establish a process to allow them to grant exemptions from the minimum haircuts for SFTs for certain trades or netting sets of SFTs that do not meet the minimum haircuts if the bank can demonstrate that credit risk has been appropriately mitigated.

#### *Recognize collateral*

Transactions that do not meet the minimum haircut floors for SFTs are treated as unsecured loan exposures, even if the transaction is collateralized. Thus, banks must hold capital in excess of the risk presented by SFTs that do not meet the minimum haircut floors. IBFed recommends that collateral be recognized for these exposures—at least partially—in order to align capital charges better with risk. For example, the BCBS could consider adopting option 2

set forth by the FSB<sup>8</sup> and scaling capital requirements for transactions below the floors in proportion to the size of the collateral shortfall.

*Ensure appropriate calibration of any new standard through a QIS*

The BCBS has maintained that Basel 3 revisions will not lead to significant increases in capital requirements. Moreover, in 2014 the FSB stated the belief that the impact of the haircut floors was “*generally small.*”<sup>9</sup> The examples we describe above demonstrate that neither is the case. We believe that the impact may be unmeasured and the operation of the minimum haircut floor for SFTs inappropriate. As a result, we urge the BCBS to revise the minimum haircut for SFTs as described above and include the new refined standard as part of further QIS data collection.

### **III. The treatment of SFT transactions in the NSFR should be revised**

The IBFed supports the objective of the Net Stable Funding Ratio (NSFR)<sup>10</sup> proposed by the Basel Committee to promote stable funding profiles in relation to the composition of banks’ assets and off-balance sheet activities. Given the many other mechanisms implemented by individual jurisdictions and the FSB to strengthen banks’ structural liquidity, we encourage the BCBS to review the NSFR ensuring it adds value to the body of international standards and does not inhibit market liquidity.

An essential part of that review would address asymmetries in the current standard. For example, the IBFed remains very concerned with regard to the asymmetric treatment of SFTs with a residual maturity under six months. The approach applies unnecessarily punitive treatment to matched book transactions.<sup>11</sup>

The NSFR penalises matched book transactions by stipulating a higher required stable funding (RSF) factor for reverse repos than the corresponding available stable funding (ASF) treatment of repos. This asymmetry provides a potential disincentive for banks to provide liquidity to financial markets. Reverse repos using High Quality Liquid Assets (HQLA) as collateral are important components of diversified liquidity reserves, and we believe that the NSFR should recognize their liquidity value.

We urge the BCBS to apply symmetric treatment to both sides of the transaction. Applying asymmetric treatment to short-term SFTs in the NSFR, particularly those collateralized by HQLA collateral, restricts banks’ abilities to effectively manage liquidity and funding profiles and places unnecessary limitations on the flow of cash and securities in the financial system.

### **Conclusion**

In their current form, we do not believe that the minimum haircut floors for SFTs should be part of regulatory capital rules. Certain aspects of the framework are overly broad and go

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<sup>8</sup> FSB paper titled “Strengthening Oversight and Regulation of Shadow Banking,” October 14, 2014, See page 14- 15, available at: [http://www.fsb.org/wp-content/uploads/r\\_141013a.pdf](http://www.fsb.org/wp-content/uploads/r_141013a.pdf).

<sup>9</sup> *Id.* page 20

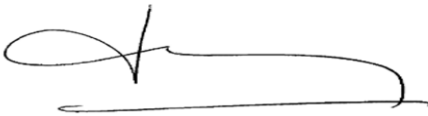
<sup>10</sup> See the FSB paper Basel standard: <https://www.bis.org/bcbs/publ/d295.htm>.

<sup>11</sup> See: <http://www.bis.org/review/r170127a.htm>.

beyond the stated intent “*to limit the build-up of excessive leverage outside the banking system, and to help reduce procyclicality of that leverage.*” We encourage the BCBS to revisit the issue to: 1) Narrow the scope of SFTs subject to the haircut floor; 2) Incorporate flexibility for specific exemptions through a supervisory review process; 3) Recognize collateral for transactions below the haircut floors; and 4) Include any revised standard in further QIS to ensure appropriate calibration. To ensure market liquidity, the IBFed strongly recommends that a symmetrical treatment is applied for secured borrowing and lending transactions in the NSFR.

We thank you for taking our comments into consideration, and we look forward to future discussions on these issues.

Yours sincerely,



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