bankenverband

Comments

of the Association of German Banks
on the Basel Committee's Consultative Document
Definition of capital disclosure requirements

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General remarks

We generally welcome the intention of the present consultative document to align the requirements for the disclosure of capital elements with the definition and composition of regulatory capital under Basel III.

At the same time, we find that the level of detail called for in the consultative document is clearly excessive. For example, the proposed capital disclosure requirements are expanded both qualitatively and quantitatively compared with the current disclosure requirements. Part of these new disclosure requirements are a response to the further development of the corresponding capital standards and definitions under the new Basel III rules and, as such, are therefore also justified. However, much of what has to be disclosed involves a level of detail that goes beyond the objectives of disclosure and is comparable with that in regulatory reporting. The additional quantitative data called for does not automatically deliver any added information value. Instead, the amount and complexity of the data that is to be disclosed are likely to make it difficult even for knowledgeable market participants to assess the capital situation of a bank properly, thereby undermining the original aim of creating more transparency. This reinforces our impression that these new requirements are essentially geared not so much to the interests of market participants but more to the information needs of banking supervisors. We wish to propose that the level of detail be discussed jointly with the banking industry and investors at a public hearing.

The approach adopted in the consultative document provides for the use of a common disclosure template. This paradigm shift is necessary, says the Basel Committee, to improve the comparability of the information disclosed. Whilst we can in principle understand the objective, we would point out that banks have for good reason been free so far to decide themselves how much information they disclose and how detailed this information should be, complying in the process with the principle of proportionality and the key disclosure principles of materiality, confidentiality and secrecy. This approach is based on the idea that market discipline ensures that every bank will adopt the best possible solution for its market, taking into account the size and complexity of its business model. This allows individual bank-specific features to be accommodated in disclosure.

Nevertheless, we believe that the development and provision of disclosure templates by the Basel Committee makes sense to achieve a common international understanding on what the substance and objective of disclosure should be. Strict compliance with the requirements and templates should not be made mandatory, however. Instead, it would be preferable if the Basel Committee's proposals were to be seen as a blueprint that banks can deviate from, while bearing in mind the above-mentioned principles.

We assume that the proposals set out in the consultative document are to directly replace the corresponding Pillar 3 rules. Disclosure in addition to existing obligations would be detrimental to market discipline because there would be differences in substance. To prevent any misunderstandings, we should be grateful for final confirmation to this effect.

To ensure maximum comparability of the information disclosed, banks should be allowed to include additional explanatory remarks. In this way, their calculation basis as well as national differences can be made transparent to investors.

In view of the complex disclosure requirements, we take a generally critical view of the Basel Committee's proposed initial implementation deadline, i.e. 1 January 2013. We do not in fact expect the proposals to be implemented at national level before the fourth quarter of 2012, so that anticipating good-quality disclosure on the basis of the new requirements in the first quarter of 2013 appears highly ambitious to us.
We therefore recommend deferring implementation until the end of 2013.

Following these introductory remarks, we now wish to comment on individual sections of the consultative document as follows:

Section 1

Details of capital are no longer to be published in future in the annual disclosure report but, instead, the frequency of publication is to be based on the respective national requirement to publish balance sheet figures in quarterly or half-yearly financial statements. This means that the current general requirement to disclose financial information annually will be abandoned. We are strongly against this modification. May we point out that, should any significant changes occur, banks are required in any case to update their disclosures within the course of a year. We regard this ad hoc disclosure requirement as sufficient to enable them to respond to the needs of market participants if necessary.

In addition, may we draw attention in connection with the mandatory common disclosure template in Section 1 to the situation in Europe: we refer to the Implementing Technical Standards (ITSs) currently published for consultation by the European Banking Authority (EBA) within the framework of the harmonised European solvency reporting regime COREP, which call in the "CA" reporting template for disclosure of comparable, similarly-detailed data that is not, however, identical with the capital disclosures proposed in the present consultative document. Even though the ITSs are regulatory reporting requirements, differences between two disclosures that are identical in substance tend to lead to adjustments and thus to an additional burden for banks. We therefore disagree with the Basel Committee when it says in Annex 1, p. 10, third bullet-point that these capital disclosure requirements do not appear to result in any additional burden for banks since banks will need the information in any case to calculate their capital requirements under Basel III. This example makes clear that, because of the different, globally diverging supervisory reporting requirements, a mandatory common disclosure format will always impose an additional burden.

For these reasons, we are opposed to any mandatory common reporting template and propose instead that – like in the past – the Basel Committee merely specify the key elements of the information to be disclosed, but not the disclosure format, and leave it to banks themselves to decide on an appropriate form of disclosure.

Section 2

It is natural that banks are required to be able to demonstrate a reconciliation of reporting information. However, we believe that they should only be required to demonstrate this to banking supervisors and auditors. It cannot and should not be up to banks to demonstrate this to market participants with the proposed level of detail. In our view, this would be an unprecedented step, opening up a completely new dimension of disclosure. We are not aware of any comparable requirements to disclose reconciliation in other sectors, e.g. for industrial enterprises or insurance companies. Moreover, reconciliation is evidently not confined only to the capital elements specified in paragraph 91 of the Basel III rules but is expanded under Annex 2 to cover all assets and liabilities.

We fully agree with the Basel Committee when it says in paragraph 26 that requiring a fixed disclosure format is not possible due to the application of different accounting standards. We wish, however, to question the need for such detailed reconciliation in the first place. It is not necessary to disclose all assets and liabilities for two different scopes of consolidation in order to reconcile balance-sheets with regulatory capital. It is instead sufficient if only the different balance sheet items required in computation are reported for different scopes of consolidation and their reconciliation is explained briefly. The proposed format is, in our view, an overly detailed form of reconciliation disclosure whose complexity may cause additional irritation. Moreover, we do not believe that the basis for reconciliation set out in the consultative document is clear-cut. Besides disclosure of assets and liabilities in the form of balance-sheet totals, made separately for the accounting-scope group and the regulatory-scope group respectively, comparative disclosure of balance-sheet items in the form of balance-sheet and the risk-weighted amounts in each case could also be considered.

Overall, we believe that an extensive and detailed reconciliation disclosure requirement like that proposed in the consultative document is unjustified. Instead, reconciliation should be confined to the capital elements specified in paragraph 91 of the Basel III rules. In particular, we question the usefulness of disclosure of the entire debt capital.

The Basel Committee refers in paragraph 16 to the possibility of requiring banks to disclose a list of all subsidiaries that are included within the accounting scope of consolidation but excluded from the regulatory scope of consolidation, and vice versa. Unless such a list concentrates on major subsidiary entities of large internationally-active banks, it may comprise several hundred institutions. It would, as a rule, include other affiliated undertakings such as real-estate companies, SPVs or insurance firms. We doubt whether such a list will have any added information value for market participants. The Basel Committee explicitly refers at this point to supervisors' information needs. Quite apart from the fact that, as we see it, it is not supervisors but market participants that are targeted by Pillar 3, we wish to point out that there are good reasons why the regulatory scope of consolidation and the accounting scope of consolidation differ since, from a supervisory perspective, only risks arising from banking business are to be measured. Also, risks arising from subsidiary entities are already adequately taken into account by other elements of the supervisory rulebook (e.g. securitisation framework/insurance regulation such as Solvency II in Europe).

We are therefore strictly opposed to any requirement to disclose a list of subsidiary entities that represents the difference between the two scopes of consolidation.

Section 3

We wish to point out that banks already disclose the terms and conditions of their capital instruments under the current Basel II (and, in Europe, CRD) disclosure requirements. These disclosures are detailed enough in our view to adequately inform market participants.

As already explained earlier, we do not believe that a requirement to provide an even greater level of detail would be helpful. The information called for on the terms and conditions of capital instruments is of no importance for the decisions made by market participants, nor is it covered by the wording cited in paragraph 29, calling for "*Summary information… of the main features…*". Its purpose is merely to demonstrate whether supervisory recognition under Basel III exists. While we appreciate the need for this question to be examined at supervisory level, we doubt whether the disclosure requirements are the right regulatory framework for this purpose. The actual target group of disclosure (investors, credit rating agencies, etc.) will not carry out such a detailed examination.

Finally, we wish to draw attention once again in this context to the materiality principle that is actually intrinsic to disclosure. Where banks with several billion euros worth of capital are concerned, a capital instruments issue for a few hundred million euros accounts for only a small percentage of their capital and therefore plays a minor role from an overall perspective. The proposed requirements force banks to disclose the main features of such an issue on an ad hoc basis, however. We doubt whether this is a crucial component of risk assessment.

Section 4

In line with our general scepticism about the justification for the requirements in Section 3, we believe that the requirements in Section 4 also go too far and are not supported by the market's information needs. These requirements stipulate that, among other things, the full terms and conditions of capital instruments have to be disclosed (paragraph 36). This list has to be updated whenever a new capital instrument is issued and included in capital (paragraph 7). The purpose of this disclosure is to enable supervisors and market participants to investigate the features of the capital instruments. While supervisors must undoubtedly be granted such a broad right of investigation, disclosure of the full terms and conditions to market participants and thus to competitors would be going too far in our view. We therefore once again urge that any commingling of supervisory reporting and disclosure to market participants be avoided.
The principle of secrecy intrinsic to Pillar 3 is also ignored at this point. What is more, the purpose of this information is not fully transparent. An assessment of whether an instrument meets the Basel III capital requirements is the responsibility of the relevant supervisory authority. This is something that market participants can, and must be able to, rely on. They have probably little interest in making this assessment themselves. This requirement thus imposes a significant burden, although there is no direct market demand.

Finally, we wish to add to our basic criticism of the requirements in Sections 3 and 4 by making two proposals for reducing the scope of disclosure:
Firstly, any capital components held by public institutions or central, regional or local authorities should be treated differently. There is no need for full ad hoc disclosure of the main features of such components as

the instruments in question cannot be acquired or traded in the market. Secondly, there should be a separate arrangement for common shares and preferential shares. Full ad hoc disclosure would – if at all – only make sense if such instruments had different features.

Paragraph 38 of the consultative document uses the terms Common Equity Tier 1, Additional Tier 1, 2 and Total Capital. In our view, it thus fails to take sufficient account of the EU's "special path" on the definition of Tier 1 Core Capital independent of the legal form of an institution and in fact unnecessarily obstructs it by using these terms. We therefore expressly call for deletion of paragraph 38.

Section 5

The purpose of transitional arrangements is to soften the full impact of legislation entering into force at a later date. This is also how we understand the transitional arrangements for the gradually phased-out inclusion of certain capital elements. We interpret the Basel III rule cited in paragraph 41 to mean that during this period only the part of the capital elements eligible for inclusion in each case has to be disclosed.

As we see it, the Basel Committee's proposal for complex time-series-based reporting including capital adjustments over this period goes well beyond the purpose of an approved transitional arrangement for disclosure in this area. We are therefore strongly in favour of disclosure of only the eligible capital elements at the time of publication.