Dear Sirs,

Response submission from ICMA ECP Committee:

Re: Basel Committee Consultative Document - “Basel III: The Net Stable Funding Ratio”

Introduction:

On behalf of the Euro Commercial Paper (“ECP”) Committee of the International Capital Market Association (“ICMA”), the purpose of this letter is to provide feedback concerning certain specific aspects of the Basel Committee on Banking Supervision’s (BCBS’s) 12 January 2014 consultative document - “Basel III: The Net Stable Funding Ratio”.

The ECP market is a professional short-term debt market which offers opportunities for issuers to raise working capital and other short-term funding as well as for institutional investors to make varied and reliable short-term investments. ICMA’s ECP Committee represents the main dealers in the ECP market. Year-end outstanding ECP amounts (in $millions), as shown in Euroclear data, provide an illustrative picture of the scale of the ECP market:

![Bar chart showing ECP amounts from 2005 to 2013]
It can be readily seen that the market has declined in size from its pre-crisis peak but is still providing a reasonably steady amount equivalent to around half a trillion dollars of funds. In an ideal world action would be being taken to nurture this valuable source of funding, but the ICMA ECP Committee remains concerned that current efforts to reduce risk in the financial system will in fact serve to further impede the ECP market’s development.

The ICMA ECP Committee notes that on 12 January 2014 proposed revisions to the Basel framework’s Net Stable Funding Ratio (NSFR) were issued for consultation by the BCBS and that the NSFR is a key component of the Basel III reforms to promote a more resilient banking sector, which will require that banks maintain a stable funding profile in relation to their on- and off-balance sheet activities. The BCBS notes that a robust funding structure makes it less likely that disruptions to a bank’s regular funding sources will erode its liquidity position in a way that would increase the risk of its failure and, potentially, lead to broader systemic stress. In particular, the NSFR is intended to limit over-reliance on short-term wholesale funding, encourage better assessment of funding risk across all on- and off-balance sheet items, and promote funding stability. The ICMA ECP Committee fully supports the establishment of a sound liquidity regime, but believes that the latest NSFR proposals still need to be adapted in pursuit of this overall objective.

Whilst there are many interesting issues discussed in this BCBS consultative document, the ICMA ECP Committee is for now going to primarily restrict its focus to those aspects that bear most directly on ECP.

**Commentary on NSFR proposals:**

The NSFR is defined as the amount of available stable funding (ASF) relative to the amount of required stable funding (RSF). This ratio should be equal to at least 100% on an on-going basis. ASF is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. The amount of such stable funding required of a specific institution is a function of the liquidity characteristics and residual maturities of the various assets held by that institution as well as those of its off-balance sheet (OBS) exposures. Concerning the calculation of the RSF, the BCBS’s proposals specifically mention that:

- Assets assigned a 15% RSF factor comprise unencumbered Level 2A assets as defined in Liquidity Coverage Ratio (LCR) paragraph 52, including corporate debt securities (including commercial paper) and covered bonds with a credit rating equal or equivalent to at least AA–; and
- Assets assigned a 50% RSF factor comprise unencumbered Level 2B assets as defined and subject to the conditions set forth in LCR paragraph 54, including corporate debt securities (including commercial paper) with a credit rating of between A+ and BBB–

The ICMA ECP Committee considers that the impact of these latest NSFR proposals will be a significant issue for the ECP market. Whilst the general concept of applying stress haircuts to existing inventory in order to calculate the term liquidity requirements is accepted across the market, the level of haircuts being proposed for short term CP/CD instruments is significantly higher than banks internal models. This discrepancy arises from an apparent inconsistency within the Basel model, which is specifying that an organisation reserve term liquidity against a short term asset. The ECP Committee understands that the NSFR is not intended to deal with a stressed event, but rather business as usual. Stressed events are covered by the LCR so taking such a punitive approach as has been proposed appears draconian and out of line with the intended aim of the NSFR.
The ICMA ECP Committee believes that in the event of a firm specific liquidity event, the likelihood is that balance sheets will contract. This does not imply a fire sale or forced sale of assets will be necessary; but rather that, as assets mature, the ability for desks to reinvest will be diminished. The amount of funding available to business lines will contract and therefore there is no need to fund, for example, a three month asset with greater than one year liquidity. However the currently proposed NSFR model results in a higher cost of term liquidity being applied to an asset that is not likely to require term funding. The ICMA ECP Committee sees that such an increased cost to fund ECP assets held on the balance sheet will precipitate a significant reduction in the willingness of dealers to provide a secondary market by themselves acquiring positions from investors. It follows that such a contraction in the secondary market will have a consequential effect on the primary market, either reducing investor appetite and/or increasing the cost of ECP funding.

Furthermore, from an issuer’s perspective the short term nature of CP means it will not contribute to the RSF. Consequently the use of CP as part of the funding mix will further diminish, reducing the amount of paper in the market. Already if CP matures within the LCR period of one month, it will need to be covered with High Quality Liquid Assets; and hence it does not result in any incremental liquidity being available to support the business. The use of CP as a funding instrument for EU banks and securities companies will therefore become purely as a cash management tool i.e. if there is a specific short term financing requirement with a defined maturity date, then CP can be used to finance it. It will not be used to support the general trading inventory of such a firm.

Before closing, the ICMA ECP Committee also draws the BCBS’s attention to the following general points. ECP dealers are well capitalised and highly regulated banks and securities firms, who utilise a strong, safe documentation framework to underpin ECP issuance. A significant proportion of ECP market issuance is from sovereign, supranational or quasi sovereign issuers; and some ECP issuance is listed and eligible as central bank collateral. ECP maturities are very short, with many outstandings maturing in one month or less and a large majority maturing in three months or less.

**Summary:**

There is much in this consultative document with which the ICMA ECP Committee agrees, including that it is helpful to establish an internationally agreed standard.

The ICMA ECP Committee believes that CP should not have to be financed with term liquidity, as holdings of CP are likely to be allowed to mature and not be replaced. Hence a risk horizon of twelve months is inappropriate; and the proposed haircuts are therefore penal and intellectually inconsistent. The ICMA ECP Committee believes that an approach which calls for a matched funding requirement for assets with short term maturity dates would provide the basis for a suitably sound liquidity regime and respectfully requests the BCBS to recognise this in its finalised NSFR proposals.

The ICMA ECP Committee draws attention to the fact that ECP is the largest and most liquid CP market in Europe. ECP plays an important role in providing much needed funding to the benefit of issuers and investors; and as efforts continue to stimulate economic growth, the case for an efficient and effective CP market is more evident than ever. Sound regulation should not impede this.

Should you have any questions, please contact David Hiscock in the first instance.
Yours faithfully,

David Hiscock
Secretary – ICMA ECP Committee
International Capital Market Association Ltd.
23 College Hill, London EC4R 2RP
Tel (direct): +44 (0)20 7213 0321
E-mail: david.hiscock@icmagroup.org

cc: ICMA ECP Committee