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Comments on the Consultation Paper "Definition of capital disclosure requirements"

Ladies and Gentlemen,

We are grateful for the opportunity to comment on the Consultation Paper "Definition of capital disclosure requirements" published in December 2011 by the Basel Committee for Banking Supervision (BCBS).

On principle, we agree with the Consultation Paper's declared goal of ensuring harmonisation of disclosure requirements of capital elements with the definition and composition of the regulatory capital under Basel III.

However, we would like to point out that the level of detail required in the Consultation Paper is clearly excessive. For instance, compared to the current disclosure requirements concerning the reporting of capital information, the proposed requirements with regard to the capital disclosure have been expanded considerably, both in terms of quantity and quality. Part of

these new disclosure requirements are in response to the further development of the respective capital standards and capital definitions under the latest Basel III provisions. Hence, they are obviously legitimate. However, in large parts, the responses to be disclosed reach a level of detail which exceeds the rationale behind the disclosure and which is on a par with the supervisory reporting requirements. The required additional quantitative disclosures are not automatically accompanied by any additional gain in insight. Rather, the breadth and complexity of the information that has to be disclosed will probably render it difficult even for experienced market participants to arrive at an appropriate assessment of a bank's capital position. This corroborates our impression that the promulgation of these new requirements is fuelled less by the interests of market participants but instead by the banking supervisor's information needs.

Furthermore, the present draft relinquishes key disclosure principles inherent in Pillar 3. To date, the definition of the scope and level of detail pertaining to the information to be disclosed, was left to the discretion of banks - under due consideration of the principle of proportionality and the core principles of materiality, confidentiality and secrecy applicable to disclosures. The rationale for this policy is the notion that market discipline will induce every single bank to choose that solution which (in view of the scope and complexity of its business model) is optimal for its market. The present Consultation Paper proposes a common master template for presenting the disclosure: This constitutes a departure from the existing policy described above. The Basel Committee purports that this paradigm change had been necessary in order to increase comparability. Thus BCBS takes over the role of a market participant. From our point of view, this is misleading and even constitutes an erosion of the Pillar 3 tools. Even today, we already experience that the disclosure requirements under Pillar 3 are less interesting for investors. Instead, they tend to attract more attention by supervisors and competitors. In our preliminary understanding this is due to the fact that the disclosure requirements were drawn up from the point of view of the supervisor. Along with the annual report, interested market participants use many other channels of the public relations departments. This is a trend which neither the envisaged considerable extension nor the standardisation of the disclosure requirements will be able to reverse. Quite on the contrary, more likely than not, this trend will probably see an increasing acceleration. Hence, in order to maintain their capacity of catering to the needs of market participants, banks must retain the right to choose their own presentation format.

After these preliminary, general remarks, we have the following more specific comments on the Consultation Paper's various sections

Section 1

It is proposed that, in future, banks shall publish this disclosure with the same frequency as the publication of their financial statements (i.e. no longer as part of the annual disclosure report). Instead, the disclosure frequency should be based on the financial reporting obligation under the respective national jurisdiction (typically quarterly or half yearly). In effect, this constitutes a departure from the existing, universally binding annual disclosure frequency. We strongly reject this amendment. We would like to point out that, even under the present regime, whenever important changes occur, banks will anyway have to provide more frequent updates throughout the year of that information which falls under the disclosure requirement. We feel that this ad-hoc reporting requirement is sufficient for addressing the needs of market participants.

Furthermore, as regards the strict requirement as to form set out in Section 1, by way of example, we would like to refer to the overall context at the European level. Recently, as part of the harmonisation process of the European Solvency notification system COREP, the European Banking Authority (EBA) published the Implementing Technical Standard (ITS) where an ongoing consultation process with interested market participants is currently underway. In its reporting template "CA", the ITS calls for a comparable level of detail in the disclosures which, however, are inconsistent with the capital disclosures required under the present Consultation Paper "Definition of Capital Disclosure Requirements". Albeit ITS deals with reporting requirements for the purposes of banking supervision, inconsistencies between disclosure requirements which, in essence, cover one and the same subject matter will, potentially, lead to adjustments in the analyses. This will result in additional burden for banks. Hence we do not share the view expressed by the Basel Committee for Banking Supervision in Annex 1, page 10(3), that said disclosure requirements of capital positions do not lead to any additional burden for banks since said banks would have to capture this data anyway in order to perform their Basel III capital calculations even in the absence of such disclosure requirements. The aforementioned example illustrates that, given the various, worldwide diverging supervisory reporting requirements, one common, mandatory disclosure format will always lead to additional burden for banks.

Based on the foregoing, we oppose any prescribed, common format. As a regulatory alternative choice, we would like to suggest that BCBS continue its present policy of refraining from any specification of the disclosure format. Instead, it ought to confine itself to the definition of the core elements of the information that has to be disclosed thus leaving it to banks themselves to decide on the most appropriate form for presentation thereof.

Section 2

In certain analyses, banks' record keeping obligations concerning the calculation or, moreover, reconciliation of disclosures are a matter of course. Notwithstanding the foregoing, from our point of view this record keeping obligation only exists vis à vis banking supervisors and auditors. We feel that banks shall and must not be put under any obligation of having to provide for such a detailed level of granularity vis à vis market participants. In our view, this lacks any legal precedent and creates an entirely new dimension for disclosure requirements. We are not aware of any comparable reconciliation requirements in other areas, such as, for instance concerning industry or insurance firms. Furthermore, apparently the reconciliation is not only limited to those capital elements that are mentioned under Paragraph 91 of the Basel III rules text. Instead, pursuant to Annex 2, the scope shall be extended to include all assets and liabilities.

We entirely agree with the observation expressed by BCBS under item no. 26, i.e. that the requirement of a fixed format would not be possible given that banks' balance sheets are not reported in a common way across jurisdictions due to the application of different accounting standards. However, we would call into question the need for such a comprehensive reconciliation statement. Presenting each and any asset and liability on the basis of two different consolidation scopes in order to reconcile the numbers used for the calculation of regulatory capital and the numbers used in the published financial statements, is unnecessary. Rather, we should like to point out that it is sufficient to merely report the different accounting items that are required in the statement on the basis of different consolidation scopes and to briefly explain how they were inferred. In our view, the proposed scheme constitutes an excessively comprehensive form of presentation for the derivation. In view of its complexity, it may cause additional confusion. In addition to this, we feel that the basis for the reconciliation calculation presented in the Consultation Paper is slightly ambiguous. Apart from the presentation of the assets and liabilities in terms of separate balance sheet volumes for the regulatory consolidation scope and the accounting consolidation scope, another option would be a comparative presentation of the balance sheet items in the form of accounting figures and risk weighted figures.

Furthermore, we should like to criticise a lack of consideration for the principle of proportionality. Item no. 21 et seq. mentions the term proportionality. According to said principle, the level of disclosure shall be proportionate, varying with the complexity of the bank's balance sheet and its capital structure. De facto, however, under the present proposal, any structure will have to be disclosed in its entirety. At best, "relief" will result from a potential reduction of a bank's total assets or a less complex capital structure. However, this is not the result of proportionality, i.e. of a measured regulatory approach.

On the whole, we feel that the requirement for publication of a comprehensive and detailed reconciliation statement like the one proposed in the present Consultation Paper is generally unwarranted which is the reason why we are opposed to this proposal. At most, the reconciliation statement should confine itself to the capital elements set out in item no. 91 of the Basel III rules text.

Under the current proposal, the Basel Committee is contemplating the option of 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 (cf. item no. 16). When it comes to large international organisations and in the absence of any prioritisation by focusing on legal entities that can be regarded as material subsidiaries, such a list may feature several hundreds of banks. This kind of list would generally include other shareholdings like, for instance, real estate companies, SPVs or insurance firms, too. We doubt that such a list would facilitate any knowledge gains on the part of market participants. At this point, BCBS explicitly refers to the information need of supervisors. Apart from the fact that in our understanding, the target group of Pillar III is not comprised of supervisors but of market participants, we would like to point out that there are sound reasons for the incongruence between the accounting consolidation scope and the regulatory consolidation scope. After all, when it comes to prudential supervision, only risks deriving from banking business should be assessed. Furthermore, risks from subsidiaries are already sufficiently covered by other elements of the regulatory framework (e.g. securitisation regulatory framework or insurance regulation such as Solvency II in Europe).
Hence, we are opposed to any requirement under which banking groups would have to disclose a list the legal entities that are included within the accounting scope of consolidation but excluded from the regulatory scope of consolidation.

Section 3

We would like to point out that, pursuant to the current disclosure obligations under Basel II (and the CRD in Europe) there already are mandatory disclosures of the terms and conditions of capital instruments. We fell that, in order to supply market participants with the required information, these disclosures feature a sufficient level of detail.
We would like to reiterate our above caveat: We firmly believe that any further level of detail would not be fit for purpose. The requested disclosures of terms and conditions are neither decision-relevant for market participants nor are they covered by the language quoted under item no. 29 which calls for "summarising information of the key criteria...". The sole purpose of the requested disclosures consists in proving the existence of supervisory recognition under Basel III. Whilst we understand the supervisory need for monitoring this, we doubt whether the disclosure requirements will constitute the right regulatory framework in order to meet

said monitoring need. The disclosure requirement's actual target group (investors, rating agencies etc.) will not carry out such a detailed review.

Hence, we object to the ad-hoc disclosure requirement envisaged for the "main features template" and the "other disclosure requirements" since we feel it is excessively comprehensive. Such far-reaching disclosure obligations would significantly aggravate banks' capital planning and control process. Especially the update of the existing disclosure obligation which would be triggered by any new issuance of an equity instrument would severely hamper management's flexibility which is so vital for a quick response to changing capital market conditions. This would render any fine-tuning during the ongoing fiscal year largely impossible: After all, any intervention in response to changing conditions would trigger renewed disclosure obligations.

In the final analysis, we should like to once more highlight the materiality principle which, actually, should be an inherent part of disclosures. In terms of percentages, looking at the overall picture, when it comes to banks with several billion Euro equity, the issuance of stock to the tune of but a few million Euro only constitutes a fairly low ratio of the overall equity; hence, this will play a subordinate role in the overall assessment. However, the present proposals would force banks into an ad hoc disclosure of the regulatory features of such an issuance. We doubt that this will constitute a significant component in a risk assessment.

Section 4

Whilst our scepticism vis à vis the legitimacy of the requirements under section 3 has already been mentioned above, also the requirements under section 4 appear excessive and seem unwarranted as far as the information need of the respective market is concerned. Under the present proposal, inter alia each and any conditions and terms of equity instruments are supposed to be listed (item no. 36). Banks would be required to update this list whenever a new capital instrument was issued and included in capital (item no. 7). The rationale behind this disclosure is that it should enable the supervisor and market participants to assess the features of these instruments. Whilst it is entirely legitimate that supervisors be granted such an in-depth information access right disclosing each and any features to market participants and thus, by default also to competitors, appears too far-reaching. Hence, we would like to caution once more against blending supervisory reporting obligations and disclosure requirements vis à vis market participants. There is a similar breach of another inherent Pillar 3 principle, i.e. the principle of confidentiality. Furthermore, the rationale behind this information is not entirely transparent. The assessment whether an instrument meets the regulatory capital requirements under Basel III is incumbent upon the respective supervisor. This is one of the fundamental tenets on which market participants shall and may rely. More likely than not, the interest in performing a DIY assessment will be limited. Hence, this requirement results in significant addi-

tional burdens for banks which, on the other hand, are not warranted by any direct market demand.

Last but not least, along with our fundamental criticism with regard to the requirements under section 3 and 4, we should like to submit two alternative proposals aimed at reducing the scope of the forthcoming disclosure requirements.
First, equity components held by state institutions or local authorities should be eligible for special treatment. Due to the fact that such instruments cannot be bought or traded in the market, there is no need for a comprehensive ad-hoc disclosure of the main features of such components. One further option for reducing the disclosure requirements would be a sui generis rule for ordinary shares and preferential shares. At most, any comprehensive ad-hoc disclosure would only be meaningful if such instruments possessed different features.

Item no. 38 of the Consultation Paper uses the terms "Common Equity Tier 1 (ET1), Additional Tier 1, 2 (T1, T2) and Total Capital (TC). In our view, this does not sufficiently reflect the European idiosyncrasy concerning a definition of forms of capital which satisfy the new common equity requirements in a way that is neutral concerning the legal form. Quite on the contrary, without any apparent reason, at this juncture the mere use of this terminology renders the said definition even more difficult. Based on the foregoing, we explicitly advocate in favour of deleting item no. 38.

Section 5

A transitional rule is intended to buffer the full impact of a rule which will come into effect at a later point in time. We also feel that this is the rationale behind the respective transitional rules for the gradual phase-out of certain, ineligible capital elements. Item no. 41 quotes a Basel III rule which, in our understanding, means that only that part of the respective capital elements shall be disclosed which is eligible.

The Basel Banking Committee presents a complex proposal concerning a time series presentation which includes a statement of changes of the capitals over this period of time. In our understanding, this approach by far exceeds the rationale behind any transitional regime concerning a disclosure of said scenario. We therefore explicitly advocate in favour of a solution where a disclosure requirement shall only extend to capital elements that were respectively eligible at the point in time of publication.

We would appreciate it if our views were taken into account in the ongoing consultation process. We would be happy to provide further information about any of the issues raised.

Yours faithfully,
on behalf of The Association of German Public Banks (VÖB), German Savings Banks Association (DSGV), Association of German Pfandbrief Banks (vdp)
Federal Association of German Cooperative Banks • BVR

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