Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

Response from the ABBL to the Consultation from the FSB on Strengthening Oversight and regulation of Shadow Banking

Information about the ABBL:	
Identity	Organisation
Capacity	Industry trade body
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The ABBL[1] takes due note of the 3 consultation papers on Shadow Banking. The association would like to first warn that the concept of "shadow" does not necessarily mean that the activities are not regulated or supervised. The association has identified in many parts of these 3 dense documents areas that are either already regulated or will soon be regulated at EU level.

In addition, the association regards this exercise as the completion of the regulatory agenda started in 2009. Indeed, if there are now ideas to regulate, supervise and organise what is in the shadow it may also mean that the origin of the shadow is already well regulated. This also means that the regulatory ideas envisaged should be understood as filling the gaps left by the current new regulatory environment and may be regarded as fine tuning of existing rules rather than an attempt to create an entire new set of additional regulations.

Although the association understands that discussions are beginning on the next steps and how to regulate "shadow activities", it may be useful to stress that the regulatory agenda of the

[1] The Luxembourg Bankers' Association (ABBL) is the professional organisation representing the majority of banks and other financial intermediaries established in Luxembourg. Its purpose lies in defending and fostering the professional interests of its members. As such, it acts as the voice of the whole sector on various matters in both national and international organisations.

The ABBL counts amongst its members' universal banks, covered bonds issuing banks, public banks, other professionals of the financial sector (PSF), financial service providers and ancillary service providers to the financial industry.

recent past has been extremely dense and goes in many directions but is for the time being still in the implementation stage. The outcome in terms of cost or capital requirement as well as the impact on credit/lending activities are still unclear and have for sure not yet fully materialised. One may expect that rules such as Basel III, Dodd-Frank or their multi-instrument EU versions will have a significant impact on the capital structure of banks, their clients and the economy. As a consequence, although things may always be improved, the first advice may be to leave some time for additional complementary measures being worked out so that a better understanding of their impact may be assessed based on real life experiences, notably in light of the high level of collateral that will be required. In other words, deleveraging is a slow process to be accompanied by a careful approach. Unfortunately some measures envisaged seem to suggest that regulation is hitting the breaks with unknown, but certainly not profitable, consequences for economies.

General Comments

From 2009 onwards, the trend, as evidenced by much research, points to a decrease in the degree of leverage of the financial sector. Yet in order not to derail the recovery this should be a carefully planned, and thus slow, process. The banks, on their side, have been forced to increase their capital positions because of Basel III. Even if a suspicious mind will consider securitisation with care, the association points to its vital use and the benefits it may bring to financial institutions and the smooth running of credit markets or markets as a whole. One of the issues with the SPVs (special purpose vehicle) may have been that the link with the originator was not well understood, resulting in the need for these entities to support SPVs that where sometimes instrumental in their financing. The association considers that the Basel III framework improved this situation and as a consequence the impact of SB (shadow banking) risk may be more limited in the future.

The association believes that the approach to SB raises questions at 3 levels: scope, need and timing. The scope covers both the depth as well as the types of measures envisaged. Some increased transparency may bring benefits, but may also be a burden on the activities up to the point of rendering them impossible. This may be especially damaging for Money Market Funds (MMF), or in the securitisation/REPO/securities lending areas. There is a clear danger with the approach envisaged in that the new rules make some central bank supporting activities impossible to the detriment of the economy (ECB LTRO). As to the question of need, the association considers that regulation improving regulation is always a well intentioned exercise;

thus some more rules may be required. But even if the world has changed since 2007, the “new normal” against which regulation has to be redesigned should not be considered as the most extreme negative scenario. Regarding the issue of timing, the association is of the view that, given the already profound re-regulation under way and the consequences it will have on the economy, an additional set of rules should first be subject to the test of events. In the end, regulation should help prevent crises, but too much regulation will inevitably have major side effects. It may be compared to accident prevention policies: if the speed limit is at 0 there may be no accidents, but at the cost that nobody is moving any longer.

The document “an integrated overview of policy recommendations” does emphasis a need for focused, proportionate, forward looking and adaptable measures subject to an effective prior assessment and review, principles to which the ABBL subscribes. Unfortunately, these principles are not so much reflected in the 2 technical papers.

In the MMF recommendations, the association has conceptual sympathy for the approach, but strong reservation as to their translation into material rules, notably in their ALM (asset and liability management) part. In the EU many funds are subject to the UCITS rules or AIFM rules, which are rather comprehensive in terms of organisation of the fund and its structure as well as investment rules. In Europe, the status, in laws and in facts, of such funds is not the same as in the US where they are quasi-banking alternatives to deposits since the end of the 1960s.

The association was also surprised by the approach to the “shadow banking entities”, where the scope is probably too large, and even if proposals are conceptually agreeable (ALM, ensuring short-term financing) their translation into a regulation will present huge challenges which points to a clear need proportionality approach. The end game is to prevent systemic risks not to freeze entire segments of the economy.

In the last paper on “securities lending and repos” there may be some benefit to increase transparency so that authorities have a better knowledge of the different activities and potential risk positions. The association has strong reservations on the principles on haircuts and other restrictions. Although many issues will have to be solved with regards to organisation, data protection, reporting procedures, scope of information to report and cost, one option to test may come from the EMIR and Dodd-Frank regulations’ concept of trade repositories. Their role may be extended to other transactions including securities lending or repo, but after careful analysis.

Regulation of shadow banking entities

Q1. Do you agree that the high-level policy framework effectively addresses shadow banking risks (maturity/liquidity transformation, leverage and/or imperfect credit risk transfer) posed by non-bank financial entities other than MMFs? Does the framework address the risk of regulatory arbitrage?

Not entirely. Generally speaking, from a theoretical approach, there may be some merit in introducing concepts of ALM at different levels, however, in many cases this may add unnecessary burden to the entities, their clients and the economy. The main issue is a question of proportionality. The fact that corporates are using non-banking channels to fund themselves through market based finance does not necessarily imply major systemic risk with regards to maturity transformation. The association was surprised to see that some private equity funds have to be subject to ALM rules because the investment cycle and their clients cycle may not be aligned. In the association's view, in order to trigger hard regulatory rules there should exist a clear, global, strong and imminent danger from a systemic point of view, which in the envisaged case the association does not foresee. That does not mean that there is no maturity transformation or liquidity transformation, but that these are neither systemically important nor critical from an investor perspective. In the case of extreme stress there may be a need for intervention and tools should be developed to address these cases, but extreme stress cases are fortunately not the norm, even after the 2007-2009 period. What is, however, agreeable is that some ALM principles should be taken into account, but as principles not to be transformed into rigid regulation.

Q2. Do the five economic functions set out in Section 2 capture all non-bank financial activities that may pose shadow banking risks in the non-bank financial space? Are there additional economic function(s) that authorities should consider? If so, please provide details, including the kinds of shadow banking entities/activities that would be covered by the additional economic function(s).

The 5 typologies of entities referenced indeed cover the range of financial market actors. It is surprising not to see re-insurance entities, which may also perform maturity transformation and be impacted by liquidity mismatch. What is perhaps more debatable is their qualification in light of future regulation. The association is not convinced that per se there is a need for regulation at all levels. Again one of the issues is in the association's view not to create global rules because of a specific concern in one single country, such as the case mentioned of deposit taking entities from New-Zealand. The end game is to prevent systemic risk and at FSB level the scope of risks envisaged should be of a global nature.

In addition, regarding funds, by their nature, there is a discrepancy between the "time" of assets and "time" of shareholders. But presented in this simple format, one forgets that dense regulation exists, notably in the EU context. Funds, whether aimed at institutionals (AIF) or retail clients (UCITS), are subject to detailed regulations prescribing for UCITS allocation rules, limit to leverage (AIF)… In addition, - alternative - funds have introduced exit mitigation rules a long time ago and the redemption periods are also longer (often quarterly or more). Again the issue is to avoid that financing through these entities becomes too difficult or impossible. In that regard, including private equity vehicles that invest in the economy or help finance corporates is a rather strange approach.

The association does not see major problems with financial companies as envisaged under 2.2. On the one hand their counterparts, banks, are under Basel III and shall assess their credit quality, on the other hand, they may indeed develop alternative plans to ensure financing even during stress periods, which may be enough.

The category 3 composed of broker-dealers may also be under the scrutiny of SB considerations, but at the same time, even in the recent past and failure of such broker-dealers in the commodity markets had no large systemic impact, even if these were not pleasant times for investors/stakeholders. That does not mean there were no concerns for single clients or groups of clients, but simply that there were no impacts at a second level (failure of another institution). Neither does that mean that there is no place for enhanced regulations or adaptation. The association has the feeling that MIFID II and Dodd-Frank are already addressing these brokerage institutions both in the EU and US.

The fourth category may target some form of state agencies that were created to help the economy. These have generally the support of states or regional authorities and are again of a size that may not be systemic. It may be that for this category additional measures in terms of ALM, prudential capital, governance structure should be in place but only once their size becomes important and their failure even if remote may have systemic repercussions (case of FANNY MAE/FREDDIE MAC in the US).

The last category, which covers securitisation, is also covered by a dedicated paper to which the association has also responded. One of the basic features identified is that most of these vehicles have as one of their counterparts a bank subject to Basel III which now imposes some “skin in the game”, forcing the issuer to keep some exposures on its balance sheet to better build awareness of risks or at least trigger a quicker response. These should cover to a large extent concerns that are presented in this consultation.

Q3. Are the suggested information items listed in the Annex for assessing the extent of shadow banking risks appropriate in capturing the shadow banking risk factors? Are there additional items authorities could consider? Would collecting or providing any of the information items listed in the Annex present any practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided instead.

The templates are relatively complex and will require researches within institutions, they would also require a consistency check to ensure that local or regional authorities do not deviate from these standards and that they are produced in a smooth and convenient way using an appropriate communication language like XBRL.

Q4. Do you agree with the policy toolkit for each economic function to mitigate systemic risks associated with that function? Are there additional policy tool(s) authorities should consider?

No. It is unrealistic to impose maximum maturity to portfolio of assets. Doing so will mean that long-term maturity investments will not be available for these pools. In this case, what will governments do with their 30 years debt? Should these pools introduce, as an alternative, redemption periods of 5 years to investors? That is highly unrealistic. On the other hand, forcing these pools to have maturity diversification may appear to be a good idea on paper, yet this would however overlook the fact that this may be contrary to investors’ expectations when they seek managers to get exposure to specific maturities.

Management of client cash pools

The association considers that the tool kit envisaged is not totally realistic in practice. Tool 1 for example on the limitation of duration or maturity will lead to the situation where some products will become excluded from investments, bar some specific investor groups (pension schemes). This can be the case for long dated debt instruments. The consequence of this requirement may be that no retail investor will ever be able to invest in 30 years debt (or vehicles that invest in such instruments when there is a daily NAV). This will mean that, for example, governments will have to issue only short-term debts with consequences on their volatility. The next tools envisaged are already covered by EU regulations for funds, be they UCITS or AIF (at a more basic degree), thus leverage, concentration of risks are already regulated.

The limits on non-liquid assets are more of a debate for investors willing to take a risk or not. Investors may probably need better information rather that seeking specific limits on eligible instruments (which are already existing for UCITS). The illiquidity or relative low liquidity may be part of the risk-reward balance that the investor shapes for his/her own expectation profile, thus excluding certain investment opportunities, risking either to limit investors' opportunities or push them further into the shadow to less regulated instruments or actors. The tool on liquidity buffer may be conceptually interesting but it may not be appropriate in all circumstances and in a low yield environment this risks to heavily penalise funds and investors. An alternative may be to secure lines of credit with financial institutions and introduce exit gates or suspension or partial redemption procedures under a predefined set of scenarios. On the other hand, although gates, postponement of redemption or side pockets may be appealing regarding systemic risk, they may also be totally unappealing for clients and investors. The issue of side pockets may be particularly debatable: how will they be managed and for how long?

In the end, there is the issue of avoiding systemic risk in one type of vehicles or instruments and creating other risks elsewhere.

Loan provision dependent on short term funding

The association considers that a lender should have a sound process to at least understand and ideally mitigate its ALM risks (or profile), but that does not prevent a loan provider to rely on short-term funding, that is simply maturity transformation. The fact that it is done outside banks may present an unlevel playing field for banks, but at the same time in some countries these entities are state sponsored in one form or other and implicitly at least benefit from a state or regional guarantee, which may then be used to access more regular forms of credit/loans. Here perhaps one should first focus on governance structure and organisation before tackling risks in the “banking” services they offer. One noticeable fact is that often these entities function as (co-) guarantor besides bank loans that will otherwise not be offered or not on the same terms without this guarantee.

Securitisation and funding of financial entities

The ABBL disagrees with the proposed approach, on the ground that at least on one side of these entities lies a fully regulated bank; with the advances of Basel III and CRD IV in the EU many of these concerns shall already be addressed. Proposing restrictions is a strategy that the ABBL does not consider adapted to the present time. The association would propose instead that these vehicles be subject to “ALM analysis” so that the manager has a tool to adapt the vehicle to a changing environment if need be. Then, if unavoidable, restriction of collateral rules should be market based, and instead of out-right restrictions, haircuts should come as a more gradual approach over a long-term horizon.

To conclude, setting ambitious goals is a good thing but at the same time, as these rules will be a global template, realism should prevail. The starting point may be to determine workable objectives that are acceptable and achievable for all stakeholders, ensuring that no single location will remain out of these global standards to avoid the risk of excessive regulatory arbitrage.

Q5. Are there any costs or unintended consequences from implementing the high-level policy framework in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers to the extent possible.

The association believes that the area of quantifying risks of unintended consequences is a complex exercise this will depend on the various assumptions and scenarios that will in the end be chosen, as a famous quote says: “it is difficult to make predictions especially about the future”.

As a consequence, if the ideas are transformed, as the ABBL hopes, into building awareness, or some transparency mechanism, the impact may be marginal for stakeholders and the economy. On the other hand, if hard rules on ALM, restrictions on eligible collateral or entities are enforced then consequences may be huge, but difficult to numerically assess as these would be subject to many ex-ante assumptions. One of these may be that government (or companies) will no longer be able to issue long term debt; another impact may be on loans to the private sectors which may be severely reduced because securitisation rules become too complex and/or costly.

In the end, as mentioned several times in the paper, banks are often at one side of any deal and they are subject to strict Basel III rules. In addition, the association is of the opinion that the proposed requirements aim to address only systemic or cataclysmic events that are unlikely to occur, even if the 2007-2009 period was one of these extreme periods. Regulation should frame risks and limit them, but thinking that regulation will remove all risks may be a step too far.

Risks in Securities Lending and REPOS

Q1. Does this consultative document, taken together with the earlier interim report, adequately identify the financial stability risks in the securities lending and repo markets? Are there additional financial stability risks in the securities lending and repo markets that the FSB should have addressed? If so, please identify any such risks, as well as any potential recommendation(s) for the FSB's consideration.

The approach to identify typologies of risks appears to be comprehensive. However, it is subject to at least 2 caveats. One is that additional risks may always emerge from any unforeseen events or combination of events and they may unfold only in exceptional circumstances, which, moreover, does not always trigger a systemic impact. And since the 2007-2009 period, major jurisdictions have created pre-warning mechanisms or institutions, among them the ESRB (European Systemic Risk Board) or the FSOC (Financial Stability Oversight Council) in the US, whose task is to identify emerging signs of systemic risk.

As pointed out in the consultation, concerning the second risk category (links to banking) there is in many cases a banking entity as a counterpart and these entities are subject to comprehensive prudential rules that cover not only solvency but also liquidity. This should be sufficient to achieve the objectives envisaged.

The association was particularly intrigued by an element of "good policy" which is to try to avoid runs. In theory, this is an agreeable objective, but for some investment products there may be a need to put this into perspective: avoiding a run in a given market may trigger consequences in another, with the overall outcome being negative in either case. Therefore, the need for tailor made solutions. A general framework may help in setting directions but in case of crisis there is probably a need for a case by case approach.

Another element that draws the association attention is under item 1.iv, where a reference is made to the fact that contracts are among financial institutions and go in different/opposite directions. This seems to be presented as a risk, while there may in fact be a limitation of these risks, notably through a mutually off-setting of positions.

Moreover, in point 1.v, the association understands that collateral was not always priced optimally. Yet whose fault is it? Accounting is a way of presenting information, and then the question is what it is real? Is it the very low value given to an instrument because there is no active market or should it, on the other hand, be valued on models because the underlying still pays dividend or interests or there retains some value (properties, for example). Market based accounting is appropriate for investors but it is perhaps more questionable for prudential purposes, the issue being that both sides have to live with a single set of rules.

Q2. Do the policy recommendations in the document adequately address the financial stability risk(s) identified? Are there alternative approaches to risk mitigation (including existing regulatory, industry, or other mitigants) that the FSB should consider to address such risks in the securities lending and repo markets? If so, please describe such mitigants and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?

If the purpose is to address extreme stress scenarios, these policy options may be appropriate, but these are what it said to be: extreme scenarios. The issue is that regulation will apply in all circumstances of the day-to-day business, for which the proposals may often be either impracticable or excessive.

To be pragmatic, one option as mentioned may be to rely on a newly created institution: the trade repositories (TR). They will exist as a result of EMIR/Dodd Frank. They may be a convenient place to store information and deploy supervisory tools for a better understanding of the different market segments. Information could be stored transaction by transaction in one location or TR. Some issues will need to be solved, namely where will the TR be located, what access will authorities and stakeholders have, who will report what? There may also be consideration of publishing information of a competitive nature on selected positions. Situations where one party is in one jurisdiction and the other in a different zone need to be clarified. Then, of course, there are 2 other remaining questions. One of which is the cost: who will pay for the service? Counterparties or authorities that will be real beneficiaries or a private service that will later produce, for example, indexes? Moreover, the association wonders if it would not be possible to rely on existing information like the one produced by the BIS who on a regular basis presents aggregated exposures to different types of products or vehicles at a relatively granular level?

The association, however, agrees that rules, if any, should try to leverage on existing solutions and should help shed some more light on certain markets. But they should not by themselves lead to further regulations as a default scenario. Fine tuning may be required, but not a complete set of regulations.

Q3. Please explain the feasibility of implementing the policy recommendations (or any alternative that you believe that would more adequately address any identified financial stability risks) in the jurisdiction(s) on which you would like to comment?

The ABBL is of the opinion that as a first step recommendation 3 (surveys) is the best approach to better understand the systemic implications, number of actors and level of risks… this can be done with relative ease as long as the format of the data requested is available within institutions. Then the option of requesting that transactions be reported to TRs where necessary may be rolled out once the TRs have been in exercise for some time and issues mentioned under response to question 2 have been addressed. One additional reason why there may be a need for some breathing space to understand TR is that these are new concepts. It is likely that many actors will enter the activity to seize economic opportunities, but at some point merge or disappear. Given the volume of information and necessity to ensure resiliency of the information, it may be wise to first analyse how these work under the EMIR/Dodd-Frank framework. These entities together with CCPs will be of systemic importance.

One thing is clear: standardisation of communication through common language (i.e. XBRL/ISO messages) and common templates of information are a must have. This will help, together with other regulatory projects, to increase the understanding of the different markets and, as the case may be, to take customised and tailor made regulatory actions.

Q4. Please address any costs and benefits, as well as unintended consequences from implementing the policy recommendations in the jurisdiction(s) on which you would like to comment? Please provide quantitative answers, to the extent possible, that would assist the FSB in carrying out a subsequent quantitative impact assessment.

Estimating cost is at this stage difficult, given that the options are ranging from a survey that may take a few man/days to complete to a full scale institutional solution. What is certain is that over the next few years financial institutions, and banks more precisely, will be subject to a comprehensive regulatory regime that will impact their capital requirements and, as a consequence, rules that may render access to financing more difficult or costly are in the short term not appropriate

Q5. What is the appropriate phase-in period to implement the policy recommendations (or any alternative that you believe would more adequately address any identified financial stability risks)?

Bearing in mind the fact that the association will first dispute the fact that there is a need for a full scale policy review, the first phases envisaged may start after the finalisation of the policy agenda at FSB/G20 level. It may be important to define not only the first steps but also medium to long-term objectives. The idea is that stakeholders understand where they go, what would be the trigger for actions and the timeframe. In any circumstances, starting before Basel III is enforceable across jurisdictions is not ideal, nor starting before TRs are operational and have survived their first years.

Q6. Do you agree with the information items listed in Box 1 for enhancing transparency in securities lending and repo markets? Which of the information items in Box 1 are already publicly available for all market participants, and from which sources? Would collecting or providing any of the information items listed in Box 1 present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be collected or provided to replace such items.

Q7. Do you agree TRs would likely be the most effective way to collect comprehensive market data for securities lending and/or repos? What is the appropriate geographical and product scope of TRs in collecting such market data?

Q8. What are the issues authorities should be mindful of when undertaking feasibility studies for the establishment of TRs for repo and/or securities lending markets?

TRs may indeed be, at least in theory, the most effective tool to centralise information. This does not mean that they represent the one and only solution nor that this option presents no challenges. Besides the cost and data protection issues, there is the question of access to the database. How will access be granted, to whom and with what level of granularity? Then the question will arise on how to handle trans-regional trades, where one side of the transaction is in Europe and the other in Asia. Who will report to whom and how will double counting be addressed? What would happen for products where there is a chain of stakeholders spread across several jurisdictions (rehypothecation)? TRs may indeed represent a good operational institutional solution, but as it is a new concept introduced by the G20 following the requirements on OTC trades and as they have barely started to be operational there is a need to test them first as infrastructures for OTC derivatives before extending their business case to other instruments. In the end, there is also a need for coherence and here the association believes that a common technical language and harmonisation is a minimum. Relying on a language such as XBRL is probably a necessity.

Q9. Do you agree that the enhanced disclosure items listed above would be useful for market participants and authorities? Would disclosing any of the items listed above present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be disclosed instead.

No, conceptually it is easy to ask more information as it costs nothing to ask for it. The issue is that any additional reporting represents a cost, sometimes justified. As a consequence, the association prefers that information requested be first assessed as to its usefulness for the users. In the proposal, the level of detail seems to be very granular and it will probably be difficult to produce as internal information systems do not necessarily have this type of information in that particular structured way and/or the granularity of the information may render the analysis too complex. A bank or a financial institution is a large organisation with business lines often mutually off-setting their risks. The big picture is important in many cases, and with excessive details there is a risk of ending up in a situation where one can no longer see the forest for the trees.

Q10. Do you agree that the reporting items listed above would be useful for investors? Would reporting any of the items listed above present any significant practical problems? If so, please clarify which items, the practical problems, and possible proxies that could be reported instead.

No, or at least it depends for which investors. For the vast majority of retail investors, this information is of relatively low value, the main reason being that these investors rely on professional and regulated entities to perform a task they either do not like to do or do not have time to do. Again there is in this case a trade off to be made. It may indeed be nice to have all this information, a pragmatic solution may be to publish it on the asset manager/product web pages.

The association sees another issue, which is of a competitive nature. It may be that this information will be used mostly by other professionals to copy successful products or position themselves against a specific counterparty rather than by clients willing to understand what impact a level of REPO or securities lending may have on their holding. In many cases, the information risks creating more confusion for retail investors than solve potential problems. The association is of the opinion that there should be some proportionality measures in the requirements to which these institutions are subject.

This does not discuss the practical problem of presenting this information and ensuring the appropriate follow up. In terms of cost, this would probably need some investments that may eat up part of the performance of the fund. The association would, in a first time, at least opt for generic information referring to the different items, such as: describing what is a REPO transaction, why they are used and the potential impacts, positive and negative… on the website of the issuer, without entering into the details of how many transactions are done and with whom…

Q11. Are the factors described in section 3.1.2 appropriate to capture all important considerations that should be taken into account in setting risk-based haircuts? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?

The association believes that haircuts, if any are first and foremost a prerogative of the counterparties; mandating haircuts may affect business in unintended ways and may for sure be detrimental to the economy in the short term via indirect consequences.

In fact, there are 2 roads: either the haircuts are “set into stone” and thus acyclical, but then they have to be set at level that may be detrimental in normal times to prevent excess of volatility, and accordingly probably be meaningless. Or they are “fluctuating” depending on market conditions, but then have an obvious pro-cyclical effect. This latter solution is, however, probably the most appropriate as it would be the most acceptable for normal business times. They then would have to be set by market participants who are the best placed to know market conditions.

The procyclical effect may be difficult to deal with through regulatory measures. It may be envisaged to introduce counter measures like buffers when haircuts become loose in expanding economies. The issue will be how to proceed and at which level they would have to kick in. On the other side of the coin, in deteriorating economies would this mean that buffers should be removed or even inversed to stimulate the economies in question? And this on assets and counterparties that may present additional risks? Procyclicality is thus probably one-sided. This pleads for letting the industry define the potential haircuts when and where needed.

An additional factor to take into account will be the effect at portfolio level. Between two counterparties, the association is of the opinion that the effect should be analysed at counterparty level rather than for each individual trade.

In addition, as one counterparty in many of these transactions will be a bank, it may be wise to remember that they are subject to Basel III, which introduces buffers, haircuts and weighting of assets on the balance sheet and off the balance. Something that is different from the period prior to 2007.

Q12. What do you view as the main potential benefits, the likely impact on market activities, and possible unintended consequences of introducing a framework of numerical haircut floors on securities financing transactions where there is material procyclicality risk? Do the types of securities identified in Options 1 and 2 present a material procyclical risk?

Q13. Do you have a view as to which of the two approaches in section 3.1.3 (option 1 – high level – or option 2 – backstop) is more effective in reducing procyclicality and in limiting the build-up of excessive leverage, while preserving liquid and well-functioning markets?

Q14. Are there additional factors that should be considered in setting numerical haircut floors as set out in section 3.1.3?

Q15. In your view, how would the numerical haircut framework interact with model-based haircut practices? Also, how would the framework complement the minimum standards for haircut methodologies proposed in section 3.1.2?

The association is not convinced that introducing mandatory floors or haircuts is an appropriate policy choice, notably for the reasons mentioned above in response to question 11. Furthermore, the association thinks that when a bank is at one end of the transaction, it will have to apply prudential regulation that already includes haircuts or similar rules. They would thus be penalised two times for the same trade.

As stated, fixed numbers present many inconveniencies, both in expanding, decreasing and normal economic scenarios.

An additional factor that pleads against setting fixed rules are that timing wise it may not be optimal, given the future regulatory agenda yet to implement and the many unknowns surrounding the need for collateral. Nor is the attitude of clearing houses (EMIR and Dodd-Frank) vis-à-vis collateral and margin fully clear at market level. When fixing hard limits at such a high international level one may forget that markets change and fluctuate. A few decades ago bonds and shares were traded in the same way. Since then new products have emerged, funds (UCITS/AIF in the EU) have entered the market. Thus, requiring these types of boundaries may be counterproductive, fixing markets in a perpetual stand still. Setting floors or haircut rates in stone may be counterproductive and difficult to change, or if change is possible, it will likely imply a huge lag, which may create its own set of issues. The association thus pleads to first test live scenarios before setting at a global level what would in the end be arbitrary thresholds.

Q16. In your view, what is the appropriate scope of application of a framework of

numerical haircut floors by: (i) transaction type; (ii) counterparty type; and (iii) collateral type? Which of the proposed options described above (or alternative options) do you think are more effective in reducing procyclicality risk associated with securities financing transactions, while preserving liquid and well-functioning markets?

Q17. Are there specific transactions or instruments for which the application of the numerical haircut floor framework may cause practical difficulties? If so, please explain such transactions and suggest possible ways to overcome such difficulties.

Q18. In your view, how should the framework be applied to transactions for which margins are set at the portfolio basis rather than an individual security basis?

As mentioned above, the association is of the opinion that it is not appropriate to set fixed haircuts, but all elements are to be taken into account. Separately each transaction is important, as well as the collateral type, but then counterparties present different risk profiles. Some are riskier than others, some have transactions with off-setting effects. That is why it is not appropriate to rely on a single factor even if haircuts or floors were set per type of instruments this would represent only one single view of the "problem".

Regarding portfolio, the association believes that correlation effects should be taken into account. Even if there is at a given time a fixed haircut by security once, they are regrouped in a basket of instruments and they naturally will have off-setting or neutralising effect. It is part of portfolio theory. Thus these effects need to be taken into account, ideally relying on real market data not fixed ex-ante arbitrary measures.

Q19. Do you agree with the proposed minimum standards for the reinvestment of cash collateral by securities lenders, given the policy objective of limiting the liquidity and leverage risks? Are there any important considerations that the FSB should take into account?

No, the main reasons for disagreement are that there is no proportionality criterion, that the risks envisaged may be only marginal for some of the entities considered and that it is likely that at on one side of the transaction there will be a bank, which means that many such transactions will be covered under Basel III/CRD IV rules. In addition, these rules will partially be applicable under the EMIR regulation (concentration of risks). The association would invite the FSB to first assess the feasibility of this requirement before extending it to other non-institutions

Q20. Do you agree with the principles set out in Recommendation 9?

Not entirely. The association supports the idea that only institutions subject to liquidity risks mitigation mechanism may be authorised to reuse assets or that they act as sponsors for others. The association understands the principle that clients have to agree contractually to the reuse of their assets. Regarding the limitation of use of these rehypothecated assets, the association believes that, based on most EU civil right laws, these assets become ownership of the entity that reuses them. As a consequence, there may be no material reasons why they will not be used for "own purposes" that may be very broad, ranging from facilitating settlement, collateral management, tri-party repo or for covering short positions. What is important for the association is that the entity is able to locate the assets and is able to return them or similar securities (in case of fungible securities) to their client when needed.

Q21. Do you agree with the proposed minimum standards for valuation and management of collaterals by securities lending and repo market participants? Are there any additional recommendations the FSB should consider?

No, the association considers that the securities under these contracts are subject to an agreement between two consenting parties; therefore they may agree on the terms of the contracts. The association is furthermore not convinced that regulatory standards should be determined as to valuation criteria. The requirement to locate assets and "delegate" them to a third party should be limited to the "first layer" of contract. It would then fall on the receiving entity to locate, risk manage… if it further rehypothecates the assets received. Contractually and legally speaking, they will in many jurisdictions become owner of the assets and thus be entitled to use them.

Q22. Do you agree with the policy recommendations on structural aspects of securities financing markets as described in sections 4.1 and 4.2 above?

Not entirely, the association considers that recommending changes in the bankruptcy law may indeed be premature and probably too difficult a task to justify efforts now. Regarding central clearing of securities lending or REPO contracts the association is unconvinced that, given the particularities of these contracts, they are suitable for on CCP clearing. This would, in addition, further concentrate the systemic risk on CCPs that already have to clear financial instruments and OTC traded derivatives.