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From:	Presidency
To:	Delegations
Subject:	Articles 411, 413, 428a-ag & 510 CRR Net Stable Funding Ratio (NSFR)

Delegations will find attached Presidency non-paper for the 15/16 February 2017 meeting.

Articles 411, 413, 428a-ag & 510 CRR
Net Stable Funding Ratio (NSFR)

Background

The Commission proposed amendements to the CRR to introduce a harmonised binding requirement for stable funding (Net Stable Funding Ratio - NSFR) at European Union (EU) level.

The proposal while implementing Basel standards, proposes some adjustments based on the EBA report (vide Annex II) to take into account European specificities. These adjustments relate to specific treatments for:

i) **Pass-through models in general** and **covered bonds issuance** in particular, whose funding risk can be considered as low when assets and liabilities are matched funded;

ii) **Trade finance activities**, whose short-term transactions are less likely to be rolled-over than other type of loans to non-financial counterparties;

iii) **Centralised regulated savings**, whose scheme of transfer renders the client deposits (liabilities) and claims on the state-controlled fund (assets) interdependent;

iv) **Residential guaranteed loans**, whose specific characteristics make them similar to mortgage loans; and

v) **Credit unions**, whose statutory constraints on investment of their excess of liquidity entail a funding risk similar to that of non-financial corporates for the institution receiving the deposits.

The proposed specific treatments broadly reflect the preferential treatment granted to these activities in the EU Liquidity Coverage Ratio (LCR).

Beyond these limited specific treatments, other adjustments to the Basel standard are proposed in order not to hinder the good functioning of EU capital markets and to preserve the liquidity of sovereign bond markets:

- Regarding the treatment of **derivative transactions**, several measures are proposed:
    - Phase-in of the RSF factor applied to unmargined transactions and optional alternative based on SA-CCR for margined transactions for **future funding risk**
    - Recognition of HQLA Level 1 posted as **variation margin** to offset derivatives assets
    - Exemption of **client clearing** activities
- Phase-in of RSF factors applied **short-term transactions** with financial institutions
- Lower RSF factor for **HQLA Level 1** in line with LCR treatment

Feedback Provided by Member States

While Member States welcome the introduction of the NSFR proposal in the EU, a number of Member States want to limit deviations from the Basel standards.

A number of Member States support adjustments based on the recommendations of the EBA report:
- With regards to the *recognition of covered bonds issuance with assets and liabilities having similar maturities,* a majority of MS agree with the idea but the text of the proposal must be better framed and clarified to reflect the intention of the Commission.
- Most MS agree with the proposed treatment of centralised regulated savings, trade finance activities, and residential guaranteed loans, however one MS proposes better alignment with Basel for trade finance and factoring assets with a maturity with less than 6 months, while other mentioned that they are still analyzing the proposals.
- Regarding the *treatment of credit unions as non-financial institutions* the responses suggest that there is a need for further clarity (especially for the term 'credit unions').
- To introduce exemptions for CCPs in line with EBA Report.

A number of Member States expressed their opposition to deviations from the Basel standards beyond the EBA recommendations:

Some MS are in agreement with the proposed application of a **0% RSF factor to HQLA Level 1** (excluding extremely high quality covered bonds). However, other MS consider that the 0% RSF is too lenient. One proposal was made to lower the RSF factor for non-HQLA covered bonds.

A number of MS opposed the proposed **phase-in of RSF factors applied for short term transactions with financial institutions**. These MS highlighted unease with the deviation from the Basel standard and indicated that they could support a phase-in that automatically aligns with Basel at the end of the transitional period.

With respect to the treatment of **derivatives transactions**:
- A number of MS oppose the proposed phase-in of RSF factor for unmargined derivatives future funding risk. Here again these MS hinted that they could support a phase-in that automatically aligns with Basel at the end of the transitional period.
- On margined derivatives future funding risk, a number of MS expressed an interest for a metric based on SA-CCR but called for the implementation of the Basel standards until an alternative treatment is agreed upon at international level.
- With respect to the exemption of derivatives client clearing activities, the proposal seems to be acceptable to MS.
- Views in respect of the recognition of variation margins received in the form of cash and HQLA Level 1 to offset derivative assets were generally positive. One MS suggested to also recognize the HQLA Level 1 covered bonds.

Identified Issues

The main issues identified include the following:

- Alignment of the NSFR proposal with the Basel framework (impact of SA-CCR is unclear and may have technical flaws, issues regarding the phase-in, RSF factors proposed are lower than those in Basel standards).
- Derivatives – concerns with respect to the Delegated Acts.

- Clarifications needed regarding covered bonds and the treatment of credit unions as non-financial institutions.

Questions

Regarding the phase-in of RSF factors applied to short term transactions with financial institutions:

Q1: Do Member States support the Commission delegated act to amend the treatment of RSF factors applied to short term transactions with financial institutions after 3 years?

Q2: Do those Member States that do not support a Commission delegated act still deem it useful to have an EBA report assessing the impact of the current treatment of short term transactions with financial institutions?

Q3: In the absence of a Commission delegated act, would Member States be willing to extend the phase-in period beyond 3 years to enable the Commission to act upon the recommendations of the EBA report through a Level 1 legislative proposal?

Regarding the phase-in of the RSF factor applied to unmargined derivatives transactions future funding risk:

Q4: Do Member States support the Commission delegated act to amend the treatment of unmargined derivatives transactions future funding risk after 3 years?

Q5: Do those Member States that do not support a Commission delegated act still deem it useful to have an EBA report assessing the impact of the current treatment of unmargined derivatives transactions future funding risk?

Q6: In the absence of a Commission delegated act, would Member States be willing to extend the phase-in period beyond 3 years to enable the Commission to act upon the recommendations of the EBA report through a level 1 legislative proposal?

Regarding the optional alternative for margined derivatives transactions future funding risk:

Q7: Some MS, even though they want to envisage an alternative treatment to the 20% RSF factor on gross derivatives liabilities for margined transactions, expressed reservations about the proposed optional approach based on SA-CCR. What alternative treatment would you envisage for future funding risk on margined derivatives transactions?

Q8: Would Member States be willing to introduce the proposed optional approach based on SA-CCR with a review clause to enable the Commission to refine the approach based on practical experience, on the recommendations of the EBA report and on developments at international level through a level 1 legislative proposal?

ANNEX I

"Article 510

Net Stable Funding Requirements

…4. EBA shall monitor the amount of required stable funding covering the funding risk linked to the derivatives contracts listed in Annex II and credit derivatives over the one-year horizon of the net stable funding ratio, in particular the future funding risk for these contracts set out in Article 428u(2) and Article 428x(2) to (4), and report to the Commission on the opportunity to adopt a more risk-sensitive measure by [two years after the date of application of the net stable funding ratio as set out in Title IV of Part Six]. This report shall at least assess:

(a) *the adequacy of using the standardised approach for measuring counterparty credit risk exposures as set out in Section 3 of Chapter 6 of Title II of Part Three, or elements thereof, to calculate the future funding risk for derivatives contracts;*

(b) *the opportunity to distinguish between margined and unmargined derivatives contracts;*

(c) *the opportunity to remove or replace the requirement set out in Article 428u(2) and in Article 428x(2) to (4);*

(d) *the opportunity to change more broadly the treatment of derivatives contracts in the calculation of the net stable funding ratio, as set out under Article 428d, Article 428k(3), Article 428u(2), Article 428x(2) to (4), points (a) and (b) of Article 428af and Article 428ag(3), to better capture the funding risk linked to these contracts over the one-year horizon of the net stable funding ratio;*

(e) *the impact of the proposed changes on the amount of stable funding required for institutions' derivatives contracts.*

5. The Commission is empowered to adopt a delegated act in accordance with Article 462 to amend the treatment of derivatives contracts listed in Annex II and credit derivatives for the calculation of the net stable funding ratio as set out in Title IV of Part Six if it deems it appropriate considering the impact of the existing treatment on institutions' net stable funding ratio and to take better account of the funding risk linked to these transactions over the one-year horizon of the net stable funding ratio. For this purpose, the Commission shall take into account the report referred to in paragraph 4, any international standards that may be developed by international fora and the diversity of the banking sector in the Union.

The Commission shall adopt the delegated act referred to in the first subparagraph by [three years after the date of application of the net stable funding ratio as set out in Title IV of Part Six].

In the absence of adoption of the delegated act referred to in the first subparagraph or of a confirmation by the Commission of the accuracy of the treatment of derivative contracts listed in Annex II and credit derivatives for the calculation of the net stable funding ratio by [three years after the date of application of the net stable funding ratio as set out in Title IV of Part Six], the *requirement set out in Article 428x(2) of this Regulation shall apply for all institutions and all derivatives contracts listed in Annex II and credit derivatives regardless of their characteristics, and the provisions of Article 428u(2) and Article 428x(3) and (4) shall cease to apply.*

6. EBA shall monitor the amount of stable funding required to cover the funding risk linked to secured lending transactions and capital market-driven transactions, including to the assets received or given in these transactions, and to unsecured transactions with a residual maturity of less than six months with financial customers and report to the Commission on the appropriateness of this treatment by [two years after the date of application of the net stable funding ratio as set out in Title IV of Part Six]. This report shall at least assess:

(a) *the opportunity to apply higher or lower stable funding factors to secured lending transactions and capital market-driven transactions with financial customers and to unsecured transactions with a residual maturity of less than six months with financial customers to take better account of their funding risk over the one-year horizon of the net stable funding ratio and of the possible contagion effects between financial customers;*

(b) *the opportunity to apply the treatment set out in point (b) of Article 428s to secured lending transactions and capital market-driven transactions collateralised by other types of assets;*

(c) *the opportunity to apply stable funding factors to off-balance sheet items used in secured lending transactions and capital market-driven transactions as an alternative to the treatment set out in Article 428q(3);*

(d) *the adequacy of the asymmetric treatment between liabilities with a residual maturity of less than six months provided by financial customers that are subject to a 0% available stable funding factor in accordance with point (c) of Article 428k(2) and assets resulting from transactions with a residual maturity of less than six months with financial customers that are subject to a 5% or 10% required stable funding factor in accordance with point (b) of Article 428s and points (a) and (b) of Article 428u;*

(e) *the impact of the introduction of higher or lower required stable funding factors for secured lending transactions and capital market-driven transactions, in particular with a residual maturity of less than six months with financial customers, on the market liquidity of assets received as collateral in these transactions, in particular of sovereign and corporate bonds;*

(f) *the impact of the proposed changes on the amount of stable funding required for those institutions' transactions, in particular for secured lending and capital market-driven transactions with a residual maturity of less than six months with financial customers where sovereign bonds are received as collateral in these transactions.*

7. The Commission is empowered to adopt a delegated act in accordance with Article 462 to amend the treatment of secured lending transactions and capital market-driven transactions, including of the assets received or given in these transactions, and the treatment of unsecured transactions with a residual maturity of less than six months with financial customers for the calculation of the net stable funding ratio as set out in Title IV of Part Six if it deems it appropriate regarding the impact of the existing treatment on institutions' net stable funding ratio and to take better account of the funding risk linked to these transactions over the one-year horizon of the net stable funding ratio. For this *purpose, the Commission shall take into account the report referred to in paragraph 6, any international standards developed by international fora and the diversity of the banking sector in the Union.*

The Commission shall adopt the delegated act referred to in the first subparagraph by [three years after the date of application of the net stable funding ratio as set out in Title IV of Part Six].

In the absence of adoption of the delegated act referred to in the first subparagraph or of a confirmation by the Commission of the accuracy of the treatment of secured lending transactions and capital market-driven transactions, including of the assets received or given in these transactions, and of unsecured transactions with a residual maturity of less than six months with financial customers by [three years after the date of application of the net stable funding ratio as set out in Title IV of Part Six], the required stable funding factors applied to the transactions referred to in Article point (b) of 428s and in points (a) and (b) of Article 428u shall be raised to 10% and 15% respectively.".

Annex II

EBA Report On Net Stable Funding Requirements under Article 510 of the CRR

Recommendation 1: A net stable funding requirement (NSFR) should be introduced for credit institutions in the EU.

Recommendation 2: The NSFR should be applied on a consolidated and individual basis, in which case an approach based on waivers and intragroup preferential treatment for the individual requirements of the banks forming part of a group or affiliated to a central body should be considered. Therefore, this recommendation follows the general approach to liquidity envisaged in the CRR, where sub-consolidated requirements are subject to a competent authority's decision.

Recommendation 3: The calibration and definition adopted in Basel fit well with the European banking system, except for those cases where European specificities justify a different calibration of factors for specific transactions. These cases are described separately in the report. The report recommends taking into consideration the upcoming Basel review on derivative margining and adopting its recommendations.

Recommendation 4: A minimum amount of available stable funding should be imposed in relation to assets and off-balance-sheet commitments. An appropriate balance is to be set between the liquidity of the assets and the stability of the funding.

Recommendation 5: The calibration of a net stable funding requirement for trade finance-related transactions needs to be differentiated:

- For off-balance-sheet commitments, low and graduated RSF factors are suggested, e.g. 5% if the residual maturity is below six months, 10% if up to one year, and 15% if above one year.
- For on-balance-sheet exposures:

- in the case of import and export loans, an RSF factor between 10-25% is suggested if the residual maturity is below six months, 50% if up to one year, and 85% if above one year; and
- in the case of factoring/forfaiting, some alternative treatments are suggested, either a similar treatment as for import/export loans, or a lower NSFR requirement or a waiver on a solo basis.

Recommendation 6: The treatment of interdependent assets and liabilities, as envisaged in the Basel standard, is recommended in the case of fully matched funded amortised mortgage lending.

Recommendation 7: As long as CCPs' activity (CCPs having banking licence) is focused on acting purely as mediators between counterparties without incurring the specific type of banking maturity transformation risk that the NSFR is designed to capture, CCPs could be exempted from the net stable funding requirement.

Recommendation 9: Residential loans guaranteed by banks or insurers who, in the case of default of the borrower, would repay the loans to the originating credit institution and contractually benefit from a mortgage on the real estate should be assimilated into mortgage loans and have an equal treatment under the NSFR.

Recommendation 10: Following the analysis described, smaller banks should be subject to the same stable funding requirement as the rest of the banks.

Recommendation 11: The net stable funding requirement should be equal to at least 100% on an ongoing basis.