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Basel's Bank Funding Disclosure Proposal: A Good Start, But It Does Not Go Far Enough

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*(**Editor's Note:** This article is part of a series of comments by Standard & Poor's Ratings Services highlighting disclosure gaps in banks' published reporting and providing recommendations on how to address these gaps to enhance transparency. Standard & Poor's views do not necessarily represent those of any other entity to which it may be affiliated. We intend our comments to reflect the analytical needs and expectations of our credit analysts, as well as the questions we receive from investors.)*

On Dec. 9, 2014, the Basel Committee on Banking Supervision published a consultative document on its proposed net stable funding ratio (NSFR) disclosure standards, under which banks will disclose the proportion of their long-term assets that are funded by long-term, stable funding. The committee intends to introduce the NSFR as a minimum standard by Jan. 1, 2018. The main purpose of the NSFR is to reduce refinancing risks for banks by requiring them to better match their asset and liability profiles, while allowing banks to perform maturity transformation that serves economic needs. The disclosure standards aim to improve transparency and enhance market discipline.

Here, Standard & Poor's Ratings Services provides its analytical opinion of the proposed disclosure standards based on our understanding of the document. This builds on our report: "How Enhanced Funding And Liquidity Disclosure Could Improve Confidence In The World's Banks," published May 29, 2012, on RatingsDirect. This report detailed our views on qualitative principles and quantitative information that we believe would help market participants to consistently assess banks' funding and liquidity positions.

Overview

- In our view, the Basel Committee's proposed net stable funding disclosure standard for banks would enhance transparency.
- We nevertheless still see room for improvement in the proposed standard because it does not meet all principles and data that we would consider to be sound reporting practices.
- We believe that mandatory disclosure of further important information common to all banks in a standardized format would be helpful for market participants.
- What's more, we consider Basel's timeline for implementation of the disclosure standard by Jan. 1, 2018, to be slow.

In essence, we believe that implementation of the currently proposed funding disclosure standard for all banks--not only those that are internationally active--would be an important step in enhancing transparency and consistency of reporting globally. We nevertheless believe that the Basel committee could improve its proposed standard by expanding the requirements to include further information, some of which may go beyond what is strictly required for the calculation of the NSFR. We also believe the committee could implement the new standards sooner than its current timeline and bring forward the first date on which banks should report this data to before the NSFR becomes a regulatory requirement. Conversely, we believe it would be regrettable if the consultation process resulted in a softening of the minimum standard that the committee finally implements.

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How The Proposed Standard Compares Against Our Key Principles And Data

The Basel Committee's proposed funding disclosure standard meets some, but not all of the key principles and data that we consider would be the most useful in helping us and other market participants to better assess the funding and liquidity profiles of banks (for details of our proposals see: "How Enhanced Funding And Liquidity Disclosure Could Improve Confidence In The World's Banks," published May 29, 2012). The key differences between the Basel proposals and our views are as follows.

1. Qualitative Principles Of Reporting

Provide globally compatible formats. We believe that Basel's proposal to provide globally compatible reporting formats would be consistent with our view that reporting should follow globally harmonized definitions and use standardized templates to enhance comparability. However, we see it as a weakness that reporting under the proposal would not allow for reconciliation with banks' respective accounting information. Furthermore, we believe that reporting of consolidated information should be supplemented by mandatory disclosure of unconsolidated information if consolidation does not reflect economic realities, for example due to important restrictions to intra-group funding flows. Exceptions could be granted if, for example, authorities have confirmed that there are no restrictions regarding the flow of funds within corporate groups or if authorities have additionally granted a regulatory waiver for subsidiaries.

Offer quarterly and timely disclosure. We would consider it appropriate if the proposed standard were to provide for funding disclosures on a quarterly basis, within six weeks of each quarter-end. At the same time, we agree that data must represent quarter-end observations and preceding quarters. However, if the Basel Committee decides to move ahead with the proposed funding disclosure "with the same frequency as, and concurrently with, the publication of financial statements," we hope that this does not discourage banks from publishing quarterly financial reports when their regulators do not require them to do so.

While the proposal allows banks to choose between various ways of disclosing funding data (financial, regulatory, or separate reports), we would prefer harmonized rules to help market participants find data. In addition, banks should publish the complete standardized template that they use to compute the NSFR in "Excel" format to allow for easy use and processing (see also below "2. Quantitative Information").

Report funding and liquidity risk in major currencies.

The proposed NSFR would allow banks to report in a single currency. While we acknowledge that this is useful and convenient, experience has shown that convertibility or access to foreign currency or cross-currency swap markets cannot be taken for granted in times of stress. At the same time, we consider full disclosure in each currency impractical. Therefore, we would suggest in addition to single currency reporting an abbreviated disclosure of funding and liquidity positions in major currencies exceeding 5%-10% of consolidated assets.

2. Quantitative Information

Show the maturity profiles of assets and liabilities. The proposed standard requires the disclosure of unweighted values of assets and liabilities for four maturity buckets: no maturity; less than six months; between six months and one year; and above one year. We would find it useful for maturity profiles to be reported in more time buckets than this, and for all balance-sheet items. We see, for example, that the current NSFR calculation template captures five different time buckets of: up to three months; three to six months; six to nine months; nine to 12 months; and above 12 months. We believe that, in addition, banks should report contractual maturities between one to two years, and two to three years, because this more granular information would be useful to identify potential maturity concentrations beyond the one-year time horizon embedded in the NSFR.

Although we welcome the disclosure of unweighted and weighted values, we believe that the proposed format that lumps together various balance-sheet items into potentially heterogeneous aggregates falls short of market participants' needs and adds an unnecessary burden on readers and the banks themselves. We would therefore support the publication of the complete template used to compute the NSFR, which would enhance transparency and avoid using different templates. We believe that by using the proposed less detailed template a reconciliation with balance-sheet items would not be feasible. Also, we consider that important information could be lost, such as a breakdown of high quality liquid assets--which the Basel Committee's liquidity coverage ratio disclosure standards doesn't mandate either--and other securities holdings, a bank's reliance on central bank borrowing, the composition of what the proposal considers wholesale funding (e.g., different types of secured and unsecured borrowing), or the nature of loans (e.g., by counterparty).

Disclose details of collateral management In our view, enhancing the NSFR proposal for detailed and standardized disclosure on the collateral that banks have received or pledged, and on assets that may otherwise be restricted, would improve funding and liquidity analysis. It would also inform market participants about the amount and nature of assets on which the banks have granted secured creditors a preferential claim. Considering that initiatives to improve transparency of banks' asset encumbrance are under way, we would consider it useful if the format of both types of reporting were aligned so that readers could see which of the items that require stable funding are encumbered as well as the length of their encumbrance. The importance of providing detailed information on asset encumbrance is further enhanced in light of the legislative changes in some major jurisdictions, which protect secured creditors but intend to facilitate burden-sharing with unsecured creditors to banks in distress.

Further information

Although the Basel committee recognizes that more qualitative and quantitative information is important to provide readers with a better understanding of a bank's funding risks, it does not include even those reporting items that are not entity-specific in its proposed disclosure standard. In order to enhance reporting consistency and comparability, we consider it necessary that banks not only provide regular and detailed quantitative and qualitative disclosure on the composition of the proposed new regulatory funding and liquidity ratios, but also on risks that a single metric cannot embrace. These items should include :

- Funding concentrations by creditors, tenor, and funding instruments.
- The quality and composition of the bank's customer deposits (e.g. by depositors; amount of insured versus uninsured deposits).
- The size and composition of the bank's wholesale funding.
- The bank's reliance on funding from nonresidents.
- Maturity mismatches in foreign currency.
- The bank's reliance on central bank funding or other forms of official support.
- The potential constraints in transferring liquidity within the bank group.
- Detailed information on off-balance-sheet items and contingent liquidity funding needs that may or may not materialize in the future.
- Committed and irrevocable liquidity lines from third parties with a remaining maturity of one year or more.
- The expected amount and nature of the bank's asset encumbrance and its trend over time.
- The granularity of the bank's customer loans.

- The influence of the bank's ongoing funding interactions with the issuer's group and/or with the government on its funding and liquidity assessment.

Implementation horizon

The NSFR will become a minimum standard only by Jan. 1, 2018, and the Basel committee proposes that banks will be required to comply with its disclosure requirements from the date of their first reporting period after that date. We consider this proposed timeline for the implementation of the NSFR to be slow and would welcome if at least the mandatory disclosure requirements were brought forward. A number of banks have already reported the new funding ratio, even though the regulation was not final. In our view, earlier and detailed reporting in line with enhanced disclosure standards would significantly aid transparency and foster market discipline.

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