COMMITTEE ON SECURITIES LENDING

November 30, 2016

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Board of Governors
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Dear Messrs. Campbell and McDonough,

The Securities Lending Committee of the Risk Management Association ("RMA") welcomes the opportunity to submit this supplemental letter to the Board of Governors of the Federal Reserve System ("FRB") on behalf of several of its members that participate in the securities lending industry as agent banks on behalf of their clients. In response to our meeting with you on September 8, 2016, RMA asked member agent lender firms to voluntarily provide data on the impact to securities lending market volumes for equity and fixed income instruments, as well as the revenue impact to beneficial owners.

The following is a summary of the data-collection efforts by RMA related to the FRB's proposed Single Counterparty Credit Limits (SCCL) and its impact on the securities lending market and our clients. Unfortunately, the number of participants that were able to produce data was limited due to undetermined credit line allocation for many firms that have a significant number of business lines, beyond agency-lending, and that interact with the same counterparties. While the impact of SCCL may vary from institution to institution, we feel the data is representative of the overall industry effect. This assumption is based on the fact that the data covers approximately half of the loan activity of the RMA membership and many institutions would be affected by the punitive treatment for securities financing transactions (SFTs) relative to other types of transactions. Namely, the currently proposed treatment for SFTs does not account for portfolio effects from correlation and diversification, whereas other business lines would be able to benefit from such effects (i.e., SA-CCR for derivatives). This essentially means that the SFT business lines are being risk weighted based on a gross exposure basis, whereas derivatives and other business lines are being risk weighted on a net exposure basis. The uneven and inconsistent treatment of these lines of business will result in a significant market distortion that will move transactions from the simpler physical market which creates price transparency to the more opaque and complex derivative-based synthetics. Overall, this seems to be inconsistent with the general goals of regulatory reform under both Basel III and the Dodd-Frank Act to strengthen the financial system and reduce the potential for systemic risk.

The significant and growing level of non-cash collateral and indemnified repo within counterparty netting sets results in exposure calculations for SFTs that are 15 to 20 times higher than those derived under advanced methods. Additionally, the results vary by many multiples from the proposed Basel enhanced comprehensive approach for credit exposure for SFTs. Based solely on the chosen measure of credit exposure, the return from SFTs will almost always be less than that of other businesses.

Therefore, all other things being equal, we would anticipate that in instances where a reduction in credit exposure utilization can be achieved by reducing trading in multiple businesses, in the preponderance of cases the reduction will take place in SFTs.

For those institutions that were able to provide data, we found that, on average, six to ten SFT counterparties would have to be reduced, which comprise approximately 90% of SFT balances. The average required exposure reduction across the top ten counterparties was 36.5%, with the largest counterparties requiring exposure reductions in excess of 50%. From a loan portfolio perspective, this would result in a decline in fixed income lending balances of 30% to 35%, or $180 to $205 billion, and a reduction in equity lending balances of 30% to 35%, or $170 to $195 billion. This would result in total securities lending balances declining by approximately $350 to $400 billion. In these scenarios, all lending of US Treasury securities with maturities in excess of five years would be halted with the largest counterparties. As noted in our September meeting, the impact of the uneven treatment of different business lines from a credit exposure perspective will likely have a significant impact on market liquidity.

The clients participating in securities lending include public employee pension plans, private pension plans, endowments, foundations, and mutual funds. Based on the data provided, we also anticipate a significant decline in client revenues. We estimate that it will be approximately 23%, or roughly $3.5 to $4.0 billion per annum.

Based on this data, we would strongly urge the FRB to consider the use of an alternative measure for SFT which on a portfolio basis is more in line with the treatment of other transaction types. The currently proposed method for calculating credit exposure for SFTs on an absolute basis, which results in higher credit utilization relative to other similar economic exposures, will significantly impact businesses, markets and beneficial owners.

While simple haircuts are appropriate for one-way exposures, such as individual SFTs, agent lending programs are managed on a portfolio basis with offsetting loan and collateral exposures that have significant diversification benefits. Based on the impact of other Basel and FRB regulatory changes, such as the Supplementary Leverage Ratio, Liquidity Coverage Ratio, and the pending Net Stable Funding Ratio, the level of non-cash collateral in the agency lending business has substantially increased in recent years, and we would anticipate that this trend will continue. As such, the importance of capturing the complexity of a loan and collateral portfolio from a netting perspective will only continue to increase.

Please let us know if we can be of any further assistance in ensuring the proportionate treatment of SFTs in the SCCL framework, which can achieve the regulatory goals of the FRB to protect the liquidity of the capital markets and maintain parity across varying businesses lines.

Sincerely,

Fran Garritt

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The Risk Management Association

Glenn Horner

Chairman, RMA Executive Committee
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