Net Stable Funding Ratio (NSFR) – Executive Summary

Following the failure of many banks to adequately measure, manage and control their liquidity risk in 2007 and in subsequent years, the Basel Committee on Banking Supervision (BCBS) introduced two liquidity standards as part of the Basel III post-crisis reforms. The first of these is the Liquidity Coverage Ratio (LCR). It enhances banks' short-term resilience and is presented in another Executive Summary. The second standard – the Net Stable Funding Ratio (NSFR) – aims to promote resilience over a longer time horizon by creating incentives for banks to fund their activities with more stable sources of funding on an ongoing basis.

Private incentives to limit excessive reliance on unstable funding of core (often illiquid) assets are weak. In good times, banks may expand their balance sheets quickly by relying on relatively cheap and abundant short-term wholesale funding. The NSFR aims to limit this and in general seeks to ensure that banks maintain a stable funding structure. One goal of the BCBS in developing the NSFR has been to support financial stability by helping to ensure that funding shocks do not significantly increase the probability of distress for individual banks, a potential source of systemic risk.

The NSFR is expressed as a ratio that must equal or exceed 100%. The ratio relates the bank's available stable funding to its required stable funding, as summarised in the following formula:

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

To determine total ASF and RSF amounts, factors reflecting supervisory assumptions are assigned to the bank's sources of funding and to its exposures, with these factors reflecting the liquidity characteristics of each category of instruments.

ASF

A bank's total ASF is the portion of its capital and liabilities that will remain with the institution for more than one year. The broad characteristics of an institution's funding sources and their assumed degree of stability are the basis for determining ASF. An ASF factor is assigned to the carrying value of each element of funding. ASF factors range from 100% – meaning that the funding is expected to be still fully available in more than a year – to 0% – reflecting that funding from this source is unreliable. The three other ASF factors are 95%, which applies, for instance, to well divided retail deposits, 90% and 50%. The total amount of ASF is the sum of the ASF amounts for each category of liability.

RSF

A bank's total RSF is the amount of stable funding that it is required to hold given the liquidity characteristics and residual maturities of its assets and the contingent liquidity risk arising from its off-balance sheet exposures. For each item, the RSF amount is determined by assigning an RSF factor to the carrying value of the exposure. These range from 100% to 0%. An RSF factor of 100% means that the asset or exposure needs to be entirely financed by stable funding because it is illiquid. This is, for instance, the case for all loans to financial institutions with a residual maturity of 12 months or more. An RSF factor of

0% applies to fully liquid and unencumbered assets. The other RSF factors are 85%, 65%, 50%, 15%, 10% and 5%. The total RSF amount is the sum of the RSF for each category.

Specific treatments

While the NSFR treats liabilities and equity instruments and assets separately, some transactions warrant specific treatments. While off-balance sheet exposures generally receive an RSF factor of 5%, specific factors may be determined at national discretion for certain products or certain non-contractual obligations. Special treatments also apply to transactions involving interdependent assets and liabilities when these involve little or no maturity transformation. This is typically the case with offsetting trades conducted by banks as part of their activities as market intermediaries. Moreover, derivatives transactions are also subject to particular treatments. Subject to conditions, these allow for bilateral netting and take account of variation margins.

Implementing the NSFR

The NSFR became a minimum standard applicable to all internationally active banks on a consolidated basis on 1 January 2018, although national supervisors may also apply it to any subset of entities of large internationally active banks or to all other banks. Banks must meet the NSFR requirement on an ongoing basis and report on a quarterly basis. Because of its impact on maturity transformation, and since its implementation may have unintended consequences, the NSFR is subject to an observation period which started in 2011.

This Executive Summary and related tutorials are also available in FSI Connect, the online learning tool of the Bank for International Settlements.