



# EBA future actions to improve Transparency of institutions

# Outline

The current state of play and challenges in terms of Transparency

The EBA's future actions

- Guidelines and technical standards in the CRR
- Other EBA's actions
- Easing the access to disclosures

The forthcoming 2013 Transparency exercise

# The EBA and transparency

- Transparency relates to information that institutions have to make public in accordance with accounting or regulatory requirements (disclosures).
- These disclosures are an essential tool for market discipline.
  - The ability of third-party claimants like debt and equity holders to identify risk in financial institutions and to act in a way that signals those risks to other market participants or changes the behaviour of a financial institution.
- Transparency is one of the supervisors crisis prevention and crisis remediation tool.
  - Incentive for banks to adjust their risk-taking policies to contain their cost of capital
  - Crises demonstrated that transparency supports financial stability (dissipates and counter rumours, helps understand properly the risk profiles of the different credit institutions and distinguish the soundest).
  - Lack of transparency favours rumours and distrust, thus channelling crises.
- The EBA and supervisors have a role to play in ensuring adequate transparency.
  - Ensuring compliance, improving requirements, bridging gaps, level playing field.
  - Transparency is in the EBA's mandate.

# What has been done so far

## ■ **Transparency reports (since 2008)**

- Review of the adequacy or compliance of accounting or Pillar 3 disclosures and promotion of best practices to tackle issues of heterogeneity in both the form and the content of reports, low comparability, low interaction between Pillar 3 and financial statements disclosures.

## ■ **Disclosures principles in times of stress (2010)**

- Guidance on how to conform with existing disclosures requirements (general principles, content of disclosures, presentational aspects) while improving the quality of disclosures in terms of substance, presentation and internal consistency without increasing, amending or duplicating the current disclosure requirements –institutions are encouraged to apply them in normal time.

## ■ **Stress-test and recapitalisation exercise disclosures (2010, 2011 and 2012)**

- Disclosure of thousands data points for between 60 and 90 banks using common data structures and common definitions. Information released on capital composition, EADs, RWA, sovereign exposures.

## ■ **Monitoring/involvement in the development of new requirements**

# Disclosure challenges

- Despite actions by the EBA, other public institutions and private sector initiatives (for instance, the EDTF), leading to increased requirements, disclosures still face significant challenges impairing the effectiveness of market discipline.
- Disclosures gaps
  - Disclosures requirements may be un-complied with and institutions (cf Transparency reports).
  - Ever-evolving nature of risks/ the issue of emerging risks – institutions do not always go beyond mere compliance with existing requirements even if necessary to convey a true vision of risks.
- Consistency and comparability
  - Issues regarding the content, underlying definitions and presentation of disclosures (too much variation prevents meaningful comparisons).
  - Difficulty to get a comprehensive risk picture because low interaction between disclosures provided in different frameworks (unexplained differences).
- Accessibility of information
  - Disclosures are spread across different reports in different locations.

# The EBA's future actions

- The EBA will go a step beyond its current actions to address disclosures challenges.
  - Through specific actions forecast in the newly issued Capital Requirements Regulation.
  - Through other actions of its own initiative.
- The EBA actions will mainly be aimed at improving regulatory disclosures.
  - Disclosures requirements laid out by Part Eight of the CRR (Pillar 3 disclosures).
  - Accounting disclosures will be covered more specifically via cooperation with other relevant EU institutions (for instance ESMA).
- Enhanced action by the EBA regarding Pillar 3 disclosures is supported by stakeholders although not all wish the same type of actions.
  - Credit institutions favour guidance over standardisation (leaning towards idiosyncrasy).
  - Users support standardisation of Pillar 3 information and support reconciling Pillar 3 with accounting information (leaning towards consistency).
- The EBA's actions will follow both a consistency and an idiosyncratic track.
  - Compliant and tailored information based on consistent definitions and presentation formats.

# Ensuring consistency and comparability

- Transparency works properly only if underlying data is consistent, of high-quality and reliable.
  - Harmonisation of both the form of the content is crucial.
    - ▶ Harmonisation through guidelines, definitions, templates.
  - Harmonisation but not standardisation.
    - ▶ Idiosyncratic aspect of disclosures preserved.
- Harmonisation will be achieved via the CRR provisions on disclosures.
  - Guidelines on the need for more frequent disclosures, and on the notions of materiality, confidentiality and proprietary,
  - Guidelines on unencumbered assets,
  - Implementing technical standard on own funds disclosures,
  - Implementing technical standards on disclosures of GSII indicators.
- Harmonisation could also proceed from other EBA tasks.
  - Review of Pillar 3 reports, Guidelines on Pillar 3 or other topical disclosures.

# Guidelines in the CRR (1)

- Need for more frequent disclosures (Article 433 CRR)
  - Exchanges with stakeholders have shown they value frequent disclosures of regulatory information (ex: quarterly).
  - More frequent Pillar 3 disclosures are a national discretion in the CRR/CRDIV and practices of jurisdictions and institutions vary (cf 2013 Transparency report).
  - Guidelines to foster convergence of practices and consistency of content regarding more than annual disclosures.
  
- Materiality, confidentiality and proprietary nature of disclosures (Article 432 CRR)
  - Non-materiality, confidential or proprietary nature of information is often argued to justify its non-disclosure in Pillar 3 reports or exchanges with NSA.
  - Materiality is a widely used concept: 159 hits in the CRR, also in accounting standards (IAS 1, Conceptual framework) and audit regulations (ISA 320).
  - Confidentiality has a legal backing with differences across the member states.
  - Proprietary is tied to the institution's policies.
  - Guidelines to ensure consistency in the understanding and application of these different concepts by institutions to ultimately ensure better compliance with disclosure requirements.



## Guidelines in the CRR (2)

- Unencumbered assets (Article 443)
  - ESRB recommendation 2012/2 December 2012 to address the lack of disclosure requirements on unencumbered assets.
  - Provide consistent definitions and format as encumbered/unencumbered is not currently defined in the regulatory or accounting frameworks and disclosures currently provided by institutions (following some initiatives like the EDTF) vary in content and presentation.
  - Take into account current CRR and IFRS requirements and recommendations from the EDTF.
  - Possible technical standard in 2016.
  
- Time-table
  - Guidelines on frequency, and notions of materiality, confidentiality and proprietary nature to be written in 2014 (deadline for finalisation: 31 December 2014).
  - Guidelines on unencumbered assets are currently being drafted (deadline for finalisation: 30 June 2014).
  - All guidelines will be released in 2014 for an appropriate consultation period.

# Technical standards in the CRR

- Own funds disclosures (article 437)
  - Comparability of own fund disclosures often questioned, in particular regarding the definitions of concepts (core Tier 1, core capital) and the granularity of components and deductions (see last and previous Transparency reports).
  - Technical standard is the EU declination of the 2012 Basel rule text on own funds disclosures adapted to the EU.
    - ▶ consistent and comparable disclosures on the characteristics of own funds, capital components and deductions, reconciliation accounting/regulatory elements, effects of the transition to Basel III.
  - Released in July and in the process of being endorsed by the EU Commission.
- GSII indicators (Article 441)
  - Uniform format and date for the disclosures by relevant institutions of the value of indicators used to identify them as Globally Systematically Important Institutions.
  - Take into account the BCBS disclosure requirements adapted to the EU situation.
  - Currently under drafting and will be consulted upon in 2014 (deadline for finalisation: 1 July 2014).
  - Stakeholders will be able to assess and compare the GSII status of institutions.

## Other EBA's actions

- Increased consistency and comparability via harmonisation is also needed in areas without explicit CRR task assigned.
- The EDTF recommendations (October 2012) have provided a well-noted push for accounting and regulatory disclosures improvement but efforts are still required.
  - As of July 2013, 50% of recommendations had been implemented and 72% should be implemented by end 2013 (EDTF survey of 31 G-SIB and N-SIB institutions).
    - ▶ Expected implementation by end 2013: 100% UK, 60% continental Europe, 40% US,
    - ▶ Has improved granularity and comparability of disclosures when implemented ,
    - ▶ Most implemented: index of disclosures, description of risks and risk management,
    - ▶ Least implemented: liquidity, asset encumbrance, capital and RWA flow statements, linkage between market risks and balance sheet exposures.
- The Basel Committee has started work to revise the Pillar 3 framework.
- The EBA will leverage on initiatives by the private and public sectors in its own work aimed at increasing comparability and consistency of disclosures.

## Other EBA's actions (2)

- Monitoring of compliance with disclosure requirements and promoting best practices.
- Provision of definitions that can be used for disclosures.
  - Asset encumbrance
- Work towards harmonisation in Pillar 3 disclosures and the provision of other topical disclosures when needed.
  - Implementation of revisions to the Pillar 3 framework by the BCBS when finalised.
    - ▶ Basel Working Group on Disclosures will consult on revised Pillar 3 disclosures.
  - Improvement of disclosures in areas that are of interests for stakeholders and supervisors.
    - ▶ Some may depend on the outcome of some on-going work (AQR, TCOR, Other SII...).
    - ▶ Improvements may leverage on supervisory reporting to provide a common minimum disclosure presentation framework and definitions – supervisory reporting used as an input in disclosures on unencumbered assets.

# Facilitating access to disclosed information

- Market discipline works if stakeholders have access to information.
  - Information currently disclosed by institutions but costs of access would be lowered and market discipline empowered if essential parts of it were accessible in a single location.
- In the US the SEC and the Federal Financial Institutions Examination Council act as central repository for information on financial institutions.
  - The SEC centralises annual and quarterly disclosures of institutions (no Pillar 3 in the US yet).
  - The FFIEC makes annual and quarterly supervisory reporting publicly available on its website for all supervised institutions.
- The EBA has only centralised information on an ad hoc basis for individual data.
  - Stress test, recapitalisation exercise.
  - Acts as central repository for aggregate disclosures and disclosures by supervisors.
- The EBA will continue and expand its role of repository to make consistent and comparable information easily available.
  - 2013 Transparency exercise
  - Further extension in accordance with progress in harmonisation of disclosures

# The 2013 Transparency exercise (1)

- The EBA has since 2011 undertaken work to facilitate direct disclosure of specific exposures and capital breakdown.s
- **The EBA will run a Transparency exercise in late 2013 in preparation of the 2014 stress tests** to dissipate lingering uncertainties about EU banks' balance sheets.
- **2011 stress test**
  - 3400 data points were disclosed (unprecedented disclosure) on 90 banks.
  - Common data structure accompanied with appropriate and public definitions.
  - Participants were able to perform their own analyses, understand the drivers of the stress test results and simulate the impact of alternative assumptions.
  - Sovereign risk, capital elements and definition of Core Tier 1, breakdown of EAD across homogeneous portfolios and geographical areas with identification of defaulted exposures.
- **2012 recapitalisation exercise**
  - Recapitalisation report covered 61 banks.
  - Common breakdown of capital elements and definition of Core Tier 1 and common breakdown of RWAs across homogeneous risk categories.
- These exercises had a well-known and measurable **positive impact on markets.**

## The 2013 Transparency exercise (5)

- Academics' views on the disclosures in the 2011 stress test
  - *Overall, our analysis shows that stress tests produce valuable information for market participants and can play a role in mitigating bank opacity. (Petrella, Resti 2013)*
  - *First, we find that the timing and content of different mandatory disclosure events helps explain the levels of stress test banks' voluntary disclosures about sovereign risk. Second, although the bid-ask spreads of stress test participants generally increased after the mandatory stress test in 2011, our results suggest that the decrease in market liquidity is entirely attributable to those stress test participants that did not commit to voluntarily maintaining the disclosures of sovereign risk exposure. (Bischof, Daske 2013)*
- The 2013 Transparency exercise aims at achieving similar outcome as the stress test disclosures.

## The 2013 Transparency exercise (6)

- The 2013 Transparency exercise will disclose relevant, consistent information both in the content and in format.
  - Complementary to disclosures in accordance with accounting/regulatory requirements.
- Information will be released on the following areas of interests for markets:
  - **Capital and RWA** : CRD 3 rules but identification of relevant elements for CRD IV/CRR (minority interests, DTA, CVA)
  - **Credit risk and value adjustments and provisions**: Separately by country, regulatory approach (AIRB, FIRB, Standard), credit status (defaulted, non-defaulted), CRR exposure classes
  - **Securitisation**: Banking book, trading book, correlation trading portfolios
  - **Market risk**: Derivatives and cash positions by regulatory risk classes
  - **RWA**: Credit risk, securitisation, market risk, operational risk, floors, others
  - **Sovereign risk**
- Templates to be filled according to a methodology that will be published.
- Release in **December 2013** (December 2012 and June 2013 data).



# Conclusion

- More has still to be done to ensure adequate disclosures and the proper functioning of market discipline.
- The EBA will conduct a number of actions from now to 2014 and beyond to achieve this goal.
  - Transparency exercise, guidelines, technical standards.
- The EBA will play its part in improving disclosures but efforts have also to come from the industry.
  - Compliance with applicable requirements and disclosure principles.
  - Remember these requirements only set minimum disclosures thresholds (required information has to be supplemented by more tailored information to adequately picture the risk profile of the institution).
  - Proactivity in identification of new risk areas and needed related disclosures / participation in the EBA disclosures initiatives and implementation of disclosures recommendations.