

Response from the ESRB to the EBA Consultation Paper on Draft Guidelines on disclosure of encumbered and unencumbered assets

Introduction

The European Systemic Risk Board, hereinafter “the ESRB”, welcomes the publication by the European Banking Authority (EBA) of the draft guidelines on disclosure of encumbered and unencumbered assets.

In December 2011 the Advisory Technical Committee (ATC) set up an Expert Group on Bank Funding, which concluded, among other things, that there were relevant risks arising from excessive asset encumbrance and that such risks could be mitigated by market transparency. A High Level Group (HLG) was later given the task of finding a balance between transparency requirements and the need to avoid the use of central bank facilities being detected by the market. The need to maintain the ability to conduct covert liquidity support operations was considered important by General Board members as it is a valuable tool that can be deployed to help deal with severe institution specific or market wide liquidity stresses in pursuit of financial stability

Against this background, the ESRB issued a Recommendation (ESRB/2012/2)¹, accompanied by an explanatory Annex.

As this Consultation Paper is related to Recommendation D of ESRB/2012/2, this response follows the thrust of the ESRB Recommendation. However, the response will be without prejudice of the ESRB’s formal compliance assessment, which will be performed according to timeline and criteria set out in the Recommendation.

General comments

The ESRB agrees on the analysis about the shortfalls of current disclosure requirements and the necessity of setting specific disclosure rules for encumbered and unencumbered assets, as requested by Recommendation D of ESRB/2012/2.

However, the ESRB believes that the proposed guidelines do not take fully into account the concerns that transparency regarding assets encumbered to central banks and emergency liquidity assistance given by central banks might have unwanted effects on financial stability, as it will be explained in details in the replies to specific questions.

The ESRB is aware that the trade-off between the benefits of transparency and the risks of unintended disclosure of central bank operations is perceived differently across countries. It

¹ http://www.esrb.europa.eu/pub/pdf/recommendations/2012/ESRB_2012_2.en.pdf?9aa57b9f48595c124eb071b23b643c6a

must be underlined, however that the requirements set in these draft guidelines are intended as a minimum, for individual institutions as well as for national authorities, as correctly stated in par. 7 of Title I. Institutions will be free to disclose more, and in particular to align with the Financial Stability Board requirements, if they believe that the market requires them to do so. National authorities will be also free to set higher requirements. In both cases, the only constraint will be that data will need to be comparable with the templates defined in the guidelines.

The ESRB further believes that the guidelines should explicitly state that they require disclosure of information in addition to IFRS 7 disclosure².

Replies to EBA specific questions

The ESRB replies to the 9 questions raised in the EBA consultation paper are provided in the table below, to the extent that they are not specifically addressed to market participants

The ESRB does not object to the EBA publishing the ESRB response to the EBA Consultation Paper on draft Guidelines on disclosure of encumbered and unencumbered assets.

Questions	Replies
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.	The ESRB believes that it would be better to set a separate category for sovereign, central bank and supranational debt (or at least the first, which is separate also in supervisory reporting). It is important, anyway, that loans are not reported as separate from other financial assets ³ . These criteria should be used instead of reporting assets encumbered to central banks via Emergency Liquidity Assistance (ELA) as unencumbered, which could cause encumbrance to be understated in public disclosures by the banks involved. Disclosure should also be comparable with

² IFRS 7, whose requirements are summarised in section 3 of the consultation paper, does not explicitly exempt any asset from being reported.

³ See compliance criterion (a) of Recommendation D

	the Liquidity Coverage Ratio disclosure, required by the Basel standard ⁴
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.	The ESRB believes that information on the quality of encumbered and unencumbered assets should be added at a later stage, after a first analysis of information obtained both in market disclosure and in supervisory reporting.
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 (see <i>paragraph 7 of Title II</i>) and the lag for disclosure is 6 months (see <i>paragraph 10 of Title II</i>)?	Yes, the ESRB believes that, if loans are reported separately, the information could lead to detection of the level and evolution of assets of an institution encumbered with a central bank. Loans are usually encumbered either with central banks or to obtain market funding via securitisation or covered bond programmes, and the amount encumbered for the latter is usually disclosed, often with sufficient frequency that it would be possible to calculate the median level of loan encumbrance for market funding purposes. This would reveal central bank funding by deduction; the disclosure would be even clearer for institutions whose business models do not involve regular loan encumbrance in the market.
4. Should the disclosure of information relating to the ' <i>nominal amount of collateral received or own debt issued not available for encumbrance</i> ' on unencumbered collateral be requested? Please explain the relevance of this information for market participants and the sensitivity of the disclosure of this information.	The ESRB believes that such information may be useful, but it is not essential, at least in this first stage.
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	The ESRB welcomes the proposal that collateral received from central banks in collateral swap transactions should not be disclosed in Template B. Central banks in the

⁴ <http://www.bis.org/publ/bcbs259.pdf>

disclosure of this information is.	<p>EU operate using different instruments for a variety of reasons, and this proposal will ensure equal treatment for central bank liquidity received through (i) repos (which would not be captured by this template, but only in Template A, together with other encumbrance) and (ii) securities lending transactions.</p> <p>The ESRB believes that Template B should have the same granularity as Template A, and therefore should be subject to the same changes proposed in question 1.</p>
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)? Please explain the relevance of this information for market participants and the sensitivity of the disclosure of this information.	Yes, the ESRB thinks that information in Template C, combined with the one in Template A could still be too sensitive to be disclosed and it had better be disclosed only as narrative information, at least for the time being.
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.	No, the ESRB believes that medians should be used, both to reduce risks of unintended disclosure of central bank operations and because they are more conducive to a portrayal of structural levels on encumbered and unencumbered assets and less prone to window dressing. In order to achieve both goals, it would be better to use medians of monthly data.
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?	Yes, the ESRB agrees with the proposed list of disclosures and believes it would be better to state explicitly that ELA should not be disclosed. As long as loan assets are not reported separately, ELA data could be included in the templates and would not need to be artificially reported as unencumbered (see response to question 1). Furthermore, as liquidity support can be provided via different routes at different central banks, the exemption should be extended to all potential covert liquidity assistance.



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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?	The ESRB believes that, as a rule, disclosures should be published together with annual accounts. Only in case annual accounts are published more than five months after the end of fiscal year, asset encumbrance disclosure should be published before them.
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