German Banking Industry Committee comments on "Draft Implementing Technical Standards on Disclosure for Own Funds by Institutions"

Ladies and Gentlemen,

We are grateful for the opportunity to comment on the Consultation Paper "Draft Implementing Technical Standards on Disclosure for Own Funds by Institutions" which you published on 7 June 2012.

On principle, we agree with the Consultation Paper’s declared goal of ensuring harmonisation between disclosure requirements for capital elements and the definition and composition of regulatory capital under the CRR.

However, we would like to point out that the level of detail required in the Consultation Paper is clearly excessive. For instance, both in terms of quantity and quality - compared to the current disclosure requirements concerning the reporting of capital information, the proposed capital disclosure requirements have been expanded considerably. Whilst part of these new disclosure requirements can be seen as a response to the further development of the respective capital standards and capital definitions under the new CRR requirements and are thus obviously warranted, large parts of the responses to be disclosed reach a level of detail that goes well beyond the rationale behind the disclosure and is tantamount to supervisory reporting requirements. The requested additional quantitative disclosures do not necessarily promote transparency and a better understanding. Quite on the contrary, more likely than not, even for knowledgeable market participants the sheer breadth and complexity of the information that has to be disclosed will render an adequate assessment of a bank’s capital position difficult. This confirms our impression that the leitmotif behind these new requirements consists less in the interests of market participants but instead in the banking supervisor’s information needs which are already met under the supervisory reporting requirements.
In the EU Commission’s draft Regulation an ITS submission as per 31 December 2013 was deemed sufficient. However, within the ITS framework, the EBA now single-handedly changes this deadline to one year earlier. At this juncture, it is worth noting that compliance with the comprehensive disclosure requirements presupposes adjustments to the IT-systems in order to ensure automatic data transfers. This migration requires a certain amount of lead time.

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

Annex I

It is self-evident that banks have to demonstrate the derivation or, moreover, reconciliation of the data used in certain analyses. However, from our point of view said onus of proof only exists vis à vis banking supervisors and external auditors. We are of the opinion that banks shall and must not be obligated to provide the same evidence to market players, at least not featuring the level of detail requested under the current proposals. In our view, this lacks any 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 in the field of industry or insurance firms. Furthermore, the reconciliation is apparently not only limited to the capital elements mentioned in the CRR. Instead, its scope is being extended to include each and any assets and liabilities.

In our view, the reconciliation statement envisaged under Annex I is clearly excessive. In order to arrive at reconciliation between regulatory capital and capital within the meaning of the local GAAP, it is not necessary to present each and any asset on the basis of two different consolidation scopes. Rather, it is sufficient to merely report the different accounting items that are required in the reconciliation statement on the basis of different consolidation scopes and to briefly explain how they were derived. In our view, the proposed methodology constitutes an excessively comprehensive presentation format for the derivation. Given its complexity, this may cause additional confusion. Furthermore, we feel that the basis for the reconciliation statement presented in the Consultation Paper is rather ambiguous. Along with a presentation of assets and liabilities separately as the balance sheet figures used respectively for the scope of regulatory consolidation on the one hand and accounting consolidation on the other hand, it would also be conceivable to have a comparative presentation of the numbers used in the published financial statements and of the risk-weighted figures.

Furthermore, we hold the view that there is an urgent need for a stronger focus on the principle of proportionality, i.e. a balanced requirement (for instance an abbreviated version of the disclosure requirement).

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 least, the reconciliation statement should be limited to the capital elements set out in the CRR.
Annex II

We would like to point out that disclosure of information on the terms of the capital instruments is already mandatory under the current disclosure requirements. In our view, these existing disclosures are already sufficiently detailed in satisfying market participants’ information needs.

We would like to reiterate our view already expressed above that requests for more detailed disclosures are superfluous. The requested disclosures of the terms and conditions are not decision-relevant for market participants. The sole purpose of the requested disclosures consists in proving the existence of supervisory eligibility as set out under the CRR. Whilst we recognise the supervisory need for verifying this criterion, we doubt whether the disclosure requirements will constitute the correct regulatory framework in this regard. The disclosure requirement’s actual user group (investors, rating agencies etc.) will not hold such a detailed review. For them, it is sufficient to be aware of the material capital items on an aggregated level.

The envisaged ad-hoc reporting requirement is excessive which is why we reject this proposal. Such far-reaching reporting requirements would significantly aggravate the banks’ capital planning and control process. Especially the need to update existing disclosure information which would result whenever a new capital instrument is issued 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. As far as banks holding capital to the amount of several billion Euros are concerned, issuance volumes amounting to but a few million Euros merely account for a small percentage of the banks’ total capital meaning that such issuance plays but a subordinate role in the broader picture. 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 decision-relevant element in risk assessments.

Annex III

Whilst our fundamental scepticism vis à vis the legitimacy of the requirements under Annex II has already been mentioned above, also the requirements under Annex III appear excessive and seem unwarranted as far as the market’s information need is concerned. Under the present proposals, inter alia each and any terms and conditions of capital instruments are supposed to be listed. Banks would have to update this list whenever a new capital instrument is issued and included in capital. 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 the right to such in-depth insight, disclosing the terms and conditions likewise to market participants and thus, by default also to competitors, appears to be excessive. Hence, we would like to caution once more against blending supervisory reporting requirements and disclosure requirements vis à vis market participants. Another inherent Pillar 3 principle which is being ignored at this juncture is the principle of confidentiality. Furthermore, the rationale behind this information is not entirely transparent. Any assessment whether an instrument meets the regulatory capital requirements set out under the CRR comes within the respective supervisor’s purview. This is one of the fundamental tenets on which market participants shall and may rely. More likely than not, the interest in performing this assessment single-handedly will be extremely limited. After all,
this will incur additional costs for market participants. Hence, this requirement will prove to be a major drain on the overall economy which is not offset by any pan-economic benefit.

Last but not least, along with our general criticism concerning the requirements under Annex II and III, we should like to submit three specific proposals aimed at reducing the scope of the forthcoming disclosure requirements.

Since the scope of the disclosure needs to be transparent, meaningful and because last but not least since it should allow a visualisation of the content we would like to propose that it shall generally be left to banks' individual discretion whether the bank wishes to summarise the capital agreements on the basis of material elements. For instance, capital instruments within banks' are based on the respective individual agreement / terms of an issuance. Whilst these agreements are largely identical regarding their basic features, they may vary in terms of the individual contractual elements meaning that this could potentially result in up to 350 different capital classes that would have to be disclosed. For instance, in one bank a summary for internal purposes led to a reduction to thirty capital classes of a similar nature where the disclosure would not involve any loss of material information for the reader in terms of prudential supervision treatment or for capital management purposes. Hence, also in the framework of capital disclosure we feel that a summary into capital classes is meaningful and we explicitly endorse the creation of a corresponding option in the final EBA ITS.

Furthermore, capital components held by sovereign institutions or local authorities should be given special consideration. Due to the fact that such instruments cannot be bought or traded in the market, there is no need for a comprehensive ad-hoc presentation of the main features of such components.

One further option for reducing the requirements would be a lex specialis for ordinary shares and preferential shares. At most, any comprehensive ad-hoc disclosure would only be meaningful if such instruments possessed different features.

We would like to submit the following, more specific comments on the questions contained in the Consultation Paper:

**Q01: Are the provisions included in this draft ITS sufficiently clear? Are there aspects which need to be elaborated further?**

The ITS does not elaborate the issue of the disclosure frequency. Thus far, in our preliminary understanding, it relies upon the final general provisions on the disclosure frequency as set out under Article 420 of the draft CRR. In this context, however, there ought to be a definitive clarification concerning the expected deadline and the minimum intervals for first-time ITS application. In this respect, the Basel document now stipulates clearly that the mandatory deadline for first-time application will be 30 June 2013 and that the disclosure frequency shall be in line with financial reporting.

Furthermore, whilst the BCBS paper stipulates a need for ongoing updates of the disclosed information if and when changes occur affecting the eligible capital instruments, the draft ITS does not make it clear to which extent this will become necessary. At this juncture, we would welcome avoiding inconsistencies between the submitted ITS and the Basel paper by way of omission of a specific requirement. Since the Basel paper explicitly only addresses banks active at an international level this would also be justified. Such an approach would facilitate the search for an appropriate solution based on the principle of proportionality in the course of the European implementation process.
The Basel paper would require internationally active banks to carry out ongoing updates meaning that they would be subject to a more stringent regime. This would be consistent with the proportionality principle.

Furthermore, concerning the scope of application defined under Article 12(1) of the draft CRR – and pending its final wording – we would appreciate a clarification as to the extent to which capital disclosures as contemplated by the submitted ITS would also have to be made for subsidiaries. In this context, we strongly suggest that the disclosure scope under the proposed ITS be explicitly limited to the “parent bank” only. Hence, also in this regard, it is vital to avoid any regulatory scope that goes beyond the requirements under the Basel regime.

**Q02: Are the provisions provided for the balance sheet reconciliation methodology sufficiently clear?**

In terms of content and timeline, the forthcoming disclosure standards covering the reconciliation between the regulatory capital and the IFRS capital need to be synchronized with the switch from the local GAAP to the IFRS reporting basis. What would be particularly unacceptable is an earlier introduction of the disclosure requirements. This is due to the fact that such an approach would result in considerable additional costs for banks without being justified by any adequate benefit on the part of the users of financial information. Quite on the contrary: If the disclosure requirements were to be divorced from banks’ actual reporting practices, this might give rise to misleading information for users of financial reporting information.

**Q03: Are the instructions provided in the template on the main features of capital instruments, in the general own funds disclosure template and in the transitional disclosure template sufficiently clear? Should the instructions for some rows be clarified? Which ones in particular? Are some rows missing?**

Concerning the composition of the templates we would like to share the following observations:

**General observations:**

a. We have our reservations over the disclosure of quantitative capital details. Yet, should this be inevitable, in order to ensure consistency and in order to alleviate the implementation effort we suggest modelling this template on the corresponding COREP reporting template.

b. Furthermore, under indent 41, the final Basel Paper “Composition of capital disclosure requirements” prohibits any amendments to the templates. This means that even the numbering [of the lines] has to be identical. Should a detailed version become necessary in the submitted form, during the implementation by EBA these aspects should absolutely be taken into account. In order to ensure compliance with the requirements set out under the Basel Paper, especially in cases where the ITS lines were not adopted or where they were adopted in an amended form, the rationale behind this amendment should be explained.

Line 10 of the (Transitional) Own funds disclosure template:
The “of which” references concerning “Instrument type 1-3” are unclear. Which EBA list as defined by Article 24(4) draft CRR does this refer to? Furthermore, we object to any further spread [of the balance sheet] beyond the level [of granularity] laid down in the Basel templates. Our objection is due to the fact that such an approach would fail to deliver any added value for users of financial reports.
Q04: Our analysis shows no impacts incremental to those included in the text of the Level 1 text are likely to materialise. Do you agree with our assessment? If not please explain why and provide estimates of such impacts whenever possible.

The disclosure requirements for own funds presented in the ITS are based on the Basel paper "Composition of capital disclosure requirements", which originally was not part of "Basel III". Furthermore, the Basel paper or, moreover, the provisions presented in the ensuing ITS exceed the requirements under the CRR/CRD IV meaning that there is by no means any consistency with the impact of the "Level 1 text".

Contrary to your assessment, there will be material impacts which will especially result on the following grounds:
Even if the envisaged introduction achieves congruence with the detailed information necessary for COREP, in terms of the disclosure channel this requires creating previously non-existent infrastructure (e.g. proprietary website).
However, especially the requested reconciliation statement exceeds the „Level 1 text“ and thus requires the creation of previously non-existent processes. (cf. Q02)
In the case of changes to eligible capital instruments, the potentially required on-going updates, i.e. not only disclosure based on a given deadline constitutes a paradigm shift in the regulatory disclosure regime and requires entirely new processes as well as the corresponding IT-infrastructure.

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 German Banking Industry Committee
Federal Association of German Cooperative Banks

[Signatures]
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