Secretariat of the Financial Stability Board c/o Bank
for International Settlements
CH-4002, Basel
Switzerland

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB
Tel +44 (0) 207 545 8380
Fax +44 (0) 207 545 8553

22 April 2016

FSB consultation on possible measures of non-cash collateral re-use

Dear Sir or Madam,

Deutsche Bank welcomes the opportunity to provide comments on the above consultation. We agree with the objective to increase transparency in SFT markets. However, we have a number of concerns about the proposed approach to estimating collateral re-use set out in section 3 of the consultation paper. In brief, they include:

- **Data challenges:** The exact measure presented in section 3 would be very challenging to implement due to the fungibility of assets held by counterparties. Market participants will therefore have to report data using one of the three proposed alternative methodologies.

- **Usefulness:** Widely diverging estimates will be generated as a result of the underlying assumptions applied when the alternative methodologies are used. This raises questions about the usefulness of the re-use measures. Such imprecise measures would result in an unreliable basis for understanding collateral re-use and for any policy recommendations. Additional metrics which rely on the incorporation of an imprecise re-use measure may also be insufficiently robust as a result.

- **Unintended outcomes:** Conclusions drawn from such estimates may increase the risk of inappropriate measures being adopted which affect the supply and fluidity of high-quality collateral in financial markets. Limitations on collateral re-use will likely negatively affect collateral fluidity, at a time when mandatory clearing and margining rules around OTC derivatives are expected to increase the demand for collateral.

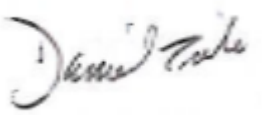
- **Existing regulatory measures:** The potential risks noted in the consultation paper, such as the build-up of leverage of individual entities and the increased sensitivity of market participants to counterparty credit risk, are addressed by existing and proposed regulatory measures. These include the Basel large exposure regime and leverage ratio, which limit the leverage and credit exposures of the largest systemically-important entities. The US Securities and Exchange Commission (SEC) is also addressing leverage concerns in the asset management industry; the Commission is currently reviewing public input on two proposals which limit the amount of leverage a fund may obtain through derivatives transactions and new requirements on open-end fund liquidity risk management programs. In Europe, robust rules around funds already exist under the UCITS and AIFM Directives. Further, the EBA has guidelines on large

exposure limits to shadow banking entities while ESMA has developed guidelines on ETFs and other UCITS issues. It is critical that sufficient time and analysis is permitted in order to assess the cumulative impact of these requirements before finalising additional rules that may unnecessarily hinder efficient market functioning.

In light of the above concerns we suggest additional consideration should be given to suitability of the proposed methodologies before they are finalised. If the FSB were to adopt one of these methodologies, however, we believe the **"approximate measure"** presented in section 3.2 of the paper represents the least problematic of the three options and should be limited in scope to SFTs, as suggested by the FSB in section 2.

We hope our comments and suggestions are helpful. Please do not hesitate to contact us if you have questions or wish to discuss these issues further.

Yours sincerely,



Daniel Trinder
Global Head of Regulatory Policy

Section 2 - Scope of re-use measure

Q1. Does the proposed scope of transactions for data collection (Scope (A)) provide a practical basis for the meaningful measure of non-cash collateral re-use? If not, please explain how you think the scope should be broadened and the reasons why this alternative scope is more appropriate than the proposed scope.

The proposed scope makes sense; however, when looked at in conjunction with the proposed measures of re-use set out in section 3, the implementation challenge becomes more difficult. For example, the alternative formula provided under section 3.1 intrinsically assumes that all receipts, other than purchases, are SFT collateral receipts. In practice, especially where there are large global trading firms involved, the source of receipts could include many other non SFT related forms.

We suggest that the alternative methodologies' treatment of the source of collateral included in its calculation may serve as an important factor when selecting the most appropriate methodology to measure SFT collateral re-use.

Section 3 - Collateral re-use measures at the national/regional level

Q2. Are there any practical issues (e.g. updating current business practices, IT systems) in relation to the three measures of collateral re-use that are set out in this Section? Are there any ways to improve these measures?

<u>General considerations on the proposed data collection exercise on collateral re-use:</u>

Any re-use calculation which is performed in order to provide data to National Competent Authorities (NCAs) should be done at level of the firm receiving the collateral for each International Securities Identification Number (ISIN) and not at counterparty level. It should also be calculated across all SFTs and not for individual SFT independently.

This is required due to the fungible nature of the receipts and deliveries associated with the firm's depot of collateral where ISINs are not correlated with individual trades or counterparties. In this instance, for certain components that are part of the re-use proposed calculations - e.g. 'own assets' – if the calculation is done separately for each type of SFT the 'own asset' figure will be the same for each calculation and will intrinsically overestimate the use of own assets for each SFT type.

Further, if the FSB proceeds with one of the proposed methodologies, additional clarification will be needed in relation to the implementation of these calculations to ensure that there is a consistent approach taken by all firms and NCAs. Currently, there are points in the proposed calculation methodology which are open to interpretation and may lead to divergent and inaccurate results.

For example, for collateral received in respect of Margin Lending activity, it could be assumed that this includes collateral re-hypothecated out of a client collateral depot and into the firm's depot, as this is the only information that is available at ISIN level. Also, it is unclear whether stock loans and stock borrows are included within collateral received and collateral posted.

Moreover, in order for these measures to be generated, they will need to be performed independently of any trade reporting that may be required by NCAs. The calculations may use different data sources and systems and also require information on non-SFT related elements. In this regard, consideration needs to be given to the implementation requirements and how long it may take firms to provide this data to NCAs for use by the FSB.

Comments on specific proposed alternative methodologies

3.1 – Exact measure (alternative calculation)

$$collateral_{ij}^{reused} = collateral_{ij}^{posted} - assets_{ij}^{own,encumbered})$$

The alternative calculation proposed under section 3.1 appears to prioritise purchases within the re-use measure. From the definitions provided, it appears that securities lent are also to be treated as collateral posted (against a reverse repo or securities borrow).

This element of the calculation is consistent with scope (A) in Section 2, as it enables the collateral posted to capture collateral 'subsequently re-used in SFTs'; however, other assumptions in the calculation could lead to inaccurate results.

Specifically, given the absence of a requirement to identify the collateral received when carrying out the calculation, it could be assumed that all non-own assets are deemed to be SFT collateral receipts. These non-own assets, however, could also include other asset sources, for example, securities borrowed and OTC derivative collateral.

As a result, this could overestimate the re-use from SFT collateral as the sources are not limited to SFT collateral. This conflicts with scope (A) in section 2. Assuming all receipts in the depot other than purchases are associated with SFT collateral is an inaccurate approach.

3.2 Approximate measure

$$collateral_{ij}^{reused} = \left(\frac{collateral_{ij}^{received,eligible\ for\ reuse}}{collateral_{ij}^{received,eligble\ for\ reuse} + assets_{ij}^{own}}\right) \times \left(collateral_{ij}^{posted}\right)$$

As this measure applies a proportionate approach and requires identification of the SFT components of the calculation, it appears to be the least problematic of the three proposed options. The identification of the SFT elements enables consistency with scope (A) in section 2, and provides for clear delineation of SFT and non-SFT related collateral.

It should also be assumed, in line with both scope (A) and the previous definition of collateral posted on section 3.1, that collateral posted also includes securities lent.

We suggest, however, that this measurement could benefit from additional clarification on the identification of collateral. Specifically, the concept and definition of 'eligible for re-use' could lead to confusion, as the only assets that the calculation will be able to be performed on are those which have been title transferred into the firm's depot (which means that ownership of the collateral has been transferred to the receiving counterparty).

As previously noted, while none of the three proposed alternative measures (i.e. 3.1, 3.2 and 3.3) will likely result in sufficiently accurate and reliable data on collateral re-use, if the FSB decides to move forward with one of the proposed methodologies, the "approximate measure" in 3.2 includes the most balanced assumptions.

3.3 Indirect approximation of re-use based on data elements

$$collateral_{ij}^{reused} = min\ (collateral_{ij}^{received}, collateral_{ij}^{posted})$$

This option prioritises SFT collateral for the 'source' of on-delivery (i.e. settlement) of SFTs. It is based on the overly simplistic assumption that an entity first posts all the collateral securities received in other transactions. As the FSB has highlighted, it will overestimate the re-use of SFT collateral and thus is not an appropriate measure for collateral re-use.

Q3. For the first measure, are there any practical issues in reporting whether collateral you posted is in the form of "own assets" or in the form of assets that were received as collateral in a previous transaction?

Firms should have the ability to provide a snap shot of the source of the assets at a given point in time, whether they are purchases or SFT related.

However, it would be very challenging to determine wheather assets were received as collateral in a previous transaction and also serve very little purpose given the fungibility of collateral. Any data provided and used for any re-use measure will only be a source identification at a particular point in time, irrespective of what occurred the previous day.

Q4. Are there other measures of collateral re-use that the FSB should consider for financial stability purposes?

Any measure provided will be an estimate, as calculating an exact collateral re-use figure is not practicable.

We suggest the FSB focus on clarifying the expected application of the proposed calculations to aid market participants in determining exactly how these measures could be implemented and what impact they think this would have on presenting a reliable re-use estimates.

Section 4 - Collateral re-use metrics

Q5. Do you have views on any of the six metrics related to collateral re-use that are set out in this Section? If so, please indicate the metric(s) and explain the views you have.

As an exact measure is likely very difficult to achieve, the alternative methodologies would need to be relied on to provide an approximate measure of collateral re-use. The use of the resulting estimates in further calculations, as proposed in section 4, should be approached with caution given the questionable usability of such data. Specific comments on the proposed metrics are noted below.

4.1 Collateral re-use at the jurisdiction and global level

As this data will provide a compilation of multiple firms' data but lack data on how many firms are included, the results generated by this metric may provide limited use.

4.2 Collateral re-use rate

This could be a usable metric; however, consideration would need to be given to the assumptions underlying the re-use calculation. Specifically only an approximation of actual collateral re-use activity is being generated.

4.3 Re-use reliance rate

The usability of this data will be very dependent on the choice of calculation used as per section 3. The key consideration in evaluating the usefulness of this metric is the extent to which it is possible to know what alternative sources of assets are available on delivery. As none of the suggested measures fully take account of these sources, this metric may be expected to provide misleading results.

In relation to 3.1, as prioritisation is given to own assets, the metric assumes that there are no other assets to have reliance on and results in over-reliance of collateral re-use. The problem remains that this assumption cannot be made, and it is likely that there will be other non SFT collateral related assets that can be relied upon that are not accounted for in the outcome of this calculation.

If calculation 3.2 is used, the data again is questionable as the reliance on the re-use data is only proportionate as per the calculation methodology.

If calculation 3.3 is used, then this data would be in practice be very challenging to use as it would not be possible to know what other sources of assets are available and thus there can be no assumption that there is full reliance on the re-use data provided. This is the disadvantage of using a calculation that will always overestimate the re-use data.

4.4 Concentration of re-use activities

The key question would be how the 'largest entities' would be identified. This may be relatively arbitrary and thus the use of the result of this metric would be open to interpretation. If this is purely done based on notional re-use data, this could also result in misleading interpretations due to the lack of comprehensive information related to the associated entities and how the re-use is applied within those entities.

4.5 Collateral circulation length

This could be a usable metric; however, consideration would need to be given to the assumptions underlying the re-use calculation. Specifically only an approximation of actual collateral re-use activity is being generated.

4.6 Collateral multiplier (at the global level only)

It is unclear what this is actually trying to show. As a result, the usability of the information is not clear.