Basel Committee
on Banking Supervision

Basel III – The Net Stable Funding Ratio: frequently asked questions

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BANK FOR INTERNATIONAL SETTLEMENTS

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Introduction

The Basel Committee on Banking Supervision has received a number of interpretation questions related to the October 2014 publication of the Basel Committee's Net Stable Funding Ratio (NSFR). To promote consistent global implementation of its standards, the Committee has agreed to periodically review frequently asked questions (FAQs) and publish answers along with any technical elaboration of the standards text and interpretative guidance that may be necessary.

This document sets out an updated set of FAQs that relate to the Basel III Net Stable Funding Ratio framework, inclusive of the FAQs previously published in July 2016. The questions and answers are grouped according to different relevant areas, as follows: (i) Definitions; (ii) Repo/secured lending; (iii) Derivatives; (iv) Maturity; and (v) Other.

The updates since the first publication of this document in July 2016 consist of new FAQs 5.1 (a-d) and 34.

Definitions

1. *How does the meaning of the term "claims" differ from the meaning of the term "loans"? More specifically, does paragraph 36(c) referring to "claims on central banks" capture a broader range of instruments than paragraphs 38 and 39 referring to "loans to financial institutions"?*

   Answer: Yes, the term "claims" is broader than loans. The term "claims" in paragraph 36(c), for example, also includes central bank bills and the asset account created on banks' balance sheets by entering into repo transactions with central banks.

2. *To which category (financial or non-financial) do insurance companies and investment companies belong?*

   Answer: Consistent with paragraph 131(d) and (e) of the LCR standard and paragraph 16 of the NSFR standard, banks, securities firms, insurance companies, fiduciaries (defined in this context as a legal entity that is authorised to manage assets on behalf of a third party, including asset management entities such as pension funds and other collective investment vehicles), and beneficiaries (defined in this context as a legal entity that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract) are considered as financial institutions for the application of the NSFR standard.

3. *"National development bank" in paragraph 24 of the NSFR standard is a term newly introduced by the BCBS which does not appear in either the LCR standard or the Basel capital framework. Does the Basel Committee plan to provide a list of NDBs?*

   Answer: No, the Basel Committee does not plan to provide a list of NDBs. Banks should refer to guidance from their supervisors to determine if any NDBs in their jurisdictions or abroad can qualify for the treatment under paragraph 24 of the NSFR standard. These entities would likely include banks that provide financing for development projects. Contrary to multilateral development banks, whose membership and operation involve several countries, national development banks typically belong to or are controlled by the state in which they are incorporated.

Repo/secured lending

4. *What is the treatment in terms of encumbrance for collateral pledged in a repo operation with remaining maturity of one year or greater but where the collateral pledged matures in less than one year?*

Answer: In this case, for the purpose of computing the NSFR, the collateral should be considered encumbered for the term of the repo or secured transaction, even if the actual maturity of the collateral is shorter than one year. This follows because the collateral would have to be replaced once it matures. Thus, the collateral pledged under a transaction maturing beyond one year should be subject to a RSF factor of 100%, regardless of its maturity.

5. *Under what circumstances can positions arising from securities financing transactions (such as repo or reverse repo) be reported on a net basis in the NSFR?*

Answer: Amounts receivables and payable under these securities financing transactions should generally be reported on a gross basis, meaning that the gross amount of such receivables and payables should be reported on the RSF side and ASF side, respectively. The only exception, as per paragraph 33 in the NSFR standard, is that "securities financing transactions with a single counterparty may be measured net when calculating the NSFR, provided that the netting conditions set out in Paragraph 33(i) of the *Basel III leverage ratio framework and disclosure requirements* document are met".

5.1 *How should reverse repo and secured funding transactions be treated in the NSFR?*

a. *What is the applicable RSF factor for the amount receivable by a bank under a reverse repo transaction?*

Answer: With the exception of loans (reverse repos) to financial institutions with residual maturity of less than six months secured by level 1 assets (which receive a 10% RSF factor as per paragraph 38 of the NSFR standard) or by other assets (which receive a 15% RSF factor as per paragraph 39 of the NSFR standard), the treatment for the amount receivable is the same as with any other loan, which will depend on the counterparty and term of the operation.

b. *What is the treatment for the collateral received?*

Answer: According to paragraph 32 of the NSFR standard governing secured funding arrangements, the NSFR treatment of collateral received in a reverse repo is determined by the collateral's balance sheet and accounting treatments, which should generally result in banks excluding from their assets, securities that they have borrowed in securities financing transactions (such as reverse repos and collateral swaps) which are kept off-balance sheet. In this case, there is no NSFR treatment for the collateral. If, however, the collateral received is kept on-balance sheet, such collateral should receive an RSF factor according to its characteristics (whether it is HQLA, its term, issuer, etc).

c. *How should the encumbrance treatment as specified in paragraph 31 of the NSFR framework be applied to secured lending (eg reverse repo) transactions where the collateral received does not appear on the bank's balance sheet, and it has been rehypothecated or sold thereby creating a short position?*

Answer: The encumbrance treatment should be applied to the on-balance sheet receivable to the extent that the transaction cannot mature without the bank returning the collateral received to the counterparty. As per paragraph 31 of the LCR framework (referenced in footnote 14 of paragraph 31 in the NSFR framework), for a transaction to be "unencumbered", it must be "free of legal, regulatory, contractual or other restrictions on the ability of the bank to liquidate, sell, transfer or assign the asset". Since the liquidation of the cash receivable is contingent on the return of collateral that is no longer held by the bank, the receivable should be considered as encumbered. When the collateral received from a secured funding transaction has been rehypothecated, the receivable should be considered encumbered for the term of the rehypothecation of the collateral. When the collateral received from a secured funding transaction has been sold outright, thereby creating a short position, the receivable related to the original secured funding transaction should be considered encumbered for the term of the residual maturity of this receivable. Thus, the on-balance sheet receivable should:

- be treated according to the answer to question 5.1.a if the remaining period of encumbrance is less than six months (ie it is considered as being unencumbered in the NSFR);
- be assigned a 50% or higher RSF factor if the remaining period of encumbrance is between six months and less than one year according to paragraph 31; and
- be assigned a 100% RSF factor if the remaining period of encumbrance is greater than one year according to paragraph 31.

d. *How should the encumbrance treatment specified in paragraph 31 of the NSFR framework be applied to secured lending (eg reverse repo) transactions where the collateral appears on the bank's balance sheet, and it has been rehypothecated or sold, thereby creating a short position?*

Answer: Collateral received that appears on a bank's balance sheet and has been rehypothecated (eg encumbered to a repo) should be treated as encumbered according to paragraph 31. Consequently, the collateral received should:

- be treated as being unencumbered if the remaining period of encumbrance is less than six months according to paragraph 31 of the NSFR standard, and receive the same RSF factor as an equivalent asset that is unencumbered;
- be assigned a 50% or higher RSF factor if the remaining period of encumbrance is between six months and less than one year according to paragraph 31; and
- be assigned a 100% RSF factor if the remaining period of encumbrance is greater than one year according to paragraph 31.

If the collateral has been sold outright, thereby creating a short position, the corresponding on-balance sheet receivable should be considered encumbered for the term of the residual maturity of this receivable, and receive an RSF factor according to the answer to question 5.1.c above.

6. *Some loans are only partially secured and are therefore separated into secured and unsecured portions with different risk weights under Basel II. How should these portions be treated for the calculation of the NSFR?*

Answer: The specific characteristics of these portions of loans should be taken into account for the calculation of the NSFR: the secured and unsecured portions of a loan should each be treated according to its characteristics and assigned the corresponding RSF factor. If it is not possible to draw the distinction between the secured and unsecured part of the loan, the higher RSF factor should apply to the whole loan.

7. *What is the adequate period for a non-maturity reverse repo (also known as open reverse repo)? Would that be categorised under "loans with residual maturities of less than six months"?*

Answer: Paragraph 29 states that assets should be allocated to the appropriate RSF factor based on their residual maturity or liquidity value. When determining the maturity of an instrument, investors should be assumed to exercise any option to extend maturity. For assets with options exercisable at the bank's discretion, supervisors should take into account reputational factors that may limit a bank's ability not to exercise the option. In particular, where the market expects certain assets to be extended in their maturity, banks and supervisors should assume such behaviour for the purpose of the NSFR and include these assets in the corresponding RSF category. In the case of a non-maturity reverse repo, they should be assigned as RSF=100% (to continue over the one-year term), unless banks can demonstrate to supervisors that the non-maturity reverse repo would effectively mature in a different period.

Derivatives

8. *What is the outcome of the Basel Committee's work to evaluate the treatment of margining in the NSFR described in Section 42(a)?*

Answer: The analysis conducted by the Basel Committee to evaluate the treatment of margining in the NSFR has determined that the current treatment of 85% stable funding requirement will be maintained. Section 42(a) of the NSFR standard is therefore revised to read as follows:

"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 central counterparty (CCP). Where securities or other assets posted as initial margin for derivative contracts would otherwise receive a higher RSF factor, they should retain that higher factor."

9. *Do derivative transactions qualify for the treatment of interdependent assets and liabilities referred to in paragraph 45 of the NSFR standard?*

Answer: No, according to paragraph 45 of the NSFR standard, national supervisors have discretion in limited circumstances to determine whether certain asset and liability items, on the basis of contractual arrangements, are interdependent. The strict conditions of paragraph 45 must all be fulfilled to allow this treatment to apply. This treatment, therefore, is not intended to be applied to derivative transactions, since it is rarely the case that derivatives would meet all conditions. Furthermore, the fulfilment of the conditions provided for by paragraph 45 would not automatically lead to the application of the treatment of interdependent assets, as supervisors are still required to consider whether perverse incentives or unintended consequences are being created by approving this treatment for certain operations, before exercising such discretion.

10. *Under which conditions should the exemption found in footnote 18 apply to initial margin in the NSFR standard?*

Answer: Footnote 18 specifies the conditions allowing for an exemption of the 85% RSF factor for initial margin posted by a bank on behalf of a customer. This refers to the cases in which the bank provides a customer access to a third party (eg a CCP) for the purpose of clearing derivatives, where the transactions are executed in the name of the customer, and the bank does not guarantee the performance of this third party.

11. *Does the existence of minimum thresholds of transfer amounts for exchange of collateral in derivative contracts automatically preclude such contracts from being considered for the condition of paragraph 35 of the NSFR standard to allow an offsetting of collateral received (in particular regarding the daily calculation and exchange of variation margins)?*

Answer: No. Paragraph 35 of the NSFR standard refers to paragraph 25 in the Basel III Leverage Ratio which states in subsection (iv) that "variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty". The requirement on frequency of calculation and exchange of margins is stipulated in paragraph 25(ii), which states "Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions".

12. *Footnote 6 of the NSFR standard states that NSFR derivative liabilities = (derivative liabilities) – (total collateral posted as variation margin on derivative liabilities). In contrast, paragraph 43(d) of the NSFR standard requires a 100% RSF factor to be applied to 20% of derivative liabilities calculated before*

deducting variation margin posted. Should derivative liabilities be calculated before or after deducting collateral posted as variation margin on the derivative contracts? Additionally, would the 100% RSF factor be applied to 20% of derivatives liabilities even in cases when a bank is in a net derivative asset position (ie the net derivative asset is already subject to a 100% RSF factor)?

Answer: NSFR derivative liabilities, as defined in paragraph 20, should be calculated after deducting collateral posted as variation margin on the derivative contracts. However, for the purpose of paragraph 43(d), the 20% RSF factor applies to the gross amount of derivative liabilities as defined in paragraph 19, ie before deducting the collateral posted. There are no exceptions to this treatment: thus, the 100% RSF factor is applied to 20% of the gross amount of derivatives liabilities in all cases, and is not dependent on a bank's net derivative position as described in paragraph 43(b).

13. *What is the appropriate treatment of initial margin and variation margin if they are not separate?*

Answer: For OTC transactions, any fixed independent amount a bank was contractually required to post at the inception of the derivatives transaction should be considered as initial margin, regardless of whether any of this margin was returned to the bank in the form of variation margin payments. If the initial margin is formulaically defined at a portfolio level, the amount considered as initial margin should reflect this calculated amount as of the NSFR measurement date, even if, for example, the total amount of margin physically posted to the bank's counterparty is lower because of VM payments received. For centrally cleared transactions, the amount of initial margin should reflect the total amount of margin posted (IM and VM) less any mark-to-market losses on the applicable portfolio of cleared transactions.

14. *Are listed and OTC cleared transactions out of the scope of derivatives payables used to work out additional RSF of paragraph 43(d)?*

Answer: No, all derivative transactions should be included.

15. *Does the 85% RSF factor defined in paragraph 42(a) for assets posted as initial margin for derivatives contracts apply to securities that are not on the balance sheet (eg securities received as collateral)?*

Answer: Yes. The 85% RSF factor from paragraph 42(a) applies to cash, securities or other assets posted as initial margin for derivative contracts, regardless of whether those assets are on- or off-balance sheet.

16. *If an on-balance sheet asset is associated with collateral posted as initial margin for purposes of the NSFR, should it be treated as encumbered?*

Answer: To the extent that the bank's accounting framework reflects on balance sheet, in connection with a derivative contract, an asset associated with collateral posted as initial margin for purposes of the NSFR, that asset should not be counted as an encumbered asset in the calculation of a bank's RSF to avoid any double-counting.

Maturity

17. *Paragraph 24 provides that funding from national development banks with residual maturity of less than one year should be subject to a 50% ASF factor, the same as funding from non-financials, sovereign and PSEs. However, paragraph 40(e) only specifies that loans to non-financials, sovereigns and PSEs that have a residual maturity of less than one year should be subject to a 50% RSF factor but does not specify the treatment for loans to national development banks that have a similar residual maturity. Shall we infer that loans to national development bank maturing in one year should also be subject to a 50% RSF factor as in the case of loans to non-financials, sovereign and PSEs maturing in one year?*

Answer: Yes, paragraph 40(e) is a catchall category for all other non-HQLA not included in other categories under paragraph 40 that have a residual maturity of less than one year. Loans to non-financial corporate clients, retail customers, small business, sovereigns and PSEs are provided as examples under this category and are not themselves exhaustive.

18. *What maturity – and consequently what RSF factor – is applied to a floating rate unencumbered loan without a stated final maturity where the borrower may repay the loan in full and without penalty charges at the next rate reset date?*

Answer: According to paragraph 29 of the NSFR standard, "investors should be assumed to exercise any option to extend maturity". Thus, these loans are deemed to have an effective residual maturity period of more than one year, and should be given either a 65% or 85% RSF factor depending on their risk weights under the Basel II standardised approach for credit risk.

19. *Should all claims on central banks with residual maturities of less than six months get a 0% RSF factor, following paragraph 36, or should they get a 5% RSF factor if they fall into the second bullet of paragraph 37, ie if they are issued by central banks which are non-0% risk-weighted?*

Answer: All claims on central banks with residual maturities of less than six months get a 0% RSF.

20. *Should assets be allocated to the NSFR maturity buckets based on their contractual or behavioural/expected maturities?*

Answer: 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 as described in paragraphs 18 and 29 of the NSFR standard.

21. *Some non-maturity loans may be subject to periodic (eg annual) review, following which banks may decide to renew or not to renew them for a further term. An example of such a loan is an overdraft facility provided to a business customer. How should such loans be allocated to the NSFR maturity buckets? Should these loans be modelled as maturing at their next review date?*

Answer: Paragraph 29 of the NSFR standard, states that "for assets with options exercisable at the bank's discretion, supervisors should take into account reputational factors that may limit a bank's ability not to exercise the option". If there is a contractual provision with a review date to determine whether a given facility or loan is renewed or not, supervisors may authorise, on a case by case basis, banks to use the next review date as the maturity date. In doing so, supervisors must consider the incentives created and the actual likelihood that such facilities/loans will not be renewed. In particular, options by a bank not to renew a given facility should generally be assumed not to be exercised when there may be reputational concerns.

22. *How should retail term deposits that are subject to a residual maturity greater than 30 days or withdrawal notice period of more than 30 days be treated in the calculation of the NSFR and reported in the NSFR template?*

Answer: In line with the treatment for the LCR, but with a different relevant horizon, deposits maturing below one year, or which can be withdrawn early without a significant penalty, that are classified as retail term deposits in the LCR should, for purposes of the NSFR, be classified according to their characteristics (eg insured, held in transactional account etc) as stable or less stable. Retail term deposits maturing over one year and which cannot be withdrawn early without significant penalty are subject to a 100% ASF.

Other

23. *How should assets be treated in the NSFR that are owned by banks, but segregated to satisfy statutory requirements for the protection of customer equity in margined trading accounts?*

Answer: Those assets should be reported in accordance with the underlying exposure, whether or not the segregation requirement is separately classified on a bank's balance sheet. However, those assets should also be treated according to paragraph 31 of the NSFR standard. That is, they could be subject to a higher RSF depending on (the term of) encumbrance. The (term of) encumbrance should be determined by authorities, taking into account whether the institution can freely dispose or exchange such assets and the term of the liability to the bank's customer(s) that generates the segregation requirement.

24. *While referring to liabilities, paragraph 17 says that "carrying value" is recorded before the application of any regulatory deductions, filters or other adjustments. Is this extended to assets?*

Answer: The carrying value of an asset item should generally be recorded by following its accounting value, ie net of specific provisions, in line with paragraph 52 of the Basel II Standardised Approach and paragraph 12 of the Basel III leverage ratio framework and disclosure requirements.

25. *Should the treatment proposed in paragraph 29 for amortising loans be applied to other claims?*

Answer: Yes. The portion of any claim that comes due in a given time bucket has to be assigned to the corresponding maturity and is subject to the corresponding RSF factor.

26. *Should sovereign bonds issued in foreign currencies that are excluded from HQLA according to LCR standard paragraph 50(e) get the treatment of HQLA in the NSFR? (This question applies to those sovereign or central bank debt securities issued in foreign currencies which are not computable given that their amount exceeds the bank's stressed net cash outflows in that currency and country.)*

Answer: Yes, the total amount of these securities can be treated as Level 1 and assigned to the corresponding bucket.

27. *Soft-bullet structures are essentially bonds with an option for the issuer to extend the maturity of the bond if certain criteria specified by the contract are met. Thus, by exercising the option the bank can postpone the repayment of the debt by extending the maturity of the bond. The extension period may vary depending on the specific contract. What is the treatment of bonds with soft-bullet structures issued by a bank for the purposes of computing the ASF for the NSFR?*

Answer: The NSFR standard (paragraph 18) states that for "funding with options exercisable at the bank's discretion, supervisors should take into account reputational factors that may limit a bank's ability not to exercise the option". Along the same lines, when calculating the NSFR, options by a bank to extend funding maturity of its obligations should generally be assumed not to be exercised when there may be reputational concerns.

28. *Is it acceptable for banks accredited to use the IRB approach to credit risk to use the IRB risk weight instead of the standardised approach to calculate risk weights for the purposes of the NSFR?*

Answer: No, only the Basel II Standardised Approach risk weights may be used to determine the NSFR treatment.

29. *What is the treatment of retail and small business deposits that are subject to higher (than 5% and 10%) outflow assumptions than those for stable and less stable deposits in the LCR?*

Answer: The treatment of retail and small business deposits follows the definitions provided in the LCR standard, and not the run-off rates applied to them in a particular jurisdiction. Thus, such retail and small business deposits could be treated as stable and less stable, unless a given jurisdiction chooses to apply a more conservative treatment (lower ASF).

30. *Corporates, PSEs and covered bonds with a credit rating equal or equivalent to at least AA– have an RSF of 15%. However, only corporates with a credit rating of between A+ and BBB– have an RSF of 50%, while this is not applicable for PSEs and covered bonds. Is this correct?*

Answer: Sovereign and PSEs bonds rated between A+ and BBB– are also eligible as Level 2B assets and, as such, would be subject to an RSF of 50%. This is also the case for corporate securities that would qualify as Level 2A assets but whose price has declined more than 10% within a 30-day period, but not over 20%. With respect to covered bonds, only those whose rating is above AA– are eligible as level 2A assets, and the LCR does not contemplate including covered bonds as level 2B assets. Those assets that do not qualify as HQLA should be classified according to their maturity.

31. *Paragraph 41(a) and (b) sets a 65% RSF factor on unencumbered residential mortgages and other loans, excluding loans to financial institutions, with a residual maturity of one year or greater, which would qualify for the 35% or lower risk weight under the Basel II standardised approach for credit risk. Does this treatment include loans to sovereigns and PSEs?*

Answer: Yes, in line with paragraph 41(b) of the NSFR standard, only loans to financial institutions are excluded.

32. *What RSF factor should be assigned to non-operational deposits held at other financial institutions?*

Answer: Non-operational deposits held at other financial institutions should have the same treatment as loans to financial institutions, taking into account the term of the operation. That is, demand deposits and term deposits with residual maturities of less than six months will be assigned a 15% RSF factor; and term deposits with residual maturity of between six months and less than one year will have a 50% RSF factor or 100% if the maturity is beyond one year.

33. *As some central bank operations may involve the use of derivative transactions such as foreign exchange swaps, would such derivative transactions arising from central banks' short-term monetary policy and liquidity operations be excluded from the reporting bank's NSFR computation?*

Answer: A limited national discretion allows derivative transactions with central banks arising from the latter's short-term monetary policy and liquidity operations to be excluded from the reporting bank's NSFR computation and to offset unrealised capital gains and losses related to these derivative transactions from ASF. These transactions include foreign exchange derivatives such as foreign exchange swaps, and should have a maturity of less than six months at inception. As such, the bank's NSFR would not change due to entering a short-term derivative transaction with its central bank for the purpose of short-term monetary policy and liquidity operations.

34. *Would excess over-collateralisation (OC) (OC in an amount higher than the legal OC requirement) in a covered bond collateral pool constitute encumbered assets for the purpose of the NSFR? For example, should the OC requirements to maintain a particular rating imposed by rating agencies be taken into account for determining excess OC?*

Answer: The treatment of excess OC will depend on the ability of the bank to issue additional covered bonds against the collateral or pool of collateral, which may depend on the specific characteristics of the covered bond issuance programme. Where collateral is posted for the specific issuance of covered bonds and it is thus an intrinsic characteristic of a particular issuance, then the excess collateral committed for the issuance cannot be used to raise additional funding or be taken out of the collateral pool without affecting the characteristics of the issuance, and should be considered encumbered for as long as it remains in the collateral pool.

If, however, the covered bonds are issued against a collateral pool that allows for multiple issuance, subject to supervisory discretion, the excess collateral (which would actually represent excess issuance capacity) may be treated as unencumbered for the purpose of the NSFR, provided it can be withdrawn at the issuer's discretion without any contractual, regulatory, reputational or relevant operational impediment (such as a negative impact on the bank's targeted rating) and it can be used to issue more covered bonds or mobilise such collateral in any other way (eg by selling outright or securitising). A type of operational impediment that should be taken into account includes those cases where rating agencies set an objective and measureable threshold for over-collateralisation (ie explicit OC requirements to maintain a minimum rating imposed by rating agencies), and to the extent that not meeting such requirements could materially impact the bank's targeted rating of the covered bonds, thus impairing the future ability of the institution to issue new covered bonds. In such cases, supervisors may, taking national specificities and other factors into account, specify an OC level below which excess collateral is considered encumbered.