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DATA REQUIREMENTS AND IMPROVEMENTS NECESSARY FOR ASSESSING THE HEALTH OF SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

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Introduction

This note offers some input for Session 2 of the IMF-FSB Users conference, to be held in Washington DC on 8 and 9 July 2009. The main focus is on the two questions to be tabled during this session, namely:

- What data do we need to form a better picture of the underlying health of systemically important financial institutions?
- What improvements in disclosure[2] are needed to provide these data?

To help stimulate discussion at the conference, this note also covers aspects regarding the information available with regard to large financial institutions and the international comparability of these data. This note draws on the ECB's experience, which naturally focuses on the health of the financial system in the euro area and, to some extent, the European Union.

In fact, the current financial crisis has meant that new responsibilities for macro-prudential supervision (including early warning exercises) are being assigned to a European Systemic Risk Board. This new body will be given macro-prudential tasks and will benefit from the analytical, statistical, administrative and logistical support of the ECB.[3] While the exact specifications of the new institutional arrangements have not yet been finalised, this development necessitates a careful appraisal of the information requirements needed for financial stability purposes. This appraisal is currently still at an early stage.

1 I would like to thank Paolo Poloni, Richard Walton and Stefan Wredenborg for their valuable input into this note.

2 The term "disclosure" here is understood in a broad sense, i.e. encompassing both the information publicly available and regulatory reporting requirements.

3 See ECOFIN conclusions of 9 June 2009: www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/en/ecofin/108392.pdf.

The macro-prudential analysis currently carried out by the ECB

The European System of Central Banks (ESCB) and the Eurosystem have already been carrying out macro-prudential analysis of the stability of the EU and euro area financial system for many years. In particular, the ECB, in cooperation with the ESCB's Banking Supervision Committee (BSC), publishes a biannual Financial Stability Review, which provides an assessment of financial stability in the euro area.[4] Formally, the role of the ECB/ESCB in financial stability is enshrined in the Treaty establishing the European Community. According to Article 105(5), one of the ESCB's tasks is to "*contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system*". Currently, the ECB cannot collect data exclusively for the purpose of fulfilling the above-mentioned task. However, the situation is changing, as the Council regulation governing the statistical powers of the ECB is expected to allow the collection of statistics from euro area countries solely for financial stability purposes.[5]

The ECB/ESCB's financial stability analysis is currently based on a variety of (statistical, supervisory and market) data sources. In particular, the ECB's Financial Stability Review focuses on analysing the condition of and risks confronting a group of large financial institutions and relies heavily on public data disclosure (e.g. Pillar 3 of the Basel II framework). Further ESCB macro-prudential analysis is based on aggregate supervisory data for national banking sectors.

Financial institutions have improved their public data disclosure in recent years (in particular in response to the current financial crisis) and the harmonisation of accounting standards has improved the comparability of data across institutions.[6] Nevertheless, data from public disclosures are resource-intensive to collect and the data are often still not fully comparable across institutions. In addition, public disclosures lack sufficient details about, for example, liquidity and solvency positions, and they do not contain sufficient information about institutions' different exposures to form a complete assessment.

Overall, given the users' needs and the drawbacks of the available data sources, there is a need for a more formalised approach in order to develop and compile harmonised datasets for large financial institutions. A fortiori, such datasets will be required by the newly established European Systemic Risk Board, which will need to analyse financial interlinkages and potential risk spillovers at the EU level and beyond.

Focus on large financial institutions

The main focus of the financial stability analysis undertaken at the ECB is on large and complex banking groups and large insurance companies in the euro area. While data for the financial sector as a whole are important, it is also essential to analyse data for individual, systemically important, large financial institutions to assess the transmission of systemic risks within the financial system, including via stress tests.

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4 In addition, the BSC conducts periodic analyses of the stability of the EU banking sector.

5 See the ECB's recommendation for a Council regulation amending Regulation (EC) No 2533/98 concerning the collection of statistical information by the European Central Bank (www.ecb.int/ecb/legal/pdf/c_25120081003en00010005.pdf).

6 The Committee of European Banking Supervisors published two reports on 24 June 2009 setting out the outcome of its efforts in assessing banks' disclosures provided: i) in their 2008 audited annual reports on activities and exposures affected by the financial crisis; and ii) under Pillar 3. The review of banks' transparency in their 2008 audited annual reports showed improvements, whereas the analysis of Pillar 3 disclosures indicated a need for further convergence.

In order to overcome the current data drawbacks, reliance on public disclosure may no longer be sufficient and reporting requirements may need to be imposed for systemically relevant financial institutions. One possible approach, at least from a European perspective, could be to focus on two cornerstones.

First, it would be important *to identify the reporting population* to which reporting requirements would apply. Systemically important financial institutions are important for financial stability not simply because they are large, but because the nature of their business is such that their failure and inability to operate would most likely have adverse implications for financial intermediation, the smooth functioning of financial markets or other financial institutions operating within the system, and indirectly on the real economy. To date, the ECB has used a multiple indicator approach to identify large and complex banking groups for financial stability analysis. By using 19 different size and interconnectedness indicators, different "clusters" of banks that meet certain "largeness" characteristics that go beyond balance sheet size are identified.[7] However, it is conceivable that in the future more formal criteria will be developed that could support the fulfilment of statistical reporting requirements.

The second cornerstone could be to define *reporting requirements for systemically important financial institutions* and to maintain the current aggregate supervisory data for national banking sectors. An adequate information base should include *the regular collection of macro-prudential data and statistics, such as those relating to the macroeconomic environment, financial markets and related infrastructures, payment and settlement systems, regulated and unregulated intermediaries, non-financial corporations and households, as well as the relationships between the main economic and financial sectors;* it should also include *the regular collection of firm-level information and data, in particular for large and complex financial institutions*.[8] The overriding considerations for defining the future harmonised framework will be the data needs of the future European Systemic Risk Board and the minimisation of the supervisory and statistical response burden for the financial industry in the EU.

Beyond public disclosures, the types of data which may be needed to assess the financial condition of and risks confronting systemically important financial institutions (and the banking/financial sector in general) could be grouped into two main datasets.

1. *Balance sheet, income statement and solvency data*. This core information is broadly harmonised in the EU, as the Committee of European Banking Supervisors has developed a series of templates for International Financial Reporting Standards (IFRS) based on consolidated financial statement information (known as the FINREP framework) and solvency data (the COREP framework) to be used by national supervisors. However, since the use of these templates at national level is currently a matter of national discretion (the use of COREP will be compulsory in the EU from 2012 onwards), their implementation is far from complete. This situation makes data comparison across countries and institutions rather difficult. The ECB collects, on a regular basis, selected information extracted from FINREP and COREP, via an ECB guideline. This dataset broadly coincides with the Pillar 1 requirements of Basel II.

2. *Data on liquidity risk, leverage, risk concentration (including large exposures), detailed exposures/bilateral positions, etc.* This dataset broadly coincides with the Pillar 2

[7] See ECB, "Identifying large and complex banking groups for financial system stability assessment", *Financial Stability Review*, December 2006.

[8] See the speech by L. Bini-Smaghi, member of the Governing Council and Executive Board of the ECB, at the Fourth International Conference on Financial Regulation and Supervision, "After the Big Bang: reshaping central banking, regulation and supervision", Bocconi University, 19 June 2009.

requirements of Basel II. The reporting requirements vary from country to country and are not harmonised, although the Committee of European Banking Supervisors is making an effort to standardise some parts (e.g. large exposures and liquidity risk disclosure).

The above-mentioned datasets, if made available for all systemically important financial institutions and in a harmonised format with the necessary degree of detail, data frequency and timeliness, would already represent a significant improvement. Importantly, quite some work will need to be undertaken in order to harmonise the second dataset mentioned above, as it is currently a matter of national discretion.

Moreover, additional information requirements (beyond Pillar 1 and, to some extent, Pillar 2) may be necessary in order to accurately capture cross-border, cross-sector and cross-institution exposures. However, it is difficult to obtain these data in a consistent way from supervisory sources. In this respect, it appears appropriate to identify and exploit information that could be made available on a security-by-security or loan-by-loan basis. For instance, the information contained in a possible future securities holdings statistics dataset supported by the ESCB's Centralised Securities Database[9] would not need to be collected again. In the longer term, loan-by-loan data within credit registers (currently available in almost all EU countries, but with fairly divergent content) could be harmonised, in order to make it possible to quickly meet ad hoc requests on specific exposures. Hence, consideration needs to be given to supplementing the supervisory data, for example, with information drawn from the above-mentioned micro-databases. This would improve flexibility, as well as reduce costs and data overlaps. In any case, the combining of supervisory and statistical data sources in order to provide the data needed to underpin regular systemic risk assessments may be challenging and resource-intensive.

International data comparability

The statistical initiatives undertaken within the EU should be aligned with those of international institutions. As a minimum common factor, any regional reporting framework for assessing systemic risk in the financial sector should be based on international accounting (IAS/IFRS) and supervisory (Basel II) standards.

Moreover, it will be important that new reporting frameworks aim to maintain a link with international statistics to the extent possible (e.g. the Bank for International Settlements' consolidated banking data and the IMF's Financial Soundness Indicators[10]) and to exploit synergies with global initiatives such as those of the IMF and FSB.

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9 The ESCB's Statistics Committee has recently set up an advisory group to develop strategic guidelines for data collection and compilation of securities holdings statistics.

10 There is already a significant degree of consistency between the IMF's Financial Soundness Indicators and the ECB's macro-prudential indicators based on consolidated banking data for national banking sectors (see A. Agresti, P. Baudino and P. Poloni, "The ECB and IMF indicators for the macro-prudential analysis of the banking sector – a comparison of the two approaches", ECB Occasional Paper No 99, November 2008 (www.ecb.int/pub/pdf/scpops/ecbocp99.pdf)).