HIGHER SCHOOL OF ECONOMICS
National Research University
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http://www.hse.ru/en/

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Basel Committee on Banking Supervision
Email: baselcommittee@bis.org

Dear Sirs,

Basel Committee on Banking Supervision Consultative Document
Definition of Capital Disclosure Requirements

On behalf of the National Research University Higher School of Economics (NRU HSE), and particularly the Center for Institutional Analysis, the International Laboratory of Decision Choice and Analysis, the Laboratory of the Banking Institute we would like to thank Basel Committee on Banking Supervision for the opportunity to deliver our opinion on the Consultation Document 'Definition of Capital Disclosure Requirements' [further on - *BCBS212*] published by the Basel Committee on Banking Supervision on December 19, 2011 at http://www.bis.org/publ/bcbs212.htm.

The comments are presented in three parts:
(a) 'General Comments' refer to the overall issues related to capital disclosure;
(b) 'Comments on Directly Addressed Issues' deal with the questions that were specially raised by the Basel Committee experts.
(c) 'Paragraph-wise Comments' correspond to the particular paragraphs that attracted our attention.

We hope our comments would be of use for deriving financial stability-oriented identification and regulation principles with respect to introduction of proper capital disclosure requirements.

In case of further questions, please, do not hesitate to get in touch through email (dhm-econ@hse.ru), telephone (+7.495.621.13.42, ext. 2006) or fax (+7.495.772.95.90, ext. 2101).

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General Comments

1. The templates are considered to be published by banks in addition to the financial statements already included into the jurisdiction's disclosure regime. This results into extra costs for banks, but do not guarantee that all the banks will include the same items into this or that line of the template. The problem may be especially severe for the jurisdictions applying Basel recommendations partially or newcomers – namely those being the target for potential extension of a-la Basel regulation introduction. Our suggestion is to introduce a separate unit in each Central Bank or other regulatory body dealing with reported financial statements. This unit should be responsible for filling in the templates using the already reported bank-specific data and preparing a full set of the templates in perfectly comparable format. This will reduce the degree of banks' freedom in interpreting the templates and the possibilities of manipulation. However an additional document should address this issue.

2. We believe that regulators as well as the research community would welcome the following way of presenting items in the main template.

   Primarily the reported capital amount figure should be stated, then deductions and add-ons should be listed, then should follow the regulatory figure as the final one, So each analyst might trace how the capital figure evolves (otherwise significant additional work is to be done when comparing the columns and understanding what was included as for the reporting purposes, and as for the regulatory ones). This would need the fifth bullet point at page 10 to be changed stating "The template does not include any information regarding the reconciliation of items back to the published financial statements".

3. Another point that is not taken into account by this document is the transmission channel for the disclosed information, which would deliver it to the ultimate consumer. Retail depositors as well as other small stakeholders may lack expertise needed to interpret the disclosed data correctly. On the other hand they may initiate a severe bank run in response to information signals coming from market or from media, as they are simpler and more straightforward. So it's important to deliver the disclosed information in a format that is less detailed and sophisticated but is easier to interpret and to incorporate into decision-making.

Comments on Directly Addressed Issues

1. **Page 1, paragraph 3 "Market participants responding to this consultative document are asked to provide feedback on whether the use of templates across jurisdictions, with consistency in format and information disclosed, is necessary to achieve an appropriate level of comparability in disclosure, or whether the focus should be only on the consistency of the information disclosed, with the formats potentially varying between jurisdictions."**

We must admit that the unique templates would definitely increase the comparability in disclosure. Current Pillar III leaves much freedom in choosing the ways the capital components are or can be disclosed. Using any cross-country database for research purposes usually imply introducing the assumptions on the differences or reporting formats. This may limit the received results as the researcher should admit the aggregation definitions adopted by database creators (such as Fitch ones for Bankscope) or use originally disclosed data and be responsible for the intervention of his/her own aggregation strategy.

2. **Page 7, paragraph 34 "are asked to consider whether the current list of items included in the main features template represents the most useful set of minimum summary disclosures on the key feature of capital instruments that banks could be required to make. They are also asked to provide feedback on whether, and if so how, they would use the information provided"**

We would suggest adding at least the last point of the box at p.7, namely, *whether the instrument is issued to parent or affiliate*. Some banks may use different debt instruments to artificially infuse the capital of the affiliates to put them in line with the regulatory rules. This kind of disclosure may prevent from that strategy as this information may not only as signal the deterioration of financial conditions but also undermine the issuer's reputation. I believe this may reduce the degree of window-dressing especially for the new jurisdictions that will join the implementation of Basel guidelines. This feature may also enhance outsiders' understanding of bank's ownership structure.

For the economic research purposes the capital and its elements over the banking systems is monitored to estimate the procyclicality effects[1].

3. **Page 8, paragraph 35 "The Basel Committee would also welcome feedback on whether this should also include the common shares issued by the bank"**

In case the capital disclosure is made as the capital amount evolution from reported figure to regulatory one additional inclusion of common shares issued by the bank is redundant as it is presented for the reported capital amount.

Otherwise if the format is decided to be kept as it is now, then the information on common shares issued by the bank is welcomed.

[1] Andrievskaya I.K., Penikas H.I., Pilnik N.P. How to Deal with Basel II Procyclicality in Russia? // Eurasia Business and Economics Society (EBES) Conference (October 28 – 30, 2010; EBES - Athens, Greece). URL: https://www.hse.ru/data/2011/06/20/1215788555/Procyclicality_Russia.pdf

Paragraph-wise Comments

4. **Page 3, paragraph 10 "Banks should also make available on their websites an archive of all templates relating to prior reporting periods."**

It is proposed to add that "In cases of changes in capital disclosure reporting standards due to M&A, restructuring etc. archives are to include figures according to previous standards and according to new ones. New standards are to be applied to previous figures revision dated to 1-3 years back depending on the decision of local regulator".

5. **Page 4, paragraph 16 "the Basel Committee is considering requiring banking groups to disclose the list the legal entities that are included within accounting scope of consolidation but excluded from the regulatory scope of consolidation."**

It is recommended to introduce the materiality (significance) threshold for disclosure, e.g. by saying "banking groups to disclose the list of legal entities … *that represent more than 5% of reported banking group assets*".

It would be desirable to link the disclosure in dependence of *risk-weighted assets*, but it might cause difficulties for banking groups. The banking groups being aware some entities of their own to be out of scope of regulatory supervision might not have the tools to calculate RWAs for these entities (that is why the per cent of assets, not risk-weighted ones is proposed).

6. **Page 9, paragraph 44 "(1) an additional column indicates the amounts of the regulatory adjustments that will be subject to the existing national treatment"**

It is desirable to present the capital ratios both for the transitional regulation and for the final ones to have a sort of early notification system showing whether the convergence to the adequate capital level is in place or not.

7. **Page 11, paragraph 3 "Accumulated other comprehensive income (and other reserves)"**

It is important to confirm that the article includes translation movement arising from revaluation of the bank's net open currency positions. The explanation on inclusion is welcomed to be put within respective comments on page 13.

8. **Page 11, paragraph 14 "Gains and losses due to changes in own credit risk on fair valued liabilities"**

Additional point 14.1 is proposed to be added including "of which debit valuation adjustment for *derivatives*".

9. **Page 11, paragraph 20 "Mortgage servicing rights (amount above 10% threshold)"**

It is proposed to add "but less than 15% threshold" otherwise there will be double counting with the point 24 that states "Amount exceeding the 15% threshold" for "Amount exceeding the 15% threshold".

10. **Page 12, paragraph 61 "Common Equity Tier 1 (as a percentage of risk weighted assets)"**

It is proposed to include capital ratios as after 1 Jan 2022.

11. **Page 13, paragraph 7 "Valuation adjustments according to the requirements of paragraphs 698 to 701 of Basel II."**

It is recommended to add "and paragraph 99 of Basel III"

12. **Page 20, paragraph 53 "This template was developed in a spreadsheet that would be made available to banks following finalisation of the consultation process"**

An example of filled-in template is welcomed as it is not quite clear whether each instrument is to be reported in a separate column or otherwise.

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