



20 March 2014

Our ref: ICAEW Rep 44/14

Your ref: EBA/CP/2013/48

EBA
Tower 42 (level 18)
25 Old Broad Street
London
EC2N 1HQ

Dear Sirs

Consultation Paper on draft guidelines on disclosure of encumbered and unencumbered assets

ICAEW is pleased to respond to your request for comments on your *draft guidelines on disclosure of encumbered and unencumbered assets*.

The matters considered in this consultation including disclosure of central bank support by financial institutions continue to be considered closely by ICAEW and we seek to promote an informed and useful debate on at the highest levels.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

CONSULTATION PAPER ON DRAFT GUIDELINES ON DISCLOSURE OF ENCUMBERED AND UNENCUMBERED ASSETS

**Memorandum of comment submitted in March 2014 by ICAEW, in response to
European Banking Authority (EBA) Consultation Paper on draft guidelines on
disclosure of encumbered and unencumbered assets published in December 2013**

Contents	Paragraph
Introduction	1
Who we are	2 – 4
Major points	5 – 10
Responses to specific questions	11 - 24

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the *Consultation Paper on draft guidelines on disclosure of encumbered and unencumbered assets* published by the EBA on 20 December 2013, a copy of which is available from this link.
[http://www.eba.europa.eu/documents/10180/534767/EBA-CP-2013-48+\(Disclosure+of+asset+encumbrance\).pdf](http://www.eba.europa.eu/documents/10180/534767/EBA-CP-2013-48+(Disclosure+of+asset+encumbrance).pdf)

WHO WE ARE

2. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services and provides a monthly magazine FS Focus.

MAJOR POINTS

5. Information on encumbered and unencumbered assets is important to understand the financial position of banks. In its 2012 report the Enhanced Disclosure Task Force (EDTF) stated that the objective of this disclosure is “to differentiate assets which were used to support funding or collateral needs at the balance sheet date from those assets which were available for potential funding needs.”¹ This is particularly important for banks due to maturity mismatch and high gearing, which mean banks rely on the confidence of depositors.
6. Whilst this information is highly relevant and useful to the market, increasing the amount of information disclosed can lead to identification of troubled institutions which can then create a systemic risk, as was seen during the 2008 financial crisis. This creates a difficult to reconcile tension between transparency of disclosure and financial stability, but we are of the view that if there is a problem of this nature, the solution is not non-disclosure.
7. We agree that banks can improve the quality of their disclosures which in turn provides the market with better information. We acknowledge that the tensions between transparency and financial stability are particularly problematic for banks and that good disclosure should aim to meet these competing needs.
8. We have serious concerns that elements of the EBA’s proposed disclosure rules will create an unresolvable tension for directors between applying the guidelines and executing their duties

¹ *Enhancing the Risk Disclosures of Banks* http://www.financialstabilityboard.org/publications/r_121029.pdf

as directors under the Companies Act 2006² in the UK, generally accepted accounting principles, the Financial Conduct Authority's Transparency and Disclosure Rules³, the disclosure guidelines in the 2012 EDTF report and existing and future European Union legislation⁴. It must also be borne in mind that once information is disclosed to the market, it is difficult to cease disclosing that information going forward.

9. We feel that the EBA should recast their proposed guidelines to achieve consistency with European legislation and to avoid directors of financial institutions being required to break existing laws and rules to meet the requirements of the proposed guidelines.
10. Disclosure of central bank support by financial institutions is a matter which ICAEW continue to consider closely and seek to promote an informed and useful debate on at the highest levels. We are continuing to engage with the Prudential Regulation Authority, banks and the accounting and legal profession in this area. ICAEW supports transparent reporting which is fair, balanced and understandable and believes that material information should be disclosed.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Should the disclosure information on encumbered and unencumbered assets, in particular on debt securities, be more granular and include information on, for example, sovereigns and covered bonds? Please explain how sensitive the disclosure of this information is.

11. We do not think that more granular disclosure is required. It would be benefit for the proposed disclosures to align with the existing EDTF recommendations which will give banks the ability to tailor the disclosure to fit it to their risk and asset profile. Generally, we understand that there is some inconsistency in how encumbrance is defined, and should additional disclosure be required or encouraged going forward, a harmonised definition of encumbrance should be pursued.

Q2: Should the disclosure information on encumbered and unencumbered assets also include information on the quality of these assets? What would be a suitable indicator of asset quality? Please explain how sensitive the disclosure of this information is.

12. There are a variety of ways to derive a conclusion about asset quality including consideration of the credit quality of the borrower and how quickly the asset could be realised in the market (for example, is it is level 1 mark to market asset). Increasing the availability of information about asset quality would increase the sensitivity of the disclosure, for example is it was disclosed that low quality assets were becoming encumbered the market may draw negative conclusions about the position of the bank. As currently proposed the disclosure do not indicate asset quality, so we do not consider them to be sensitive in this way, but also limited in their usefulness.

Q3: Do you think that the disclosure required in Template A could lead to detection of the level and evolution of assets of an institution encumbered with a central bank, given that the information should be disclosed based on median values (see paragraph 7 of Title II) and the lag for disclosure is 6 months (see paragraph 10 of Title II)?

13. We do not believe counter party information could be detected from the information disclosed in Template A as currently set out, and therefore do not believe this to be a risk.

²The Companies Act 2006 section 393 requires accounts to give a true and fair view of the company's assets, liabilities; financial position and profit or loss and the auditor of the company must have regard to the directors' duty in carrying out his functions.

³ DTR 2.2 Disclosure of inside information and DTR 2.5 Delaying disclosure of inside information

⁴ The Market Abuse Directive and the Market Abuse Regulation permit, but do not require non-disclosure of emergency liquidity assistance.

14. Disclosure of median values with a time lag will make it harder to detect the level and evolution of assets encumbered with a central bank, however we would question the value of median information and the relevance of information following a six month disclosure lag, please see Q7 and Q9 below. There would be other mechanisms available to the market which would indicate liquidity issues which the median disclosure seeks to avoid, for example interest rates.

Q4: Should the disclosure of information relating to the ‘nominal amount of collateral received or own debt issued not available for encumbrance’ on unencumbered collateral be requested? Please explain the relevance of this information for market participants and the sensitivity of the disclosure of this information.

15. We do not believe nominal values provide relevant information in the absence of information about credit quality and therefore do not feel this disclosure would necessarily be cost beneficial.

16. It would be useful to the market to understand the amount of own debt issued and packaged to act as collateral, as this would give meaningful information to the market about assets which could be encumbered to a high quality counter party as securitised own debt would be more transferrable than the loans as originated. However, such disclosure may be more beneficial from a liquidity point of view and located elsewhere.

Q5: Do you agree with the proposed granularity of Template B given that collateral swaps with central banks will not be disclosed? Please explain how sensitive the disclosure of this information is.

17. We believe the disclosure proposed in Template B is of sufficiently high level so as not to be sensitive in this way.

Q6: Do you think that the information on the sources of encumbrance in Template C is too sensitive to be disclosed? Should this information be disclosed in Template D instead (as narrative information)? Please explain the relevance of this information for market participants and the sensitivity of the disclosure of this information.

18. We do not believe that the information in Template C would be too sensitive, given the high level of disclosure. However, it is important to understand the sources of collateral, which would not currently be shown. Further disclosing assets encumbered to central banks would be useful to the market, and may not be as sensitive as feared, given that this takes place in the normal course of business, and is only likely to have a negative signalling effect in a stressed situation. In such a situation the information would be material and therefore should be disclosed.

Q7: Should the information be disclosed as a point in time (e.g. as of 31 December 2014) instead of median values? Please explain why.

19. We do not feel that median data would be useful to the market. It would also likely be more burdensome to produce, with associated costs not explicitly considered in the costs and benefits section of this consultation.

20. Much other information would be needed to add meaningful context to a median value, including information over the period under consideration and at a point in time. Disclosure of the range of information (as with market risk disclosures) would also encourage closer management of levels of encumbrance. Median disclosure would also ignore the effect of stressed situations on the bank’s encumbrance position, which is what is relevant to the market. Given the additional information needed to make a median number meaningful, we feel that the prima facie goal of disclosing a median (promotion of stability but also new information) would be negated. Depending on the nature of the narrative disclosure, this could contradict the median position disclosed.

21. It may also be possible for entities to manipulate the median figure disclosed depending on the number of data points used in reaching the median. Paragraph 7 states that 'at least' quarterly data of the reporting year should be used, but if monthly data was used for example, the median position could be quite different. Trend information would be more useful, but we note that this would be too costly to produce on a daily basis, so quarter end information as proposed to make up the median disclosure may be more appropriate.

Q8: Do you agree with the proposed list of disclosures under narrative information in Template D? Should the guidelines explicitly state that emergency liquidity assistance by central banks (ELA) should not be disclosed?

22. Any narrative disclosure should be fair, balanced and understandable. We do not agree that the guidelines should explicitly state that emergency liquidity assistance by central banks should not be disclosed as it is material information for the market. As discussed in 'Major Points' above, prohibiting disclosure contravenes law, regulation and accepted practice for reporting this sort of information.

23. Prohibition of disclosure that an institution is in receipt of ELA may exacerbate the feeling of banks that it is beneficial to disclose that they are not in receipt of ELA depending on if ELA is made available system wide, or only to a specific institution. If market wide, we do not foresee that this would be a problem, but if it was institution specific there will likely be market speculation which would lead institutions to wanting to disclose that they are not in receipt of support. It would be exceedingly difficult for regulators to make it so that banks cannot disclose this information and the EBA would have no power in this regard (unless an emergency situation). This is an existing concern in the UK and it is not thought that the EBA's guidance as currently written would facilitate a sensible solution to this.

Q9: Do you agree that the disclosures should be published no later than six months after the publication of the financial statements? Do you consider a time lag of no more than six months sufficient to ensure that the information disclosed will not adversely impact the financial stability of markets and institutions?

24. Any delay in publication decreases relevance of the information to the market. Delayed publication in conjunction with the points raised above regarding the value of median disclosures will raise questions about the cost benefit of producing and disclosing the information.

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