Deutsche Börse Group
Response

to DG FISMA Consultation Paper on

'Further considerations for the implementation of the NSFR in the EU'

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A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on DG FISMA consultative document 'Further considerations for the implementation of the NSFR in the EU' issued in May 2016.

DBG operats in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such is mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A., Luxembourg and Clearstream Banking AG, Frankfurt/Main, who act as (I)CSD[1] as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are classified as credit institutions and are therefore within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transposed i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

Due to the settlement activities of Clearstream Banking S.A. and Clearstream Banking AG in more than 40 currencies and additional value-added service being ancillary to the CSD activities the banking licences is needed by the two companies. The current usage of the banking licence is already reflecting almost the future requirements to perform ancillary banking services as defined for CSDs by Article 54 of the CSD-Regulation (CSD-R) in combination with Section C of the Annex of CSD-R.

However, the business model of both CSDs and CCPs as financial market infrastructures (FMIs) is completely different from the business of ordinary banks. There is no proprietary trading, only minor maturity transformation, very limited financial risk due to tight additional rules based on the CPSS-IOSCO principles on financial market infrastructures[2] as implemented in EU regulations (EMIR and CSD-R) and dedicated business limitations. As such, several parts of the CRD IV / CRR framework do not applied (trading book, general market risk, securitisation, etc.) and other elements are not meaningful in the context of FMIs. The latter is in particular true for the NSFR and the Leverage ratio.

The document at hand contains therefore a description of our dedicated business models in context of the NSFR in Part B (CSDs) and Part C (CCPs) and our position

[1] (International) Central Securities Depository;

[2] http://www.bis.org/cpmi/publ/d101a.pdf.

of the scope of application and details of the NSFR including dedicated response to selected questions raised in the consultative document in Part D.

B. Dedicated description of CSD business in the context of NSFR

CSDs operating with a banking licence which respects the limitations of Article 54 CSD-R[3] to only perform banking-type ancillary services as specified in Section C of the Annex of CSD-R. CSD-R (a) clearly defines allowed banking activities as <u>ancillary</u> to the core CSD services, (b) <u>limits</u> the services heavily and (c) requires not only highest banking standards but also <u>additional requirements</u>. As such, CSDs offering banking services are massively limited in their banking activities and prudentially regulated by EU law going forward and respect most of these limitations already now.

Deposit taking and cash lending is only performed ancillary to the core business and consequently has a very short maturity (i.e. intraday or overnight). Limited securities lending activities (in general using client assets only) are not impacting the liquidity and are not taking into account in the balance sheet or as an off-balance sheet position according to applicable accounting rules. The balance sheet is driven by the above mentioned short term cash <u>deposits</u> used to foster settlement and resulting short term assets are the consequence of placing such funds including a certain portion of such assets being a cash residuum. As such, besides equity and long term provisions only short term liabilities exist and assets are mainly short term as well. Only the investment of equity and the long term provisions is done in an investment portfolio of highly liquid assets and a part of the cash residuum is placed in short term money market placements (e.g. reverse repos).

Being driven by short term cash deposits (the overnight usage of cash loans is low compared to the cash deposits), the funding structure does not really matter and maturity transformation is done only to a very limited extent in order to reduce operational burden and to take advantage of slightly higher interests rates for placing cash residuum slightly longer than overnight. In addition, the size of the balance sheet is depending on the cash disposition of clients only and consequently it is <u>highly volatile</u>.

The ability to manage the balance sheet volume is very limited for CSDs. The magnitude of cash deposits received by its participants can only be influenced to a limited

[3] Although, the CSD-R licencing process has not been started yet the current ancillary banking services of CSDs are more or less comparable to the limitations set by CSD-R.

extent – if at all. They depend solely on the participants' disposition, expected settlement, custody (interest, dividends, redemptions, corporate actions) payments or new issuance payment obligations as well as the timing of transactions[4] and the ability of the participants' treasury departments to forecast cash balances and manage cash positions. This is even more true for customer overnight overdrafts which receive a punitive interest charge[5] while deposits in general do not receive any interest in line with CSD-R requirements. Both, participant's cash deposits as well as (collateralised) [intraday] overdrafts are necessary to secure a high degree of settlement efficiency and as such limiting cash deposits is not regarded as a valid option and steering of cash deposits and overdrafts used via interest rates or additional fees is already used to limit in general overnight overdrafts but have only a limited impact on the cash deposits.

C. Dedicated description of CCP business in the context of NSFR

CCPs intermediate as legal counterparty into (derivative) transactions between trading and final fulfilment. They perform appropriate risk management including sufficient collateralisation within multiple lines of defence as requested by EMIR. According to EMIR CCPs may hold an additional banking licence to support their operations or when deemed suitable by the competent authority. Such CCPs like Eurex Clearing AG in general have to fulfil full requirements of CRD IV / CRR. Nonetheless, the banking activities are very limited and are <u>ancillary</u> to their core function.

In order to operate as CCP and in line with the dedicated regulatory framework EMIR as well as generally recognised business practices, the business model of a CCP is risk averse, does not include a trading book / proprietary trading and does not lead to material maturity transformation. Cash received as collateral within the CCP function is based on the sole discretion of the clearing members[6]. As such, CCPs are highly dependent on the short term cash flows of its participants resulting in highly volatile positions in the balance sheet.

In addition, CCPs are required by Article 47 EMIR to have adequate liquid resources which have to cover at least the default of their two largest clearing members, includ-

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[4] Keep in mind that we operate a 21 hours day and therefore cash balances may be left in order to facilitate settlement for the next settlement date.

[5] See Article 59 (3) CSD-R in conjunction with Article 18 (1) of the final draft EBA/RTS/2015/10.

[6] Margin/collateral requirements may be fulfilled by either cash or securities to the discretion of the client.

ing all their clients. Article 47 EMIR in addition requires that financial resources (including received cash collaterals) must be invested with low credit risk and to a large degree without maturity transformation. Existing maturity transformation (strictly limited) is done based on proper liquidity management principles and not driven by intention to gear net interest income. Contrary, interest earned on clients' deposits is forwarded to the clients to a large extent. Only a limited margin is maintained. For the CCP business collateral taken is the consequence of the general political preference for CCP cleared business especially for financial derivatives. In order to secure sufficient liquidity for the CCP function at any time a preference for cash collateral received in comparison to other forms of collateral (e.g. securities) is inherent in the CCP business model.

D. Scope of application of the NSFR and response to selected questions raised in the consultative document

The dedicated business model of CCPs have been captured in the EBA report on Net Stable Funding Requirements under Article 510 of the CRR[7] where EBA proposes to exclude CCPs with a banking licence from the application of the NSFR. As stated above and in line with EBA's conclusion in recommendation 7 of its report business models of both CSDs and CCPs are not based on maturity transformation.[8] In contrast, the intention of the NSFR is to capture funding risks arising from such maturity transformation. Thus, in our view the application of this measure is not reasonable for CSDs and CCPs.

However, in case the NSFR will be applied to CSDs / CCPs we do want to point out resulting implications which may have negative impacts on the stability of financial markets. The clients' behaviour to place deposits with CSDs or cash collateral with CCPs is driving the balance sheet volume. Consequently, the balance sheet volume is highly volatile and hence also the NSFR would be highly volatile. It needs to be noted that due to the structure of the balance sheet the NSFR (depending on the final definition) is supposed to be well above the minimum requirement at all times. Nonetheless, disclosing high volatile NSFR without underlying related movements of fund-

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[7] EBA/Op/2015/22: https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-22+NSFR+Report.pdf

[8] We consider that EBA has proposed the exemption for CCPs only while the CSDs have been forgotten unintentionally.

ing necessities may indicate biased information. As such, the disclosure of NSFR figures will most likely give misleading information of CSDs / CCPs and in this regard is creating reputation risks and unintended negative market observations as a reduction of the NSFR most probably will be read as a deterioration of the liquidity situation.

As the NSFR does not reflect the CSD / CCP business in an adequate manner and the purpose of the NSFR is already captured by law through business limitations the NSFR should not be applied to CSDs / CCPs regardless if they operate with or without (additional) banking licence.

In case our strong request is not followed, we at least require to consider a distinct treatment of CSDs and CCPs in the upcoming legislative proposal according to Article 510 paragraph 3 CRR.

The short term deposits (CSDs) or cash collaterals (CCPs) have an operational background. Although the amounts are highly volatile in both cases a certain percentage remains quite sticky (cash residuum). This is true for CCPs to a larger extent as for CSDs. As the short term cash liabilities are placed short term and the liabilities have an operational character as well as the overall amount shows a substantial cash residuum, the current treatment as defined by the BCBS of a 10-15% weight for the RSF and 0% weight for the ASF does not make sense. The cash position of CCPs and CSDs is driven by the deposited funds and not by taking loans. Consequently, the ASF factor for the short term cash liabilities should be higher than the RSF factors for the cash assets. Hence, we propose to classify CSD cash deposits and CCP cash collaterals by default as operational deposits and therefore allocate an ASF factor of 50% as mentioned above.

Please find in the following our particular feedback to selected questions raised in the consultative document.

Question 1:

In light of previous consultations, could you describe more specifically, if appropriate, the specific activities, transactions and business models where you have evidence that the implementation of the NSFR could have an excessive impact or important unintended consequences?

As described in Part B and C, the business models of CSDs and CCPs are completely different from that of a “normal” bank and the application of the NSFR (as well as of the Leverage Ratio) in the same manner as for “normal” banks or even at all in our view is not appropriate. CSDs and CCPs are highly dependent on the <u>short term</u> cash positions of its participants related to cash collateral (CCPs) or cash deposits for settlement and custody payment purposes (CSDs).For CCPs this is true regardless if an additional banking licence is received or not. Therefore the application of the liquidity rules and measures as defined in EMIR are sufficient for CCPs and there is no need to apply the NSFR on top. This is also warranting a level-playing field between CCPs with or without banking licence.

The disclosure of highly volatile NSFR for FMIs without a real maturity mismatch reasoning further underpins the inappropriateness of the NSFR in this case.

<u>Question 2:</u>

If a respondent is a bank, could you please quantify the level of your expected shortfall of stable funding, the changes to the composition of your balance sheet that may result from meeting the NSFR and what the impact of these changes may be on the European economy?

In principle FMI’s liabilities consist of very short term deposits (CSDs) or short term cash collaterals (CCPs) which are placed without a material maturity mismatch on the market. Equity and short term provisions are in general sources of stable funding which are invested into high liquid financial assets which only require a small portion of stable funding resources. As such, no shortfall is expected but a rather constant absolute excess funding. As the balance sheet total is highly volatile, due to its calculation rule the NSFR will be highly volatile as well despite a more or less constant funding surplus.

<u>Question 6:</u>

In light of previous consultations, could you provide substantiated evidence about possible issues caused by the application of the BCBS NSFR standard to short term transactions with financial institutions at European level and which have not been taken into account at Basel level? If yes, what alternative treatment would you propose for NSFR calculation purposes to deal with the funding needs arising from short-term transactions with financial institutions? If possible, please provide the impact on your institution of the alternative treatment you propose (as compared to the BCBS standards).

In regard to this question we refer to our introducing descriptions in Part D. The treatment of short term cash positions towards financial institutions in our case would lead to the fact that by cash deposits and cash collaterals driving the balance sheet volume would receive a 0% ASF factor while the placing of these funds would receive a 10-15% RSF factor. Consequently, there would be a structural funding short fall in the NSFR while practically excess funding is existing. In order to solve the problem cash deposits and cash collaterals of CSDs / CCPs in scope of the NSFR (if despite our strong recommendation applied) should be defined as operational deposits and consequently receive a 50% RSF factor as proposed by the BCBS (paragraph 24 (a) of the Basel III net stable funding ratio standard).

We also want to point out that the NSFR is not foreseen to identify a short term liquidity gap which would be signalised by the NSFR if overnight cash positions are handled with impaired weights overweighting the RSF. As such, the current proposed treatment should not be taken into account at EU level and should be reconsidered at Basel level.

Question 7:

If you propose special treatment for specific activities (e.g. client's short facilitations activities, prime brokerage businesses…), how would you define these activities?

If our request to exclude CSDs and CCPs from the NSFR is not followed, we request that cash deposits of CSDs and cash collaterals of CCPs would be defined as follows: *"Liabilities of central securities depositories according to Article 2 paragraph 1 of Regulation (EU) No 909/2014 towards its participants and central counterparties according to Article 2 paragraph 1 of Regulation (EU) No 648/2012 towards its clearing members with remaining maturity of less than three month are treated as operational deposits for the purpose of the net stable funding ratio."*

Question 9:

In particular, what criteria could be used to define institutions with a "low liquidity risk profile"? What simplified metrics (e.g. core funding ratio close to loans to deposits +

capital) could be used to identify these institutions? Should certain institutions be completely exempted from the NSFR and on what basis?

As already stated above, CSDs / CCPs with banking licence should be completely exempted from the NSFR. We highly request an exemption of business models for which the NSFR does not fit at all.

In case our request is not followed for either of the two business models, we at least recommend to consider a distinct treatment of CSDs and CCPs in the NSFR regime. As such, the classification of cash liabilities towards clients could be regarded as operational deposits (see Question 6.).

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We are at your disposal to discuss the issues raised and proposals made if deemed useful.

Yours faithfully,

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