# Response from the ESRB to the EBA Consultation Paper on Draft Implementing Technical Standards on asset encumbrance reporting under article 95 of the draft Capital Requirements Regulation

## Introduction

The European Systemic Risk Board, hereinafter "the ESRB", welcomes the publication by the European Banking Authority (EBA) of the draft Implementing Technical Standards (ITS) on asset encumbrance.

In December 2011 the Advisory Technical Committee (ATC) set up an Expert Group on Bank Funding, which concluded that there were relevant risks arising from excessive asset encumbrance and that it would be necessary to closely monitor these risks. 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 C 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 of the risks arising by asset encumbrance and on the necessity to monitoring its dynamics, as already pointed out by the ATC's Expert Group.

In particular, the ESRB agrees that the proposed data collection is necessary, as the relevant information is not covered by the existing templates. The ATC's Expert Group, before launching its ad-hoc data collection, also considered using existing data, and in particular the Net Stable Funding Ratio (NSFR) template, but discarded such option, as it would not have allowed to gather information, broken down by asset type, on all collateral used.

The ESRB is aware that a definition of "encumberable assets" may be subject to controversy and uncertain information. Nevertheless, the ESRB believes that some distinction needs to be done, also considering that the ESRB Recommendation requires monitoring of "unencumbered but encumberable assets": at least, all "intangibles" which are deducted from Basel III capital should be considered as not encumberable, for the same reasons that lead to their Basel III deduction.

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

There are several possibilities that can be considered to further operationalize this concept. One possibility that has a high potential of consistent practical implementation is to consider assets to be encumberable whenever they can be encumbered with central banks, central clearing counterparties (CCPs) or encumbered in covered bonds. However, this definition would discard, in particular, the encumberability for bilateral repos, and the possibility to retain securitisation of other types of assets. A solution could be to report separately the assets which are encumberable according to this, more restrictive, definition.

This more granular decomposition of banks' headroom of unencumbered but encumberable assets is desirable for assessing risks to financial stability. However, it is important that data on banks' encumbrance with central banks and on their headroom of central bank eligible assets are not disclosed to market participants in a manner that could jeopardise the ability of central banks to conduct covert non-conventional operations. The covert aspect of such operations is critical to financial stability.

The ESRB would like reporting to start as soon as possible, possibly together with COREP.

The ESRB generally would welcome the requirements to enhance the consistency of the data and minimise the reporting burden.

**Replies to EBA specific questions**

The ESRB replies to the 10 questions raised in the EBA consultation paper are provided in the table below. As explained above, and given the fact that the ESRB is responding to the consultation from the viewpoint of a user, the replies concern more the merits of the EBA proposals rather than their costs.

The ESRB does not object to the EBA publishing the ESRB response to the EBA Consultation Paper on draft implementing technical standards on asset encumbrance reporting under article 95 of the draft Capital Requirements Regulation.

| **Questions** | **Replies** |
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| Q1: Is the definition of asset encumbrance sufficiently clear? | Yes. |
| Q2: Do you agree with the decision to follow the level of application as set out for prudential requirements? If not, what other level of application would be appropriate? explain them | The ESRB agrees to follow the level of application as set out for prudential requirements. |
| Q3: Do you believe the chosen definition of asset encumbrance ratio is appropriate? If not, would you prefer a measure that is based solely on on-balance sheet activities | The ESRB believes that the chosen definition is appropriate, but due regard should be given to specific refinancing activities of certain types of institutions. In particular, |

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| (collateral received and re-used, for instance from derivatives transactions would not be included) or a liability? | collateral pledged for derivatives transactions needs to be included, as pointed out by both the Annex to the Recommendation and the CGFS Working Group[2]. It could be consider to report also collateral pledged to derivatives which have zero or positive values. |
| Q4: Do you agree with the thresholds of respectively 30 bn. € in total assets or material asset encumbrance as defined as 5% of on- and off-balance sheet assets encumbered? If not, why are the levels not appropriate and what would be an appropriate level? Should additional proportionality criteria be introduced for the smallest institutions? | The ESRB agrees that the introduction of additional proportionality criteria may be needed, provided that the reporting remains sufficiently representative, both at a European and a country level, as long as due regard is given to specific refinancing activities of certain types of institutions. We note the EBA data collection exercise to assist with calibration. The EBA should ensure that the respective thresholds are appropriate according to the data collected through this exercise and continue to review appropriateness of these thresholds. |
| Q5: Under what circumstances might unencumbered assets of the types of loans on demand, equity instruments, debt securities and loans and advances other than loans on demand not be available for encumbrance? | The ESRB believes that such assets may be assumed as all encumberable, however, their encumberability depends on several factors. These factors encompass, among others, credit quality, marketability and eligibility for operations with central banks and central clearing counterparties (see also general comments on the encumberable assets). A possible solution could be to add new columns in Part A: encumbrance overview – Template AE-Assets" regarding encumberable assets, in accordance with the definition that covers, at least, assets eligible for operations with CCPs and for cover pools of covered bonds. |
| Q6: What additional sources of material asset encumbrance beyond the one listed in rows 20 to 110 and 130 to 150 in template | None. |

[2] See its final report http://www.bis.org/publ/cgfs49.pdf , particularly section 2.3

| AE-Source do you see? | |
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| Q7: Do you believe the central bank repo eligibility criteria is an appropriate marketability criteria or should other criteria, such as risk weights, be used? If other criteria should be used, what could be the alternative? | The ESRB believes that eligibility for standard liquidity operations of a central bank is, at least in the short run, the best possible criterion to assess the quality of unencumbered assets. However, there are some shortcomings, as also identified in the EBA consultation paper (e.g. eligibility criteria may differ across countries and may change in time). Further, calling them "marketable assets" could be misleading, as eligible assets are not necessarily marketable: it would be better to refer to them simply as eligible. The EBA should review on an on-going basis the appropriateness of central bank eligibility as the measure of asset quality, and where appropriate consider other alternatives such as high quality liquid assets under the LCR or risk weightings. |
| Q8: Do you believe the chosen scenarios are appropriately defined? What alternative definitions would you apply? | The ESRB generally agrees on the scenarios. However, the impact of multiple downgrades, particularly for high rated banks, could be explored as an alternative scenario. |
| Q9: Does the instructions provide a clear description of the reporting framework? If not, which parts should be clarified? | Yes. However, it should be specified how to report the collateral received which is reported as a balance sheet item. |
| Q10: Do you identify any overlaps with the existing reporting framework, which could be mitigated? | No (see also general comments). |