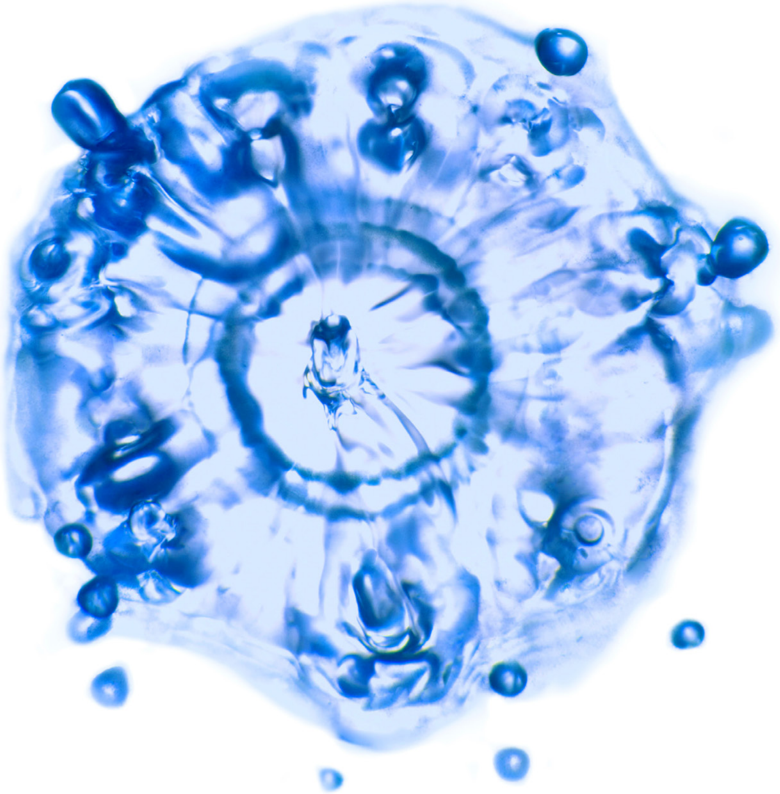

Pillar 3 disclosure: **The business as usual impact**

Pillar 3 requirements are evolving

The Basel Committee on Banking Supervision ("BCBS") is focused on regulatory disclosures as a cornerstone of transparency. A number of regulatory requirements have recently been issued by various regulatory bodies including BCBS and the European Banking Authority ("EBA") which will impact Pillar 3 reporting for institutions. There are two particular aspects to the requirements of which firms need to be aware. Firstly, the requirements are driving Pillar 3 disclosures to become an integrated 'business as usual' reporting requirement for firms, rather than a standalone project exercise. This is not unexpected as Regulators are becoming more data intensive as evidenced by BCBS 239 data aggregation principles and large data exercises such as the comprehensive assessment, stress testing and AnaCredit. Secondly, the content of the disclosures is increasing and this is leading to a number of challenges for firms. This article explores the requirements and challenges in more detail.

(For more on BCBS 239, please see our article that establishes BCBS 239 compliance as a critical success factor for securing competitive advantage).

The Evolution of Disclosure Requirements

In January 2015 the BCBS published standards for a 'revised Pillar 3 disclosures framework' which dramatically increased the recommended disclosures for institutions. The belief of the BCBS is that throughout the financial crisis the existing Pillar 3 framework at the time "failed to promote the identification of bank's material risks and did not provide sufficient, and sufficiently comparable, information to enable market participants to assess a bank's overall capital adequacy and to compare it with its peers"[1]. As a result, investors did not derive sufficient information to perform comprehensive and fundamental analyses of banks. That regulatory landscape fostered information asymmetry between preparers and users of Pillar 3 reports, which can be viewed as a contributory factor to market failure. As the scope of this revised framework far exceeds the scope of the disclosure requirements contained in Part Eight of Regulation 575/2013 ("the CRR") the EBA has issued guidelines to bridge the gap between the CRR and the revised Pillar 3 disclosures framework. These guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 ("the Guidelines") were finalised and published on the 14th December 2016 with an applicability date of 31st December 2017[2].

Aside from the recently issued EBA Guidelines, the EBA requirements in relation to disclosures are continuously being enhanced and institutions must also consider four related guidelines and four

1 Revised Pillar 3 disclosure requirements, http://www.bis.org/bcbs/publ/d309.pdf

2 This date is subject to a recommendation that they apply to global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) and to any other institution opted into these guidelines on the basis of a supervisory decision.

technical standards[3] as well as ongoing responses to the EBA Q&A's on Part Eight of the CRR.

Outside of the main BCBS and EBA Guidelines, firms also need to be aware that enhanced regulatory disclosures are also required for other prudential topics. For example, the EBA is also continuing to publish other disclosure related guidelines such as the Guidelines on disclosure requirements on IFRS 9 transitional arrangements[4] and Internal Governance[5]. Similarly, the Enhanced Disclosure Task Force[6] ("EDTF") have issued a number of recommendations for risk disclosures (e.g. Impact of expected credit loss approaches on Pillar 3[7]) thus reinforcing the importance of transparency and market discipline.

Disclosure Requirements are continuing to evolve

The next round of proposed disclosure enhancements from the BCBS are already in progress and the BCBS Enhanced Pillar 3 framework, which was published in March 2017[8], included disclosure recommendations within their Standards on Interest rate risk in the banking book (IRRBB). It remains to be seen how the EBA will ensure harmonisation of this Standard as well as the March 2017 BCBS Enhanced Pillar 3 Framework.

Furthermore, it should be noted that many of the tables (for disclosure guidance) or templates (for disclosure formats) referenced in the January 2015 BCBS Revised Pillar 3 disclosure requirements and the March 2017 Enhanced Pillar 3 framework relate to emerging requirements such as the Standardised Approach to Counterparty Credit Risk (SA-CCR) and therefore the disclosure requirements should not be overlooked when CRR II projects are being scoped. Clearly, these requirements must first be reflected in European regulations before actual disclosure requirements are known, but planning should allow for anticipated related disclosure requirements.

At this point, we anticipate further guidelines to be published by the EBA, which we expect to be released in tandem with the proposed CRR II (and beyond e.g. CRR III) updates.

The Challenges

We set out below a summary of the main challenges that institutions are likely to face when implementing the EBA Pillar 3 Guidelines.

Disclosure of possible confidential/ proprietary information

Institutions may struggle to implement the Guidelines for 31 December 2017 reporting due to the level of detail and the new methods of data aggregation required. There is also a concern regarding some qualitative disclosures, which some banks consider as having the effect of disclosing confidential or proprietary information. For example, the EBA Guidelines require the disclosure of internal risk limits[9]. There is a clear link between internal risk limits and an institution's risk appetite statement (RAS), with the RAS being fundamental to institutions' strategies and how they operate. The Guidelines also call for descriptions on how the business model of the institution determines and interacts with the overall risk profile of the institution[10], which is in essence a requirement to disclose strategic information about the institution.

3 https://www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/-/activity-list/u47Q7IIqoeRc/more

4 https://www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/guidelines-on-disclosure-requirements-on-ifrs-9-transitional-arrangements

5 https://www.eba.europa.eu/documents/10180/1972987/Final+Guidelines+on+Internal+Governance+%28EBA-GL-2017-11%29.pdf/eb859955-614a-4afb-bdcd-aaa664994889

6 Part of the Financial Stability Board

7 Financial Stability Board website, http://www.fsb.org/wp-content/uploads/Impact-of-expected-credit-loss-approaches-on-bank-risk-disclosures.pdf

8 Pillar 3 disclosure requirements – consolidated and enhanced framework, http://www.bis.org/bcbs/publ/d400.pdf

9 Table 1: EU OVA – Institution risk management approach of the Guidelines, https://www.eba.europa.eu/documents/10180/1696202/Final+report+on+the+Guidelines+on+disclosure+requirements+under+Part+Eight+of+Regulation+575+2013+%28EBA-GL-2016-11%29.pdf/20370623-9400-4b5e-ae22-08e5baf4b841

10 Table 2: EU CRA – General qualitative information about credit risk of the Guidelines, https://www.eba.europa.eu/documents/10180/1696202/Final+report+on+the+Guidelines+on+disclosure+requirements+under+Part+Eight+of+Regulation+575+2013+%28EBA-GL-2016-11%29.pdf/20370623-9400-4b5e-ae22-08e5baf4b841

Understandably, this is a topic that institutions are not comfortable disclosing publicly.

Increase in the volume of disclosures
The Guidelines now require up to 38 data templates of disclosures across thousands of data points for the more complex institutions. Up to four (e.g. EU MR2-B: RWA flow statements of market risk exposures under an IMA) templates are required to be disclosed on a quarterly basis for complex firms. Less complex firms are subject to the semi-annual production of between 10 and 21 credit risk templates (e.g. EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range) depending on their approach to credit risk, i.e. Standardised or Internal Ratings Based.

The increase in reporting templates presents a challenge for firms on how best to manage manual adjustments (particularly credit risk) and reconciliation between disclosure templates and the wider regulatory reporting population. Institutions must consider the importance and the role of due diligence and assurance in the Pillar 3 production process. Another notable challenge is the development of the qualitative text to be included in reporting templates, which will most likely be subject to a considerable level of internal review given the potentially confidential and subjective nature of the disclosures (e.g. internal risk limits disclosure requirement discussed above).

Board declarations
The EBA has taken a broad interpretation of the requirements under Part Eight of the CRR and some have argued that its issued Guidelines are not supported by the regulations.

One important example of this is the CRR requirement for institutions to have: "...policies for assessing the appropriateness of their disclosures, including their verification and frequency"[11]

This requirement has a related recommendation under the Guidelines, which states that:

"The management body and senior management are responsible for establishing and maintaining an effective internal control structure over the institution's disclosures..."

This has been interpreted by some to mean that assurance reviews of Pillar 3 disclosures are required to be undertaken (typically by third parties) and that Board member declarations attesting to the appropriateness of the internal controls processes will be required. Boards therefore should look to comprehensively understand the disclosures and their interaction with the institution's risk appetite, so that they can clearly define their Pillar 3 disclosures roles and responsibilities.

Data Quality and Production
In many cases, the additional data required to produce the quantitative disclosures for the new Pillar 3 templates will represent a challenge. For a number of institutions, there is no central data repository in operation and therefore aggregation of data will be necessary to enable them to meet the disclosure requirements. In other cases however, the data required to complete the Pillar 3 quantitative disclosures resides in source systems but is currently not mapped to, and as a result not extracted by, regulatory reporting systems. For the few institutions where clean reconciled data is delivered to regulatory reporting systems, external vendors typically do not offer Pillar 3 modules as a product, thus necessitating a manual reporting solution.

For the vast majority of institutions, manual manipulation of data is therefore inevitable.

Governance Arrangements
Given the increased frequency of disclosures and the new requirement to perform, at a minimum, the same level of internal verification on Pillar 3 disclosures as for information disclosed within the management discussion and analysis part of the financial report, the Pillar 3 disclosures will require a formal production and governance process.

"The management body and senior management are responsible for establishing and maintaining an effective internal control structure over the institution's disclosures..."

11 Article 431(3) of the Capital Requirements Regulations

Existing procedural documentation will need to be enhanced to reflect the relevant regulatory requirements and incorporate the regulatory interpretations and assumptions as they apply to the institutions. The enhanced procedural documentation should be reviewed at an appropriate governance forum (e.g. audit committee) of the institution and subsequently be reviewed at least annually, ensuring that the internal controls are adequate and effective.

The Pillar 3 production process is likely to include a formal data attestation process between relevant business lines and the regulatory reporting functions similar to financial reporting standard operating procedures. In addition, institutions should consider the need to establish service level agreements between business lines and regulatory reporting functions to address the short timeframe for production and publishing of the Pillar 3 disclosures.

The Reporting Team's end-to-end process for the production of Pillar 3 disclosures and appropriateness of the associated internal controls will need to be re-assessed. This assessment should check that the production process includes reconciliations and variance analysis.

Institutions must also establish a process to align financial statements with quarterly, semi-annual and annual Pillar 3 disclosures with consideration given as well to the linkage to Common Reporting (CoRep), Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP). The dependencies in the production process for Pillar 3 need to be fully documented so that the associated risks can be identified, assessed and mitigated effectively. Risk management for the Pillar 3 disclosures process should also be included as part of the wider governance framework of the institution.

Adequacy of Staff Resources

The increased frequency of disclosures will undoubtedly highlight the need for a clear ownership of Pillar 3 reporting by a department and individuals. Thus, roles, responsibilities and accountability must be internally well-defined and agreed upon. The production of Pillar 3 reporting and the need for internal assurance underlines the need for firms to evaluate the adequacy of staffing. The assessment of resourcing requirements should consider capacity and the training needs of new and existing staff on the new Pillar 3 reporting. When planning for periods of required additional resourcing, institutions should consider a split between permanent staff and contractors to meet the peak period Pillar 3 reporting schedule.

The ideal time to change?

Now may be the ideal time for regulatory reporting functions to address these challenges head on. For the few institutions with Regulator-mandated Risk Mitigation Programmes, this provides the internal focus required to obtain resources for expensive data improvement projects. For other institutions the data driven exercises such as the implementing changes under IFRS 9, AnaCredit, the General Data Protection Regulation and recommendations under the BCBS Principles for Effective Risk Data Aggregation and Risk Reporting (BCBS 239) mean that work is already underway in key areas. Regulatory reporting functions should ensure they are recognised as key stakeholders in these projects.

Deloitte are working with our clients to address these and wider regulatory reporting challenges. If you would like to discuss Pillar 3 disclosures or any other reporting topics please contact one of the team members below.

Contact us:

If you would like to discuss any aspects raised in this summary in more detail please contact:

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