The voice of banking
& financial services

British Bankers' Association response to EBA Draft Implementing Technical Standards on Asset Encumbrance Reporting under article 95a of the draft Capital Requirements Regulation (CRR)

Introduction

The British Bankers' Association[1] ("BBA") is the leading association for UK banking and services representing members on the full range of UK and international banking issues. It has more than 200 banking members that are active in the UK, which are headquartered in 50 countries and have operations in 180 countries worldwide. All the major banking groups in the UK are members of our association as are large international EU banks, US and Canadian banks operating in the UK and a range of other banks from the Middle East, Africa, South America and Asia, including China. The integrated nature of banking means that our members are engaged in activities ranging widely across the financial spectrum from deposit taking and other more conventional forms of retail and commercial banking to products and services as diverse as trade and project finance, primary and secondary securities trading, insurance, investment banking and wealth management. Members include banks headquartered in the UK, as well as UK subsidiaries and branches of foreign banks, many of which will have operations in the United States, and on behalf of all of which the BBA is pleased to respond.

The BBA welcomes the opportunity to comment on the draft Implementing Technical Standards on "Asset Encumbrance Reporting under article 95a of the draft Capital Requirements Regulation (CRR)[2]."

Key points

The BBA acknowledges the goals of the EBA to develop a harmonised measure of asset encumbrance for reporting across institutions. We welcome that the draft standards include a clear definition of asset encumbrance but have some serious misgivings on the expected implementation timescales for the new requirements.

The BBA would like to highlight our key concerns:

- We note that the consultation does not specify an implementation date and highlight the challenges of meeting these requirements for the EBA's consideration in setting this date. These proposed requirements are more granular than current PRA requirements for UK banks and require significant further clarification. The accuracy of implementation is partly dependent upon sourcing and reconciliation of good quality data which require further IT development. Any increased staffing for this development should also be taken into consideration, particularly in light of the resources needed to meet the various other reporting requirements (including those relating to LCR, NSFR, and capital) also coming into effect in January 2014. On the basis that the finalised rules are released later this year, members realistically will not be able to implement this until

[1] Registration ID in the Transparency register: 5897733662-75
[2] http://eba.europa.eu/documents/10180/40063/CP-on-Asset-Encumbrance.pdf

British Bankers' Association
Pinners Hall
105-108 Old Broad Street
London
EC2N 1EX

T +44 (0)20 7216 8800
F +44 (0)20 7216 8811
E info@bba.org.uk
www.bba.org.uk

24 June 2013

1st January 2015. Accordingly we suggest that this the implementation date is aligned with the BCBS and FSB data aggregation standards[3] of 1st January 2016. It is also recommended that the EBA assess the data received through the LCR submissions before mandating additional reports that may have duplicative information.

The EBA has previously explained in discussion of the data point model delivery that although these asset encumbrance reporting requirements are closely aligned with FINREP requirements due to their relatively late introduction, a phased approach would be more suitable. Members seek clarification on whether these requirements are aligned with FINREP and if so whether these would this also be required by non-IFRS firms.

- The consultation states that these rules 'will ensure a level-playing field by preventing diverging national requirements and will ease the cross-border provision of services.' Although this statement is applicable to the EU, these requirements diverge from reporting requirements outside of the EU, and in particular the US. Such differing requirements would lead to a further fragmentation of global reporting standards and reduce the degree of comparability across jurisdictions. Given that other regulators and Basel are continuing to articulate their views on encumbered assets, it would be preferable to for the EBA defer any reporting requirements until a broader consensus approach has been adopted among regulators.

- The level of granularity required in the asset encumbrance templates is particularly onerous and complex to implement. Furthermore, we fail to see how this level of granularity will contribute to the stated aim of understanding the level of asset encumbrance in financial markets. Some aspects of the template requirements such as the reporting of asset encumbrance by maturity are aggregated in a manner that is not used for management information or monitoring purposes. This will add the implementation complexity and a significant cost and of complying with the new reporting requirement.

- The proposals include a request for an asset encumbrance ratio, although it is not clear why this has been requested or how this data will be used. Public disclosure of asset encumbrance ratios at the start of a stressed period may lead to unsecured creditors reacting negatively and thus fulfilling expectations that the bank's asset encumbrance will increase. Members are also concerned that this may lead to the application of a maximum asset encumbrance ratio across the industry.

- The definition of asset encumbrance is unclear in relation to Reverse Repo. It is standard market practice for banks to repo in securities (Reverse Repo) and then use these securities for their own liquidity management up to the contractual date of the trade. More clarity is required to ascertain whether these securities would be disclosed as being encumbered or unencumbered. It is important for the treatment to be clear and consistent with LCR to ensure the encumbrance ratio and LCR follow the same pattern or behaviour depending on the reverse repo activities of a bank. For example, level 1 assets are treated as 0% roll off under LCR and are therefore assumed to be LAB eligible. Are these assets considered to be encumbered? This would assume all of LAB is to be treated as encumbered and therefore not eligible for use under a stress. There is a greater need for clarity over the linkage between encumbrance reporting and LCR, with Reverse Repo being the main area of focus.

---

[3] See BCBS consultation paper 'Principles for effective risk data aggregation and risk reporting' (June 2012) http://www.bis.org/publ/bcbs222.pdf

Questions asked in the consultation

We offer comments to specific questions asked in the consultation below:

Q1: Is the definition of asset encumbrance sufficiently clear?

Yes, the definition of asset encumbrance is clear. Nevertheless, there are concerns about the scope of this definition, particularly the inclusion of assets related to repo, reverse repo and derivatives activity. Firms active in these businesses would show inflated encumbered asset levels which may not accurately reflect underlying liquidity risk. , For this reason, we ask the EBA whether investment firms should be required to report under this template. On a related point, it would be useful to understand how this data will be used, particularly with regard to any proposed asset encumbrance ratio. To the extent there is an expectation that a maximum ratio requirement needs to be met, the impact this could have on specific businesses, such as repo and derivatives, should be taken into consideration.

Also it would be useful to define "freely". The definition references assets that have been pledged to "any transaction from which (they) cannot be freely withdrawn". Though bulleted examples are given, this is open to interpretation and could lead to significant inconsistencies between reporting institutions.

For example:

For Open repo's, where only the first leg is booked, so a firm could ask for the stock back at any time, and hence would consider this stock to be 'freely available'
For Overnight repos, unless 'rolled' , the stock would be due back daily- should these assets be considered encumbered?
For Term repo's where the contract is fixed over a period of time we would consider that the assets involved would not be freely available (although contracts with a short, e.g. 2 day, termination clause might be considered 'freely available' if the definition were broad enough)

Also Tri-party Repos, where stock is held by a third party and can be 'auto-exchanged' and is mostly not rehypothecatable, does not in our view create encumbrance because the stock is 'freely available'.

As part of the consultation can the EBA please clarify what is meant by the term 'freely available'?

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?

The current proposal is for these requirements to be subject to the same level of application as the LCR and NSFR reports. This means reports would need to be submitted within fifteen business days following the effective reporting date and on an individual and consolidated basis for those entities subject to this regime.

However, we believe consolidated reporting offers little additional value, particularly given that this same information will be reported by individual subsidiaries within the group. Unless the group parent company is part of a Defined Liquidity Group and is legally obligated to provide liquidity support to its subsidiaries, the consolidated reporting requirement should be dropped.

In terms of the remittance period, the EBA should be pragmatic about the submission times, especially during the earlier periods, in light of the detailed nature of the reports as well as the fact that NSFR reports will be due in addition to the LCR reports.

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 (collateral received and re-used, for instance from derivatives transactions would not be included) or a liability?

There is no objection to the definition of an asset encumbrance ratio, although the consultation paper does not provide details of why this asset encumbrance ratio is required and how it will be used. As highlighted above, we are concerned that publishing asset encumbrance ratios during a stressed period may fulfil expectations that the bank's asset encumbrance will increase. We request further explanation on this point.

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 EBA's proposed proportionality threshold is too narrow and, for some larger institutions, could result in a significant incremental volume of detailed reports on entities posing immaterial levels of risk. In addition, the requirement that institutions not exceed the thresholds at any period over the previous two years is too onerous and, in some cases, difficult to compute. For this reason, we would propose setting a single threshold, such as balance sheet size, under which there should be no reporting requirement.

We would support a separate threshold for the smallest institutions of €3 billion instead of the €1billion stated.

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?

Covenants could lead to restrictions over unencumbered assets where lending to an institution is restricted by an agreed percentage of overall encumbrance

There may be other loan assets which for operational reasons may be less readily available and/or eligible for currently-known forms of standard encumbrance

Q6: What additional sources of material asset encumbrance beyond the one listed in rows 20 to 110 and 130 to 150 in template AE-Source do you see?

We do not have specific comments for this question.

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?

Central bank repo eligibility differs from central bank to central bank. So the eligibility criteria laid out in this proposal is too narrow. Repos should be considered marketable if the collateral satisfies the existing Basel rules on eligible collateral. Institutions should have the ability to argue that particular asset classes that are not central bank eligible are nevertheless marketable. Central bank eligibility should be a criterion for immediate inclusion in marketable, with other low risk weighted assets potentially included as well.

Q8: Do you believe the chosen scenarios are appropriately defined? What alternative definitions would you apply?

Along the lines of what has been noted above, the proposed reporting requirements are extensive and detailed. Before mandating additional reports, we urge the EBA to assess information received through the LCR submissions and remain cognisant of the approach taken by other regulators. The proposal to require yearly stress testing falls outside the realms of the level of proportionality which we would like to see applied.

10% currency swings, provided these include the home currency of the institution, seem reasonable, though currencies can drift by this much over a number of months and be notable but not necessarily stressful
Clarification is also sought by members concerning overlap with, inconsistency to or duplication of any stress tests undertaken for other purposes, such as recovery and resolution planning or for LCR requirements.

Additional questions in Annex II
Q9: Does the instructions provide a clear description of the reporting framework? If not, which parts should be clarified?

The instructions are clear. What is not clear is why this level of detail is needed and whether the cost of compiling such large of amounts of data is financially justified or whether it achieves the required aims.

Q10: Do you identify any overlaps with the existing reporting framework, which could be mitigated?

Again, we think there is a potential for significant overlap between the information provided in the proposed reports and what would be available through the LCR reporting. For this reason, we strongly recommend that the EBA review the LCR submissions in closer detail before requiring additional reports.

BBA responsible executive Simon Hills
+44 (0) 207 216 8861
simon.hills@bba.org.uk