



European Banking Authority  
25 Old Broad Street  
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Date  
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Subject  
EBA Consultation Paper  
Handled by  
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Please quote date and our  
reference in all correspondence

**Response to EBA Consultation Paper: Draft guidelines on disclosure of encumbered and unencumbered assets**

Dear Sirs,

PGGM welcomes the opportunity to comment on the EBA's consultation paper on encumbered and unencumbered assets. PGGM is a cooperative Dutch pension fund service provider. Institutional clients are offered: asset management, pension fund management, policy advice and management support. On 1 March 2014, PGGM has EUR 158.5 billion in assets under management. The PGGM cooperative has approximately 670,000 members and is helping them to realise a valuable future. Either alone or together with strategic partners, PGGM develops innovative future provisions by linking together pension, care, housing and work.

As an unsecured lender to financial institutions in both short term and long term securities and across the capital structure, we welcome initiatives that attempt to increase the transparency disclosures by financial institutions. We strongly believe that transparency must go hand in hand with the increasing burden being placed on unsecured creditors who will be asked to shoulder the cost of the failure of an institution in the future. Detailed, timely information not only on earnings performance, but also on balance sheet composition and regulatory metrics will be critical tools for investors in identifying the appropriate cost of financing and capital for institutions that may be deemed non-viable in the future. More symmetry of information between regulators on one side and private, unsecured creditors on the other is a necessary prerequisite for the new resolution system to function as intended.

Given this backdrop we find several aspects of the consultation paper raise significant concerns – specifically the recommendation to classify as unencumbered assets legally pledged to central banks for emergency funding and the introduction of smoothing mechanisms and timing delays that will prevent market participants from reviewing accurate asset encumbrance information on a timely basis. We find the former to be particularly concerning as it effectively proposes that investors continue to lend blindly on an unsecured basis to stressed financial institutions while regulators with greater access to current information would remain fully secured. This information asymmetry might spur investors to pre-empt regulatory action by withdrawing credit earlier in times of stress, lest they get caught in a resolution of an organisation and all of its associated economic

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consequences. The lack of disclosure could prove even more destabilising than full disclosure of bank ELA usage as investors would likely “assume the worst” absent complete information.

Please find below a full list of our comments which relate to the questions for consultation:

1. **Emergency Liquidity Assistance:** The proposal states that “in public disclosures assets and matching liabilities encumbered to central banks via ELA shall be reported as unencumbered.”<sup>1</sup> While we support the ESRB recommendation that the amount of (emergency) liquidity assistance given by central banks should not be reported, the proposed misrepresentation is factually incorrect and could be subject to legal and accounting challenges, particularly from international investors and/or regulators and it would represent a reduction in the level of transparency currently available to investors. In the extreme, such an approach could result in public disclosures that show available collateral levels increasing at stressed banks as they lose market access because the assets pledged for ELA would be shown as unencumbered, while those pledged to market counterparties remain encumbered (e.g., the more a bank relies on ELA, the more “liquid” its balance sheet will appear in public disclosures). Rather than requiring banks to misrepresent encumbered assets as unencumbered, we would recommend that banks provide no information about the encumbrance levels of certain assets at all, namely those assets that private investors would not normally accept as collateral (e.g., fixed assets). At a minimum, it is critical for investors to have an accurate understanding of the amount of available collateral in banks’ securities portfolios. Debt and equity securities pledged for ELA funding in Template B should be reported as encumbered and unavailable in public disclosures, even if the source of that encumbrance is not disclosed in Template C. (*This response relates to consultation questions 3, 4, 5, 6, and 8.*)
2. **Granularity of disclosure:** Investors almost universally prefer more-granular disclosure. The Enhanced Disclosure Task Force, of which PGGM is a member, has recommended a more-granular breakout of encumbered and unencumbered assets by balance sheet category, including breakouts for cash & equivalents, sovereigns, other investment securities, derivatives, loans and other assets. In terms of disclosure about the quality of encumbered and unencumbered assets, investors would find it useful to distinguish between “investment grade” and “below investment grade” debt securities. This information is crucial for investors considering unsecured investments in a bank because the encumbrance of the balance sheet directly impacts recovery rates in the event of a default and there are marked differences in the liquidity and secondary marketability of each of the balance sheet categories requested. (*This response relates to consultation questions 1 and 2.*)
3. **Timing of disclosure:** The Enhanced Disclosure Task Force recommends disclosure of all relevant financial information at the same time. Disclosures on asset

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<sup>1</sup> Consultation paper (p.12) states that “Institutions should not disclose [...] the amount of emergency liquidity assistance (ELA) provided by central banks, which means that in public disclosures assets and matching liabilities encumbered to central banks via ELA shall be reported as unencumbered, such that the sum of encumbered assets corresponds to the institutions’ total assets on balance sheets;” In addition to the considerations outlined above, the italicized statement should be clarified, perhaps by expanding to include “encumbered and unencumbered assets”.

encumbrance should be no exception. Toward that end, we would encourage banks to provide information on asset encumbrance in conjunction with regular financial reporting, ideally on a quarterly basis, and there should be clear criteria that define when a time delay of up to six months is appropriate. In periods without significant systemic distress, complete disclosure of asset encumbrance information should be provided immediately, even if that provides a means for the market to identify institutions that are experiencing specific idiosyncratic challenges. *(This response relates to consultation question 9.)*

4. **Sources of encumbrance:** Template C presents valuable information on sources of encumbrance that is critical to analysts' understanding of the institution's business model and the funding choices that affect its balance sheet. An open narrative as proposed in Template D would not only reduce comparability over time and across institutions, but could be less comprehensive if institutions were to emphasise certain forms of encumbrance at the expense of others. We believe that the proposed grouping of liability line items would not necessarily enable market participants to identify encumbrance related to specific transactions such as ELA. *(This response relates to consultation question 6.)*
5. **Balance sheet reconciliation:** Reconciliation to balance sheet statements is important for debt and equity investors and reporting of median values is unlikely to tie to quarter-end financial statements. As a result we would suggest that banks report both median and end-of-period balances for asset encumbrance disclosures. *(This response relates to consultation question 7.)*
6. **Implementation date:** Asset encumbrance is a critical area of interest for investors at present and we would encourage the EBA to accelerate the finalisation and implementation dates for the proposed technical standards with effective dates no later than 2016.

We would greatly appreciate your considering our comments.

A handwritten signature in black ink, appearing to read "Eloy Lindeijer".

Eloy Lindeijer  
Chief Investment Management and Member, Executive Committee, PGGM