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FINANCIAL STABILITY BOARD (FSB)

STRENGTHENING OVERSIGHT AND REGULATION OF SHADOW BANKING
POLICY FRAMEWORK FOR ADDRESSING SHADOW BANKING RISKS IN SECURITIES LENDING AND REPOS

FBF'S RESPONSE

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, *i.e.* more than 500 commercial, cooperative and mutual banks. They employ 500,000 people in France and around the world, and serve 48 million customers.

The FBF welcomes the initiatives undertaken by the Financial Stability Board (FSB) and the opportunity to contribute to the analysis of the evolution needed to enhance transparency, strengthen regulation of security financing transactions, and improve market structure, regarding Securities lending and Repos.

As French banks plays an active role in the repo and securities markets over the world, the FBF is very much interested by the Workstream 5 and any regulatory development in that matter.

The FBF shares the view that upholding the integrity and credibility of these market activities are key to the industry.

If there is a growing consensus that supervision and a strengthened regulatory framework is needed to harness the Shadow banking system, it is necessary to **preserve a useful channel of financial intermediation that can provide benefits to the real economy** at a time when bank financing is more constrained.

GENERAL COMMENTS ON HAIRCUTS

The FBF would like to draw the FSB attention on a most undesired consequence of proposition under discussion: regulatory minimum haircuts for regulated banks' securities funding transactions (SFT) to non-bank investors may put regulated banks in the position of potential shadow supervisors of all non-banking financial intermediaries (whether or not regulated) dealing with them. This has three negative consequences:

- the burden of the regulation is borne by banks only (at the risk of seeing banks removed from the market which would create an uneven playing field and would also weaken the regulation's efficiency);

- adequately regulated non-banking financial intermediaries do not contribute to the regulation as indirect regulators (doing so they would avoid a double penalty when dealing with a bank and in the same time it would alleviate the preceding weakness of the framework as regards banks);

- it leaves unregulated, or poorly regulated, non-banking financial intermediaries out of the scope of the regulation when transacting with non-banking financial intermediaries (by using banks and regulated non-banking financial intermediaries as indirect regulators, this structural weakness of the proposed approach would be reduced to the transactions done by unregulated financial intermediaries amongst themselves).

In this context, we note that an article published by the NY Fed indicates that there are systemic risks associated with the mandating of high haircuts in the repo and securities lending markets[1].

[1] NY Fed document dated 08/2013 titled "*Are Higher Haircuts Better? A Paradox*" (http://libertystreeteconomics.newyorkfed.org/2013/08/are-higher-haircuts-better-a-paradox.html)

KEY POINTS OF THE FBF'S RESPONSE

- **Regarding the FSB's recommendations:**

  - On the scope, we are of the opinion that the scope of entities considered as regulated should not be limited to those which are only subject to Basel II/III,

  - If we are supportive of recommendation 1 on transparency, it remains unclear how authorities intend to use it and how the confidentiality issue will be considered,

  - On recommendations 7 & 8 dealing with re-hypothecation and re-use, we would need to be provided with a precise definition of re-hypothecation and reuse, notably to make clear the fact the re-hypothecation of clients' assets is allowed,

  - On recommendation 10 dealing with the central clearing we stress that some repo and securities lending transactions appear not to be sufficiently standardised to fit with the central clearing requirements, notably transactions with equity as underlying.

- **Regarding the proposed regulatory framework for haircuts:**

  - We are sceptical of the effectiveness of regulations targeting minimum haircuts in reducing procyclicality,

  - Current proposed haircut levels are not way out of line with current market levels,

  - There is a strong need for clarification from the FSB on which entities this proposal will apply to,

  - We believe that as proposed the level for numerical floors could be appropriate but should the numerical floors be set at higher levels this would drive secured financing activity to occur between non-prudentially regulated entities directly as noted above,

  - We think that cash collateral received by securities lenders should not be in the scope,

  - Concerning the phase-in, we urge the FSB to consider the regulatory burden that market participants are currently facing.

I. REGARDING RECOMMENDATIONS PROPOSED BY THE FSB

The FBF would like to recall the following principal messages already raised within the its response to the previous FSB consultation paper.

1. Scope

In the European regulatory framework, the FBF strongly believes that all activities under the ESA's supervision (notably ESMA and EIOPA) should be qualified as adequately regulated in the context of this regulation and they should be considered equivalent to banks in this regulatory context.

In other words, **we are of the opinion that the scope of entities considered as regulated should not be limited to those which are only subject to Basel II/III**. For instance, in Europe we think that notably the UCITS directive (asset managers), the AIFM directive (alternative investment firms) or the Solvency 2 directive (insurance companies) impose enough obligations to those market participants to be qualified as regulated entities.

Furthermore, the FBF is reserved on the principle of regulating non-banking financial intermediaries through the banking sector only. Regarding penalties in case of breach of compliance with the rules: why targeting banking industry (imposing higher capital charges in case of breach) if the objective is to regulate shadow banking? Rules will be much more efficient if control and penalties are supported both by the banking industry and their non-banking financial counterparts**.** In that sense, in the European regulatory framework, AIFM Directive demonstrates that regulating unregulated funds remains possible.

However, any significant variation in the definition or scope of such regulation ultimately applied by different jurisdictions will inevitably lead to uncertainty and disruption, as well as the opportunity for regulatory arbitrage.

2. Improvement of transparency (recommendations 1 & 2)

The FBF is supportive of recommendation 1 which relates to transparency and the need for authorities to obtain more granular data. Nevertheless, **we would like to ask for more clarity on the objectives which authorities would like to achieve through the increase of transparency**.

Once trade repositories will be implemented in the context of the repo and securities lending markets, it is unclear how authorities intend to use them and notably whether regulators intend to impose regulatory burden such as positions limits. If it is the case, we do think that authorities should carefully assess all the market impacts before proposing to impose any rule in that nature.

In addition, we are very concerned about the way data transferred to trade repositories could be disclosed to third parties. We are of the opinion that all measures should be taken into account to protect these data and avoid any market disruption. We would like to remind that the confidentiality issue has been highly discussed both in the US and in the EU in the context of the OTC derivatives regulation

First of all, the FBF points out that while enhanced transparency through increased reporting obligations may be helpful for regulators and the market, **a careful analysis should be made** of the extent of such disclosure, **in order to ensure that the value of the information received justifies the cost of extracting it**.

The bulk of such activities being by nature 'over the counter', information on volumes, liquidity, etc. even if already disclosed in different ways is not publicly available, which is inconsistent with the importance of the economic and social role of these transactions.

Hence, we strongly support any initiative which will contribute to enhancing the transparency of repo and securities lending markets. Reporting to one or a limited number of trade repositories is one of them. Given the number of trades, the structure of such reporting would have to be carefully designed alongside with the industry, in order to allow for speedy and useful reporting, at reasonable costs to all parties.

This intent to procure transparency should be borne and framed by the following principles:

- Detailed articulation of the regulatory concern and risk metrics;
- Clear definition of underlying product scope, agent and transaction perimeter;
- Reduce redundancy scope by including existing regulatory remits (amongst others Basel III capital and liquidity regulatory guidelines) on both regulated and shadow banking segments activity;
- Seeking full industry involvement;
- Leveraging on existing initiatives (ERC/ICMA quarterly survey, Markit efforts,…);
- Attempting to calibrate full activity landscape by product type, region and type of agent.

3. Definition on re-hypothecation and re-use (recommendations 7 & 8)

The FBF would need to be provided with a precise definition and concrete examples of re-hypothecation and reuse, notably to make clear the fact the re-hypothecation of clients' assets is allowed. In that matter, and given the differences across the various legal regimes over the world, we stress the need for market participants to be submitted to the same approach as to what should be considered as re-hypothecation and re-use.

Furthermore, we would like to stress our concern on the scope of the potential ban of re-hypothecation for the purpose of financing the "own-account activities". Once again, we do not understand what is covered by "own-account activities" and what the rationale of such ban is.

We have the same concern regarding the scope of "clients' assets" and we are wondering whether the cash would be included.

4. Mandatory central clearing (recommendation 10)

Regarding recommendation 10 on central clearing, we would like to underline that a proportion of the repo market is already centrally cleared, notably when it relates to government bonds. We are therefore supportive of any measure aimed to incentivise the central clearing for products which are suitable for clearing.

Nevertheless, we would like to raise the two following points.

On the one hand, **we stress that some repo and securities lending transactions appear not to be sufficiently standardised to fit with the central clearing requirements, notably transactions with equity as underlying**. When non-standardised transactions are at stake, we are of the opinion that central clearing should not incentivised.

On the other hand, **we do not think that there is a strong case for authorities mandating the use of CCPs for repo and securities lending transactions. We would prefer an incentivisation instead of mandating their use to avoid any disruption in the market.**

In addition, we would like to stress that the **vast majority of the trades having less than one week maturity, and very often one day, the contribution of central clearing to the mitigation of counterparty risk is questionable.** We therefore suggest that clearing of repo or securities lending does not become mandatory, and to let market participants resort to clearing offers whenever these are competitive and useful.

II. REGARDING THE PROPOSED REGULATORY FRAMEWORK FOR HAIRCUTS ON NON-CENTRALLY CLEARED SECURITIES FINANCING

The FBF also requests that similar levels of analysis be performed in respect of other proposals, including **the use of mandatory minimum haircuts**. Its concerns include (amongst others) the fact that **minimum haircuts will extract large volumes of liquidity from the market and may not be successful at preventing further liquidity being withdrawn from the market during a crisis**, since lenders may simply take other action such as reducing existing credit lines.

For that reason, we have strong reservations in relation to numerical floors to haircuts set by regulation. **Haircuts are part of the trades' price. Quantifying haircuts should remain the prerogative of the finance industry i.e. market participants**, **whilst regulators should be independently reviewing the applied methodology as to risk assessment practice, governance and application scope**.

Finance industry practitioners pride themselves of having established, over the years, a strong credit risk expertise, which would become totally subordinated in the face of mandatorily imposed haircuts. A further danger exists, that mandatorily imposed haircuts might incite to weaken the fiduciary function, as responsibility to discern credit risk would implicitly be shifted to the regulator.

Above all, minimum haircuts may have unintended consequences such as imposing too high exposures of banks to non-banking entities (through equity repo for instance) drying specific sector liquidity and/or distorting investment allocations. More generally, **we consider that the imposition of haircuts may introduce elements of administrative control which may hamper the efficiency of the market.**

Finally, haircut dynamics also generate sizeable and immediate impact on unsecured debtors, which could be one of the unintended consequences regulators wish they had avoided, both as a function of market impact and litigation exposure.

However, it may be argued that (1) there are more effective ways to tackle leverage limits and (2) that haircuts' role in lending pro-cyclicality should not be overestimated.

We are sceptical of the effectiveness of regulations targeting minimum haircuts in reducing procyclicality.

In our response to the November 2012 consultation, named "French Banking Federation Response to the Financial Stability Board Consultation Document for the Regulation of Shadow Banking Risks in Securities Lending and Repos" (http://www.financialstabilityboard.org/publications/c_130129aj.pdf), brought forward "strong reservations in relation to numerical floors to haircuts set by regulation."

Statements below must be read in the wake of that very document:

- Leverage containment is better addressed at entities' level as opposed to transactions levels;
- Using banks only to indirectly regulate SFT may incentivise bank-regulated business lines to switch into the non-bank regulated universe;

- Considering all regulated non-banking financial intermediaries as shadow banking entities may incentivise them to deal with other shadow banking entities rather than with banks. Doing so their transactions do not fall within the scope of the proposed regulation anymore.
- Hypothesis of haircuts being a major source of pro-cyclicality is contentious at best as other factors will invariably come first.
- Thus, regulatory haircut floors appear:
    - Off-target with regards to their objectives (leverage containment and pro-cyclicality prevention);
    - Redundant with regards to existing banking and non-banking specific regulations (in Europe: CRR, Solvency 2, UCITS and AIFM Directives);
    - Dangerous with regards to the potentiality for regulatory arbitrages they create;
    - Potentially detrimental to liquid and well-functioning market activities.

You will find below detailed answers to the specific questions and proposals set out in Annex 2 of the Policy Document.

SPECIFIC COMMENT ON ANNEX 2

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?

We cannot support the principle of regulating shadow banking entities through the banking sector only. Regarding penalties in case of breach of compliance with the rules: why targeting banking industry (imposing higher capital charges in case of breach) if the objective is to regulate shadow banking? Rules will be much more efficient if control and penalties are supported both by the banking industry and the shadow banking industry**.** In that sense, in the European regulatory framework, AIFM directive demonstrates that regulating unregulated funds remains possible.

Furthermore, we do not believe that haircuts are pro-cyclical and the hypothesis of asset-sensitive haircut being a major source of pro-cyclicality is hardly verifiable as other factors will invariably come first; such as: decision (yes/no) to lend to a given counterparty regardless of collateral, and if applicable, credit limits, counterparty risk premium (idiosyncratic spread being priced), maturity.

QIS1 interpretation that “haircuts generally increased for all collateral types since 2006” cannot be taken for granted:

- In Europe, data on the “insignificant” impact of repo haircuts in terms of the scale of deleveraging in Europe from 2007 to 2009 may be found in an ICMA ERC document named “Haircuts in initial margins in the repo market” (February 2012)[2]:

[2] http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Repo-Markets/Haircuts%20and%20initial%20margins%20in%20the%20repo%20market_8%20Feb%202012.pdf

- As for the US market, haircuts irrelevance in terms of pro cyclicality is illustrated in a January 2012 NBER Working Paper named "Sizing up repo": haircuts overall relative stability between 2007 and 2010 is illustrated by numerous data[3]:with structured credit in general and the now defunct subprime market in particular being the exception.

Consensus has emerged that leverage containment is better addressed at entity level as opposed to transactions levels (such as haircut floors on long only securities financing transactions), very much in line with a Note written for the Economic and Scientific Policy Department of the European Parliament dated July 2013 named "Shadow Banking – Minimum Haircuts on Collateral". Quote: "direct regulatory limits on leverage offers greater certainty than the indirect, unproven and questionable mechanism of minimum mandatory haircuts"[4].

- **Current proposed haircut levels are not way out of line with current market levels** as they appear in the proposal dated august 2013. However, regulatory levels may create some uncertainty with regards to their possible upwards regulatory revisions
- The patchy implementation for minimum haircuts will create side effects that will incentive dealing counterparties (both borrowers and lenders) to opt for less regulated environment.

At last, we are wondering whether it would be appropriate to exempt from the haircut's requirements all products considered as sufficiently liquid. We note that the liquidity is one of the main criteria that the FSB encourages to take into account when setting margin requirements (see page 24 of the FSB's paper).

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

Making sure that level playing field is in place. The FBF response to the FSB consultation late 2012 made it clear: "it is necessary to take into account the existing or proposed framework implemented for each entity in a geographical perimeter. We believe that much has already been done in Europe concerning the banking system as well as the non-banking system. Thus, we are highly supportive that the FSB focus on potential arbitrage which may exist between identical entities submitted to different jurisdictions."
Considering the nature and specificities of various market actors, same functions or same activities must call for equivalent but not identical regulations in order to address the same objectives and have the same effects and consequences. Once again, we believe that much has already been done in Europe with regards to both banking and non-banking system.

+ See answer to question 7.

[3] http://www.nber.org/papers/w17768.pdf?new_window=1
[4] http://www.europarl.europa.eu/RegData/etudes/note/join/2013/507462/IPOL-ECON_NT%282013%29507462_EN.pdf

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]

Potential consequences: marginal fall in overall liquidity, or a potentially systemic one depending on the implementation scope. See answer to question 8.

Additionally:

- More clearing through CCP implies more concentration risk, more dependence on CCP collateral eligibility and haircut policy. One drawback for such concentration is the increase of interconnected risks from a single point, in addition to the dependence on a single liquidity supplier criterion (bilateral transaction should remain a viable alternative in order to keep necessary flexibility).

- Relative pricing between unsecured and secured funding pricing may be distorted.

- Incitation to relocate market-based finance business "in the shade" so that securities financing take place between non-regulated entities for the most part.

Moreover, flooring haircuts may discourage risk-based approaches which may stick to the regulatory floors as proprietary methods may no longer add competitive advantage. FBF 2012 response reminder: "A regulator imposing mandatory haircuts is blurring the separation of duty principle between economic agents and their supervisors."

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.

See answer to question 20.

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 have some conceptual reservations on pro-cyclical VaR use. The FSB requirement that time series of price data should cover "at least one stress period" may mitigate such pro-cyclicality without eliminating it (lengthening a cycle dependency rather than eliminating it). Besides, it should be recalled that SFT are subject to regular margin calls and that counterparty linked credit decisions (volume and price) come ahead of collateral linked haircut decision in times of market stress.

From a more discretionary judgemental view, one may also push to have legal (bankruptcy law) and operational (hardly quantifiable) risks as further inputs to assess haircut levels for a

given counterparty (in addition to idiosyncratic “wrong way risk” as described in the FSB document: degree of correlation between borrower and collateral risks).

Last, haircut calibration cannot ignore margin calls specificities (minimum transfer amounts, calls frequency; e.g. the more frequent the margining, the less important the haircut).

For illustration purposes, internal “add on” modelled risks are calculated for regulatory capital requirement. Methodology is comparable to haircut and both risk based add on risk and actual haircut can be compared (especially if haircut is inferior to add on): thus modelled add-on risk may be seen as guidance for business decisions on haircut %. Add-on model input include in particular:

- 99th percentile of the distribution of future prices of a given bond, with respect to the Interest rates and credit risk factors,
- Duration and rating.

Generally speaking, we think haircut parameters should take into accounting the following:

- Contractual arrangements allowing close out netting
- Market risk (price volatility)
- Credit risk (default probability and assumed recovery given default)
- Correlation risk between debtor and collateralised portfolio (“wrong way risk”).

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?

Margin calls will have pro-cyclical consequences, regardless of haircut levels.

As for haircuts calibration methodology, inputs in section 3 look appropriate but not exhaustive. In particular, the FBF is supportive of the risk based approach proposed by the FSB for portfolio margining. We do consider that taking in consideration in the methodology:

- contractual arrangements allowing close out netting
- market risk (price volatility) of the whole portfolio
- credit risk of the whole portfolio(default probability and assumed recovery given default)
- portfolio view: concentration by jurisdictions and, economic sectors, individual issuers, net market risk, net credit risk, assumed liquidity
- correlation risk between debtor and collateralised portfolio (“wrong way risk”)

Those five parameters capture most of the important factors that should be taken into account in setting risk-based haircuts.

However we do think that it is also very important in the haircuts methodology to take in consideration volatility parameters. It is inevitable that to a certain extent haircuts increase when volatility increases, and decrease when volatility decreases. This means that it will be very difficult to consider that portfolios margin calculation should not be procyclical at all.

Last but not least, when it comes to portfolio margining where collateral risk is mingled with borrower credit risk, we do think that the creditworthiness of the counterparty and the

transaction parameters should also be taken into account , in order to ensure proper protections.

In addition to the legitimate focus on a given SFT, haircuts on marginal transactions should not ignore net counterparty exposure on given collateral and default correlation, which is market practice.

Haircut should consider the whole collateralised portfolio of exposures so that collateral risk is better reflected. Such risk will be assessed depending on all positions (long and short) and assumed correlations thereof.

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?

There is a strong need for clarification from the FSB on which entities this proposal will apply to. For the time being, we have difficulties to understand who exactly will fall in it or not. Is the funds community (leverage funds or all types of funds?) only targeted or does it concern also insurance companies?

In Europe, funds (UCITS and AIFM) and insurance companies (Solvency 2) are regulated and their leverage is already under control by regulators. We do not think there is a clear need to add one more layer of regulation.

In that sense, in the European regulatory framework, the FBF strongly believes that should be qualified as regulated all activities under the ESA's supervision (ESMA, EBA, EIOPA). As a consequence, entities acting under regulatory frameworks as UCITS, AIFM or Solvency 2 should be included within the scope so defined by the FSB.

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?

If the scope is on all non-banking entities: the systemic damage on liquid and well-functioning markets could probably be effective enough to prevent excessive leverage and pro-cyclicality as the threat could disappear along with the targeted transactions (unless more business gets done between non-regulated borrowers and lenders).

Regulations in place for funds such as UCITS and/or AIFM are constraining enough in terms of leverage, market and credit risks, to refrain from calling such entities as non-regulated.

Not only the distributed European funds but also their managers are submitted to regulations and/or relevant supervision. Of no least relevance, every Undertaking for Collective Investment (under UCITS or AIFM directives) is required to have its assets posted into a legally segregated Custodian account. Such custodian shall control its client in terms of compliance. It cannot be stressed enough that a given UCI assets are segregated into a bankruptcy remote part of its custodian. The depositary has legal means to make sure that secured lenders are not treated on a par with UCI shareholders.

Still in Europe, Solvency 2 has already been voted and one cannot talk of domestic insurance regulation vacuum.

If the scope is non-regulated entities only, the previous FBF response dated 2012 still applies:
- “we have strong reservations against any numerical haircut floor whatever its design”;
- “if numerical haircut floors were kept, we strongly advocate that (…) any trade where at least one party is a regulated financial intermediary (investment firm of bank) [be] exempted from these haircuts”.

We take note of the implicit incentive to clear through CCP (which may reduce counterparty risks at the expense of concentration risk)

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.

We believe there is a risk that the policy recommendations may lead to greater secured financing activity directly between non-prudentially regulated entities.

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.

In addition to what has been answered in question 1 and 8 regarding the insignificant contribution of haircuts to pro-cyclicality overall, haircut floor levels set out in table 1 do not appear way out of line with current market standards, even though market practice is far more granular in its approach.

Therefore, we believe that as proposed the level for numerical floors could be appropriate but should the numerical floors be set at higher levels this would drive secured financing activity to occur between non-prudentially regulated entities directly as noted above.

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?

Provided the floors are set at back-stop levels we see no reason to complicate the table. Should there be any desire to increase the floors there would be a need for the table to include more specifically defined asset types and quality (such as credit ratings and instrument types). It should be made clear that market participants have the right to increase the suggested haircuts, as it should be noted that a high degree of flexibility in major firms has already been seen in applying haircuts, with intraday changes already possible.

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?

Although practical difficulties do not stand out for applying numerical haircut floors at the portfolio level, we do not think numerical haircuts floors should apply whenever portfolio margining is relied upon. Those two methods should be exclusive one of each other. In particular, numerical haircuts floors are not well calibrated for portfolio margining and it will be very difficult to capture all situations. Let's take 3 examples of portfolio:

- Long / short portfolio with good correlation (e.g. a Convertible Bond vs its underlying), the numerical haircut floors will make no sense as we will be able to apply very small haircut as we can net the long with the short position,

- Long/short portfolio well diversified: in such case, the numerical haircut floors are not appropriate as they would lead to a very high and unjustified average haircut. A risk-based portfolio approach is much more appropriate as it would take into consideration all risks and parameters,

- Long only portfolio with derivative, such as long option with an option premium of 3%, in that case there will be a situation where the haircut could be higher than the premium… In this situation again risk based approach will be much more appropriate to take in consideration all risks and parameters.

More generally, a bank relying on a risk based portfolio approach has to accurately capture all actual risk parameters of a transaction. Its analysis is hence much closer to its actual risks, whereas if numerical haircuts were the driver, banks would be dis-incentivised to conduct actual risk analysis. This all the more true that in most instances, the risk based portfolio approach encompasses the credit worthiness of the counterparty and the characteristics of the trade, whereas if numerical haircuts are the driver banks could reduce their analysis of the creditworthiness of their counterparty.

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?

We fully support the FSB proposal that numerical haircut floors are not relevant when the purpose of the transaction is to borrow/ lend a specific stock and not to finance the shadow banking industry.

However we do think that it does not make sense to restrict/limit this exemption only if the lender of the securities reinvests the cash collateral into a separate reinvestment fund and/or account subject to regulation…. In this situation it will be almost impossible for the bank to know what the entity that has received the cash collateral will do with it and then almost impossible for the Bank to benefit from this exemption.

What do we propose is to look at the collateral direction:

- If in a stock borrow transaction, the bank is subject to haircut requirement(the bank post cash collateral in excess of the value of the securities received) vis a vis the shadow banking entity, in that case we can consider that this transaction is not a financing transaction of shadow banking but just a borrow/lend transaction.

- In the opposite if it is the bank receiving haircuts (the bank received more securities that the cash it has lent) from the shadow banking entity , in that case we can consider this transaction as a transaction financing the shadow banking industry.

Furthermore, we think that that cash collateral received by securities lenders should not be in the scope notably because cash is a very effective form of collateral and it is estimated that approaching 50% of all transactions in the global securities lending segment are collateralised with cash.

We would like to underline that in some parts of the world lenders are actively encouraged to accept cash by regulation.

In terms of requiring cash collateral to be reinvested in accordance with the FSBs minimum standards we believe that this may imply practical difficulty.

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?

As already mentioned in question 13 above we do not see why banks should monitor cash reinvestment made by non-regulated entities.

As already noted, concerning the fact that the use of cash collateral should be exempted we do not see clearly how such an exemption could work in practice as it would suppose to identify / segregate this collateral before transferring it to a CCP.

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.

The proposals for collateral upgrade transactions are consistent with the FSB's policy recommendations but we do not believe that securities lenders are entering into such transactions for the purpose of obtaining finance and we do not think it is appropriate.

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?

Indiscriminate reuse ban is detrimental to collateral velocity, hence potentially detrimental to liquid and well-functioning markets.

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?

Levelling haircuts may dis-incentivise best practice for risk management.

Uncertainty regarding futures floors updates, revisions and methodology evolutions could dry liquidity further.

We understand the view of FSB that regulatory capital regimes have the merit to be exist and that using this tool is easier or faster to deploy that going through a new regulation.

Nevertheless, we are under the impression that such message might not be as strong as initially intended: such proposal would tell to the market participants that the floor are not mandatory but only indicative, and that not applying the floor “only” conducts to capital surcharge.

One might also fear that such proposal will not achieve its goal:

- market participants are not using exclusively SFT to finance funds and only repos are included in the scope of the proposal;
- capital calculation are produced based on the stock at reporting dates and do not reflect activity between those dates, and ill-intentioned participant could easily circumvent the rule.

In addition, the proposal lacks of clarity since as far as repos are concerned capital regimes impact not only counterparty risk but also CVA risk, large exposure, liquidity ratios and leverage ratio. Therefore we believe that FSB should further clarify its goal before choosing such option.

Lastly, we strongly advocate FSB not to further disconnect the capital regimes from the economics of the bank. Indeed, it would be detrimental that capital ratio were discredited and not used any more as a management tool. For this matter we want to stress that the level of haircut does not impact the eligibility of the collateral, and that the level of haircut is already a significant input to determine the residual risk exposure.

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?

See answers to question 1 and 8.

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.

Blank.

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.

We believe that the phase-in of any regulatory framework governing haircuts for secured financing transactions should follow sometime after the implementation of the transparency proposals as suggested in the FSB's document in order to enable regulators to better consider the implications of any proposal.

That being said, we urge the FSB to consider the regulatory burden that market participants are facing, notably:

- In the context of the structural reforms, banks are working hard to prepare themselves to be compliant with new domestic and international standards,

- The market structure will also be substantially modified over the world – notably in Europe by MiFID II as of 2016,

- In the context of OTC derivatives, the initial margin requirements for non-centrally cleared derivatives that should come into force progressively between December 2015 and December 2019.

Given that regulatory burden, we do think that sufficient time should be given to market participants to implement such changes in the repo and securities lending markets. Any reform in this area should be proposed to enter into force progressively between 2019 and 2021.