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The Role of Financial Information in European Banking Regulation – The Past, Present and Future of FINREP*

Éva Kissné Ladányi

European banks have been providing financial information to their supervisory authorities for ten years under the single FINREP reporting system developed by the European Banking Authority. This article reviews the role of financial information, and in particular the application of IFRS, in the consolidation of European banking regulation, the specificities of the FINREP reporting system, which presents bank financial information in a comparable way, and the possibilities and limitations of the statistical use of financial data.

1. Introduction

Financial information and financial reporting based on regulated accounting principles has become increasingly important for businesses with ownership and management being separated. Ownership control and investment decision-making in public companies are essentially based on financial information, which is why it has become necessary to standardise such information, initially at the national level and then, with globalisation, increasingly at the international level. In the European Union, the application of International Financial Reporting Standards (IFRS), adopted by the EU for companies issuing publicly traded securities, became mandatory for consolidated financial reporting in 2005, rendering the application of national accounting standards increasingly obsolete. In Hungary, too, more and more companies are switching from Hungarian accounting rules to IFRS, a process that was given a significant additional boost by the 2015 amendment to the Accounting Act,[1] which allowed the use of IFRS instead of Hungarian accounting rules (HAS) not only for consolidated financial statements, but also for individual financial statements, and made it mandatory for banks to use IFRS instead of HAS

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Éva Kissné Ladányi: Magyar Nemzeti Bank, statistician. Email: kissne1960eva@gmail.com

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[1] International Financial Reporting Standards. Current consolidated version: 10/04/2008. http://data.europa.eu/eli/reg/2002/1606/oj
Act CLXXVIII of 2015 on implementing the application of the International Financial Reporting Standards in Hungary for individual reporting purposes and the modification of certain financial laws.

from 2018.[2] This amendment of the Accounting Act ensured that the application of IFRS would not be an additional burden on public companies that are also required to prepare consolidated accounts, but that they could choose to apply IFRS at both the individual and consolidated level, instead of the Hungarian accounting standards.

Understanding and applying the system of IFRS, especially during the transition period of changeover/first-time adoption, is a major challenge for users. For the Hungarian banks in transition, this coincided with the introduction of the new standard on financial instruments, IFRS 9, the impact of which was analysed from a supervisory perspective by *Háda* (*2019*). The advantage of using IFRS is that financial information can be prepared on the basis of principle-based, continuously evolving standards, which are developed and continuously maintained by a recognised, highly professional international organisation,[3] which supports preparers and users of financial statements with a range of publications, guidance and events. IFRS are developed with the needs of the primary users, the owners/investors, in mind, which does not mean that financial information under IFRS does not play an important role for other users, creditors, authorities and statisticians. Of particular relevance to our topic *is the use of financial information for banking supervision purposes, and the data requirements of supervisory authorities.* The outstanding economic importance and specific risks of financial institutions require a robust prudential regulatory framework. Compliance with these rules is monitored by supervisory authorities, partly through financial information and the regular additional data reporting that builds on it.

2. The role of financial information in banking regulation

European banking regulation, taking into account the Basel recommendations, aimed to establish a single set of requirements for banks' capital adequacy in relation to their risk exposure, already starting in 1989, and later on for the management of liquidity risks. The application of a converging set of rules within the European Union has been accompanied by uniform reporting obligations with an increasing content. The COREP (common reporting framework) reporting system for monitoring compliance with prudential rules, recommended for introduction from 2008, was implemented by the Member States, which meant only minimal harmonisation. Until 2014, the frequency and level of detail of the reporting requirements varied widely, but since then a truly uniform reporting regime applicable to all EU-based banks has been introduced under the CRR.[4]

[2] Domestic banks fully transitioned to IFRS at the individual level over three years, from 2017 to 2019.
[3] IASB: https://www.ifrs.org/
[4] CRR: *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012*: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex%3A32013R0575

In the context of maximum regulatory harmonisation realised with the entry into force of the CRR, a single FINREP report containing financial information was introduced alongside COREP from September 2014, the purpose of which is set out in Article 99(4) of Part 3 of the CRR as follows:

"(4) The financial information referred to in paragraph 2 and the first subparagraph of paragraph 3 shall be reported to the extent this is necessary to obtain a comprehensive view of the risk profile of an institution's activities and a view on the systemic risks posed by institutions to the financial sector or the real economy in accordance with Regulation (EU) No 1093/2010."[5]

This means that, unlike IFRS, the financial information presented in supervisory reporting must meet the needs of a specific user group, the supervisory authorities, which explains why the IFRS report of a credit institution that also prepares a FINREP report is not identical to a FINREP report, with significant differences in content and format (*Turner – Sedlacek 2015*). The need to reflect systemic risks, as stated in the purpose of the report, indicates that, unlike the financial report of an individual company, the FINREP report must be capable of aggregation, and comparability is also a key requirement in this regard.

The requirement for comparability has not only come to the fore in the case of reports to supervisors. The third pillar of European banking regulation, the disclosure requirements, is also increasingly subject to the requirement to present information in a unified content and format and to ensure consistency with supervisory data reporting.

In order to standardise the content and form of supervisory reporting, the European Banking Authority (EBA) was mandated to develop implementing technical standards, which are mandatory for all EU credit institutions from 2014, significantly reducing the shortcoming of International Accounting Standards (IAS) namely that IFRS, which are elaborated for all entities, do not prescribe mandatory levels of detail and schemas, but those can be determined by the preparer of the financial statements, taking into account the principle of materiality and adapted to the nature of the business entity. This means that even the IFRS-based financial statements of companies operating in the same sector, and the financial indicators based on them, are only comparable to a very limited extent, and differences in detail, in addition to differences in accounting policies, also represent a barrier. While the Hungarian accounting standards, complementing the Accounting Act by government accounting decrees have introduced a uniform balance sheet structure and accounting standards allowing for comparison that take into account the specificities of the financial sectors, IFRS are not sector-specific. The financial

[5] Ibid., Part 3, Article 99(4)

reporting package, FINREP,[6] developed by the EBA as a draft implementing technical standard under the mandate given to it by the CRR and applicable by law, fills this gap for credit institutions. In this paper, I show the importance of the introduction of a standardised FINREP taxonomy and the advantages and limitations of using banking data standardised in FINREP.

As mentioned in the introduction, the FINREP report, based on the specificities of the activities and risks of credit institutions, is intended to complement the COREP report, which is the primary measure of regulatory compliance, and therefore the scope of consolidation to which the financial data refer is not the same as the scope of consolidation defined in IFRS. In the case of capital adequacy rules to be complied with at both the consolidated and individual level, the competent supervisory authority determines the institutions belonging to the group, the scope of consolidation for the COREP report, based on the principles of CRD.[7] Due to the different detailed rules for accounting and prudential consolidation, there may be a number of differences in the scope of consolidation method between the institutions concerned. In practice, this is a significant difference in the case of financial conglomerates, where the group to be consolidated under IFRS also includes an insurance company. Due to the specific risks of insurance activities, their risk-weighted minimum capital requirements are different in this case from those of credit institutions, and they are therefore subject to a different set of capital adequacy rules. The CRR capital requirements for a conglomerate apply to a narrower group of institutions, and in line with this, the consolidated FINREP report also covers the financial data of the narrower group.

Currently, the CRR only imposes a FINREP reporting obligation uniform at the European level on a consolidated level for groups of credit institutions applying IFRS that are headquartered in an EU Member State. The largest European banking groups typically operate in several countries, and thus their consolidated financial data and the indicators based on such reflect their overall activities and their risks in an aggregated way, without isolating the financial markets of each country. This feature makes the report suitable for drawing conclusions on the stability of the European banking system from the analysis of the financial data of the largest banking groups, which the EBA publishes in its regular publications, notably the quarterly Risk Dashboard.[8] The statistical publications are made possible by the collection of quarterly COREP and FINREP reports by the EBA through the

[6] *Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions and repealing Implementing Regulation (EU) No 680/2014 (Text with EEA relevance):* https://eur-lex.europa.eu/eli/reg_impl/2021/451/oj

[7] CRD: *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC*: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013L0036

[8] https://www.eba.europa.eu/risk-and-data-analysis/risk-analysis/risk-monitoring/risk-dashboard

supervisory authorities of the EU Member States, starting in 2021 not only for large banks but also for the nearly 5,000 credit institutions and groups of credit institutions operating in the EU. However, the regular statistical publications of the European Banking Authority continue to focus only on the large banks, and the financial indicators of individual Member States also reflect the highest levels of consolidation. In the case of Hungary, this currently includes primarily the two banking groups which are also supervised at group level by the MNB (OTP and MBH), and, in order to meet the confidentiality criterion (at least 3 groups of credit institutions), this is supplemented by the data of one additional EU-based banking group supervised at the highest consolidation level by the ECB, subconsolidated at the Hungarian level. Thus, these average risk indicators, also broken down by country, do not purely reflect the stability and performance of the financial market of a given country, depending on the weight of banking groups active in several countries.

The EBA's collection of financial information does not yet cover the so-called solo FINREP data at the non-consolidated level. The European Central Bank (ECB), as the supervisory authority, imposes a solo FINREP reporting obligation by regulation,[9] but this only applies to banks supervised by the ECB within the euro area or the single supervisory mechanism (SSM). In line with the proportionality principle, which also applies to reporting, the ECB Regulation does not impose the solo FINREP reporting obligation uniformly, but at four levels of detail, namely full, simplified, further simplified and containing data points only, depending on the size and complexity of the institutions. This practice, which is justified from a supervisory point of view in order to ensure proportionality of costs for banks, does not allow for the production of aggregated financial data for all credit institutions in full detail, and the ECB therefore publishes aggregated financial data for euro area banks separately for institutions classified as significant and those classified as less significant. The former send the full FINREP package to the ECB on a quarterly basis, while the latter provide much less detailed financial information.

The broader usability of FINREP data is hampered by the fact that, unlike IFRS reports, a bank's FINREP report is not public, and individual bank data collected for supervisory purposes are confidential. Therefore, only aggregates containing data from at least 3 credit institutions may appear in statistical publications.

The ECB regulation requiring the application of the FINREP at the individual level – given that Hungary is neither a member of the euro area nor has voluntarily joined the SSM – does not apply to banks supervised by the MNB. The MNB, as the supervisory authority, regulates data reporting by domestic banks in its own

[9] *Regulation (EU) 2021/943 of the European Central Bank of 14 May 2021 amending Regulation (EU) 2015/534 on reporting of supervisory financial information (ECB/2021/24)*: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R0943

regulations. As of 2018, in addition to the application of FINREP at the consolidated level, the MNB collects financial information at the individual level in an integrated approach with statistical needs, which means that the FINREP data model at the consolidated level has been extended at the national level to include the separation of resident and non-resident stocks, as well as a number of other details that are relevant for the domestic market, but are not included in the single FINREP data model applied in the euro area. The EBA also seeks to collect non-consolidated financial data from European banks that are not part of the group, as well as from group members, for its analytical and regulatory impact assessments. To achieve this, in addition to the still missing statutory mandate, the development of a single solo FINREP data model is also required, which will most likely be based on the ECB's tiered data model, which is identical in content to the consolidated FINREP, so as not to impose additional burdens on banks supervised under the SSM system. In the medium term, it is expected that the MNB will also have to adapt to the way the ECB collects solo financial information from the banks it supervises.

Having said that, let us take a closer look at FINREP, which was developed by the European Banking Authority as an implementing technical standard and whose application has been required since 2014 by the European Commission Regulation referred to above.

3. Additional features of the FINREP reporting system and its statistical use

Credit institutions applying national accounting rules, in addition to those applying IFRS, shall also provide financial information at the consolidated level in the form and with the frequency required by this Regulation, where the competent supervisory authority has extended the obligation also to them in accordance with Article 430(9) of the CRR, i.e. there is a separate FINREP standard for national accounting rules. It is understood that domestic banks will only use the FINREP templates provided for in Article 11 of the Regulation and set out in Annex III thereunto, the completion of which is regulated in Annex V to the Regulation.

One important feature is that, unlike an IFRS report, a FINREP contains almost exclusively numerical information, with no textual reporting attached to the FINREP templates. Currently, the IFRS FINREP set of templates consists of 36 main templates. Several templates are broken down into numbered sub-templates, which present financial data in different levels of detail and dimensions. One of these dimensionalities is the geographical breakdown of exposures, which is shown in template F 20. This breakdown provides the opportunity to aggregate and analyse a significant part of the financial data at the highest European consolidation level of internationally active EU-based credit institutions also at the Member State level. However, statistical use is limited by the fact that these templates are only reported by banking groups with foreign exposures exceeding 10 percent of their total exposures, so this form of reporting is not complete. The number of potential data points in the FINREP data model – the cells in the Regulation's templates – is now close to 10,000, as supervisory information needs have grown steadily since its introduction. The data points form a consistent system. The data model includes validation rules that point out formal and content-related correlations, which are automatically checked at submission to ensure the right data quality for users.

The majority of FINREP data has been available to the relevant supervisory and regulatory authorities on a quarterly basis for ten years, since 2014. During this period, minor and major changes to the data model can be tracked on the EBA website through the FINREP version numbers. The biggest change to the data model in the ten years since its introduction was IFRS 9 on financial instruments, which was adopted by European banks from 2018. For more information on the domestic experiences from the introduction of the new standard; see *Gulyás – Somogyi* (*2019*); *Gulyás – Rátky* (*2023*)*; Kocsis – Seregdi* (*2021*)*.* The new accounting standard has brought significant changes in the classification and valuation of financial instruments and in the impairment regime, which is reflected in the data model from FINREP version 2.2.1 onwards. It is also worth mentioning that the EU-wide uniform definitions of non-performing exposures/loans and forbearance were first defined in the FINREP Completion Guide for the purpose of uniform reporting, and later introduced in the first level regulation with the amendment of the CRR effective from 2019.[10]

The standardised reporting format – currently the XBRL standard[11] – and the content defined in a common data model allow the report recipients, the supervisory authorities, to define and calculate indicators reflecting different risks on this rich data content, and to produce and publish time series and cross-sectional statistics; see *Tarpataki et al.* (*2022*) for more details. Examples of key risk indicators that can be built on FINREP data include profitability ratios (ROE, ROA), risk cost trends, non-performing exposures and non-performing loan ratios, forbearance ratios, coverage of non-performing or forborne exposures with impairment and collateral, and, following the introduction of IFRS 9, the impairment losses recognised for impairment stages and the proportion of exposures classified in each stage, to mention only the most important ones.

[10] *Regulation (EU) No 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures*: https://eur-lex.europa.eu/eli/reg/2019/630/oj

[11] XBRL (eXtensible Business Reporting Language): a free and global framework for exchanging business information.

The need to standardise the reporting format was raised not only for banks, but also for the publication of financial reports by businesses. One important objective of the new European Single Electronic Format (ESEF) developed by the European Securities and Markets Authority (ESMA) is to make it easier for creditors to process and analyse the ratios underlying corporate IFRS reports (*Tarpataki et al. 2022*).

Following the practice of the European institutions (the EBA and the ECB), the MNB was the first among the Member States to start processing and publishing the main data of the COREP and FINREP reports in 2018, with a comprehensive thematic statistical approach, which it has extended from time to time since then. The latest quarterly publication is also available in interactive format on the MNB website: https://sta.mnb.hu/Reports/powerbi/STA/HitelintPrudencialis_EN?rs:embed=true

4. Conclusions

The standardisation of financial reporting requirements in Europe, taking into account the specificities of the banking system, was achieved with the introduction of FINREP in 2014. The experience of the past ten years has shown not only how significant a step this has been in the supervisory methodology of banks, but also the wide potential for using comparable financial data for analytical and statistical purposes. For the time being, only supervisory authorities with direct access can fully use these possibilities. In addition to the wider dissemination of FINREP, the challenge for the period ahead will be to work out how to share the primarily supervisory-purpose dataset with secondary users at a deeper level, while respecting confidentiality constraints.

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