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EBA found that extensive use of central bank facilities drove asset encumbrance ratios up in 2020

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- *The encumbrance ratio went up from 25% in December 2019 to 27.8% by the end of 2020.*
- *More than half of central bank eligible assets and collateral are now encumbered.*

The European Banking Authority (EBA) published today its annual report on Asset Encumbrance. As COVID-19 spread across Europe, banks made extensive use of central bank facilities to strengthen their liquidity buffers and maintain the flow of credit to the real economy. This resulted in the largest yearly rise in the asset encumbrance ratio since data is available.

Overview of key figures

	Asset Encumbrance ratio	Encumbrance ratio of central bank eligible assets
Q4 2020	27.8%	50.3%
Q4 2019	25.0%	44.1%

The outbreak of the COVID-19 pandemic led to a significative increase in encumbrance. Amid wholesale funding tensions in the first half of 2020, banks made an extensive use of secured funding to maintain their support to the real economy. The substantial increase in total assets was outpaced by the rise in encumbered assets and collateral.

Central bank funding has become the main source of asset encumbrance. The extensive use of central bank liquidity facilities has driven up the share of central bank funding over total sources of encumbrance. As a result, more than half of central bank eligible assets are already encumbered. In contrast, banks have reduced their reliance on covered bonds given the favourable conditions of central bank facilities, an increasing deposit base, and banks’ focus on the issuance of MREL eligible instruments.

After a sharp rise, the average overcollateralization (OC) level of banks’ secured funding returned to pre-COVID levels. Amidst market tensions in the first quarter of 2020, banks were requested margin calls and had to pledge additional collateral to obtain secured funding. As market instability receded and the ECB eased collateral requirements, OC levels returned to pre-pandemic levels. Nonetheless, this metric remains higher for certain funding categories such as derivatives.

Increasing encumbrance ratios might pose prudential risks. Although banks exhibit comfortable liquidity buffers, as encumbrance subordinates unsecured creditors, the latter might demand higher spreads. Moreover, secured creditors may apply larger haircuts on collateral or make margin calls. This could lead to an adverse feedback loop of higher encumbrance and higher funding costs.

DOCUMENTS

- Report on Asset Encumbrance

LINKS

- Risk reports and other thematic work

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