

20 March 2014

European Banking Authority (EBA)

Dear Sirs

**Consultation Paper 2013-48: Draft guidelines on disclosure of encumbered and unencumbered assets**

The Investment Management Association (IMA) is the trade body for the UK asset management industry, representing around EUR5 trillion of assets under management. Its member firms include managers of a wide range of asset classes for a wide range of clients, including institutional funds, authorised unit trusts and open ended investment companies. Our surveys lead us to believe our members manage from the UK over one-third of Europe's assets under management.

We welcome the opportunity to comment on the latest consultation.

Our engagement with banks and broker/dealers are multiple: investor shareholders, lenders (by way of buying their bonds), wholesale depositors and users of their services (detailed in Annex 2).

Therefore, we are particularly concerned by asset encumbrance: whether as regards transparency for investors or, in a resolution itself, what "free" assets may be available to claimants. In addition, risk managers at our members regularly review their counterparty risk and will need such information to mitigate the risk.

**Key messages**

We support the efforts of the authorities, at all levels, to promote transparency and, with regard to cross-border financial institutions, to align their approaches.

The main focus of the authorities and politicians has been on deposit takers and credit institutions, but it should not be forgotten that these banks serve the firms that manage savings, investments and pensions, much of it money from retail investors.

Payment, clearing and settlement services are provided by banks to their clients. Some services may be provided by a non-bank entity, e.g. broker-dealers.

Moreover, in managing assets for both retail and institutional investors, IMA members are major investors in companies, including credit institutions, whose securities are traded on regulated markets. As such, they value the transparency of those companies to the markets in that it is important for market confidence that investors can rely on the information reported.

We thus welcome the EBA creating guidelines in accordance with Article 443 of the Capital Requirements Regulation (CRR) (575/2013) on unencumbered assets and seeking to introduce a harmonised disclosure framework for asset encumbrance throughout the EU. Nor are these disclosures specified elsewhere. IFRS 7 requires some types of asset encumbrance to be disclosed such as reverse repos and securities lending, but does not have a comprehensive view on asset encumbrance. Moreover, the EDTF recommends summarising encumbered and unencumbered assets in a tabular form by balance sheet category but is not mandatory.

Thus in requiring a credit institution to provide narrative information in relation to the value placed upon encumbrance within its funding models, the draft guidelines should facilitate market participants comparing credit institutions and analysing their respective liquidity and solvency profiles.

That said, we have a concern that the guidelines have been drafted such that emergency liquidity assistance provided by central banks would be excluded from this disclosure. We understand the concerns/request of the European Central Bank (ECB), conveyed by the EBA at its hearing in January 2014, that assets encumbered to central banks and central bank emergency liquidity assistance (ELA) should be treated as an unencumbered asset. We recognise the rationale behind this in that it is vital that financial stability is maintained and such disclosures could have wider systemic issues. We have also had regard to the Report of Mr Lambert to the Court of the Bank of England on this subject. However, we would highlight that not requiring such disclosures would mean that it would not be possible for institutional investors to detect the level and evolution of assets encumbered to central banks and the amount of liquidity assistance given by central banks. This could result in the markets applying their own exaggerated discounts to credit institutions' valuations and is unlikely to help their investability in the future.

In this context, we believe it is important that the likely behaviour of institutional investors is acknowledged in reaching a balance between disclosure and non-disclosure of ELA. At the very least, we believe that this approach to non-disclosure should be revisited, perhaps in a transition by the time the EBA issues binding technical standards (BTS) in 2016, as the counterparty risk should not be hidden, or not for long, perhaps after a corrective action plan has been agreed by the firm and its supervisors.

As stated above, we are also concerned by the availability of "free" assets for claimants in resolution. Client asset protection is an important feature of any recovery and resolution plans. As this framework evolves, the existence of different client regimes should be taken into account. The term "client" can mean many things. In some jurisdictions, client assets can be understood as those belonging to the end investor (a natural or legal person) whereas in others, "client" can mean the next institution in the chain. Therefore, local regulators should have the final say in implementation, but based on what the EBA guides.

The EBA may receive representations, suggesting that disclosures be based on materiality. We would oppose any such concession as this may be a way of undermining the transparency that market participants require.

## **Conclusion**

The IMA looks forward to working with the international standard setters to develop a framework that is appropriate and effective for all stakeholders.

Annex 1 to our letter contains our further response to the consultation, with more specific observations and questions arising from the proposals.

Annex 2 summarises the critical functions used by the asset management industry.

We hope that you will find our comments useful. Please contact either of us by way of e-mail ([lmurrall@investmentuk.org](mailto:lmurrall@investmentuk.org) or [gsears@investmentuk.org](mailto:gsears@investmentuk.org) ) or telephone on (00 44) (0) 20 7831 0898 should you require further information.

Yours faithfully



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**IMA's OBSERVATIONS ON THE QUESTIONS RAISED**

1. 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.

The information should be granular, include government and covered bonds, and distinguish between the types of securities and their currencies as risk profiles are different.

2. 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.

There should be information on asset quality. Some firms will have their own *modus operandi*, which may not mean anything to an external party, but, perhaps, reference to a specified pool of credit ratings agencies (CRAs), for example those CRAs that are part of the ECAI rules, should be considered.

3. 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)?

Disclosure on the basis of median values and after six months is sufficient to avoid the detection of encumbrance at central banks and central bank support. Banks and securities firms should be weaned off such support, so this protection should not be permanent.

4. 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.

Yes, there should be disclosure as this will aid market discipline and risk management.

5. 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.

Such swaps should be disclosed, or be eventually disclosed, so that market participants are aware of the risk profiles of others.

6. 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.

The sources of encumbrance should be disclosed. A full picture is essential for risk mitigation.

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

Point in time is preferable in terms of accuracy, matching other disclosures, and (provides) the ability for counterparties and other assessors to build up their data, e.g. patterns.

**IMA's OBSERVATIONS ON THE QUESTIONS RAISED**

8. 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?

We agree with the list in Template D.

The guidance should not, or not for long, exempt ELA. Please see our covering letter in this regard.

9. 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?

Six months is sufficient lag to avoid a negative impact.

## **CRITICAL FUNCTIONS USED BY THE ASSET MANAGEMENT INDUSTRY**

As per the key messages, the functions that are of importance to the fund management industry are as follows:

### 1) Payments, clearing and settlement

These services are provided by banks to their clients. Some services may be provided by a non-bank entity of the firm, e.g. broker-dealers. Such services are often on a cross-border basis, e.g. foreign exchange clearing and cash management.

The drivers of criticality are market concentration and the availability of substitutes, geographical footprint, complexity of services and asset classes for clearing, links to ancillary services (transaction accounts (including collateral for transactions), deposits and custody) and the reliance of financial market infrastructure (FMI) providers on banks.

### 2) Wholesale activities

This refers to lending and borrowing in the wholesale markets between financial counterparties. Stress can lead to funding and liquidity strains if the firms are of systemic importance (e.g. major providers of liquidity and/or funding by short-term deposits (net stable funding ratio)).

The drivers of criticality are systemic importance and interconnectedness, market concentration, maturity transformation and leverage.

### 3) Capital markets activities

This is about the issuance and trading of securities, often related to advisory services and prime brokerage. Such activities rely on payment, clearing and settlement functions.

The drivers of criticality are market concentration and the availability of substitutes, whether services are bundled, and the portability of client accounts across providers and markets.