

Brussels 18 May 2018

Second Draft - EBF response to the BCBS Pillar III disclosure requirements

Key messages

- The EBF is concerned that in several requirements, the information to be disclosed does not add value to the reader; on the contrary, in many cases as explained below the amount of information increases the risk of misinformation and reduces the ability to compare firms
- Our members anticipate that the phasing period including the output floor will de facto be shortened substantially due to market expectations penalising any deviations from the proposed requirements well in advance
- We would like to express our severe concern about introducing the Standardised Approach as a benchmark in the calculation of RWAs because it would wrongly lead investors to consider it to be the “correct and benchmark measure”
- We agree with the Basel Committee on Banking Supervision’s (BCBS) motivation for the proposed amendments to the credit risk template as a consequence of the revisions made to the SA and internal approaches, however we oppose the margin of discretion recurring throughout the consultative document for reasons of comparability
- With respect to operational risk the detailed qualitative and quantitative information about losses should only be provided to European supervisors
- The detailed level of disclosure as regards the Credit Valuation Adjustments, notably the exhaustive list of the inputs used in the calculation, description of the proxy spread etc., stands in stark contradiction to the notion of confidentiality and risks exposure of sensitive information

The EBF would like to thank the BCBS for the opportunity to comment on the consultative document “Pillar 3 disclosure requirements – updated framework”. The EBF and its members associations appreciate the open dialogue initiated by the BCBS including the Outreach session on April 4th inviting banks as well as users of Pillar 3 information to share their views on the updated framework. This response aims to document the concerns raised by European banks which we hope you will find informative and relevant in finalising the requirements.

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Enabling market participants to obtain an adequate picture of banks' risks is crucial to ensuring the proper functioning of financial markets as well as to building trust. As a consequence of the 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.

In general, we support the effort to formalise and coordinate disclosure requirements in the interests of increasing transparency. With this in mind, however, we are concerned about the increasing volume of disclosures which could bring about confusion. The disclosures should address issues that can be understood by the wider public. Information that is sensitive or too technical should be part of supervisory reporting but not disclosed. We give some examples in our response.

The EBF remains ready to engage in the debate during the finalisation of this important global standard.

Question 1: *What are respondents' views on the proposed disclosure requirements set out within the Consultative Document?*

The comprehensive scope of the underlying requirements may be questioned as several indices are not meaningful to readers and are not conducive to providing a valuable overview. Further, the overall low usage of Pillar III information does not support these additional enhanced requirements, note rating agencies which would be a small user group are already in possession of the information regardless. In addition, regulators should assess the effects of Phase 1 and 2 disclosures along with IFRS9 before proceeding with the introduction of new requirements.

The compromises reached on the Basel III package, including the new output floor, envisage that the new requirements will be phased in until 2027. Owing to the proposed disclosures, however, there is a danger that market expectations will make this phasing-in period much shorter in practice. With the help of the disclosed information, it will be possible to gauge the difference in every single asset class between the RWAs calculated using an internal model and the final 72.5% floor. The experience of phasing-in capital requirements under Basel III clearly demonstrates that, regardless of the transitional arrangements in force at a particular point in time, the market penalises any divergence from the final target level and expects future requirements to be met from the outset. It can therefore be assumed that these disclosures will also have the effect of bringing forward the impact on regulatory capital of the final level of the floor.

For this reason, we are opposed to these disclosure requirements in their entirety.

The implementation date for Phase III shall be January 1st, 2022 (see page 14 ff.). For banks with a fiscal year different to 31/12, this would lead to disadvantages as the implementation phase would be shortened for such institutions. We would prefer as an implementation date "the year-end 2022 report" or "end 2022" to avoid disadvantages (as adopted in the January 2015 Revised Pillar 3 disclosure requirements, page 2).

EBF comments by Chapter

1.1 Revised and additional disclosure requirements for credit risk

As the EBF, we agree that the implementation of the additional requirement regarding NPL exposure will prove detrimental to the level playing field when considering EU banks.

We should bear in mind that in the European Union, the EBA has already issued the template EU CR1-E with similar information about NPLs and forbearance exposures within its guidelines (EBA GL-2016/11) which had entry into force in December 2017. G-SII and O-SII entities are all required to disclose template EU CR1-E from that reporting date.

In the case of NPLs and forbearance information, the BCBS gives a margin of discretion to the national supervisor that could jeopardize the goal of offering comparable information between entities. Further, it would put those entities required to disclose this information at a disadvantage compared to those not required.

Recommendation

The BCBS should delete the margin of discretion conceived to national supervisors regarding information on NPLs and forbearance exposures.

1.2 Revised disclosure requirements for operational risk

Given that different banks are at different levels regarding the quality and quantity of their loss information, the extent to which the data is meaningful and comparable remains in question. The bald information required could lead to wrong conclusions and therefore establish an unlevel playing field resulting in raising more questions.

In addition, it is not clear how external parties can interpret a total loss figure in order to conclude on the quality of operational risk management as this figure covers very different aspects of the evolution of the loss (additional losses on past incidents, new losses, recoveries, adjustment of provisions,...).

Recommendation

In preference to the current proposal, it would be more informative of a bank's actual risk management and operational risk to break down losses by categories, and show a percentage breakdown of risk categories, rather than giving absolute amounts. Many members believe percentages and trends, rather than absolute amounts, would be more useful and less likely to raise problems of confidentiality. In any case there is the concern that some operational risk losses notably such as pending litigations and settlements may be subject to confidentiality. A specific mention of specific cases which allow not to report pending litigations and settlements should be provided. The detailed qualitative and quantitative information about losses should be provided to European Supervisors only.

1.3 Revised disclosure requirements for leverage ratio

The EBF is in support of the semi-annual disclosure of LR1 and LR2 as opposed to quarterly. A semi-annual disclosure would provide sufficient useful information for the end user. Moreover, a semi-annual frequency would be more aligned with that of CC1 and CC2.

Besides, it should be noted that, at the European level, the European Banking Authority advises to disclose full information on the leverage ratio semi-annually.

1.4 Revised disclosure requirements for credit valuation adjustments (CVA)

Following the finalised Basel III framework and the development of two approaches, - the standardised approach (SA-CVA) and the basic approach (BA-CVA), the BCBS has extended the disclosure requirements for a better understanding of banks' CVA capital charge and the strategies and processes on that matter.

However, the level of the detailed description of the regulatory CVA calculations – i.e. notably, the exhaustive list of the inputs used in the calculation, description of the proxy spread, - as required in table CVAB raise main concerns. It could imply to disclose information that is confidential and sensitive. Such information should not be shared with the market, but should rather be only disclosed to supervisors. Even if paragraph 5.1.5 in the consultation aims to allow banks not to publicly disclose any confidential information, it requires banks to provide an explanation of the non-disclosure due to confidentiality.

Recommendation

The number of inputs required for many templates is not providing meaningful information to the readers. The EBF advises to reduce the CVA requirements in their scope. More specifically, we recommend disregarding the requirement of such detailed information, especially respective to the quantitative information. If necessary, the information should be required to be disclosed to supervisors only.

1.5 New disclosure requirements for SA RWA to benchmark internally modelled capital requirements

Institutions authorised to use internal models, will be required to publish the hypothetical risk-weighted exposure amounts that would result if the applicable standardised approach was used for the relevant exposures. This means that the readers of Pillar 3 disclosures are being encouraged to use the standardised approach as a benchmark which will mislead them in the interpretation of the entities' level of risk. Overall, we have serious reservations about making direct comparisons between internal model results and requirements calculated under

prudential standardised approaches. Internal model approaches are much more risk sensitive than standardised approaches, so it is only logical that there will be differences between the results. A direct comparison, however, will normally suggest that the prudential figures are the “right” ones, especially if the internal model results produce lower RWAs. The evident focus in the two templates on the figures calculated under the standardised approach could lead users of the Pillar 3 report to regard these figures as the more relevant/more accurate, with the result that internal models become less valuable to banks and are gradually dispensed with. We would be highly critical of such a development since we believe that internal models allow for a better assessment of risk and that dispensing with them might sometimes cause risks to be underestimated. On top of that, the floor was designed as an “across-the-board” benchmark. Comparing results risk by risk would carry the idea to the point of absurdity and most likely lead the market to draw false conclusions.

In addition, disclosures by type of risks or type of assets could alter the gain from the phasing of the output floor until 2027. With such disclosures, starting 2022, the analysts and rating agencies would be able to compare and restate the capital requirements of the banks that are using internal models into standardised approach, without any floor.

Moreover, hypothetical RWAs under the standardised approach would provide neither more transparency on internal models nor more understanding of internal models. It would not reflect the risk profile of banks using internally modelled RWAs. To provide information on hypothetical RWAs under the standardised approach would bring more complexity in reading the Pillar 3 information. It would be difficult for users to understand the relevance of the standard RWAs compared to internal models based RWAs.

Recommendation

For all these reasons, we fully disagree with the BCBS proposed requirement to disclose standardised RWAs.

Alternatively, if granular information requirements were to be maintained for supervisory benchmarking purposes, we urge the BCBS to circumvent such data to the sole supervisory reporting remit and not to extend it to public disclosure.”

Part 2 New disclosure requirements on asset encumbrance

The EBF has remarks about the asset encumbrance disclosure requirements in that the information, albeit optional, is sensitive and may very well hamper the level playing field with respect to non-EU banks.

Part 3 New disclosure requirements on capital distribution constraints (CDC)

One of the main goals underneath Pillar 3 disclosure requirements is to provide standardised and comparable information to the market. In this regard, the BCBS should seek homogeneity as much as possible by deleting the margin of discretion

conceived to national supervisors and then, the level playing field will not be at risk.

We encourage members of the BCBS to clarify whether the CDC template should include Pillar 2 as a requirement and specify if this Pillar 2 includes also P2G.

Recommendation.

In Europe, Pillar 2 information is included in the requirement in contrast to other non-European banks, therefore we have severe concerns that the level playing field will be put at risk by requiring disclosing sensitive information. Further, the complication of implementing a template which is not applicable globally could exacerbate the risks of such information being misinterpreted by end-users.

Regarding the leverage ratio (row 3) we recommend including it as part of the leverage ratio template (LR2) since there exists no particular reason to disclose it separately.

Alternatively, for reasons mentioned above, the EBF advocates for the deletion of the CDC template.

Part 4 Amendments to the scope of application of disclosures on the composition of regulatory capital

→ **Question 2** *What are respondents' views on the advantages and disadvantages of expanding the scope of application of Template CC1 to resolution groups, relative to retaining its current scope of application to the consolidated group?*

We believe that reopening issues that have already been decided does not set a good precedent for future discussions as it raises concerns about the stability of the decisions already taken and creates regulatory uncertainty.

We agree with the BCBS that requiring a resolution group to disclose Template CC1 would be artificial, as there is no regulatory capital requirement to be applied at that level. The CET1 rules are designed for the prudential world. The CC1 template requires a breakdown of the constituent elements of a bank's capital. The regulatory capital is designed under specific prudential rules with a different scope, nature and perimeter than those that govern the resolution requirements. Some examples are:

- There are some instruments that do not count towards TLAC/MREL in the same way they count towards capital, and vice versa.
- The excess of provisions that can count towards T2 is determined according to the prudential perimeter, which is not the same as the resolution one;
- The equity holdings of the subsidiaries are weighted according to the capital rules while in TLAC/MREL the treatment is different.
- At local level, the capital requirements of the countries are set according to local rules. Not all countries are under Basel III and therefore local rules differ among them.

By requiring capital composition to be disclosed at resolution group level there is a risk that such disclosure is also understood as a minimum requirement to comply with. Usually, disclosure requirements are built on prudential requirements already established. However, in this case, a disclosure is being discussed with no prudential requirement behind it. This could add more confusion to the way the template should be understood. Investors could understand this as a requirement and could be tempted to apply the same interpretation rules that they apply when analysing the CC1 template at consolidated level.

Given that only MPE groups would face this requirement this would lead to a situation where SPE banks provide one single template and MPE several templates where only the consolidated one would correspond to a prudential requirement. The rest would be just a mere artificial concept built on many hypotheses but that could be interpreted by the market as an assessment of the capital position of the resolution group where there is no such capital position. This could increase the risk of misinterpretation and the level playing field would be at risk.

Furthermore, investors have already all the information they need. The TLAC/MREL1 template provides broad details of the composition of TLAC/MREL at resolution group level. The template comprises regulatory capital elements and non-regulatory capital elements. In addition, the regulatory capital item includes the most important determinants of its composition: CET1, AT1 and T2. This is the information that investors need to know. A further breakdown of CET1 does not help investors to better understand the capital position of the resolution group. On the contrary, as stated above, it increases confusion.

MPE banks have regulatory capital but not TLAC/MREL requirements at consolidated group level. A different perimeter applies with regard to TLAC/MREL and capital requirements. Combining the two of them (CC1 and TLAC/MREL1) at resolution group level would be particularly confusing for investors.

According to the BCBS (see Pillar 3 consultation), the consolidation perimeter of a resolution group may not coincide with that applied to banking groups under the Basel framework, particularly in terms of the coverage of group entities (which applies to both MPE and SPE), given the different treatment of insurance subsidiaries in both frameworks.

Additionally, the BCBS (again, see Pillar 3 consultation) states that disclosure of requirements at resolution group level could lead to a greater disclosure burden for G-SIIs with an MPE resolution strategy putting them at a clear disadvantage compared to SPE banks. Not only would MPE banks have to cope with greater disclosure requirements, they would also have to face an increase in administrative costs in order to start reporting data at a new level of consolidation.

All in all, the prudential and the resolution frameworks share more differences than similarities:

- Their objectives are different

- There are differences in the scope of application of both frameworks. In principle, those subsidiaries that would be liquidated are excluded from the resolution perimeter.
- The TLAC/MREL term sheet does not apply at solo-level but to the resolution groups which responds to specific sub-consolidated units that not always correspond to the capital disclosure units.

Recommendation

Therefore, for MPE Banks, the status quo should be maintained. Their capital requirements should be asked at consolidated level while their TLAC/MREL/MREL ratios should in turn be required at resolution group level only.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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