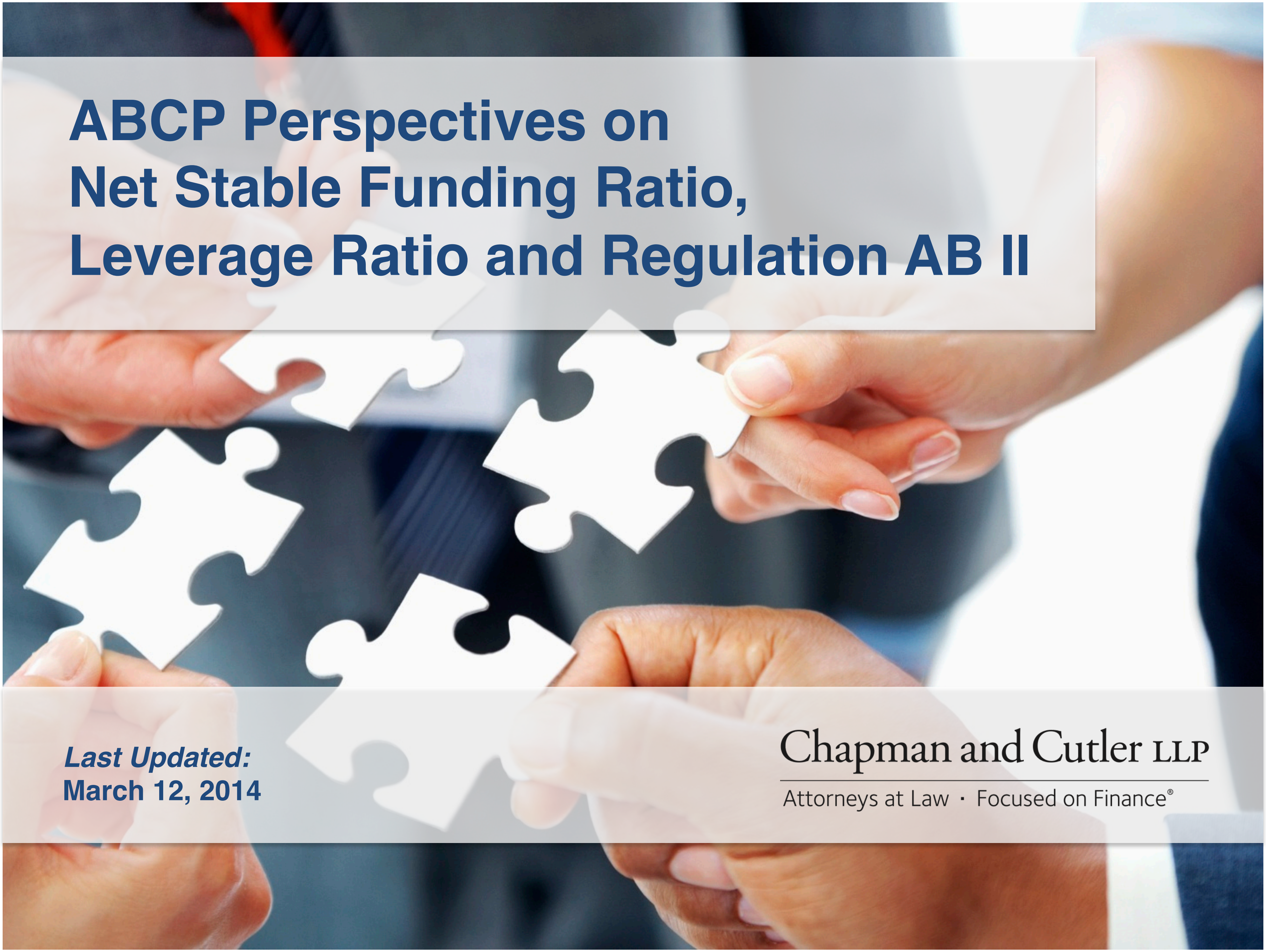

ABCP Perspectives on Net Stable Funding Ratio, Leverage Ratio and Regulation AB II

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Introduction

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Part A:

BCBS
Net Stable Funding Ratio Requirement

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Introduction to Net Stable Funding Ratio

- In January 2014, the Basel Committee on Banking Supervision (**BCBS**) published a Consultative Document presenting a net stable funding ratio (**NSFR**) requirement that will require banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

- The specific objective of the proposed NSFR requirement is to reduce funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress.

- Comments to the proposed NSFR requirement are due by **April 11, 2014**.

The Calculation

$$\text{Net Stable Funding Ratio} = \frac{\text{Available Stable Funding}}{\text{Required Stable Funding}}$$

The Numerator: Available Stable Funding

- The amount of available stable funding (**ASF**) is measured based on the broad characteristics of the relative stability of a bank's funding sources, including the contractual maturity of its liabilities and the differences in the propensity of different types of funding providers to withdraw their funding.
- To the extent that a bank treats the securitization of its assets as a liability for accounting purposes, these liabilities would seem to be given a 100% ASF factor or a 50% ASF factor based on their effective maturities. Presumably, off-balance sheet securitization liabilities would not constitute ASF.
- When determining the maturity of an equity or liability instrument, investors are assumed to redeem a call option at the earliest possible date. A bank should assume it will exercise any option available at the bank's discretion at the earliest possible date unless the bank can demonstrate to its supervisor's satisfaction that the bank would not exercise this option under any circumstances.
- For long-dated liabilities, only the portion of cash flows falling at or beyond the 6-month and 1-year time horizons would be treated as having an effective residual maturity of 6 months or more and 1 year or more, respectively.

The Numerator: ASF Look-Up Table

ASF Factor	Components of ASF Category
100%	• Total regulatory capital • Other capital instruments and liabilities with effective residual maturities of 1 year or more
95%	• Stable non-maturing (demand) deposits and term deposits with residual maturity of less than 1 year provided by retail and SME customers
90%	• Less stable non-maturing deposits and term deposits with residual maturities of less than 1 year provided by retail and SME customers
50%	• Funding with residual maturity of less than 1 year provided by non-financial corporate customers • Operational deposits • Funding with residual maturities of less than 1 year from sovereigns, public sector entities (PSEs), and multilateral and national development banks • Other funding with residual maturity of not less than 6 months and less than 1 year not included in the above categories, including funding provided by central banks and financial institutions
0%	• All other liabilities and equity not included in above categories, including liabilities without a stated maturity • Derivatives payable net of derivatives receivable if payables are greater than receivables

The Denominator: Required Stable Funding

- The amount of required stable funding (**RSF**) is measured based on the broad characteristics of the liquidity risk profile of a bank's **assets** and **off-balance sheet exposures**.
- Unless otherwise specified, the definitions used in determining the RSF factor mirror those outlined in the liquidity coverage ratio (**LCR**) requirement.
- For the purposes of calculating the NSFR, high quality liquid assets (**HQLA**) are defined as all HQLA without regard to LCR operational requirements and LCR caps on Level 2 and Level 2B assets that may otherwise limit the ability of some HQLA to be included as eligible HQLA in calculation of the LCR.
- Encumbered assets include but are not limited to assets backing securities or covered bonds.

The Denominator: High Quality Liquid Assets

	Basel LCR Guidance	U.S. Proposed LCR	Industry Comment to U.S. Proposed LCR
GSE MBS	N/A	Level 2A	The Agencies should permit Level 1 treatment for mortgage-backed securities issued by Fannie Mae and Freddie Mac ("GSE MBS") at least for so long as Fannie Mae and Freddie Mac are operating under conservatorship or receivership or are otherwise effectively guaranteed by the U.S. government. If the Agencies are unwilling to afford Level 1 treatment, the Agencies should exclude GSE MBS from the 40% cap applied to other Level 2A assets.
Private-Label RMBS	Level 2B	Do not qualify for HQLA treatment	Certain high credit quality RMBS should be afforded Level 2B liquid asset treatment. RMBS backed exclusively by Qualified Mortgages should qualify subject to a 25% haircut and all other RMBS should qualify subject to a 50% haircut.

The Denominator: High Quality Liquid Assets (Continued)

	Basel LCR Guidance	U.S. Proposed LCR	Industry Comment to U.S. Proposed LCR
Covered Bonds	Level 2B	Do not qualify for HQLA treatment.	Certain high credit quality covered bonds should be afforded Level 2B liquid asset treatment.
ABS	Do not qualify for HQLA treatment.	Do not qualify for HQLA treatment	Certain high credit quality ABS should be included as Level 2B liquid assets so long as their liquidity characteristics mirror those of publicly traded corporate debt securities.

The Denominator:
RSF Asset Look-Up Table

RSF Factor	Components of RSF Category
0%	• Coins and banknotes • All central bank reserves • Unencumbered loans to banks subject to prudential supervision with residual maturities of less than 6 months
5%	• Unencumbered Level 1 assets, excluding coins, banknotes and central bank reserves
15%	• Unencumbered Level 2A assets
50%	• Unencumbered Level 2B assets • HQLA encumbered for a period of 6 months or more and less than 1 year • Loans to banks subject to prudential supervision with residual maturities 6 months or more and less than 1 year • Deposits held at other financial institutions for operational purposes • All other assets not included in the above categories with residual maturiies of less than 1 year, including loans to non-bank financial institutions, loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns, central banks and PSEs

The Denominator: RSF Asset Look-Up Table (Continued)

RSF Factor	Components of RSF Category
65%	• Unencumbered residential mortgages with a residual maturity of 1 year or more and with a risk weight of less than or equal to 35% • Other unencumbered loans not included in the above categories, excluding loans to financial institutions, with a residual maturity of 1 year or more and with a risk weight of less than or equal to 35% under the Standardized Approach
85%	• Other unencumbered performing loans with risk weights greater than 35% under the Standardized Approach and residual maturities of 1 year or more, excluding loans to financial institutions • Unencumbered securities that are not in default and do not qualify as HQLA including exchange-traded securities • Physical traded commodities, including gold
100%	• All assets that are encumbered for a period of 1 year or more • Derivatives receivable net of derivatives payable if receivables are greater than payables • All other assets not included in the above categories, including non-performing loans, loans to financial institutions with a residual maturity of 1 year or more, non-exchange-traded equities, fixed assets, pension assets, intangibles, deferred tax assets, retained interest, insurance assets, subsidiary interests, and defaulted securities

The Denominator: Off-Balance Sheet Exposures

- The NSFR assigns an RSF factor to various off-balance sheet (**OBS**) activities to ensure that banks hold stable funding for the portion of OBS exposures that may be expected to require funding within a 1-year horizon.
- Consistent with the LCR, the NSFR identifies OBS exposure categories based broadly on whether the commitment is a credit or liquidity facility or some other contingent funding obligation.
- **Under the NSFR, off-balance sheet commitments are to be assigned RSF factors by national supervisors.** Based on the U.S. proposed LCR requirement, it seems likely that, in the United States, commitments to special purpose entities (SPEs) would be assigned a 100% (or other high) RSF factor.

The Denominator:
RSF OBS Exposure Look-Up Table

RSF Factor	Components of RSF Category
5% of the currently undrawn portion	Irrevocable and conditionally revocable credit and liquidity facilities to any client
National supervisors can specify the RSF factors based on their national circumstances	Other contingent funding obligations, including products and instruments such as: • Unconditionally revocable credit and liquidity facilities • Trade finance-related obligations (including guarantees and letters of credit) • Guarantees and letters of credit unrelated to trade finance obligations • Non-contractual obligations such as: - potential requests for debt repurchases of the bank's own debt or that of related conduits, securities investment vehicles and other such financing facilities - structured products where customers anticipate ready marketability, such as adjustable rate notes and variable rate demand notes - managed funds that are marketed with the objective of maintaining a stable value

Potential Industry Comments

- For purposes of assigning **RSF factors**, national supervisors should:
  - treat a credit commitment to an SPE under a bank customer securitization credit facility in the same manner as a revolving credit commitment to its corporate sponsor
  - not treat a securitization exposure issued by a financial institution as a loan to the financial institution so long as the securitization meets the definition of “traditional securitization” under the applicable jurisdiction’s risk-based capital rules and the sponsoring financial institution does not provide credit or liquidity support to the transaction
- For purposes of assigning **ASF factors**, the rule should treat an on-balance sheet securitization the same as an off-balance sheet securitization so long as the on-balance sheet securitization meets the definition of “traditional securitization” under the applicable jurisdiction’s risk-based capital rules. Also, the assets collateralizing such securitization should not be assigned an RSF factor.

Part B:

BCBS Leverage Ratio Requirement

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Introduction to BCBS Leverage Ratio Requirement

- In January 2014, the Basel Committee on Banking Supervision (**BCBS**) published its final Basel III leverage ratio framework and disclosure requirements.
- The Basel III framework introduced a simple, transparent, non-risk based leverage ratio to act as a supplement to the risk-based capital requirements. The BCBS intends that the leverage ratio will broadly capture both on- and off-balance sheet sources of banks' leverage.
- Banks will be required to publicly disclose their Basel III leverage ratio on a consolidated basis from the date of publication of their first set of financial statements relating to a balance sheet on or after January 1, 2015.

The Calculation

$$\textbf{Leverage Ratio} = \frac{\text{Capital Measure}}{\text{Exposure Measure}}$$

The Numerator: Capital Measure

- The **capital measure** at any particular point in time is the Tier 1 capital measure applicable at the time of measurement under the Basel III risk-based capital framework.

The Denominator: Exposure Measure

- A bank's total **exposure measure** is the sum of:
  1) On-balance sheet exposures;
  2) Derivative exposures;
  3) Securities financing transaction exposures; and
  4) Off-balance sheet items.

The Denominator:
On-Balance Sheet Exposures

- Banks must include **all balance sheet assets** in their exposure measure.

The Denominator: Off-Balance Sheet Items

- Off-balance sheet (**OBS**) items are incorporated into the leverage ratio exposure measure.
- OBS items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes, acceptances, standby letters of credit and trade letters of credit.
- In the risk-based capital framework, OBS items are converted under the Standardized Approach into credit exposure equivalents through the use of credit conversion factors (**CCFs**).

The Denominator: CCF Look-Up Table for OBS Items

CCF	OBS Item
10%	• Any commitments that are unconditionally cancellable at any time by the bank without prior notice or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness • At national discretion, undrawn servicer cash advances or facilities that are unconditionally cancellable without prior notice
20%	• Commitments other than securitization liquidity facilities with an original maturity up to 1 year • Short-term self-liquidating trade letters of credit arising from the movement of goods
50%	• Commitments other than securitization liquidity facilities with an original maturity over 1 year • Certain transaction-related contingent items • Note issuance facilities and revolving underwriting facilities • Eligible liquidity facilities
100%	• Direct credit substitutes • Forward asset purchases, forward forward deposits and partly paid shares and securities, which represent commitments with certain drawdown • All off-balance sheet securitization exposures (except an eligible liquidity facility or an eligible servicer cash advance facility)

Key Issues

There are 2 key issues that market participants hope U.S. regulators will consider in implementing the final BCBS leverage ratio requirement.

1. **The U.S. supplementary leverage ratio requirement should be revised to conform to the lower credit conversion factors set forth in the BCBS leverage ratio.**

   - Under the U.S. supplementary leverage ratio requirement, unconditionally cancellable commitments would be assigned a 10% CCF but all other off-balance sheet exposures would be assigned a 100% CCF.

2. **In connection with a bank customer securitization credit facility funded through an ABCP conduit, the portion of the bank's undrawn commitment that is available to support customer funding requests should be treated as a credit commitment with a 20% or 50% CCF, depending on its original maturity.**

Part C:

Regulation AB II Re-Proposal

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Regulation AB II Background

- In **April 2010**, the SEC proposed "Regulation AB II" – a series of new and amended rules that, if adopted, would substantially revise the offering process, disclosure and reporting requirements for publicly issued ABS and **impose new and enhanced disclosure and reporting standards for privately issued structured finance products** relying on Reg D or Rule 144A. Market participants commented extensively on this original proposal.

- In **July 2011**, the SEC re-proposed certain of its Regulation AB II rule proposals in light of Dodd-Frank and comments received on the original proposals. Among other things, the SEC solicited additional comments on:

  - its proposal to require asset-level information about pool assets and related privacy concerns; and

  - whether the disclosure requirements it proposed were responsive to the mandate of Section 942(b) of Dodd-Frank, which is to provide asset level data if such data "is necessary for investors to independently perform due diligence."

  The comment period on the re-proposed rules expired on October 4, 2011.

Regulation AB II Background *(Continued)*

- In **February 2014**, the SEC re-opened the comment period for Regulation AB II to solicit further public comment on a new approach to disseminate potentially sensitive asset-level data. More specifically, the SEC is considering requiring issuers to make asset-level information available to investors and potential investors on a restricted Web site, rather than being filed on EDGAR. **The comment deadline is March 28, 2014.**

- Concurrently with the SEC's announcement, Commissioner Piwowar released comments concerning the re-opening of the comment period and encouraged market participants to express views on whether asset-level data is required to implement the Congressional mandate in Dodd-Frank for such asset-level disclosure as is "necessary for investors to independently perform due diligence."

Impact on ABCP: April 2010 Original Proposal

- In the April 2010 Proposing Release, the SEC proposed to condition the availability of the safe harbors for privately issued structured finance products – Reg D, Rule 144A and Rule 144 – on issuer's **undertaking to provide investors, upon request in connection with initial offers or sales and on an ongoing basis, the same information as would be required in a registered transaction**.
- The disclosure and ongoing reporting requirements would apply to ABCP issued by ABCP conduit programs that provide for resales of ABCP in reliance on Rule 144A.
- ABCP conduits would be subject to, among other things:
    - asset-level disclosure, in addition to pool data;
    - periodic reporting on asset-level performance using standardized data points for specific asset types;
    - standardized electronic reporting of all information; and
    - disclosures regarding transaction parties, including originators of 10% or more of pool assets, parties who have repurchase obligations and servicers.

Impact on ABCP: April 2010 Original Proposal *(Continued)*

- As a result of the the unique characteristics of ABCP programs (such as short-term, rolling nature, credit and liquidity features, active administration by a sponsor, etc.), it would **be impractical, if not impossible, and unnecessary for ABCP conduits to comply with the information delivery requirements** given the volume and detail of asset-level data required by the April 2010 Proposing Release to be delivered to investors.

- In response to the April 2010 Proposing Release, ABCP issuers, investors and brokers proposed **alternative information delivery requirements** based on best practices in the ABCP marketplace.

Summary of February 2014 Re-Open

- As **originally proposed**, the new asset-level data points required by Regulation AB II would have been required to be **publicly filed on EDGAR**. In the view of many commenters, the asset-level data requirements would allow the identifications of individual obligors and their personal financial status, in conflict with U.S. federal and foreign consumer privacy laws.
- In an SEC staff memorandum referenced in the **February 2014 Re-Open**, the SEC staff suggests an approach that would require sensitive asset-level data to be made available to investors and potential investors **directly by the issuer on a restricted access website**, rather than being filed on EDGAR.
- Under the SEC staff's approach, asset-level information that does not raise privacy concerns would still be filed on EDGAR and made available to the general public. However, potentially sensitive information would be provided in full (rather than in ranges or categories) to investors via a website.

Impact on ABCP: February 2014 Re-Proposal

- Based on the February 2014 Re-Proposal and the related SEC staff memorandum, it is difficult to discern whether (or what kind of) new disclosure requirements for Rule 144A offerings will be included in the final Regulation AB II rules when adopted by the SEC.
  - According to the SEC staff, "***[s]ome issuers and investors may decide to move to the private market instead of incurring the costs attendant to providing or receiving information through a Web site***… If investors in the private market expect the same or similar information as provided in the public market, this move may not be significant, as issuers would be required to develop comparable disclosure systems for the private market."

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