International Banking Federation

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland
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Dear Sir/Madam:

Re: International Banking Federation[1] Comments on the Basel Committee on Banking Supervision's Consultative Document: Review of the Pillar 3 disclosure requirements

Thank you for the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) consultative document: Review of the Pillar 3 disclosure requirements ("consultative document"). At the outset, the IBFed and its member associations wish to express appreciation for the openness of the BCBS to engage in dialogue on changes to Pillar 3 disclosures with the bank, analyst and investor communities. The industry outreach meeting on September 19th provided an opportunity for the banking industry stakeholders to express themselves directly on our key concerns. This submission will document the considerations that we hope you will find relevant as you work to finalize guidance on Pillar 3 disclosures.

Providing market participants with an adequate picture of banks' risks is key to ensuring the proper functioning of financial markets as well as to building trust. As a consequence of the profound changes which have been made to the regulatory framework for banks following the financial crisis, it has become even more important to third-party claimants such as debt and equity holders to identify risk in financial institutions and to make sure that market discipline works effectively.

We understand that the BCBS is undertaking a two-phase project with the first phase focused on disclosure requirements in the areas of credit, market, counterparty credit risks, equity risk, and securitization as outlined in the consultative document. We further recognize that disclosure requirements for other risk elements covered by the existing Pillar 3 framework, including interest rate risk in the banking book and operational risk, will be considered in phase two. We look forward to engaging in a productive dialogue throughout this process.

[1] The International Banking Federation (IBFed) is the representative body for national and international banking associations from leading financial nations around the world. Its membership includes the American Bankers Association, the Australian Bankers' Association, the Brazilian Federation of Banks 'FEBRABAN', the Canadian Bankers Association, the European Banking Federation, the Japanese Bankers' Association, the China Banking Association, the Indian Banks' Association, the Korean Federation of Banks, the Association of Russian Banks, and the Banking Association of South Africa. This worldwide reach enables the IBFed to function as the key international forum for considering legislative, regulatory, and other issues of interest to the banking industry and to our customers.

In general, we support the effort to formalize and coordinate disclosure requirements in the interests of increasing transparency. With this in mind, however, we are concerned about the increasing volume of disclosures with requirements emanating from multiple sources, including securities and prudential regulators, a private sector initiative (EDTF) that was established at the request of the Financial Stability Board, and the accounting standard setters. We believe that harmonization of risk disclosures should be the top priority and we encourage the BCBS to engage with the various parties – including industry – to ensure that overlaps are identified and addressed.

Even in the absence of harmonization, when considering the Pillar 3 proposals on their own, we are very concerned that the decision usefulness of the disclosure will be undermined by the sheer volume and level of granularity of the requirements. For market discipline to work effectively, it is essential that market participants believe it is worthwhile to go through the effort of reviewing all the Pillar 3 disclosures, particularly considering that the new proposals encourage banks to publish them separately from their financial statement disclosures.

While we can understand and have some sympathy for the Basel Committee's goal to improve comparability among the banks by requiring a core set of standardized fixed templates and tables, we believe that a certain amount of flexibility is required in order to ensure that the disclosures provide an accurate and fair representation of the risks faced by each institution, and moreover that they are relevant to investors.

We are very concerned about the proposed implementation date for the first reporting period on or after April 1, 2016. A mid-year start date is awkward since many qualitative disclosures are made in a bank's annual report. We would therefore suggest that the new Pillar 3 requirements should logically start with a bank's first full annual report after the effective date. We also believe that, due to the sheer volume and granularity of the requirements, the disclosures should be phased in over time. Since each jurisdiction is starting from a different place in terms of the new Pillar 3 disclosures, views vary on phase-in and frequency. We have provided more comments on this below.

Harmonization of disclosures

We believe that there should be international coordination for disclosures that are meaningful, and that avoiding duplication in requirements is an important consideration in ensuring transparency and avoiding confusion for users. We also believe that harmonization of risk disclosures is important at a time when other new disclosure requirements are being introduced. In addition to the Pillar 3 revisions, we note that the BCBS has published new disclosure requirements for the Liquidity Coverage Ratio, Leverage Ratio, and for Globally Systemically Important Banks (G-SIBs). We also note that many accounting standards and their accompanying disclosures are changing, and with this the need for coordinated enhanced disclosure is even more relevant. We strongly believe that the Committee needs to raise the bar to a much higher level and that a more holistic view is required such that both accounting and risk frameworks do not merely co-exist but interact with each other with a view of presenting an integrated view to the readers. Accounting standard setters and regulators should, therefore, collaborate closely with each other and with other stakeholders (including users) to foster a coherent overall package of disclosures that would suit the needs of the users' community.

We invite the Basel Committee to engage in an open and transparent dialogue with the user community, preparers, and auditors about the information needs of all stakeholders before issuing its consultation on the forthcoming second phase of the Pillar 3 review. Such an approach would allow preparers to highlight, where needed, the merits of specific data items from a cost/benefit perspective.

Disclosures must be meaningful to Users

With the sheer volume of new and enhanced disclosures from multiple sources, clearly the focus must be on disclosures that are relevant for users. From our experience, very few users appear to be interested in consulting banks' Pillar 3 disclosures and financial analysts do not raise many questions either concerning such data during the bilateral contact they have with banks.

We note and fully support Principle 3 in the consultative document, which states that disclosures should be meaningful to users. While we recognize that users have been highly engaged as part of the EDTF process, we must confess surprise that users would have provided such different feedback when consulted in the development of Pillar 3 disclosures. Clearly the proposed Pillar 3 disclosures are much more granular and often slightly different from the EDTF recommendations. We would like to recommend that the Basel Committee contribute to a better understanding of the Pillar 3 disclosure framework by providing full transparency on the way it has considered the feedback provided by the user community concerning its information needs, by way of a feedback statement. As banks are in constant contact with the users of their financial statements, they also have insight into investor and analyst interests and would be open to ongoing dialogue with the BCBS from the perspective of preparers of the information that is relevant to our user groups.

Need for Materiality concept

We also recommend that the Pillar 3 proposals include a materiality concept similar to the one included in the previous version of Pillar 3.[2] Based on this concept, banks already have a significant amount of rigor around the current process, including extensive documentation and confirmation with their auditors of their materiality decisions with respect to disclosures. The use of a materiality concept would also be consistent with Principle 3 in the consultative document which states that disclosures should be meaningful to users. However, we note that paragraph 37 requires disclosure of a bank's "most significant" current and emerging risks, and clarification of this aspect of Principle 3 would be helpful. While Principle 3 states that "information which is no longer meaningful or relevant should be removed", we also recommend that the Pillar 3 requirements explicitly state that banks are not required to complete templates, or the relevant portions thereof, in cases where the disclosure is not applicable, is immaterial, or is not of real value to investors or analysts or to other sophisticated readers. Our overarching concern is that without an explicit materiality concept, the hundreds of pages of disclosure that will ensue will bury the important messages and render the disclosure less useful for users.

Need for Flexibility

While we support a harmonized set of disclosures, we also strongly believe that relevance and usefulness to users can best be attained through flexibility with respect to (i) disclosure related to banks' own business models; (ii) the use of sign-posting; and (iii) a reduction in the frequency of reporting from quarterly to annual, as appropriate.

Each bank's business model, risk profile, and risk policies and procedures are unique, and it is therefore important that this information be conveyed to users. The effect of a bank's business model cannot be ignored whenever the templates produce disclosures that do not provide meaningful information. As such, we recommend that banks should have appropriate flexibility in completing the Pillar 3 disclosures such that relevance is not sacrificed in the pursuit of comparability.

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[2] Basel Framework, Paragraph 817, Page 227.

To this end, we do support the flexibility that is permitted in the consultative document with respect to the use of sign-posting for disclosure requirements, but believe that signposting should be allowed for more than just templates with a flexible format. This will allow banks to not only reduce overlaps in disclosure but to also ensure that current presentation of information that is relevant to our users is maintained. We do note the requirements for the use of sign-posting as outlined in paragraphs 43 to 45; however, we would recommend that its use be not overly restricted in the interests of avoiding duplication and providing meaningful information. In particular, we are concerned that the requirement to provide information that is "equivalent to (or greater than) that required in the disclosure requirement (i.e., at least the same level of granularity as if the template/table were completed)" does not provide flexibility at all. We recommend that this requirement be revised or removed in order to achieve an appropriate level of signposting that is both pragmatic and efficient.

Finally, we believe that flexibility in the frequency of disclosure is key to ensuring relevant information is disclosed, since certain disclosures may not change significantly from quarter to quarter, and annual disclosure by means of the annual report may be the most appropriate and effective. In addition, the proposed frequencies in the consultative document will result in a significant volume of disclosure and work effort for banks that report quarterly results, as almost three quarters of the templates would have to be disclosed every quarter. Furthermore, since much more granular information is now being requested, the shorter timeframe that often exists for quarterly reporting creates operational and governance challenges for the significant control environment that exists for all disclosures. As such, we recommend that the required frequency of the proposed Pillar 3 disclosures be updated in accordance with our proposal below.

We would emphasize that banks take disclosure very seriously and are already bound to disclose material and relevant information. Flexibility with respect to ensuring disclosure is appropriate for banks' own business models, the use of sign-posting, and a reduction in the frequency of reporting, as appropriate ensures that banks can create the appropriate context for their disclosures, thus ensuring that the relevance of all disclosure is preserved.

Level of Granularity

One of the key differentiators of financial institutions is how they view and manage risk. In fact, we note that financial institutions often go about measuring and evaluating risk in different ways and that there is significant diversity in actual practice at a granular level. Further, since the risk profile and risk environment of each institution is unique, and since each institution uses a distinctive approach to manage its risks, standardized templates that contain the degree of granularity currently being proposed will fall short of aligning with the reality of how institutions manage risk. Hence, since banks may not manage risk in the way being proposed by the template, they will not have the granular information being requested. In trying to essentially fit a square peg into a round hole, banks will have to make some assumptions, including deciding how to slice and dice and map the information they have to fit what is being requested. Not only does this result in a false sense of accuracy and comparability, but it masks and does not clearly represent how the institution views risk.

Moreover, we believe that the level of qualitative and quantitative disclosure being requested in the Pillar 3 proposals may not be meaningful even to the sophisticated user.

Some of the challenges with the granularity requested in the tables and templates include:

- On Template OV1: Overview of RWA, we do not believe that disclosure of capital requirements on this and other templates is necessary as this is simply 8% of the RWA. We therefore recommend that the requirement to provide this information be eliminated.

- On Table CRE: Qualitative disclosures related to IRB models, a detailed description of the main characteristics of approved models will be challenging given the number of approved models that larger banks may have in place. We recommend that disclosure only be required for key models.
- On Template CR12, disclosure of back testing elements of PD calculations, including a five year average annual default rate by portfolio and PD range as required by template CR 12, would be very complex. Due to the high level of rating models usually applied by banks this would either require providing a significant number of tables at a very granular level of data - which we consider to be impractical and easily give rise to confidentiality issues. Otherwise a high level of aggregation or consolidation across all ratings models would be required, which would not result in meaningful disclosures for the user. In this regard, we strongly recommend to re-think the template for parameter back testing generally and propose to build a disclosure proposal more on the direct outcome of validation results. Moreover, we are firmly of the view that back testing should only be reported by asset class and not by PD band.
- On Templates CR7 and CR10, pre-credit risk mitigation (CRM) RWAs, as opposed to CRM in its own right would constitute a major challenge especially for CR10 due to the nature of IRB models. We do not understand how a meaningful pre-CRM RWA could be calculated for instance on a residential property loan ignoring mortgage security. The treatment would potentially bear no relation to the risk models in use or the underlying commercial practice. We recommend that this requirement be eliminated.
- On Template CR9: IRB – Credit risk exposures by portfolio and PD range, we note that this table does not conform with our internal rating systems, and does not reflect the manner in which we view risks. We recommend that flexibility be allowed for disclosure of PD bands based on how banks' manage their business. Further mapping internal PD bands to standardized PD bands will necessitate the use of judgment, thus undermining comparability and accuracy.
- On Template CR10: IRB – credit risk mitigation techniques, we question the value of separating collateral and financial guarantees in the template. We recommend that collateral and financial guarantees not be separated in this template.
- Tables such as CR3: Protections – overview should clearly identify their scope as exposures which were adjusted due to credit mitigation, as the reader may mistake the tables as capturing all credit exposures that are supported by security through a secured loss given default.

In addition to concerns regarding the usefulness of certain information, we are also concerned about the level of granularity as this could lead to disclosure of competitively sensitive information. For example:

- Table MRA: Qualitative disclosure requirements for all banks would require disclosure of strategies and processes of the bank and doing so for all types of risks and business lines would provide too much proprietary information. We note that the BCBS recognizes the importance of confidentiality as noted in paragraph 36 of the consultative document and through other pronouncements.[3] However, we recommend that the Pillar 3 requirements specifically state that disclosure of proprietary information is not required.
- For example, some banks consider information related to realized and unrealized net profit or loss, as required by template SEC2: Securitization activities in the banking book, to be confidential.

[3] See BCBS, *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version* (hereafter "**Basel framework**"), June 2006, Paragraph 819, available at: http://www.bis.org/publ/bcbs128.pdf.

Individual IBFed members associations and institutions plan to submit more detailed comments specific to individual tables and templates.

Hypothetical capital requirements according to the standardized approach

During the second phase of the review, we understand that the BCBS is considering the possibility for banks using internal ratings-based (IRB) approaches for credit risk to disclose hypothetical capital requirements according to the standardized approach. The aim of this requirement would be to reduce the opacity around banks' RWA and to enhance comparability.

We are opposed to providing such disclosure as we do not see any value in providing this information for banks with IRB-approved models that reflect the actual risks of their portfolio rather than standardized estimates. We firmly believe that this information will add more confusion than clarity on banks' regulatory capital, and may lead investors to think that internal models are inaccurate and unreliable – which goes against the measures which the regulatory community is preparing to restore the trust in internal models. We therefore urge the Basel Committee to exercise caution with respect to introducing these requirements.

Implementation

It would be very difficult for banks to meet the proposed implementation date for the first reporting period on or after April 1, 2016. The proposed timeline is ambitious considering that the new proposals will need to be transposed into domestic legislation first, which will inevitably take time. In the broader context we also note that there are many other regulatory initiatives being required at this time which are very demanding from a resource perspective (e.g., risk data aggregation, liquidity, leverage ratio). In addition, major changes in some key accounting standards (e.g., impairment), which will fundamentally change the information that will need to be disclosed, are in process as well. With implementation of all these other initiatives in progress, as well as the request for more granular Pillar 3 information, not to mention FSB-supported pressure from the EDTF to implement their similar but different disclosures, this would prove challenging.

Each and every one of these initiatives will require the development of significant IT systems and internal control processes. It needs to be emphasized, moreover, that integrating the new requirements in the way in which they will need to be presented according to the proposals (i.e., fixed format templates) will require making substantial IT changes in any event. Implementing the proposals will, furthermore, require dedicated experts within banks (i) to achieve a common understanding of the new requirements; (ii) to make the disclosures internally coherent; and (iii) to examine how to make them more user-friendly. The need to provide a higher level of assurance of Pillar 3 data is also likely to cause delays.

We also note that there will be churn in some of the existing Pillar 3 tables, since certain changes are still to be expected. We believe that energy should not be wasted on disclosures that will change in the fairly near future. For example, the Fundamental Review of the Trading Book will not be finalized for some time. We also recommend that domestic regulators in each jurisdiction should have national discretion to allow institutions to use adapted regulatory reports as alternative templates, where appropriate, and as they see fit or as is practicable, since this data is already being prepared.

We firmly believe that a phase-in of implementation is warranted given the sheer volume and granularity of the new Pillar 3 proposals. We note the logic of beginning some disclosures at year end, given that many other types of qualitative disclosures are required for annual reports rather than quarterly. We therefore recommend that the new Pillar 3 requirements should start with a bank's first annual report after the effective date.

Reflecting on the rigor around the production of the management discussion and analysis, including the time required for internal control processes, we also request flexibility with respect to the requirement for banks to publish Pillar 3 reports concurrently with their financial reporting when the two reporting dates align (paragraph 22 of the consultative document). We recommend that banks be allowed additional time to complete their Pillar 3 disclosures such that publication would not necessarily have to coincide with financial reporting dates.

We also note that the consultative document requires disclosures other than those relating to capital requirements calculations to be provided "in line with the reporting schedule of a bank's financial reporting" (paragraph 21 of the consultative document) – meaning that banks reporting quarterly to the market should similarly produce quarterly quantitative Pillar 3 reports. We strongly challenge the usefulness of a general rule requiring banks to update templates on a quarterly basis. Clearly, much of the required Pillar 3 data tends to be stable over time and, as a result, the movements are, in general, expected to be only marginal. The principle should be that – except where more material items are concerned – information needs to be updated on an annual basis only, unless material changes have occurred to such information.

While all jurisdictions support some form of phase-in mechanism, there are varying views on the appropriate way to phase in specific templates. Most jurisdictions appear to be open to starting phase in from Q4 2016, with completion in Q4 2017 or 2018. Some jurisdictions believe that annual disclosure is most appropriate, and that more frequent updates should only be required where there is a material change or where new developments have occurred. Others are more open to providing quarterly updates, but only for critical templates. We will leave it to each jurisdiction to provide their views on phase-in and frequency as per their individual submissions on this topic.

Support for other industry submission

We would also like to express our general support for conceptual underpinnings of the joint Institute of International Finance (IIF)-International Swaps and Derivatives Association (ISDA)-Global Financial Markets Association (GFMA) submission, as we are broadly aligned as an industry with the key messages expressed in their submission, and indeed many of our member banks have participated in its development.

We thank you for taking our comments into consideration and would be pleased to discuss them further at your convenience.

Yours sincerely,

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