EBA/CP/2013/48: Draft guidelines on disclosure of encumbered and unencumbered assets

Banking Stakeholder Group Submission

GENERAL COMMENTS

EBA draft Guidelines on the disclosure of encumbered and unencumbered assets have been produced following its mandate as given in Article 443 of Regulation (EU) 575/2013 and have taken into account, as is required, the European Systemic Risk Board’s (ESRB) Recommendation ESRB/2012/2 on funding of credit institutions. Compared with the current position, the proposed Guidelines will provide a single framework consistent with an Enhanced Disclosure Task force of the Financial Stability Board.

The Banking Stakeholder Group (BSG) welcomes the draft Guidelines aimed at enhancing transparent, and EU-wide harmonised, information about encumbered and unencumbered assets. BSG strongly supports all measures designed to enhance transparency and comparability regarding banks’ balance sheet positions and most especially regarding their liquidity, funding and solvency positions. In this regard, we believe the draft Guidelines make a helpful contribution in four main dimensions:

- Enabling more information to assist in making judgments about the true state of banks’ balance sheet positions especially with regard to liquidity and solvency positions;
- Potentially enhancing the important role of market discipline;
- Facilitating a higher degree of data comparability, a uniform disclosure framework, and relevant definitions between banks across the EU;
- Thereby facilitating more informed comparisons between institutions.

These are particularly important areas in assessing and monitoring banks’ funding strategies.

BSG recognises that the draft Guidelines are only a first step towards harmonisation in this area and that they will be reviewed after one year with the aim of establishing binding technical standards on more extensive disclosure requirements which EBA is set to develop by 2016. BSG presumes that at that stage there will be further opportunities to comment.

On a general perspective:

- Encumbrance has acquired a pivotal importance in funding models of financial institutions, and its consistent and reliable disclosure represents therefore a key element in the public assessment of their solvency and liquidity profiles
- None of the existing disclosure standards provides a comprehensive asset encumbrance representation: for instance, IFSR 7 refers to transferred assets as opposed to encumbered ones whilst Council Directive 86/635 doesn’t cover the whole encumbrance spectrum
- Furthermore, the complexity and heterogeneity of funding strategies, accounting standards and legal frameworks require that analytical data are supplemented with explanatory narrative qualifying the submissions by each institution
- In this framework, the use of standardized templates that allow clear and reliable comparisons across banks and over time poses a significant challenge. Still, such an objective looks an essential requisite for a prompt and uniform supervision of European banks
- The BSG appreciates that, as the structure of the disclosure templates are derived from the existing reporting templates, the disclosed information and the supervisory reporting can be easily mapped, and hence minimises the costs of compliance for the institution.
OBSERVATIONS

- The EBA proposal represents a welcome progress towards a common disclosure framework consistent with the work of the FSB-sponsored Enhanced Disclosure Task Force (EDTF): however, comparing it with EDTF and ESRB recommendation, BSG believes that further improvements might be appropriate in the longer run, provided that the information requirement for supervisory purposes and disclosure purposes remain strongly connected.

- BSG deems that the most relevant disclosure profile relates to the amount of “Bank Assets earmarked against own liabilities” (Template A - Assets): the resulting amount of “free” Net Interest Margin allows to rate the sustainability of business models and the serviceability of all remaining generic claims (eg. Senior and Subordinated Debt, Customer Deposits)

- Template B - Collateral Received carries less information relevance in our view: a simple distinction between Secured and Unsecured lending would go a long way in gauging an institution’s Credit Policy. The breakdown by type of collateral is therefore less essential despite the administrative burden for reporting institutions. In general, BSG always seeks to avoid unnecessary complexity in regulatory and reporting requirements in cases where excess complexity and granularity adds little, if any, value in terms of securing regulatory objectives. However, as the required information can be easily mapped to the supervisory reporting, the administrative burden is considered to be manageable.

- In relation to Template A, some BSG members advocate the breakdown of guaranteed claims by category: Covered Bonds, CCP Margins, State Guarantees, Repo financing, self-liquidating revolving liabilities, etc. The Debt-Equities distinction is not particularly informative other than to derive how discerning is the balance sheet deployment. “Loans on-demand” are probably intended as Undrawn Facility, which is an unlikely candidate to encumbrance. The “Other assets” category is too generic and should be replaced by the ESRB distinction (cash, financial assets, hard assets). Another view within the BSG is that for small and medium sized institutions, disclosed information should be easily mapped to the supervisory reports and any additional information would increase the compliance costs, which in general are already very high.

- Disclosure of Central Banks Emergency Liquidity Assistance should be exempted as per ISRB recommendation, specifically for small institutions. Although there are some BSG members who do not endorse such stigmatization and would support instead an ex-post reporting. If the time-lag in reporting were to be six months, then ex post reporting should suffice. ELA should, by definition, be short term which means that ex post reporting should not prove to be market sensitive. Any such assistance lasting more than six months is likely to imply a deeper problem.

- As for methodology, BSG suggests that Median values should be preferred to Point-in-time although a time-weighted, six-month moving average, could alternatively provide a better calibrated view. However, taking into account the relative simplicity of calculating the median values, for less complex small and medium-sized institutions the disclosure of median values is probably appropriate.

- As a general remark, BSG recommends an extensive application of the Proportionality Principle: levels of granularity should vary according to the systemic importance of each institution. The disclosure requirement for small and medium-sized institutions should not in any case be more granular than those for supervisory requirement purposes: rather, it should be less given the sensitivity of some information, which is included in the supervisory reports.
QUESTIONS

1) Should the disclosure information on encumbered and unencumbered assets, in particular on debt securities, be more granular and include information on, for example, sovereigns and covered bonds? Please explain how sensitive the disclosure of this information is

Covered Bonds should be singled out. Disclosure should also include a breakdown by counterparty. However, taking into account the principle of proportionality, small and medium-sized institutions should not need to be required to provide more granular information than is suggested in the CP.

2) Should the disclosure information on encumbered and unencumbered assets also include information on the quality of these assets? What would be a suitable indicator of asset quality? Please explain how sensitive the disclosure of this information is

We do not think so. It is not easy to find a common indicator. A possible alternative could be the risk weight under the standardized approach, since the liquidity rules refer to those risk weights, but they could be less meaningful in non-investment grade Member States, where only a few issuers are rated at all.

3) Do you think that the disclosure required in Template A could lead to detection of the level and evolution of assets of an institution encumbered with a central bank, given that the information should be disclosed based on median values and the lag for disclosure is no more than 6 months?

It represents an important addition to the information set, but sometimes, in case of small and medium-sized less complex institutions, which do not have a substantial volume of transactions, the asset encumbrance by the central bank could be detected.

4) Should the disclosure of information relating to the ‘nominal amount of collateral received or own debt issued not available for encumbrance’ on unencumbered collateral be requested? Please explain the relevance of this information for market participants and the sensitivity of the disclosure of this information

Given that in case of large and publicly quoted institutions this information can be derived by default, a proactive disclosure would facilitate the assessment of creditworthiness.

5) Do you agree with the proposed granularity of Template B given that collateral swaps with central banks will not be disclosed? Please explain how sensitive the disclosure of this information is

A few amendments are required, as per BSG Observations above. Regarding Central Banks assistance, some BSG members fail to understand why its disclosure is stigmatized. Another view among members is that small and medium-sized institutions which have less access to interbank financing may need to enter into collateral swaps or other similar transactions with the central bank. Therefore more granular information, than the one suggested by EBA is not desirable.

6) Do you think that the information on the sources of encumbrance in Template C is too sensitive to be disclosed? Should this information be disclosed in Template D instead (as narrative information, as set out in paragraph 8 below)? Please explain the relevance of this information for market participants and the sensitivity of the disclosure of this information

Sources of encumbrance should be disclosed and qualifying narrative should be mandatory.
7) Should the information be disclosed as a point in time (e.g. as of 31 December 2014) instead of median values? Please explain why

In order to avoid potential pro-cyclicality, which can arise when information about increased asset encumbrance tends to raise the demand for collateral, BSG generally supports the proposal that information should be disclosed based on the median value of the quarterly data rather than on a point-in-time basis.

However, BSG also suggests for consideration that a time-weighted six-month moving average be applied to the data. Because recent observations would have a higher weight, extreme values would not be eliminated as they would be with use of median values, and there would be less scope for window-dressing compared with median values.

In case of small and medium sized institutions it may occur that the volume of encumbered assets covers only a few transactions. In our opinion a minimum threshold should be set below which, due to the scarcity of relevant data, information should be considered as non-material and disclosure should not be mandatory.

8) Do you agree with the proposed list of disclosures under narrative information in Template D? Should the guidelines explicitly state that emergency liquidity assistance by central banks (ELA) should not be disclosed?

In our view the emergency liquidity assistance by central banks is considered to be highly sensitive information. The disclosure of that information might give ground for speculation and increase the liquidity problems by increasing the potential idiosyncratic stress effects.

9) Do you agree that the disclosures should be published no later than six months after the publication of the financial statements? Do you consider a time lag of no more than six months sufficient to ensure that the information disclosed will not adversely impact the financial stability of markets and institutions?

Quarterly disclosure would be preferable for those institutions which disclose prudential information on a quarterly basis. However, as a general rule, we agree that the disclosure frequency should match the general frequency of prudential disclosure. At present the time lag is between prudential disclosure and the publication of the financial statements is regulated by the Member States. Taking this into consideration, the six months’ time lag seems reasonable.

Submitted on behalf of the EBA Banking Stakeholder Group

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