ICSA
INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

April 16, 2010

Mr Nout Wellink
Chairman
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Comment on Basel Committee's consultation package, *Strengthening the resilience of the banking sector* and *International framework for liquidity risk measurement, standards and monitoring*, issued December 2009

Dear Mr Wellink

I am writing to you in my capacity as Chairman of the International Council of Securities Associations' (ICSA) Standing Committee on Financial Stability and Risk Management. As we noted in a previous letter to you, ICSA serves as a forum for trade associations and self-regulatory organizations that represent and/or regulate firms active in the securities market, which includes both securities firms and prudentially regulated banks that have securities businesses.[1] The Standing Committee on Financial Stability and Risk Management is specifically tasked with developing ICSA's views on issues related to financial stability, including the work being done by the Basel Committee on Banking Supervision.

ICSA Members strongly support the Basel Committee's emphasis on developing a uniform and consistent definition of capital and improving the measurement of market risk. In that context, we welcome the opportunity to comment on the consultation package issued in late 2009. Because of the nature of ICSA's membership, which includes a broad range of jurisdictions and a diverse range of businesses involved in financial markets, we will limit our comments to high level observations on potential effects on the functioning of financial markets and matters on which we believe the Basel Committee needs to give further consideration.

Global Reform Agenda Context

It is essential to bear in mind the global nature of these reforms affecting many varied national markets. Governments, regulators and banks have strong incentives to ensure that liquidity regulation strikes a good balance between better management of liquidity risk and supporting a cost-effective and efficient financial system. In practice, this means that the global liquidity

[1] ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA and a list of ICSA members is available at: www.icsa.bz

principles must enable national regulators to calibrate their detailed application in a manner that reflects the features of their particular financial system and the economic environment within which it is based. Because of the standardization of assumptions, the measures may not be fully adapted to a firm's mix of business, geographical scope, and participation in markets. This needs to be kept in mind in mind in finalizing the proposals.

The consultation package only touches in passing on the inter-relationships with the real economy and the various participants beyond the banks, such as market intermediaries, financial product providers, credit rating agencies, clients and regulators. Globally, a substantial amount of work is underway involving the authorities and industry to improve the institutional and legal infrastructure of financial markets. The objective is to control systemic risk of the global financial system as a whole by improving the overall resiliency of the system, and managing the transfer of risk through the system. This is exampled by the work on developing central counterparties for over-the-counter derivatives, transparency measures, new resolution regimes, and improved internal risk management.

Market Effects

The cumulative effect of the proposals still needs to be assessed but it can be anticipated that they will affect the ability of banks to play as vital a role in promoting the full potential of latent economic activity that may exist in low growth economies than under current rules. For example, banks will be restricted in their ability to carry out maturity transformation and provide liquidity to clients. This would result in reduction of overall liquidity and possibly the partial transfer of liquidity risk management to non-prudentially regulated financial institutions, or a significant shift of liquidity risk and liquidity management back to the corporate sector.

The financial markets may not be able to absorb the long-term funding requirements flowing from the Basel Committee's proposals. This is especially true since the unfavourable treatment of fixed income instruments, especially when issued by banks, would constrain the liquidity and hence the depth of the bond market. Similarly given the steep rise in banks' capital requirements in 2009, the measures should be calibrated so as to consolidate the prior increases rather than to trigger a fresh wave of capital charges. It may not be feasible to cover the new requirements by further fundraising alone, since market depth is not limitless and equity investors demand returns that would be hard to deliver in an environment where reduction of risk needs to take precedence. Banks would also have to reduce their balance sheets, notably lending. The macroeconomic impact of the proposed changes is likely to be felt through higher interest rates, reduced credit to the private sector with a consequent impact on investment, productivity and employment, and higher risk management costs. This might lead to a lower stock of capital in the economy and less output than would otherwise be the case.

ICSA supports more effective recognition of liquidity risks within the Basel Principles as inadequate recognition of liquidity risks, along with excessive transformation by some market participants, was among the main causes of the global financial crisis. However, the two liquidity ratios provide a mechanism among a range of others that are cited in the consultation package and used in the Basel Principles. Tighter liquidity requirements will interact with the new capital requirements, changing accounting standards, other new regulatory and market rules, such as for structured products and hedge funds. Placing disproportionate regulatory emphasis on two liquidity ratios that are defined identically for all participants is a problematic one-size-fits-all approach that could produce undesirable systemic outcomes because of the different characteristics and mix of financial instruments available in national markets.

An appropriate definition of liquid assets is central to the effective management of liquidity risk by banks. Given the interconnectivity between the banking system, financial markets and the real economy and the variability of these components across jurisdictions, it is important that the liquidity framework provides sufficient flexibility for national regulators to regulate liquidity in a manner that will deliver the most effective regulatory outcome in their jurisdiction.

The proposals could adversely change markets for both eligible and ineligible assets, in unintended ways. A narrow definition could increase large fixed holdings in eligible assets, increasing the chance that they will become relatively less liquid with flow on effects to pricing, particularly for assets which regulation encourages static holdings. Such a measure could increase rather than reduce systemic risk by reducing necessary flow within the system. Conversely, demand for ineligible assets may diminish.

Conclusion

The macroeconomic effects of the proposals along with other aspect of the capital framework need to be proactively considered through the Quantitative Impact Study, the Basel Committee's top-down study, and full analysis of the cumulative impacts of regulatory change on the international financial system and the real economy. Aside from the proposed amendments to the measures planned by the Basel Committee, the authorities should ensure that the impact studies take full account of the way the measures might affect the economy as a whole.

Once again, we welcome the opportunity to comment on the Basel's Committees recent consultation report. Please do not hesitate to contact Pierre de Lauzun (pdelauzun@amafi.fr) or Marilyn Skiles (mskiles@sifma.org) to discuss the comments made in this letter.

Yours sincerely,

Pierre de Lauzun
Chairman, ICSA Standing Committee on
Financial Stability and Risk Management