Deutsche Bank

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Dear Mr. Farkas

Deutsche Bank's response to the European Banking Authority's Discussion Paper on Asset Encumbrance Reporting under article 95a of the draft Capital Requirements Regulation (CRR).

Deutsche Bank (DB) welcomes the opportunity to comment on the EBA's consultation paper on Asset Encumbrance. DB actively contributes to various industry and regulatory initiatives on this topic, including the European Systemic Risk Board's 2011 analysis and assessment, and the Enhanced Disclosure Task Force (EDTF) working group on enhanced liquidity.

General comments
We support the EBA's proposal to establish a harmonised methodology to report asset encumbrance so that supervisors get a consistent view across institutions. Common reporting of current levels of asset encumbrance is a helpful tool. This reporting will provide enhanced information to supervisors about the safety and soundness of financial institutions.

In DB's opinion, there are many similarities between the proposals in the consultation paper on encumbered assets and industry disclosure initiatives led by the EDTF. While we recognize that disclosure and supervisory reporting will by their nature require different levels of granularity, we believe that there should be alignment with the EDTF's approach as far as possible to ensure supervisors, investors and creditors have access to similar data, and reduce the operational burden on banks of implementing multiple systems changes.

There are several areas in the EBA's proposal where we believe that we can offer constructive suggestions for enhancing the consultation's provisions. These include:1) the scope of the proposed provisions in comparison to the Level 1 legislative intent; 2) the level of overlap between the proposed and pre-existing requirements; 3) the value of examining the role of asset encumbrance in isolation; and 4) the timeline for implementation.

In summary, we believe that certain provisions in the consultation would result in unnecessarily assessing a risk in isolation that is appropriately covered through existing instruments.

Legislative intent in CRR: On page 6 of the Consultation Paper, the EBA says that "not only the levels of actual encumbrance were considered of importance, but also the risk of additional encumbrance was deemed important." However, Article 95 of the CRR as amended in the legislative process requires banks to report their levels of encumbrance. It does not allude to either contingent encumbrance or the proposed detailed breakdown of balance sheet items. We feel that the EBA has interpreted the legal mandate set out in Article 95 more broadly than the co-legislators had intended. While the additional items would be interesting from a macroprudential perspective, they are duplicative with other areas of regulation as set out below and would be extremely difficult to operationalise for banks with large balance sheets.

Duplication: DB is of the opinion that the consultation proposes some unnecessary, burdensome and duplicative provisions which could be avoided by taking into consideration pre-existing measures. For example the stress testing element is already captured by a combination of the Liquidity Coverage Ratio (LCR), internal stress testing methodology (which will be reported both under the EDTF proposals and likely under the liquidity disclosures that will be proposed by the BCBS later this year), and the Recovery Plan. All of these measures individually and collectively test liquidity counter-measures, including encumbrance levels, in specific and detailed severe stress scenarios. Moreover, the International Financial Reporting Standards 7 (IFRS 7) currently captures the required subordination information sought by the EBA.

DB would urge the EBA to avoid a scope of reporting on encumbrance which will require banks to put expensive and duplicative systems in place to generate data that is already available.

The role of asset encumbrance: DB believes that reporting asset encumbrance should be limited solely to the actual ratio, and not stipulate any type of stress effects, nor include an assessment of available assets in a resolution scenario. The benefit of measuring asset encumbrance in isolation, using a stressed scenario is not clear. Rather, this measurement is one part of a far wider set of metrics. Ignoring the other metrics results in an inaccurate reflection of how a stressed liquidity scenario would impact a bank, or how a bank would respond in such a situation. The LCR takes into account the liquidity outflows which include asset encumbrance related effects, such as additional margin requirements, while also demonstrating the degree to which assets could potentially be encumbered. It is important to remember that buffer assets can either be sold or used in refinancing arrangements such as repos to monetize required liquidity. The LCR simulates these effects, as well as many other effects in one ratio. Therefore DB believes this holistic approach to be a much more meaningful view of how additional asset encumbrance could potentially impact the bank.

Through the monitoring tools that will be implemented in addition to the LCR, there is an existing requirement to identify assets that could potentially be used and/or encumbered, outside of those allowed in the LCR buffer. In our view, this additional monitoring tool should provide a view on all the remaining assets that could potentially highlight asset encumbrance levels. As a firm we would aim to make use of these assets prior to resolution as we believe this measure to be part of a recovery scenario rather than a resolution scenario.

DB is concerned that disclosure of potential future asset encumbrance levels risks confusing or misleading investors.Such disclosures introduce a high degree of subjectivity and are highly dependent on the timeframe and underlying assumptions used. Investors may mistenely feel that they are not suitable metrics for comparing across institutions, which is not the case.

DB understands that asset encumbrance will also be captured in the monitoring tools proposal. We would appreciate greater clarity on how these proposals will fit together.

Timing: Finally, DB believes that aligning the timing of the new reporting requirements with the implementation of COREP/FINREP by 1 January 2014 is exceptionally ambitious. Given prior comments regarding the scope of the current proposal and the enormous complexity of stress simulations it would be very difficult to accommodate these requirements in the specified time frame.

The following responses to the consultation questions provide technical comments and further identify areas where DB believes that the approach presented in the consultation is disproportionately burdensome.

We would welcome the opportunity to discuss further any of the points in our response.

Yours sincerely,

Andrew Procter
Global Head of Compliance, Government and
Regulatory Affairs

Responses to consultation questions

Q1 – Is the definition of asset encumbrance sufficiently clear?

DB believes that the definition is sufficiently clear, but that the treatment of reverse repos and stock borrows needs further consideration.

The act of reversing in collateral (where full rehypothecation rights are held) does not encumber that collateral, and indeed for Liquidity Risk Management purposes, including LCR reporting, such collateral would in the first instance explicitly be treated as unencumbered. Subsequent use of that collateral may separately cause it to become encumbered, but the original reverse repo does not give rise to encumbrance. This view is consistent with the accounting interpretation under IFRS whereby collateral received under a reverse repo is not considered to be an on balance sheet position when disclosing what elements of the balance sheet are encumbered. This is supported in the additional disclosure table required by the Enhanced Disclosure Task Force (EDTF) which analyses the balance sheet between unencumbered and encumbered.

We therefore believe the starting balance sheet for considering the level of asset encumbrance should exclude reverse repos.

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?

DB believes this requirement to be solely of relevance at the consolidated level of an institution. Decisions taken by creditors and depositors are typically based on the 'Group' view, such as capital ratios, and this approach would significantly reduce the complexity of considering the treatment of intra-group commitments. Implementing the proposed approach on a 'solo' basis would pose significant technical reporting challenges which believe outweigh the overall benefits.

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?

DB has doubts about the utility of an asset encumbrance ratio. Whilst we agree that a common form of encumbrance reporting is a reasonable expectation, it should not then be translated into published ratios. A ratio is a blunt instrument that can easily be misinterpreted and used for inappropriate comparison purposes. For example, one cannot judge whether a bank with 6% CET1 ratio and 5% encumbrance ratio or a bank with 15% CET1 ratio and 25% encumbrance ratio, is safer.

Importantly, any calibration is highly dependent on the treatment of matched book repo/reverse repo activity. A firm with significant matched book activity would have a higher ratio, yet this activity (subject to certain conditions), poses a neutral liquidity risk. Consequently this has no detrimental impact on unsecured creditors; therefore matched book repos/reverses should be excluded from any threshold ratio calculations.

Q4 – Do you agree with the thresholds of respectively €30bn 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?

We find the EBA's initial proposal to apply a EUR 30bn threshold or material asset encumbrance as defined as 5% of on- and off-balance sheet encumbrance worthy of further exploration.

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 issue pertaining to marketability and potential future encumbrance is in our opinion too speculative to determine. To get an accurate view one would need to examine all the available tools and their interaction in a stress situation. In addition, we believe that much of what the EBA would want to capture is already appropriately covered by the previously mentioned framework under the LCR, internal stress testing methodology and the Recovery Plan.

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?

From a cost/benefit analysis point of view, DB does not believe that the added value of the advanced templates outweighs the cost. As mentioned in our response to Question 5, the issue of marketability and potential future encumbrance is too narrow a view to provide accurate information about how these tools would be used on a day-to-day basis. Banks are currently faced with a high burden of reporting changes which require intensive infrastructural work. The level of resources needed to implement the full suite of reporting and disclosure requirements should not be underestimated. It is therefore essential that duplicative requirements be avoided where data is already available in other reports.

Q7 – Do you believe the central bank repo eligibility criteria is an appropriate marketability criteria or should another criteria, such as risk weights, be used? If other criteria should be used, what could be the alternative?

DB does not believe that the added value of the advanced templates outweighs the cost. As mentioned in our responses to Questions 5 and 6, the issue concerning marketability and potential future encumbrance is too narrow and is appropriately covered by LCR framework and other tools.

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

We would be interested in understanding the basis for the 30% decrease in the fair value of encumbered assets. It appears that this assumption, and many of the other suggested assumptions for the 'stress simulations,' are even more extreme than most of the current LCR volatility assumptions. Applying 30% to the entire government bond refinancing market seems inappropriate. We suggest that the preferred approach should focus on ratings-based triggers that require additional collateral to be posted and would reiterate that banks have already carried out that type of stress simulation in their Recovery Plans.

Additional questions in Annex II

Q9 – Does the instructions provide a clear description of the reporting framework? If not, which parts should be clarified?

We have the following issues for which we would appreciate further clarification on the following:

1. In the table under 2.1.3 of Annex II, Pos. 20, 30: An overlap is likely as some positions can be issued by other group entities as well as be Central Bank eligible. We would appreciate confirmation that the overlap should be avoided in reporting 'of which'-positions and clarity on where to report amounts captured by two or more sub-positions.

2. Are the 'Of which issued by other group entities' positions applicable for Legal Entity level reporting only or also for group level calculations?

3. Covered bonds and the ABS template: Further clarity would be appreciated here, for example should this template report those issuances which are unencumbered and also available for encumbrance?

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

We have identified the following overlaps:

1. Basel 3 LCR buffer reporting (for example, unencumbered, available liquidity assets per definition are already disclosed as part of the buffer provisions).

2. Basel 3 monitoring tool covering available unencumbered assets.

3. EDTF recommendation to disclose asset encumbrance information (for example, by product and encumbered / unencumbered, unavailable for liquidity / unencumbered, and available for liquidity).

4. Contingent asset encumbrance as shown in the LCR components including downgrade triggers, and market valuation changes for collateral.