6 EBA report on NSFR

Good to go with some adjustments for Europe

On 18 December, 2015, the European Banking Authority (EBA) released a full report on the suitability of implementing the Net Stable Funding Ratio (NSFR) on European banks as suggested by the Basel Committee on Banking Supervision (BCBS). The NSFR aims to ensure that banks have sufficient stable funding to cover their on- and off-balance sheet activities for a one-year horizon. The EBA report recommends the introduction of the NSFR in the European Union in line with the global standard but with some minor adjustments.

Five general recommendations can be derived from the report. Firstly, that a NSFR should be introduced in credit institutions in the European Union. Secondly, that the NSFR should apply both on a consolidated and individual basis, while taking into consideration waivers and intragroup preferential treatment. Thirdly, **the BCBS' definition and calibration of the ratio is well suited to the EU system, while taking into consideration some specificities for trade finance, pass-through models, central counterparty clearing houses (CCPs), centralized regulatory savings and residential guaranteed loans.** Fourthly, small banks should be equally subject to the same NSFR as larger banks. And fifthly, the NSFR should be set at a minimum of 100% on an ongoing basis. The EBA has essentially concluded that the NSFR as proposed by the BCBS is a prudential measure well suited to ensuring adequate funding for credit institutions in Europe and therefore limiting liquidity risks that might arise under the normal operation of banking activities.

The report is comprehensive and has both quantitative and qualitative elements. For the former, the most significant results are that by the end of December 2014 most banks (70%) in the representative sample studied were NSFR-compliant (above 100%), while 14% had an NSFR below 90%.[1] For non-compliant banks, the shortfall is low as it represents only 3% of total available funding to banks. Only four business models had greater shortfalls: banks specialising in auto and consumer loans, securities trading houses, pass-through banks and diversified institutions without deposits. Finally, since December 2012 (first data point) until December 2014, 93 banks improved their NSFR, 80 stayed at the same level and 24 had their NSFR deteriorate. All in all, **the EBA report concludes that the European banking system can implement an NSFR as proposed by BCBS with a limited negative impact on a bank's ability to lend and without significant distortions of market activity.**

Assessment

There are several concerns from the banking industry regarding the EBA's report. First of all, the final recommendations are drawn in part from the quantitative analysis of the report, which had the objective of estimating the impact of an NSFR on banks and was based on few data points: five for the dynamic analysis of estimating the NSFR and one for the simulation exercise where non-compliant banks are forced to abide by the NSFR. Secondly, banking activities such as trade finance and covered bond structures are penalised too harshly by the NSFR and do not take into consideration the full nuance of these products, especially given the limited funding risk they exhibited during the most recent financial crisis. Thirdly, the NSFR has been defined as a ratio to be estimated under a business-as-usual scenario; however, many high quality liquid assets are treated as if under a stress scenario and unnecessary haircuts are applied. Lastly, the industry has suggested some better alignment with the LCR and expressed their concern with the tight implementation schedule once the European Commission assesses the appropriateness of submitting a legislative proposal to the European Parliament by the end of the year. Full compliance is expected by January 2018 and twelve months seem few for a slowly adjusting ratio like the NSFR.

1: The representative sample is made up of 279 banks and covers 13 different business models.

DISCLAIMER

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