August 5, 2016

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Re: ***Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements; Proposed Rule [Board: Docket No. R-1537; RINs 7100-AE51] [OCC: Docket ID OCC-2014-0029; RIN 1557–AD97] [FDIC: RIN 3064-AE44]***

I. Introduction

The Coalition for Derivatives End-Users (the "Coalition") is pleased to respond to the request for comments from the Agencies[1] on the proposed rule titled *Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements* (the "Proposed NSFR").[2] The Coalition represents end-user companies and trade associations that employ derivatives primarily to manage risks. Hundreds of companies have been active in the Coalition on both legislative and regulatory matters,[3] and our message is straightforward: financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on corporate end-users, who are the engines of the economy. Imposing unnecessary regulation on corporate end-users—parties that did not contribute to the financial crisis—would fuel economic instability, restrict job growth, decrease productive investment and hamper U.S. competitiveness in the global economy.

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[1] The "Agencies" consist of the Department of the Treasury's Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation.

[2] Proposed Rule, *Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements*, Office of the Comptroller of the Currency, 81 Fed. Reg. 35124 (June 1, 2016).

[3] For a list of companies and trade associations that have been active in the Coalition, please see http://coalitionforderivativesendusers.com/AboutUs/coalition-members.

The Coalition recognizes the importance of long-term stable funding and its function as a liquidity buffer in a time of financial stress. However, while we appreciate the efforts of the Agencies to address these concerns by proposing a net stable funding ratio ("NSFR"), we would again[4] stress the need for the Agencies to carefully consider and implement a final rule in a manner that allows main street businesses to continue prudently hedging their commercial and market risks, and ensures sufficient liquidity and access to commercially viable means of credit.

Implementation of various aspects of the Proposed NSFR would harm end-users in unintended ways. The costs of incremental long-term funding required for banks and dealers under the Proposed NSFR would likely result in increased transaction costs to end-users and could potentially lead to banks exiting particular markets. In particular, the Coalition is concerned with the potential for the Proposed NSFR to deter financial institutions from facilitating corporate end-user transactions:

- *The Proposed NSFR would unfairly penalize risk mitigation*: Corporate end-users do not view derivatives as a profit center. Instead, corporate end-users utilize derivatives as a mechanism to hedge commercial risk, a practice that benefits the global economy by allowing a range of businesses—from manufacturing to health care to agriculture to energy to technology—to improve their planning and forecasting and offer more stable prices to consumers and more stable contributions to economic growth. The Proposed NSFR currently ignores the congressionally recognized benefits of unimpeded corporate end-user access to derivatives as a commercial risk mitigation tool,[5] and, as a result, would destabilize this practice by requiring end-user counterparties to meet burdensome funding requirements.

- *The Proposed NSFR would restrict commercial growth*: Corporate end-users rely on financial institutions to serve as capital markets intermediaries and sources of stable credit. They use banks to underwrite their corporate debt and equity securities and provide the liquidity that they require to invest in their businesses, create jobs and generate economic growth. Costly funding requirements under the Proposed NSFR are likely to be passed on to end-users or may force banks to exit such business lines altogether, thereby decreasing liquidity and affecting end-users' access to credit and the ability to efficiently hedge and execute transactions in the capital markets.

To ensure stable growth in economic activity contributed by the corporate end-user community, we believe that the final rule should be further tailored in order to regulate banking organizations in ways that do not impose undue burdens and costs on end-users that use derivatives to manage the risks of their businesses. Indeed, the cumulative impacts of the implementation of the Basel

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4 Coalition for Derivatives End-Users, *Consideration of the Net Stable Funding Ratio and its Impact to the End-User Community* (Oct. 8, 2015), *available at* http://coalitionforderivativesendusers.com/uploads/sites/351/2015%2010.8%20Coalition%20for%20Derivatives%20End-Users%20-%20Letter%20on%20NSFR%20Impacts%20to%20the%20End-User%20Community.pdf.

5 For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 2(h)(7) to the Commodity Exchange Act ("CEA"), which exempts corporate end-users from clearing requirements when "using swaps [or derivatives] to hedge or mitigate commercial risk."

III regime in the U.S. are already being realized. A number of Coalition member companies have indicated that they have experienced impacts on derivatives transaction pricing as the implementation of Basel III is underway.[6] Ultimately, these downstream costs would likely lead to increased costs to consumers and stifle productive investment and job growth.

We write to you today to express our deep concerns with several aspects of the Proposed NSFR. In particular, we note that the cumulative effects of the Proposed NSFR likely would serve to (1) cause dealers to pass funding costs on to corporate end-users; (2) restrict corporate end-user access to credit by discouraging dealer participation; and (3) reduce liquidity in markets necessary for commercial businesses to thrive. Below, we suggest ways in which these harms to end-users could be mitigated.

II. Exemption for Nonfinancial End-Users

The Proposed NSFR could materially undermine congressionally mandated exemptions afforded to corporate end-users under the Commodity Exchange Act ("CEA").[7] These exemptions reflect a broad policy consensus that end-user risk mitigation activities do not threaten financial stability; rather, they contribute to companies' ability to make stable contributions to a vibrant economy. Unambiguous end-user exemptions from clearing and uncleared margin requirements reflect the need for liquid and efficient markets in which corporate end-users can effectively and efficiently hedge their commercial risks. Indeed, these exemptions reflect reasoned debate and consideration of the stability of the financial marketplace,[8] and serve as an explicit declaration that the commercial hedging activities of end-users promote economic growth and job creation and do not create systemic risk.[9]

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[6] A June 2016 U.S. Chamber of Commerce study found that 50% of nonfinancial business respondents said that "increased bank capital charges have increased their costs and challenges" and that "more than three-quarters of American companies of all sizes report that the cumulative effect of financial regulations adopted over the past six years is making it harder for them to access the financial services they need." *Financing Growth: The Impact of Financial Regulation*, U.S. Chamber of Commerce (June 16, 2016), *available at* https://www.uschamber.com/sites/default/files/documents/files/financing_growth_report_16_june_16.pdf.

[7] 7 U.S.C. § 2(h)(7); 7 U.S.C. § 6s(e)(4).

[8] As the drafters of the Dodd-Frank Act explained, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators "must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk. . . . If regulators raise the costs of end user transactions, they may create more risk. It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth." 156 CONG. REC. S 6192 (daily ed., July 22, 2010) (statement of Senators Christopher Dodd and Blanche Lincoln). Chairman Frank echoed these concerns with similar sentiment several years later when testifying before the House Committee on Financial Services by agreeing with the Coalition's position that end-users did not create the risks that led to the financial crisis. *See Assessing the Impact of the Dodd-Frank Act Four Years Later*, 113th Cong. 20-21, 33, 56 (July 23, 2014).

[9] Congress again recognized the need for non-interference with corporate end-user risk mitigation when passing H.R. 26, which amended Section 4s of the CEA by making clear that end-users are exempt from margin requirements for uncleared swaps. *See* H.R. 26, 114th Cong. § 320 (2015). Congress then reaffirmed its commitment to the success of the corporate end-user community by clarifying in H.R. 2029 that Section 2(h)(7)

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Although the Proposed NSFR would not remove the federal exemptions provided to end-users in the CEA, in practice, the Proposed NSFR would likely cause covered banks to pass on the costs of additional long-term funding requirements to corporate end-users. In order to cover the costs associated with raising long-term funding, it is likely that banks would increase transaction fees and/or force end-users to post collateral, thus increasing costs for and discouraging activities that did not contribute to the financial crisis and that are designed to protect businesses from risks and make the global economy more stable.

Further, including end-user derivatives transactions in the Proposed NSFR calculations under Section _.107 would add unnecessarily to the regulatory burden faced by banking organizations in ways that will ultimately impact end-users' ability to efficiently manage risk. Such impacts can be plainly observed in the effects of other bank regulations. For example, as demonstrated by JP Morgan's commercial deposit-taking surcharge—and the increased inability for end-users to efficiently engage a single banking entity to provide all necessary services[10]—additional capital and liquidity standards would only compound end-user risk.[11] Such examples illustrate that regulators should exercise extreme care when implementing bank regulations that have material impacts on end-users. Requiring unnecessarily high long-term funding reserves for non-speculative transactions would increase end-user costs without materially reducing systemic risk and would discourage commercial hedging transactions that promote economic growth and jobs in the real economy.

To address these concerns, the Coalition requests that the Agencies provide an exemption from the calculation under Proposed NSFR Section _.107 for all end-user trades that qualify for any of the exceptions from clearing or margin requirements under the Agencies' final margin rules for uncleared swaps.[12] Relieving such transactions from the full effects of Section _.107 would not undermine the Proposed NSFR's systemic risk objectives, yet would help minimize the adverse economic impact of raising end-user costs and better align the Proposed NSFR's objectives with the current regulatory regime and congressional intent.

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of the CEA exempts end-users utilizing a centralized treasury unit from clearing requirements. *See* H.R. 2029, 114th Cong. § 705 (2015).

[10] A recent June 2016, U.S. Chamber of Commerce study found that 86% of nonfinancial businesses "indicated that it is important for financial services providers to offer a wide spectrum of services" and 85% of respondents noted their reliance on four or more banking services, such as cash management, derivatives hedging, long- and short-term loans, financing, and issuances. *Financing Growth: The Impact of Financial Regulation*, U.S. Chamber of Commerce (June 16, 2016), *available at* https://www.uschamber.com/sites/default/files/documents/files/financing_growth_report_16_june_16.pdf.

[11] Emily Glazer, *J.P. Morgan to Start Charging Big Clients Fees on Some Deposits*, THE WALL STREET JOURNAL (Feb. 24, 2015), *available at* http://www.wsj.com/articles/j-p-morgan-to-start-charging-some-big-clients-deposit-fees-1424743293; *see also* Phillip Lindow and Lori Schwartz, *A defining moment*: *New regulations and their impact on the definition of cash deposits*, J.P. Morgan (2015), *available at* https://www.jpmorgan.com/directdoc/defining-moment-liquidity-regulations.pdf.

[12] Final Rule, *Margin and Capital Requirements for Covered Swap Entities*, 80 Fed. Reg. 74840 (Nov. 30, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf.

Further, even with such an exemption, U.S. banks would still be required to have significantly greater stable funding; indeed, it has been estimated that the current aggregate shortfall in available stable funding for the U.S. banking industry exceeds $1 trillion.[13] By including an exemption for end-user derivatives activities in a final NSFR, the Agencies would in no way exclude risks associated with speculative trading.

We note that a capital requirements-related exemption for end-users has already been adopted by the European Union ("EU") through its implementation of Basel III standards. The EU exempted non-centrally cleared OTC derivatives transactions between banks and nonfinancial corporates from a component of the Credit Valuation Adjustment ("CVA") calculation. Disparate treatment between European and U.S. regulation would further burden the end-user community as EU commercial firms would benefit from reduced costs due to exemptive relief on key aspects of the overall capital requirements framework. Current U.S. law does not provide a similar CVA exemption, but exemptive relief from the Proposed NSFR would help achieve the same goal of reducing costs and burdens imposed unnecessarily on end-users that use derivatives to hedge or mitigate commercial risks.

While we respect the Agencies' efforts to promulgate rules substantially similar to international standards issued by the Basel Committee on Banking Supervision ("BCBS"),[14] the Coalition respectfully asks the Agencies to reconsider the true burdens that the Proposed NSFR would pose to the U.S. economy. We would ask that the Agencies take a nuanced approach in implementing an NSFR, recognizing that certain aspects of the BCBS NSFR have the potential to stifle growth with unclear risk reduction benefits. In this regard, we urge the Agencies to coordinate with their counterparts on the BCBS to make necessary changes to the BCBS NSFR that reflect such a targeted approach and that consider the impacts on end-users, so that the NSFR is implemented consistently across jurisdictions. Relief for the end-user transactions described above from Proposed NSFR calculations would strengthen U.S. commerce by allowing end-users to effectively hedge against commercial risks.

III. THE PROPOSED NSFR WOULD PLACE DISPROPORTIONATE COSTS ON END-USERS

While we believe an exemption from Proposed NSFR Section _.107 is appropriate, should the Agencies continue with the current framework, we would recommend that the Agencies take other steps to mitigate the financial burdens of the Proposed NSFR on corporate end-users.

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[13] End-user transactions represent a small portion of the overall over-the-counter ("OTC") derivatives market. It has been noted that end-users represent less than 10% of the total OTC derivatives market. Thomas Deas, *Testimony before the U.S. House of Representatives' Subcommittee on Capital Markets and Government Sponsored Enterprises – Committee on Financial Services* (Apr. 11, 2013), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-113-ba16-wstate-tdeas-20130411.pdf. An October 2014 study conducted by the Bank of International Settlements noted that "many (but not all) end users have a much smaller footprint in the OTC derivatives market than typical broker-dealers." *See* OTC Derivatives Assessment Team, *Regulatory reform of over-the-counter derivatives: an assessment of incentives to clear centrally*, Bank of International Settlements at 18 (Oct. 2014), *available at* http://www.bis.org/publ/othp21.pdf.

[14] *See Basel III: the net stable funding ratio*, BCBS Supervision (Oct. 2014), *available at* http://www.bis.org/bcbs/publ/d295.pdf [hereinafter, "BCBS NSFR"].

Treatment of corporate end-user derivatives activity under the Proposed NSFR disproportionately burdens a community traditionally associated with stability and growth. The Coalition's concern with the Proposed NSFR is threefold: (1) the long-term funding costs would limit and discourage bank swap dealer involvement in derivatives and derivatives-related transactions, effectively reducing liquidity in the market that end-users rely on to hedge risks; (2) end-user access to credit will decrease as a result of counterparty funding requirements; and (3) the costs associated with capital-raising in a less liquid and capital-intensive market would inevitably be borne by corporate end-user companies. These costs are likely to be passed on in the form of increased fees or transaction costs, less favorable terms and collateral requirements and would hinder end-users' abilities to effectively hedge risk.[15]

In particular, the Coalition is concerned with the impacts of several specific provisions of the Proposed NSFR that would adversely affect corporate end-users: (1) the add-on costs associated with counterparty payables; (2) the treatment of uncollateralized receivables; (3) the lack of collateral offsetting provisions; and (4) the treatment of corporate debt, which could result in a liquidity squeeze. In the subsections that follow, we discuss these concerns and the unnecessary and asymmetrical burdens that the Proposed NSFR, if finalized, would likely impose on end-users.

A. Add-on costs associated with counterparty payables are restrictive and should be reduced.

The Proposed NSFR would require dealer counterparties to provide required stable funding ("RSF") for 20% of the negative replacement cost of derivative liabilities (before deducting variation margin posted). This 20% add-on is a clear example of the direct burdens that would affect end-users' ability to efficiently mitigate risk, as it would unnecessarily increase costs for corporate end-users with no clear benefit to the stability of U.S. financial markets. The concept of this add-on requirement was first introduced in the final BCBS NSFR without being subject to stakeholder comment, and has since been of critical concern to the corporate end-user community.[16]

While the Coalition recognizes and understands the importance of addressing contingent risks with derivatives instruments, the add-on requirement under Section _.107(b)(5)(i)[17] of the Proposed NSFR is unnecessarily protective and ignores payables and receivables that are

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[15] A January 2015 study of the OTC derivatives market by Oliver Wyman concluded that the NSFR's treatment of OTC derivatives would require an additional $500 billion in long-term funding, generating $5-8 billion in incremental costs to the industry, with a cost increase of 10-15% for derivatives transactions.

[16] The BCBS failed to include for public comment the addition of a 20% funding requirement. *Compare* BCBS NSFR Consultive Document ¶ 35 (Jan. 2014), *available at* http://www.bis.org/publ/bcbs271.pdf, *with* the final BCBS NSFR Proposal ¶ 44 (Oct. 2014), *available at* http://www.bis.org/bcbs/publ/d295.pdf.

[17] The add-on requirement is "[a]n amount equal to 20 percent of the sum of the gross derivative values of the [BANK] that are liabilities, as calculated under paragraph (ii), for each of the [BANK]'s derivative transactions not subject to a qualifying master netting agreement and each of its QMNA netting sets, multiplied by an RSF factor of 100 percent." Proposed NSFR, § _.107(b)(5)(i).

matched. In fact, it is unclear whether the add-on requirement would actually address the risk it seeks to capture. For example, even if a derivative payable obligation were perfectly matched to an identical receivable obligation, the counterparty payable would still need to retain 20% long-term funding—even though the derivatives instruments would cancel out each other's contingent risk in the event of market movements. The Proposed NSFR ignores this reduction of contingent risk that results from matching exposures, and instead imposes a blunt 20% requirement when a more nuanced approach is warranted.[18]

To mitigate unintended consequences of this requirement, the downstream effects of any add-on requirement to derivatives transactions should be especially considered.[19] While we appreciate the Agencies' consideration of alternatives described in Proposed NSFR Question 43,[20] we would respectfully request the Agencies consider alternatives that do not burden the end-user community and account for greater granularity with respect to certain liabilities; as bank derivative exposures vary, so should any add-on funding requirement.

Alternatively, should the Agencies continue with a blanket add-on requirement, a regulatory exemption for corporate end-users from the add-on requirement for derivatives liabilities used for commercial hedging and risk management purposes would complement the statutory exemptions already established by the CEA. Such an exemption would buttress the congressionally recognized benefits of prudent risk management by corporate end-users: market security, financial stability and sustainable growth for U.S. commercial business.

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[18] Regarding the risk that derivatives pose to the economy, the Senate bill managers explained that "[i]t is . . . imperative that regulators do not assume that all over-the-counter transactions share the same risk profile." 156 CONG. REC. S 6192 (daily ed., July 22, 2010) (statement of Senators Christopher Dodd and Blanche Lincoln).

[19] We have heard from end-users that the Proposed NFSR introduces a market inefficiency with respect to swap terminations and novations. For example, an end-user would see the costs of the NSFR passed through as a result of their initial hedge with a bank counterparty. For any number of risk management reasons, the end-user may seek to novate that position to another bank rather than maintaining the swap with the original bank. However, because the transferee bank would also need to maintain long-term capital against the full amount of the derivatives position, the pricing for the novation will become inefficient compared to the mark-to-market price of the swap with original bank. Accordingly, novating a swap would become inefficient and uneconomical compared to maintaining or terminating the swap with the original bank. This may result inability for end-users to effectively manage risk and an unintended accumulation of risk within the original bank counterparty. The Proposed NSFR in the case of swap terminations would tend to increase market cost and decrease liquidity to the detriment of the market efficiency.

[20] "The agencies are considering alternative methodologies for capturing the potential volatility of a covered company's derivatives portfolio, and associated funding needs, within the NSFR framework. One alternative to the proposed treatment would be to require an RSF amount based on a covered company's historical experience. Under such an alternative, a factor could be based on the historical changes in a covered company's aggregate derivatives position, such as the largest, 99th, or 95th percentile annual change in the value of a covered company's derivative transactions over the prior two or five years. Another alternative could be to require an RSF amount based on modeled estimates of potential future exposure. Commenters are encouraged to provide feedback on methodologies, both those discussed and other potential alternatives, that best capture the funding risk associated with potential valuation changes in a covered company's derivatives portfolio, are conceptually sound, and are supported by data." 81 Fed. Reg. at 35154.

B. The treatment of uncollateralized receivables should be commensurate with transaction tenor.

Corporate end-users are currently exempt from the legal requirement to post collateral, including initial and variation margin; however, Section _.107(b)(1) the Proposed NSFR would undermine this exemption by requiring dealers to fund uncollateralized net receivables with 100% long-term funding, regardless of the maturity of the receivable.[21] This would likely encourage dealer counterparties to require end-users to collateralize transactions with cash margin meeting the stringent leverage ratio requirements under Section _.107(f)(1)[22] of the Proposed NSFR, or, alternatively, if a dealer chose not to demand collateral, the dealer would pass on the costs of long-term funding in the form of embedded derivatives fees.

The funding requirements for uncollateralized receivables should be commensurate with the tenor of the derivatives transaction. As reflected in the introductory language to the Proposed NSFR, funding obligations should reflect the "credit quality, ***tenor***, encumbrances, counterparty type, and characteristics of the market in which an asset trades."[23] Currently, the Proposed NSFR ignores the tenor of derivatives transactions when other assets are assigned funding requirements commensurate with their maturities.[24] For example, unsecured wholesale lending transactions with maturities over one year are subject to an 85% funding requirement, whereas the same transaction with maturities under one year are subject to either a 15% or 50% funding requirement.[25] In contrast, all derivatives receivables, regardless of maturity, are subject to a blanket 100% funding requirement under Section _.107(b)(1).

Requiring dealers to hold long-term capital when serving as counterparties to short-term derivatives exposures further burdens corporate end-users and penalizes prudent risk management strategies. This is particularly relevant as many corporate end-users, particularly those that operate globally, frequently utilize short-term derivatives transactions to hedge currency risk and other exposures as part of their risk management programs.[26] Without recognition for the stable nature of uncollateralized commercial hedges, the Proposed NSFR

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[21] "The [BANK]'s NSFR derivatives asset amount, as calculated under paragraph (d)(1) of this section, multiplied by an RSF factor of 100 percent." Proposed NSFR, § _.107(b)(1).

[22] The Proposed NSFR cites to the requirements enumerated under 12 C.F.R. § 324.10(c)(4)(ii)(C).

[23] 81 Fed. Reg. at 35127 (emphasis added).

[24] *Compare* Proposed NSFR, § _.106, *with* Proposed NSFR, § _.107(b)(1). The Proposed NSFR's treatment of derivatives liabilities is also unclear, especially those with maturities under one year. Resultantly, the Coalition respectfully asks the Agencies to clarify whether Section _.106(a)(5)(v) applies to derivatives with maturities under one year.

[25] Proposed NSFR, § _.106(a)(4), (5), (7).

[26] The use of FX derivatives is critical to the financial stability of corporate end-users. Although currency fluctuations are a large concern for corporate end-users, the cumulative effect of corporate end-users engaging in FX derivatives instruments on the overall stability of the financial markets is likely minimal given the transparency and liquidity of currency markets and the heterogeneity of currency hedging risks and resulting hedging strategies. .

could materially undermine a legislatively encouraged and permitted practice. To better mitigate commercial risk, better recognize current statutory exemptions and better align long-term funding obligations with the tenor of uncollateralized receivables, the Proposed NSFR should be revised to reflect funding requirements for uncollateralized receivables owed by corporate end-users with greater granularity—such as those described as funding values commensurate with haircuts assigned to high-quality liquid assets under the Proposed NSFR, 12 C.F.R. § 329.20, 12 C.F.R. § 249.20 and 12 C.F.R. § 50.20.[27]

C. Collateral posted by corporate end-users should better offset costs associated with increased long-term funding requirements.

The Agencies should endeavor to better align stable collateral with long-term funding requirements. Although many corporate end-users do not post margin for their derivatives with bank counterparties, as intended by their exemption from margin requirements on uncleared swaps,[28] the bank counterparties do need to hedge the resulting positions from their end-user trades. Those "back-to-back" hedging transactions by the bank counterparties are subject to mandatory clearing and margin requirements. Consequently, costs borne by banks on transactions established to offset end-user transactions will be passed on to end-users through transaction prices. In particular, below we highlight the asymmetrical treatment of initial margin and the funding securities collateral.

1. The treatment of initial margin is asymmetrical and should be better aligned.

In instances where an end-user would be required by a dealer to post initial margin to enter into a derivatives transaction (e.g., the dealer may require initial margin based on the risk profile of the end-user), the Proposed NSFR should better align end-user collateral with a dealer's long-term funding requirements. The Proposed NSFR would require that dealers hold 85% long-term funding against the initial margin they post to counterparties under Section _.107(b)(7)[29] of the Proposed NSFR, but assigns zero funding value to initial margin received under Section_.107(c)(2)[30] of the Proposed NSFR.

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[27] For example, U.S. Treasuries, sovereign debt, and corporate debt.

[28] *See* Sections 2(h)(7) and 4s(e) of the CEA.

[29] "The fair value of initial margin provided by the [BANK] for derivative transactions (regardless of whether the initial margin is included on the [BANK]'s balance sheet), which does not include initial margin provided by the [BANK] for cleared derivative transactions with respect to which the [BANK] is acting as agent for a customer and the [BANK] does not guarantee the obligations of the customer's counterparty to the customer under the derivative transaction (such initial margin would be assigned an RSF factor pursuant to § _.106 to the extent the initial margin is included on the [BANK]'s balance sheet), multiplied by an RSF factor equal to the higher of 85 percent or the RSF factor assigned to each asset comprising the initial margin pursuant to § _.106." Proposed NSFR, § _.107(b)(7).

[30] "The following amounts of a [BANK] are assigned a zero percent ASF factor . . . (2) The carrying value of NSFR liabilities in the form of an obligation to return initial margin or variation margin received by the [BANK]." Proposed NSFR, § 107(c)(2).

The complete disregard for the risk mitigating effects of initial margin posted by corporate end-users is unjustified and does not comport with the goals of an NSFR. Although the Agencies cite the fact that "initial margin is meant to cover a party's potential losses in connection with a counterparty's default"[31] as evidence for excluding any funding value to initial margin received by a dealer, the Coalition believes that this position is overly restrictive. Moreover, the Agencies' justification for excluding initial margin seemingly contradicts itself, as earlier in the Proposed NSFR, the Agencies state that the promotion of "stable funding profiles for large, interconnected institutions . . . would strengthen the safety and soundness of covered companies and promote a more resilient U.S. financial system and global financial system."[32] A key means through which dealers address derivatives exposures is the collection of initial margin, which, as the Agencies already observe, can be used to cover a bank's potential losses in connection with its counterparty's default. To ignore clear streams of funding, which can easily be liquidated in the event of an economic downturn, would discourage the use of initial margin and therefore increase financial instability.

The Proposed NSFR should recognize benefits of end-user collateral and the potential for stable funding in times of liquidity scarcity. To offset funding requirements, the treatment of initial margin could be assigned funding values commensurate with haircuts assigned to high-quality liquid assets under the Proposed NSFR, 12 C.F.R. § 329.20, 12 C.F.R. § 249.20 and 12 C.F.R. § 50.20. Recognition of initial margin posted by the end-user under an adopted NSFR would further reduce costs of the derivatives transaction by allowing dealers to offset funding requirements with end-user collateral.[33]

2. The treatment of collateral should account for the funding value of securities-based collateral.

In addition to the asymmetrical treatment of end-user initial margin, the BCBS NSFR's treatment of end-user collateral ignores the funding value of securities-based collateral received in the form of variation margin under Section _.107(f)(1) of the Proposed NSFR.

Under Section _.107(f)(1), securities-based collateral, even U.S. Treasury bonds, posted by end-users would not count toward a dealer's long-term funding obligations, and the dealer would still need to fund 100% of a derivatives receivable position. This treatment would ignore the funding value of highly liquid securities, such as U.S. Treasury bonds. To offset these funding requirements, end-users may be forced to monetize their U.S. Treasury bonds in order to post cash as collateral, which would increase cost without a commensurate benefit in risk reduction. To mitigate increased fees and the liquidation of end-user securities, the Proposed NSFR should

[31] 81 Fed. Reg. at 35151.

[32] *Id*. at 35128. Similarly, the BCBS has noted that the NSFR is intended to "require banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities." BCBS NSFR at 1.

[33] Because many end-users are generally exempt from requirements to post initial margin under the Final PR Rule, the initial margin that is posted to their counterparties is not subject to segregation and non-rehypothecation requirements in the same manner as financial end-users with material swaps exposure. We therefore clarify that rehypothecable initial margin should receive funding value.

recognize the funding value of high-quality liquid assets, or a subset thereof, described in 12 C.F.R. § 329.20, 12 C.F.R. § 249.20 and 12 C.F.R. § 50.20. Although it may be appropriate under a revised NSFR to impose haircuts on such securities, consistent with other calculations under the Proposed NSFR, doing so would be a meaningful improvement over the current disregard for funding value and would better align assumed risks of end-user counterparties.

The Proposed NSFR should follow the spirit of the BCBS NSFR, but should also recognize the economic realities of the U.S. marketplace. When crafting the Proposed NSFR, the Agencies should give funding credit for the actual collateral received and pay particular attention to the downstream effects that collateral treatment may have on the end-user community. Revisions to the Proposed NSFR should incorporate a funding value similar to that used for high-quality liquid assets; assets which can easily be liquidated to meet a bank's funding needs in times of economic downturn.

D. The treatment of corporate debt could hinder end-user capital raising efforts.

Corporate debt securities issuances are critical to the financial stability of corporate end-users. To facilitate short-term funding needs, end-users rely on the ability of dealers to hold short-term inventory as part of the business of underwriting end-user corporate debt issuances, which are used to fund growth and to meet business needs. The Proposed NSFR would be unduly burdensome on the end-user community, as it (1) fails to recognize the stability and creditworthiness of certain corporate debt and (2) fails to recognize the short-term tenor of such financial instruments. In finalizing the Proposed NSFR, the Agencies should accurately capture the creditworthiness and tenor of corporate debt, as the currently Proposed NSFR threatens to restrict liquidity in corporate debt markets and prevent end-users from meeting their short-term liquidity needs.

1. Funding requirements for corporate debt should reflect the creditworthiness of the issuer.

The Proposed NSFR oversimplifies the contingent risks of corporate debt by merely bifurcating funding requirements for corporate debt based on whether it qualifies as "investment grade," noting that corporate debt is assigned higher RSF factors because of its "relatively higher credit risk, lower trading volumes, and elevated price volatility."[34] By reference to the finalized regulations under the Liquidity Coverage Ratio, the Proposed NSFR assigns a 50% funding requirement for all Level 2B assets, which include "investment grade" corporate debt, defined as debt where "the issuer . . . has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected."[35] In instances where such debt fails to meet

[34] 81 Fed. Reg. at 35144.

[35] Proposed NSFR, § _.107(b)(5)(i) (citing 12 C.F.R. § 1.2(d)).

"investment grade" definitional requirements, it is assigned a generic 85% funding requirement.[36] The Coalition would argue that not all corporate debt is the same, and that, although some debt has higher volatility and lower trading volumes, "investment grade" debt by its very nature is stable and can provide an adequate source of funding in times of financial stress.

In contrast to the general bifurcation under the Proposed NSFR, the spirit of the BCBS NSFR contemplates a more granular regime, with funding requirements as low as 15% for "corporate debt securities (including commercial paper) and covered bonds with a credit rating equal or equivalent to at least AA-."[37] In recognition of the relatively risk-free nature of highly rated corporate debt, the BCBS NSFR explained that funding requirements for such debt would be 15%, commensurate with other unencumbered Level 2A assets, which include guaranteed sovereign debt.[38] By way of comparison, AAA-rated corporate debt under the Proposed NSFR would be assigned a 50% RSF and treated generally as Level 2B, an asset classification deemed as risky as an unsecured wholesale loan.[39] Under the BCBS NSFR, corporate debt would be assigned a 50% funding requirement only when the security was rated between A+ and BBB-.[40] And only when corporate debt was rated BB+ or below did the BCBS assign an 85% funding requirement.

The Proposed NSFR fails to recognize the stability of certain bonds, like those issued by corporate end-users and held by dealers, and should be redrafted in a manner consistent with the BCBS NSFR. A blunt 50% funding requirement for stable corporate debt is overly punitive and does not reflect the true risk of such financial instruments.

2. *Funding requirement for corporate debt should reflect its tenor.*

End-users rely on the ability of dealers to hold short-term inventory as part of the business of underwriting end-user corporate debt issuances, which are used to fund growth and to meet business needs. Indeed, a recent Federal Reserve study indicates that over 56% of commercial paper issued in the United States has a maturity of five weeks or less.[41] The Proposed NSFR, however, ignores the tenor of corporate debt and applies blanket funding requirements of 50% and 85%. This is inconsistent with the Proposed NSFR's consideration of tenor for other types of assets held by banks, where the funding requirements are much lower.[42]

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[36] *See* Proposed NSFR, § _.106(a)(7)(iv).

[37] BCBS NSFR at 9, ¶ 39(a).

[38] *Id.*

[39] *See* Proposed NSFR, § _.106(b)(5)(i).

[40] BCBS NSFR at 9, ¶ 40(a).

[41] *Data Download Program: Maturity Distribution of Commercial Paper Outstanding*, Board of Governors of the Federal Reserve System (Apr. 2015), *available at* http://www.federalreserve.gov/datadownload/Choose.aspx?rel=CP.

[42] For example, riskier, unsecured wholesale lending transactions are only subject to a 15% RSF obligation. *See* Proposed NSFR, § _.106(b)(4)(ii) (15% RSF for unsecured wholesale lending transactions maturing under six

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In times of financial stress, corporate end-users—entities whose success and stability are tied to metrics other than the state of the financial markets—are a safe haven that can provide stable funding to banks that hold their corporate debt. The stability of such debt is further compounded by the relatively short tenor of these assets, thus reducing bank risk of any default. In instances of longer-term corporate debt, given the longer duration and presumably less severe market conditions, market demand for higher quality securities would likely extend beyond those defined as high-quality liquid assets in order to appropriately diversify an entity's risk mitigation strategy. Accordingly, the Agencies should revise Section _.106 of the Proposed NSFR to account for the tenor of corporate debt in a manner consistent with the creditworthiness and stability of corporate end-users.

To facilitate commercial growth and the success of main street America, the Coalition notes that the Proposed NSFR's general application would restrict liquidity in the corporate debt markets by requiring dealers to raise 50-85% long-term funding to support their inventory, which would discourage market-making. As noted above, the Agencies should ensure that the treatment of corporate debt adequately considers the "*credit quality*, *tenor*, encumbrances, counterparty type, and characteristics of the market in which an asset trades."[43] In light of the end-user reliance on market-based funding and the importance of liquid markets for corporate bonds and commercial paper, the Agencies should reconsider the Proposed NSFR's 50-85% funding requirements for corporate debt.

IV. CONCLUSION

The Coalition comprises hundreds of companies that provide critical commercial goods and services on a worldwide basis. To help facilitate commercial endeavors, Coalition members regularly use derivatives as mechanisms to reduce commercial risks associated with their businesses. We ask that the Agencies, in finalizing the Proposed NSFR, provide exemptive relief for corporate end-users' derivatives transactions so that beneficial hedging activities are not discouraged. Such relief would encourage economic growth and jobs creation, promote a liquid marketplace, align with congressional intent and foster sound and prudent financial regulation.

Implementation of the Proposed NSFR would likely increase costs borne by the end-user in the form of higher transaction fees, less favorable terms and more collateral requirements. The potential decrease in dealer participation, coupled with additional funding costs borne by the end-user, would hinder end-users' abilities to effectively hedge and reduce business risks.

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months); *see also* Proposed NSFR, § _.106(b)(3)(i) (10% RSF for secured lending transactions maturing under six months).

[43] 81 Fed. Reg. at 35127 (emphasis added).

The Coalition thanks the Agencies for the opportunity to comment on the Proposed NSFR. We appreciate the Agencies' efforts to implement NSFR requirements that serve to strengthen the derivatives markets without unduly burdening end-users and the economy at large.

Thank you for your consideration of these very important issues to corporate end-users. Please contact Michael Bopp at 202-955-8256 or at mbopp@gibsondunn.com if you have any questions or if you would like to discuss our comments in more detail.

Yours sincerely,

Coalition for Derivatives End-Users