Net Stable Funding Ratio

Aims to establish a minimum acceptable amount of stable funding based on the liquidity characteristics of an institution’s assets and activities over a one year horizon.

The amount of stable funding available is calculated through applying weightings to different categories of liability which is then compared with the amount of stable funding required, calculated by applying weightings to the institutions assets and off-balance sheet items, including potential liquidity exposure.

1. Why it matters
   1.1. It is important that banks maintain sufficient levels of liquidity, both in terms of quantity and quality, to be able to navigate plausible and sufficiently severe market-wide and firm specific liquidity shocks.
   1.2. The industry has raised a number of design issues with the Net Stable Funding Ratio (NSFR) as it stands and it will be essential that the new standard is appropriately calibrated and that it’s effects are modelled comprehensively to mitigate the risk of causing unintended consequences such as pricing and market distortions.
   1.3. The lack of clarity surrounding the preliminary nature of this measure has not been communicated clearly to all stakeholders, fuelling speculation around banks’ NSFR positions, which is in turn applying pressure for them to change their business activities and funding arrangements far in advance of the envisaged implementation of the ratio. This will, in turn, have the effect of restricting the ability of standard-setters to make any changes considered necessary from lessons learned during the observation period.

2. Summary of AFME Position
   2.1. AFME seeks engagement with BCBS and other standard setters on the continued development and refinement of the NSFR (similar to that undertaken for CVA). AFME would like to explore some of the reservations it has on the current design and characteristics of the ratio.
   2.2. AFME is also of the view that the observation period should allow for some modification of the NSFR’s computation methodology to better take into consideration the banks’ various business models and European specificities. In addition, wider market disclosure of the NSFR should not occur until the completion of full implementation.

3. Regulatory Context
   3.1. One of the five building blocks of the Basel III and CRD 4 proposals is the need to improve the management of liquidity. The Basel Committee has developed two new standards for use in the supervision of liquidity risk.
The NSFR is the second of these new measures (the first being the LCR or Liquidity Coverage Ratio) and aims to establish a minimum acceptable amount of stable funding based on the liquidity characteristics of an institution’s assets and activities over a one year horizon. It aims therefore to limit over-reliance on short term wholesale funding during times of buoyant market liquidity and encourage better assessment of liquidity risk across all on and off balance sheet items.

4. Overview of the NSFR

Over-arching NSFR Calculation

4.1. The NSFR can be summarised as the requirement for a minimum amount of ‘stable funding’ over a one year time horizon based on liquidity risk factors assigned to assets, off-balance sheet liquidity exposures and other contingent funding obligations. The objective of the standard is to ensure stable funding on an ongoing, viable entity basis, over one year to cover an extended firm-specific stress scenario, where a bank encounters, and investors and customers become aware of:

- A significant decline in the institution’s profitability or solvency arising from heightened credit risk, market risk, operational risk and/or other risk exposures;
- A potential downgrade in the institution’s debt, counterparty credit or deposit rating;
- A material event that calls into question the reputation or credit quality of the institution.

4.2. Under this scenario, extended borrowings from central bank lending facilities outside regular open market operations are not considered.

The formula used is:

\[
\text{Available amount of stable funding} / \text{Required amount of stable funding} = \text{greater than 100%}
\]

Available amount of stable funding (‘ASF’)

4.3. Stable funding is defined as the portion of those types of equity and liability financing expected to provide reliable sources of funds over a one year time horizon to cover conditions of extended stress. The available amount of stable funding is calculated by first assigning the carrying value of an institution’s equity and liabilities to one of five categories below. The amount assigned to each category is to be multiplied by an ASF factor ranging from 0% to 100% and the total ASF is the sum of the weighted amounts.

4.4. Available Stable Funding (ASF) categories are as follows:
(a) Tier 1 and Tier 2 capital after deductions, preferred stock and secured/unsecured borrowings with a maturity of greater than one year;

(b) 'Stable' (as per LCR) small business / retail demand deposits and/or term deposits with residual maturities of less than one year residual maturity;

(c) ‘Less Stable’ (as per LCR) small business / retail demand deposits and/or term deposits with residual maturities of less than one year residual maturity;

(d) Unsecured wholesale funding, non-maturity deposits and/or term deposits with a residual maturity of less than one year, provided by non-financial corporates, sovereigns, central banks, multilateral development banks and PSEs; and

(e) All other liabilities and equity categories not included in the above categories.

4.5. Institutions are required to apply the same funding 'stability' considerations as for the LCR. For further details, please refer to the separate briefing note for LCR.

4.6. When determining the maturity of an instrument, investors are assumed to call for repayment at the earliest possible date. For funding with options exercisable at the institution's discretion, supervisors are expected to consider firm reputational factors as well as repayment expectations of the market.

**Required amount of stable funding ('RSF')**

4.7. The amount of stable funding required by supervisors is to be measured using supervisory assumptions on the broad characteristics of the liquidity risk profiles of an institution's assets and off-balance sheet ('OBS') exposures. The required amount of stable funding is calculated as the sum of the value of assets held and funded by the institution, multiplied by a specific Required Stable Funding ('RSF') factor assigned to each particular asset type, added to the amount of off-balance sheet activity (or potential liquidity exposure) multiplied by its associated RSF factor(s).

4.8. The RSF factors are intended to approximate the amount of a particular asset that could not be monetized (through sale or collateralized funding) on an extended basis during a liquidity event lasting one year.

4.9. Therefore, assets that are more liquid and more readily available to act as a source of extended liquidity in the stressed environment identified above receive lower RSF factors (and require less stable funding) than assets considered less liquid in such circumstances and, therefore, require more stable funding.
Off-balance sheet exposures:

4.10. Many potential OBS liquidity exposures require little direct or immediate funding but can lead to significant liquidity drains in times of market or idiosyncratic stress. As a result, the application of an RSF factor to various OBS activities results in a requirement for the institution to establish a “reserve” of stable funding to cover liquidity draws. Consistent with the LCR, the NSFR identifies OBS exposure categories based broadly on whether the commitment is a credit or liquidity facility or other contingent funding liability.

Secured funding arrangements:

4.11. For secured funding arrangements that are assets of a bank maturing within the one-year horizon, a bank should look through the secured funding transaction to see what asset will be used to settle the transaction at the maturity date, and use the corresponding RSF factor for that asset. If the bank will receive cash, then the RSF of the transaction would be 0%. If the bank will receive another asset, the RSF factor of that asset would be used.

Encumbered assets:

4.12. Encumbered assets on the balance sheet receive a 100% RSF, unless there is less than a year remaining in the encumbrance period. In that case, the assets are treated as “unencumbered”.

Assets and liabilities with a remaining maturity of less than one year:

4.13. The treatment of assets and liabilities maturing within one year is yet to be finalised by the Basel Committee. Supervisors are in the process of gathering data to allow analysis on buckets of both assets and liabilities maturing within the one-year horizon during an observation period of 2012 to 2017, to further consider the treatment of these instruments in the NSFR. Buckets will be from 0-3 months, 3-6 months, 6-9 months, and 9-12 months. This is to evaluate the treatment of matched funded assets and liabilities, and to provide incentives for terming out funding within a year.

5. Issues and commentary

5.1. Below is a link to the Table of Issues that AFME has sent to BCBS on behalf of its members.

Table of Issues
5.2. Our main concerns and recommendations can be summarised as follows:

**Outstanding design issues**

5.3. It is important that the NSFR gives a fair representation of the funding requirements of a bank’s assets and funding provided by its liabilities, so we are concerned that a number of design issues raised by the industry remain unanswered.

5.4. As an illustration, the assumptions on the banks’ behaviour regarding rollover funding activity in a crisis situation can not be pre-fixed and should be left at the discretion of national supervisors taking into consideration certain European specificities, and monitored under the Pillar 2 approach.

5.5. One key item of note is the impact of the ‘cliff effect’ on match funded transactions (e.g. covered bonds or development bank-sponsored loans), where full allowance is given for funding of one year residual maturity with a sudden drop-off in the allowance as soon as the funding becomes less than one year, while the RSF associated to the related assets still applies, creating an NSFR deficit.

5.6. AFME has also prepared worked examples of how the NSFR can interact with the LCR and Leverage Ratio, which demonstrates that the cliff effect can create significant issues. [link to be inserted] – To be added by AFME

**Preliminary status**

5.7. While AFME and its members understand that the transitional arrangements applying to the NSFR (final revisions to be implemented by mid-2016) are designed to allow the BCBS time to adjust the design of this measure, we are concerned that the preliminary status of this measure has not been clearly communicated to all stakeholders. This lack of clarity is fuelling speculation around banks’ NSFR positions which is forcing them to look at changing their balance sheets far in advance of their envisaged implementation of this ratio.

**Disclosure**

5.8. Like the LCR, the disclosure requirements for the NSFR are currently unclear and we recommend that public disclosures occur after full implementation.

**6. Transitional Regime**

6.1. Given the concerns about impact and other questions relating to the computation of the NSFR, AFME will be pressing both the BCBS and the EU (through the EBA) to use the monitoring period to engage fully with the industry and examine the impact of the current design of the NSFR, specifically addressing any unintended consequences. Understanding gained from the current Basel III QIS exercise should be fully factored into future engagement with the industry and any recalibration of the NSFR.
6.2. Reporting processes will be implemented from January 2012 which will enable supervisors to monitor aspects of the NSFR for an observation period through to end December 2017. During this time supervisors will determine if revisions or recalibration of the NSFR are necessary. The NSFR, including any revisions, will be introduced on 1 January 2018.

7. Case Studies

7.1. AFME has also developed a case study which examines the interplay of the LCR, NSFR and LR using a stylised balance sheet. The study highlights that:

- The ratios must be managed together, but their design makes steering difficult;

- The cures associated with a breach in one of the ratios may result in responses that cannot effectively address the underlying ‘capital or liquidity issues’.

- A breach in, for example, the NSFR can result in a cure that has the bank raising capital in response to a funding problem that cannot be addressed by longer term funding invested in high quality liquid assets owing to constraints presented by the leverage ratio.

Interplay Case Study