European Banking Federation

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EBF COMMENTS ON THE CEBS CONSULTATION PAPER ENTITLED "DISCLOSURE GUIDELINES: LESSONS LEARNT FROM THE FINANCIAL CRISIS"

GENERAL COMMENTS

1. We fully understand the concern raised by the SSGS, FSB and CEBS that institutions should not merely pay attention to respecting disclosure requirements which are being imposed by a wide range of mandatory rules and regulations. We agree that, in doing so, it is also important to provide the user with a comprehensive picture along the lines indicated in CP30.

   We welcome the fact that the recommendations proposed in CP 30 are struck as principles-based good practice guidelines rather than prescriptive requirements and are not mandatory. However, we agree that they provide a clear and strong message to institutions that they are expected to adopt them on a voluntary basis concerning disclosures that they will make from 2010 onwards.

2. The lack of sufficient focus and clarity of the proposed recommendations is a cause of confusion to preparers as their meaning may be different depending on the answer to their objective and scope. We would, therefore, like to invite CEBS to provide for more clarity as to the precise objective and scope of each guideline. It may be useful to recall that the Industry Good Practices Guidelines on Pillar 3 Disclosure Requirements for Securitisation provided an explanation of the objective(s) pursued by each requirement imposed by the CRD in the area of Pillar 3 disclosures for securitisation before turning to the specific implementation guidance.

3. The proposed guidelines have the merit of guiding public disclosures to be made by institutions in stressed circumstances.

   Our impression is, however, that they are overly focused on extreme situations. As a consequence, it is not always clear if they need to be taken into account in times of exceptional or stressed events only, if they need to be implemented in general, or otherwise. The Paper should be more explicit on this as their impact will change depending on the answer to these questions.

4. In our view, the proposed guidelines should acknowledge that the design and level of disclosures made by institutions will vary in accordance to the specific risk profile of an entity and the complexity of its business model

5. Experience has demonstrated that only a very limited number of stakeholders have gone through the effort of consulting Pillar 3 disclosures – notwithstanding the educational efforts which have been made by the industry and the supervisory community.

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We encourage CEBS to engage with institutional investors to better understand their views in relation to Pillar 3 disclosures.

I. GENERAL PRINCIPLES

1. Financial institutions should provide timely and up to date information irrespective of the timing of their normal publication calendar

Existing legal requirements, e.g. stock exchange rules, already address this principle and impose sufficient requirements concerning relevance, timing and content of ad-hoc disclosures. Further regulatory action is, therefore, not required.

2. In order to enhance the quality of information, financial institutions should provide adequate disclosures on areas of uncertainty

Whilst we agree with the general principle that is being proposed, it needs to be observed that providing too detailed information on sensitivity analyses would be likely to add to the complexity of disclosures, require specific knowledge of the reader and, finally, may - because of banks' individual business models - conflict with Principle 4 with regards to inter-entity comparability.

Appropriate language would be needed to differentiate between reported data and forward-looking statements which require judgment and which cannot be relied on in the same way as reported data. This could lead to cumbersome narrative and potential confusion for the reader.

3. Financial institutions should provide comprehensive and meaningful information that fully describes their financial situation

The proposed principle is fully in line with what is currently required under IFRS 7 and CRD Annex XII.

We do not believe that it would be appropriate to require institutions to publish sensitive disclosures which would have a destabilising effect on their position before they have contacted their competent authorities.

4. Disclosures should allow comparisons over time and between institutions

We agree that institutions should provide comparative information over time as trends which can be observed over time may provide useful information. We do not believe, however, that institutions should be obliged to re-state disclosures which they have made in previous years merely to allow readers to make comparisons over time because of business developments; it should suffice that institutions provide narrative information in this respect.

Enhancing consistency across institutions would indeed be desirable. However, the main objective should remain to provide transparency about an institution's own risk profile. Allowing for comparability across institutions is more difficult to achieve as the risk profile of each institution largely depends on its risk appetite, its business model, the internal models which it uses, etc. Moreover, it should be avoided that institutions be compelled to disclose information that is not material merely for the sake of comparability. Finally, as the EBF has highlighted[1], differences across institutions where Pillar 3 disclosures are concerned, may be driven by Member State requirements or legitimate differences in bank approaches.

The European industry has taken specific initiatives to increase the consistency of institutions' Pillar 3 disclosures[2] and is determined to undertake further efforts to that effect. However, achieving consistency will inevitably require an iterative and evolutionary process. It would not be appropriate for CEBS to interfere with this process by issuing guidelines taking into account that Pillar 3 Disclosures form an integral part of the Basel II Framework. Against this backdrop, it is essential that guidelines from regulators aimed at improving consistency, if any, be prepared at a global level by the Basel Committee. It would in any event be unacceptable that European banking groups would be made subject to differing and/or stricter requirements.

5. Financial institutions should seek to early adopt new disclosure standards and best practice recommendations from standard-setters and regulators

We agree that institutions need to strive for early adoption of new disclosure standards on a best effort basis. It needs to be highlighted, however, that preparing an institution to modify its disclosure practices often requires time (e.g. because of IT-systems implications or simply because awareness needs to be created within the institution by means of educational initiatives). Moreover, institutions cannot be expected to prepare for implementing standards at a moment in time at which standard setters have not yet reached a definite agreement.

6. Financial institutions should specify whether and to what extent information has been verified by external auditors

We do not believe that it would be appropriate for the CEBS Paper to imply that disclosures which are not audited should be reconciled to audited information whenever possible.

Reconciling Pillar 3 disclosures with IFRS disclosures may particularly be extremely burdensome to achieve [bearing in mind, amongst others, (i) that the concept of "exposure" has a different meaning under both frameworks and (ii) that the scope of consolidation is entirely different] and is, moreover, likely to hamper flexibility.

Anyway, it needs to be highlighted that there are safeguards surrounding disclosures made on information that has not been verified by external auditors:

- financial institutions have set up adequate internal verification processes;

[1] See the EBF Paper entitled "Driving Alignment of Pillar 3 Disclosures. An Industry Contribution to Enhance Transparency".
[2] We refer to the paper referred to above as well to the "Industry Good Practice Guidelines on Pillar 3 Disclosure Requirements for Securitisation".

- the circumstance that non-audited information which institutions disclose is also being used internally by management provides for sufficient incentives to have the numbers right;
- supervisors take action if an institution would make Pillar 3 disclosures that would deviate from what it reported within the framework of COREP.

II. CONTENT

7. Financial institutions should elaborate on the position and importance of the activities under stress within their business model

We support the Principle that institutions need to provide insight into their risk management processes for areas under significant stress and into potential enhancements to these processes (see also principle 10).

However, providing disclosures which are too detailed may be counterproductive because it may be difficult for an institution to make clear statements about the current and expected curtailing of its own business due to stressed events. The current crisis demonstrated that some events may not be foreseeable, e.g. because of psychological factors. Moreover, information about curtailing own activities, exposures and capital resources may be highly subjective.

Finally, forward looking assumptions would give hypothetical outcomes yet the public could seize such information and consider it reality, bringing unnecessary increased instability in stressed times. Equally forward looking stressed assumptions are not part of Pillar 3; they should be included under Pillar 2/ ICAAP, which will be reviewed by the Regulator.

8. Disclosures should include clear and accurate information regarding the impacts on results and on risk exposures of the activities under stress

- It needs to be highlighted that disclosure of trend information may create legal issues: if the developments which the institution has announced do not materialise, investors may feel entitled to claim compensation for the damage incurred.

- Stress testing is a subjective exercise as assumptions and methodologies can vary greatly across firms. Comparability is, therefore, an issue and there is a danger that the market may misinterpret stressed results.

9. Disclosures should also include information regarding the impacts on the institution's financial position

We agree - subject to the comments made above.

10. Financial institutions should communicate appropriately on the management of risks linked to activities under stress

We agree - subject to the comments made above.

11. Financial institutions should be as specific as possible with regard to sensitive accounting issues.

We agree subject to the comments made above.

III. PRESENTATIONAL ISSUES

12. Disclosure should as far as possible be provided in one place with appropriate cross-references where necessary

We agree that disclosures relevant to an understanding of an institution's involvement in a certain activity should ideally be provided in one place and be appropriately cross-referenced where necessary to aid the reader's understanding. This being said, it needs to be highlighted that it is up to each institution to exercise judgment in this regard, which may consider disclosures being comprehensive as more important than being in one place.

13. Disclosure should be provided at an appropriate level of granularity to help achieve a high level of transparency

We agree. However, an appropriate balance needs to be achieved.

14. Financial institutions should seek an appropriate balance between quantitative information and narrative information

We agree with the principle.

Our understanding is that CEBS is not suggesting that it would be appropriate for the industry to develop a single tabular format; adopting a uniform approach would not be likely to reflect the individual circumstances of financial institutions.

15. Financial institutions should continue to develop an educational approach

The industry welcomes the suggestion made in the Consultation Paper that institutions should consider the inclusion of executive summaries in their disclosures and aim to tell a story about their activities.

Although we agree that an institution should seek to identify its primary risk factors, it is important to recall that disclosures such as Pillar 3 are intended to provide a point in time picture of an institution's risk profile.

16. ***Financial institutions which are not exposed to the activities under stress should clearly specify that fact when this is likely to provide useful information for users in their decision-making***

The point which is being made under this heading is appreciated: when stress areas become apparent (e.g. Dubai crisis), financial institutions that do not have significant exposures to activities under stress have taken the habit of disclosing this to the market. We believe that this has a positive market effect. That being said, care must be taken to prevent the effectiveness of disclosures being undermined by unfocussed and unnecessary 'noise'. We, therefore, believe that management must be permitted to exercise judgment as to when such a statement should be made.

However, the principle should not apply to going concern situations as the market tends to be suspicious about negative statements. We strongly doubt, therefore, that it would indeed be appropriate for the final version of the CEBS Paper to encourage institutions to mention explicitly that they are not – or only slightly – involved in activities under stress. Institutions should in any event retain the possibility of remaining silent about their involvement in some types of activities on the basis of the principle of materiality.