Executive summary

The analysis of Pillar 3 disclosures made by the CEBS on 25 banks highlights the fact that banks have made a huge effort to provide market participants with information, allowing a better assessment of their risk profile and their capital adequacy. Banks have notably heightened the level of quantitative and qualitative disclosures on their credit risk and securitisations activities.

However, CEBS has identified some areas in which disclosures could be enhanced:

- the composition and characteristics of own funds;
- the back-testing information for credit risk and market risk;
- the quantitative information on credit risk mitigations and counterparty credit risk; and
- the granularity of information on securitisations.

CEBS has also identified good practices in these areas and expects that market discipline will play its role in promoting them.

CEBS also observed that Pillar 3 disclosures are mixed in terms of the presentation, the timeframe, the format and the nature of the data disclosed. Even though some of those differences may relate to the non-prescriptive approach retained by the Capital Requirement Directive (CRD) and the member states, this may raise comparability issues for users.

CEBS will continue to closely monitor Pillar 3 disclosures in order to ensure that the market discipline mechanism operates effectively and contributes to enhance the quality and the comparability of Pillar 3 disclosures. In addition to exchanges with the banking Industry, CEBS has also engaged in a dialogue with the final users of Pillar 3 disclosures in order to assess whether this information fits their needs.

At this point in time CEBS does not envisage issuing guidance in the area of Pillar 3 disclosures but intends to foster further convergence of Pillar 3 disclosure practices through liaison with the industry. For this purpose an open meeting is foreseen to be held in early autumn 2009.
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I. Introduction

The purpose of Pillar 3 – market discipline – is to complement the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2), while 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 applying pressure on the bank’s management, so it will act in the stakeholder’s best interests. Bearing this in mind, bank’s management should be encouraged to anticipate and adjust their risk-taking policies, with a view to contain their cost of capital. In this sense, market discipline acts as a form of self-regulation.

The part of market discipline within the Basel II framework seems even more important, as the increasing use of internal models gives more discretion to financial institutions when assessing their capital requirements under approval of their respective supervisors. Transparency in such cases acts as a counter-balance.¹

The main contributions of Pillar 3 are expected in the following areas:

- securitisation exposures;
- internal-risk assessment models;
- regulatory capital requirements;
- composition of own funds;
- operational risk (even if, in practice, most banks already provide information on this field); and
- risk exposures.

This work is part of the follow-up work² undertaken by CEBS on banks’ transparency and goes along with an assessment of banks’ 2008 financial statements.

II. Objective and methodology

The main objective of this report is to assess how the Pillar 3 disclosures provided by financial institutions comply with the Pillar 3 requirements, which are reflected in Chapter 5 (disclosures by credit institutions) of Title V of Directive 2006/48/EC and in Annex XII (technical criteria on disclosure). These requirements include new information related to capital structure, capital adequacy, risk management and risk measurement. In undertaking this work, CEBS also took into account the differences caused by Member States approaches towards disclosure requirements under

¹ In paragraph 809 of the Basel II Framework it is stated that "the Committee aims to encourage market discipline by developing a set of disclosure requirements,(...) such disclosures have particular relevance under the framework, where reliance on internal methodologies gives banks more discretion in assessing capital requirements."

² See CEBS’s Report on banks’ transparency on activities and products affected by the recent market turmoil, published on 18 June 2008.
Pillar 3. Attention is drawn on the fact that CRD applies only for European banks. Non-EU banks have to comply with Basel II or their own national regulation, which may account for slight differences.

Since Pillar 3 disclosures are directed towards market participants, CEBS sought the opinion of users by making direct contact with some of them and carrying out an open meeting with stakeholders.

The analysis is based on a sample of 25 large banks\(^3\) with cross-border activities, 20 of which have their headquarters in the European Union. The findings cover all the institutions irrespective of their origin.

### 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 (location, timeframe and presentation). Nevertheless, some supervisors have provided material in order to assist institutions in the implementation of Pillar 3 (non-mandatory illustrative examples for the design of the templates, a newsletter with explanations on Pillar 3 requirements, etc).

#### III.1. Formal disclosure policy

The CRD requires financial institutions to set up a formal disclosure policy towards publishing Pillar 3 disclosures. Within the sample only eight banks out of 25 mentioned the adoption of such formal policy.

It is good practice for banks to disclose a separate policy for Pillar 3 disclosures, highlighting the appropriateness of the disclosures, the mode of verification and the frequency of disclosing Pillar 3 disclosures. For that matter, such disclosure is specifically required by some supervisors.

#### III.2. 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, a few supervisors have imposed a timeframe, such as for Pillar 3 reports to be published simultaneously with financial statements.

The effective date of publication of Pillar 3 disclosures vary significantly among the financial institutions of the sample, ranging from March 2009 to the end of May 2009.

For most financial institutions, 2008 was the first year of implementation of Pillar 3 disclosures, which may possibly explain some delay in their publication. Some other reasons were also given, like the need to finalise 2008 year-end accounting.

\(^3\) The list of banks appears in annex 1. The sample does not include US banks because Basel II has not yet been implemented in that country.
numbers before finalising the Pillar 3 report. There was also a need to set up proper procedures within organisations where the function of handling accounts was different from regulatory reporting.

In future, it is reasonable to expect the publication of Pillar 3 report close to that of financial report. In fact, both the annual accounts and Pillar 3 disclosures provide timely information and are necessary for the market discipline mechanism to operate effectively.

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 require their banks to publish certain quantitative disclosures on a more frequent basis. CEBS considers that internationally active financial institutions should disclose, on a more frequent basis, certain quantitative disclosures on capital resources and capital requirements that are prone to rapid changes.

III.3. Presentation and location

Regarding the means of publication, several approaches have been noted:

<table>
<thead>
<tr>
<th>Type of presentation</th>
<th>Number of banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-sufficient Pillar 3 document</td>
<td>12</td>
</tr>
<tr>
<td>Separate section within annual report</td>
<td>6</td>
</tr>
<tr>
<td>Complementary Pillar 3 information in a separate publication</td>
<td>7</td>
</tr>
</tbody>
</table>

It is interesting to note that financial institutions have chosen different ways of presenting their Pillar 3 information to the market.

The most common way was perhaps the presentation of a self-sufficient document, which has the advantage of having all the information relating to Pillar 3 gathered in one place, but some repetitions in Pillar 3 were noted, with the same information provided in the financial report and minor differences between both sets of qualitative information.

Some institutions tend to minimise duplication by including a section on Pillar 3 within the financial report. This approach has the advantage of providing users with an all-inclusive document that gives a more comprehensive picture of the bank’s financial soundness and risk profile. However, in some cases, the use of many cross-references may reduce the readability of the report.

Finally, some banks opted for an intermediate solution in producing a separate Pillar 3 document, with various cross-references to the financial report. One institution even sets up a Pillar 3 report with only quantitative information and refers to the financial report for all qualitative information.

The reasons for these differences in presentation were varied. One of the key factors that influenced the presentation of Pillar 3 disclosures was the lack of time and separate allocation of responsibility between preparing accounts under IFRS and producing Pillar 3 disclosures based on regulatory measures. Also, there may
have been a different perception about the role of Pillar 3 disclosures and users’ needs.

CEBS does not want to advocate one specific presentation, as long as banks provide the complete set of Pillar 3 disclosures to users and the necessary tools to understand the link between the annual accounts and Pillar 3.

In the long run, market participants may play a significant part in bringing about harmonisation in the presentation of Pillar 3 disclosures. In the short term, the diversity in the means of publication may still hinder users’ access to relevant information.

The CRD does not specify the means of publication but 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. Small institutions that do not have their own website should find the appropriate means of communication to make their Pillar 3 information publicly available to the market without any undue delay.

III.4. Synergies with IFRS

Some of the Pillar 3 disclosures overlap with the disclosure requirements of IFRS (IFRS 7 and IAS 1) with regard to the qualitative disclosures and certain quantitative disclosures.

In order to help users benefit from the two sets of information (annual accounts and Pillar 3) and to understand the structuring of accounting and prudential information, banks should provide adequate explanation in their Pillar 3 disclosures on the differences in the scope of consolidation for accounting and regulatory purposes, as required by the CRD (annex XII Part 2 point 2). CEBS noticed some room for improvement on this matter. On the other hand, CEBS noted that some banks provided reconciliations from Pillar 3 to accounts for differences in various figures which appear helpful for the understanding.

III.5. Confidential, proprietary or non-material information

According to the CRD (article 146), in exceptional cases financial institutions may leave out information they consider confidential or proprietary. However, in these cases, the reasons for non-disclosure should be clearly stated and, when possible, supplemented with more general information about the disclosure requirement.

In its analysis, CEBS noted that some information was missing and assumed that it may relate to confidentiality or proprietary issues. Yet the reason for non-disclosure was hardly stated (in one case only, the absence of quantitative information was justified by the misleading nature of the results due to the use of widely different approaches by banks) and general information was not often provided.

With regard to non-material information, which may be left out according to the CRD, only a few banks elaborated on this topic. CEBS noted that a few banks provided the threshold for materiality, which was used to decide whether to disclose some information or not even if this information not required by the CRD.
III.6. Other presentational issues

CEBS is aware that it is the first year of implementation for most banks included in the sample and that part of the information required by the CRD may appear quite complex for some users. There is a need to allow some time for market participants to familiarise themselves with the regulatory concepts under Pillar 3 disclosures.

In that regard CEBS appreciates the huge educational efforts that many institutions have made. In most cases, a glossary of technical terms has been provided. Some banks have also provided extensive explanation about the CRD requirements and the methodologies used to elaborate quantitative information.

CEBS noted that some banks provided an executive summary of the most significant points for each subsection, which improved the clarity of their report.

CEBS also noted that some of the banks that were already applying Pillar 3 have provided comparative information, as well as analytical comments on significant changes.

IV. Compliance with the CRD

Section 2 will cover Part 2 (general requirements) and Part 3 (qualifying requirements for the use of particular instruments or methodologies) of Annex XII. A summary of these requirements is included in Appendix 2.

IV.1. Capital resources and adequacy

On the whole, due to the implementation of Pillar 3, banks have provided supplementary information with regard to own funds and capital requirements. However, the granularity could be enhanced and further explanation could be disclosed.

a) Own funds (CRD, Annex XII - Part 2 point 3)

Disclosures on own funds

<table>
<thead>
<tr>
<th>Level of detail of disclosures(^4)</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>68 %</td>
<td>32 %</td>
<td>0 %</td>
</tr>
</tbody>
</table>

It has been noted that, in most cases, disclosures regarding the terms and conditions of each item included in the own funds are not as detailed as required by the CRD.

Information regarding items deducted from own funds are often aggregated in one line (except for intangibles and excess of expected losses on impairment).

\(^4\) The level of detail may reflect the level of compliance because there is a positive correlation between detail and commitment to comply. However, when interpreting this figures as level of compliance, it must be taken into account that some subjects will be of lesser importance to some banks, or even immaterial.
Even though not explicitly required by the CRD, the efforts made by some institutions in light of the present circumstances are worth noticing, such as:

- some banks have provided information on the amount of capital received within the frame of state supports and their impacts on Tier 1 ratios; and
- some banks have also provided comparative information between eligible Tier one capital under Basel I and Basel II.

**b) Minimum capital requirements (CRD, Annex XII - Part 2 point 4)**

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>76 %</td>
<td>24 %</td>
<td>0%</td>
</tr>
</tbody>
</table>

Banks generally provide generic descriptions on the method applied to assessing the adequacy of internal capital needed to support current and future activities. In most cases there is a reference to the internal capital adequacy assessment process (ICAAP), which the bank has implemented in the context of Pillar 2.

Although it is not required by the CRD, in a few cases banks provide 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 of the risk profile of the entity.

Most of the banks provide detailed information regarding risk-weighted exposure amounts and/or capital requirements. However, the information is sometimes provided in various ways across the industry, both in terms of presentation and content. For example, some banks provide an overview table with capital requirements for all exposure classes, as defined by the CRD and broken down by type of approaches (standard or advanced), while others provide several tables sometimes scattered throughout the report. A few banks disclosed breakdowns of capital requirements by exposures classes, which slightly differ from the exposures classes required by the CRD and, in such cases, related discrepancies were not always clearly explained.

**IV.2. Credit risk**

Disclosures provided on credit risk are much more detailed since the implementation of Pillar 3. However, disclosures related to some areas could be enhanced - in particular, counterparty risk and credit risk mitigation techniques - and back-testing information has not been properly disclosed.

**a) General requirements for credit risk (CRD, Annex XII - Part 2 point 6)**

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>84 %</td>
<td>16 %</td>
<td>0 %</td>
</tr>
</tbody>
</table>

Pillar 3 reports contain detailed quantitative information on total exposures by exposure type, geographical area and industry, as well as by residual maturity.
However, in some cases, information regarding impaired and past due exposures is aggregated and sometimes information on past due is not disclosed. If not specifically required by the CRD, when cross references are made to financial statements, scope differences should be further explained.

With regard to the nature of the information disclosed, some banks present on-balance sheet exposures only. Also, since it was not specified in the CRD, some banks provide information on gross exposures while others disclose EAD.

Some good practices that go beyond CRD requirements have also been noted, for instance:

- some banks have provided comprehensive detailed explanation on the definition of credit risk exposures by main types of transactions (loans, irrevocable lending commitments, contingent liabilities, etc); and
- a few banks have matched the information disclosed in the reconciliation of changes during the period in value adjustment and provision for impairments with the results in their profits and loss accounts.

**b) Standardised approach (CRD, Annex XII - Part 2 point 7)**

Disclosures on the standardised approach for credit risk

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
<th>None</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>52 %</td>
<td>24 %</td>
<td>16 %</td>
<td>8 %</td>
</tr>
</tbody>
</table>

Disclosures on the standardised approach for credit risk are not very detailed in some cases. This observation may be linked to the fact that most of the large banks tend to generalise the Internal Ratings Based (IRB) approach to determine their credit risk exposures.

It has been noted that the information regarding the exposure classes for which each External credit assessment institution (ECAI) is used, is generally not disclosed. In some cases, the report does not even mention the name of the ECAI that has been used.

Quantitative information could be enhanced. In some cases, the exposures are not as detailed as required by the CRD and the exposure values are generally given after credit risk mitigation, without information on exposures before credit risk mitigation. Some banks do not even specify whether the information is after or before credit risk mitigation.

It should be noted that one bank has not provided any information on the standardised approach on credit risk, even if it uses this approach.

**c) Qualifying criteria for the use of IRB approach (CRD, Annex XII - Part 3 point 1)**

Disclosures on internal rating systems

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
<th>N.A</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>52 %</td>
<td>44 %</td>
<td>4 %</td>
<td>0%</td>
</tr>
</tbody>
</table>

In general, qualitative information regarding IRB approach (explanation and review, description of internal ratings) appears rather generic. The information on the
internal ratings system could be more detailed (structure of internal rating systems and relation between internal and external ratings, process for managing and recognising credit risk mitigation, control mechanisms including a description of independence, accountability and rating systems review).

As for quantitative information, the level of granularity varies strongly among institutions and some disclosures on the back-testing are lacking. For example, many institutions do not provide sufficient information on the credit institution's estimates against actual outcomes over a longer period. Even if the comparison between regulatory expected loss estimates and actual losses has some limitations, it provides some useful insight, notably in the current context. Even if not specifically required by the CRD, the explanation of the differences between prudential and accounting figures that has been provided by some banks adds to the clarity of the report.

CEBS observed that banks that did not disclose all the information required by the CRD did not make any mention of confidentiality reason.

d) **Counterparty credit risk (CRD, Annex XII - Part 2 point 5)**

Disclosures on counterparty risk

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>40 %</td>
<td>56 %</td>
<td>4 %</td>
</tr>
</tbody>
</table>

Generally, institutions provide a discussion on qualitative information, encompassing management of counterparty credit risk limits and netting agreements. However, information is often included within the overall description of the credit risk management, leading sometimes to minimise the focus set on counterparty credit risk management. For some banks, CEBS noted a lack of disclosure of the method used to assign internal capital for counterparty credit risk. It has also been observed that, in some cases, the discussion on credit-value adjustments policies is insufficiently developed and the discussion regarding the potential impact on collaterals of a downgrade in the credit rating of the institution is lacking. CEBS noted that some banks have not only provided granular qualitative information on this latter issue, as required by the CRD, but also quantitative information.

With respect to quantitative information, only a few banks display separately gross fair values of contracts, netting benefits, collateral held and net derivative credit exposure. Similarly, only a few banks publish proper segregation of notional amounts of credit derivative transactions, between own-credit portfolio and intermediation activities, with a further breakdown of protections sold or bought.

The isolation of the risk-weighted exposure value for counterparty credit risk, which has been made by quite a few banks, appears useful for comparability purposes.

e) **Credit risk mitigation techniques (CRD, Annex XII - Part 3 point 2)**

Disclosures on credit risk mitigation techniques

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>48 %</td>
<td>44 %</td>
<td>8 %</td>
</tr>
</tbody>
</table>
Broadly speaking, disclosures on credit risk mitigation techniques do not appear fully compliant with the CRD requirements. In most cases, the following information is missing: a description of the main types of guarantor and credit derivative counterparty and their creditworthiness; information about market or credit risk concentrations within the credit mitigation instruments; information on exposure values covered by eligible financial collateral, guarantees or credit derivatives under the standard approach or the IRB foundation approach.

Institutions are strongly encouraged to enhance disclosures relating to credit risk mitigation techniques in order to help users to properly assess the policies implemented, the quality of guarantees and the resulting residual credit risk.

f) Securitisation exposures (CRD, Annex XII - Part 2 point 14)

Disclosures on securitisations

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>56 %</td>
<td>36 %</td>
<td>8 %</td>
</tr>
</tbody>
</table>

A significant contribution of the Pillar 3 implementation relates to the disclosure of specific and detailed information regarding securitisation activities. Institutions that were used to providing disclosures on securitisation, in particular in the context of the market turmoil, have generally enhanced their previous disclosures on this matter (description of objectives, role and involvement in securitisation activities).

However, given the complexity of securitisation transactions, there is still room for improvement to help the users undertake proper assessment of the related risk.

For example, qualitative disclosures could be more specific regarding accounting policies or key assumptions for valuing retained interests. Similarly, approaches to calculating risk-weighted exposure amounts could be made clearer.

In some cases, the quantitative information disclosed is not fully compliant with the CRD requirements. For instance, the information on the amounts securitised is sometimes not precise and does not always indicate the amounts of synthetic securitisations or the amounts by type of exposure. CEBS observed that information on securitised revolving exposures is not always provided.

It has been noted that the amounts of securitisation positions retained or purchased broken-down by exposure types, are not always disclosed. Similarly, the breakdown of the position by risk weight does not always encompass the total position and the granularity of the bands differs across institutions. Though information about securitisation activity in the period is provided, banks do not always provide the recognised gains or losses (or else, mention their absence).

Banks that have followed the industry good practice guidelines\(^5\) as the basis for preparing the securitisation disclosures, have on the whole provided more comprehensive and understandable information.

\(^5\) “Industry Good Practice Guidelines on Pillar 3 disclosure requirements for securitisation” published on December 18, 2008 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.
IV.3. Equity risk not included in the trading book (CRD, Annex XII - Part 2 points 8 and 12)

Disclosures on equity risk

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>56 %</td>
<td>28 %</td>
<td>16 %</td>
</tr>
</tbody>
</table>

Information on equity risk outside the trading book could be more detailed by some banks in order to comply with the CRD requirements. In particular, the differentiation of exposures based on their objectives (strategic reasons or capital-gains perspectives) is not always disclosed; some banks have omitted to disclose the breakdown of exposures by type (exchange-traded equities, private equity and others).

With regard to quantitative information, banks could provide further information on the difference between figures provided in the financial statements and Pillar 3. Only a few banks have provided adequate disclosure regarding realised and unrealised gains and losses.

IV.4. Market risk (CRD, Annex XII - Part 2 points 9 and 10)

Disclosures on market risk

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>N/A6</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>60 %</td>
<td>36 %</td>
<td>4 %</td>
</tr>
</tbody>
</table>

Even though core items on market risk are generally disclosed, information on market risks is not fully satisfactory when assessed against CRD requirements.

Taking a closer look on the shortcomings, it has been noted that:

- the breakdown of capital requirements by types of risk is often missing;
- the model used is often well described, but the limits of the Value at Risk (VaR) - in general and for the models used in particular- are not always specified;
- disclosures on model validation and back-testing could be further developed – in a few cases the number of occurrence where a daily trading loss exceeds the VaR is not provided; and
- procedures to ensure the quality of accounting inputs (requirements set out in Annex VII, Part B of the Directive 2006/49/EC, dealing with systems and controls designed to provide prudent and reliable valuations and to carry out adjustments/reserves) are briefly described when not simply ignored.

Aside from these shortcomings, a number of best practices have also been noted:

- Some banks have elaborated charts of daily-trading profit or loss compared with daily VaR. These charts were even more enlightening when based on a two-year period.

6 Relates to the fact that one bank used the standard approach
- A few banks provide detailed information on secondary limits, which play a non-negligible part in the daily management of market risk.
- Some banks make reference to the enhancement planned by the Basel Committee (i.e. the inclusion of the Incremental Risk Charge), giving an insight of the limits of the current model and their possible corrections.
- Some banks have provided quantitative information regarding the results of their stress tests.

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

**Disclosures on operational risk**

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>32 %</td>
<td>68 %</td>
<td>0%</td>
</tr>
</tbody>
</table>

The level of detail regarding the disclosures on operational risk could be improved. Within the sample, only a few banks provide detail on the methodology used to determine capital requirements and some banks do not make any mention of the risk factors (internal and external) incorporated in the model (only applicable to AMA banks). Finally, banks under the Advanced Measurement Approach (AMA), which makes use of insurance techniques, could be more specific with regard to the impact on capital requirement.

A number of good practices can also be highlighted:
- Some banks display two distributions of events by risk category: actual losses and number of occurrences. Due to the use of the same typology of events, these charts provide an interesting source of comparison across the industry.
- A few banks provide the threshold above which a loss event is recorded into the database.
- A few banks provide capital requirements by line of business.

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

**Disclosures on interest rate risk management**

<table>
<thead>
<tr>
<th>Level of detail of disclosures</th>
<th>Detail</th>
<th>Some</th>
<th>Little</th>
<th>None</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of banks</td>
<td>56 %</td>
<td>32 %</td>
<td>8 %</td>
<td>4 %</td>
</tr>
</tbody>
</table>

In relation to the most qualitative information, generally disclosures on the nature of interest-rate risk and related key assumptions (e.g. assumptions on loan prepayments and behaviour of non-maturity deposits) are not sufficiently detailed (potential confidentiality issues). CEBS also noted a lack of information on frequency of measurement of the interest-rate risk.

On the quantitative side, sensitivity analyses are generally provided, but CEBS observed a relative diversity on the scenario retained (impact on earnings or on the economic value, number of basis points, horizon, etc).
V. Conclusion

On the basis of the assessment of the Pillar 3 reports of 25 large banks, CEBS considers that the new concept forwarded by Pillar 3 reports contribute significantly to the analysis of financial institutions’ risk profile and capital adequacy.

However, CEBS observes some room for improvements regarding disclosures, in particular in the following areas:

- More specification needs to be provided with regard to the composition and characteristics of own funds in order to achieve better comparability across industry.
- Back-testing information for credit risk and market risk could be further developed in order to provide comprehensive information to users.
- Disclosures on credit risk mitigation techniques appear too synthetic. CEBS noticed an insufficiency with regard to quantitative information and on the information related to the quality of guarantors.
- Banks could elaborate further on counterparty credit risk value adjustment policies and provide more granular quantitative information in this area.
- Disclosure on securitisation transactions could have been more granular. CEBS noted that banks that have followed the industry good practice guidelines have on the whole provided a more comprehensive and understandable information.

Even though CEBS welcomes the educational efforts made by institutions in their report, further explanation regarding figures and definition of the concepts would also facilitate understanding. Part of the Pillar 3 concepts may appear quite complex for final users. They would probably have to make efforts to become familiar with these concepts in order to get most of the benefits.

CEBS expects that the diversity observed during this first year of implementation of Pillar 3 will step-by-step be reduced by practice and market discipline mechanism. Meanwhile, CEBS will continue to closely monitor the Pillar 3 publications.

While it is not envisaged issuing guidance in the area of Pillar 3 disclosures at this stage, CEBS nevertheless intends to foster further convergence of Pillar 3 disclosure practices through liaison with the industry. For this purpose an open meeting is foreseen to be held in early autumn 2009.
Annex 1 - Banks covered in the survey

Barclays
Commerzbank
Credit Agricole
Credit Suisse
Deutsche Bank
Dexia
ING
Intesa SanPaolo
Nordea
Rabobank
RBS
RZB
SEB
Société Générale
UBS
Unicredit Group
DZ-Bank
KBC
BBVA
EFG Eurobank Ergasias
BNP Paribas
RBC
National Australia Bank
Mitsubishi UFJ
HSBC
Annex 2 – Brief summary of CRD requirements

1. Capital resources and adequacy

1.1. Own Funds (CRD, Annex XII - Part 2 point 3)

This section contains qualitative information concerning own funds, its terms, conditions and main features, as well as quantitative information, such as total amounts and deductions.

1.2. Summary of minimum capital requirements (CRD, Annex XII - Part 2 point 4)

At this point the credit institutions should include the capital requirements for credit risk, operational risk, foreign exchange and commodities risk for all business activities. Regarding trading book activities, credit institutions should publish position risk, settlement and counter-party risk. The institution shall describe briefly the adequacy of its internal capital to support current and future activities.

2. Credit risk

2.1. General requirements for credit risk (CRD, Annex XII - Part 2 point 4)

In the section of credit risk, the credit institutions should start providing the definitions of ‘past due’ and ‘impaired’ for accounting purposes, and a description of the methods for determining value adjustments and provisions. A reconciliation of changes in the value adjustments and provisions for impaired exposures is also requested, indicating separately those directly affecting the income statement. Regarding quantitative aspects, institutions will disclose the total amount of exposures after accounting offsets and before taking into account the effects of credit mitigation, broken down by different types of exposures classes. They should also show the geographic and industrial distribution of the exposures by exposure type (impaired, past due exposures, value adjustments and provisions) and changes on them. Finally, information containing the residual maturity breakdown of all the exposures broken down by exposure classes should be published.

2.2. Qualifying criteria for the use of IRB approach (CRD, Annex XII - Part 3 point 1)

Those institutions under IRB approach should disclose the competent authority acceptance of approach. They should explain the structure of their internal rating system, indicating the use of test and controls mechanisms. Also, a description of internal rating models, including the types of exposures included in the exposure class, the definitions, methods and data for estimation and validation of Probability of default (PD) and Loss Given Default (LGD), and conversion factors should be disclosed. The institution should describe those factors that have impacted on the credit losses in the preceding period. Apart from this qualitative information, credit institutions should provide information regarding exposure values, own estimates of LGDs and conversion factors. Information for exposure classes and across different number of obligors should include drawn and undrawn exposures, exposure average LGD (in percentage), the exposure-weighted average risk weight and, in case of
calculating conversion factors, undrawn exposures and exposure-weighted average exposure values. Finally, credit institutions should disclosure the actual value adjustment in the previous period and the comparison of its estimates against actual outcomes (back-testing).

2.3. Capital requirements under standard approach (CRD, Annex XII - Part 2 point 7)

This section will be complete only for those credit institutions that make use of the standard approach, there are specific requirements. They should disclose the name of the ECAIs the exposure for which the ECAI has been used, and the exposure values before and after credit risk mitigation associated with each credit quality step, as well as those exposures deducted from own funds.

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

In this section, institutions should provide a discussion of the methodology to assign internal capital and credit limits for counterparty credit exposures, and descriptions of policies of collateral, setting credit reserves and wrong-way risk exposures. They will have to provide the methods used and the exposure values. Likewise, credit institutions will have to indicate the total amount of collateral they will have to provide given a downgrade in its credit rating. At this point, the Directive also requires quantitative information, in particular gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held, net derivative credit exposures and information of credit derivatives. Among this information, credit institutions should disclose the notional value of credit derivatives hedges and the notional value of credit transactions, distinguishing between use for its own portfolio, as well as for intermediation activities, classified by protection bought and sold by product. Finally, in case an institution uses internal model method, it will have to disclose the estimate of parameter alpha.

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

Those institutions applying credit risk mitigation techniques should provide the policies and processes of on and off-balance sheet netting, for collateral valuation and management, the types of collateral taken, the types of guarantor and credit derivative counterparty and their creditworthiness, and the existence of market or credit risk concentration within the credit mitigation. For those credit institutions under foundation internal rated based approach (FIRB)or standard approach (SA), the total exposure value after on and off balance sheet netting that is covered by eligible financial collateral and other eligible collateral should be provided. The total exposure covered by guarantees or credit derivatives for each exposure class should be disclosed.

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7 In case of retail exposures the disclosure could be done against a sufficient number of EL grades.
8 It arises when there is significant correlation between the underlying assets and the counterparty which in the event of default would lead to a significant mark to market loss.
9 The net derivative credit exposure is the credit exposure on derivatives transactions after considering the benefits from legally enforceable netting agreements and collateral arrangements.
3. Securitisation exposures (CRD, Annex XII -Part 3 point 14)

For those credit institutions with securitisation exposures, the qualitative disclosure should cover the objectives of securitisation and banks’ roles and involvement. Banks should also provide the approaches chosen to calculate risk-weighted assets, the name of the ECAI used, the types of exposure for each of them and a summary of accounting policies for securitisation activities.

Regarding the quantitative aspects, credit institutions should disclose the total outstanding amount of exposures securitised, the amount of impaired and past due exposures securitised and the losses recognised during the period by exposure type, broken down into traditional and synthetic. Banks should also provide the positions retained and purchased, broken down into risk-weighted bands\(^{10}\), the outstanding amount of securitised revolving exposures broken down into originator’s interest and investor’s interest, and a summary of the securitisation activity in the period.

4. Equity risk not included in the trading book (CRD, Annex XII -Part 2 points 8 and 12)

In this section, credit institutions should disclose the exposures on equities not included in the trading book, differentiating them based on their objectives, with an overview of the accounting techniques and valuation methodologies. They should also provide its balance-sheet values, broken down into exchange-traded exposures, private equity exposures\(^{11}\) and other exposures. They should also disclose the gains and losses arising from sales and liquidation, as well as unrealised gains and losses, and the amounts of these included in the own funds.

5. Market risk (CRD, Annex XII - Part 2 points 9 and 10)

Those entities eligible to calculate their capital requirements for position risk, foreign-exchange risk and commodities risk using internal models should specify the characteristics of the models, a description of the stress testing and back-testing and its accuracy. They should specify the scope of the permission granted by the authority and the systems and controls in place should also be described.

6. Operational risk (CRD, Annex XII - Part 2 points 11 and Part 3 point 3 and 10)

The credit institution should state the approach used to assess the capital requirements for operational risk and, in the case of Advance Measurement Approaches (AMA) being used, it should provide a description of the methodology.

7. Interest rate on positions not included in the trading book (CRD, Annex XII - Part 2 point 4)

Credit institutions will disclose interest-rate positions not included in the trading book, specifying the nature of interest rates and the assumptions, such as loan prepayments and behaviour of non-maturity deposits and frequency of measurement of interest-rate risk. It should also publish the variation in the relevant measure used by management for upward and downward rate shocks.

\(^{10}\) Disclosing separately those exposures with risk weighted at 1250% or deducted.

\(^{11}\) Sufficiently diversified portfolios.