BANGKO SENTRAL NG PILIPINAS

Frequently Asked Questions on Basel III Net Stable Funding Ratio (NSFR) under Circular No. 1007 dated 06 June 2018, as amended by Circular No. 1034 dated 15 March 2019

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The NSFR aims to promote long-term resilience against liquidity risk by requiring a bank/quasi-bank (QB) to maintain a stable funding profile in relation to the composition of its assets and off-balance sheet activities. The NSFR seeks to limit the overreliance on short-term wholesale funding and promoting enhanced assessment of funding risk across all on- and off-balance sheet accounts. It complements the Liquidity Coverage Ratio (LCR), which promotes short term resilience of a bank's/QB's liquidity profile. The NSFR applies to all universal and commercial banks (UBs/KBs) and their subsidiary banks and QBs on both solo and consolidated bases.

In order to address various concerns related to the NSFR, the BSP is posting the following frequently asked questions (FAQs) to guide relevant stakeholders.

Available Stable Funding

1. **Question**. How are options embedded in capital instruments treated for purposes of determining compliance with the NSFR?

   Answer. Options that are embedded in capital instruments are assumed to be exercised. Thus, capital instruments with embedded options shall be considered to have expected maturities that coincide with the time of exercise of the embedded option.

   This is consistent with the guidelines under Items 6.a and 6.b under Attachment 1 of Circular No. 1007 dated 06 June 2018 which provide 100 percent ASF factor to the following:

   6.a) Total amount of regulatory capital before the application of regulatory adjustments excluding Tier 2 instruments with residual maturities of less than one year or those instruments with explicit or embedded options that, if exercised, would reduce the expected maturities to less than one year.

   6.b) Other capital instruments not included above, that have effective residual maturities of one year or more, but excluding any instruments with explicit or embedded options that, if exercised, would reduce the expected maturity to less than one year.

2. **Question**. Are the discount factors which are applied to Tier 2 capital instruments for purposes of determining their valuation considered regulatory adjustments?

Remaining maturity	Discount factor
5 years & above	0%
4 years to <5 years	20%
3 years to <4 years	40%
2 years to <3 years	60%
1 year to <2 years	80%
< 1 year	100%

Answer. No. The valuation of Tier 2 capital which takes into account the application of discount factors based on the remaining maturity of the capital instrument does not constitute a regulatory adjustment. Thus, the amount of Tier 2 capital, as adjusted for the discount factor, should be reported as regulatory capital.

Regulatory adjustments to Tier 2 capital are enumerated in paragraph 8 of Part II of Appendix 59 of the New Manual of Regulations for Banks (MORB).

3. **Question**. What is the treatment of preferred shares of stock?

Answer. Preferred shares of stock that meet the definition of regulatory capital under the Basel risk-based capital adequacy standard are considered regulatory capital under the NSFR.

4. **Question**. What is the treatment of general loan loss provisions in determining the amount of regulatory capital that forms part of available stable funding under the NSFR framework?

Answer. Current capital regulations include general loan loss provisions as part of Tier 2 capital, subject to a limit of 1 percent of credit risk-weighted assets. Thus, general loan loss provisions, up to the 1 percent limit, is included as part of total regulatory capital for purposes of determining compliance with the NSFR requirement.

5. **Question**. Are all wholesale current and savings accounts considered as operational deposits for purposes of computing NSFR?

Answer. Yes. This simplified treatment has been adopted for purposes of calculating the NSFR.

6. **Question**. How should banks classify deposits of trust entities for purposes of assigning the same with ASF factors?

Answer. Deposits obtained from trust entities are considered as deposits from financial institutions.

The BSP-NSFR standards are aligned with the Basel III liquidity standards.

Paragraph 16 of the Basel NSFR standards states that the definitions under the Basel III NSFR mirror those outlined in the Basel III Liquidity Coverage Ratio (LCR), unless otherwise specified.

Paragraph 131 (e) of the Basel LCR standards include fiduciaries and beneficiaries under the term financial institutions. It states that a bank should assume a 40 percent drawdown of the undrawn portion of committed credit facilities to other financial institutions, including securities firms, insurance companies, fiduciaries, and beneficiaries.

It is also for this reason that the BSP-LCR standards assign the same drawdown rate of 100 percent to the undrawn portion of committed obligations to financial corporates, trust and other fiduciaries, beneficiaries, special purpose entities, among other counterparties, in calculating the expected cash outflows.

7. **Question**. Are the secured and unsecured funding accounts under the LCR framework similar to that under the NSFR framework?

   Answer. No. While the nature of the funding and the enumerated counterparties (e.g. Philippine National Government, LGUs, GOCCs, etc.) are similar between the LCR and the NSFR, the scope of the LCR differs from that of the NSFR. The LCR standard requires covered banks/quasi-banks to report the expected cash outflows relative to secured and unsecured funding over the next 30 days while the NSFR standard requires covered FIs to report all outstanding secured and unsecured funding classified according to residual maturity.

8. **Question**. What are trade date payables and why are these assigned a zero percent ASF factor?

   Answer. Trade date payables are defined under the Financial Reporting Package (FRP) as Accounts Payable Arising from Purchase of Financial Assets under the Trade Date Accounting. This refers to payables arising from the purchase of financial assets under trade date accounting, pending actual settlement/receipt of the underlying securities which shall require corresponding asset/liquid asset cover.

   Trade date payables are assigned a zero percent ASF factor because trade date payables cannot be considered as stable funding. These types of payables are settled within a few days in accordance with market convention.

9. **Question**. What is the treatment of accrued interest payables for purposes of determining compliance with the NSFR?

   Answer. Accrued interest payables are treated as other liabilities and applied a 0 percent ASF factor.

Required Stable Funding

10. **Question**. For purposes of reporting assets and liabilities under the NSFR, will banks/quasi-banks follow the trade date reporting standard?

    Answer. Yes. Paragraph 27 of the BSP-NSFR guidelines provides that for purposes of determining the RSF, covered banks/QBs shall include financial instruments, foreign currencies, and commodities for which a purchase order has been executed and shall exclude those for which a sales order has been executed.

11. **Question**. How are assets measured under the NSFR framework?

    Answer. The valuation of assets under the NSFR framework shall follow the prudential accounting standards. As an additional requirement, Item 23 of the BSP-NSFR standards prescribe that the carrying value of these assets shall be gross of the general loan loss provisions (GLLP) and net of specific provisions.

12. **Question**. How will financial assets that are held within a hold-to-collect business model be recorded under the NSFR framework?

    Answer. Financial assets that are held within a business model whose objective is to hold financial assets to collect contractual cash flows and the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest shall be measured at amortized cost for purposes of determining compliance with the NSFR.

13. **Question**. How will Equity Securities at Fair Value through Other Comprehensive Income (FVOCI) be reported under the NSFR framework?

    Answer. Equity Securities at FVOCI should be reported at fair value, that is, adjusted for accumulated market gains/losses.

14. **Question**. Are financial assets that are used as compliance with the Expanded/Foreign Currency Deposit Unit (E/FCDU) asset cover considered encumbered under the NSFR framework?

    Answer. No. The primary objective of the E/FCDU asset cover is to ensure the withdrawability of E/FCDU liabilities. Thus, assets used as compliance with the asset cover requirement are generally not considered encumbered. They may be liquefied to service withdrawals or payments of E/FCDU deposits or liabilities.

    Item 35 of Part I (Definition of Terms) of Appendix 72 of the New MORB defines the term “unencumbered” for the purpose of the LCR. This definition likewise applies for the NSFR. “Unencumbered” is defined in the provision as being free of legal, regulatory, tax, accounting, contractual or other impediments or practical restrictions on the ability of the bank to liquidate, sell, transfer, or assign the asset. Liquid assets may also be considered unencumbered if the potential credit or funding for which the assets are pre-positioned, deposited with or pledged to the BSP, to a clearing and settlement system, or to another financial entity is not currently extended to the bank or to any of its related parties.

15. **Question**. Are all bonds listed in the Philippine Dealing Exchange Corporation eligible as NSFR HQLA?

    Answer. No. The issuer and credit rating of a given debt instrument are the relevant factors used in determining whether an asset qualifies as HQLA under the NSFR.

    Debt securities that are considered as NSFR HQLA include securities that are:

    1) Issued by the Philippine National Government, Bangko Sentral, Local Government Units, Government-Owned or Controlled corporations and sovereigns that are given a risk weight of zero percent up to fifty percent under the risk-based capital adequacy framework, or

    2) Issued by corporates that are given a risk weight of at least BBB- or its equivalent.

16. **Question**. How shall banks report debt securities that are rated by local rating agency under the NSFR framework?

    Answer. Covered financial institutions shall refer to the mapping of the ratings given by the recognized credit assessment agencies for purposes of determining the appropriate risk weights under the Basel risk-based capital adequacy standard which is provided under Appendix 59 of the New MORB and Appendix Q-46 of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFI).

17. **Question**. What is the RSF factor for property, plant and equipment?

    Answer. Property, plant and equipment are assigned a 100 percent RSF factor.

18. **Question**. What is the treatment of accrued interest receivables for purposes of determining compliance with the NSFR?

    Answer. Accrued interest receivables are treated as other assets and applied a 100 percent RSF factor.

19. **Question**. How are credit card loans treated for purposes of determining NSFR compliance?

    Answer. Credit card loans are considered as consumer loans under the BSP-NSFR framework.

20. **Question**. What is the definition of residential real estate loans under the NSFR framework?

    Answer. Residential real estate loans pertain to loans granted to individuals, which may be for the acquisition, construction or improvement of a residential unit that is or will be occupied by the borrower.

21. **Question**. In preparing the NSFR report, should a covered FI report the notional amount of derivatives?

    Answer. No. Paragraph 66 of the BSP-NSFR guidelines indicate that the amount of derivatives shall be based on the "replacement cost" of the derivatives contracts obtained by marking-to-market methodologies.

22. **Question**. What are trade date receivables and why are these assigned a zero percent RSF factor?

    Answer. Trade date receivables are defined under the Financial Reporting Package (FRP) as Accounts Receivable Arising from Sale of Financial Assets under the Trade Date Accounting. This refers to the receivables arising from financial assets sold under trade date accounting pending actual settlement/delivery of the underlying securities.

    Trade date receivables are assigned a zero percent RSF factor because trade date receivables do not require stable funding. These types of receivables are collected within a few days in accordance with market convention.

23. **Question**. What is the treatment of unconditionally revocable uncommitted credit facilities in the NSFR framework?

    Answer. Unconditionally revocable uncommitted credit facilities should be reported under Part III. Item 5.d.4 (Others) of the latest template of the NSFR report.

24. **Question**. How should commitments be valued for purposes of determining compliance with the NSFR?

    Answer. The valuation of assets and off-balance sheet exposures shall follow the prudential accounting standards. Thus commitments shall be measured in accordance with Philippine Accounting Standards 37, Provisions, Contingent Liabilities and Contingent Assets, net of specific provisions, as provided under Philippine Financial Reporting Standards 9.

<u>Supervisory Expectations</u>

25. **Question**. Can a bank's/quasi-bank's Held-for-Trading financial assets be reported as part of its LCR and NSFR HQLA assets?

    Answer. Yes, subject to certain conditions.

    The BSP-LCR standards under Circular No. 905 dated 10 March 2016, as amended, state that for an asset to be eligible as HQLA, it should meet operational requirements for monetization. Further, banks are expected to implement policies, procedures and appropriate systems to establish the proper authority and operational capacity of the liquidity management function to monetize any HQLA. Under existing liquidity risk guidelines, such function is expected to be performed by the Asset-Liability Management Desk.

In considering whether trading book assets are eligible as HQLA, banks should recognize that there may be constraints in the monetization of the trading portfolio if the portfolio is maintained to implement a business strategy. In line with this, financial assets that are in the bank's/quasi-bank's trading book may be considered as eligible LCR HQLA only if the bank/quasi-bank has policies in place that shall explicitly state that control over the trading book assets shall be relinquished by the head of the trading unit and that these assets shall be made immediately available to cover liquidity requirements during a stress period.

Under the Basel III NSFR standard (particularly Footnote Number 12), NSFR HQLA are defined as LCR HQLA without regard to LCR operational requirements and the LCR caps on Level 2 and Level 2B assets that may otherwise limit the ability of some HQLA to be included as eligible HQLA in calculation of the LCR.

Thus, trading book assets may be eligible as NSFR assets, subject to the application of relevant RSF factors.

26. **Question**. Has the BSP released a validation tool to assist covered financial institutions in ensuring the accuracy of the NSFR report?

    Answer. Yes. The BSP has published the updated validation rules on NSFR under Memorandum No. M-2019-003 dated 12 February 2019.

    Notwithstanding the publication of the same, a bank/quasi-bank is expected to have adequate reporting governance systems in place to ensure the quality and timeliness of prudential reports. It should not rely solely on the validation rules of the BSP in ensuring accuracy of its reports.

27. **Question**. Will banks be penalized for inconsistencies in amounts reported in their NSFR report as against their FRP report, even if there is delayed release of the validation results of the BSP?

    Answer. Yes. A bank/quasi-bank is expected to have adequate reporting governance systems in place to ensure the quality and timeliness of prudential reports. It should not rely solely on the validation rules of the BSP in ensuring accuracy of its reports.

    The submission of the NSFR report by a bank shall be subject to the governance process on the quality of bank reporting under Section 171 of the New MORB.

    Any non-compliance with the reporting standards, or non-submission or delayed submission of the NSFR report by a bank/quasi-bank shall be subject to the monetary and non-monetary sanctions provided under Subsection 171 of the New MORB and the fines for delayed reports under Subsection 4192Q.2 of the MORNBFI, respectively.

28. **Question**. Are banks required to maintain automated systems to be able to monitor compliance with the NSFR?

    Answer. While banks are not explicitly required to maintain automated systems, a bank is expected to have adequate systems in place to be able to monitor compliance with the NSFR, as well as other prudential requirements such as capital and liquidity standards.

29. **Question**. What are the regulatory requirements in case a bank experiences a shortfall in its NSFR requirements?

    Answer. Subsection X176.7 of the MORB[1]/4176Q.7 of the MORNBFI states that in the event that a shortfall in the stock of HQLA/eligible liquid assets/available stable funding occurs on three (3) banking/business days within any two-week rolling calendar period, thereby causing the LCR or NSFR to fall below the minimum threshold/the MLR to be breached on such days, the bank/quasi-bank must notify the Bangko Sentral, through the appropriate supervising department, of such noncompliance within the banking/business day immediately following the occurrence of the third liquidity/stable funding shortfall, notwithstanding the restoration of the LCR or NSFR/compliance with the MLR on the day that the shortfall must be reported.

30. **Question**. Are banks required to disclose the NSFR ratios in the published balance sheet?

    Answer. The BSP is in the process of amending the template of the Published Balance Sheet to incorporate and consolidate the Basel Pillar III disclosure requirements. An exposure draft of this Circular is expected to be released for comments of the industry within the year.

31. **Question**. If a bank has back-dated transactions, will this require the re-calculation of NSFR for purposes of determining daily compliance with the NSFR?

    Answer. Back-dated transactions shall be handled on a case-by-case basis.

    A bank will have to provide an explanation as to the nature of the back-dating of the transaction.

[1] Provided under BSP Circular No. 996 dated 08 February 2018, as amended by BSP Circular No. 1007 dated 06 June 2018. The New MORB currently covers rules and regulations cumulatively issued as of end-December 2017.