Pillar 3: A Preparers View

Jonathan Gray

Chair, EBF Working Group on Pillar 3

December 2009

Pillar 3

- Objectives
- Coverage
- Industry focus
- Convergence
- Challenges
- Concluding remarks

Objectives I

"Market Discipline has the potential to … impose strong incentives on banks to conduct their businesses in a safe, sound and efficient manner, including an incentive to maintain a strong capital base…"

Source:

Basel Committee

Working Paper on Pillar 3

September 2001

Objectives II

- Market Confidence: maintaining confidence in the financial system
- Public awareness: promoting public understanding of the financial system
- Consumer protection: securing the appropriate degree of protection for consumers
- The reduction of financial crime; reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime

FSA

- Maintaining a safe, efficient and cost effective payments system
- Conducting economic research to support monetary policy and advance economic understanding
- Maintaining a safe and sound banking system
- Sharing our expertise to benefit the public

FEDERAL RESERVE BANK OF BOSTON™

Objectives III

European Banking Federation

- Market Confidence
- Public Awareness
- Consumer Protection

FSA

Banks

Coverage

European Banking Federation

CAPITAL RESOURCES	CREDIT RISK: MITIGATION	SECURITISATION RISK
CAPITAL ADEQUACY	CREDIT RISK: COUNTERPARTY	OPERATIONAL RISK
CREDIT RISK: IRB	CREDIT – OTHER: e.g. PROVISIONS	MARKET RISK
CREDIT RISK: STANDARDISED	EQUITY RISK	INTEREST RATE RISK BANKING BOOK

- Audience is the market; not regulators
- Key are analysts and rating agencies

EU Bank and Trade Body Focus

European Banking Federation

Three objectives:

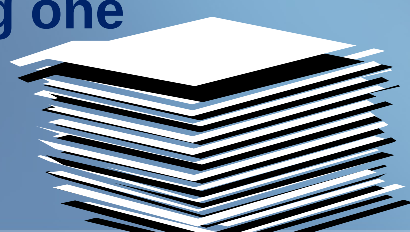
- **Agreeing the basis and frequency of publication – “the what, where, when etc”**
- **Driving convergence, wherever possible**
- **Supporting market education**

Convergence I

European Banking Federation

8 years leading up to Basel II BCBS published 150+ papers including 4 major consultations

6 years leading up to Basel I BCBS published 13 papers including one consultation



Source: Industry Statistics:

Convergence II

- **Driving alignment of Pillar 3 disclosures:** issued September 2008:
  - ✓ Made specific recommendations on issues where CRD would benefit from further explanation (e.g. model validation)
  - ✓ Highlighted differences in disclosures driven by regulatory requirements (e.g. capital disclosures, internal capital)
  - ✓ Recognised legitimate differences in bank approaches (e.g. treatment of derivatives, accounting / prudential rules)

Convergence III

European Banking Federation

- **Good Practice Guidelines for Securitisation:** issued December 2008:
  - ✓ Made specific recommendations on the scope of application and the interrelationship between quantitative and qualitative disclosures
  - ✓ Recommended transactions with no retained positions should be reported in year of inception
  - ✓ Firms should provide a comprehensive view of positions, including trading book and transactions which do not meet the minimum requirements for risk transfer
  - ✓ Recommendations regarding exposure values

Challenges I

- **Aggregation to a complete bank view:** various disclosures under Standardised, Foundation & Advanced for credit risk are not additive at the micro level

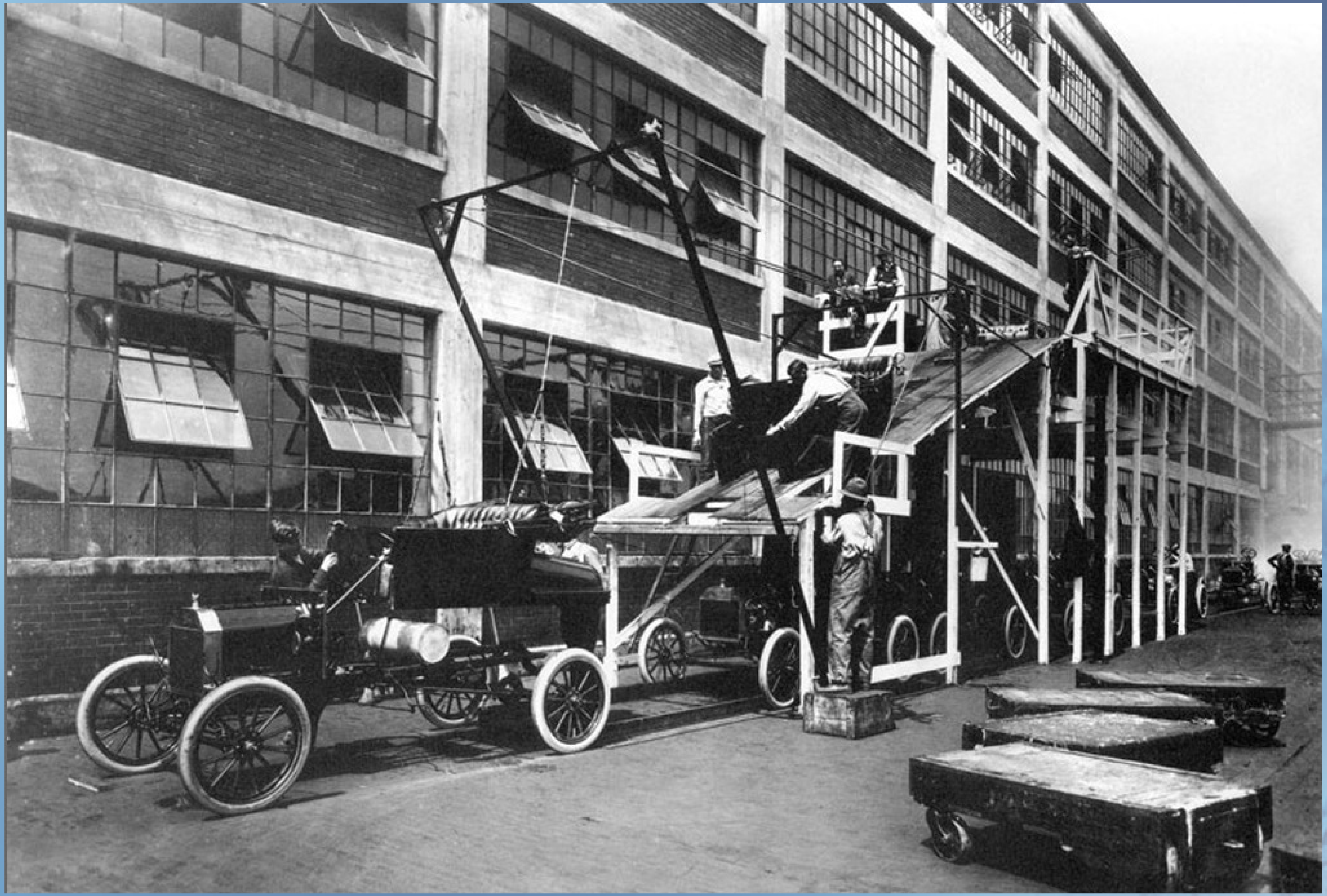
- **Accounting vs Prudential:** there are differences between accounting and regulatory definitions; especially relating to exposure / level of consolidation

- **Detailed disclosures:** some data are aligned to how risk is managed within the firm – e.g. through the eyes of management

- **Interpretation of regulatory definitions differ** – i.e. EL/Provisions and Model Disclosure

Challenges II

How much convergence is possible?



Concluding Remarks I

European Banking Federation

- **CEBS review is welcomed:** practical insights around disclosure policies, timing, presentation etc
- **2009 year-end should include comparatives:** there may be challenges, however, especially around restatement following organisation changes or changes in Basel II approaches
- **Disclosures will evolve by practice and market discipline**

Concluding Remarks

- **Different stakeholders have important roles in market disclosures:**
  - **Regulators:** transparency of supervisory approaches, education and promotion, consistency and compliance
  - **Banks:** provide information to improve transparency; promote understanding of disclosures – sufficient granularity, information on key risk decisions
  - **Users:** better understanding of risk and return, which requires a knowledge of Pillar 3, digging below the headlines and a significant investment in time and effort

Adapted from José María Roldán's Pillar 3 presentation to IBFed and IIF, January 2009