Basel Liquidity Framework

The Basel Committee published the final version of the Net Stable Funding Ratio (NSFR)

Matías Viola

BBVA

In October the 31st 2014 the Basel Committee released the final version of the NSFR. The publication of this liquidity ratio is, together with the Liquidity Coverage Ratio (LCR), one of the main components of the Basel liquidity framework. Meanwhile the LCR measures the liquidity capacity of financial institutions under stressed conditions; the NSFR is a more structural ratio and tries to ensure that financial institutions maintain a stable funding profile over a one-year period. This final version presents some improvements vis-à-vis the drafts opened for public consultation in 2010 and early 2014. Above all, it maintains the structural features of the NSFR and produces a more calibrated ratio.

Rationale of the NSFR

As the recent crisis has shown, many banks experienced difficulties due to an improper liquidity management. In this regard, public authorities focused on the development of a new liquidity framework that minimizes the probability of similar episodes taking place. As such, two liquidity ratios were defined: on the one hand, the LCR that ensures the liquidity capacity of financial institutions under a situation of severe stress. And, on the other hand, the NSFR that obliges financial institutions maintaining a stable funding profile. To be more precise, the NSFR establishes a minimum acceptable amount of stable funding based on liquidity characteristics of on- and off-balance sheet exposures and activities over a one-year period avoiding therefore an overreliance on unstable funding sources such as short term wholesale funding.

It is defined as the relation between Available Stable Funding (ASF) and Required Stable Funding (RSF):

- ASF factor is the portion of capital and liabilities expected to be reliable over one year. Its computation in the ratio will depend on maturity and relative stability of each funding source.
- RSF factor is a function of the liquidity characteristics and residual maturities of the various assets held by that institution as well as those of its off-balance sheet exposure. Its computation in the ratio will depend on liquidity risk profile and residual maturity.

Financial institutions must keep the NSFR above 100% at a consolidated level. It will entry into force from January 2018 without a phase-in period.

Main changes of the final NSFR standards

As noted in Graph 1 there are several changes in the final standards vis-à-vis the 2010 draft. However, it is very similar to the version published in January 2014. Among other things, this final version shows a bigger alignment with LCR HQLA (High Quality Liquid Assets) definitions and its granularity for assets and liabilities is higher ensuring therefore a more calibrated ratio.

Some of the changes are as follows:

- Reduction of the asymmetrical treatment of short term (<6 months) reverse repos with nonfinancials. This asymmetry has been smoothened through the reduction of the RSF factor from 50% to 10% for Level 1 assets as collateral and to 15% for other collateral.
- Derivatives: regulatory netting rules would be based on the leverage ratio framework giving therefore more clarity in this regard.
- Assets posted as initial margin for derivatives contracts. Even if these assets are assigned an 85% RSF factor or higher¹, the Basel Committee will continue to evaluate the treatment of margining in the NSFR through quantitative analysis.
- Encumbered assets. For assets that are encumbered for exceptional central bank liquidity operations, the supervisor and central bank may agree to reduce the RSF factor, but the reduced RSF factor must not stand below the RSF factor applied to the equivalent asset that is unencumbered.

¹ Exempted when banks act as an agent on behalf of clients

Graph 1

BBVA

Final outcome of the NSFR²

ASF components		RSF Components	
Regulatory capital	100%	 Cash and equivalents (Central bank reserves and claims on CB with maturities of less than 6 months) 	0%
 Secured and unsecured borrowings and liabilities (including term deposits) with maturity of > 1 year 	100%	Unencumbered Level 1 Assets (claims on/guaranteed by sovereigns, central banks and PSEs with 0% RW)	5%
 Stable (as defined in the LCR) non-maturity retail deposits/term deposits with maturity < 1yr 	95%	New Loans to financial institutions with maturity < 6 months secured against Level 1 assets	10%
 Less Stable non-maturity retail deposits/term deposits with maturity of < 1 year, 	90%	 Unencumbered Level 2A Assets (claims on/ guaranteed by sovereigns, central banks and PSEs with 20% RW and corporate debt securities with a credit rating of at AA-) Other hear to financial institutes with a comparison of the security of the secu	15%
		New Other loans to financial institutions with maturity < 6 months	
 Wholesale funding by non-financial corporates, sovereigns, central banks and PSEs with maturity < 1yr 	50%	 Unencumbered Level 2B assets (RMBS rated at least AA, corporate debt securities rated between A+ and BBB-, exchange trade common equity shares) 	50%
Funding (secured and unsecured) with residual maturity of less	50%	 HQLA encumbered between 6 months and 1 year 	50%
than one year provided by non financial corporate customers		 Deposits held at other financial institutions for operational purposes 	50%
 Operational deposits and other funding with residual maturity between 6 months and 1 year 	50%	 Loans to financial institutions and CB between 6 months and 1 year 	50%
		Unencumbered residential mortgages and other loans with max 35%	65%
All other liabilities and equity not included in the above categories, including liabilities without a stated maturity	0%	RW under Basel II standardized approach • Other unencumbered loans >1yr and RW <35% under BIS II	65%
		Other unencumbered performing loans with RW>35% under the Basel II standardized approach	85%
 Derivatives payable net of derivatives receivable (LR 		New Collateral posted as initial margin on derivative contracts	85%
definition taking into account netting and collateral) if	0%	Other on-balance sheet assets (ie: encumbered assets >1yr)	100%
payables are greater than receivables		 Derivatives receivable net of derivatives payable (LR definition staking into account netting and collateral) if receivables are 	100%
		greater than payables	100%
	>	20% of derivatives liabilities (taking into account netting) New	
Netting rules are based on leverage framework	e ratio		
		 Off-balance sheet exposures-conditionally revocable and irrevocable credit and liquidity facilities 	0%

Source: BIS Committee

Assessment and next steps

In general, the calibration of the final version of the NSFR is better than the 2010 version. However, there is some consensus in the industry of the potential penalization to equity markets or to trade finance of these final standards.

Even if this publication represents the definitive standards for the NSFR, in the coming months, public authorities will take some measures related to this ratio. For instance, the actual impact of the final version will be monitored through a QIS exercise during the observation period. In addition, in early 2015, the Basel Committee is expected to issue NSFR disclosure standards and issue updated QIS templates to incorporate the final standards.

² In bolded blue differences with January 2014 proposal and in bolded green with 2010 proposal

BBVA

This document has been prepared by BBVA Research Department, it is provided for information purposes only and expresses data, opinions or estimations regarding the date of issue of the report, prepared by BBVA or obtained from or based on sources we consider to be reliable, and have not been independently verified by BBVA. Therefore, BBVA offers no warranty, either express or implicit, regarding its accuracy, integrity or correctness.

Estimations this document may contain have been undertaken according to generally accepted methodologies and should be considered as forecasts or projections. Results obtained in the past, either positive or negative, are no guarantee of future performance.

This document and its contents are subject to changes without prior notice depending on variables such as the economic context or market fluctuations. BBVA is not responsible for updating these contents or for giving notice of such changes.

BBVA accepts no liability for any loss, direct or indirect, that may result from the use of this document or its contents.

This document and its contents do not constitute an offer, invitation or solicitation to purchase, divest or enter into any interest in financial assets or instruments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

In regard to investment in financial assets related to economic variables this document may cover, readers should be aware that under no circumstances should they base their investment decisions in the information contained in this document. Those persons or entities offering investment products to these potential investors are legally required to provide the information needed for them to take an appropriate investment decision.

The content of this document is protected by intellectual property laws. It is forbidden its reproduction, transformation, distribution, public communication, making available, extraction, reuse, forwarding or use of any nature by any means or process, except in cases where it is legally permitted or expressly authorized by BBVA.