



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP18/14

CRD IV: compliance with the European Banking Authority's Guidelines on disclosure of encumbered and unencumbered assets

September 2014

Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

Prudential Regulation Authority, registered office: 8 Lothbury, London EC2R 7HH.
Registered in England and Wales No: 07854923



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP18/14

CRD IV: compliance with the European Banking Authority's Guidelines on disclosure of encumbered and unencumbered assets

September 2014

The Bank of England and the Prudential Regulation Authority (PRA) reserve the right to publish any information which it may receive as part of this consultation.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure, in accordance with access to information regimes under the Freedom of Information Act 2000 or the Data Protection Act 1998 or otherwise as required by law or in discharge of our statutory functions.

Please indicate if you regard all, or some of, the information you provide is confidential. If the Bank of England or the PRA receives a request for disclosure of this information, the Bank of England or the PRA will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England and the PRA.

Please address any comments or enquiries by email to:

CP18_14@bankofengland.co.uk by Monday 24 November 2014.

1 Introduction

1.1 This consultation paper (CP) seeks views on the Prudential Regulation Authority's (PRA's) draft supervisory statement on the European Banking Authority's (EBA's) Guidelines on disclosure of encumbered and unencumbered assets⁽¹⁾ (the EBA Guidelines).

1.2 The draft supervisory statement sets out the PRA's expectations relating to firms' compliance with the EBA Guidelines. The statement is not intended as guidance on meeting disclosure obligations other than the EBA Guidelines.

1.3 The CP is relevant to firms to which CRD IV⁽²⁾ applies.

Purpose of the supervisory statement

1.4 The purpose of the draft supervisory statement is to help the PRA meet its primary objective of promoting the safety and soundness of firms. The ability of central banks to undertake liquidity assistance effectively, including the orderly disclosure of that assistance, is regarded as critical to financial stability. In recognition of this, Title II paragraph 4 of the EBA Guidelines allows competent authorities to waive the requirement to disclose template B.

1.5 To meet its primary objective, the PRA is seeking to reduce the risk that firms' compliance with the EBA Guidelines could enable the use or non-use of liquidity assistance to be deduced. The draft supervisory statement sets out the PRA's waiver permitted under the EBA Guidelines. Firms do not need to apply for the waiver.

1.6 The draft supervisory statement also sets out the PRA's expectations as to the:

- factors to be considered in determining the appropriate level of disclosure provided in complying with the EBA Guidelines;
- basis of calculation to be applied where the EBA Guidelines require median values to be disclosed; and
- frequency with which firms publish disclosures prepared to comply with the EBA Guidelines.

Statutory obligations

1.7 In discharging its general function of determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as is reasonably possible, act in a way that advances its general objective to promote the safety and soundness of the firms it regulates. It must also promote its secondary competition objective. The PRA considers that the policy proposals in the draft supervisory statement advance its general objective. The impact of the policy proposals on the secondary objective has

been considered in developing the proposals, and is discussed in the cost benefit analysis section below.

1.8 The PRA has considered matters to which it is required to have regard, and it considers that the draft supervisory statement is compatible with the Regulatory Principles in section 3B of the Financial Services and Markets Act 2000 and relevant provisions of the Legislative and Regulatory Reform Act 2006. It has considered equality and diversity issues and has not identified any equality or diversity implications arising from the draft supervisory statement. The proposals in this CP should not affect mutuals any differently to other affected firms.

Cost benefit analysis

1.9 The PRA supports greater public transparency of risk and regulatory information. However, to promote its safety and soundness objective, a trade-off needs to be achieved between greater public transparency of firms' funding sources and ensuring that the Bank of England is able to provide effective liquidity assistance.

1.10 Providing the disclosures set out in the EBA Guidelines ought to enable market participants to make better assessments about the funding practices of firms. It ought, too, to facilitate peer group comparison. As a result, firms' transparency will be increased. That may in turn increase the effectiveness of market discipline and support the PRA's safety and soundness objective and financial stability. On the other hand, disclosures enabling market participants to deduce the use of Bank of England liquidity assistance may make that assistance less effective and harm the economy by undermining confidence. This is particularly the case if published information frustrates liquidity assistance being disclosed in an orderly way. These consequences could threaten the PRA's safety and soundness objective and be a cause of financial instability.

1.11 To reduce this risk, the PRA proposes to grant a limited waiver from the obligation to disclose template B in the EBA Guidelines. The waiver will apply to firms meeting at least one of three criteria.

Meeting the criteria for waiver of template B

1.12 Firms' use of the proposed waiver will not create additional costs. However, it could reduce firms' transparency, compared to a situation where all banks disclose template B. In developing the proposed waiver criteria, the PRA has sought to recognise that the risks posed by disclosure in template B are greater for some firms than for others, due to differences

(1) The EBA Guidelines (published on 27 June 2014) are available at www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/guidelines-on-disclosure-of-encumbered-and-unencumbered-assets.

(2) The Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR) — jointly, 'CRD IV'.

in firms' business models. The PRA considers that a differentiated treatment is justified in this instance, given the potential adverse impact on its safety and soundness objective, and on financial stability, that disclosures enabling the use or non-use of liquidity assistance to be deduced can have. The PRA does not expect any material adverse effects on competition from this differentiated treatment.

1.13 For firms to determine whether they meet the waiver criteria, they may need to make a number of calculations. For most firms, the calculations can be performed using existing regulatory data. The incremental cost of making this determination should therefore be low. A small minority of large firms may need to base their calculations on monthly data, whereas they collate regulatory reporting data quarterly. However, as the draft supervisory statement envisages firms would use data which are readily available, the PRA considers that the incremental costs these calculations entail will also be low.

Calculating median values

1.14 The draft supervisory statement explains that the PRA expects the median values used in complying with the EBA Guidelines to be based on monthly data, calculated on a rolling basis over the previous twelve months. This calculation applies to all numerical disclosures required under the EBA Guidelines, including the first disclosure. The PRA considers the proposed use of monthly — rather than, say, quarterly — data will further help to reduce the risk that compliance with the EBA Guidelines could enable the use or non-use of liquidity assistance to be deduced, thereby frustrating liquidity assistance being disclosed in an orderly way.

1.15 To estimate incremental compliance costs involved in calculating median values, the PRA used information from a survey of firms asked to estimate the effort and cost of:

- collecting the data and publishing template B; and
- preparing for, compiling data and reporting information according to the CRD IV reporting requirements.⁽¹⁾

1.16 The PRA has extrapolated the above costs to the entire set of affected firms (approximately 2,200 institutions) and across firm types and sizes. It has estimated total ongoing costs of up to £50 million and a one-off cost of up to £4 million for using monthly rather than quarterly data. The PRA considers those figures likely to be over-estimates because they do not take into account that firms will probably not use monthly data where the volatility in the level of encumbered assets month to month is not significant.

1.17 For the first disclosure of the information required by the EBA Guidelines, firms may need to construct historic data on asset encumbrance by retrospectively applying the methodology for regulatory reporting in accordance with CRR Article 100. This will involve additional costs which the PRA estimates to be between £25 million and £50 million.

1.18 Overall, the PRA considers the estimated costs to implement the draft supervisory statement to be proportionate to — and outweighed by — the benefit of reducing the risk to its safety and soundness objective, and to financial stability, posed by the use of liquidity assistance provided by the Bank of England being disclosed in a way that is not orderly.

Responses and next steps

1.19 Please address any comments or enquiries to CP18_14@bankofengland.co.uk by Monday 24 November 2014. The PRA will publish a supervisory statement with a finalised threshold before 31 December 2014.

(1) Costs are from a survey of firms in 2012.

Draft supervisory statement — CRD IV: compliance with the European Banking Authority's Guidelines on disclosure of encumbered and unencumbered assets

1 Introduction

1.1. This supervisory statement sets out a waiver from the requirement to disclose template B of the European Banking Authority's (EBA's) Guidelines on disclosure of encumbered and unencumbered assets⁽¹⁾ (the EBA Guidelines). It also sets out the PRA's expectations in respect of certain aspects of firms' compliance with the EBA Guidelines. This supervisory statement is not intended to provide guidance on meeting disclosure obligations other than the EBA Guidelines.

1.2. The purpose of the supervisory statement is to help the PRA meet its primary objective of promoting the safety and soundness of firms. The ability of central banks to undertake liquidity assistance effectively, including the orderly disclosure of that assistance, is regarded as critical to financial stability. In recognition of this, the EBA Guidelines allow competent authorities to waive the requirement to disclose template B. This supervisory statement seeks to reduce the risk that firms' compliance with the EBA Guidelines could enable the use or non-use of liquidity assistance to be deduced.

1.3. This supervisory statement is relevant to firms to which CRD IV applies.⁽²⁾

2 Waiver of disclosure of template B of the EBA Guidelines

2.1 Title II paragraph 4 of the EBA Guidelines allows competent authorities to waive the requirement to disclose template B if disclosure of this template 'would allow, now or in the future, for the detection of liquidity assistance provided by central banks via collateral swaps'.

2.2. The PRA considers that such disclosure would have that result for some firms. The PRA therefore waives the requirement to disclose template B of the EBA Guidelines for firms that meet at least one of the following criteria at the reporting reference date:

- (a) Both conditions laid down in Article 94(1) of the Capital Requirements Regulation (CRR) relating to the size of on and off balance sheet trading book business are met.
- (b) The fair value of collateral received by the firm in the form of debt securities (including both encumbered and unencumbered amounts), as reported by the firm in accordance with CRR Article 100,⁽³⁾ has not exceeded

£100 billion for any single reporting reference date under CRR Article 100 in the twelve months preceding the reporting reference date under the EBA Guidelines. If the firm has yet to submit a report under CRR Article 100 at the first reporting reference date for the EBA Guidelines, then the amount as at the first reporting reference date under CRR Article 100 should be used instead.

- (c) The arithmetic mean of the fair value of collateral received by the firm in the form of debt securities (including encumbered and unencumbered amounts), calculated using monthly data on a rolling basis over the twelve months immediately preceding the reporting reference date, is less than £100 billion. The monthly data used should be calculated in a manner that is consistent with the data reported in accordance with CRR Article 100. For the purpose of calculating monthly data, firms are expected to use data that are readily available. It is acceptable to interpolate between quarterly data reported in accordance with CRR Article 100 — or other sources — when there is no reason to believe that it would not result in reasonable approximations of the monthly data. For the first calculation, firms may use available data for a one-year period to estimate the arithmetic mean.

2.3. If a firm is satisfied it meets one of the above criteria at the EBA Guideline reporting reference date, no further assessment against the other criteria is needed. Firms do not need to apply for the waiver.

3 PRA expectations regarding the use of discretion available to firms in complying with the EBA Guidelines

3.1 In the context of complying with the EBA Guidelines, firms have various discretions, including determining the appropriate level of disclosure, the basis of calculation for median values and the frequency of disclosure. The PRA expects firms to exercise the discretions they have in a manner that is consistent with the PRA's primary objective of promoting the safety and soundness of firms. Firms would do this by reducing the risk that information disclosed about encumbered and unencumbered assets, for the purpose of complying with the EBA Guidelines, could enable market participants to deduce the use or non-use of liquidity assistance provided by the Bank of England.

(1) The EBA Guidelines (published on 27 June 2014) are available at www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/guidelines-on-disclosure-of-encumbered-and-unencumbered-assets.

(2) The Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR) — jointly, 'CRD IV'.

(3) This is the information reported under the EBA's *Implementing Technical Standards on Supervisory Reporting Annex XVI Template F 32.02*, available at www.eba.europa.eu/regulation-and-policy/supervisory-reporting/draft-implementing-technical-standard-on-supervisory-reporting-asset-encumbrance-.

Determining the appropriate level of disclosure

3.2 In determining the appropriate level of disclosure for the purpose of complying with the EBA Guidelines, the PRA expects firms to consider the principles underlying the following:

- The European Systemic Risk Board (ESRB) Recommendation ESRB/2012/2 of 20 December 2012⁽¹⁾ 'to ensure that the level and evolution of assets encumbered to central banks, as well as the amount of liquidity assistance given by central banks, cannot be detected'.
- The Bank of England has noted that 'in relation to liquidity support operations, considerations of policy effectiveness and transparency have the potential to conflict with each other. But even here the conflict can be reconciled through time: for any given instance of liquidity support, the financial stability benefit of keeping that assistance covert is only temporary. With a sufficient lag, disclosure that a firm had received temporary liquidity support from the Bank should not undermine confidence in that firm or the financial system as a whole. This also explains why the Bank publishes data on the use of its Discount Window Facility (DWF) with a five-quarter lag'.⁽²⁾
- The Bank of England has highlighted in its *Sterling Monetary Framework Annual Report 2013–14* that 'The Bank sought to reduce the financial stability risks posed by premature disclosure of DWF drawings by extending its own disclosure lag and ensuring that firms have the capacity to turn over their liquid assets in repo markets regularly. The Bank continues to argue the case for ensuring that new national and international liquidity disclosure regimes do not increase that risk through other channels'.⁽³⁾

Basis of calculation for median values

3.3 The EBA Guidelines require the quantitative information to be disclosed to be based on median values of at least quarterly data. As the EBA Guidelines explain, this is 'to provide users with information on longer-term structural levels of encumbrance' whilst at the same time 'recognising the need for central banks to retain the ability to undertake covert liquidity support operations to ensure there is financial stability'.

3.4 To ensure these objectives are met as fully as possible, the PRA expects firms to use median values of monthly data on a rolling basis over the previous twelve months for all numerical disclosures, including for the first disclosure, provided to comply with the EBA Guidelines.

3.5 There is one exception to the PRA's expectation. The PRA accepts that volatility in the level of encumbered assets month to month will not be significant for all firms. Where volatility is not significant, the use of monthly data is unlikely to result in materially different information compared to using quarterly data. This may be the case for firms that, for example, enter infrequently into secured financing transactions, or collateral agreements for relatively small amounts. The PRA does not expect firms in this situation to use monthly data to comply with the EBA Guidelines.

3.6 CRR Article 432 permits firms to omit disclosure of certain information that is not regarded as material. The PRA expects firms to apply the concept of materiality to the EBA Guidelines as they would to other disclosures made in accordance with Part Eight of the CRR.

Frequency of disclosure

3.7 The PRA expects disclosures prepared to comply with the EBA Guidelines to be published no more frequently than annually.

4 Future revisions

4.1 Revisions may be made to this supervisory statement in response to the binding technical standards on disclosure of unencumbered assets that the EBA is expected to develop by 2016, and in light of data gathered under the regulatory reporting of asset encumbrance.

(1) ESRB Recommendation ESRB/2012/2 is available at www.esrb.europa.eu/pub/pdf/recommendations/2012/ESRB_2012_2.en.pdf.
(2) *Bank of England Quarterly Bulletin*, Vol. 54, No. 3, 'Changes to the Bank's weekly reporting regime', available at www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q309.pdf.
(3) *Bank of England Quarterly Bulletin*, Vol. 54, No. 2 'Sterling Monetary Framework Annual Report 2013–14', available at www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q210.pdf.