Fostering convergence of Pillar 3 disclosures

Roundtable

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Nathalie Beaudemoulin

CEBS

Committee *of* European Banking Supervisors

1- Main findings of CEBS's report on Pillar 3 disclosures

Work carried out

- Assessment of the Pillar 3 disclosures of 25 large banks - mainly European banks - at the end of 2008
- Pillar 3 disclosures analysed against CRD requirements
- Report issued on CEBS website on June 24th, 2009

Main findings

- There is a broad diversity in Pillar 3 disclosures
  - Some banks provide noticeable enhancement of qualitative and quantitative disclosures on risks
  - Some others just provide the bare information to be broadly compliant with the CRD. In some cases, information required by CRD is lacking

General Findings

- There is no prescriptive requirements of the CRD with regard to

  - Timeframe for publication
  - Location of information
  - Presentation

…which contribute to the heterogeneity observed between Pillar 3 disclosures

- Besides, 2008 was the first year of implementation for most European banks

General Findings

- A part of the information required by the CRD is lacking
  - This may be due to materiality, proprietary or confidential issues
  - But, in general, no explanation on the reasons for lack of disclosures
  - In a few cases, banks mention a potential risk of misinterpretation of information

- A part of the information may be difficult to understand
  - Pillar 3 disclosures deal with complex areas:

    Users need to get familiar with this new material

  - Some practices are prone to enhance the clarity of information:

    Provision of a glossary

    Provision of sufficient explanations on CRD requirements

Specific Findings

Compliance with the CRD requirements

– **Credit risk**

- Rather generic description of internal rating process
- In general no sufficient granularity on past due and impaired assets (notably breakdown by industrial and geographical areas)
- Very few information on back testing

– **Credit risk mitigation techniques**

- Lack of information on market or credit risk concentration, and on credit derivative counterparty and their creditworthiness
- Limited quantitative information

– **Counterparty risk**

- Lack of information on several items (in particular on quantitative items), for instance on the impact of the amount of collateral the credit institution would have to provide given a downgrade of its credit rating; notional value of credit derivative hedges.

Compliance with the CRD requirements – cont'd

– **Market risk**

- Disclosures on model validation, back testing and stress test could be further developed.
- Limited disclosures on procedures to insure the quality of accounting inputs (annex VII part B of the Directive 2006/49/EC)

– **Operational risk**

- Limited information on the methodology used to calculate capital requirements
- Some banks do not make any mention of the risk factors

Compliance with the CRD requirements – cont'd

– Securitisations (banking book)

- Information on role played and extent of involvement in securitisation activities not always very clear
- Breakdown by exposure type of the amount of impaired and past due exposures securitised is not always provided
- Lack of information on securitised revolving exposures
- Though information about securitisation activity in the period is provided, banks rarely provide the recognised gains or losses
- Aggregate amount of securitisation positions retained or purchased broken down by exposure types not always disclosed
- Aggregate amount of securitisation positions retained or purchased broken down by risk weight bands often partially disclosed

2- Feedback from bilateral meetings with the banks included in the panel

Feedback from banks

Usefulness and complexity

Common observation

- Gap perceived between the level of technicality of the disclosure required and the average knowledge of users on the Basel 2 framework
- Explain that few questions have been received from users after first year of implementation

Suggestion / open issues

- Users need to become familiar with B2 framework
- Banks should keep on making educational efforts
- Should banks distinguish between different users' profile (ie. Expert / non-expert)?

Interrelationship with accounting and presentation

Two opposite views

- Regulatory and accounting disclosures are build on different perspective which may justify issuing two separate reports
- One integrated document leads to a clearer and more transparent reporting of risk management - Banks should look for a unity in the whole set of disclosures provided

Feedback from banks

Implementation difficulties and frequency

Temporary difficulties

- Timing issues due to first-time application
- Pillar 3 requirements do not always match with information required in regulatory reporting => need to adapt systems in consequence (not always achieved for 2008 publications)

Other difficulties

- Some requirements raise interpretation issues (eg: comparison of EL and actual losses)
- Some requirements raise proprietary issues (eg: key assumptions to calculate interest rate risk)

Feedback from banks

Need for guidance

Pros

- Would be very helpful in order to achieve a higher level of homogeneity
- Investors may find it easier to have standardised disclosure
- Would welcome feedback from CEBS on analysis conducted and on industry initiatives to harmonise certain aspects of pillar 3

And cons

- Pillar III should be market driven
- Guidance on P3 disclosure will arrive too late
- Would result in additional implementation costs for banks

Feedback from banks

Need for guidance - cont'd

Median line

- Would welcome guidance if not overly prescriptive
- It is important to encourage market feedback on current disclosures. CEBS can take up a role as catalyst in this matter
- The CEBS's current approach to encourage convergence on the best practice visible on the market seems appropriate.

Open issues

- To which extent can we trust market discipline to provide truly homogeneous disclosure?
- On the other hand, is fully harmonised P3 disclosure a prerequisite for a useful instrument of analysis?

3- Feedback from the meeting with a panel of users

Feedback from users

Form

- Utility of Pillar 3 disclosures acknowledged – analysts welcome detailed information on the risk profile of banks
- Yet, utility reduced by consistency and comparability issues
- Timeliness of the information is important – analysts would welcome that the publication of Pillar 3 disclosure should be made at the same time than annual report
- More frequent information would be welcome – wish reinforced by current situation
- No clear-cut views on presentational issues: interest for a unique picture of the bank but not at the expense of clarity, ie: potential for greater confusion if accounting and prudential figures are put together

Feedback from users

Content (CRD and beyond)

- Own funds: need for clarification / more granular information (characteristic of hybrid instruments, grandfathering practices, deduction rules, prudential floors and filters...)
- Credit risk:
  - Need to clarify and homogenise the notion of exposures (before or after CRM, before or after CCF...),
  - Need to provide accurate information on concentration risk
  - Need to provide further information on credit risk mitigation (distinguishing between financial and physical collateral and enhancing buying protection disclosures)
  - Need to enhance disclosure on non-performing loans, impairments and provisions attached
  - Comparable measure of risk weights by category would be most useful

Feedback from users

Content (CRD and beyond) – cont'd

- Equity risk: need to clarify the link between prudential and accounting figures and provide more detailed information on equity performance
- Securitisation: need to provide information on underlying assets and more generally to provide accurate information on the bank's implication in securitisation transactions
- Market risk: need to distinguish between specific and general risk and to provide accurate and detailed back-testing and stress testing information (tail risk, comparison of daily VaR measures to one-day changes of the portfolio's value…)
- Operational risk: need to go beyond boilerplate information and provide detailed information on risk factors

Feedback from users

Content (CRD and beyond) – cont'd

- Interest rate risk: need to provide further information on the assumptions retained and to present clear sensitivity analyses
- Analysts would welcome that banks should expand on the allocation of their economic capital and notably on risk that are not encompass within the spectrum of Pillar 1
- In particular, analysts would welcome more detailed and more quantitative information on liquidity risk

4- Way forward

Way forward

- Objective assigned by the CEBS to our working group: foster convergence
- In 2010, CESB will renew its assessment exercise of Pillar 3 disclosures based on 2009 publications
- Reflection on the need for a guidance under way but still open

5- Issues open for discussion

Usefulness of Pillar III disclosures

Some banks have questioned the usefulness of Pillar III. Do participants share this view? Are there areas that are missing/irrelevant?

Complexity of Pillar III disclosures

There are also views that Pillar 3 requirements (and related disclosures) are too complex for users but also for preparers. Do you share this view? What is the profile of the users (expert / non-expert)?

Need for guidance

The implementation of Pillar 3 requirements relies on market discipline. Yet, in the view of the heterogeneity of the first publications, some may advocate the need for guidance. Do you share this view?

If you do, what sort of guidance would you expect? Clarification to ensure that the provisions of the CRD are consistently interpreted and applied? Templates?

Disclosure perspective

With the recent CRD 2 amendments and CRD 3 enhancements under way, the scope of Pillar 3 disclosures will evolve from a narrow perspective (i.e.: a window on Pillar 1) towards a broader one where banks would have to provide a comprehensive picture of their overall risk profile. How do you view this change? Do you think it will significantly alter the design of Pillar 3 disclosures?

Annex

Amendments under way

- Following to the Basel Committee's proposals in the wake of the financial crisis
- Amendments to the CRD under way (package n°3), last version expected before the end of the year
- Expected implementation date : 01.01.2011
- Content of the amendments:

  Article 145 (3) - addition

  Credit institutions' disclosures **should convey their risk profile comprehensively** to market participants

  => institutions should disclose additional information not explicitly listed in this Directive if necessary to meet this objective

Amendments under way

CRD - Annex II, Part 2

- Points 9 and 10: Market risk and use of VaR model
  - Methodologies for Incremental Risk Charge
  - Additional information of the highest, the lowest and the mean of daily VaR, stressed VaR and incremental risk capital charge
  - Comparison of daily VaR to changes of the portfolio's value and an analysis of any important overshooting
- Point 14: Securitisation
  - Information requirements duplicated for the trading book (presented separately) and considerably strengthened
- Point 15: Remuneration policy
  - New point pertaining to information regarding remuneration policy and practices for those staff whose activities have a material impact on the risk profile