AUSTRALIAN BANKERS' ASSOCIATION INC.

Tony Burke
Policy Director

Level 3, 56 Pitt Street
Sydney NSW 2000
Telephone: (02) 8298 0409
Facsimile: (02) 8298 0402

14 February 2012

Secretariat of the Basel Committee on
Banking Supervision
Bank for International Settlements,
CH-4002 Basel, Switzerland
baselcommittee@bis.org

Dear Secretariat,

Proposed regulatory capital disclosure requirements issued by the Basel Committee

The Australian Bankers' Association (ABA) supports the Basel Committee's objective to achieve greater transparency and facilitate the comparison of the relative capital strength of banks subject to different jurisdictional applications of the Basel III minimum capital standards. The ABA believes this is best done by focusing on the consistency of the information disclosed, rather than a rigid set of standard templates, as the later will always struggle to accommodate local variations as to accounting, legal and prudential frameworks.

The Basel Committee's proposals have three main components:

- A common template for the disclosure of regulatory capital ratio calculations;
- Requirements for the disclosure of a reconciliation between regulatory capital and the audited financial statements; and
- Disclosure requirements for the key features of capital instruments.

The ABA believes that, rather than line by line reconciliation to accounting balance sheets, the focus should be on a disclosure of comparable capital ratios calculated using the Basel III minimum standards and a reconciliation of these with the capital ratios calculated under national specific standards. The proposed reconciliation between the financial statements and regulatory capital calculations is excessive and could be simplified to show the adjustments required to

shareholders' equity in the financial statements to produce the regulatory capital Common Equity Tier 1.

The ABA also believes the disclosures should be included within each banks' Pillar 3 disclosure document rather than the financial statements, and be limited to the consolidated banking group reporting level.

Below is a high level summary of the ABA's comments on each of the three main components of the proposals:

- **Common template**. The ABA believes the only way to facilitate a true comparison of the capital adequacy of banks across jurisdictions is through the disclosure of capital ratios calculated on a consistent basis – this requires consistent calculation of both the numerator (definition of capital) and denominator (risk weighted assets).
- **Reconciliation with financial statements**. The ABA believes the level of detail in the proposed three step process is excessive. Providing more detailed information does not necessarily lead to better disclosure outcomes, as it can sometimes result in market participants missing the key disclosures. The reconciliation should be limited to the adjustments required to the shareholders' equity in the financial statements to produce the regulatory capital Common Equity Tier 1.
- **Key features of capital instruments**. The ABA believes that a standard template will not adequately provide the flexibility for banks to report accurately and completely the material terms of bespoke Tier 1 securities, and the interaction of those terms under different scenarios. The Basel Committee should instead publish a list of potential key terms and leave the format of the disclosures to bank management to best evaluate.

The ABA provides the following more detailed comments for consideration:

1. Common template

The Basel Committee's proposal involves the presentation of one set of capital ratios calculated under local implementation of the Basel III requirements in sufficient detail that market participants can identify and adjust for the differences introduced by national discretion when completing cross jurisdictional comparisons. The ABA believes that this approach will continue to place significant computational burdens on market participants which will impede the process of generating the cross jurisdiction comparisons.

It is also highly likely that the transparency objective will be undermined by different market participants using different definitions to arrive at the cross jurisdiction comparisons. It is possible that some agreed benchmark may eventually emerge but the ABA believes it would be better for the Basel

Committee to adopt its own minimum standards as that benchmark and for the template to focus on explaining the differences between the Basel minimum standards and the local implementation of Basel III.

Adopting this alternative approach would not only potentially reduce the amount of detail required to be disclosed, but would also facilitate expanding the template to offer enhanced transparency around differences in the calculation of risk weighted assets across different jurisdictions.

The issue is particularly important for Australian banks due to APRA's conservative approach in relation to the calculation of RWA, in particular:

- APRA requires Australian banks to hold RWA against interest rate risk in the banking book. This has an impact on Australia's major banks' capital ratios of approximately 30bps; and
- APRA requires a more conservative calculation of RWA for residential mortgages than other jurisdictions; a recent IMF working paper estimated the impact of this on Australian major banks' Tier 1 capital ratios relative to Canadian banks is 100bps[1].

This is not covered by the Consultative Document, which states that "Further work may be undertaken in due course on disclosure requirement for the capital requirements of banks". However, the ABA believes that concrete steps can be taken now to begin to address part of the problem rather than making the denominator contingent on identifying and having a complete solution to all potential sources of inconsistent risk exposure measurements.

The Consultative Document asks for "feedback on whether the use of templates across jurisdictions, with consistency in format and information disclosed, is necessary to achieve the appropriate level of comparability in disclosure, or whether the focus should be only on consistency of the information disclosed, with the formats potentially varying between jurisdictions."

The ABA believes it is appropriate for the format of the template to vary between jurisdictions to accommodate local variations in accounting, legal and prudential frameworks. However, the Basel Committee should set a minimum set of requirements for the jurisdictional templates to ensure the objective of cross jurisdictional comparisons can be achieved. The ABA suggests the following minimum disclosure requirements for the templates:

- The template should include two clearly marked sets of ratios:
  - one based on Basel III minimum standards (excluding all "National specific regulatory adjustments") – this should be the primary set used for comparison purposes; and

[1] IMF Working Paper - Bank Capital Adequacy in Australia, January 2012, page 10.

- another based on national standards that incorporate "National specific regulatory adjustments"– this is the set of ratios that should be compared to national minimum ratio requirements.

  Allowing market participants to see the difference between the two sets of ratios will improve transparency by allowing users to clearly see and place a value on the level of conservatism being applied in each jurisdiction.

- Regulatory capital disclosures (Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital), based on both minimum Basel III standards and after "National specific regulatory adjustments" to show the key items of national divergence from the Basel III minimums.

- Risk weighted assets disclosure based on both minimum Basel III standards and after "National specific regulatory adjustments" identifying areas of national divergence from minimum international standards (for example a requirement for IRRBB RWA). It should be noted that some areas of national divergence within the regulatory capital definition will also impact on risk weighted assets (for example a jurisdiction that does not allow threshold deductions will result in higher CET1 deductions and lower RWA).

This minimum level of disclosure should be sufficient to facilitate the consistent comparison of the capital adequacy of banks across jurisdictions by market participants.

2. Reconciliation with financial statements

The ABA believes the reconciliation between the financial statements and regulatory capital calculations should be simplified to show the adjustments required to shareholders' equity in the financial statements to produce the regulatory capital Common Equity.

The Consultative Document outlines a detailed three step set of reconciliation disclosure between the audited financial statements balance sheet and the components that are included in the definition of regulatory capital. The level of detail in the three step process is excessive and overly complicated in that:

- Full deconsolidation of the financial group balance including balance sheet items not relevant to the capital calculations (e.g. cash at bank, fixed assets) are not necessary.

  A detailed line by line reconciliation of the balance sheet does not address the main issue around education as there is no disclosure around the reasons for the differences between Financial and Regulatory balance sheet.

- Allowing flexibility for a more simplified reconciliation would avoid unnecessarily increasing the length of Pillar 3 disclosure documents that are already very lengthy and detailed documents.

- Furthermore, the proposed reconciliation appears to assume all regulatory capital items are identifiable in the financial statements balance sheet, which is not always the case. The following are some examples:

  - Treasury Shares are eliminated in the financial balance sheet and therefore the 'of-which' approach would not be applicable

  - Shortfall/surplus of Eligible Provisions against Expected Losses, with Expected Losses not a financial disclosure item.

  - Provisions included in Tier 2 would not be easily related to financial balance sheet items for some banks.

Finally, given the reconciliation is with the audited financial statements, the frequency of this reconciliation should be limited to the frequency of the production of audited financial statements.

3. Key features of capital instruments

The ABA believes that a standard template will not adequately provide the flexibility for banks to report accurately and completely the material terms of bespoke Tier 1 securities, and the interaction of those terms under different scenarios. The Basel Committee should instead publish a list of potential key terms and leave the format of the disclosures to bank management to best evaluate.

Yours sincerely

Tony Burke

cc. Mr Charles Littrell, APRA