EUROPEAN CENTRAL BANK

BANKING SUPERVISION

ECB staff response to the European Commission's call for evidence on a targeted amendment to the prudential treatment of securities financing transactions under the net stable funding ratio

European Central Bank (ECB) staff welcome the European Commission's call for evidence on a targeted amendment to the prudential treatment of securities financing transactions (SFTs) under the net stable funding ratio (NSFR).[1] The Commission's initiative aims to make permanent the current transitory prudential treatment of SFTs and unsecured transactions with a residual maturity of less than six months, undertaken with financial customers, for the purposes of the NSFR.

The NSFR standard agreed by the Basel Committee on Banking Supervision requires banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.[2] To calculate the NSFR, available stable funding (ASF) factors are assigned to a bank's sources of funding according to their relative stability, for example depending on the residual maturity and the propensity of different types of funding providers to withdraw their funding. Similarly, required stable funding (RSF) factors are assigned to assets and off-balance sheet items based on their residual maturity and liquidity characteristics.

Under the Basel NSFR standard, positive RSF factors are assigned to short-term transactions – i.e. those with an effective residual maturity of less than six months – undertaken with financial customers. When a bank lends via an SFT, it assigns an RSF factor of 10% to lending transactions that are backed by collateral in the form of Level 1 assets. For other short-term transactions undertaken with financial customers, including unsecured transactions, it assigns an RSF factor of 15%.

1 See the European Commission's call for evidence on "Net Stable Funding Ratio – prudential treatment of short-term securities financing transactions (amending regulation)".

2 "Basel III: the net stable funding ratio", Bank for International Settlements, October 2014.

In the EU, the NSFR has been implemented through the Capital Requirements Regulation (CRR), which introduced a transitional period with lower RSF factors for short-term transactions undertaken with financial customers.[3] For banks providing funding, short-term SFTs undertaken with financial customers and backed by collateral in the form of Level 1 assets, including EU sovereign bonds, do not currently require any stable funding. All other short-term transactions undertaken with financial customers are subject to RSF factors of 5% or 10%. This transitional arrangement was initially set to expire on 28 June 2025. In the absence of a legislative amendment as considered by the Commission, the treatment of such transactions for the purposes of the NSFR would automatically be aligned with the Basel NSFR standard once the transitional period ends.

With respect to short-term SFTs backed by collateral in the form of Level 1 assets, including EU sovereign bonds, ECB staff have considered the impact of the targeted amendment proposed by the Commission on SFT market functioning and financial stability.

On the one hand, the expiry of the transitional arrangement could have adverse effects on the distribution of liquidity and the absorption of government bonds via SFT markets. More specifically, the increase in regulatory costs could lead to a repricing and a reduction in the depth of SFT markets. Such frictions might materialise at a time when the announced changes to the Eurosystem's operational framework for implementing monetary policy foresee an increased reliance on the SFT market for liquidity redistribution. Moreover, a possible decrease in SFT market activity could eventually spill over into sovereign bond markets, as the two markets are tightly linked. Against this background, several jurisdictions, such as the United States and the United Kingdom, do not require stable funding for these transactions in their national implementation of the NSFR.

On the other hand, the prudential and financial stability considerations behind the calibration of the Basel NSFR standard, as also highlighted by the European Banking Authority, remain valid.[4] From a financial stability perspective, the transitional RSF factors may not adequately cover the funding risks from short-term transactions with financial customers. In particular, requiring stable funding for short-term transactions, including SFTs backed by Level 1 assets, undertaken with financial customers, may better account for the potential franchise risk that banks would not be willing to fully stop rolling over their short-term lending. In addition, a positive RSF factor could reduce the risk of maturity mismatches between lending and funding within the category of short-term SFTs as well as contagion risks between institutions during liquidity shocks.

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3 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

4 "EBA Report on specific aspects of the NSFR framework under Article 510 (4), (6) and (9) of Regulation (EU) No 575/2013", European Banking Authority, January 2024 and "EBA Report on Net Stable Funding Requirements under Article 510 of the CRR", European Banking Authority, December 2015.

On balance, in view of concerns about market functioning and the associated implications for the implementation of monetary policy, ECB staff support extending the current treatment of short-term SFTs backed by Level 1 collateral, for example by five years, as a temporary measure, which should be subject to a review clause. It is too early to conclude that concerns about market functioning permanently outweigh financial stability and supervisory benefits. ECB staff suggest extending the temporary exemption, for example by five years, also underlining the EU's commitment to international standards. The issue could then be reviewed again, taking into account the functioning of SFT markets following the finalisation of the Eurosystem operational framework as well as prudential and financial stability considerations.

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For specific terminology please refer to the ECB glossary (available in English only).