Draft report on the calibration of a stable funding requirement under Article 510 CRR

London – 15 October 2015

Disclaimer

The purpose of this presentation is to inform on the state of play of the report on the calibration of a stable funding requirement, which the EBA is mandated to produce by 31 December 2015 for the Commission as per Article 510 (1) and (2) of the CRR. The findings and conclusions that will be discussed are only preliminary and may change substantially when the analysis is finalised and the full report is published.

Structure

1. Background and rationale for funding and liquidity regulation
2. Methodology and preliminary high level conclusions
3. Next steps

Background (1/4)

The banking crisis and the need for further funding and liquidity regulation:

1. The liquidity and funding position of banks was seriously hit during the crisis.

2. Inappropriate funding structures and scarce liquidity buffers prevailed.

3. Liquidity and funding stresses proved lasting over time and led, on many occasions, to public interventions. Banks hoarded liquidity, which harmed the funding structures of other banks and other non-bank financial entities.

4. The lack of appropriately stable financing structures thus led to bank failures, costly interventions, and contributed to the contraction in credit from banks to the economy.

5. There is a clear evidence of need to intervene through regulations in the banking liquidity management.

Background (2/4)

International policy developments on liquidity and funding:

1. December 2010: The Basel Committee on Banking Supervision (BCBS) announced the introduction of a Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), to be put in place in 2015 and 2018 respectively.

   a) The LCR promotes short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets (HQLA) to survive a significant stress scenario lasting for one month. It basically sets the minimum liquidity buffer to bridge liquidity mismatches for one month in a crisis scenario.

   b) The NSFR has a time horizon of one year and requires that banks maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

2. January 2013: The Basel standard on LCR was published.
3. October 2014: The Basel standard on NSFR was published.

Background (3/4)

European regulatory reforms on liquidity and funding:

June 2013: Regulation (EU) No 575/2013 and Directive 2013/36/EU (CRR/CRD IV).

a) It requires liquidity coverage and empower the EU Commission to adopt a delegated act to specify it. This delegated act was published in January 2015 and is applicable from 1 October 2015.

b) It includes a general principle where “institutions shall ensure that long term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions” but does not include any specific requirement.

c) The CRR contains specific mandates for the EBA to develop draft Technical Standards and Reports related to liquidity and funding in order to enhance regulatory harmonisation in Europe through the single rulebook.

Background (4/4) Mandate to the EBA on NSFR preparation

- Article 510 (1) and (2) CRR mandates the EBA to report to the Commission by end 2015 on:
  - ***Whether and how it would be appropriate to ensure that institutions use stable sources of funding***
  - An assessment of the impact on
    - ***the business and risk profile*** of institutions established in the Union
    - ***financial markets***
    - ***the economy and bank lending***, with a particular focus on lending to SMEs and on trade financing, including lending under official export credit insurance schemes and pass through financing models, including match funded mortgage lending.
  - ***Methodologies*** for determining the amount of stable funding available to and required by institutions and on appropriate uniform definitions ***for calculating such a net stable funding requirement***
- This has been complemented by a call for advice from the Commission particularly on an analysis on proportionality.
- By 31 December 2016, the European Commission, considering the EBA report and the diversity of the European banking sector, shall assess the appropriateness of submitting a legislative proposal to the co-legislators on a requirement on stable funding.

Introduction to the Report and its methodology

- **The Basel NSFR is the starting point** of the report.

- It assesses the impact of **its implementation in Europe since multiple angles**: banks' structure, lending activity, market liquidity… for the final calibration.

- **A simulation exercise is conducted to assess the necessary adjustments in banks** for their compliance with the NSFR and a multivariate regression analysis assesses the correlation of the NSFR and a number of variable in real and financial economy.

- The analysis is based on a wide sample of banks which gives a comprehensive view of the European scenario and is also developed by 13 business models similarly to the case of the calibration of the LCR.

- The report develops a sensitivity analysis to detect the effect of the NSFR on banking lending and potential distortions in financial assets markets.

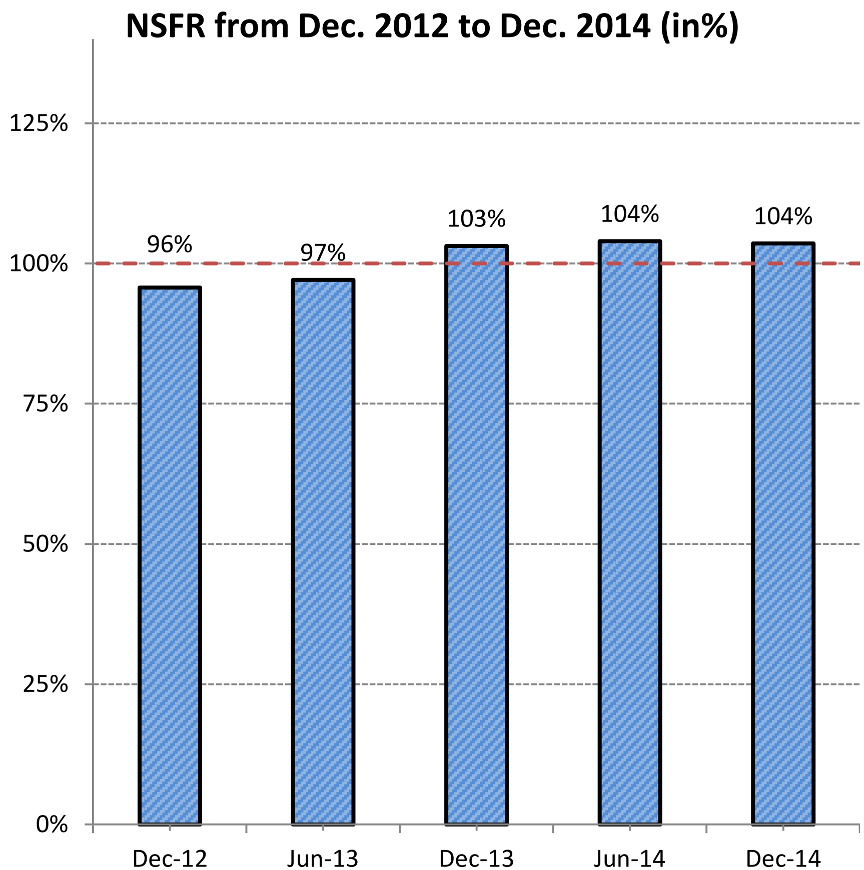
Overall the NSFR compliance of the banking sector is already strong (1/3)

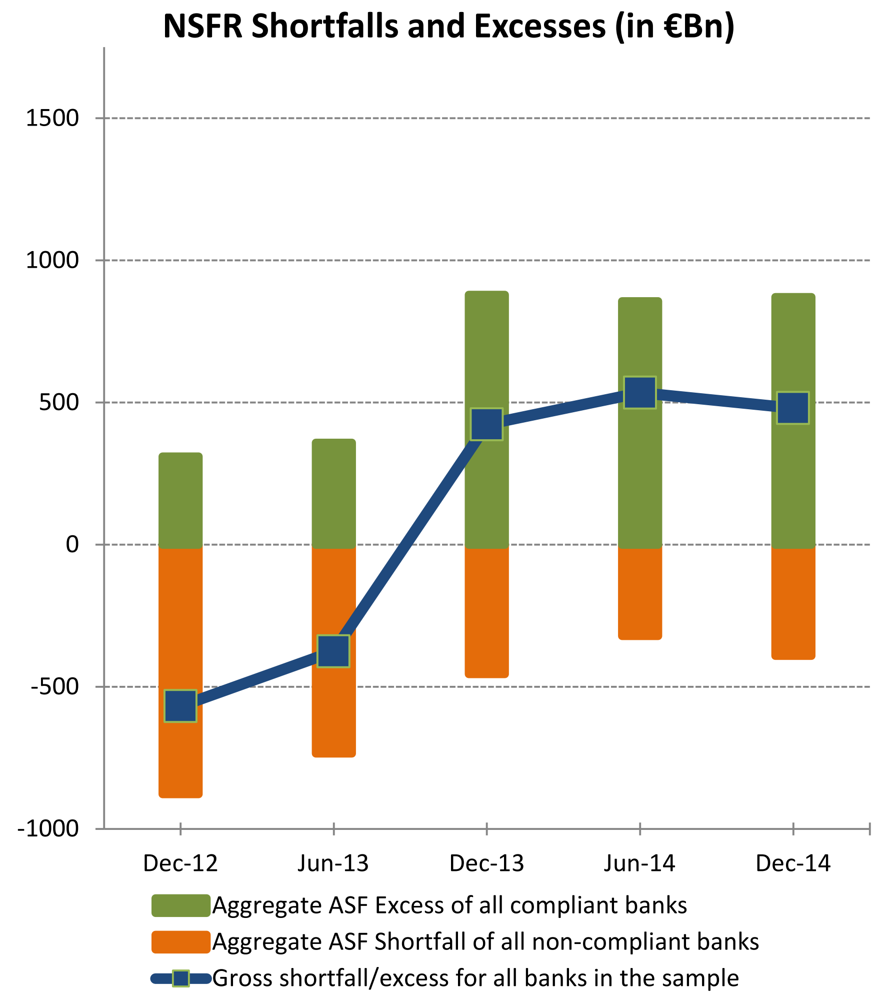
Number of banks in the sample per business model since December 2012

	Dec-14	Jun-14	Dec-13	Jun-13	Dec-12
Auto & cons.	6	8	11	12	10
CCPs	3	3	19	21	21
Co-operatives	46	46	36	43	44
Custodian	1	2	1	1	1
Diversif. no retail dep.	3	9	56	65	68
Local Universal	80	66	29	39	27
Mrtg. & Build. Soc.	20	17	22	24	25
Other specialised - taking retail deposits	20	21	4	6	7
Other specialised no retail deposits	12	17	11	9	11
Pass-through	7	10	21	50	46
Savings	40	41	1	3	3
Securit. trading house	9	10	14	17	6
Universal cross border	32	22	29	37	36
Total	**279**	**272**	**254**	**327**	**305**

Revised QIS templates to take into account Basel final proposals

Overall the NSFR compliance of the banking sector is already strong (2/3)





Data Source: QIS and EBA Monitoring Exercise. Consistent sample of 123 credit institutions

Overall the NSFR compliance of the banking sector is already strong (3/3)

Migration of NSFR levels in numbers between Dec 2012 and Dec 2014

		December 2014			
		<90%	**90-100%**	**100-110%**	**>110%**
Dec 2012	**<90%**	18	14	6	15
	90-100%	—	12	12	17
	100-110%	2	2	4	29
	>110%	6	3	11	46

Migration of NSFR levels in total assets (in trillion €) between Dec 2012 and Dec 2014

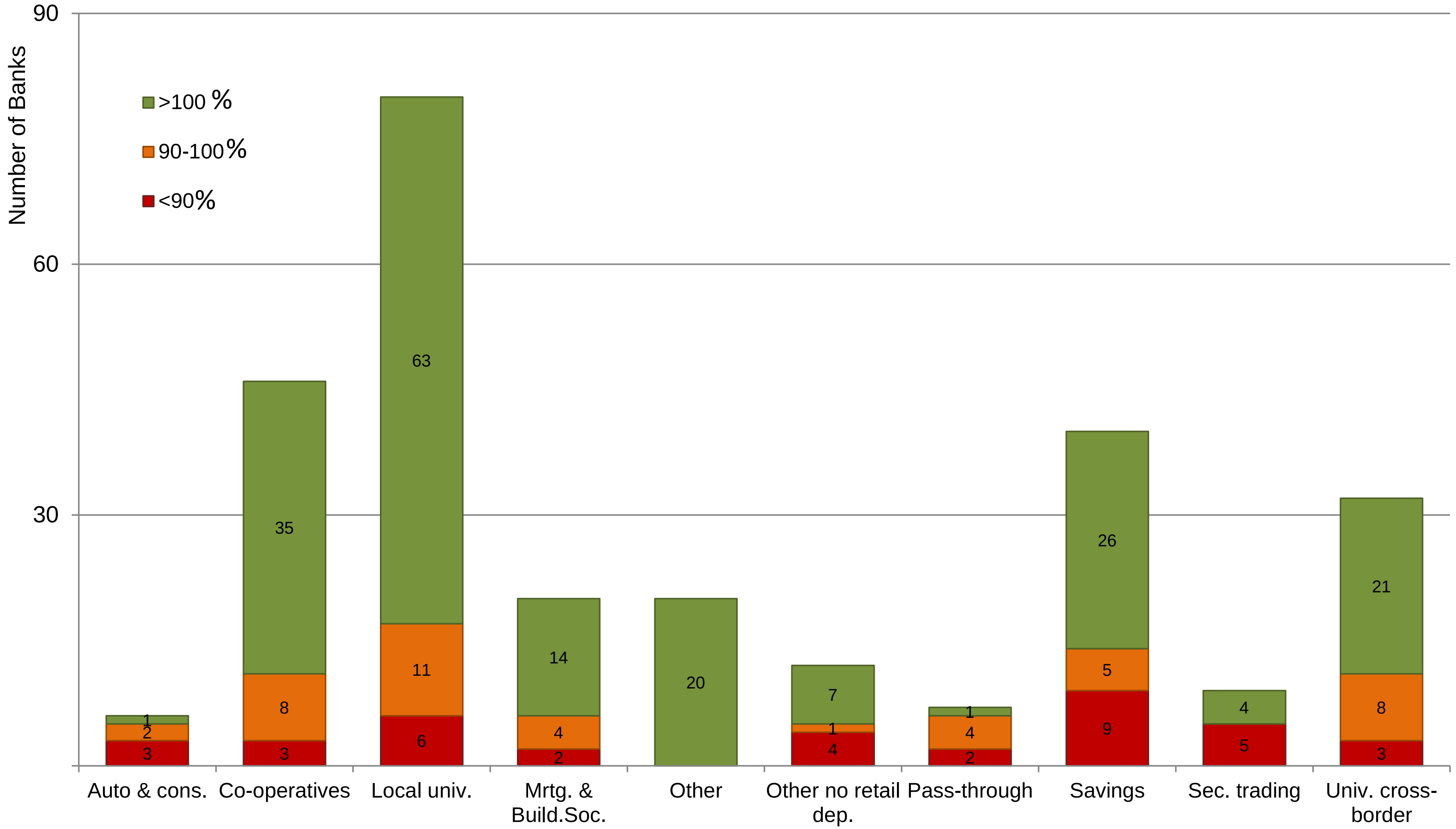
		December 2014			
		<90%	**90-100%**	**100-110%**	**>110%**
Dec 2012	**<90%**	2.06	3.27	0.84	0.50
	90-100%	—	4.65	2.99	1.20
	100-110%	0.04	0.01	2.29	4.12
	>110%	0.04	0.00	0.57	1.82

NSFR improved	Same Range	NSFR degraded

Compliance by business model and size(1/4)

		NSFR		NSFR Shortfall			Compliance	
	Number of firms	Weighted Average	Median	Abs. shortfall in bn. Euros	relative to total stable funding in %	relative to total assets in %	Fraction of compliant banks in %	Fraction of total assets of compliant banks in %
Auto & cons.	6	97.3	93.0	5.0	4.3	2.9	16.7	12.7
Co-operatives	46	106.7	113.8	29.9	2.2	1.5	76.1	65.1
Local univ.	80	103.7	114.0	106.7	3.1	1.9	78.8	71.6
Mrtg. & Build.Soc.	20	111.8	117.1	12.4	1.9	1.6	70.0	75.0
Other	20	116.4	117.8	—	—	—	100.0	100.0
Other no retail dep.	12	107.1	109.0	9.0	2.6	1.7	58.3	75.4
Pass-through	7	93.7	96.7	33.0	8.6	7.2	14.3	7.1
Savings	40	114.9	110.4	13.6	2.1	1.6	65.0	89.5
Sec. trading	9	60.1	83.1	100.0	80.3	10.1	44.4	10.1
Univ. cross-border	32	102.9	107.8	279.3	2.9	1.4	65.6	58.5
Total	**279**	**103.6**	**111.3**	**594.7**	**3.5**	**1.9**	**70.3**	**60.8**

Compliance by business model and size (2/4)



Compliance by business models and size (3/4)

Preliminary conclusions on business models and specific activities

- EU specificities: Consideration is being given to:
  - **Trade finance**: Differentiation of factors for specific transactions?
  - **Pass through**: Fully matched funded mortgage lending – interdependent assets and liabilities?
  - **Centralized regulated savings** – interdependent assets and liabilities?
  - **Residential guaranteed loans** – equivalent to mortgages?
  - **Credit unions** – equivalent to non-financial customers?
  - **CCPs** – is there a stable funding risk here in the context of the NSFR?

Compliance by business models and size (4/4)

The analysis by size buckets reveals that the relative or absolute size of banks does not seem to be correlated with compliance in the sample.

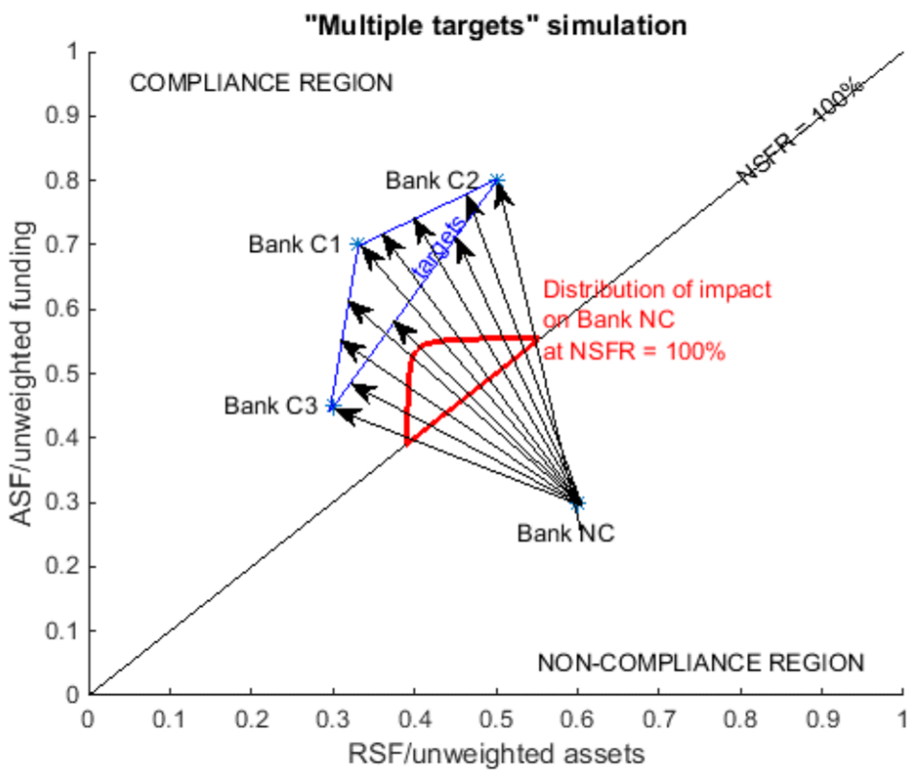
Average NSFR per size bucket (dec. 2014)

	Absolute size		Percentage of domestic GDP		Percentage of Total Assets held by domestic bank and foreign branches	
	Number of banks	Average NSFR	Number of banks	Average NSFR	Number of banks	Average NSFR
Very large	36	103%	70	104%	70	104%
Large	22	98%	70	112%	70	112%
Medium	110	109%	69	101%	70	101%
Small	111	116%	70	109%	69	106%

Impact assessment – adjustment to compliance and impact on lending and financial markets (1/3)

The NSFR is not expected to have a detrimental effect on banking lending or significant distortions in financial assets markets.

Adjustment to compliance with NSFR



Impact assessment – adjustment to compliance and impact on lending and financial markets (2/3)

Main regressions of change in lending on change in NSFR shortfall

This table shows regression coefficients of the change in lending to the real sector (columns 1 to 4) and the change in lending to SME (columns 5 to 8) on the change in NSFR shortfall (the variable of interest) and a set of other control variables. '**' and '*' denote statistical significance respectively at 5 and 10%.

	Change in total lending to the real sector				Change in SME lending			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Change in NSFR shortfall	-0.000	-0.019	-0.001	-0.000	0.030	0.010	0.031	0.030
	(0.029)	(0.027)	(0.030)	(0.029)	(0.023)	(0.024)	(0.023)	(0.022)
Retail business model				-0.009				0.010
				(0.006)				(0.007)
Diversified business model				-0.007				-0.001
				(0.005)				(0.004)
Specialized business model				-0.005				-0.002
				(0.010)				(0.005)
Constant	-0.007**	-0.007**			0.003	0.001		
	(0.003)	(0.003)			(0.003)	(0.004)		
Observations	273	259	273	273	273	259	273	273
R-squared	0.000	0.005	0.020	0.017	0.004	0.019	0.016	0.017
Prob > F	0.987	0.248	0.306	0.292	0.196	0.0734	0.200	0.450

Impact assessment – adjustment to compliance and impact on lending and financial markets (3/3)

- The report pays special attention to the most relevant transactions in financial markets and to the potential impact of a stable funding requirement.
- These transactions include securities borrowed to cover clients' short sales and interrelated repo and reverse repo transactions.
- The NSFR does not appear likely to become a decisive element in the volume of specific financial markets.
- The report will include a correlation analysis of the NSFR and the trading book in banks.
- The report will discuss the impact on NSFR of assets pledged in long term central bank operations.
- Preliminary analysis would not show strong reasons to deviate from the Basel treatment on derivatives.

Preliminary conclusions: Summary

- A stable funding requirement seems to be necessary for banks. An appropriate balance between illiquid assets and stable funding is deemed necessary to mitigate the externalities which give banks incentives to take excessive funding risk. The same principle underpins the Basel NSFR.

- The NSFR is not expected to have a detrimental effect on bank lending, in particular to SMEs.

- There are business models with significant shortfalls. For instance some securities trading houses currently have low NSFRs because they rely on short-term wholesale funding to fund an asset profile that is not entirely in HQLA. Some EU specificities are being considered.

- Impact on financial markets:
  - The NSFR is not expected to result in significant distortions in financial markets.
  - The report will specifically discuss funding risks associated with prime brokerage and market making and the impact of the NSFR on the provision of these services.
  - The report will discuss funding risk associated with derivatives.

Next steps

1. The final draft report will be presented to the EBA Governance Structures in November and December.

2. The final report will be submitted to the European Commission by end this year.

3. The final report will be published on the EBA website.

EUROPEAN BANKING AUTHORITY

Floor 46, One Canada Square, London E14 5AA

Tel: +44 207 382 1776
Fax: +44 207 382 1771

E-mail: info@eba.europa.eu
http://www.eba.europa.eu