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Comments by the German Banking Industry Committee on the Consultative Document 'Review of the Pillar 3 disclosure requirements'

10. October 2014

Dear Madam, dear Sir,

We welcome the publication of the above-mentioned Consultative Document and appreciate this opportunity to provide our comments in the following:

General comments

In principle, we welcome the Basel Committee's initiative to revise the Pillar 3 disclosure requirements and thereby to improve the provision of meaningful information for users of Pillar 3 reports. It also makes sense to require a more formal structure for certain disclosures and to standardise them since this will improve the comparability of information.

At the same time, however, we note that there has been a significant increase in the **scale of information to be disclosed**. We have serious concerns that the sheer abundance of information might overwhelm users, rather than helping them to obtain a better understanding of the risk exposures faced by individual institutions.

Our experience to date has shown that interest in Pillar 3 reports has tended to be low. This was shown clearly by the number of reports downloaded from the Internet as well as by the small number of queries received and by feedback from investors and analysts.

We have doubts as to whether the proposed disclosure requirements will meet their information needs. We are propos-

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ing in this case to proceed along the same lines as for the EDTF recommendations and to **identify the information requirements in an interactive process involving the preparers and users of the reports**. Ultimately, however, the package of requirements should only stipulate mandatory disclosure for information that is highly relevant for the majority of the users. Cost/benefit considerations should also be examined carefully at all times.

It is our impression that the proposed requirements also heavily reflect the information needs of supervisory authorities. We would like to stress at this point that, as a rule, the supervisory reporting mechanisms already give supervisors more comprehensive access to the institutions' Pillar 1 information. In the case of many disclosure requirements, it is not clear how they are expected to or can achieve the stated objectives of improving market discipline and decision-usefulness for market participants.

Additionally, we would urge the Basel Committee to examine whether the scope of Pillar 3 disclosures is still appropriate: in some cases the scale of the Pillar 3 report is likely to exceed that of the annual report and risk report.

We would also welcome greater transparency surrounding the revision of the disclosure framework. It would be helpful if the Basel Committee issued feedback statements explaining how the individual comments of preparers and users have been taken into account.

According to the Consultative Document, the requirements are expected to be implemented as early as the beginning of April 2016. We think that this timetable is unrealistic. Rather, the Pillar 3 revision should be used to develop a framework that is focused on the interests of users, and quality should take priority over speed. In this respect, we strongly urge the Basel Committee to step up its dialogue with preparers and users and to identify the actual information needs – including in order to distinguish it from other reporting obligations. We believe that **the beginning of 2017** would be the **earliest possible implementation date**. Overall, we think that the timing for the effective date of the disclosure requirements chosen by the Basel Committee is extremely disadvantageous and wish to draw express attention to the fact that, for example, the rules for determining RWAs are currently being revised (Basel IV: Fundamental Review of the Trading Book, counterparty credit risk, standardised approach to credit risk) and that the amendments resulting from this revision will entail further modification of the disclosure templates. In addition, granular data is now required in a new format in many places (for example in templates LI1 and LI2), which will also trigger corresponding implementation activities. Overall, we therefore suggest a phase-in approach. During this phase, the decision-usefulness of the disclosures could be validated by the Basel Committee and the information needs discussed in the course of a dialogue with the preparers and users of the reports. The aim here should be to eliminate duplication or excessive disclosures and granularity.

In addition, the requirements cannot be implemented within a short period of time. In particular, for example, the use of fixed template formats means that IT systems will have to be modified at considerable effort to allow the necessary information to be captured. In turn, the banks can only start their implementation projects once the final rules are known. In Europe, for example, these will also have to be transposed into EU law.

Overall, we welcome the move to **standardise** the required information. However, in many cases the level of detail required is too great. Equally, the principles of relevance and materiality, as well as non-disclosure of information that is sensitive for competitive reasons, are not adequately reflected in the

package of requirements. We therefore ask the Basel Committee to relax the rigid requirements at least by clarifying the general principle that fields in a template or table need only be populated if the information is deemed to be relevant and material. We would also like to draw attention to the fact that equivalent concepts are already applied in financial accounting and banking supervision disclosures. For example the European Banking Authority (EBA) has recently published draft guidelines on materiality and the protection of proprietary and confidential information. We are therefore urging a close exchange of information between the regulators in this respect so as to ensure conceptual consistency.

We believe that the **frequency of disclosure** is too high. For institutions with quarterly financial reporting, the requirements mean that almost ¾ of all tables will have to be disclosed. Much of the information will only change insignificantly, so considerations of relevance mean that more frequent reporting than an annual cycle does not appear to make sense. Moreover, quarterly reports are prepared in a much tighter time frame than the year-end report. Given that the supervisory reporting information only has to be transmitted to the supervisory authorities after 30 working days, we believe that it is not appropriate to publish part of this information in advance as part of the Pillar 3 disclosures. We are therefore advocating allowing annual disclosure for the templates listed in the column 'As frequently as financial reporting'.

The simultaneous publication of financial and disclosure reports, as proposed in para 22, would not be practicable in our view, given the increasing scale of disclosure requirements and the increasing frequency of disclosure. Since the disclosure report is based on accounting and reporting information, it cannot be compiled until this information is available in its final form. For this reason, it would be virtually impossible to publish both sets of data at the same time. We would suggest amending para 22 to require publication of the disclosure report without undue delay. We believe publication within a period of at least four weeks would be feasible.

We are also concerned about the proposal in the Consultative Document to require banks to disclose **hypothetical capital requirements** based on the standardised approach to credit risk. This makes a nonsense of the use of internal models and will not help improve transparency about an institution's risk exposures. Equally, disclosing the results of applying the standardised approach to credit risk does not say anything about the quality of a model. Rather, it should be borne in mind that internal models are considerably more risk-sensitive than standardised approaches can be. They are also subject to regular backtesting exercises and are sufficiently validated. To this extent, we are firmly against calculating and disclosing such hypothetical results.

Please note in addition the following comments on the individual templates:

As regards the reconciliation from financial statement to prudential exposures required in Part 4 (Linkages between financial statements and prudential exposures), we are arguing in favour of revising the definitions and objective of the templates currently being proposed. In this context, we wish to draw attention to the fact that a comprehensive reconciliation (differences in the scope of consolidation, definitions, impairment, treatment of off-balance-sheet items, etc) would entail a considerable implementation effort without producing any significant increase in understanding for users. As far as disclosure template LI1 is concerned, we are also uncertain whether financial statement carrying amounts or exposure values should be entered in columns c to g. Based on our current understanding, the reconciliation from financial statement amounts to regulatory exposure amounts proposed in disclosure template LI2 would mean that significant differences, for example FV changes of AFS or HfT securities, would have to be reported in 'Other differences'. We therefore proposing reviewing whether the structure of the two templates matches

the information objective. As an alternative to the granular reconciliation, we believe that a qualitative explanation of the main differences would be more useful for the users.

As regards the credit risk templates contained in Part 5: Credit Risk, we would like to start by commenting that certain of the new disclosure templates would trigger an implementation effort at the institutions that is entirely disproportionate to the disclosure objectives, because it would be necessary to create and maintain new databases solely for disclosure purposes. This refers in particular to disclosure templates CR4, CR5, CR9, CR10, CR11, CR12 and CCR8. From our perspective, these templates should be considerably reduced.

Our understanding is that the value to be analysed in template CR1 is the regulatory EAD; however, the template calls for gross values to be disclosed, ie before credit risk mitigation. Because this will result in considerable additional implementation effort, we are requesting clarification as to the Basel Committee's information objective in defining gross values here.

In disclosure template CR3, the Basel Committee is using a new, broadly defined concept of 'protections'. Institutions will have to compare the exposure before and after protections and net of provisions and impairments. However, guarantees directly affect the PD in the (basic) IRB approach, for example, so 'deducting' this credit risk mitigation would again result in considerable additional implementation effort. We are therefore asking for clarification in this respect that 'deducting' and disclosing this credit risk mitigation is not what is intended by the Basel Committee.

Disclosure template CR4 calls for a highly detailed breakdown of the way the coverage ratio is calculated. In light of the information on asset quality and in view of template CR3, we suggest examining the extent to which the information needs of the users can also be met by ratios instead of granular specific data.

To avoid information overload for the users, the principle of materiality should apply to the very comprehensive information requirements being proposed in template CRE (eg rows e and f), and only information that is actually necessary for an understanding of credit risk should have to be disclosed.

Template CR10 requires an overview of the effects of credit risk mitigation on RWAs under the IRB approach. Because the data are unlikely to change much from quarter to quarter, we are firmly against quarterly disclosure and in favour of annual disclosure.

We hope that you will be able to consider our comments.

Yours sincerely,

on behalf of the German Banking Industry Committee
National Association of German Cooperative Banks

by proxy

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