RBI releases final guidelines on Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR)

The Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR) are significant components of the Basel III reforms. The LCR guidelines which promote short term resilience of a bank's liquidity profile have been issued vide circular DBOD.BP.BC.No.120/21.04.098/2013-14 dated June 9, 2014. The NSFR guidelines on the other hand ensure reduction in 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. The draft guidelines on the NSFR for banks in India were issued on May 28, 2015 for comments. The final guidelines, after considering comments received from various stakeholders, are given below for implementation by RBI.

Final Guidelines on Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR)

Introduction

In the backdrop of the global financial crisis that started in 2007, the Basel Committee on Banking Supervision (BCBS) proposed certain reforms to strengthen global capital and liquidity regulations with the objective of promoting a more resilient banking sector. In this regard, the Basel III rules text on liquidity – "Basel III: International framework for liquidity risk measurement, standards and monitoring" was issued in December 2010 which presented the details of global regulatory standards on liquidity. Two minimum standards, viz., Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) for funding liquidity were prescribed by the Basel Committee for achieving two separate but complementary objectives.

The LCR promotes short-term resilience of banks to potential liquidity disruptions by ensuring that they have sufficient high quality liquid assets (HQLAs) to survive an acute stress scenario lasting for 30 days. The NSFR promotes resilience over a longer-term time horizon by requiring banks to fund their activities with more stable sources of funding on an ongoing basis.

At the time of issuing the December 2010 document, the Basel Committee had put in place a rigorous process to review the standard and its implications for financial markets, credit extension and economic growth and agreed to review the development of the NSFR over an observation period. The focus of this review was on addressing any unintended consequences for financial market functioning and the economy, and on improving its design with respect to several key issues, notably: (i) the impact on retail business activities; (ii) the treatment of short-term matched funding of assets and liabilities;

and (iii) analysis of sub-one year buckets for both assets and liabilities. These guidelines are based on the final rules text on NSFR published by the BCBS in October 2014 and take into account the Indian conditions.

Objective

The objective of NSFR is to ensure that banks maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. A sustainable funding structure is intended to reduce the probability of erosion of a bank's liquidity position due to disruptions in a bank's regular sources of funding that would increase the risk of its failure and potentially lead 4 to broader systemic stress. The NSFR limits overreliance on short-term wholesale funding, encourages better assessment of funding risk across all on- and off-balance sheet items, and promotes funding stability.

Definition of NSFR

The NSFR is defined as the amount of available stable funding relative to the amount of required stable funding. "Available stable funding" (ASF) is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. The amount of stable funding required ("Required stable funding") (RSF) of a specific institution 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 (OBS) exposures.

Minimum Requirement and Implementation Date

$$NSFR = \frac{(Available\ Stable\ Funding\ (ASF))}{Required\ Stable\ Funding(RSF)} \geq 100\%$$

The above ratio should be equal to at least 100% on an ongoing basis. However, the NSFR would be supplemented by supervisory assessment of the stable funding and liquidity risk profile of a bank. On the basis of such assessment, the Reserve Bank may require an individual bank to adopt more stringent standards to reflect its funding risk profile and its compliance with the Sound Principles (issued vide circular "Liquidity Risk Management by Banks" DBOD.BP.No.56/21.04.098/2012-13 dated November 7, 2012). The NSFR would be binding on banks with effect from a date which will be communicated in due course.

Definition and computation of Available Stable Funding

The amount of ASF is measured, based on the broad characteristics of the relative stability of an institution'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. The amount of ASF is calculated by first assigning the carrying value of an institution's capital and liabilities to one of five categories as presented below. The amount assigned to each category is then multiplied by an ASF factor, and the total ASF is the sum of the weighted amounts. Carrying value represents the amount at which a liability or equity instrument is recorded before the application of any regulatory deductions, filters or other adjustments.

Sr. No.	Components of ASF category (liability categories)	Associated ASF factor
(i)	• Total regulatory capital (excluding Tier 2 instruments with residual maturity of less than one year) • Other capital instruments with effective residual maturity of one year or more • Other liabilities with effective residual maturity of one year or more	100%
(ii)	• Stable non-maturity (demand) deposits and term deposits with residual maturity of less than one year provided by retail and small business customers	95%
(iii)	• Less stable non-maturity deposits and term deposits with residual maturity of less than one year provided by retail and small business customers	90%
(iv)	• Funding with residual maturity of less than one year provided by non-financial corporate customers • Operational deposits • Funding with residual maturity of less than one year from sovereigns, PSEs, and multilateral and national development banks • Other funding with residual maturity between six months and less than one year not included in the above categories, including funding provided by central banks and financial institutions	50%
(v)	• All other liabilities and equity not included in the above categories, including liabilities without a stated maturity (with a specific treatment for deferred tax liabilities and minority interests) • NSFR derivative liabilities net of NSFR derivative assets if NSFR derivative liabilities are greater than NSFR derivative assets • "Trade date" payables arising from purchases of financial instruments, foreign currencies and commodities.	0%

Definition and computation of Required Stable Funding (RSF)

The amount of required stable funding is measured based on the broad characteristics of the liquidity risk profile of an institution's assets and OBS exposures. The amount of required stable funding is calculated by first assigning the carrying value[4] of an institution's assets to the categories listed in the in appended table below. Unless explicitly stated otherwise in the NSFR standard, assets should be allocated to maturity buckets according to their contractual residual maturity. However, this should take into account embedded optionality, such as put or call options, which may affect the actual maturity date. The amount assigned to each category is then multiplied by its associated required stable funding (RSF) factor, and the total RSF is the sum of the weighted amounts added to the amount of OBS activity (or potential liquidity exposure) multiplied by its associated RSF factor in appended table Definitions mirror those outlined in the extant LCR guidelines, unless otherwise specified.

Sr. No.	Components of RSF category	Associated RSF factor
(i)	• Coins and banknotes • Cash Reserve Ratio (CRR) including excess CRR • All claims on RBI with residual maturities of less than six months • "Trade date" receivables arising from sales of financial instruments, foreign currencies and commodities.	0%
(ii)	• Unencumbered Level 1 assets, excluding coins, banknotes and CRR • Unencumbered SLR Securities	5%
(iii)	• Unencumbered loans to financial institutions with residual maturities of less than six months, where the loan is secured against Level 1 assets as defined in LCR circular dated June 9, 2014 and updated from time to time, and where the bank has the ability to freely re-hypothecate the received collateral for the life of the loan	10%
(iv)	• All other 'standard' unencumbered loans to financial institutions with residual maturities of less than six months not included in the above categories • Unencumbered Level 2A assets	15%
(v)	• Unencumbered Level 2B assets • HQLA encumbered for a period of six months or more and less than one year • 'Standard' Loans to financial institutions and central banks with residual	50%

	maturities between six months and less than one year • Deposits held at other financial institutions for operational purposes • All other assets not included in the above categories with residual maturity of less than one year, including 'standard' loans to non-financial corporate clients, to retail and small business customers, and 'standard' loans to sovereigns and PSEs	
(vi)	• Unencumbered 'standard' residential mortgages with a residual maturity of one year or more and with the minimum risk weight permitted under the Standardised Approach • Other unencumbered 'standard' loans not included in the above categories, excluding loans to financial institutions, with a residual maturity of one year or more and with a risk weight of less than or equal to 35% under the Standardised Approach	65%
(vii)	• Cash, securities or other assets posted as initial margin for derivative contracts and cash or other assets provided to contribute to the default fund of a CCP • Other unencumbered performing loans with risk weights greater than 35% under the Standardised Approach and residual maturities of one year or more, excluding loans to financial institutions • Unencumbered securities that are not in default and do not qualify as HQLA/SLR with a remaining maturity of one year or more and exchange-traded equities • Physical traded commodities, including gold	85%
(viii)	• All assets that are encumbered for a period of one year or more • NSFR derivative assets net of NSFR derivative liabilities if NSFR derivative assets are greater than NSFR derivative liabilities • 5% of derivative liabilities as calculated according to para 8.1 • All other assets not included in the above categories, including non-performing	100%

	loans, loans to financial institutions with a residual maturity of one year or more, non-exchange-traded equities, fixed assets, items deducted from regulatory capital, retained interest, insurance assets, subsidiary interests and defaulted securities • All restructured ‘standard’ loans which attract higher risk weight and additional provision	

Please find attached the final guidelines on Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR) released by RBI for your kind reference.

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Warm regards,

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