Securitization Perspectives on Net Stable Funding Ratio

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Introduction

- In January 2014, the Basel Committee on Banking Supervision (**BCBS**) published a Consultative Document presenting a net stable funding ratio (**NSFR**) requirement that will require banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.
- The specific objective of the proposed NSFR requirement is to reduce funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress.
- Comments to the proposed NSFR requirement are due by **April 11, 2014**.

The Calculation

$$\textbf{Net Stable Funding Ratio} = \frac{\text{Available Stable Funding}}{\text{Required Stable Funding}} \geq 100\%$$

Calibration

- The amounts of available and required stable funding specified in the NSFR standard are calibrated to reflect the presumed degree of stability of liabilities and liquidity of assets.
  - **Funding Tenor** – Longer-term liabilities are assumed to be more stable than shorter-term liabilities.
  - **Funding Type and Counterparty** – Short-term (maturing in less than one year) deposits provided by retail customers and funding provided by small business customers is assumed to be behaviorally more stable than wholesale funding of the same maturity from other counterparties.

The Numerator:
Available Stable Funding

- The amount of available stable funding (**ASF**) is measured based on the broad characteristics of the relative stability of a bank's funding sources, including the contractual maturity of its liabilities and the differences in the propensity of different types of funding providers to withdraw their funding.
- To the extent that a bank treats the securitization of its assets as a liability for accounting purposes, these liabilities would seem to be given a 100% ASF factor or a 50% ASF factor based on their effective maturities. Presumably, off-balance sheet securitization liabilities would not constitute ASF.
- When determining the maturity of an equity or liability instrument, investors are assumed to redeem a call option at the earliest possible date. A bank should assume it will exercise any option available at the bank's discretion at the earliest possible date unless the bank can demonstrate to its supervisor's satisfaction that the bank would not exercise this option under any circumstances.
- For long-dated liabilities, only the portion of cash flows falling at or beyond the 6-month and 1-year time horizons would be treated as having an effective residual maturity of 6 months or more and 1 year or more, respectively.

The Numerator:
ASF Look-Up Table

ASF Factor	Components of ASF Category
100%	• Total regulatory capital • Other capital instruments and liabilities with effective residual maturities of 1 year or more
95%	• Stable non-maturing (demand) deposits and term deposits with residual maturity of less than 1 year provided by retail and SME customers
90%	• Less stable non-maturing deposits and term deposits with residual maturities of less than 1 year provided by retail and SME customers
50%	• Funding with residual maturity of less than 1 year provided by non-financial corporate customers • Operational deposits • Funding with residual maturities of less than 1 year from sovereigns, public sector entities (PSEs), and multilateral and national development banks • Other funding with residual maturity of not less than 6 months and less than 1 year not included in the above categories, including funding provided by central banks and financial institutions
0%	• All other liabilities and equity not included in above categories, including liabilities without a stated maturity • Derivatives payable net of derivatives receivable if payables are greater than receivables

The Denominator: Required Stable Funding

- The amount of required stable funding (**RSF**) is measured based on the broad characteristics of the liquidity risk profile of a bank's **assets** and **off-balance sheet exposures**.
- Unless otherwise specified, the definitions used in determining the RSF factor mirror those outlined in the liquidity coverage ratio (**LCR**) requirement.
- For the purposes of calculating the NSFR, high quality liquid assets (**HQLA**) are defined as all HQLA without regard to LCR operational requirements and LCR caps on Level 2 and Level 2B assets that may otherwise limit the ability of some HQLA to be included as eligible HQLA in calculation of the LCR.
- Encumbered assets include but are not limited to assets backing securities or covered bonds.

The Denominator:
High Quality Liquid Assets

	Basel LCR Guidance	U.S. Proposed LCR	Industry Comment to U.S. Proposed LCR
GSE MBS	Level 1	Level 2A	The Agencies should permit Level 1 treatment for mortgage-backed securities issued by Fannie Mae and Freddie Mac ("GSE MBS") at least for so long as Fannie Mae and Freddie Mac are operating under conservatorship or receivership or are otherwise effectively guaranteed by the U.S. government. If the Agencies are unwilling to afford Level 1 treatment, the Agencies should exclude GSE MBS from the 40% cap applied to other Level 2A assets.
Private-Label RMBS	Level 2B	Do not qualify for HQLA treatment	Certain high credit quality RMBS should be afforded Level 2B liquid asset treatment. RMBS backed exclusively by Qualified Mortgages should qualify subject to a 25% haircut and all other RMBS should qualify subject to a 50% haircut.

The Denominator:
High Quality Liquid Assets *(Continued)*

	Basel LCR Guidance	U.S. Proposed LCR	Industry Comment to U.S. Proposed LCR
Covered Bonds	Level 2B	Do not qualify for HQLA treatment.	Certain high credit quality covered bonds should be afforded Level 2B liquid asset treatment.
ABS	Do not qualify for HQLA treatment.	Do not qualify for HQLA treatment	Certain high credit quality ABS should be included as Level 2B liquid assets so long as their liquidity characteristics mirror those of publicly traded corporate debt securities.

The Denominator:
RSF Asset Look-Up Table

RSF Factor	Components of RSF Category
0%	• Coins and banknotes • All central bank reserves • Unencumbered loans to banks subject to prudential supervision with residual maturities of less than 6 months
5%	• Unencumbered Level 1 assets, excluding coins, banknotes and central bank reserves
15%	• Unencumbered Level 2A assets
50%	• Unencumbered Level 2B assets • HQLA encumbered for a period of 6 months or more and less than 1 year • Loans to banks subject to prudential supervision with residual maturities 6 months or more and less than 1 year • Deposits held at other financial institutions for operational purposes • All other assets not included in the above categories with residual maturities of less than 1 year, including loans to non-bank financial institutions, loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns, central banks and PSEs

The Denominator:
RSF Asset Look-Up Table *(Continued)*

RSF Factor	Components of RSF Category
65%	• Unencumbered residential mortgages with a residual maturity of 1 year or more and with a risk weight of less than or equal to 35% • Other unencumbered loans not included in the above categories, excluding loans to financial institutions, with a residual maturity of 1 year or more and with a risk weight of less than or equal to 35% under the Standardized Approach
85%	• Other unencumbered performing loans with risk weights greater than 35% under the Standardized Approach and residual maturities of 1 year or more, excluding loans to financial institutions • Unencumbered securities that are not in default and do not qualify as HQLA including exchange-traded securities • Physical traded commodities, including gold
100%	• All assets that are encumbered for a period of 1 year or more • Derivatives receivable net of derivatives payable if receivables are greater than payables • All other assets not included in the above categories, including non-performing loans, loans to financial institutions with a residual maturity of 1 year or more, non-exchange-traded equities, fixed assets, pension assets, intangibles, deferred tax assets, retained interest, insurance assets, subsidiary interests, and defaulted securities

The Denominator: Off-Balance Sheet Exposures

- The NSFR assigns an RSF factor to various off-balance sheet (**OBS**) activities to ensure that banks hold stable funding for the portion of OBS exposures that may be expected to require funding within a 1-year horizon.
- Unlike the LCR, however, the NSFR **does not distinguish** amongst types of commitments in assigning RSF factors. Unfunded credit, securitization credit and liquidity facilities would be treated like all other unfunded commitments under the NSFR and would be assigned a 5% RSF Factor.

The Denominator: RSF OBS Exposure Look-Up Table

RSF Factor	Components of RSF Category
5% of the currently undrawn portion	Irrevocable and conditionally revocable credit and liquidity facilities to any client
National supervisors can specify the RSF factors based on their national circumstances	Other contingent funding obligations, including products and instruments such as: • Unconditionally revocable credit and liquidity facilities • Trade finance-related obligations (including guarantees and letters of credit) • Guarantees and letters of credit unrelated to trade finance obligations • Non-contractual obligations such as: - potential requests for debt repurchases of the bank's own debt or that of related conduits, securities investment vehicles and other such financing facilities - structured products where customers anticipate ready marketability, such as adjustable rate notes and variable rate demand notes - managed funds that are marketed with the objective of maintaining a stable value

Treatment of Bank-Consolidated ABCP Conduits Under NSFR

- The assets of ABCP conduits would be assigned an RSF factor under the NSFR.

- The ABCP issued by such ABCP conduits with maturities of less than six months, however, generally would not count as available stable funding.

- Without modification the NSFR would therefore require a bank to maintain two sets of liabilities to fund such assets: shorter-term ABCP (consolidated on the bank's books but actually issued by an ABCP conduit) and the longer-term liabilities or other form of ASF borrowed by the bank not to fund the customer's assets but to meet NSFR requirements.