

EBA final draft implementing technical standards

On asset encumbrance reporting under Article 100 of Capital Requirements Regulation (CRR)



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1. Executive summary

The Capital Requirements Regulation (EU) No 575/2013 (CRR), in its Article 100, mandates the European Banking Authority to develop reporting templates for all forms of asset encumbrance and that this information should be included in the implementing technical standards (ITS) on COREP and FINREP reporting (EBA-ITS-2013-02). The European Systemic Risk Board (ESRB) published in February 2013 a Report on Bank Funding, which includes recommendations for national supervisory authorities and the EBA. Recommendation C of this report recommends that the EBA 'issue guidelines on harmonised templates and definitions in order to facilitate the monitoring of asset encumbrance, in accordance with its established consultation practices'. The ITS presented also serve the purpose of complying with the ESRB Recommendation.

In order to allow institutions time to prepare for reporting of asset encumbrance, the EBA decided to advance its work on asset encumbrance templates before the publication of CRR. The final draft ITS have been updated according to the mandate in CRR and have taken into account the industry responses received during the consultation period.

The ITS consist of three parts. The first part consists of the legal text to be incorporated into the full reporting framework, which already consists of COREP, FINREP, large exposures, liquidity and leverage ratio reporting.

The second part consists of reporting templates and instructions for the templates. This constitutes the part that will be used for regulatory reporting on asset encumbrance from now on. The templates draw on existing concepts from the COREP and FINREP reporting framework, which should help institutions implement the asset encumbrance reporting. Further explanations of the definition of asset encumbrance are also included in the instructions.

The third part consists of a data point model and validation rules. This is expected to achieve harmonisation by describing the business concepts and their relations in the necessary detail, and by defining all the relevant technical specifications necessary for developing information technology (IT) reporting formats and common dictionaries of terms that can be used in the institutions' databases. The EBA has incorporated the data point model (DPM) for the asset encumbrance templates into the DPM already available in the full reporting framework.

The asset encumbrance reporting will provide supervisory authorities with the necessary information on the level of asset encumbrance in institutions. This will provide a valuable input for a number of reasons. Firstly, it will allow a harmonised measure of asset encumbrance across institutions, which will allow supervisory authorities to compare the reliance on secured funding and the degree of structural subordination of unsecured creditors and depositors across institutions. Secondly, it will allow supervisors to assess the ability of institutions to handle funding stress, by providing an assessment of the ability of switching to secured funding. Thirdly, it can be incorporated into crisis management, as it will allow for a broad assessment of the amounts of assets available in a resolution situation. Asset encumbrance reporting is to be implemented on [30 June /31 December] 2014 depending on the size of the institution.

2. Background and rationale

Draft ITS on supervisory reporting and the CRR

On 27 June 2013, the Capital Requirements Directive 2013/36/EU (CRD IV) and Capital Requirements Regulation (EU) No 575/2013 (CRR), which seek to apply the Basel III framework in the EU, were published in the European Union's Official Journal. They have recast the contents of the previous Capital Requirements Directive (CRD) and are together colloquially referred to as the CRD IV/CRR.

Article 100 of the CRR requires the institutions to report to the competent authorities the level of their repurchase agreements, securities lending and all forms of asset encumbrance, and mandates the EBA to include this information in the implementing technical standards on COREP and FINREP reporting (EBA-ITS-2013-02). Since the mandate to include asset encumbrance was introduced only in the trilogue negotiations between the European Commission, the European Council and the European Parliament, and institutions will require some time to implement additional templates, beyond the templates already consulted upon by the EBA, the EBA felt it necessary to advance its work on asset encumbrance templates before the publication of the CRR. Because the mandate was late, the EBA had to develop the standards in a very tight timeframe; however, the final version of these draft ITS reflect the changes in the CRR.

In addition to the mandate in CRR, the ESRB recommendations on funding of credit institutions, published in February 2013, also cover the topic of supervisory reporting of asset encumbrance. More specifically, Recommendation C recommends that the EBA 'issue guidelines on harmonised templates and definitions in order to facilitate the monitoring of asset encumbrance, in accordance with its established consultation practices'. These draft ITS, consequently, also serve the purposes of complying with the ESRB recommendation.

The reporting on asset encumbrance will be incorporated into the reporting ITS that currently cover COREP, FINREP, large exposures, leverage ratio and liquidity reporting. The reporting on asset encumbrance will consequently be included in the ITS 2013-02, and the current draft ITS should be read together with these ITS on reporting.

To facilitate uniform and problem-free application of the regulation, these draft ITS will include detailed instructions to the templates set out in Annex I, in particular:

- a. references to the relevant articles of the CRR as included in the instructions of Annex II;
- b. additional data definitions as included in the instructions set out in Annex II;
- c. validation rules (quantitative relations between rows and columns of each template, and among templates) set out in Annex IV;
- d. DPM containing all the relevant technical specifications necessary for developing an IT reporting format set out in Annex III; and
- e. XBRL (eXtensible Business Reporting Language) taxonomies to ensure unambiguous IT interpretation of the data included in the ITS.

The nature of ITS under EU law

Any draft ITS are produced in accordance with Article 15 of the EBA regulation. According to Article 15(4) of the EBA regulation, ITS shall be adopted by means of regulations or decisions.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

Shaping these rules in the form of a regulation will ensure equal conditions by preventing diverging national requirements and will ease the cross-border provision of services. Currently, each time an institution wishes to take up operations in other Member States it has to comply with a different set of requirements regarding supervisory reporting in each of them.

Background and regulatory approach followed in the draft ITS

These ITS provide uniform templates, which contain data fields that will provide competent authorities with the necessary information on the asset encumbrance in institutions, in the form of quarterly reporting. This will ensure a harmonised approach to the definition of asset encumbrance and the reporting framework across all European institutions.

The development of these ITS was based on a number of principles. Firstly, the regulatory approach adopted in these ITS is to collect data arranged in a data structure that refers as far as possible to data reported according to Article 99(5) CRR related to the minimum own funds requirements (COREP). This will minimise the implementation burden for institutions.

Secondly, the asset encumbrance templates are based on accounting values (carrying amounts) in order to ensure the possibility of reconciling the reported figures with the balance sheet items (FINREP). This is supplemented by a number of fields that collect market values/fair values. Again, this should minimise the implementation burden and ensure a consistent harmonised approach.

Thirdly, it was agreed that proportionality principles were needed in order to lower the reporting burden for smaller institutions which have no material levels of asset encumbrance, because of their business models, lower complexity or other circumstances. As a consequence, these institutions will not be required to report all the templates. This allows the implementation of these ITS in a proportionate manner.

Finally, not only were the levels of actual encumbrance considered of importance, but also the risk of additional encumbrance was deemed important. As a consequence, a template on contingent encumbrance was added with an annual reporting frequency. This will require institutions to calculate the level of asset encumbrance in a number of stressed scenarios related to significant asset value declines and currency shocks.

Contingent encumbrance denotes the additional assets which may need to be encumbered when the reporting institutions face adverse developments (decrease of the fair value of the encumbered assets

or currency shock, inter alia). In these cases, the reporting institution will need to encumber additional assets as a consequence of already existing transactions. Contingent encumbrance will, therefore, be triggered by an external event over which the reporting institution has no control. Two scenarios have been included.

Level of application and frequency of the asset encumbrance reporting

The level of application of these ITS will follow that of prudential reporting requirements (COREP). The frequency of reporting will be quarterly for most institutions, but a lower reporting frequency has been proposed for some templates.

In order to apply these ITS in a proportionate manner, not all institutions will be subject to reporting according to all templates in Annex I. Some templates will, consequently, not be required from smaller institutions without material levels of asset encumbrance.

The reporting of asset encumbrance shall be implemented on [30 June] 2014 for templates that are reported quarterly, and [31 December] 2014 for templates that are reported once or twice a year.

3. EBA FINAL draft Implementing Technical Standards on Asset Encumbrance Reporting

COMMISSION IMPLEMENTING REGULATION (EU) No .../... amending Commission Implementing Regulation (EU) No .../... [DRAFT ITS IN EBA/2013/ITS/02] laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council

of XXX

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012¹ and in particular Article 99(5) thereof,
Whereas:

- (1) Reporting on asset encumbrance should be based on existing reporting concepts from prudential and accounting reporting and on balance sheet items to the extent possible in order to minimise the implementation and reporting burden for institutions.
- (2) In accordance with the principle of proportionality, smaller institutions which do not have material levels of asset encumbrance should not be subject to the detailed reporting requirements applied to larger institutions.
- (3) The reporting requirements should measure all forms of asset encumbrance including contingent encumbrance, as this is of vital importance as a material risk to the liquidity and solvency profiles of institutions, especially institutions with material levels of asset encumbrance.
- (4) Institutions which issue covered bonds as referred to in the first subparagraph of Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)² should report information concerning encumbrance of those assets.
- (5) This Regulation is based on the draft implementing technical standards submitted by the European Supervisory Authority (European Banking Authority) (EBA) to the Commission.
- (6) The EBA has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.

¹ OJ L 176, 27.06.2013, p. 1.

² OJ L 302, 17.11.2009, p. 32.

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- (7) To provide institutions and competent authorities with adequate time to implement the requirements of this Regulation in a manner that will produce data of high quality, a deferred application date should apply in relation to these reporting requirements, while taking into account the requests from the European Systemic Risk Board on the monitoring of asset encumbrance in Recommendation ESRB/2012/2³. The first reporting reference dates should therefore be 31 December 2014 for smaller institutions and 30 June 2014 for larger institutions.
- (8) Commission Implementing Regulation (EU) No xxx/xxx⁴ [DRAFT TS IN EBA/2013/ITS/02] should be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1- Amendments to Regulation (EU) No xxx/xxx [DRAFT TS IN EBA/2013/ITS/02]

Regulation (EU) No xxx/xxx [DRAFT TS IN EBA/2013/ITS/02] is hereby amended as follows:

1. in Article 1, point (e) is replaced by the following:
 - ‘(e) Liquidity Coverage requirements and Net Stable Funding requirements according to Article 415 of Regulation (EU) No 575/2013;
 - (f) asset encumbrance in accordance with Article 100 of Regulation (EU) No 575/2013.’;

2. the following Chapter is inserted:

‘CHAPTER 7A

Format and frequency of reporting on asset encumbrance on an individual and consolidated basis

Article 16a

1. In order to report information on asset encumbrance in accordance with Article 100 of Regulation (EU) No 575/2013 on an individual and consolidated basis, institutions shall submit the information specified in Annex XVI according to the instructions in Annex XVII on the following basis:
 - (a) the information in Parts A, B and D shall be reported on a quarterly basis;
 - (b) the information in Part C shall be reported on an annual basis;
 - (c) the information in Part E shall be reported on a semi-annual basis.
2. Institutions are not required to report the information in Parts B, C or E of Annex XVI if they meet each of the following conditions:
 - (a) they have total assets, calculated in accordance with Section 1.6 of Annex XVII, of less than EUR 30 billion;
 - (b) their asset encumbrance level, as defined in Section 1.6 of Annex XVII, is below 15%.

³ Recommendation ESRB/2012/2 of the European Systemic Risk Board of 20 December 2012 on funding of credit institutions (OJ C 119, 25.4.2013, p. 1).

⁴ OJ L [...], [xx.xx.XXXX, p...].

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3. Institutions are only required to report the information in Part D of Annex XVI if they issue the bonds referred to in the first subparagraph of Article 52(4) of Directive 2009/65/EC.
 3. the following paragraph is inserted in Article 18:

‘In respect of information to be reported pursuant to Article 16a the first reporting reference date for institutions which meet the condition specified in paragraph 2(a) of that Article shall be 31 December 2014.’
 4. the following paragraph is inserted in Article 19:

‘Article 16a shall apply from 30 June 2014 except that in respect of Parts C and E of Annex XVI it shall apply from 31 December 2014.’;
 5. Annex XIV is amended as set out in Annex I;
 6. Annex XV is amended as set out in Annex II;
 7. the annex set out in Annex III is inserted as Annex XVI.
 8. the annex set out in Annex IV is inserted as Annex XVII.

Article 2 – Final provisions

This Regulation shall enter into force on the the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

On behalf of the President

[Position]

ANNEX I

[See separate document]

ANNEX II

[See separate document]

ANNEX III

[See separate document]

ANNEX IV

[See separate document]

4. Accompanying documents

4.1 Cost–benefit analysis/impact assessment

The EBA's mandate to draft ITS on reporting requirements covering asset encumbrance is a result of the triologue negotiations between the European Commission, the European Council and the European Parliament. For this reason, no specific reference is made to the concept of asset encumbrance in the impact assessment document accompanying the July 2011 proposal of the CRD IV/CRR, or to any of the elements justifying regulatory intervention.

The process of asset encumbrance is the process of using assets, by an institution, in order to secure or collateralise specific claims, in other words in order to make sure that creditors holding those claims can benefit from the economic value of the assets should the institution fail to meet its obligations. Asset encumbrance is the result of an institution creating a legally binding preferential claim on its assets or financial items it had received as collateral under other transactions in favour of a selected group of its creditors (including holders of claims on the reporting bank's general estate not recognised on the balance sheet); asset encumbrance is thus characterised by the loss of a previously enjoyed level of control over assets or collateral received.

The ESRB published in February 2013 a Report on Bank Funding that, among other topics, collects evidence on the materiality of asset encumbrance in Europe and describes some of the risks associated to it. The report backs a series of ESRB recommendations on the matter of bank funding: Recommendation C ('Monitoring of asset encumbrance by supervisors'), in particular, recommends that national supervisory authorities (NSAs) monitor the level, evolution and types of institutions' asset encumbrance. The ESRB explicitly asks NSAs to focus supervision on (1) framework, policies and contingency plans for asset encumbrance management; (2) level, evolution and types of asset encumbrance and related sources of encumbrance; (3) level, evolution and credit quality of both encumbered assets and assets available for encumbrance; and (4) evolution and types of contingent asset encumbrance.

The ESRB collected data on asset encumbrance for a sample of large European institutions and compared asset encumbrance levels in 2007 and 2011. The comparison highlights a substantial increase in the levels of assets encumbrance, with the median ratio of encumbered assets over total assets increasing from 7 % in 2007 to 27 % in 2011. The average asset encumbrance ratio, weighted by total assets, increased from 11 % in 2007 to 31 % in 2011 ⁽⁵⁾.

Increasing levels of asset encumbrance may pose the following risks to individual institutions and to the whole financial system:

⁽⁵⁾ The ESRB could collect data covering both 2007 and 2011 for only 28 large European institutions. As a result of the uncertainty of the composition of collected data variables, the ESRB computed the encumbrance ratio under different assumptions. A 'conservative' version of the asset encumbrance ratio, for certain institutions, is computed by deducting from encumbered assets the amount of retained securities, given that the latter could also be reported under covered bonds and other collateralised securities. A less conservative version of the ratio includes matched repos in the encumbered assets value (numerator) as well as in the total assets value (denominator). The median and mean figures described here refer to the encumbrance ratio that includes matched repos.

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- a. Increasing structural subordination of unsecured creditors and depositors: the shift towards secured funding underlying asset encumbrance may imply decreased recovery rates for unsecured creditors and, consequently, increased costs of unsecured wholesale funding, potentially leading to crowding-out of unsecured wholesale funding. The impact of asset encumbrance on unsecured investors' expectation of further encumbrance can potentially give rise to a phenomenon of self-fulfilling expectations. Bank funding excessively skewed towards secured funding and increasing encumbrance of high-quality assets can negatively impact the rating received by institutions and, consequently, generate further increases in encumbrance. Banking theory suggests that decreasing proportions of unsecured funding imply decreasing intensity of market discipline, since unsecured investors are notably the ones that have the right incentives to carry on monitoring and to correctly price in risks.
 - b. Increasing funding and liquidity risks: institutions with encumbered balance sheets have fewer assets eligible for encumbrance, that is assets that act as an unused liquidity buffer and that can be used for unexpected future liquidity needs, such as committed credit lines and margin calls on derivatives positions.
 - c. Increasing sensitivity of the liquidity profile of the institution to market values of collateral: whenever the value of collateral decreases, the institution usually has to provide additional collateral (additional encumbrance occurs) to offset the initial fall in value.
 - d. Risk that asset encumbrance worsens during phases of financial stress, amplifying the latter, and giving rise to non-linearities in the evolution of risks mentioned at points (a), (b) and (c) above: the perverse effects of debt subordination, funding and liquidity risks, are higher for higher levels of encumbrance of an institution's balance sheet.

Ultimately, the potentially negative implications of asset encumbrance can constitute a threat to the regulatory objectives of financial stability, depositor protection and reduction of systemic risk.

Furthermore the asset encumbrance reporting can be integrated into crisis management proposals, as the reporting will provide competent authorities and institutions with a harmonised and comparable set of information on the broad types of assets that will be potentially unavailable in a resolution situation.

Monitoring by supervisory authorities of asset encumbrance dynamics, introduced by Article 95a of the CRR through reporting requirements on asset encumbrance, is therefore expected to contribute to the general policy objectives of the CRD IV/CRR policy initiative.

4.1.1 Problems addressed by the ITS and objectives

Within the mandate received by Article 100 of the CRR, the ITS establish the type of information and data variables, formats and frequencies of the data, which are appropriate in order to ensure that the supervision of asset encumbrance and the monitoring of the risks related to it are effective and harmonised.

Effective and harmonised monitoring and supervision of assets encumbrance contribute to the realisation of the general regulatory objectives mentioned in the previous section. In particular,

harmonisation of supervisory practices related to asset encumbrance, which is the main objective of this ITS, contributes to those objectives by realising the following specific objectives:

- 1) increased effectiveness and efficiency of supervision of asset encumbrance in institutions operating across borders in the Single Market;
- 2) increased effectiveness and efficiency of supervision of asset encumbrance, and the associated risks, from a macro-prudential perspective in the Single Market.

As with any other reporting requirement, the technical standards on reporting asset encumbrance have to strike the right balance between the proportionality of the reporting compliance burden (costs) on the one hand, imposed on institutions when requiring to collect and report new data and new information, and on the other the level of detail and data breakdown which is appropriate in order to ensure that supervision of asset encumbrance, and the monitoring of risks related to assets encumbrance, are sufficiently effective and harmonised.

4.1.2 Proposed approaches and impacts on markets, institutions and regulators

The reporting requirements introduced by the ITS are expected to generate, at least in part, both continuing (employed staff hours) and one-off (investment in IT equipment) new compliance costs, borne by institutions in order to carry out the processing and transmission to the supervisory authorities of data variables according to new and/or more detailed levels of balance sheet breakdown. New costs are more likely to arise for medium and small institutions, because within large institutions the necessary infrastructure and analytical tasks for monitoring and reporting asset encumbrance might already be in place.

National supervisory authorities will have to increase the resources, both continuing staff hours and infrastructure resources, devoted to processing the data on asset encumbrance received from the institutions under the scope of Article 100 CRR.

The benefits of the ITS materialise to the extent that the general and regulatory objectives associated with effective and harmonised supervision of assets encumbrance are achieved. Increased financial stability, depositor protection and reduced risk of systemic events are expected to result in reduced losses for institutions as well as for the Member States' economies.

Proportionality of the reporting requirements

The ITS proposes to address proportionality of compliance burden by introducing two levels of reporting requirements characterised by increasing levels of data breakdown and, consequently, increasing levels of compliance burden. The information required is deemed to be necessary to ensure that supervision of asset encumbrance is sufficiently effective and harmonised over the institutions under the scope of the CRR.

One 'Main Template' includes all the information and data variables breakdown that all institutions addressed by Article 99(5) CRR are required to report.

The final ITS propose that the 'Advanced Templates', including information on the characteristics of encumbered and unencumbered assets in a detailed breakdown of balance sheet items and the asset encumbrance information under hypothetical stressed scenarios (i.e. contingent asset encumbrance), be a reporting requirement for the institutions fulfilling at least one of the following conditions:

- 1) The institutions with an individual or consolidated balance sheet value of total assets equal to or more than EUR 30 billion. These are the institutions whose profile of asset encumbrance is particularly relevant for the monitoring of the risks of systemic nature associated with trends of increasing asset encumbrance.

- 2) All the other institutions whose level of asset encumbrance, measured as the ratio between encumbered assets and total assets, is equal to or larger than 15 %.

Condition 2, above, had been calibrated to 5 % in the draft ITS published for consultation of stakeholders (consultation paper). During consultation, stakeholders expressed their concern that the two thresholds in the draft ITS could be too low; this highlighted the need for further impact analysis. Some stakeholders also proposed to exempt small institutions (total assets below EUR 1 billion) from reporting templates B, C and E so that small institutions would have to report only the overview template A, which is quarterly, and template D if they issue covered bonds.

In order to carry out further impact analysis around the thresholds, the EBA ran a data calibration exercise in June/July 2013 and analysed other potential threshold values. The threshold calibration exercise was based on data submitted by 23 EU jurisdictions and covers 3 638 institutions.

The asset encumbrance ratio (% AE) was computed for the institutions in the sample, taking into account both on-balance and off-balance sheet items, in accordance with the following definition:

$$\% \text{ AE} = \frac{\text{Total encumbered assets} + \text{Total collateral received re-used}}{\text{Total assets} + \text{Total collateral received}}$$

The weighted asset encumbrance ratio in the sample collected amounts to 14.01 %.

Different levels of coverage were investigated where condition 1 above is verified, depending on condition 2 being characterised by different percentage threshold values, as illustrated in Table 1 below:

Table 1

AE ratio	5%	10%	15%	20%	25%
Number of institutions	322	215	192	179	165
Number of which are below EUR 1 billion total assets	59	12	8	6	5
Total assets	85.89 %	84.26 %	83.61 %	83.17 %	82.86 %

The proposed threshold value for condition 2 was raised from 5 % to 15 %, since, as illustrated in the table, a 15 % threshold would materially reduce the number of firms required to report all the templates. This addresses the stakeholders' concerns around the reporting burden on small firms without materially reducing the percentage of total assets in the sample that falls within the scope of the asset encumbrance reporting rules.

Among the 192 institutions falling into the scope of the proposed threshold values, only eight institutions (4.2 %) are characterised by total assets equal to or less than EUR 1 billion.

As already proposed in the draft ITS published for consultation, an additional template relates to the detailed information on covered bonds. This template will naturally only have to be filled in by institutions issuing covered bonds.

Encumbered versus unencumbered assets

The split between encumbered and unencumbered assets, following from the proposed definition of asset encumbrance, constitutes the general level of breakdown proposed in all the templates accompanying these ITS.

As an alternative, a more detailed approach could require reporting of (1) encumbered assets, (2) assets that are unencumbered but not available for encumbrance and (3) assets that are unencumbered and available for encumbrance.

Given the type of funding and liquidity risks that might stem from asset encumbrance, such a more detailed reporting breakdown would allow supervisory authorities to form a better picture of the actual residual capacity of the institution to raise liquidity and/or funding by means of pledging available assets.

The harmonisation of such an additional split, however, would entail providing NSAs with a definition of unencumbered assets not available for encumbrance (an example being, for instance, goodwill), which would most likely be weak and subject to controversy and uncertain interpretation. Given this

disadvantage, and the possibility for the supervisor to infer information on the residual capacity of raising liquidity/funding by means of other sections of the templates, the alternative split is not proposed in these ITS, except for collateral received under collateral agreements that, because of contractual restrictions, cannot be re-used.

Marketability

As mentioned, one of the crucial concerns behind asset encumbrance has to do with its implications on the capacity of the institution with an encumbered balance sheet to raise liquidity and funding, should the necessity arise and/or should conditions of market stress materialise. With respect to this concern, monitoring only whether assets are currently encumbered or can be used to raise liquidity/funding can provide an incomplete picture, because this does not consider the level of marketability of encumbered/unencumbered assets, that is how easy it is to trade those assets for funding and/or use for deleveraging purposes.

The ITS proposes eligibility for repo financing with the Central Bank as the criterion to distinguish more marketable assets from less marketable ones. Despite being an imperfect measure of marketability, eligibility for repo financing with the Central Bank was chosen as the preferred approach after the advantages and disadvantages of the following alternative approaches were considered:

<p>Alternative option 1: identifying marketability with the criteria defining liquid assets within the liquidity reporting requirements</p>	<p>Part of the information on marketability of assets from a liquidity perspective will be collected from NSAs via the liquidity reporting requirements to be proposed as a component of the whole reporting requirement package. In addition, at the present stage, liquidity reporting requirements and liquid assets definition are still being defined and so are not ready to be used for asset encumbrance purposes. For these reasons, this approach is not the proposed one in the final ITS</p>
<p>Alternative option 2: identifying marketability by the risk weight assigned to assets within the credit risk framework</p>	<p>The link between risk weights assigned under either the Standardised or the IRB Approach to credit risk and the marketability of assets does not appear to be stronger than the one between eligibility for Central Bank repo financing and marketability. In addition, information on risk weights on collateral received is not expected to be readily available within institutions' existing reporting practices</p>

Carrying amounts and fair values

To ensure investors' confidence in a transaction, the encumbrance of assets is particularly sensitive to changes in the value of assets (collateral) pledged. Changes in the market value of the pledged assets can materially affect their quality as encumbered assets and, related to this, the need for further asset

encumbrance by institutions willing to sustain current levels of secured funding and/or additional sources of funding.

Given the risks associated with asset encumbrance an effective supervision of asset encumbrance levels and composition would not be realised if asset encumbrance reporting only required carrying amounts, if these are different from market/fair values.

The ITS templates take this into account in that, where reporting of encumbered and unencumbered assets' value is required, for some asset classes, both in terms of carrying amount and fair value. However, in order to limit the burdens related to the calculation of market/fair value, this calculation is required mainly for equity instruments and various debt instruments.

Contingent asset encumbrance

To ensure investors' confidence, the encumbrance associated with a transaction typically increases if (1) the value of assets (collateral) pledged decreases, (2) the rating assigned either to the entity pledging the assets or to the assets themselves deteriorates or (3) depreciation of significant currencies occurs, affecting the value of assets (collateral) pledged for a certain transaction. In addition, as documented in data collected by the ESRB, institutions domiciled in jurisdictions where banking and sovereign stresses were more pronounced tend to report the largest increases in asset encumbrance, and asset encumbrance levels appear to be correlated with the rating assigned to the institution pledging the assets. In other words, asset encumbrance appears to be a response that varies, in magnitude, according to the severity of idiosyncratic and aggregate stress conditions and is characterised by non-linearities, such that higher absolute levels of encumbrance tend to generate higher increases of encumbrance during/after stress events.

For the reasons just described, effective and harmonised supervision and monitoring of asset encumbrance cannot be carried out without the collection of data on the potential evolution of asset encumbrance levels and compositions during pre-established hypothetical scenarios of extreme but plausible stress (i.e. contingent asset encumbrance).

The reporting template on contingent asset encumbrance proposes two different scenarios that attempt to incorporate three different types of extreme but plausible stress that the reporting institution might experience:

- 1) A 30 % decrease in the fair value of encumbered assets is meant to capture the implications, for asset encumbrance, of a more aggravated stress event, such as negative asset price spirals that can trigger during market phases of asset fire-sales and liquidity/funding crises.
- 2) A 10 % depreciation in significant currencies aims at capturing the implications, for asset encumbrance, of disruptions in foreign currency markets which could, for instance, accompany episodes of sovereign stress.

The scenarios above represent choices which are consistent with the scenarios used by the ESRB to assess the distribution of asset encumbrance levels in adverse scenarios. A similar requirement is already included in the liquidity reporting, where the liquidity impact of a three-notch downgrade is

assessed. This may supplement the two scenarios above. More scenarios may, however, be added at a later stage.

In a regulatory framework where establishing a socially optimal level of asset encumbrance does not seem feasible, if national, market and business model specificities have to be taken into account, it appears to be extremely important for supervisors to draw a picture on the evolution of asset encumbrance under harmonised high-stress scenarios.

Additional information on covered bonds issuance

The ITS includes a reporting template for covered bonds programmes that gives additional information on cover pools. Specific monitoring related to covered bonds is deemed necessary in order to ensure an effective and harmonised supervision of asset encumbrance and cover bond issuance. The main reasons are:

- 1) Covered bonds programmes constitute one of the main drivers of assets encumbrance.
- 2) Asset encumbrance in covered bonds programmes is mainly a long-term encumbrance, as opposed to encumbrance generated by repo financing and securities lending, and mainly involves loans assets.
- 3) Asset encumbrance profiles, due to covered bonds programs, are particularly heterogeneous, and consequently difficult to compare, across institutions and Member States, because the extent of overcollateralization varies not only as a function of varying national regulatory minimum requirements but also as a function of rating agencies' requirements and the issuer's strategies in terms of voluntary collateralisation buffers.

4.2 Feedback on the public consultation

The EBA publicly consulted on the draft proposal contained in this paper.

The consultation period lasted for three months and ended on 24 June 2013. Twenty-three responses were received, of which 20 were published on the EBA website.

The feedback statement below presents a summary of the main issues and comments arising from the consultation, the analysis and discussion triggered by these comments and the actions taken to address them if deemed necessary.

In many cases, several industry bodies made similar comments or the same body repeated its comments in the response to different questions. In such cases, the comments and EBA analysis are included in the section of this paper where the EBA considers them most appropriate.

Changes to the final draft ITS have been incorporated as a result of the responses received during the public consultation.

Summary of key issues and the EBA's response

The main points raised by the industry as with regard to these draft ITS are the following.

- (1) There are overlaps and inconsistencies between asset encumbrance reporting and other regulatory reporting requirements.
- (2) Complying with the requirements involves a reporting burden and cost.
- (3) The industry emphasised the need for a later implementation date.
- (4) The industry highlighted that additional guidance should be given on how credit institutions applying local GAAP should report.
- (5) There were concerns related to disclosure on asset encumbrance.

These and the other issues are addressed in detail in the feedback table 'Summary of main issues and responses to the consultation and the EBA's analysis' below.

Summary of main issues and responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Overlap with liquidity reporting	Many respondents see an overlap between asset encumbrance reporting and liquidity reporting	<p>At the moment, following the review of the templates, the EBA sees very limited overlap between the asset encumbrance reporting template and the expected reporting template for liquidity purposes. Furthermore, harmonised EU liquidity reporting regulation and standards are expected to be implemented during 2014 but have not been finalised at this stage. The EBA notes and has taken into account the need for consistency with asset encumbrance and liquidity reporting templates and will continue to review the templates in order to avoid inconsistencies and overlapping in the future when the liquidity regulation is fully implemented.</p> <p>In particular, it should be noted that liquidity reporting covers only encumbered debt securities, whereas asset encumbrance reporting covers all on- and off-balance sheet items</p>	No change
Reporting burden	Most respondents commented on the reporting burden that asset encumbrance templates would imply. The templates are seen as highly complex and granular and would cause high implementation costs. Respondents called for simplification and/or deletion of the templates	<p>In order to reduce the reporting burden to smaller institutions, the EBA has adjusted the threshold in the total asset definition (excluding collateral) and threshold asset encumbrance ratio to 15 % (Article 5.b). Furthermore the reporting template Part D – Covered Bonds Assets Eligible for Covered Pools has been eliminated and some other templates have been</p>	<p>Increase the threshold for reporting purpose in Article 5.</p> <p>Eliminate a template in Part</p>

		streamlined. In addition, some instructions on templates have been revised and some clarifications have been made with respect to comments from the industry in order to reduce the reporting burden. The EBA expects to help further with implementing the reporting template using the EBA Q&A tool	D – Template AE-CB Eligible Assets
Implementation date and reporting frequency	The industry emphasised the need for a later implementation date: 1 January 2015 was suggested by most respondents. In addition, the reporting frequency for some templates was considered too high	Implementation date has been set as the following: for Parts A, B and D (if applicable) on the first reporting date 30 June 2014 in line with COREP reporting, and full reporting on all templates from 31 December 2014. Owing to the continuing monitoring requirements on asset encumbrance following the mandate of the ESRB and majority view of NSAs, the frequency of reporting has not been changed	Change of first reporting date to 30 June 2014
Accounting: local GAAP-IFRS	Since reporting is based on IFRS, some respondents highlighted that additional guidance should be given on how banks applying local GAAP should report	The EBA agrees with the comment and has included in the instructions (Annex II) additional guidance on how institutions should report when applying local GAAP	Guidance in instruction has been included for institutions applying local GAAP
Concerns related to disclosure	Some respondents expressed their concern on how this reporting information would be used and if some information would need to be disclosed	This information is only for reporting purposes and, therefore, confidential. The EBA has also been asked to provide guidance on disclosure of asset encumbrance and it will publish a consultation paper on these guidelines separately	No change

Responses to questions in Consultation Paper EBA/CP/2013/05

<p>Question 1</p>	<p>The approach followed by the EBA on the definition of encumbered asset and on reporting was doubted by some respondents. Alternative definitions were suggested in addition.</p> <p>Some respondents noted that 'freely withdrawn' is not clear and gives room for too many interpretations, even though bulleted examples have been given.</p> <p>Explanations under the instructions were considered unclear regarding repos and reverse repos.</p> <p>Consistency with different legal frameworks was requested, and regarding the bail-in, recovery and resolution frameworks.</p> <p>There were comments that the amount pledged but unused should not be considered as encumbered and should, therefore, be excluded from the ratio.</p> <p>The treatment of assets that are collateralised in pools but not fully used should be reviewed. A waterfall approach that would take into account asset classes and potential haircuts should be used instead of the pro-rata approach proposed by the EBA. Furthermore, the calculation of pro-rata allocation is said not to be clear.</p> <p>Regarding covered bonds, the definition should be altered in a way that it requires both pledging and absence of free withdrawal of assets, rather than one of them, for encumbrance of cover assets to have occurred.</p>	<p>The concept of asset encumbrance is hard to define; several definitions were considered, including a purely legal definition. EBA proposed to use an approach based on the economic substance of asset encumbrance, which is consistent with the Basel framework.</p> <p>The EBA considers that the definition is clear as it is. The further clarifications are provided in the instructions and also in the reporting templates where breakdown per product is required.</p> <p>Instructions have been revised and clarifications have been made with respect to the comments from the industry and a couple of Q&As have been prepared by the EBA to further clarify that (1) reverse repos, (2) assets held in order to comply with the LCR and (3) freely available O/C in cover pools that is not necessary to fulfil regulatory requirements would not be deemed to be encumbered for Parts A, B, C and E.</p> <p>Any future requests for clarification raised by the industry can be submitted via the EBA Q&A tool.</p> <p>The EBA will strive for consistency with liquidity, bail-in, recovery and resolution frameworks once these have been finalised</p>	<p>No change to definition.</p> <p>More guidance in instruction has been provided and several Q&As have been formulated</p>
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Question 2	<p>Several respondents agree with the decision to follow the level of application of COREP; however, others think that the level of application should be that of liquidity reporting because of the links between asset encumbrance reporting and liquidity reporting.</p> <p>The majority of respondents that commented on the scope were in favour of reporting only at consolidated basis, but some others argued in favour of reporting on an individual basis.</p> <p>Some respondents that were in favour of consolidated basis thought that, in the case of the covered bond template, the reporting should be on an individual basis only</p>	<p>The EBA decided to follow the COREP level of application, which means that in principle it is on both a consolidated and an individual basis.</p> <p>The EBA recognises that, for Part D (covered bonds), reporting on a consolidated basis in a majority of cases would replicate the reporting of the individual basis, unless a waiver has been granted on an individual basis, and unless this credit institution issues UCITS-compliant covered bonds</p>	No change
Question 3	<p>The majority of respondents were in favour of a ratio including both on-balance sheet and off-balance sheet items. Some would also favour an on-balance sheet asset-side ratio for simplicity. Respondents were, in general, not in favour of a ratio based on liabilities. Some respondents proposed a ratio of unencumbered assets to unsecured liabilities.</p> <p>Some agreed with the purpose expressed by the EBA, which was to set a materiality threshold. To others, the purpose of the ratio was not so clear and they expressed concerns about its disclosure.</p> <p>There were some doubts on the treatment of certain operations, which were in line with some of the issues expressed on the definition of asset encumbrance</p>	<p>The feedback indicates that the asset encumbrance ratio, which includes on- and off-balance sheet items, as proposed by the EBA, is suitable for most respondents. The text has been made clearer to ensure this is only for proportionality purposes</p>	More guidance in instruction has been provided

Question 4	<p>Responses were in general favourable to the two thresholds set by EBA for proportionality purposes; however, some argued that they should not be cumulative. Some preferred only one threshold based on total assets. Very small entities that do not encumber their assets should be exempted from reporting. It was also commented that more analysis was needed to calibrate the thresholds. Respondents also commented that thresholds should be set at higher levels and that the amounts should be also adjusted to inflation and other developments. The requirement that institutions should not exceed the thresholds at any period over the previous two years was seen as too onerous by some of the respondents.</p> <p>Some respondents said that there should be a specific threshold for covered bonds. Some respondents said that there should be a specific criterion for some specialised institutions</p>	<p>Following the impact assessment and calibration exercise, the thresholds are set at the size of total assets of EUR 30 billion (excluding collateral), and a 15 % asset encumbrance ratio in a certain period of time (past two years).</p> <p>The total size threshold is the same as for the Single Supervisory Mechanism to determine systematically important financial institutions</p>	<p>Increase the threshold for reporting purpose in Article 5.</p> <p>Eliminate Part D – Template AE-CB Eligible Assets</p>
Question 5	<p>Some respondents were of the view that this issue is highly specific by jurisdiction and business model and that this information would not contribute to improving the assessment. Some respondents gave examples of unencumbered assets not available for encumbrance, such as assets where the credit quality is insufficient or valuation is not reliable, claims that cannot be transferred or pledged or permitted only with the consent of the debtor/issuer, or debt securities blocked for minimum reserve purposes.</p> <p>One respondent proposed to include another column for</p>	<p>Following the industry comments, the EBA has decided not to include a template on unencumbered but encumberable assets</p>	<p>No change</p>

	encumberable assets that would include at least assets eligible for operations with CCPs and for cover pools of covered bonds		
Question 6	<p>Most of the respondents were not aware of any additional source of material asset encumbrance. Few highlighted other possible sources such as contribution to default funds of CPs or payment commitments to protection funds or mutual solidarity funds, and leasing in some jurisdictions.</p> <p>One respondent suggested that the template of additional sources of encumbrance follows the same granularity as balance sheets</p>	Following the feedback from the industry, the EBA believes that the template covers most material asset encumbrance sources. Other sources of encumbrance can be reported in line 160	No change
Question 7	<p>Views were split on this respect. Several respondents thought that the criteria applied on liquidity reporting should be used to identify marketability. The central bank eligibility criterion was seen as too narrow. In the case of international banks, additional guidance is needed where there is no possibility to extend the central bank eligibility criterion to other countries where this mechanism does not exist. Some respondents were of the view that the liquidity reporting framework provides more accurate information.</p> <p>Other respondents agreed on central bank eligibility as a marketability criterion, although some of them also saw that it had drawbacks. One respondent believed that central bank eligibility was, at least in the short run, the best criterion and that EBA should continually review this option and consider other alternatives.</p> <p>Few commented on the use of risk-weights as a</p>	EBA has decided to leave central bank eligibility as the criterion, as it believes it adds additional information regarding the quality and liquidity. Once the liquidity regulation and reporting standards are in place in 2015, EBA will review this option	No change

	<p>marketability criterion and their views were split; however, some thought that this criterion would also be appropriate, as the information was already available for them</p>		
Question 8	<p>While some respondents generally support the proposed scenarios, others see an overlap with liquidity regulation and ask for consistency between asset encumbrance and liquidity regulation. Some also see an overlap with recovery and resolution plans and stress tests.</p> <p>Several respondents consider that a 30 % decrease in Fair Value is not realistic, or is too extreme. They also consider that it is not appropriate for loans or other assets that are not marked to market, nor for government bonds or cash. They see a need to differentiate by type of asset.</p> <p>Respondents see an overlap between the scenario of 10 % depreciation in significant foreign currency and some national regulations; some see an overlap with liquidity coverage ratio by currency.</p> <p>Some respondents commented that the scenarios should be the ones already defined for liquidity. Others argue that the CRR has already defined scenarios for the liquidity framework and that the EBA should not introduce new scenarios; they ask EBA to remove this template.</p> <p>Some argue that deterioration in valuation does not automatically trigger encumbrance; rather this depends on the legal environment.</p> <p>On rating downgrades, the views are split: some</p>	<p>The EBA has decided to leave the scenarios as proposed in the CP, as it believes it adds additional value at the moment. Once the liquidity regulation and reporting standards are in place in 2015, the EBA will review this template. Furthermore, the EBA has provided some more guidance on the stress test and reporting.</p> <p>Significant currency is defined in paragraph 2 of Article 415 CRR</p>	<p>More guidance in the instructions has been provided</p>

	<p>respondents think that this scenario should be included whereas others think that it is already included in other parts of the regulation.</p> <p>Significant currency needs to be defined</p>		
Question 9	<p>Comments on instructions in the templates were provided under other questions</p>	<p>The EBA has amended and provided clarifications in the instructions and reporting templates to reflect some of the comments</p>	<p>See above</p>
Question 10	<p>Most of the respondents did not have further comments in this respect other than the ones already expressed in previous questions or in the general comments. However, some of them wanted to reiterate that they saw an overlap with the liquidity reporting framework and the high level of complexity and implementation cost of the reporting</p>	<p>Already answered in previous comments</p>	<p>See above</p>