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The monthly Financial RegTech news dose

Vinyamak

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RBI guidelines for NSFR

Net Stable Funding Ratio (NSFR) requires the available amount of stable funding to exceed the required amount of stable funding for a one-year period of extended stress. Key criteria and assumptions defined in the guidelines are as under:

Resilient Credit Creation

- NSFR requires stable funding for some proportion of lending to the real economy in order to ensure the continuity of this type of intermediation

Bank Behaviour

- NSFR is calibrated under the assumption that banks may seek to roll over a significant proportion of maturing loans to preserve customer relationships.

Asset Tenor

- NSFR assumes that some short-dated assets (maturing in less than one year) require a smaller proportion of stable funding because banks would be able to allow some proportion of those assets to mature instead of rolling them over

Asset Quality and Liquidity Value

- NSFR assumes that unencumbered, high-quality assets that can be securitised or traded, and thus can be readily used as collateral to secure additional funding or sold in the market, do not need to be wholly financed with stable funding

Objective and Definition

The NSFR requires banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. This ratio should be equal to at least 100% on an on-going basis.

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

ASF

- The portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year

RSF

- The amount of stable funding required of a specific institution is a function of the liquidity characteristics and residual maturities of the various assets held by that institution as well as those of its off-balance sheet (OBS) exposures.

NSFR disclosure standards defined by RBI

- NSFR information to be calculated on a consolidated basis and presented in Indian Rupee on an ongoing basis.
- Banks are required to maintain required systems for calculating and monitoring NSFR
- NSFR data is required to be published to RBI within 15 days from the end of quarter in a prescribed BLR7 report. However, RBI is yet to announce the start date for reporting NSFR.
- NSFR disclosure is required to be published in a common template to promote consistency and market discipline. For banks following semi-annual reporting, data from preceding 2 quarter are to be reported and for banks following annual reporting, prior 4 quarter data is required

Comparative study of RBI and BIS guidelines

While RBI has largely followed global guidelines, it has also taken Indian conditions into consideration for categorization of RSF Factor.

RBI	BIS
Additional component Unencumbered SLR Securities (RSF Factor 5%)	-
5% of derivative liabilities (RSF Factor 100%)	20% of derivative liabilities (RSF Factor 100%)

***Table 1**: Summary of differences in asset categories and associated RSF factors*

For below off-balance sheet items where BIS had suggested National Supervisor to specify RSF factor, RBI has defined these factors as following:

Off-balance Sheet Items which require stable Funding	Associated RSF factor
• Unconditionally revocable credit and liquidity facilities • Debt repurchase of bank's own debt • Certain Structured products • Certain managed funds	5% of the currently undrawn portion

• Trade finance-related obligations • Guarantees and letters of credit unrelated to trade finance obligations	3% of the currently undrawn portion

***Table 2**: RSF factor definition by RBI*

The reporting requirements advised by RBI are in line with BIS recommendations.

Impacts of NSFR

The cost of NSFR in its current form will impact banks that traditionally rely on wholesale banking for funding. This is due to the fact that ASF factor for wholesale deposit is less than retail deposit

The regulation may also cause banks to shift away from assets that require more stable funding to those that require less. This effectively means moving away from long term assets to non-financials firms and households. This would mean change in the business models of foreign banks whose major lending is in form of term loans towards corporates

Cost of derivative business will increases because net derivative liability carries ASF of 0%, net derivative asset requires RSF of 100% and 5% of derivative liabilities require RSF of 100%

Pre termination of term deposit will be charged heavily by banks since the regulator needs to be convinced that long term stable deposit will not be closed before their contractual maturity.

Corporate loans with risk weight greater than 35% will require stable funding of 85%. Whereas corporate loans with risk weight less than 35% will require stable funding of 65%. It is unlikely for corporate loans to have risk weight less than 35% (equivalent to S&P rating of AA- or above) and hence it will increase cost for the bank

Trading commodities for corporate clients will require stable funding of 85% increasing cost for the bank

Off balance sheet exposures such as undrawn portion of revocable and irrevocable facilities will require stable funding.

Technology an enabler in achieving efficient calculation

NSFR regulation impacts the way data is stored in bank's systems. Quality of data would play an important role as regulators would expect minimum to zero inconsistency between reporting documents. Any such inconsistency could affect bank's reputation and credibility. This effectively means that banks should emphasize on data integrity and governance.

Data Integrity
- Efficient data quality and traceability

Technology Solutions
- Capable solutions to produce integrated reports seamlessly

IT Architecture
- Flexible IT architecture to adapt to changing regulatory requirements

Data availability
- Most of the data required for automating NSFR calculation would be available with reporting systems

From technological standpoint, banks should have efficient and capable solutions in place to produce integrated reports in most seamless way possible. Automated solutions should be developed to produce reports required by internal management as well as regulators. IT system should be flexible enough to comply with the changing regulatory requirements and should adapt to new regulations and modifications.

Traditionally risk, compliance and finance functions in banks are managed through separate silo applications. This makes it difficult to get a holistic view of data. Consolidating risk, compliance and finance function would speed up the process of becoming compliant with NSFR guidelines. In the final guideline RBI has not advised start date of reporting of NSFR and currently the frequency is set to be quarterly, however banks should scale up their IT architecture so that they are able calculate and report NSFR on daily basis.

One advantage for banks in India is that they have already been mandated by RBI to automate their regulatory reports. Given this, from data perspective, most of data required for NSFR reporting would be already available in reporting systems. New data requirements would come mostly around determining encumbrance of assets, operational deposits and undrawn portion of credit and liquidity facilities. Banks would need to identify the sources of incremental data and plan on using them for NSFR reporting through automated system.

Business Benefits

NSFR provides an opportunity for the banks to enhance stability in the system by migrating to asset and liability structures that are more stable and less pro-cyclical. It also provides an accurate picture on the liquidity of the bank and will be useful in indicating the liquidity requirements if all cash outflows occurred at the earliest possible date

The regulation would push banks to upgrade their financial management system across their balance sheets and groups, helping improve more timely risk identification.

Easy access to bank wide view of the amount of unencumbered assets a bank has which could potentially be used as collateral for secured funding

NSFR requirements presents a strong case to the banks to leverage the existing technology for not only timely reporting but also effective monitoring

Conclusion

NSFR regulation aims at ensuring that banks are able to meet their long term liquidity requirements in both normal and stressed conditions. It has potential to alter the nature of assets and liabilities held by a bank. Also, in order to monitor their positions across the globe consistent reporting solutions should be used. Regulatory bodies and banking consortiums should look forward to introducing such standardized tools and applications to measure liquidity.

Regulatory News

Withdrawal of Exemptions Granted to Government Owned NBFC's

The Reserve Bank of India (RBI) has withdrawn the special dispensation granted earlier for non-banking financial corporation (NBFCs) owned by the government.

RBI has decided to make the NBFC regulations applicable to Government NBFCs. The notification talks about details of Norm, Extant Provisions of other NBFC's along with Provisions and timelines for implementation of these regulations.

Norm consists of Asset classification, provisioning requirements, capital requirements, Leverage ratio, corporate governance and others to be complied by year 2022.The official notification can be accessed here.

RBI revises guidelines on Priority sector lending for urban co-operative banks (UCB's)

Basis review of existing Guidelines of Master Circular issued in July 2015, Reserve Bank of India has revised guidelines on priority sector lending for urban co-operative banks. Guidelines of the circular have been put into effect from 10th May. Key features of the revised guidelines include:

- Target for PSL and Weaker Section will continue to be 40% and 10% of ANBC and credit equivalent of off-balance sheet exposure, whichever is higher.
- Distinction of direct and indirect agriculture has been done away with.
- Bank Loans to food and agro units will be part of Agriculture.
- Medium Enterprises, Social infrastructure and Renewable energy will come under priority Sector.
- A Target of 7.5 % of ANBC or credit equivalent of off-balance sheet exposure, whichever is higher is applicable for Micro enterprises.
- Micro Credit will no longer remain a separate entity under priority sector.
- Distinction between loans for education in India and abroad has been removed
- Loan limits has been revised for housing loans qualifying under priority sector.

- Priority sector assessment will be monitored basis monthly and Quarterly Statements.

For Classifying UCB's as Financially Sound and well managed (FWSM), achievements of priority sector lending will be taken as a criteria with effect from 1st of April 2018. The official notification on the same can be accessed here

Monitoring of Foreign Investment Limits in Listed Indian Companies

The Reserve Bank of India, in consultation with Securities and Exchange Board of India (SEBI) has decided to put in place a new system for monitoring investment limits. Necessary infrastructure and systems to kick-start monitoring mechanism will be made available by depositories.

All listed Indian companies are required to provide the specified data/information on foreign investment to the depositories. The requisite information should be furnished on or before May 15, 2018.The listed companies in non-compliance with the above instructions will not be able to receive foreign investment and will be non-compliant with Foreign Exchange Management Act, 1999 (FEMA) and regulations made thereunder. The official notification on the same can be accessed here.

Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSRF) – Final Guidelines

The objective of NSFR is to ensure that banks maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. The intention is to have sustainable funding structure and reduce probability of erosion of bank's liquidity position due to disruptions in a bank's regular source of funding which would increase the risk and failure and potentially lead to broader systematic stress.

NSFR would be applicable for Indian banks at a solo as well as consolidated level. For foreign banks operating as branches in India, the framework will be applicable for Indian operations only. The official notification can be accessed here

Other Regulatory News

Enhanced Disclosure and Transparency Norms for Credit Rating Agencies

After incorporating comments and suggestions, basis consultation paper released by SEBI, it has issued guidelines to all registered credit Rating Agencies (CRAs) to enhance their quality of disclosures and improve their accountability. It has issued that all cases of requests by an issuer for review of the rating(s) provided to its instrument(s) by the CRA, shall be reviewed by a Rating Committee of the CRA. All non-accepted ratings shall be disclosed on the website of CRA. Here are the details of the disclosures to be made in this regard.

Amendment to investment Guidelines for NPS Schemes

PFRDA has modified investment guidelines for NPS Schemes {Other than Govt. Sector (CG & SG), Corporate CG, NPS Lite and APY}. Under NPS, the cap on equity investment has been increased to maximum limit of 75% for private sector subscribers from erstwhile 50% cap. More details of amended slab and other changes can be viewed here.

Revised rating criteria for investments under NPS schemes

As per earlier guidelines by PFRDA on NPS investments, investments were permitted only in securities having minimum of AA rating or equivalent in the applicable rating scale; rated by minimum two credit rating agencies registered with SEBI.

However, PFRDA has now issued new guidelines wherein it has been decided to allow pension funds to invest in corporate bonds/ securities which have minimum of 'A' rating or equivalent in the applicable rating scale provided investments between A to AA- rated bonds should not be more 10% of overall corporate bond Portfolio under Scheme/Asset Class C of the pension fund.

The pension funds have been asked to submit a quarterly statement on the investment made in securities.

Other details of the same can be viewed here.

Consultation Paper on "Review of SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009

The Securities and Exchange Board of India has placed a consultation paper on Issue of Capital & Disclosure requirements (ICDR) regulation. The regulation has undergone various amendments since its inception in 2009. Several other developments took place in market practices and regulatory. So, it was decided to review and realign the ICDR regulations with these developments. A committee was formed in June 2017 to review the ICDR guidelines to ensure the alignment of regulations as per global standards. Interested parties can send their comments by post or email.
The official communication from SEBI for the same can be viewed here.

Global Regulatory News

ESMA adopts final product intervention measures on Contract for Differences (CFDs) and binary options

ESMA has formally adopted new measures on the provision of CFDs and binary options. These measures will be effective from 2nd July, 2018 for binary options and from 1st August, 2018 for CFDs. They will remain in force for a period of three months from the date of application.

These measures include prohibition on the marketing, distribution or sale of binary options and CFDs to retail investors. It will ensure that the loss to the investors is limited to the amount invested and will also provide risk warnings to investors. The official press release can be viewed here.

ESMA publishes guidelines for MiFID II Suitability Requirements

The assessment of suitability is one of the most important aspects for investor protection. It applies to any type of investment advice, independent or not and portfolio management. Investment companies should give personal recommendations or should make suitable investment decisions on behalf of the clients.

The guidelines also focusses on sustainable finance which means including environmental, social and governance factors while recommending or making any investments. The final press release can be viewed here.

EBA consults on standards on estimation and identification of an economic downturn in IRB modelling

The European Banking Authority (EBA) launched two consultations on draft regulatory technical standards (RTS) and on a set of Guidelines related to the estimation of loss given default (LGD).

RTS will require firms to consider macroeconomic and credit factors. It focusses on the methods used for quantifying LGD estimates. Full information can be viewed here.

EBA and ESMA published a joint statement stating that authorities should consider retail holders of debt instruments subject to BRRD

The European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) have today published a joint statement encouraging institutions, market and resolution authorities to consider retail holders of debt financial instruments subject to the Bank Recovery and Resolution Directive (BRRD) when carrying out their respective tasks.

A significant portion of the debt instruments issued by institutions are held by retail investors and BRRD does not take into account this factor currently. Hence, the resolution authorities are encouraged to factor this in their resolution planning.

The distribution of debt instruments issued by financial institutions to retail clients may raise significant consumer protection issues and affect the practical application of the resolution framework under the BRRD. Complete details can be accessed here.

CFTC Opens Access for U.S. Customers to Trading in Australian Markets

The Commodity Futures Trading Commission (CFTC) announced the approval of Australian Securities Exchange Limited's (ASX 24) application to permit direct access for U.S. customers to trade on its platform. This move reflects Commission's trust and confidence in market infrastructure by relevant home country regulators.

As per the notification, a foreign board of trade (FBOT) is registered with the CFTC and allowed to permit members and other participants in the U.S. to trade by direct access on the exchange without having to trade through an intermediary. The official release can be viewed here.

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