30 June 2010

Follow-up review of banks' transparency in their 2009 Pillar 3 reports

Executive summary

The analysis of Pillar 3 disclosures made by CEBS on 24 banks highlights the fact that banks have maintained their efforts to provide market participants with information allowing for a better assessment of their risk profile and their capital adequacy. CEBS has noted some welcome improvements in 2009 Pillar 3 disclosures, compared to the first set of disclosures published last year. Some banks have followed some of the best practices promoted by the CEBS in its report of last year. In particular, more detailed information has been provided on the banks' economic capital framework, on their exposure to counterparty credit risk as well as to operational risk.

In terms of presentation, CEBS observed a shift towards the publication of a separate, all-inclusive Pillar 3 report in preference to a more integrated solution (i.e. within the annual report or with extensive cross-references to the latter).

Contrary to expectations, no significant reduction of the publication timeline has been observed. The time-lag, for some financial institutions, between the publication of their annual report and their Pillar 3 report remains quite significant. CEBS expects that those banks will be able to publish their Pillar 3 report close to that of the financial statements since both the annual report and the Pillar 3 disclosures are necessary for the market discipline mechanism to operate effectively.

Regarding the degree of compliance with the CRD, some items of information (both qualitative and quantitative) required by the CRD are not provided by all credit institutions. Improvements are still needed in the following areas:

- detailed information on the composition of own funds;
- quantitative back-testing information for credit risk;
- clearer information on credit risk mitigation techniques supplemented by adequate quantitative information on their impacts and;
- valuation methodology used and detailed quantitative information on credit derivative instruments.

Similar to its findings of 2008, CEBS observed variations this year in the presentation and the content of Pillar 3 disclosures (such as the scope for the data provided, the definition of particular concepts or the structure of the breakdowns). These differences may raise comparability issues for users.

The analysis of 2009 Pillar 3 disclosures led CEBS to identify best practices in all areas. The best practice examples are not intended to be exhaustive or exclusive; rather, they are considered useful and potentially conducive to increasing quality and comparability of Pillar 3 disclosures.

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I. Introduction and background

Last year, CEBS carried out an assessment of banks' Pillar 3 disclosures for their first-time implementation. The present report is a follow-up review of banks' transparency in their 2009 Pillar 3 disclosures. A similar report analysing the transparency of 2009 audited annual reports has been published in parallel.

The purpose of Pillar 3 – market discipline – is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2), by allowing market participants to assess the capital adequacy of a bank through key pieces of information on capital, risk exposure and the risk assessment process.

The concept of market discipline relies on the idea that well-informed stakeholders are capable of putting pressure on the bank's management, so it will act in the stakeholders' best interests. Bearing this in mind, the bank's management should be encouraged to anticipate and adjust their risk-taking policies and improve risk management practices, with a view to containing their cost of capital. In this sense, market discipline acts as a form of self-regulation.

Transparency of a firm's capital resources and requirements seems even more important given the increasing use of internal models by financial institutions.

CEBS's June 2009 report assessed the Pillar 3 disclosures of 25 banks and concluded that they constitute a real contribution to the analysis of financial institutions' risk profiles and capital adequacy. In addition, CEBS welcomed the educational efforts made by banks on this occasion.

Nevertheless, the report highlighted a number of weaknesses especially in the following areas:

- the composition and characteristics of own funds could be more detailed in order to achieve better comparability across the industry;
- back-testing quantitative information for credit risk and market risk could be further developed;
- disclosures on credit risk mitigation techniques appeared too synthetic and sometimes insufficient with regard to quantitative information;
- counterparty credit risk could be enhanced with regard to value adjustment policies and to the granularity of quantitative information; and
- disclosures on securitisation transactions could have been more granular. CEBS noted that banks that have followed the industry good practice guidelines have provided more comprehensive information.

In addition, CEBS's 2009 report on Pillar 3 disclosures emphasised the degree of heterogeneity between banks in terms of the presentation, timeframe, format and also the nature of the data disclosed; all of which raised comparability issues for users. This last observation was confirmed by a panel of users invited by CEBS for an open meeting held in early autumn 2009 as well as by the participants of the public round table discussion organised by CEBS in December 2009.

II. Objective and methodological remarks

The objective of the report is to assess the compliance of banks' Pillar 3 disclosures provided by financial institutions with the requirements in Title V of Directive 2006/48/EC, chapter 5 - disclosures framework - and Annex XII's detailed requirements on disclosure (see Annex 2).

In addition, with a view to promoting convergence between banks, a set of best practices has been emphasised throughout the report. The notion of best practices is to be understood as a practice that stands out and in some cases goes beyond the strict compliance to CRD requirements. Best practice examples are neither meant to be exhaustive nor exclusive, rather, they are considered to be particularly useful and conducive to increasing comparability[1]. It is, however, important to note that, by nature, the approach implies the exercise of a certain amount of judgement.

The analysis is based on a sample of 24 European banks with cross-border activities (cf. annex). The sample has been slightly adjusted compared to last year's to replicate the sample used for the assessment of annual reports.

The methodology for the assessment has been somewhat revised compared with last year, both in terms of process and scoring approach. With regard to the process, a cross-analysis by topics has been added to the assessment made by each bank's national supervisor[2]. This revised process was designed to reduce the amount of judgement implied in any assessment.

The scoring approach has also been revised, being more focused on the appropriateness of the disclosures rather than on the level of details provided by banks as was previously the case.

The scores have been defined as follows:

- NA = item is not applicable;
- 0 = no information disclosed;
- 1 = insufficient information provided;
- 2 = disclosure could be improved; and
- 3 = disclosure adequate

National supervisors have agreed to discuss, as far as possible, the individual assessments and scores with the institutions covered in the exercise in order to provide banks with direct and immediate feedback on the outcome of CEBS's analysis, as well as an opportunity to understand any specific issues facing particular banks.

[1] It should also be noted that banks identified as best practice examples for a specific area might need to improve in other areas. A conclusion on a specific area should not be generalized to all the Pillar 3 disclosures of the bank.

[2] At the time of the finalisation of the report, two banks had not yet published their Pillar 3 disclosures in English. As a result, those banks could not be included in the cross-analysis.

III. General observations

Pillar 3 deals with market discipline, which leads many supervisors to adopt a non-prescriptive approach regarding the practical aspects of publication, for example, location, timeframe and presentation.

III.1 Timeframe and frequency

The CRD does not require a specific deadline for publication of Pillar 3 disclosures, but does require financial institutions to publish them as soon as practicable. It also empowers supervisors to set deadlines. In practice, few supervisors have imposed a specific timeframe, such as for Pillar 3 reports to be published simultaneously with financial statements.

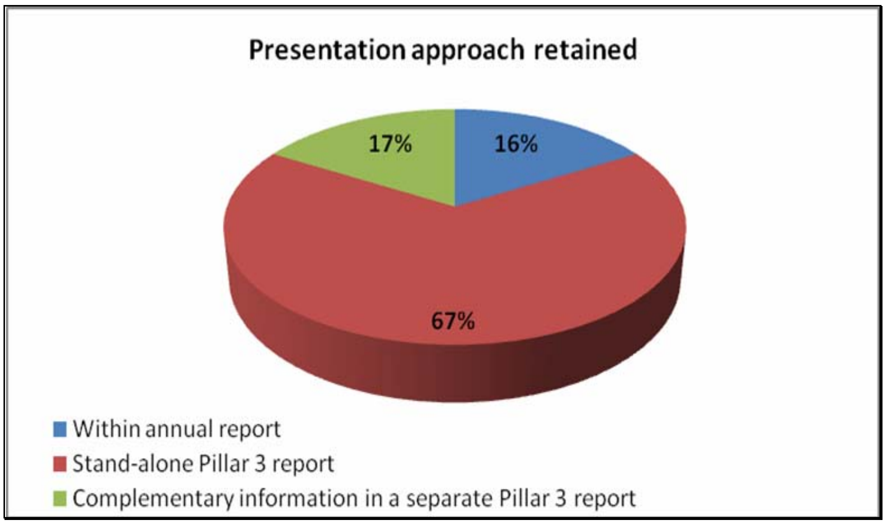
The date of publication of Pillar 3 disclosures varied significantly among the banks in the sample, ranging from the beginning of March 2010 for banks providing Pillar 3 disclosures within the annual report to the end of May 2010.

The average timeline for publication has not decreased compared with last year's. This observation may be a source of concern, notably for banks publishing their annual report long before the publication of the Pillar 3 report. CEBS expects that the gap between the publication dates of annual reports and Pillar 3 reports will be reduced, to allow for a combined analysis of the financial information provided on the bank.

With regard to the frequency of publication, the CRD requires Pillar 3 disclosures to be published on an annual basis as a minimum. A few supervisors (e.g. Italy, Switzerland and Sweden) require their banks to publish certain quantitative disclosures on a more frequent basis.

In practice, many banks also provide prudential measures in their quarterly communication to the market. Such regular updates on key ratios meet users' needs for up-to-date information especially in a changing environment.

III.2 Presentation and location



The majority of the banks included in the sample have produced a stand-alone Pillar 3 report. The proportion of stand-alone Pillar 3 reports has increased since 2008, ranging from 54%[3] to 67%; this presentation has the advantage of gathering all the Pillar 3 information in one place. However, as mentioned above, when the Pillar 3 and the annual reports are not provided within a short time of each another, it may prevent users from carrying out a combined analysis.

The presentation of Pillar 3 disclosures within the annual report has the advantage of providing users with an all-inclusive document that gives a comprehensive picture of the bank's financial soundness and risk profile. In addition, overall financial information is provided at the same time, which is not always the case when the bank publishes a separate Pillar 3 report Yet,, the use of many cross-references may reduce the overall readability of the report and users may get confused with regard to which parts – or subparts - of the report are audited and which are not.

Finally, some banks opted for an intermediate solution in producing a separate Pillar 3 document, with various cross-references to the financial report. Yet, CEBS noticed a decline in the number of banks which have opted for this approach.

CEBS does not want to advocate one specific presentation, as long as banks provide, in a timely manner, the complete set of Pillar 3 disclosures to users and the necessary tools to understand the link between the annual report and Pillar 3 information. In all cases, it may be difficult for users to understand the interrelationship between accounting and prudential figures unless clear reconciliation and explanations are provided (see chapter III.4).

With regard to the location of the information, the CRD only requires Pillar 3 information to be publicly disclosed. All the banks included in the sample have published the Pillar 3 information on their website, which is currently the best way to make information easily accessible. Yet, for some banks Pillar 3 information may require clearer signposting.

III.3 Formal disclosure policy and verification of the disclosures

The CRD requires financial institutions to set up a formal policy to comply with Pillar 3 disclosure requirements. CEBS considers it to be good practice for banks to provide information about their disclosure policy, highlighting notably the mode of verification and the frequency of Pillar 3 disclosures.

Due to the commonalities between IFRS and some Pillar 3 requirements, some of the Pillar 3 disclosures fall within the scope of legal external verification when they are provided in the financial statements. For the remaining part, very few supervisors have set up specific requirements for external verification of Pillar 3 disclosures. Indeed, a query conducted by CEBS on the means of verification set out in the different EU member countries[4] shows that only one country requires an external verification of Pillar 3 information similar to that required for financial statements. Two countries require limited external verification of compliance with

[3] Calculation adjusted on the 2009 sample.

[4] According to Article 149 (d) of Directive 2006/48/EC, Member States are empowered to define the specific means of verification for the disclosure requirements laid down in Article 145 of the Directive.

Pillar 3 requirements, while one country requires the verification of a selection of Pillar 3 information (capital components, minimum capital requirements and capital ratios).

It is interesting to note though, that in some countries reflections on the role of auditors with regard to Pillar 3 disclosures have been initiated by auditors or even, in a few cases, by bankers.

III.4 Synergies with IFRS

As mentioned last year, some Pillar 3 disclosures overlap with disclosure requirements of IFRS (IFRS 7 and IAS 1) with regard to qualitative and certain quantitative disclosures.

In order to help users benefit from the two sets of information, CEBS reiterates that banks should provide adequate explanation in their Pillar 3 disclosures of the differences in the scope of consolidation for accounting and regulatory purposes, as required by the CRD (Annex XII, Part 2, point 2). The assessment of 2009 Pillar 3 disclosures show that further improvements are still needed in this area since many banks provide only generic information.

In addition, CEBS noted that the provision of reconciliation tables and explanations for differences between Pillar 3 and annual reports appears very helpful in providing this overall picture and could, therefore, be considered as a best practice. In this respect, CEBS noticed that banks were heading in the right direction.

III.5 Other presentational aspects

CEBS appreciated the huge educational efforts that many banks have made in 2008 and 2009. Most of them have provided in their report descriptions about the CRD requirements and the methodologies used to elaborate quantitative information. Indeed, an educational approach still appears necessary to allow market participants to familiarise themselves with the regulatory concepts.

CEBS noted that the balance between general information on CRD requirements and entity-specific information – that is, the practical implementation of the requirements by the bank - still need to be fine-tuned. Depending on the topic, some banks provide only general information or, conversely, only entity-specific information while, at this stage, both aspects may be desirable to provide a comprehensive picture on a given topic.

Most banks provided comparative information with last year’s figures. Although not specifically required, comparative information is useful for showing how the entity’s situation has evolved. Where there have been significant changes, additional commentary is helpful in explaining the reasons behind such changes.

CEBS noted that omissions may leave the reader with some doubt regarding the reasons for these omissions – that is, the information may be immaterial, proprietary, or confidential, or the omission may actually be genuine. When the disclosures are not provided for proprietary or confidentiality reasons, the CRD requires that it should be clearly stated and, when possible, supplemented with more general or aggregated information about the disclosure requirements. When they are not provided for materiality reason, it could be useful for the reader to explicitly mention the fact, at least for significant CRD items, where there is room for doubt as to whether the item is relevant to the particular bank.

It should be noted that few banks in the study, for example, Barclays, provided reasons for exceptions to the disclosure requirements

IV. Detailed findings by topic

The following paragraphs discuss the main observations stemming from the analysis of the disclosures of the banks included in the sample and identify areas for which disclosures could, in some cases, be enhanced.

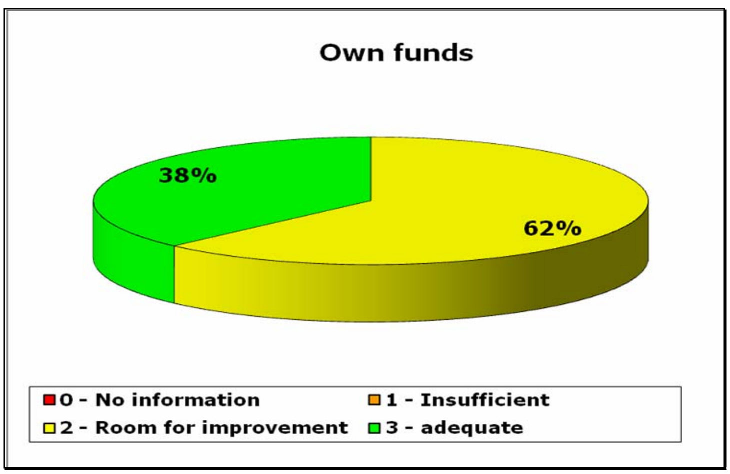
In addition, the discussion provides best practice examples, which are meant to serve as useful guidance as well as to promote convergence towards high-quality disclosures.

On the whole, some improvements have been noticed compared to last year, even though a large number of the disclosures remain similar to those of the first year..

IV.1 Capital resources and adequacy

IV.1.1 Disclosures on own funds (CRD, Annex XII - Part 2, point 3)

The assessment of the disclosures on own funds has been summarised in the following graph:



Around two thirds of the banks in the sample could improve their disclosures on own funds. Indeed, some banks did not provide summary information on the terms and conditions of the main features of all items included in own funds as required by CRD. In a few cases, banks provided detailed quantitative data, but many descriptions were limited to generic information.

Despite the CRD requirements, positive items and deductions from original own funds were, in most cases, aggregated and not all banks revealed the components of these aggregated amounts. Also, the requirement for separate disclosure of the excess or shortfall of provisions over expected losses was sometimes ignored.

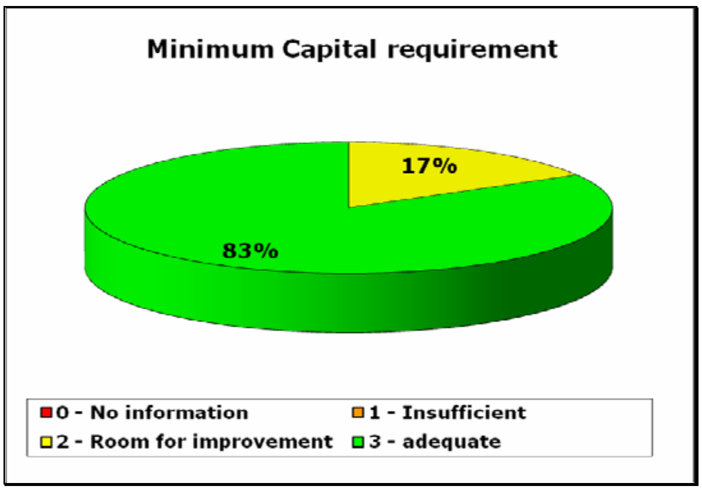
It is worth noticing at this stage that international regulators are considering strengthening the disclosure requirements relating to the composition of own funds (see “Basel III” consultation paper of December 2009).

As best practice examples, CEBS has identified:

- *reconciliation of IFRS equity to Tier 1 capital (e.g. UBS, Deutsche Bank); and*
- *in addition to capital resources and the capital ratio, an explicit disclosure of the additional capital requirement due to the Basel I floor (provided by several banks).*

IV.1.2 Minimum capital requirements (CRD, Annex XII - Part 2, point 4)

The assessment of the disclosures on minimum capital requirements has been summarised in the following graph:



On the whole, disclosures on the minimum capital requirement appear satisfactory and have improved compared to last year’s. Banks provided descriptions on the methods applied for assessing the adequacy of internal capital needed to support current and future activities although it remained too generic in some cases.

Albeit not required by the CRD, some banks provided the distribution of the economic capital per type of risks (credit risk, ALM risk, market risk, business risk, operational risk or insurance risk). This kind of information provides a useful insight into the risk profile of the entity.

Disclosures regarding credit, market and operational risk exposures and the calculated amounts of minimum risk-weighted exposures are disclosed in tabular form. The information is, for the most part, broken down appropriately. Some banks only disclosed the risk weighted amounts instead of the minimum capital requirement of 8% as required by the CRD.

As best practice examples, CEBS has identified:

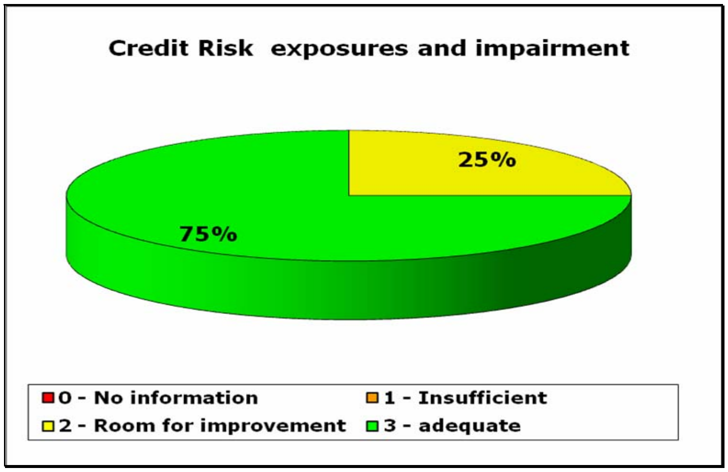
- *clear explanations on the interrelationship between minimum regulatory requirements and internal capital targets (e.g. Barclays); and*
- *quantitative information on the allocation of the economic capital (e.g. Dexia, Deutsche Bank) or a measure of the group’s “risk taking capacity”, defined as*

the group's available financial resources divided by its internal capital (e.g. Unicredit Group).

IV.2 Credit Risk

IV.2.1 Exposures and Impairments (CRD, Annex XII - Part 2, point 6)

The assessment of the disclosures on credit risk exposures and impairment has been summarised in the following graph:



A large part of the banks included in the sample provided all the disclosures required by the CRD while a limited part, i.e. around one quarter, did not.

CEBS noted that some banks did not disclose the breakdown of exposures by CRD classes but provide an entity-specific breakdown of exposures, while other banks did not provide the breakdown of average exposure amounts. In some cases, information concerning impaired and past due exposures was aggregated or, alternatively, information on past due was not provided at all. For a few banks, the breakdowns by geographical area or by economic sectors were missing.

From a more global perspective, CEBS noticed heterogeneity across banks in terms of both diversity of presentation and differences in content. For instance, securitisation exposures, equities and non-financial assets were included in the scope in some cases, but not in others; exposures were sometimes disclosed before accounting offsets and credit risk mitigation, but they were disclosed after these items in other cases; several concepts (past-due assets, write-off, provision…) may be used differently between banks.

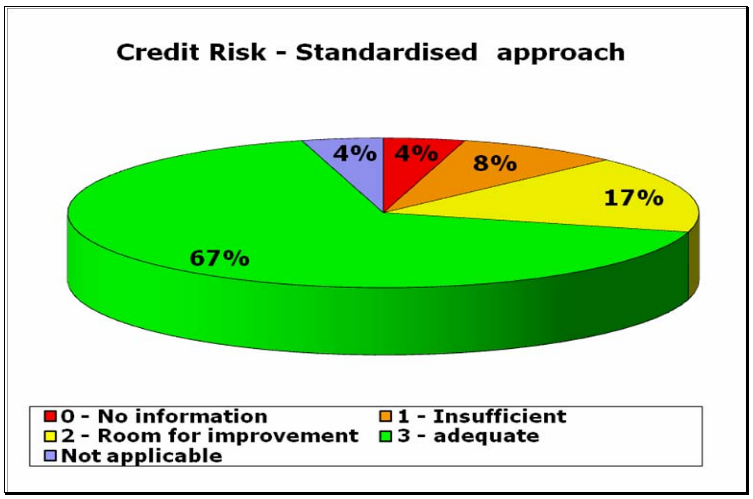
As best practice examples, CEBS has identified:

- *reconciliation of balance sheet and CRD exposure amounts (e.g. Nordea) and reconciliation or clarification related to scope differences for impairment amounts;*
- *distinction within the tables on exposures between credit risk and counterparty credit risk, or by nature of transactions (loans, derivatives, repos…– provided by several banks);*

- *analytical approach through the use of percentages (e.g. Crédit Agricole), and narrative comments notably on significant changes; and*
- *a distinction made between individual and collective impairment charges and the balance on the allowance account shown within the tables (provided by several banks).*

IV.2.2 Standardised approach (CRD, Annex XII – Part 2, point 7)

*The assessment of the disclosures on credit risk standar*dised approach has been summarised in the following graph:



Disclosures on the standardised approach for credit risk are generally sufficient. In some cases, the information was not very detailed, but this appears somehow commensurate with the tendency observed for most of the large banks to use the Internal Ratings Based (IRB) approach for a large part of their portfolios.

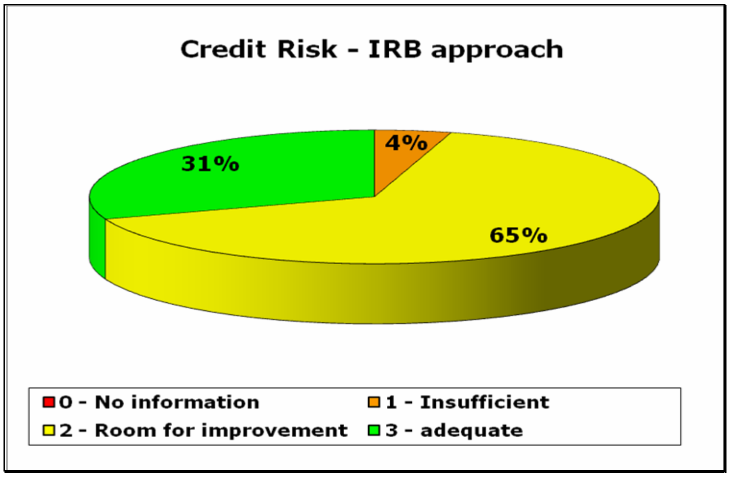
CEBS noticed that many banks provided exposure values by credit quality steps before <u>or</u> after credit risk mitigation, while both breakdowns are required by the CRD – yet, the differences between both sets of disclosures may be deemed not very significant. CEBS also noticed that the information on exposure classes for which each External Credit Assessment Institution (ECAI) is used was rarely provided.

As best practice examples, CEBS has identified:

- *separate disclosure of unrated exposure amounts and sufficient granularity of credit quality steps with no excessive concentration on one step (done by several banks); and*
- *clear delineation of the scope for the standardised approach (e.g. Barclays).*

IV.2.3 Internal Rating Based approach (CRD, Annex XII - Part 3, point 1)

*The assessment of the disclosures o*n credit risk Internal Ratings-Based approach has been summarised in the following graph:



The disclosures on the IRB approach leave room for improvement. With regard to qualitative information, the mapping between internal and external ratings was sometimes missing, and the description of the internal rating process broken down by exposure classes was often too generic.

There is also room for improvement with regard to the quantitative disclosures; notably back-testing information – i.e. the credit institution's estimates against actual outcomes over a long period - was usually very brief, or not even provided at all.

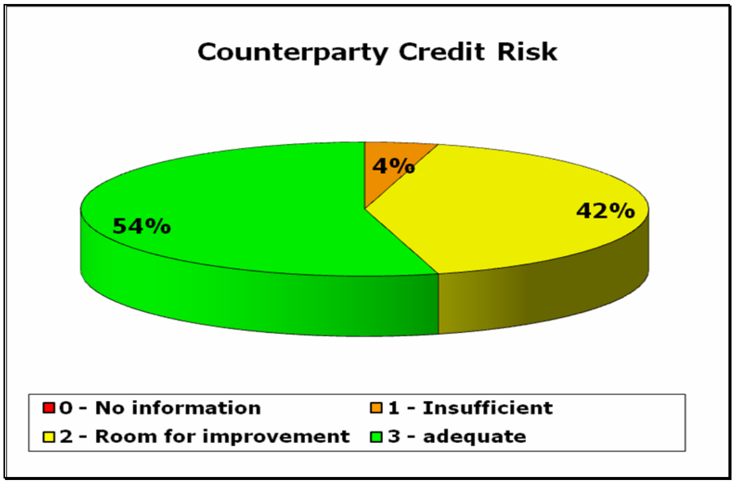
In terms of presentation, the use of an overall table comprising all the effective parameters used under the IRB approach (including, for instance, gross exposures, exposures-weighted average Credit Conversion Factor, EAD, exposure-weighted average in percentage terms for PD, LGD, and RWA) for each of the exposure classes, may appear convenient for users.

As best practice examples, CEBS has identified:

- *analysis of expected credit model performance versus actual results over a particularly long period (e.g. BBVA, which provides a comparison of effective losses versus estimated losses over a 8-year period for some portfolios), or at the parameter level (e.g. Barclays, which provides a comparison of estimated versus actual PD, LGD and EAD of defaulted assets by exposure classes for the period);*
- *probabilities of default (bucket or mean) for each internal grade (provided by several banks); and*
- *discussion on the approach retained for its ratings with regard to the situation in the economic cycle (e.g. Nordea).*

IV.2.4 Counterparty credit risk (CRD, Annex XII - Part 2, point 5)

The assessment of the disclosures on counterparty credit risk has been summarised in the following graph:



Disclosures on counterparty credit risk could be further developed for approximately half of the banks included in the sample.

A majority of the banks assessed provided information on counterparty credit risk in a separate section. When this was not the case, that is when information was inserted within credit risk disclosures, the reader may get somewhat confused if there is no additional explanation.

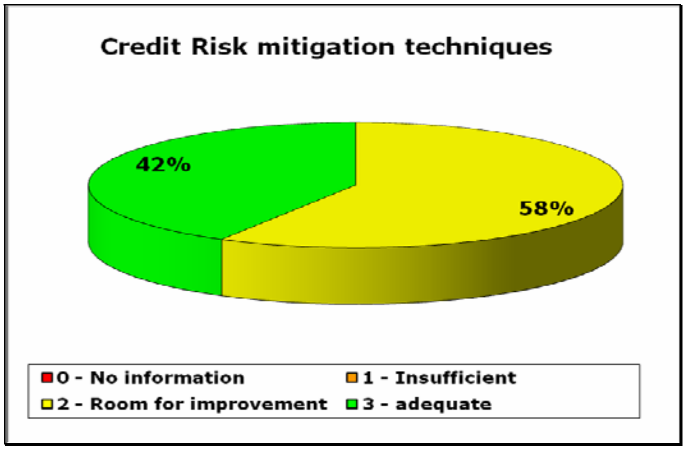
The main areas of improvement are the following: (i) qualitative information on the methodology used to assign internal capital and to establish credit reserves could be, in some cases, further developed; (ii) quantitative information on exposures by method used and on credit derivative transactions is not always provided or not sufficiently detailed.

As best practice examples, CEBS has identified:

- *quantitative information on potential future credit exposures for derivatives (provided by several banks);*
- *breakdown of EAD by exposure classes and by internal ratings (e.g. Société Générale);*
- *concentration measure of counterparty risk (e.g. Nordea provides the percentage of net exposures represented by the 10 largest counterparties); and*
- *breakdown of counterparty credit risk exposures by contract type (e.g. Barclays).*

IV.2.5 Credit risk mitigation techniques (CRD, Annex XII - Part 3, point 2)

The assessment of the disclosures on credit risk mitigation techniques has been summarised in the following graph:



With slightly more than 40 % of the banks included in the sample providing adequate information, disclosures on credit risk mitigation techniques could still be further improved.

The extensive range of the Basel II treatments for mitigation techniques probably requires from banks more educational information than commonly provided. Also, the linkage between the calculation of LGD – which takes into account the effect of some mitigants - and the information on credit risk mitigation techniques could, in many cases, be better emphasised.

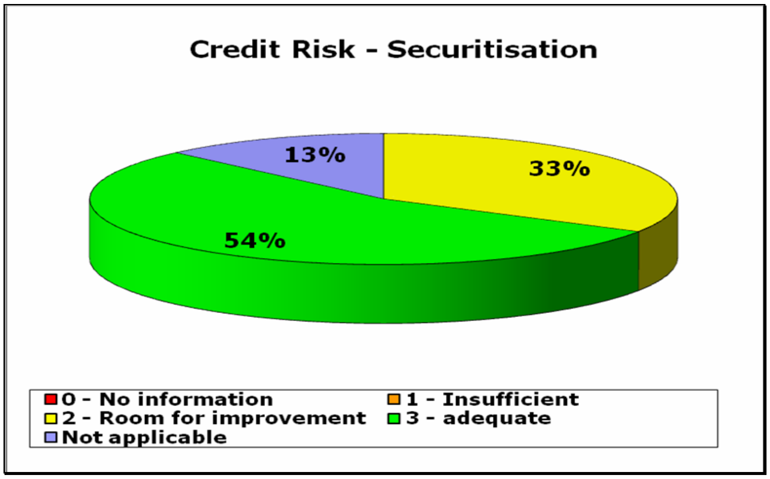
On the whole, information could be improved by providing further descriptions on the main types of collateral and guarantors, and on the way they are managed, as well as by emphasising their impact on exposures. In some cases, cross-references to the appropriate section of the financial statements – where further information on collaterals and guarantees was provided - could have usefully been added.

As best practice examples, CEBS has identified:

- *a table presenting the exposure amounts, the part secured by guarantees and credit derivatives, and the part secured by collateral by type of regulatory approach (e.g. Nordea, SEB);*
- *clear explanations on the Basel II treatment of the various types of CRM (e.g. Dexia);and*
- *amount of guarantees and collateral held against impaired loans (e.g. Société Générale). This information is required under IFRS 7, but not always provided by banks or else is not cross-referenced in the Pillar 3 report.*

IV.2.6 Securitisation (CRD, Annex XII, Part 2, Points 14)

The assessment of the disclosures on securitisation has been summarised in the following graph:



Compared with last year Pillar 3 disclosures, banks' information on securitisation has been generally enhanced. Most banks provided descriptions of their objectives, role and involvement in securitisation activities supplemented by various quantitative breakdowns on securitised exposures and securitisation positions retained or purchased.

However, improvements are still needed both from a qualitative and a quantitative point of view.

Regarding qualitative information, disclosures on accounting treatment remain too generic with a mere reference to SIC Interpretation 12 *Consolidation – Special Purpose Entities.* Similarly, the description of the approaches used for the calculation of risk-weighted exposures could be further elaborated upon and more clearly linked to the figures.

As to quantitative information, some banks only disclosed aggregated data instead of providing a complete breakdown by type of exposure. In many instances, CEBS observed that it is not possible to know whether some missing information - for instance, securitised revolving exposures, synthetic securitisation breakdown or the amount of impaired or past due exposures – was due to materiality reasons or whether it was indeed missing. Were banks more explicit in such circumstances, the information might be of relevance to users.

A few banks have applied the industry good practice guidelines[5] as the basis for preparing the securitisation disclosures and have, therefore, provided more comprehensive information such as the geographical and maturity breakdown for securitisation carried out on behalf of clients.

CEBS has identified some best practice examples:

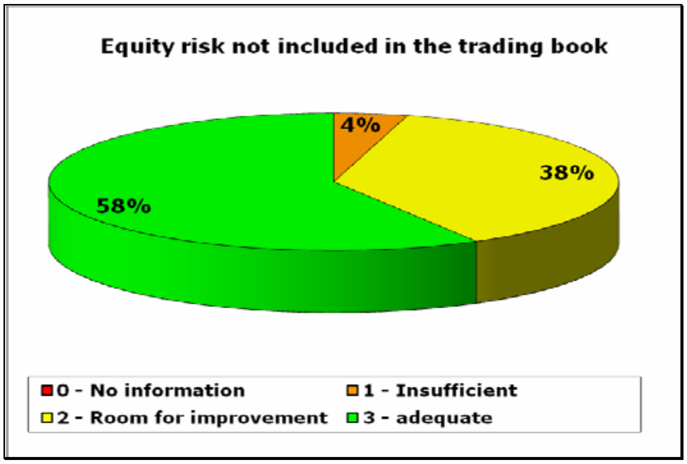
- *some banks have been very specific about their strategy (e.g. Deutsche Bank); and*

[5] "Industry Good Practice Guidelines on Pillar 3 disclosure requirements for securitisation" published on December 18, 2008 and updated in January 2010 by the European Banking Federation, the London Investment Banking Association, the European Savings Banks Group and the European Association of Public Banks and Funding Agencies.

- *others also provided comments regarding the changes between periods (e.g. Barclays provides comments at the bottom of each table, Dexia).*

IV.3 Equity risk not included in the trading book (CRD, Annex XII, Part 2, Points 8 & 12)

The assessment of the disclosures on equity not included in the trading book has been summarised in the following graph:



Disclosures on the equity risk not included in the trading book leave room for improvement. In particular, the information on realised and unrealised gains and losses was, in some cases, provided under the accounting scope instead of the prudential scope. In addition, the objectives relating to equity holdings and the valuation methodology of unlisted equities could be further developed.

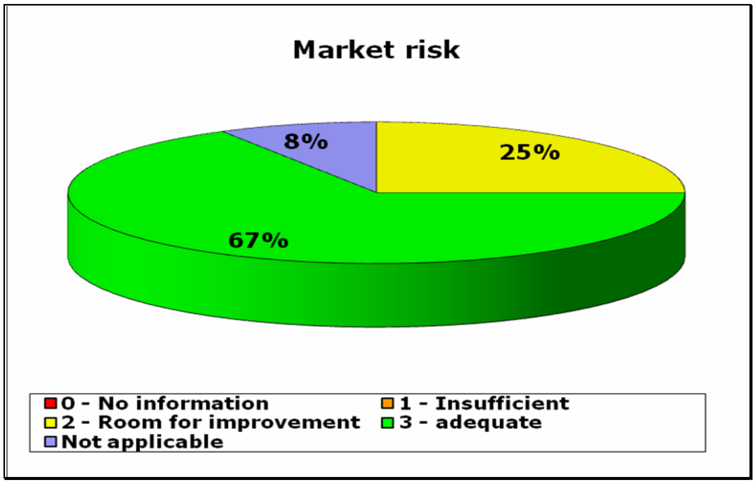
CEBS noticed that some banks provided information on the changes of unrealised gains and losses during the period while the others provided the cumulative amount at the end of the year.

As best practice examples, CEBS has identified:

- *the quantitative breakdown of exposures by objective - strategic, capital gains perspectives,... - (e.g. BNPP, HSBC);*
- *information on Basel II treatment for equity risk and notably on the grandfathering clause, when used (e.g. Dexia); and*
- *information on the fair value hierarchy of equity instruments retained in the prudential scope of consolidation (e.g. Intesa).*

IV.4 Market risk (CRD, Annex XII, Part 2, Points 9 & 10)

The assessment of the disclosures on market risk has been summarised in the following graph:



CEBS found that disclosures on market risk were generally in line with the CRD requirements, with several banks providing improved disclosures compared to those published in 2009.

Nevertheless, CEBS noted differences in the level of detail provided, including the level of quantitative disclosure. In particular, information on valuation controls and back-testing could still be enhanced in many cases. The amount of quantitative information was also affected by the extent to which a firm was able to use a VaR model to calculate capital requirements (as, for firms with VaR model permission, minimum capital requirements are determined at the portfolio level, rather than on the basis of individual position risk requirements).

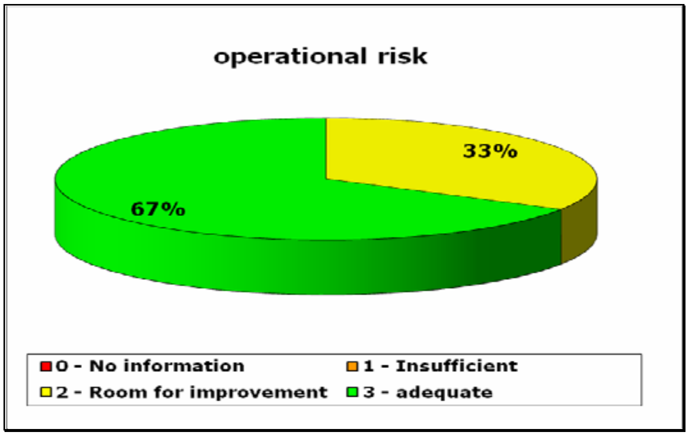
As best practice examples, CEBS has identified:

- *clear and comprehensive discussion of models used (e.g. ING, Dexia);*
- *detailed description of valuation controls (e.g. BNPP, RBS);*
- *graphs of VaR over the period (included by several banks);*
- *quantitative information on average, maximum and minimum VaR levels during the period (provided by several banks) as well as a comparison of the daily end-of-day VaR measures to the one-day changes of the portfolio's value[6] (e.g. Intesa, Société Générale); and*
- *information provided on stressed scenarios considered as part of stress testing regime (e.g. BNPP, Société Générale).*

IV.5 Operational risk
(CRD, Annex XII, Part 2, Point 11 and Part 3, Point 3)

The assessment of the disclosures on operational risk has been summarised in the following graph:

[6] *This information will be required by the CRD from 31.12.2010*



Overall, the level of detail regarding the disclosures on operational risk can be described as satisfactory. Banks using the Advanced Measurement Approach (AMA) explained their AMA models in detail.

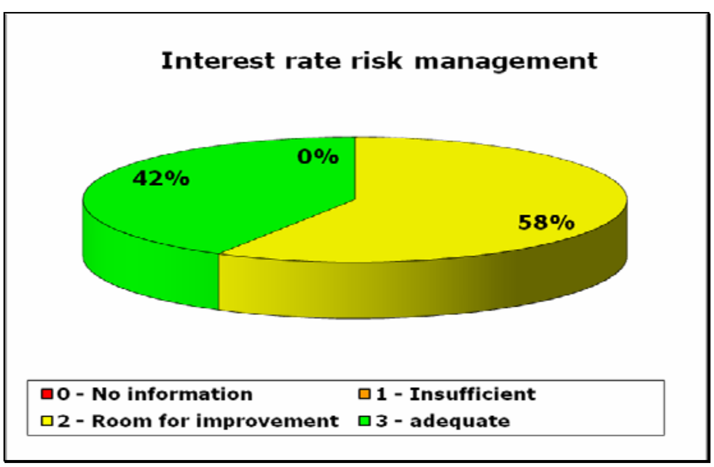
A few banks applying the AMA mentioned the use of insurance techniques and gave qualitative information on this aspect. However, the quantification of the latter's impact on capital requirements, although not explicitly required, would be useful for users.

As best practice examples, CEBS has identified:

- *disclosure of the composition of operational risk sources on average over several years (made by some banks). Some banks under AMA even provide two distributions of events by frequency and severity of losses in percentage terms (e.g. Santander); and*
- *a few banks provide the threshold above which a loss event is recorded into the database (e.g. Rabobank Group; DZ bank).*

IV.6 Interest rate risk management (CRD, Annex XII, Part 2, Point 13)

The assessment of the disclosures on interest rate risk has been summarised in the following graph:



The disclosures on the management of the interest rate risk leave room for improvement for more than half of the banks included in the sample. In particular, CEBS noticed that the sensitivity analyses were missing in a few cases and could otherwise be further expanded. Some banks did not provide the currency breakdown required. Besides, assumptions could be further developed and, in some cases, better explained (e.g. use of a different number of basis points for the upward and downward shock to interest rate) to allow an adequate interpretation of the sensitivity analyses. Finally, some banks do not disclose the frequency of their measurements.

In terms of presentation, variations arise due to the integration by certain banks of the disclosures on interest rate risk within market risk. In one case, the impact related to interest rate risk was even commingled with equity and foreign exchange risk on positions not included in the trading book.

As best practice examples, CEBS has identified

- *the presentation of interest rate gap by maturity (e.g. Nordea);*
- *a table setting out the minimum, maximum, average and end-of-the-year value for the interest rate VaR (by several banks);*
- *principle of using several scenarios, including a steepening or a flattening of the yield curve (e.g. Société Générale);*
- *mention of the quantitative limit used internally for the management of the interest rate risk (several banks); and*
- *clear discussion on the main drivers of interest rate risk (e.g. ING);*

Annex 1: Banks covered in the study

Banco Santander

Barclays

Bank Handlowy w Warszawie

BBVA

Banque et Caisse d'Epargne de l'Etat

BNP Paribas

Commerzbank

Credit Agricole

Deutsche Bank

Dexia

DZ Bank

EFG Eurobank Ergasias

Erste Bank

HSBC

ING

Intesa SanPaolo

Nordea

Rabobank Group

RBS

RZB

SEB

Société Générale

UBS

Unicredit Group

Annex 2: Checklist of Pillar 3 disclosures

CRD DISCLOSURE REQUIREMENTS	Score	Summary description of disclosures (w/ references) and related observations and comments/ Assessment	Comparison to the previous assessment
CHAPTER 5 **DISCLOSURE BY CREDIT INSTITUTIONS** *Article 145* 1. For the purposes of this Directive, credit institutions shall publicly disclose the information laid down in Annex XII, Part 2, subject to the provisions laid down in Article 146.		For national supervisors: For each part please identify the disclosures for the different items covered in the benchmark tables and provide in the table detailed references to their location in the source document together with some preliminary observations For small teams: For each part, please assess the information against the yardstick and the benchmark bank and complement with relevant observations. Also indicate whether it is NA = not applicable 0 = no information 1 = insufficient 2 = could be improved 3 = adequate	
2. Recognition by the competent authorities under Chapter 2, Section 3, Subsections 2 and 3 and Article 105 of the instruments and methodologies referred to in Annex XII, Part 3 shall be subject to the public disclosure by credit institutions of the information laid down therein.			
3. Credit institutions shall adopt a formal policy to comply with the disclosure requirements laid down in paragraphs 1 and 2, and have policies for assessing the appropriateness of their disclosures, including their verification and frequency.			
[Article 146] Not directly relevant			
Article 147 1.Institutions shall publish their disclosures as soon as possible.		Are Pillar 3 disclosure published simultaneously with financial assessments? In negative response which is the time delay?	

CRD DISCLOSURE REQUIREMENTS	Score	Summary description of disclosures (w/ references) and related observations and comments/ Assessment	Comparison to the previous assessment
2. Credit institutions shall determine whether more frequent information is required.		How many times per year must Pillar 3 disclosures be published? Have supervisors imposed deadlines?	
Article 148 1. [...] What medium, location and means of verification has been chosen? Have all disclosures been provided in one medium or location? [The analysis should cover information which support (e.g. annual report or separate publication) the institution chose to provide the disclosure, the location and whether they have been verified or even audited.]		Specify if Pillar 3 report is a independent document, or a separate section within annual report. Indicate whether the Pillar 3 report is accessible on the web? Indicated if the information has been verified or audited internally or externally? Is it required to audit or verify the Pillar 3 information at national level? Is the information checked previously by national authorities before it is published?	
2. Equivalent disclosures made by credit institutions under accounting, listing or other requirements may be deemed to constitute compliance with Article 145. Have credit institutions indicated where disclosures can be found if they are not included in the financial statements?			
Article 149 Notwithstanding Articles 146 to 148, Member States shall empower the competent authorities to require credit institutions: (a) to make one or more of the disclosures referred to in Annex XII, Parts 2 and 3; (b) to publish one or more disclosures more frequently than annually, and to set deadlines for publication; (c) to use specific media and locations for disclosures other than the financial statements;			

CRD DISCLOSURE REQUIREMENTS	Score	Summary description of disclosures (w/ references) and related observations and comments/ Assessment	Comparison to the previous assessment
(d) to use specific means of verification for the disclosures not covered by statutory audit. Have there been disclosures about any such requirements?			
Annex XII - Technical criteria on disclosure **Part 1 – General criteria** 1. [...] Materiality. 2. [...] Proprietary information. 3. [...] Confidential information. 4. [...] Need for more frequent disclosures 5. The disclosure requirement in Part 2, paragraph 4, letter (f) shall be provided pursuant to Article 72 (1) and (2). Is there disclosure whether disclosure has not been provided / been provided more frequently on these grounds? Are there explanations on criteria used?		Please specify if the reason for non disclosures clearly stated. For those instances which materiality is the justification could you indicate the threshold or rule used by the bank to consider a position as material.	
Part 2 - General requirements 1. The risk management objectives and policies of the credit institution shall be disclosed for each separate category of risk, including the risks referred to under paragraphs 1 to 14. [...] (a) – (d)			
2. Information regarding the scope of application of the requirements of the Directive [...] (a) – (e)			
3. Information regarding own funds [...] (a) – (e)			
4. Information regarding the compliance by the credit institution with the requirements laid down in Articles 75 (Minimum levels of own funds) and 123 (Credit institutions'			

CRD DISCLOSURE REQUIREMENTS	Score	Summary description of disclosures (w/ references) and related observations and comments/ Assessment	Comparison to the previous assessment
assessment process) […] (a) – (e)			
5. Information regarding the credit institution's exposure to counterparty credit risk as defined in Annex III, Part 1 […] (a) – (i)			
6. Information regarding institutions' exposure to credit risk and dilution risk […] (a) – (i)			
7. For credit institutions calculating the risk-weighted exposure amounts in accordance with Articles 78 to 83 (standardised approach), information about ECAIs for each of the exposure classes specified in Article 79 […] (a) – (e)			
8. The credit institutions calculating the risk-weighted exposure amounts in accordance with Annex VII, Part 1, points 6 or 19 to 21 shall disclose the exposures assigned to each category of the Table 1 in the point 6 of Annex VII, Part 1, or to each risk weight mentioned in points 19 to 21 of Annex VII, Part 1.			
9. The credit institutions calculating their capital requirements in accordance with Article 75, points (b) and (c) shall disclose those requirements separately for each risk referred to in those provisions.			
10. Information about the use of internal models for credit institutions which calculate capital requirements in accordance with Annex V of Directive 2006/49/EC**:**			
11. Information on operational risk […] (a) – (b)			

CRD DISCLOSURE REQUIREMENTS	Score	Summary description of disclosures (w/ references) and related observations and comments/ Assessment	Comparison to the previous assessment
12. Information about the exposures in equities not included in the trading book [...] (a) - (e)			
13. Information about the exposure to interest rate risk on positions not included in the trading book [...] (a) – (b)			
14. The credit institutions calculating risk weighted exposure amounts in accordance with Articles 94 to 101 shall disclose the following information about securitisation activities [...] (a)-(l)			
Part 3 - Qualifying requirements for the use of particular instruments or methodologies 1. Disclosure about internal rating systems [...] (a) – (i): 2. Disclosure about credit risk mitigation techniques [...] (a) – (g) 3. The credit institutions using the approach set out in Article 105 for the calculation of their own funds requirements for operational risk shall disclose a description of the use of insurance for the purpose of mitigating the risk.			