

## **REPORT ON REGULATORY IMPLEMENTATION OF PILLAR 3**

### **KEY FINDINGS**

1. The present key findings should be read in conjunction with the overall report and against the background set out in the introduction as well as in the background section.
2. With the increasing focus on Pillar 3 and on its implementation, CEBS' survey on the regulatory aspects of the implementation provides an opportune and useful overview of the situation in the EU and of the most relevant and pressing issues in this context.
3. The survey aims to elucidate how CEBS members have implemented the provisions included in Chapter 5 'Disclosure by credit institutions' of Directive 2006/48/CE.
4. The findings of the survey and the discussions within CEBS and with the industry reveal that the most critical issues pertain to the following areas:
  - scope of application of the Pillar 3 disclosure requirements: some countries apply article 72.1 and 2 by requiring limited or even full disclosure from all entities (including significant subsidiaries of EU-parent institutions); and
  - relationship between accounting and Pillar 3 disclosures.
5. The proposed follow-up work, which should be seen as an effort to create an adequate environment for the appropriate functioning of market discipline, will cover the following areas:
  - application of articles 72.1 and 2, in particular to (significant) subsidiaries, where CEBS will further investigate the potential for a solution where limited disclosure is provided with a subsidiary's (individual) financial statements; and
  - somewhat connected to this discussion, the relationship between Pillar 3 and accounting disclosures, where CEBS suggests awaiting the outcome of efforts undertaken by the industry before deciding on the need for any measures in this area.
6. Other issues related to the implementation of the Pillar 3 provisions did not give rise to major concerns to the extent that supervisory authorities are largely refraining from taking prescriptive approaches. CEBS will monitor any developments in this area.
7. Prior to the publication, the findings of the report have been discussed with a number of industry participants in the context of a Pillar 3 workshop which took place on 7 December. At this workshop, participants also had the opportunity to put forward any practical or other problems that they are facing with regard to Pillar 3.
8. In general workshop participants agreed with the issues identified. A number of participants voiced a concern that Pillar 3 data - when initially presented to the

market - might be misinterpreted by some users. Therefore there might be a need for their further education.

9. CEBS will embark on the follow-up work in close cooperation with the industry and users of bank disclosures. The outcome of this follow-up work should be delivered in the course of 2008.<sup>1</sup>

10. Further work, at a later stage, could aim at developing a good practices paper on Pillar 3 disclosures. The development of such a paper – which could contribute to the development of market practices in this area – should obviously be closely coordinated with other supervisory fora such as the Basel Committee on Banking Supervision.

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<sup>1</sup> This work notwithstanding, CEBS will also – in accordance with the ECOFIN's roadmap of key issues to be analysed and addressed following the recent market turbulence - examine by mid-2008 whether public disclosure of types and amounts of securitization exposures, of significant individual transactions and the sponsoring of Special Purpose Vehicles' exposures by banks under the Capital Requirements Framework (Basel2/CRD) is sufficient.

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## **I. INTRODUCTION**

11. With the significant progress on the implementation of Directive 2006/48/CE in the areas of Pillar 1 and 2, more attention is being devoted to the implementation of Pillar 3 disclosures. This is reflected by the fact that an increasing number of issues and concerns have recently been raised by the industry.

12. Irrespective of these issues and concerns, the 2007 work programme required CEBS to monitor members' implementation of Pillar 3 and to facilitate the exchange of experiences on the issues arising in this area with the objective of preparing a report on the regulatory implementation of Pillar 3. A discussion of this report had been scheduled for the December 2007 CEBS meeting.

13. Further to the CEBS's discussions, the main findings will be presented at the workshop on Pillar 3 implementation scheduled for 7 December, where industry participants will also have the opportunity to put forward any practical or other problems they are facing with Pillar 3.

14. This report provides an overview of how some specific areas of Pillar 3 have been or (as far as the information is available) are intended to be implemented by countries at national level. It also explains the different issues covered in the survey CEBS has conducted and flags potential related problems, some of which have been put forward by the industry. The report finally suggests some follow-up measures.

## **II. BACKGROUND**

15. The rationale underlying Pillar 3 is that adequate disclosure should allow market participants to assess an entity's capital adequacy. To this end institutions need to disclose information on the scope of application, capital, risk exposures and risk assessment processes at the top consolidated level.

16. While the disclosure should in principle be driven by the market and its participants, there is a role for supervisors in ensuring that adequate disclosure is provided where institutions, through the use of internal methodologies, have more discretion in assessing capital requirements.

17. The Basel II Pillar 3 disclosure requirements<sup>2</sup> have been transposed into EU legislation in Chapter 5 'Disclosure by credit institutions' articles 145-149 and Annex XII of Directive 2006/48/EC while the scope of application of the disclosures has been addressed in article 72 of the same Directive.

18. The findings of the report are based on CEBS members' responses to a survey<sup>3</sup> about the national transposition of the disclosure requirements included in Directive 2006/48/EC. The survey carried out by CEBS aimed to elucidate how members and

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<sup>2</sup> Paragraphs 808-826 of "Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version"

<sup>3</sup> The survey questionnaire has been included in annex 1. Responses have been received from all EEA countries with the exception of LI. The report uses the following country abbreviations: Austria (AT), Belgium (BE), Bulgaria (BG), Cyprus (CY), Czech Republic (CZ), Germany (DE), Denmark (DK), Estonia (EE), Greece (EL), Spain (ES), Finland (FI), France (FR), Hungary (HU), Iceland (IC), Ireland (IE), Italy (IT), Liechtenstein (LI), Lithuania (LT), Luxembourg (LU), Latvia (LV), Malta (MT), Netherlands (NL), Norway (NO), Poland (PO), Portugal (PT), Romania (RO), Sweden (SE), Slovenia (SI), Slovakia (SK), United Kingdom (UK).

observers have implemented some of the general provisions included in the articles of the Directive.

19. In addition, the report incorporates input and feedback received during discussions with representatives of the European Banking Federation (EBF)<sup>4</sup> which proved helpful in focusing the analysis and discussions of the issues<sup>5</sup> in the report.

20. Based on the findings of the survey as well as on the discussions with the EBF and within CEBS, the report focuses on the following areas:

- scope of application of Pillar 3 disclosure requirements;
- disclosure policy and general concepts; and
- other issues.

21. To the extent that other issues regarding the implementation of the Pillar 3 requirements, including the implementation of the options provided in the Directive have been considered – both by industry and by CEBS - to be less problematic, the report only provides a fairly brief discussion of these issues.

### **III. ISSUES ARISING FROM THE IMPLEMENTATION OF PILLAR 3**

22. In the following sections the report separately analyses each of the areas identified above. For each area, the discussion – against the background of the provisions of the Directive – aims to reflect the (potential) concerns raised by industry representatives.

#### ***III.1. Scope of application of Pillar 3 disclosure requirements (article 72)***

##### *III.1.a) Application of articles 72.1 and 2*

23. The Basel II framework states in paragraph 822 that “Pillar 3 applies at the top consolidated level of the banking group to which this Framework applies” but goes on to specify that, notwithstanding this principle, for significant subsidiaries the disclosure of summarised capital information (i.e. the total and Tier 1 capital ratios) is required.

24. Directive 2006/48/EC transposes these provisions in article 72.1 and 2 and stipulates that the entire disclosure obligations laid down in Chapter 5 shall be complied with by EU parent credit institutions<sup>6</sup> and the credit institutions controlled

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<sup>4</sup> These meetings were arranged following the receipt of a letter from the EBF President to the CEBS chair (and to the chair of the Basel Committee’s AIG) in which he flagged a number of issues that cause concern among industry participants. Some of these issues were subsequently also included and explained in more detail in the ‘laundry list’ the EBF addressed to the European Commission.

<sup>5</sup> The issues under discussion are largely in line with those identified in an internal note prepared by the Secretariat in 2005 and in the regular exchange of views and experiences within CEBS.

<sup>6</sup> Defined in article 4.16 as “a parent credit institution in a Member State which is not a subsidiary of another credit institution authorised in any Member State, or of a financial holding company set up in any Member State.”

by an EU parent financial holding company<sup>7</sup> on the basis of their consolidated situation.

25. Additionally, articles 72.1 and 2 state that significant subsidiaries of EU parent credit institutions or EU financial holding companies shall disclose the information included in Annex XII, Part 2, points 3 and 4, i.e. the information about own funds and capital requirements. The Directive does not provide guidance on the concept "significant subsidiary" or a definition thereof.

26. The analysis of members' responses regarding the implementation of articles 72.1 and 2 reveals that there are quite some differences among countries. One of the observed differences concerns the extent to which supervisors intervene with respect to the concept of significant subsidiaries:

	Set criteria <sup>8</sup>
Supervisory intervention	Quantitative: 7 countries (CY, DK, FI, IE, IT, SK, IC)  Qualitative: 1 countries (SE)  Both: 5 countries (AT, CZ, MT, PL, SI)
No supervisory intervention	9 countries*: (BE, DE, FR, LV, LU, NL, NO, RO, UK)  * Some countries noted that supervisors can exert influence.

27. The survey more importantly reveals that a number of countries apply article 72.1 and 2 in a way that they require limited or even full disclosure from all entities (including subsidiaries of EU-parent institutions):

	Significant subsidiaries	All local entities
Limited disclosure	23 countries: (AT, BE, CY, CZ, DE, DK, ES, FI, FR, IE, IT, LU, LV, MT, NL, PL, RO, SE, SI, SK, UK, IC, NO)	2 countries (EE, EL)
Full disclosure	No country	4 countries (BG, HU, LT, PT)

28. The responses show that while 23 countries restrict the disclosure requirements to the limited information specified in article 72.1 and 2, there are a 6 countries -

<sup>7</sup> Defined in article 4.17 as "a parent financial holding company in a Member State which is not a subsidiary of a credit institution authorised in any Member State or of another financial holding company set up in any Member State."

<sup>8</sup> The criteria that are being used are quite diverse and are based on aspects such as the relevance of a subsidiary for its parent or for the domestic market.

mostly host countries - that require all entities to disclose the whole (or in the case of EE and EL the limited) set of information foreseen in the Directive.<sup>9</sup>

29. Discussions with members showed that the approaches are in some cases motivated by the fact that the currently applicable disclosure requirements in these countries are far broader than the limited disclosure required in the Directive and that the strict application of article 72.1. and 2 would constitute a step backwards.

30. Moreover it has been noted by some supervisors that – not least given the importance of some of these subsidiaries of EU parent credit institutions for the domestic markets - local market participants need more information than the limited items that are set out in the Directive.

31. It showed that the views expressed by these supervisors are in stark contrast with the views held by the industry (EBF) representatives for which this approach is a source of major concern. From the industry perspective Pillar 3 disclosures are the exclusive responsibility of the firms and supervisors should only intervene to create an adequate environment for the market to develop freely.

32. Industry representatives also held the view that Pillar 3 disclosure is too complex for most stakeholders of subsidiaries of EU groups in local markets (such as depositors and even most investors) and that as a result the cost of providing the information outweighs its added value. It is felt that relevant stakeholders (such as banks or subscribers to securities issued at subsidiary level) would gain more benefit by referring to disclosures at group level.

33. On the basis of the discussions that took place within CEBS and with industry participants it is considered that a viable compromise solution can possibly be reached that satisfactorily addresses both the industry's and the respective supervisors' concerns.

**34. CEBS concluded to further investigate – in conjunction with the industry – to what extent a solution where limited disclosure on the capital structure and capital adequacy would be provided with a subsidiary's (individual) financial statements could constitute a viable compromise.**

**35. In doing that, efforts will focus on achieving practical solutions to the problem and issues. Such practical solutions could, for example, consist of addressing any differences between the accounting and prudential information (such as the scope of consolidation) by providing adequate explanations in the information provided with the financial statements.**

### *III.1.b) Application of articles 72.3*

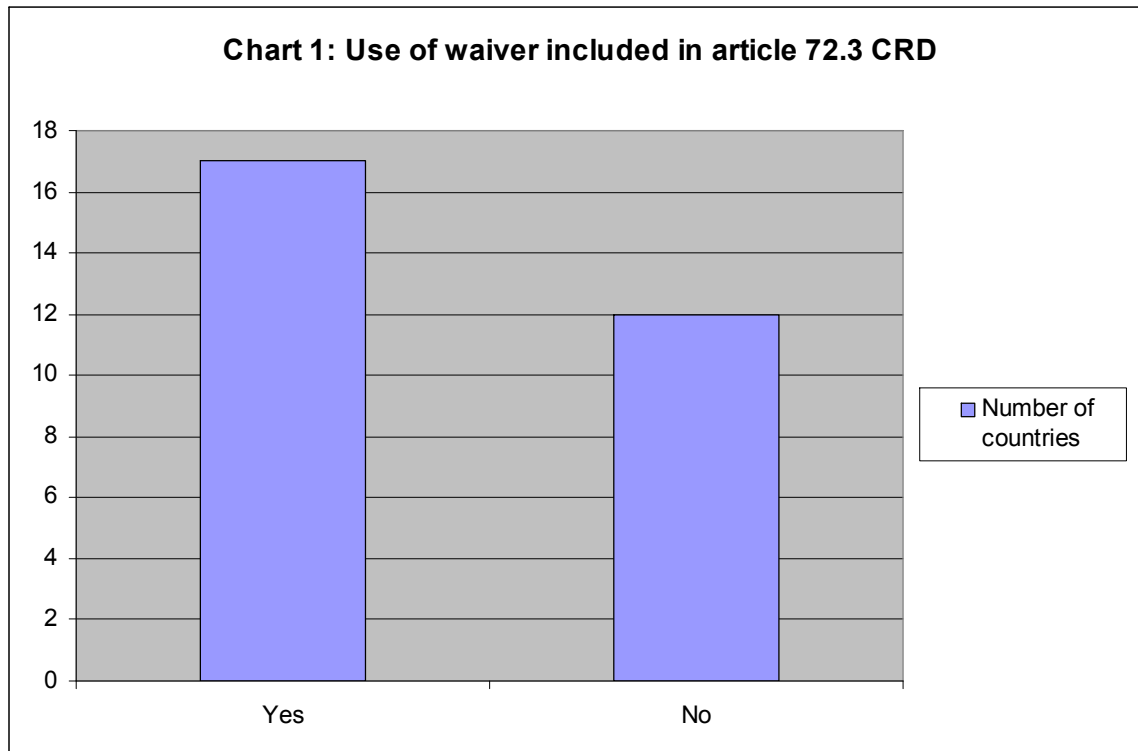
36. Directive 2006/48/EC introduces a waiver allowing countries to exempt credit institutions from the full or partial application of the disclosure requirements provided that they are included within comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country.

37. The responses show that while a majority of countries (17: BE, DE, DK, ES, FI, FR, IC, IE, IT, LV, LU, NL, RO, SE, SI, SK, UK) use this waiver (or intend to do so), a significant number of countries (12: AT, BG, CY, CZ, EE, EL, HU, LT, MT, PL, PT,

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<sup>9</sup> PT is going to propose amendments to national legislation in order to converge with the approach that the majority of CEBS members have adopted with regard to the application of articles 72.1 and 2.

NO) refrain from granting this exemption. The responses also reveal that most countries apply the waiver on a case by case basis.



38. In addition, it can be observed that the 12 countries that have decided not to apply the waiver comprise all 6 countries that apply the provisions of articles 72.1 and 2 as set out in paragraphs 27 and 28.

39. At this stage no major concern has been raised in this respect from the side of the European banking industry (EBF). It could nevertheless occur that CEBS or individual supervisors will be contacted by third country supervisory authorities with regard to this issue.

**40. For the time being CEBS does not foresee any particular follow-up action in this respect.**

### ***III.2. Disclosure policy and general concepts***

41. Much in line with the Basel II framework<sup>10</sup>, Directive 2006/48/EC sets out in article 145.3 that credit institutions shall adopt a formal policy to comply with the disclosure requirements and have policies for assessing the appropriateness of their disclosures, including their verification and frequency. The Directive does not however provide any further directions or guidance on the disclosure policy and its contents or handling.

42. The findings of the survey confirm that most countries refrain from providing supervisory guidance on the structure or content of the disclosure policy that goes beyond what is provided in the Directive.

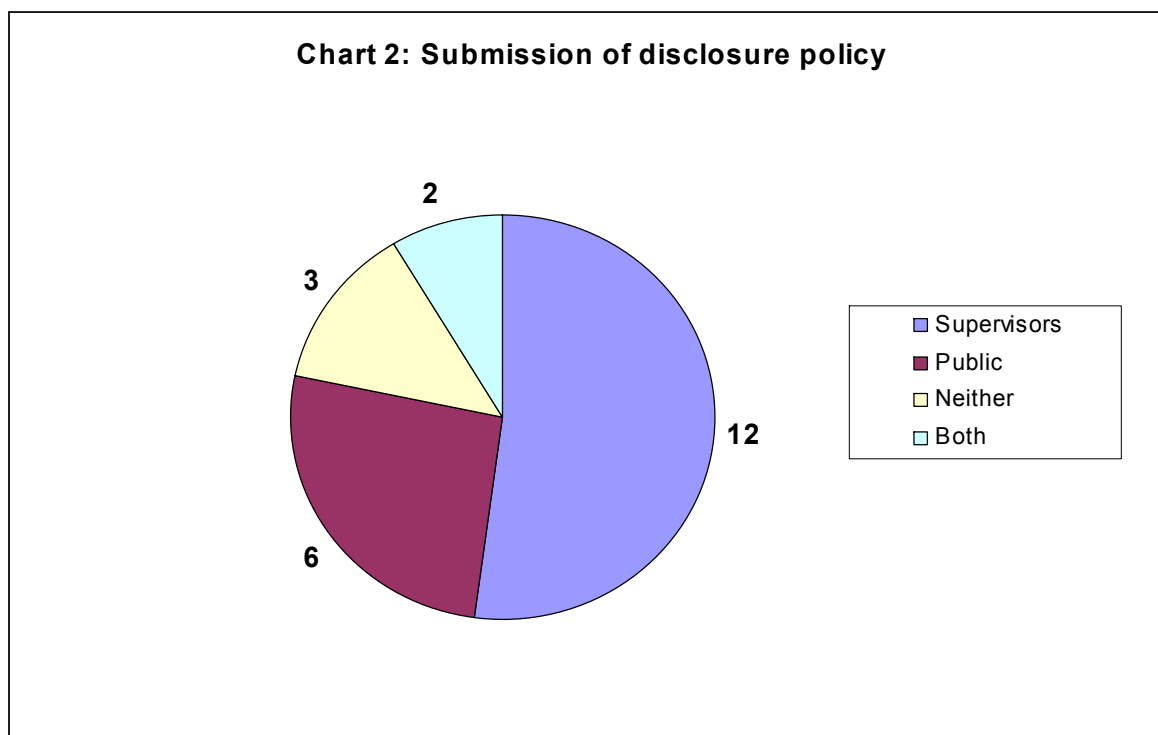
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<sup>10</sup> Paragraph 808 and 821 of Basel II Framework.



### III.2.a) Submission of the disclosure policy to supervisors or to the wider public

43. Earlier discussions indicated that different approaches could be adopted as regards the handling or dissemination of the disclosure policy. The answers reveal that 12 countries require the submission of the disclosure policy to supervisors either on a systematic basis (7 countries: CY, EL, ES, FI, IT, MT, NL) or upon supervisory request (5 countries: BE, CZ, EE, IE, LV). 6 countries (BG, DK, PL, SI, SK, UK) require the publication of the disclosure policy. 2 countries (LT, PT) request both the publication of the disclosure policy and its submission to the supervisors. The following chart provides an overview of the survey results on this issue:



44. Supervisory approaches in this respect are not of major concern to most firms even though it was noted in one case that the publication of the policy may result in increased oversight from the side of stakeholders which in certain circumstances could prove problematic.

45. In general, the industry is of the view that supervisors should focus on creating an adequate environment that will allow firms to make meaningful disclosures and the market to develop freely towards best practice.

### III.2.b) Link between the disclosure policy and the recognition of internal methodologies

46. The Directive specifies in article 145.2 that credit institutions should adopt a formal disclosure policy to comply with the provision that recognition by competent authorities of the internal methodologies for credit risk and credit risk mitigation as well as for operational risk is subject to public disclosure of the information set out in Annex XII, part 3 of the Directive.

47. The Directive is however silent on how to articulate the link between the disclosure policy and the recognition of the internal methodologies. The results of the survey show that 12 countries (AT, DE, DK, ES, FR, IE, IT, MT, NL, PT, SI, SK)

consider the development of the disclosure policy to be part of the recognition process and therefore require the development of the disclosure policy in parallel with the approval of the internal methodologies. Others (11 countries: BE, BG, EE, EL, FI, LU, LV, PL, RO, UK, NO) see this as a separate issue and do not require the disclosure policy as a prerequisite for the approval of the internal models.

48. In the latter case a timing issue can arise in that there may be a lag between the approval of the internal methodology and the implementation of the disclosure policy. It seems nevertheless that in most members this operational 'problem' is not deemed to be relevant and is therefore expected to be addressed in the ongoing discussions with banks during the approval process.

### *III.2.c) Concepts of materiality and of proprietary/confidential information*

49. Again much in line with the Basel II framework, Directive 2006/48/EC introduces in article 146 two concepts that in specific cases allow institutions to omit certain disclosures required in Annex XII, part 2 of the Directive. These are the concepts of materiality (in paragraph 1) and of proprietary/confidential information (in paragraph 2).

50. From early discussions CEBS has had it seemed as if some supervisors saw a need to develop supervisory criteria regarding the concepts of materiality and of proprietary/confidential information to Pillar 3 disclosures.

51. The survey results show however that most countries do not see a need to develop supervisory criteria. Some countries noted that guidance could nevertheless be provided on a case by case basis. Generally, it was not felt to be feasible to develop suitable criteria for all situations and firms. Where criteria are provided, they tend to be aligned with the provisions in Annex XII, Part 1.<sup>11</sup>

**52. The findings of the survey lead CEBS to conclude that no follow-up action is necessary in the area of the disclosure policy and the general concepts.**

## **IV. OTHER ISSUES**

53. Chapter 5 of Directive 2006/48/EC contains a number of further areas that give rise to potential implementation differences. These result generally from the fact that the text does not provide specific guidance or directions regarding the specific implementation of the articles. This is the case for the following aspects:

- frequency of disclosure (in article 147);
- appropriate medium and location (in article 148);
- means of verification (in article 148).

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<sup>11</sup> Annex XII, part 1 , point 1 to 3 state the following:

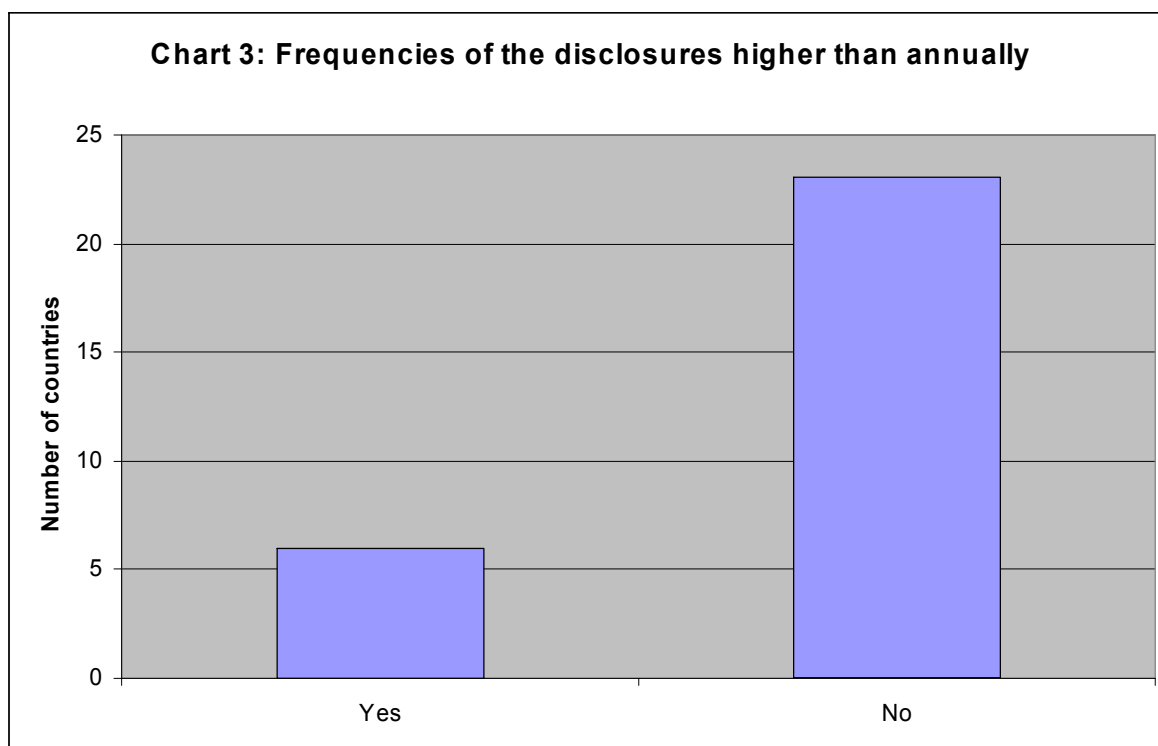
- Information shall be regarded as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions;
- Information shall be regarded as proprietary to a credit institution if sharing that information with the public would undermine its competitive position [...];
- Information shall be regarded as confidential if there are obligations to customers or other counterparty relationships binding the credit institutions to confidentiality.

54. Notwithstanding the general requirements governing these areas, article 149 goes on to say that countries can empower competent authorities to go beyond these provisions. The discussion that follows elaborates on these areas and any possible related issues.

#### **IV.1. Frequency of disclosure**

55. While the Directive states in article 147. 1 that the **frequency of the information** shall be on an annual basis at a minimum<sup>12</sup>, paragraph 2 requires institutions to determine whether more frequent publication is necessary in the light of relevant business characteristics.<sup>13</sup> Article 149 (b) goes on to say that Member States shall empower competent authorities to require credit institutions to publish one or more disclosures more frequently than annually, and to set deadlines for publication.

56. From the responses it appears that 23 countries apply the annual disclosure frequency provided in article 147.1 of Directive 2006/48/EC, even though in a number of cases it is said that institutions will not be prevented from disclosing more frequently in accordance with the 147.2 of the Directive.



57. In the 6 countries where a higher frequency is required in accordance with article 149 (b), the scope of the disclosure is in 4 cases (CY, EE, SE, SK) limited to the summarised information on the capital ratio. 2 countries (ES, IT) require the

<sup>12</sup> The Basel II framework differs from this requirement in that it establishes a basic frequency of semi-annual disclosures. Exceptions may apply to qualitative information (which can be disclosed on an annual basis) and to the capital ratio disclosures (expected to be disclosed on a quarterly basis).

<sup>13</sup> According to annex XII, part 1, point 4, relevant business characteristics can include scale of operations, range of activities, presence in different countries, involvement in different financial sectors, and participation in international financial markets and payment, settlement and clearing systems.

whole set of quantitative data on a semi-annual basis. This is mostly the case for institutions that use advanced methodologies for credit and operational risk, or for institutions whose shares and securities are quoted on a regulated market.

58. The discussions with the industry have shown that higher than annual reporting frequencies are another area of concern. The view is held that the appropriate frequency should be established, in accordance with the provisions of article 147.2, by the parent bank at consolidated level, with due consideration given to market practices as well as the information demands of market participants.

59. While the findings of the survey should allay the industry's concerns in terms of reporting frequency, the EBF raised a somewhat related concern with regard to the 'first time application' of Pillar 3. Indeed the industry mentioned that it seemed as if some countries require Pillar 3 disclosure before the other pillars come into force.

60. CEBS's findings and discussions did not allow it to confirm this issue. While it was noted that in specific circumstances it would be possible that Pillar 3 disclosure could be required as early as for the 2007 year-end (or even mid-year) data, it was at the same time felt that this was more of a theoretical than practical concern. In general it was felt that the application of the disclosure requirements would follow the coming into force of the other requirements introduced by the Directive.

#### **IV.2. Appropriate medium, location and means of verification**

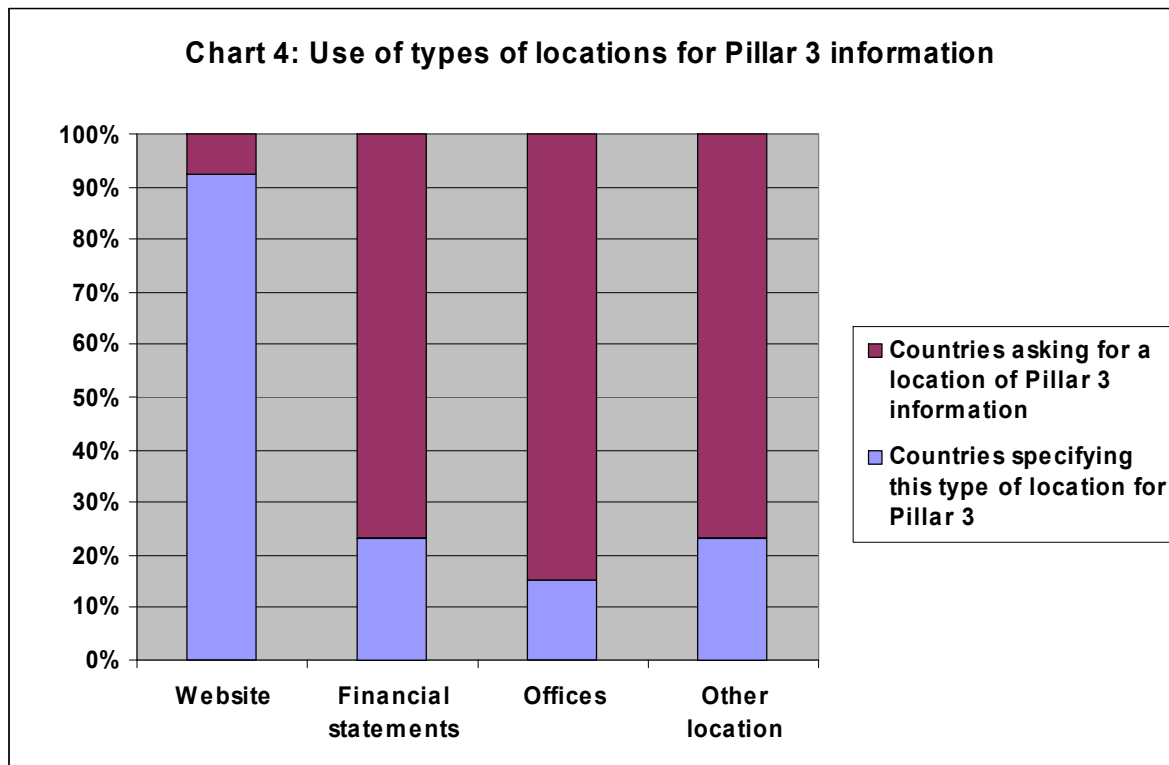
61. Whereas article 148 provides that institutions may determine the appropriate medium, location and means for verification to comply effectively with the disclosure requirements laid down in the Directive, article 149 again requires in (c) and (d) that competent authorities can go beyond these requirements.

62. Regarding the provision whereby national authorities need to be able to require institutions to use specific **media and locations for the disclosures** other than the financial statements<sup>14</sup> the survey findings show that in 15 countries (BE, DE, DK, ES, FI, FR, IE, LT, LU, LV, NL, NO, PL, RO, UK) competent authorities do not prescribe a specific medium or location, whereas in 13 countries (AT, BG, CY, CZ, EE, EL, HU, IT, MT, PT, SE, SI, SK) competent authorities have chosen a more prescriptive approach.

63. For the latter 13 countries chart 4 illustrates which possible locations supervisory authorities foresee. It appears that in 12 cases banks' websites seems to be the preferred medium for disclosure. Some national authorities allow alternative locations which explains the fact that the percentages add up to more than 100%.

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<sup>14</sup> The Basel II framework is less specific since it recognises in paragraph 814. that bank management should use its discretion in determining the appropriate medium and location.



64. From the discussions with industry representatives it appeared that – while on the whole a non-prescriptive approach from supervisory authorities would be preferred - the findings should not cause practical problems given the industry’s preference for web-based solutions.

65. As set out before, Directive 2006/48/EC requires that national authorities are able to use **specific means of verification** for the disclosures not covered by statutory audit.

66. The results of the survey reveal that a large majority of members (21 countries: BE, BG, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PL, PT, RO, SE, SK, UK) do **not** specify specific means of verification of Pillar 3 disclosures. Of the 7 countries where stricter provisions are applied, 5 countries (CY, CZ, DE, MT, SI) require external auditors to provide some form of verification of the Pillar 3 disclosure (or parts thereof). In the other 2 countries (AT, NO) internal auditors are required to verify the disclosures.

67. To the extent that the disclosure requirements are complied with – as far as possible - by means of the information provided **in** the financial statements, some supervisors consider/expect that the disclosures will be subject to statutory audit.

68. Discussions with the industry representatives showed that this is an area of major concern. Indeed there are worries that “this requirement supersedes the internal controls and procedures of the risk management function with checks that the industry does not believe to be well suited to deal with the very specific technical aspects of Basel II.”

69. Additionally, it is perceived that audit requirements would significantly increase the burden and cost of providing the disclosures. EBF representatives mentioned in that context that auditors seem to be very unenthusiastic about the prospect of having to verify or even audit this information.

70. It is felt that, given the low number of incidences of countries prescribing specific means of verification CEBS should not take up this issue at this stage.

### **IV.3. Additional considerations**

71. Other issues that came up in the discussions within CEBS or with the industry, where it was felt that the implementation of the Pillar 3 provisions could lead to divergence, related to the following:

- use/introduction of standardised formats ;
- collection of Pillar 3 information in the context of prudential reports;
- relationship between accounting and Pillar 3 disclosures;
- application of the proportionality principle; and
- supervisory actions in the absence of proper disclosures.

72. To ensure that the report captures all potential issues and concerns these areas were covered in the survey carried out by CEBS. However on the basis of the findings and the ensuing discussions both with the EBF and within CEBS, it was concluded that – with one exception - these areas do not give rise to any major concerns.<sup>15</sup>

73. With regard to the exception – dealing with the relationship with accounting - it is of great importance to ensure that the accounting and Pillar 3 disclosures are to the largest extent consistent or at least not such that they lead to major inconsistency problems. This issue also pertains to the interrelationship between Pillar 3 disclosures and IFRS 7.<sup>16</sup>

74. The results of the survey, which aimed to elucidate whether supervisors provided guidance on the relationship, reveal that most countries have refrained from taking measures (either official or informal) in this respect. In their responses, many indicated that disclosures made in the public financial statements as a result of IFRS 7 do not need to be repeated for the purpose of Pillar 3 compliance.

75. Two countries (IC, IT) noted that they may consider issuing guidance on this issue. One country is aiming to identify the parts of the accounting disclosures that can be considered equivalent to the Pillar 3 disclosures. Another country noted that, although the disclosure requirements are different in nature (e.g. as regards the scope of consolidation), they should not lead to material inconsistencies.

76. The discussion with the industry confirmed the main findings. It was felt that while there are some differences between the two disclosures, they should not be inconsistent. It was in fact noted that there is lot of commonality and that the possibility of one being complementary to the other should be further investigated.

77. This work would ideally also contribute to mitigating the industry's concerns with respect to disclosures that are (intended to be) required in some countries for significant EU subsidiaries. To the extent that the EBF has embarked on work in this

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<sup>15</sup> A detailed discussion of the other issues and the related survey findings has been included in annex 1.

<sup>16</sup> IFRS 7 deals with the disclosures on financial instruments and shall be applied by all entities. Pillar 3 disclosures which are aiming to enable the market to assess an institution's capital adequacy are intended to complement the minimum capital requirements (Pillar I) and the supervisory review process (Pillar II). While the two disclosure requirements differ both in scope and objectives, they are not considered to be conflicting or inconsistent.

respect, it is proposed to await the outcome of the industry's efforts before deciding on any measures in this area.

78. Other than that CEBS does not see the need for any follow-up work on any of the other issues at this stage.

## **V. SCOPE FOR POSSIBLE FOLLOW-UP WORK**

79. The following considerations are grounded on the perception that Pillar 3 disclosure is largely – with the possible exception of areas pertaining to internal methodologies – the responsibility of banks and that 'inappropriate behaviour' will be disciplined by an entity's stakeholders.

80. Notwithstanding this general perception, it is agreed that supervisors have a role not only in ensuring that adequate disclosure is provided for internal methodologies, but also in facilitating an environment that allows adequate functioning of market discipline.

81. It is in this context that CEBS is of the view that on the basis of the above findings only a limited number of issues that have arisen in the implementation of Pillar 3 are such that they warrant further supervisory investigation and – possibly – further action to improve the environment for market discipline.

82. These issues are the following:

- application of articles 72.1. and 2, in particular to (significant) subsidiaries: CEBS will – in conjunction with the industry – further investigate the potential for a solution where limited disclosure is provided with a subsidiary's (individual) financial statements. In doing this, further attention could also be given to the case of subsidiaries from third countries (article 72.3); and
- relationship between accounting and Pillar 3 disclosures: while it is acknowledged that there is merit in further investigating to what extent these disclosures are complementary, it is proposed to await the outcome of the industry's efforts in this respect before deciding on any measures.

83. CEBS aims to deliver on these issues in the course of 2008. This work will be undertaken in close cooperation with the industry and users of bank disclosures.<sup>17</sup>

84. For the other issues CEBS does not at this stage see the need for any further immediate measures or interventions, although it is proposed that CEBS closely monitors the developments in this area.

85. Over time, and with the benefit of analysis of concrete disclosures made by institutions, CEBS could consider the development of a good practices paper on Pillar 3 disclosures. The development of such a paper – which could contribute to the development of market practices in this area over time – would be closely coordinated with other supervisory fora such as the Basel Committee on Banking Supervision.

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<sup>17</sup> This work notwithstanding, CEBS will also – in accordance with ECOFIN's roadmap of key issues to be analysed and addressed following the recent market turbulence – examine by mid-2008 whether public disclosure of types and amounts of securitization exposures, of significant individual transactions and the sponsoring of Special Purpose Vehicles' exposures by banks under the Capital Requirements Framework (Basel2/CRD) is sufficient.

## **ANNEX 1: ADDITIONAL CONSIDERATIONS REGARDING PILLAR 3**

Is indicated in IV.4 there are a number of further issues that came up in the discussions among CEBS members or with the industry, where it was felt that the implementation of the Pillar 3 provisions could result in possible divergences. These included the following:

- use/introduction of standardised formats;
- collection of Pillar 3 information in the context of prudential reports;
- relationship between accounting and Pillar 3 disclosures (discussed in the body of the report);
- application of the proportionality principle; and
- supervisory actions in the absence of proper disclosures.

The following paragraphs provide a short discussion of the issues and on the related findings of the survey.

### ***1. Use/establishment of standardised formats***

From internal discussions it showed that one country - to meet industry demand - had decided to develop, with the involvement of the industry, a set of templates for **voluntary** use by credit institutions for compliance with the disclosure requirements arising from the Directive.

The survey results show however that the majority of countries (23 out of 29) have not resorted to developing standardised formats for the disclosure of the Pillar 3 information.

For the other 6 countries, supervisory authorities either:

- i) require standardised formats: by means of specific templates or following the prudential reporting formats (COREP) (3 countries: CZ, IC, PT);
- ii) recommended voluntary templates (2 countries: DE, HU); or
- iii) prescribe of the sequence that institutions have to follow for disclosure (1 country: IT).

Given the low number of occurrences where standardised formats are required, CEBS is of the view that this issue is not of material concern.

### ***2. Collection of Pillar 3 information in the context of prudential reports***

Similar to current practice in some countries with regard to financial statements, the discussions within CEBS showed that some supervisory authorities are considering collecting the Pillar 3 information via their prudential reports or some other medium. There were some related industry concerns that supervisors could intend to amalgamate Pillar 3 disclosure and supervisory reporting (notably COREP).

The survey results show however that such an approach is only followed by 3 countries (EE, HU, MT). For MT collection is being made in the context of the public financial statements. Another 3 countries (IC, IT, RO) have not so far decided on the approach to take in this respect.



### **3. Application of the proportionality principle**

While article 146.1 introduces the materiality principle, industry and supervisors raised the question of the applicability of the proportionality principle<sup>18</sup> to Pillar 3 disclosures. The application of this principle would imply that Pillar 3 disclosures are commensurate to an institution's profile, the costs of preparing them and their added value.

The survey responses provide the following picture:

- i) some countries adopt a formulaic approach, based on the consideration that if the Directive does not make any distinction, the disclosure requirements apply to all credit institutions;
- ii) many countries adopt a lighter regime for small entities;
- iii) some countries note that the differences in the approaches followed for the calculation of capital requirements could impact the level of detail of the disclosure requirements; while
- iv) some authorities note that lighter regimes could be applied to small and medium entities (e.g. by means of setting different frequencies).

Given the findings of the survey it is suggested that the no further follow-up work is carried out in this area.

### **4. Supervisory actions in the absence of proper disclosures**

In accordance with the rationale underlying Pillar 3 institutions that provide inappropriate disclosure or show a riskier profile with a higher premium risk will be 'disciplined' by market participants - including analysts, investors and rating agencies.

The survey results show that most supervisors consider that institutions can be sanctioned if they provide inadequate disclosure or if they omit to fulfil the requirements. The types of sanctions include penalties, fines [or even higher capital requirements?]. However, in many cases countries noted that these sanctions are generic and do not specifically relate to Pillar 3 disclosures.

The survey findings gave no indication that such sanctions would be applied on a systematic or even formulaic basis

As noted in the opening paragraphs of the report, the Directive nevertheless provides a specific role for supervisors to ensure that adequate disclosure is provided where institutions, through the use of internal methodologies, have more discretion in assessing capital requirements.

It can therefore be assumed that supervisors sanction the non-compliance with the requirements set out in article 145. 2 for institutions using internal methodologies for credit and operational risk by revoking the right to apply these methodologies.

These findings lead CEBS to conclude that no further follow-up work is necessary in this area and the other areas discussed in this annex.

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<sup>18</sup> Directive 2006/48/EC refers to this principle in articles related to the ICAAP (article 123) the SREP (article 124.4) and in the context of the exchange of information between home/host authorities (article 132.1). [I did not find this reference!]. The application of the proportionality principle is not explicitly foreseen for Pillar 3.

## **ANNEX 2: SURVEY ON TRANSPOSITION OF CRD PROVISIONS ABOUT DISCLOSURE REQUIREMENTS**

### ***Scope of application***

The CRD does not elaborate on criteria about designating significant subsidiaries. These significant subsidiaries should disclose only limited issues according to Annex XII, part 1, point 5. The CRD has neither empowered the national authorities neither the institutions in this respect. This issue could easily lead to divergent approaches within the EU on a national level.

*Question 1: Which criteria are used to determine that a subsidiary is significant, according to article 72.1 of Directive 2006/48/EC and by whom are they approved (bank, supervisor, auditor, none of them)?*

*Question 2: Are national authorities (acting either as home or as host supervisor) empowered to require to subsidiaries of EU parent credit institutions to disclose the information included in article 72.1, second paragraph? Please specify if your (prospective) national regulation only transposes the exact wording of the Directive or if additional considerations are included. If so, which?*

*Question 3a: Are national authorities going to use the waiver included in article 72.3 of Directive 2006/48/EC?*

*Question 3b: If yes: Will this provision be used on a general or a case-by-case basis? Please specify if your (prospective) national regulation only transposes the exact wording of the Directive or if additional considerations are included. If so, which?*

### ***Disclosure policy***

The CRD requires institutions to draw a disclosure policy in article 145.3 of Directive 2006/48/EC. Although not implied in this article it seems very efficient for national authorities to have this policy submitted, for it provides insight about the level of compliance to the CRD requirements and could prevent authorities to actual execute their article 149 powers. It also benefits the supervisory information exchange process between home and host supervisor in the case of cross border institutions.

Article 146.1 and 2 states that one or more disclosure requirements can be omitted if they are not material or confidential (both definitions can be found in Annex XII, Part 1) However, when defining the disclosure policy institutions may provide more guidance that may be scrutinised by the supervisory authority when approving the model. Therefore, it may be possible that national authorities have developed their own criteria to assess the application of materiality and confidentiality in the institutions disclosure policy.

*Question 4: Do national authorities require the development of a disclosure policy as part of the process for the approval of the internal methodology? Do you consider that an operational timing issue could exist because the recognition for usage of internal models should preferably be provided before the implementation of the internal model?*

*Question 5a: To whom should the disclosure policy be submitted: to the public only, or in advance to the supervisory authority? Do national authorities consider that it is necessary to have any supervisory criteria to assess the materiality used for the disclosure policy? If so, can you specify the criteria used?*

*Question 6: Do national authorities consider that it is necessary to have any supervisory criteria to assess the confidentiality used for the disclosure policy? If so, can you specify the criteria used?*

### **Options included in the Directive**

Article 149 provides some faculty to Member States to empower the national competent authorities on certain areas.

*Question 7: Do national authorities ask for disclosure requirements included in Directive 2006/48/EC with higher frequency than annually? (if yes, please specify)*

*Question 8: Will national authorities ask the supervised institutions to use specific means of verification? If so, please specify the mean (own verification by internal auditors, use of external auditors, assessment by management) and the related areas if so.*

*Question 9: Do national authorities prescribe a specific location for the disclosure requirements? If so, please specify*

### **Other issues**

*Question 10: Do national authorities establish a standardized format for disclosure of information? If so, please specify if the format is mandatory or just recommended.*

CRD does not foresee the preparation of specific templates to comply with the disclosure requirements included in Pillar 3. However, national authorities may set up formats (either mandatory or recommended) to comply with them, guaranteeing that all supervised institutions disclose the same requirements.

*Question 11: Do the national authorities have the intention to require the submittance of the disclosures under pillar 3 as part of the prudential returns?*

Although not explicitly stated in the articles 72 and 145 to 149 of the Directive 2006/48/EC national authorities may have given (national) powers to require the actual pillar 3 disclosures, for instance as part of the supervisory prudential returns. If so, please elaborate on the considerations attributable to effective prudential supervision.

*Question 12: Has your authority provided an announcement (either formal or informally) of the relation between the disclosure requirements asked by IFRS 7 and the ones asked by the Directive 2006/48/EC? If so, please specify.*

The development of the disclosure requirements included in Pillar 3 has been influenced about the relationship between them and the disclosures set by accounting standards in order to avoid inconsistencies among them. However, there are a number of differences between both (e.g. scope of consolidation).

*Question 13: What is the approach to be followed for small and medium entities? Do members consider the use of the proportionality principle?*

CRD applies to all credit institutions, regardless of their size. Therefore, it creates disclosure requirements to small and medium entities whose activities may not be frequently financed in the markets. Therefore, it may be possible a lighter application of these disclosure provisions in those cases would be more adequate for these institutions. However, this possibility is not explicitly included in CRD.

*Question 14: Which supervisory actions are foreseen if an entity does not disclose the disclosure requirements asked in due time or if the information disclosed is misleading?*

Article 145.2 of CRD sets as a requirement of approval of advanced methodologies for credit and operational risk to disclose the requirements included in Annex XII.