



## UK Finance response to the Basel Committee on Banking Supervision's consultative document on Pillar 3 Disclosure requirements – updated framework

May 2018

### *Introduction*

UK Finance is pleased to respond on behalf of its members to the Basel Committee on Banking Supervision's (BCBS) consultation on the updated framework on Pillar 3 Disclosure requirements<sup>1</sup>.

UK Finance represents nearly 300 of the leading firms providing finance, banking, markets and payments related services in or from the UK. UK Finance was created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association. Our members are large and small, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Our members' customers are individuals, corporates, charities, clubs, associations and government bodies, served domestically and cross-border. These customers access a wide range of financial and advisory products and services, essential to their day-to-day activities. The interests of our members' customers are at the heart of our work.

UK Finance's banking members, large and small, prepare Pillar 3 disclosures for the benefit of their investors and other stakeholders, so the BCBS's consultation on this topic is of interest to all of them.

### *Volume and granularity of data*

UK Finance members completely support the principle of appropriate disclosure of key capital, risk and liquidity metrics in the interests of better understanding by investors of banks' risk profiles, which in turn supports optimal capital allocation and market discipline.

Therefore, we endorse the overall objectives of the updated Phase 3 framework to incorporate the changes to be introduced by 2022 in relation to the changes to the standardised approach and internal approaches. However, UK Finance does not agree with the need to disclose hypothetical Risk Weighted Assets (RWA) on a standardised basis

We are concerned however about the granularity of disclosure in relation to both quantitative and qualitative information that it is proposed should be introduced, some elements of which will, in our view, result in the release of sensitive, proprietary information, particularly in relation to operational risk parameters and experiences and CVA strategies and model components. The benchmarking templates are excessively granular which will undermine the IRB and output floor frameworks. This could mislead

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<sup>1</sup> <https://www.bis.org/bcbs/publ/d432.pdf>

users if there are significant differences between standardised and IRB risk-weighted assets as market participants may rely on the standardised risk-weighted assets without fully understanding the underlying rationales used in the IRB calculations. The objective of comparability and additional granular detail should not be pursued at the expense of proper analysis of the specifics of a bank's business model and risk profile.

There is also a question about the utility of the granular data and how many investors actually would use the full range of data suggested. In our view the most significant users of the very granular data are likely to be rating agencies who already have access to this information directly from the banks themselves. So, we are not convinced that the significant technology and governance costs associated with preparing for such granular Phase III disclosures are warranted.

### *Timing*

Not all institutions have a reporting period ending at the calendar year end, which may result in banks with reporting dates earlier in 2022 being required to disclose sooner than the majority of banks. We recommend that the Pillar 3, Phase III should be implemented from the bank's year end 2022 financial report. This would also provide time for the finalised Basel III framework to bed down.

### *Questions raised in the consultation paper*

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

### **Frequency of disclosure requirements**

UK Finance is generally supportive of the frequency of disclosure requirements detailed in the consultative document, although there are a couple of exceptions noted below with an explanation of why we have recommended a change in the frequency of these disclosure templates.

- The leverage templates LR1 and LR2 should be a semi-annual disclosure as opposed to quarterly. A semi-annual disclosure would provide sufficient useful information for the users and be more aligned with that of the frequency required for capital templates CC1 and CC2.
- The asset encumbrance template ENC should be an annual disclosure as opposed to a semi-annual disclosure requirement in line with statutory reporting.

### **Part 2 – Credit risk**

#### **Table CRB-A: Additional disclosure related to prudential treatment of problem assets**

The newly proposed disclosures in CRB-A overlap with existing EBA requirements that came into force in December 2017 (EBA GL-2016/11) on both quantitative template CR1-E and qualitative template CRB-A. Both newly proposed and existing templates require banks to disclose both qualitative and quantitative information of non-performing and forborne exposures. Duplication of disclosure information not only puts additional operational burdens on banks but could also confuse users of the information.

In addition to the above, the EBA has recently (April 2018) published a consultation on guidelines for the disclosure of non-performing and forborne exposures. This consultation introduces some further ten disclosure templates on non-performing and forborne exposures to apply from December 2019.

UK Finance recommends disregarding the proposed additional disclosures relating to the prudential treatment of problem assets, which are the subject of a national discretion in any case, for the above reasons.

### **Part 3 – Operational risk**

Template OR1 requires very granular data on historical losses, which include confidential /proprietary information. A significant amount of disclosures is already made by banks on material losses relating to litigation and regulatory investigations in the notes to the financial statements. As the template captures historic information, due to the long running nature of most litigations and regulatory investigations, certain information cannot be disclosed due to confidentiality. This may reduce the benefit of the template to users if the published templates are 'patchy'.

The requirement to "... explain in the narrative commentary ... the fact that the specific items of information have not been disclosed and the reasons for this" will also likely require disclosure of confidential information, for instance in relation to the expected cost of ongoing litigation.

Moreover, the requirement to disclose the rationale for new loss exclusions appears to be excessive given that, in line with the document "Basel III: Finalising post-crisis reforms", banks have to follow a specific procedure with the supervisor to exclude certain operational loss events that are no longer relevant to the bank's risk profile.

An alternative approach may be to focus the disclosure on maxima and minima over a 10-year period in addition to the average without requiring disaggregation of thresholds such as €20,000 and €100,000, which may not be meaningful for our larger member banks.

We also have concerns around the disclosure of historical losses where they may not be relevant for future capital requirements and also where the national competent authority may set the internal loss multiplier at one.

The detailed analysis of components of business indicator and the related narrative in OR 2 may provide too much information to investors and users, undermining Pillar 3 principles of materiality and clarity of information to enable economic decisions.

## **Part 5 – Credit valuation adjustments**

In general, the information proposed to be disclosed for credit valuation adjustment ('CVA') appears to be disproportionately extensive and detailed in comparison with other risk types. As such, it is unclear how useful some of the requirements will be to readers of the disclosures. In addition, the disclosures, in places, risk revealing information that could be considered confidential or proprietary in nature.

In particular, Template CVA2 requires disclosure of all the components of the CVA calculation, in doing so, banks would reveal proprietary strategies on how CVA is managed including how much hedging is undertaken and which hedging instruments are used. Similarly, in Table CVAB, Section (A)(a) through to (e) appears to require an exhaustive list identifying modelling choices. These components of the models would be considered proprietary information that is too sensitive to disclose publicly. CVA3 requires disclosure of information that could identify the specific actions used to manage CVA on counterparty credit spread. This would reveal proprietary strategies which would be considered confidential.

For both CVA2 and CVAB the value to readers of this level detail is unclear and specifically for CVA3 rows 8 and 9 should be deleted.

## **Part 6 – Benchmarking**

The templates BEN 1 and BEN 2 require disclosures of RWA calculated by both Internal Ratings Based (IRB) and Standardised approach (SA) for all risk categories and "every single asset class" and go beyond the regulatory framework agreement in Europe. The proposed templates allow users to compare RWA

across banks with 100% floor and undermine both the supervisory IRB and 72.5% output floor frameworks. This is completely misleading and will unhelpfully focus users on the standardised approach, at the expense of IRB approaches, which in our view are a better assessment of the risks a bank faces. Disclosures should reflect policies and regulatory framework that are in place and not undermine them in a way that could potentially cause a lack of trust in the regulatory frameworks used by banks.

In addition, Pillar 3 Phase 1 proposals introduced templates with granular RWAs and RWA density by asset class and asset quality (Probability of Default) bands. These disclosures were introduced to improve the transparency around banks' IRB models and have only recently been implemented, at 2017 year end by most banks. Therefore, there needs to be time for users to evaluate if these already granular IRB RWA disclosures meet the market discipline objective around IRB models without requiring the disclosure of granular hypothetical standardised RWA.

Additionally, there is a range of potential users of Pillar 3 disclosures - investors, analysts and other stakeholders - whose size and sophistication vary. Detailed information, such as that required by the benchmarking templates, might be useful to only for a small number of analysts or sophisticated investors but might not be so useful for majority of investors, including individual investors. As we note above the costs of preparing such highly granular information are significant.

'Benchmarking' also suggests that the standardised approach is the preferred approach whereas prior consultation referred to 'hypothetical' RWAs. Should some level of hypothetical RWA disclosure be contemplated in the future, the template names should be revised to not undermine internally-modelled approaches used for supervisory reporting.

## **Part 9 – Capital distribution constraints**

We believe that it would be unnecessary and inappropriate to introduce Template CDC (Capital distribution constraints) into Pillar 3. As the Consultative Document indicates, the proposed disclosure could lead to a bank disclosing its Pillar 2B requirements which could be deemed sensitive information. Moreover, information containing Pillar 2 capital is not comparable across banks as the definition and application of Pillar 2 capital vary across jurisdictions; therefore, disclosures in this area will likely detract rather than add useful informational value.

*(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?*

### **Template CC1** – Composition of regulatory capital

UK Finance supports the decision of the Committee in March 2017, when it published revised disclosure requirements that included Template CC1 in finalisation of its March 2016 consultation. It is unclear why this question is being raised again so shortly after it was answered. Re-opening the question without there being a clear and fundamental error in the scope of the original disclosure requirement raises concerns about the stability of previously published rules.

In summary, for Multiple Point of Entry (MPE) Banks, the March 2017 disclosure requirements published by the Committee should remain unchanged. It is important to recognise that the scope of application of total loss-absorbing capacity (TLAC) requirements and regulatory capital requirements is different and should be reflected in separate disclosures. TLAC/minimum requirement for own funds and eligible liabilities (MREL) ratios should be required at the resolution group level only, whilst disclosures of regulatory capital requirements should be required at the consolidated level.

The Committee expressed in the consultation that disclosure by a resolution group of Template CC1 would be artificial, as there is no regulatory capital requirement necessarily applied at that level. As such, there

is a risk that such a disclosure is misunderstood as a minimum going concern regulatory capital requirement to be complied with at the resolution group level.

Usually, disclosure requirements are designed to communicate regulatory requirements already established to readers. However, in this situation there is no regulatory requirement, a disclosure is being proposed with no prudential capital requirement behind it. Observation at the Basel Outreach meeting informed that this disclosure was being requested by a few ratings agencies, a small user group, who were not able to justify how this information would be useful and what insight it would provide. To the wider Pillar 3 readers, this disclosure would result in confusion.

Additionally, UK Finance concurs with the Committee 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 with Single Point of Entry (SPE) banks. Not only would MPE banks have to cope with greater disclosure requirements, they would also have to face an increase in costs in order to report granular data at a new level of consolidation.

Significantly, investors already have the relevant information provided by the March 2017 Standards. The Template TLAC1 provides the necessary information on the composition of TLAC 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.

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