



November 2014

NEW CSSF CIRCULAR ON RISK MANAGEMENT OF ASSET ENCUMBRANCE BY INSTITUTIONS

Following the European Systemic Risk Board's recommendation on the financing of credit institutions (ESRB/2012/2), and more precisely recommendation B "Risk management of asset encumbrance by institutions", CSSF Circular n°12/552 has been updated by Circular n°14/597, dated 24 November 2014. So what's new?

What's the main purpose?

The main purpose of this new Circular is to insert, in Part III of the Circular, a new chapter (chapter 6) dealing with the risk of asset encumbrances and it only applies to credit institutions.

What does it imply for the banks?

Banks are required to organise a risk management policy specifically regarding the encumbrances on the assets and to put in place procedures and controls that guarantee that the risk relating to the guarantees and encumbrances are well identified, protected and managed.

The policy has to take into account various elements, such as the business model, the Member States where it operates, the specifics of the financial markets and the macroeconomic situation. In each case, the policy is to be approved by the board of directors, as set out in paragraph 19 of the Circular, which reads: *"The board of directors is responsible for the implementation by the authorised directors of its strategies and guiding principles in respect of internal governance matters. To this end, the board of directors has to approve the policies laid down by the authorised directors (...)."*

How often? What content?

At least once a year, information must be provided to the authorised directors and to the board of directors, particularly in respect of:

- the level, the evolution and the kind of encumbrances on the assets, as well as connected sources of encumbrances on the assets (such as guaranteed financing);
- the amount, the evolution and the quality of the credit of the assets that are not encumbered, but which are likely to be, specifying the volume of the assets available for becoming encumbered;
- the amount, the evolution and the type of the additional encumbrances on the assets, which would stem from a crisis scenario ("contingent encumbrances").

In their continuity plans, credit institutions have to include certain actions to prepare for contingent encumbrances resulting from events that might generate tensions, such as plausible shocks, including credit institution downgrading, devaluation of the secured assets or an increase of the margin requirement.

How to present this information?

The monitoring of asset encumbrances has to be done by means of complementary charts whose purpose is the declaration of the encumbered assets.

A provisional template was published by the European Banking Authority on 24 July 2014 (EBA/ITS/2013/04/rev1)

What else?

The new Circular has also modified a point on outsourcing requirements, which is applicable to any institution as defined in paragraph 2 of the Circular, including, among others, credit institutions, investment enterprises, their branches, etc. Now, the penultimate point of paragraph 182 reads as follows (new elements have been put in italics): "An institution that intends to outsource a material activity must obtain an authorisation from the CSSF in advance. *A notification to the CSSF, which justifies that the conditions set out in this Circular are complied with, is sufficient when the institution works with a Luxembourg credit institution or with a "PSF de support" according to Art. 29-1 to 29-4 of the Law on the Financial Sector of 1993.*"

When?

The new Circular comes into effect on 31 December 2014.

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