



EBA Follow-up review of banks' transparency in their 2012 Pillar 3 reports

Preliminary findings

Introduction

- Follow-up of the review of Pillar 3 disclosures performed since 2008.
- Assessment of the **compliance** of Pillar 3 disclosures with the CRD requirements.
- Objective: improving the compliance of banks with the disclosures requirements and achieving better and more consistent disclosures by the identification of good practices that institutions are encouraged to implement.
- Sample of European banks with year on year consistency since 2008 and covers the main European banking sectors.
 - AT, CH, DE, ES, FR, IT, LU, NL, UK.
 - Erste Bank, RZB, UBS, Commerzbank, Deutsche Bank, DZ Bank, BBVA, Santander, BNP Paribas, Credit Agricole SA, Societe Generale, Intesa San Paolo, Unicredit Group, BCEE, ING Bank, Rabobank International, Barclays, HSBC, Royal Bank of Scotland.
- The report focuses on areas in which needs for improvements were identified last year and includes a thematic study on interim disclosures.
 - Scope of application, own-funds, credit risk IRB, securitisation, market risk, remuneration.
- Report to be finalised and released soon.

Methodology

- Two levels of analysis to reduce potential bias even though judgement remains inherent in the nature of the assessment.
 - Institution level: national supervisors assess the degree of compliance of institutions in their remit for all the disclosures requirements in scope of the assessment.
 - Thematic level: dedicated small teams of two or three national supervisors assess the degree of compliance of all institutions towards specific disclosures requirements areas (ex: own-funds, credit risk IRB...).
- Institutions were graded for each disclosures area
 - 0 when no information is provided; 1 when insufficient information is provided; 2 when sufficient information is provided but disclosures could be improved; 3 when disclosures are compliant with; 3* when compliance is accompanied by best practices.
 - The score is 3 when an institution informs that required information is not disclosed due to immateriality or to its confidential or proprietary nature.
 - The score is lower than 3 in case information is not provided and there is no reference to its immateriality or its confidential or proprietary nature, or the supervisor has confirmed such information is applicable, or information is not provided in English.
- Good practices were identified for all banks, regardless their scores.

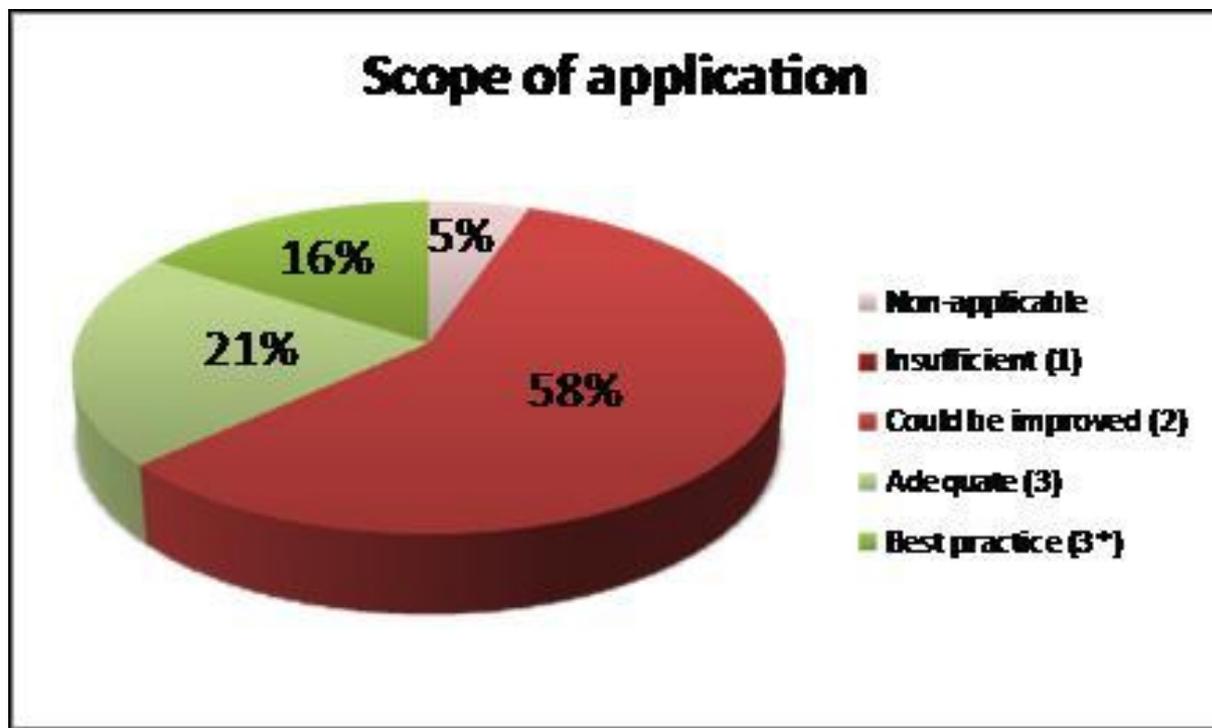
The EBA report and other initiatives

- Some parallel initiatives were developed in 2012 and 2013 from the official and the private sector to make disclosures more effective as market discipline instrument.
 - Basel Working Group on Disclosures, ESRB recommendations, Enhanced Disclosures Task Force, Eurofi disclosures principles, CFA disclosures index, IASB disclosures workshop...
- These initiatives tend to have a broader scope than the EBA report but share the same objective of improving disclosures and making them more effective.
 - The EBA reports focuses on the compliance of Pillar 3 disclosures with disclosures requirements.
 - Most of the other initiatives aim at improvements in disclosures either according to accounting or regulatory requirements.
 - Compliance is essential to improve disclosures and make them more relevant.
- The outcome of the other initiatives has been or will be considered by the EBA.
 - The EDTF recommendations: as they are not of regulatory nature, the EBA did not conduct a compliance check with them ; nevertheless some of them have been identified as good practice.
 - The WGD: propositions by the WGD will be considered in the work to be conducted in 2014.

General observations on Pillar 3 reports

- Most supervisors adopt un-prescriptive provisions on practical aspects of Pillar 3.
- Timeline and frequency: no publication deadline in the CRD and in practice publication dates stretch from end-February to mid-May, with most of banks publishing before end-April and quite close to the publication date of their annual report .
 - Improved compared to last year and further improvements expected in the context of Article 433 CRR (publication date in conjunction with the date of financial statements).
- Presentation and location: a majority of the sample released a stand-alone report, other include it in their annual report and all make their Pillar 3 information available on their website. Remuneration disclosures are sometimes disclosed in a separate remuneration report.
 - Each format has its pros and cons but the EBA emphasises on the need for appropriate cross-references where relevant.
- Verification of disclosures: only two supervisors requests a more or less deep external control of the process for the determination and disclosures of pillar 3 information.

Scope of application (1)



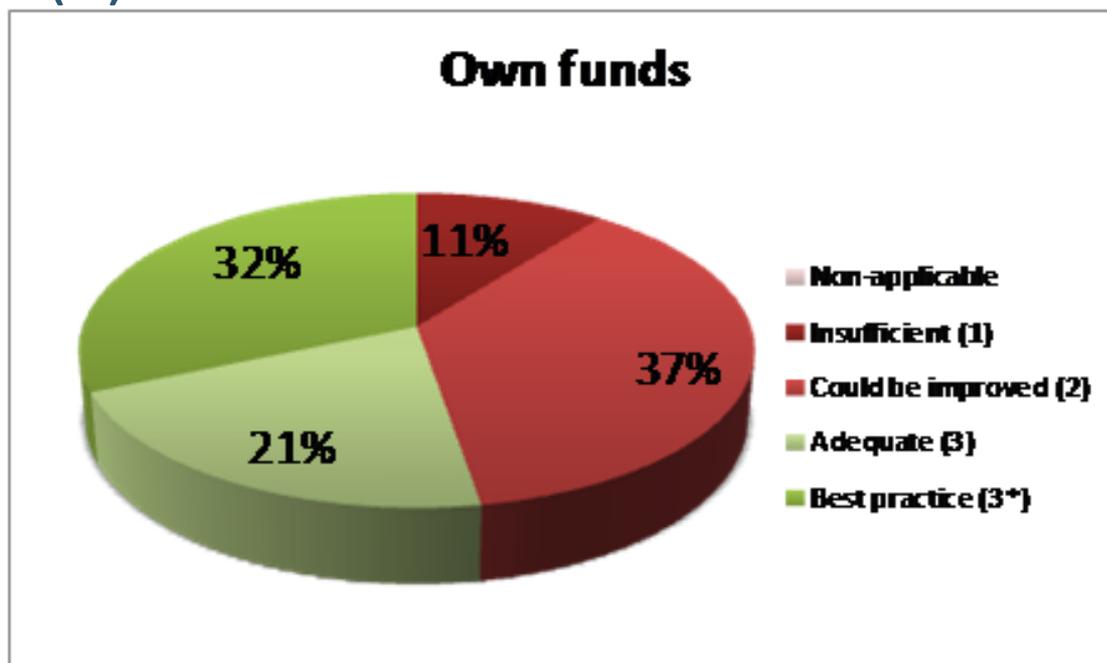
- High degree of compliance, even improved compared to last year.
 - Improvements: reconciliations between accounting and regulatory scopes, explanations of changes in the bases of consolidation.
- The compliance rate could have been higher if the non-applicability of disclosures requirements had been mentioned.

Scope of application (2)

- Some disclosures requirements are marked with a high level of non-compliance.
 - Current or foreseen impediments to the prompt transfer of own funds or repayment of liabilities between parent and subsidiaries,
 - Capital shortfall for unconsolidated subsidiaries,
 - Use of provisions of Articles 69 and 70 .

- Examples of best practices identified
 - Reconciliation of accounting scope balance sheet to regulatory scope balance sheet,
 - Description of change in the scope of consolidation and/or regulatory scope due to changes in the perimeter and corporate transactions,
 - Consolidation/derecognition of securitised assets.

Own funds (1)



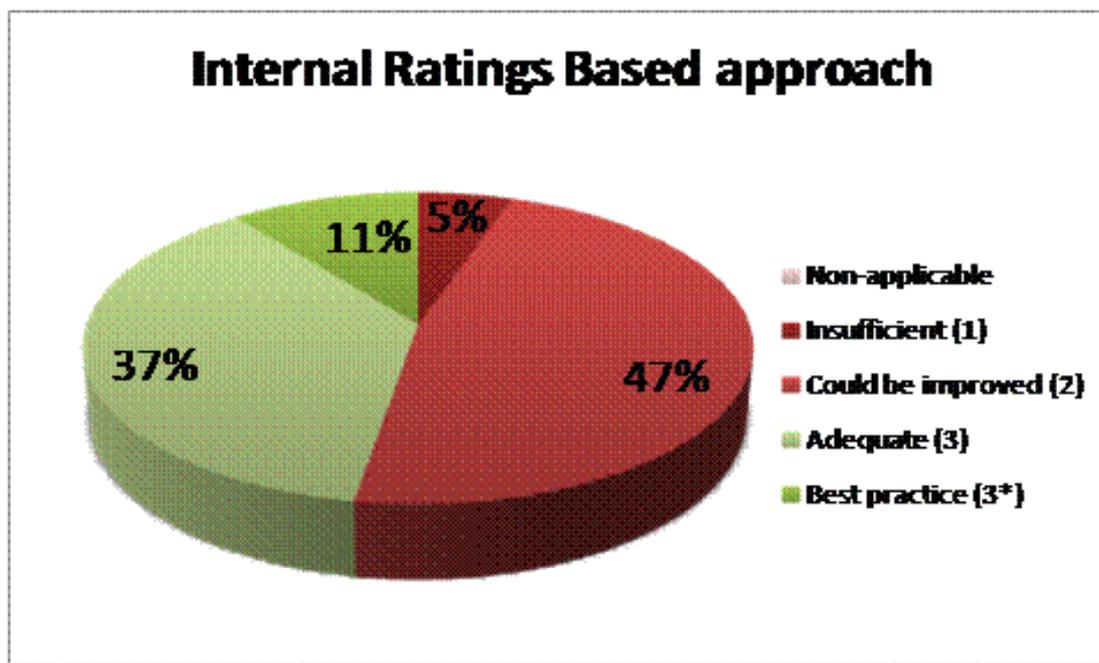
- A majority of institutions are fully compliant with the CRD requirements and provide additional useful information.
 - Reconciliation between accounting and regulatory capital items, flow statements, Basel III expected impact.
- Variety of presentation and location: dedicated section or spread throughout the report.

Own funds (2)

- The following disclosures could be improved:
 - Terms and conditions of own-funds (when provided there is moreover low consistency between institutions),
 - Separate identification of grandfathered instruments,
 - Granularity in the deductions from capital and identification of the deduction due to the EL shortfall.

- Examples of best practices identified:
 - Reconciliation of regulatory capital with accounting equity,
 - Flows for regulatory capital or regulatory deductions,
 - Informative disclosures on regulatory capital and its components - Core Tier 1, Tier 1, Tier 2 and Tier 3, if any,
 - Comments on changes compared with previous years,
 - Comprehensive information on Basel III impacts.

Credit risk – IRB models (1)



- Disclosures can still be improved for more than half of the institutions.
 - Nonetheless 2012 saw additional details provided for rating processes and more granularity in quantitative disclosures.
- Improvements in disclosures are essential to restore confidence in RWA – good practices identified in this report and explanations provided in last year’s report could help.

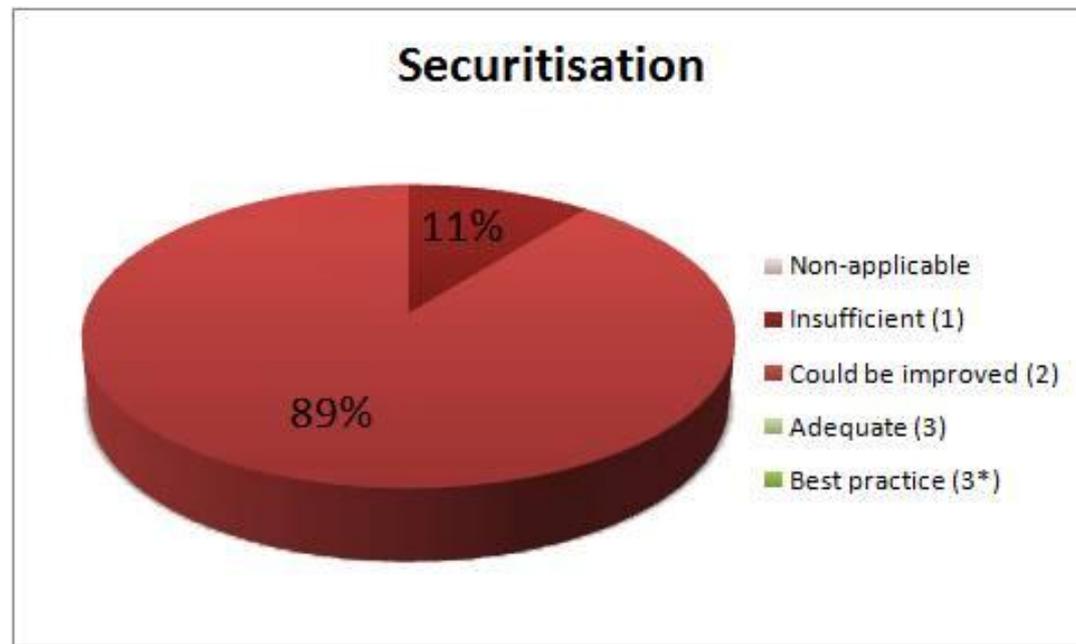
Credit risk – IRB models (2)

- Disclosures could be improved both regarding the level of details and the consistency between institutions regarding:
 - Description of the internal rating process,
 - ▶ More details on EAD and on the estimations of LGD by types of portfolios would also be helpful.
 - Value adjustment by exposure class (50% non-compliance) have various meaning in different institutions,
 - Breakdown by internal grades of exposure values between AIRB and FIRB approaches.
 - Internal grades: varying number (3 to 22) of grades in different institutions and defaulted exposures not always identified.
 - ▶ Increased use of tables to compare internal with external grades and to associate PD values (mean or range) with internal grades would improve comparability.
 - Backtesting of model parameters: highest degree of non-compliance even if the situation marginally improved (3 institutions now provide disclosures).
 - ▶ Disclosures often limited to comparisons between EL and actual losses, with limited comparability between institutions due to various granularity levels and definitions of actual losses.

Credit risk – IRB models (3)

- Examples of best practices:
 - Clear information on the scope of the application of the IRB approach and user-friendly presentation (often in table form) of the internal rating processes, types of parameters or types of models used by exposure class,
 - Provision of both the accounting (balance sheet value or off-balance sheet pre-CCF value) and the EAD exposure value,
 - Separate disclosure of exposures and model parameters for AIRB and FIRB exposures,
 - Clear presentation of the parameters by exposure classes including PD (average, median or range) facilitating the comparison between internal grades,
 - Exposures at default, defaulted exposures or risk-weighted assets split by geographical region, industry sector or business segments,
 - Risk-weighted assets by internal grade,
 - Predicted probability of default, actual default rates and EAD outcomes versus predictions for 3 years period.

Credit risk – Securitisation (1)



- No institution adequately complies with all the disclosures requirements.
- No significant improvement since last year.
 - A few improvements limited to a couple of requirements and institutions.
 - For some institutions lack of improvement may be linked to the scaling-back at that date of securitisation activities.

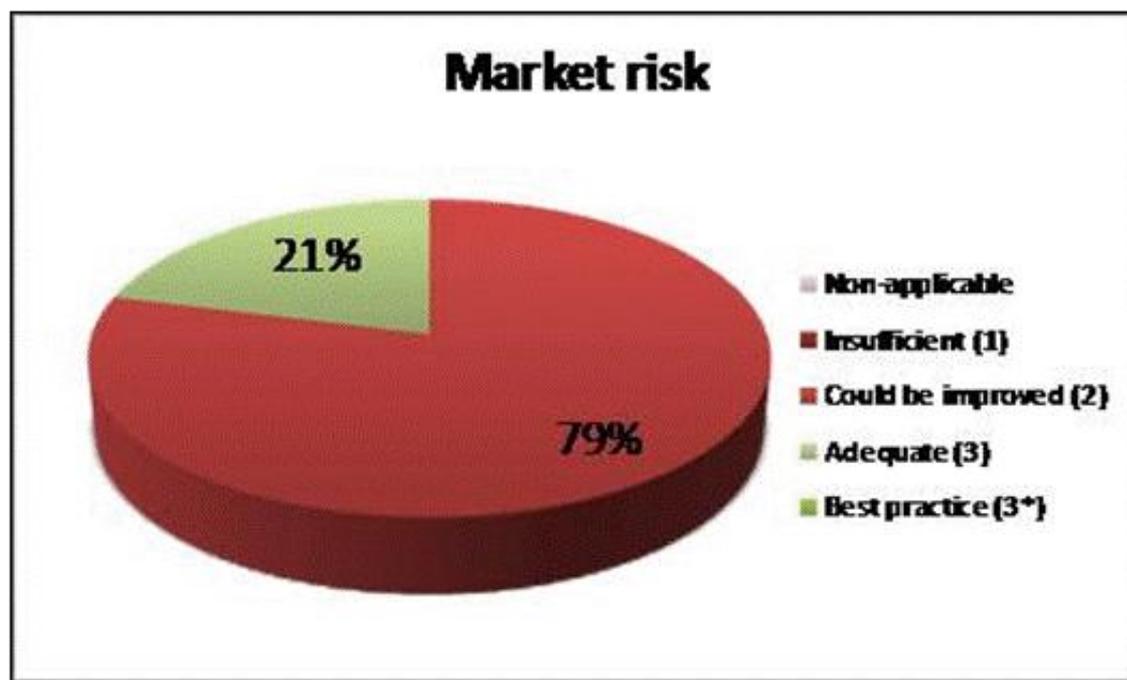
Credit risk – Securitisation (2)

- Qualitative and quantitative disclosures need to be made more specific to securitisation activities within the regulatory securitisation framework.
- Qualitative disclosures should provide more insight on securitisation activities and related risks.
 - Disclosures on accounting policies only sum-up IAS 39.
 - Disclosures on risks attached to securitisation activities and their hedging as well as on the use of the Internal Assessment Approach are under-developed.
 - Disclosures on SSPEs are unspecific on the extent of involvement of institutions with these structures.
- Quantitative disclosures suffer from inconsistencies of approaches by institutions, which undermines their comparability.
 - Few institutions provide information on the scope of their disclosures and some also include transactions that do not qualify for regulatory derecognition.
 - Information on outstanding was sometimes mixed up with information on retained and purchased exposures and 20% of institutions did not disclose trading book exposures.
 - One-third of institutions did not provide a breakdown of capital requirements by risk-weight band and disclosures provided may vary in terms of scope and number of bands.

Credit risk – Securitisation (3)

- Examples of best practices
 - Information provided on prudential de-recognition criteria and regulatory treatment of securitisation exposures,
 - Detailed disclosure of the retained exposures with some additional breakdowns such as geographical, sector or maturity breakdown,
 - Detailed disclosure on the extent of involvement in the transactions originated and quantitative information on the extent of risk exposure to SSPEs,
 - Geographical breakdown of securitised exposures,
 - Disclosure of RWAs associated with securitisation positions by underlying exposure classes,
 - Separate disclosures of transactions that have not led to risk transfer and are outside the scope of the securitisation framework.

Market risk (1)



- Compliance has slightly improved compared to last year.
 - Improvement has been marginal and unevenly spread across requirements and institutions.
 - Improvement can be seen by the disappearance of institutions falling short of the requirements (16% last year).

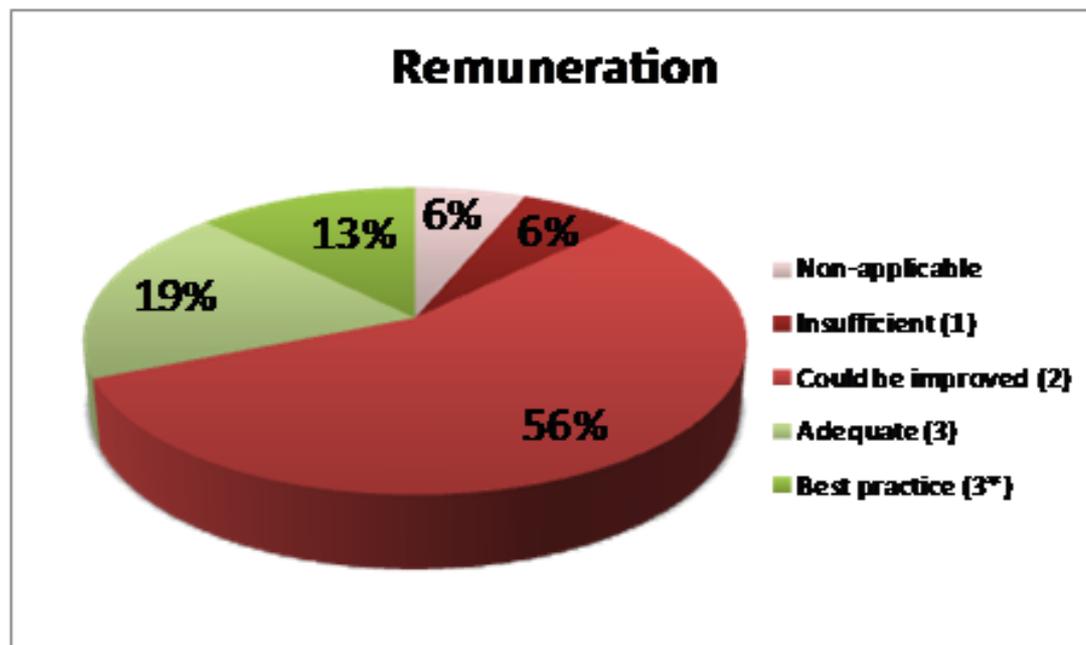
Market risk (2)

- Virtually all institutions could improve their qualitative and quantitative disclosures, especially those for which requirements were introduced in 2011.
 - Descriptions of the models used were provided by all institutions but could be enhanced, especially regarding the breakdown by portfolio and methodologies for capital charges in correlation trading portfolios
 - Disclosures on stress-testing varied in granularity and in balance between qualitative and quantitative information
 - Disclosures on prudent valuation were not specific enough
 - 50% of institutions did not disclose adequate quantitative information on the incremental risk charge, the comprehensive risk measure or the stressed VaR
 - Disclosures (qualitative and quantitative) on the VaR model sometimes referred to the management model instead of the regulatory model and the link with capital requirements was unclear
 - Disclosures on backtesting of models could be enhanced, especially regarding the consequences of exceptions on models

Market risk (3)

- The following best practices were identified:
 - Discussion and quantification of changes to the RWA, to the model and to VaR backtesting
 - Comprehensive summary of the market risk models used and the specific portfolio against which they are deployed and their features for each trading product;
 - Quantitative presentation of VaR or stressed VaR by risk type and by business division and risk type, and by geographical regions and risk type
 - Presentation of stress test results per scenario and geographical region, or per risk factor and geographical region and average amounts for historical and hypothetical stress tests throughout the year
 - Clear explanation on VaR backtesting methodology , for example by including explanation on how the P&L overshooting is calculated, or whether a static or dynamic window is used

Remuneration (1)



- No significant improvement were noted for remuneration disclosures: most of institutions could still improve their disclosures.
 - Slight improvements were noted for 20% of institutions
 - Three institutions were excluded from the analysis due to lack of disclosures at the time of analysis

Remuneration (2)

- Room for improvement especially regarding quantitative disclosures.
 - Disclosures of remuneration by business areas and by categories of risk-takers.
 - Separate disclosures of vested and un-vested outstanding amount of deferred remuneration.
 - Severance payments.
- Qualitative disclosures were generally compliant with requirements, although the level of details varied.
 - The notions of “risk-takers”, “executives”, “non-executives” should be better defined.
 - Differences in the remuneration schemes for all types of regulated populations.
 - Practical details on vesting criteria and clawback mechanisms.
- The following best practices were identified:
 - Examples and graphs on the workings of the compensation system,
 - Reconciliation between compensation and accounting costs,
 - Variable remuneration expressed as share of operating income or shareholder equity,
 - Geographical scope of the remuneration policy and details of this policy by geographical area.

Thematic Study (1)

- Assesses the similarities and differences in regulatory-type information released in interim disclosures (**not a compliance assessment**).
 - No CRD requirement for interim disclosure of regulatory information.
 - Interim disclosures: interim Pillar 3 report, financial statements, management report, press release, presentations to analysts.
- Interim Pillar 3 reports are released by a minority of institutions and most of time interim regulatory information is released via presentations to analysts .
 - Interim Pillar 3 reports are disclosed only if required by national legislations (in 2 countries).
 - Release of regulatory information most of time on a quarterly basis.
- Most of interim regulatory information consist of information on capital, capital instruments, capital ratios and RWA, supplemented by topical information.
 - Information can be qualitative or quantitative.
 - Topical information: consequences on capital of issues specific to some regions, or of a change in accounting standards.
 - Annual disclosures more complete but interim disclosures more detailed on changes.
- Comparability issue in terms of content and presentation.

Thematic Study (2)

- Institutions releasing interim Pillar 3 also include regulatory information in other interim disclosures.
- Other interim disclosures provide a common base of information on capital (nature and components, amounts of Core Tier 1, Tier 1 and total capital), capital ratios and RWAs with information on the changes since last reporting period (reconciliation charts, flow statements).
 - Granularity levels vary for capital (identification of the instruments, deductions) and capital requirements / RWA (breakdown by approach, geography, business line).
 - Reconciliation lack of comparability (drivers of changes used).
- Interim disclosures (mostly presentations to analysts) also convey information on the impact of Basel III and the preparation of institutions (transformation plans).
 - Amount of capital, RWA, capital ratios under Basel III phased-in and fully-loaded regimes and how they compare with the current Basel 2,5 figures (reconciliation of the amounts).
 - Changes in Basel III amounts and targets, globally or also for business lines.

Conclusion

- Compliance of disclosures with disclosures requirements could in general be improved, as could their consistency/comparability.
- Some improvement has already be noticed since 2008 (start of the EBA analyses).
- Improvements in terms of compliance since last year have however not been visible in all disclosures areas.
 - Scope of application and own-funds improved the most.
 - IRB, securitisation and market risk experienced more incremental improvements.
- Regulatory-type information is provided in every interim disclosures even without requirement.
 - Findings of this thematic study will be used for the future EBA work.
- The EBA will continue its work in 2014 to improve the quality and consistency of disclosures, taking into account the outcome of other works in this field.
 - CRR mandates and other tasks.

Questions?