November 28, 2013

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel, Switzerland
fsb@bis.org

Dear Sir/Madam:

Re: Canadian Bankers Association[1] and Investment Industry Association of Canada[2] Comments and Responses on Annex 2 of the FSB document: Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos

The Canadian Bankers Association (CBA) and the Investment Industry Association of Canada (IIAC), together the "Associations", appreciate the opportunity to provide comments and responses on Annex 2 of this Financial Stability Board (FSB) document, which sets out proposed recommendations on minimum haircuts for non-centrally cleared securities financing transactions, including proposed numerical haircut floors. While the Associations acknowledge the FSB's efforts to strengthen oversight and regulation of shadow banking risks in securities lending and repos, we would like to express some concerns with the FSB's proposed approach. These concerns are outlined in this cover letter, while our more detailed comments and responses to the questions contained in Annex 2 are set out in the attached table.

Consistent Application

The FSB document states that the framework of numerical haircut floors will apply to "non-centrally cleared securities financing transactions in which entities not subject to regulation of capital and liquidity/maturity transformation receive financing from regulated financial intermediaries against collateral other than government securities". While we would agree that this description of the types of transactions that would be captured under the proposed

[1] The Canadian Bankers Association works on behalf of 57 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

[2] The Investment Industry Association of Canada is a member-based professional association with 175 members representing Canada's securities industry. IIAC members represent the vast majority of securities underwriting and trading in Canada.

framework appears to be detailed and clear, we are still concerned that banks and other entities will interpret this language differently both within, and across, jurisdictions.

The Associations would like to encourage the FSB and national authorities to ensure that any framework of numerical haircut floors is applied consistently both within, and across, jurisdictions. Inconsistent application of this framework could result in an unlevel playing field and also present opportunities for regulatory arbitrage.

Limited Scope of Numerical Haircut Floors

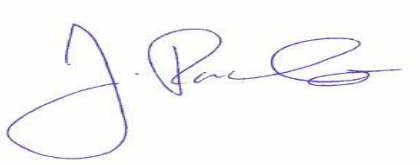
The Associations would like to comment on the results of QIS1 as outlined in Annex 3 of the FSB document, which appears to suggest that the proposed numerical haircut floors would have a relatively limited scope in relation to the broader securities lending and repos market.

Annex 3 notes that "Transactions against sovereign debt collateral were by far the largest category of securities financing transactions across time" and that "Banks and broker-dealers are the main counterparties to the transactions reported by the participating financial intermediaries…", as depicted in Exhibits 1 and 2. Annex 3 also notes that "Less than 10% of the total transactions reported as of the 2012 period were backed by non-sovereign debt collateral and conducted with counterparties that are not banks or broker-dealers", as depicted in Exhibit 3.

Given that these QIS1 results and observations would suggest that the proposed numerical haircut floors would have a limited scope in relation to the broader securities lending and repos market, the Associations question whether the implementation of such a framework is needed at all. Existing market practice often dictates haircut levels above these proposed numerical haircut floors and, as noted in the FSB document, introducing haircut floors could result in market convergence to these floors.

We thank you for taking our comments into consideration and would be available to discuss these issues further at your convenience.

Sincerely,



Marion Wrobel
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CBA and IIAC Comments and Responses on the FSB Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos, Annex 2: Proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions (for public consultation)

General questions (Please provide any evidence supportive of your response, including studies or other documentation as necessary)

Q1. Do the proposed policy recommendations in Annex 2 adequately limit the build-up of excessive leverage and reduce procyclicality? Are there alternative approaches to risk mitigation that the FSB should consider to address such risks in the securities financing markets? If so, please describe such approaches and explain how they address the risks. Are they likely to be adequate under situations of extreme financial stress?

Q2. What issues do you see affecting the effective implementation of the policy recommendations?

Q3. Please address any costs and benefits, as well as potential material unintended consequences arising from implementation of the policy recommendations? Please provide quantitative answers, to the extent possible that would assist the FSB in carrying out a quantitative impact assessment. [Note: respondents may also consider participating in QIS2]

Q4. What is the appropriate phase-in period to implement the policy recommendations? Please explain for (i) minimum standards for methodologies and (ii) the proposed framework for numerical haircut floors separately.

Q1.

The Associations do not have significant concerns over the proposed policy recommendations in Annex 2. However, it is not clear to the Associations how these proposed policy recommendations would limit the build-up of excessive leverage and reduce procyclicality as intended.

The Associations believe that strong prudential risk management frameworks, combined with ongoing dialogue between market participants and authorities, is the best way to ensure efficient and liquid markets and the health of market participants.

Q2.

The amount and pace of regulatory change in recent years is unprecedented and many of these changes are not being implemented consistently across jurisdictions. As noted in our cover letter, inconsistent application of the policy recommendations could result in an unlevel playing field and present opportunities for regulatory arbitrage. Such fragmented approaches could also result in increased costs to firms and decrease market liquidity as firms re-evaluate their levels of

participation.

The Associations would encourage the FSB and national authorities to consider conflicting regulations that could result from these proposed recommendations. We believe that it is necessary for national authorities to ensure congruence with existing rules regarding collateralization rates that affect certain entity types (for example, regulated mutual funds in Canada).

Further, it is essential that the FSB and national authorities set a consistent standard as to what constitutes "entities not subject to regulation of capital and liquidity/maturity transformation" and what constitutes "financing against collateral". The latter should exclude, for example, loans of securities that constitute "specials" or loans to parties to cover short positions.

Authorities should also recognize that some organizations may have different liquidity regimes and requirements, which should be taken into account in order to ensure that the liquidity of particular marketplaces is maintained.

We would also request that some of the definitions contained in the FSB document be more precise.

Q3.

The Associations would like to note the significant IT development costs that will be required for trade capture as a majority of securities borrowing and lending transactions currently are not traded electronically. This would increase the cost of non-purpose financing and purpose borrows and would also make the derivative market more inefficient as hedging costs for short delta will increase.

The Associations also believe that certain tax treaties may need to be revised. For example, dividend payments under securities borrowing and lending transactions retain their character as dividends only if the collateral is above 95%. Accordingly, such payments are subject to withholding tax under the Canada-US Tax Treaty.

The Associations would also like to note that a number of smaller markets rely on international players to provide additional liquidity to the markets. Should the cost infrastructures preclude the participation of international players, market liquidity will decrease and the concerns these policy recommendations are targeting will be exacerbated.

Q4.

Given the issues raised in Q2 and Q3, it is our view that the appropriate phase-in period for the proposed recommendations should be no less than five years. The phase in of BCBS margin requirements from 2016 to 2019 will pose a challenge to liquidity and affect a wider range of eligible securities. Ideally, changes to the methodology or rehypothecation rules should be clarified before that time in order to ensure an efficient flow of funding and securities.

We would like to note that banks have already committed significant IT resources to meeting the requirements of derivative reporting and clearing and that a shorter phase-in period than five years would add additional strain to these already scarce resources. Additionally, Canadian banks and investment dealers have employed significant resources in building and launching a fixed-income central counterparty facility for the clearing of domestic repo transactions.

A five-year phase-in period would also align with several other regulatory initiatives, such as the full implementation of the Basel III capital and liquidity framework in 2019.

Q5. Are the minimum standards described in Section 2 appropriate to capture all important factors 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?

We believe the minimum standards described in Section 2 are appropriate to capture all important factors that should be taken into account in setting risk-based haircuts. They are also well aligned with current market practices.

The minimum standards are already taken into account in most major jurisdictions when regulated financial institutions apply for regulatory approval of their risk-based margining. However, in order to ensure a level playing field across all jurisdictions, it would be important to ensure these minimum standards are applied in all jurisdictions, particularly in jurisdictions where these requirements are not yet applied.

Q6. Would the additional considerations described in Section 3 appropriately capture all important factors that should be taken into account in setting risk-based haircuts on a portfolio basis? Are there any other important considerations that should be included? How are the above considerations aligned with current market practices?

We believe the additional considerations described in Section 3 appropriately capture all important factors that should be taken into account in setting risk-based haircuts on a portfolio basis. They are also well aligned with current market practices. The Associations would like to note that these additional considerations are already taken into account by regulators when portfolio-based margin approvals are sought.

However, we would also like to note that the current approach does not allow for portfolio margining (i.e., it does not allow for cross-correlation risk reduction), which goes against a VaR based approach and will therefore require additional capital.

Q7. In your view, is there a practical need for further clarification with regard to the definition of proposed scope of application for numerical haircut floors?

Q8. Would the proposed scope of application for numerical haircut floors be effective in limiting the build-up of excessive leverage outside the banking system and reducing procyclicality of that leverage, while preserving liquid and well-functioning markets? Should the scope of application be expanded (for example, to include securities financing transactions backed by government securities), and if so why?

Q9. In your view, what would be the impact of introducing the numerical haircut floors only on securities financing transaction where regulated intermediaries extend credit to other entities? Does this create regulatory arbitrage opportunities? If so, please explain the possible regulatory arbitrage that may be created and their impact on market practices and activity.

Q7.

The FSB document indicates that the proposed framework of numerical haircut floors would apply to "non-centrally cleared securities financing transactions in which entities not subject to regulation of capital and liquidity/maturity transformation receive financing from regulated financial intermediaries against collateral other than government securities". As indicated in our letter and response to Q2, while we would agree that this description of the types of transactions that would be captured under the proposed framework appears to be detailed and clear, we are concerned that banks and other entities will interpret this language differently both within, and across, jurisdictions. Therefore, we would like to encourage the FSB and national authorities to ensure that any framework of numerical haircut floors is applied consistently both within, and across, jurisdictions.

The Associations would also like to note that greater distinction among "government securities" may be required in the future.

Q8.

As mentioned earlier, it is not clear to the Associations how the scope of application for these numerical haircut floors would be effective in limiting the build-up of excessive leverage outside the banking system and reducing procyclicality of that leverage, as intended.

The Associations believe that the broader policy framework for securities lending and repos (rather than just the numerical haircut floors) should only apply to "non-centrally cleared securities financing transactions in which entities not subject to regulation of capital and liquidity/maturity transformation receive financing from regulated financial intermediaries against collateral other than government securities".

We also believe that "specials" and normal course "short cover" should be excluded from the scope of the proposed numerical haircuts floors. While cash from these transactions can be used for financing purposes, it is not their primary goal. For specials, this can be easily detected by the rate level. Some holders may decide against lending their securities if they are forced to assume additional credit risk (i.e., receive less than 100/105% cash collateral). This will create an even tighter market for specials, leading to short squeezes and delivery failures. It will also potentially spill into convertible bond and derivative markets as market makers will not be able to borrow securities needed for hedging.

In addition, the Associations also believe that there should be an appropriate mechanism for market participants to appeal to regulators to move assets out of higher haircut buckets into lower haircut buckets should adequate data be provided to support the change. This is particularly important for assets that are not main index equities that may have similar characteristics as main index equities.

Q9.

As mentioned earlier, the Associations would encourage the FSB and national authorities to ensure that any framework of numerical haircut floors is applied consistently both within, and across, jurisdictions, in order to limit any opportunities for regulatory arbitrage.

Q10. In your view, would the proposed levels of numerical haircut floors as set out in table 1 be effective in reducing procyclicality and in limiting the build-up of excessive leverage, while preserving liquid and well-functioning markets? If not, please explain the levels of numerical haircut floors that you think are more appropriate and the underlying reasons.

Q11. Are there additional factors that should be considered in setting numerical haircut floors as set out in table 1? For example, should "investment grade" or other credit quality features be factored in?

Q12. Are there any practical difficulties in applying the numerical haircut floors at the portfolio level as described above? If so, please explain and suggest alternative approaches for applying the numerical haircut floors to portfolio-based haircut practices?

Q10.

It is not clear to the Associations how the implementation of numerical haircut floors would be effective in reducing procyclicality and in limiting the build-up of excessive leverage, as intended.

The Associations would like to reiterate their strong belief that strong prudential risk management frameworks, combined with ongoing dialogue between market participants and authorities, is the best way to ensure efficient and liquid markets and the health of market participants.

Q11.

The Associations do not believe that there are additional factors that should be considered in setting numerical haircut floors as set out in Table 1. In fact, we believe that the introduction of additional factors could create inefficiency and arbitrage opportunities.

However, the Associations believe that there is a need for the proposed framework to consider other asset classes, such as ETFs. For example, the treatment of ETFs holding equity from main index or government securities is not clear.

Q12.

We do not believe that there are any practical difficulties in applying the numerical haircut floors at the portfolio level**.** There are no difficulties in incorporating cross-correlations into the calculations, which is already a requirement for capital and VaR calculations.

We believe that numerical haircut floors should be viewed as a standardized approach. Portfolio risk-based margining should replace numerical floors explicitly, but implicitly take the categorization of assets into account.

Q13. What are your views on the merits and impacts of exempting cash-collateralised securities lending transactions from the proposed framework of numerical haircut floors if the lender of the securities reinvests the cash collateral into a separate reinvestment fund and/or account subject to regulations (or regulatory guidance) meeting the minimum standards? Do you see any practical difficulties in implementing this exemption? If so, what alternative approach to implementing the proposed exemption would you suggest?

Q14. Do you think cash-collateralised securities borrowing transactions where the cash is used by the securities lender to meet margin requirements at a CCP should also be exempted from the proposed framework of numerical haircut floors?

Q13.

The Associations would agree with this proposed exemption.

Q14.

Yes, we agree that cash-collateralized securities borrowing transactions where the cash is used by the securities lender to meet margin requirements at a CCP should also be exempted from the proposed framework of numerical haircut floors. However, we believe that this exemption should exist for principle lenders, but not agents.

Q15. What are your views on the proposed treatment of collateral upgrade transactions described above? Please explain an alternative approach you think is more effective if any.

Q16. What are your views on exempting collateral upgrade transactions from the proposed framework of numerical haircut floors if securities lenders are unable to re-use collateral securities received against securities lending and therefore do not obtain financing against that collateral?

Q15.

The Associations believe that the current proposed treatment is appropriate.

Q16.

The Associations would agree with exempting collateral upgrade transactions under these circumstances.

Q17. What do you view as the main potential benefits, the likely impact on market activities, and possible material unintended consequences on the liquidity and functioning of markets of introducing the proposed framework of numerical haircut floors on securities financing transactions as described above?

Q18. Would implementing the proposed numerical haircut floors through regulatory capital or minimum margin regimes for regulated intermediaries be effective in reducing procyclicality and in limiting the build-up of excessive leverage by entities not subject to capital or liquidity regulation?

Q19. Are there specific transactions or instruments for which the application of the proposed framework of numerical haircut floors may cause practical difficulties? If so, please explain such transactions and suggest possible ways to overcome such difficulties.

Q20. What would be an appropriate phase-in period for implementing the proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions? Please explain for (i) minimum qualitative standards for methodologies and for (ii) numerical haircut floors separately.

Q17.

The Associations believe that the proposed framework of numerical haircut floors could lead to lower liquidity and less market efficiency to the extent that the framework captures transactions that are not intended to be captured. In addition, we believe that regulatory arbitrage could occur if entities outside of the scope of this proposed framework are able to access leverage through other means.

Q18.

It is not clear to the Associations how these proposed policy recommendations would limit the build-up of excessive leverage and reduce procyclicality as intended.

Q19.

As mentioned earlier, we believe that the treatment of ETFs holding equity from main index or government securities is not clear. There may also be other areas in which greater clarity is required.

Q20.

It is our view that the appropriate phase-in period for the proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions should be no less than five years. The phase-in of BCBS margin requirements from 2016 to 2019 will pose a challenge to liquidity and affect a wider range of eligible securities. Ideally, changes to the methodology or rehypothecation rules should be clarified before that time in order to ensure an efficient flow of funding and securities.

We would like to note that banks have already committed significant IT resources to meeting the requirements of derivative reporting and clearing and that a shorter phase-in period than five years would add additional strain to these already scarce resources.

A five-year phase-in period would also align with several other regulatory initiatives, such as the full implementation of the Basel III capital and liquidity framework in 2019.