Basel Liquidity Framework

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

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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.

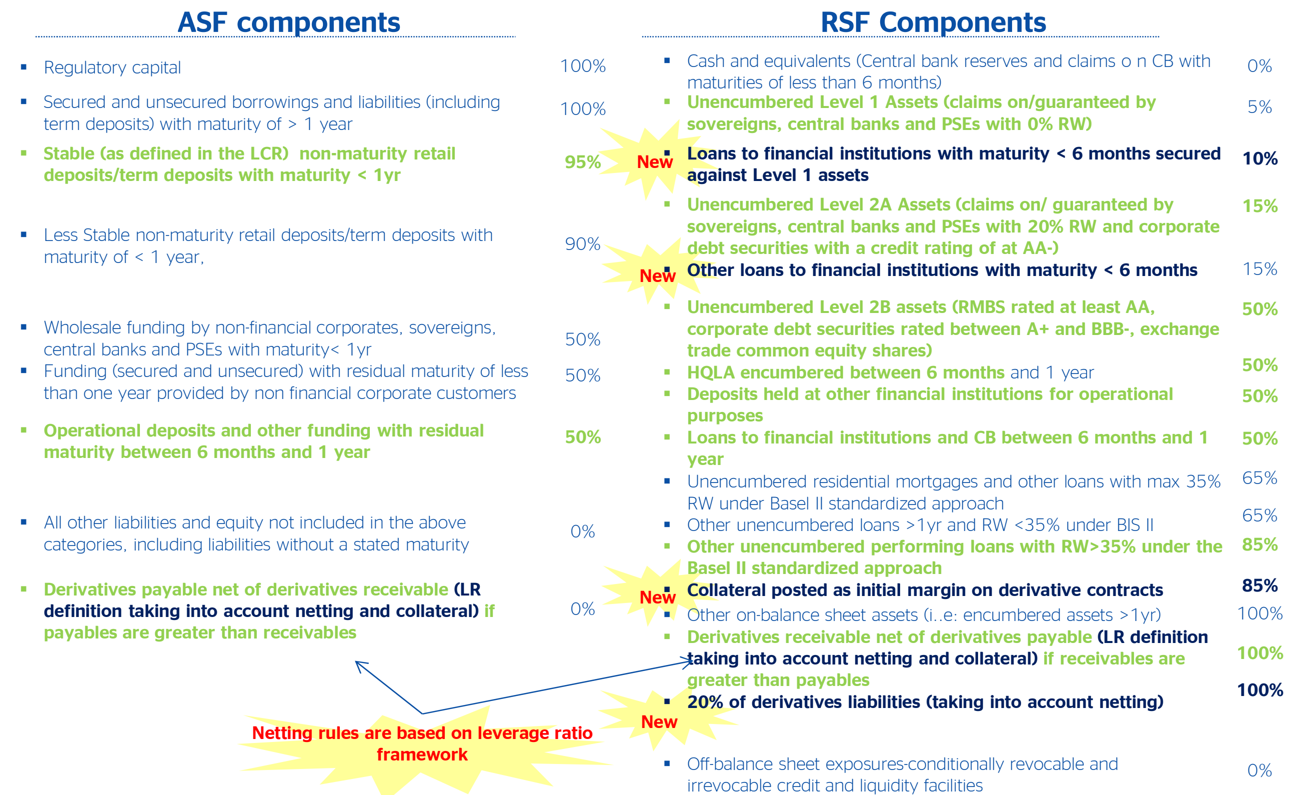
Some of the changes are as follows:

- Reduction of the asymmetrical treatment of short term (<6 months) reverse repos with non-financials. 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 higher[1], 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

Final outcome of the NSFR[2]



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

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