

March 2009

Follow-up review of banks' transparency in their 2008 4th quarter and preliminary year-end results

Executive summary

This reports sets out the findings of additional monitoring work that CEBS has carried out with respect to i) its ['Report on banks' transparency on activities and products affected by the recent market turmoil'](#) published on 18 June 2008 and ii) the related [follow-up report](#) published in October 2008 assessing how the good practice disclosures included in the June report had been implemented.

Overall the findings show that, based on the 2008 4th quarter (4Q) and preliminary year-end (YE) results from 19 banks, the situation is broadly similar to that observed in the previous assessment. This general observation feeds through to the two broad categories covered by the good practice disclosures set out in CEBS's 2008 June report:

- quantitative disclosures - on impacts and exposure levels - continue to be satisfactory although for some banks somewhat less detailed than previously; and
- qualitative disclosures - on business models, risk management and accounting - leave room for improvement.

On the whole there has been little improvement in disclosures in either of the two broad categories. More specifically:

- the findings can to a certain extent be qualified by the fact that 4Q and preliminary YE reports do not usually comprise the same amount of descriptive information as annual audited reports or even interim reports; and
- the findings relating to quantitative information can, to some extent be explained by the fact that the disclosures covered in the previous assessment were already rather detailed and satisfactory.

CEBS nevertheless considers that banks should close any expectation gaps in their 2008 audited annual reports and ensure that their disclosures are in line with the good practices identified in CEBS's June report.

This is deemed to be increasingly important for disclosures on business models, which - for some banks - have been significantly impacted by the financial crisis. In addition, the fact that government measures - which are increasingly being observed - are often linked to changes in business plans justifies related disclosures. The findings also underline the importance of disclosures on risk and risk management, as the crisis has raised some questions about the command that banks have over the risks they incur not least under adverse conditions.

Going forward, CEBS strongly encourages banks to make efforts to ensure that their interim as well as their quarterly, preliminary and full year reports are brought into

line with the good practices put forward in CEBS's June 2008 report. Whilst this is not intended to mean that the whole range of information is provided mechanically, banks should include references to other sources where information on areas that are less subject to change can be found.

In addition institutions need to apply careful judgment to ensure that all relevant exposures and risks, whether explicitly addressed by CEBS's good practices or not, are the subject of relevant and appropriate disclosures that allow market participants to assess the risks that an institution is subject to. This is all the more important as the problems banks are now facing are not limited to the areas covered in CEBS's June 2008 report (e.g. sub-prime exposures and related transactions) but have taken on a more general dimension (e.g. hedge fund exposures, asset securitisations more generally).

CEBS members will continue promoting the good practices identified in CEBS's June 2008 report among their banks and ensure they are used for disclosures on other areas, activities and products affected by the crisis. In particular the main ideas and principles underlying CEBS's good practices should be used by banks to prepare the disclosures related to the latest developments and to new areas and activities affected by the crisis.

The conclusions and related considerations set out in this report show that there is still a need for institutions to improve their quarterly and preliminary disclosures. Before deciding on any policy measures CEBS will nevertheless carefully analyse banks' forthcoming audited annual reports and Pillar 3 reports to assess whether the gaps that have been identified in the previous - and confirmed in the present - analyses have been addressed satisfactorily. The findings from this analysis will be set out in a report that is expected to be issued in June 2009.

This report has also raised a number of points that will be further explored in the June 2009 report, such as the disclosures on risks related to other areas affected by the crisis and disclosures on government interventions and measures.

Introduction

This report discusses the outcome of the additional monitoring work that CEBS has carried out with respect to i) its '[Report on banks' transparency on activities and products affected by the recent market turmoil](#)' published on 18 June 2008 and ii) the related [follow-up report](#) published in October 2008 assessing how the good practice disclosures included in CEBS's June 2008 report had been implemented.

This work on banks' transparency is also part of the work the EU institutions agreed to carry out in response to the November G20 Declaration and reflects a commitment made in CEBS's October 2008 report to analyse banks' 2008 year-end disclosures.

CEBS agreed to assess, as a first step, the disclosures included in the preliminary year-end results and this is reflected in this report. Recent developments in the area of accounting - in particular the changes in the reclassification requirements in IAS 39 -, led CEBS also to cover in this report disclosures made with respect to these accounting amendments.

For the June 2009 report CEBS will analyse and assess the disclosures banks provide in their forthcoming annual reports and Pillar 3 reports.¹

The outcomes of this and the June 2009 report will be the basis for any further measures to be undertaken. If deemed necessary the final report – to be published at the end of June - will also contain suggestions and recommendations for follow-up policy measures.

Background

CEBS's June 2008 report encompassed not only disclosures on the impacts of the market turmoil on results and on exposures levels (as in the FSF recommendations), but also information on business models, risk management practices and accounting and valuation practices.

The main findings of that report highlighted a number of weaknesses in the disclosures made by banks, particularly with regard to business models, risk management practices and accounting and valuation practices. This led CEBS to identify good practice disclosures for these areas, which have been used as a benchmark for this report.

In the follow-up report published in October 2008, CEBS concluded that the banks' interim disclosures in 2008 on the impact of the market turmoil and on exposure levels had improved to reach a generally satisfactory level. By contrast, disclosures on business models and, to a lesser extent, disclosures on risk management and on accounting and valuation practices still had scope for significant improvements.

¹ The July 2008 ECOFIN conclusions set out ' It [the Council] looks forward to the review by CEBS of its recommendations on banks' disclosure in 2009 within the scope of pillar III of the Capital Requirements Directive.'

Objective and methodological remarks

The objective of this report is to assess how the good practice disclosures put forward in CEBS's June 2008 report have been implemented in banks' 4Q and preliminary YE results and how they compare to previous disclosures, particularly with regard to areas that, in the October 2008 report, were identified as having scope for improvement.

In addition this report considers the disclosures made with regard to the changes of the reclassification requirements in IAS 39 and IFRS 7.

This report applies the same approach as applied in previous reports: the disclosures made by a sample of banks in their last quarter and preliminary year-end disclosures were compared against the benchmark set by the good practice disclosures set out in CEBS's June 2008 report. The table in Annex 1 reproduces the good practice disclosures, extended to include the reclassification disclosure requirements from IFRS 7.

To ensure comparability with the October 2008 report, this report relies – as far as possible - on the same sample of banks as used previously. More specifically the report has been based on the 2008 4Q and preliminary YE disclosures made by 19 large banks² with cross-border activities, 14 of which have their headquarters in the EU. The findings cover all the institutions irrespective of their origin.

Against these methodological remarks, it is important to stress that last quarter and preliminary year-end reports generally contain more limited disclosures than interim results and, even more so, annual reports. This is particularly valid for qualitative disclosures (such as information on business models, risk management and valuation methods).

Main findings of the analysis of the 2008 Q4 and preliminary YE disclosures

The following paragraphs discuss the main observations stemming from the analysis of the disclosures of the banks included in the sample.

i) Impact of the market turmoil

As regards the level of disclosures on the impact of the market turmoil about two thirds – previously around 75% - of the banks included in the sample provided detailed information on the elements covered in this part of the good practices. This apparent deterioration can be explained by the fact that the 4th quarter and preliminary results were generally less detailed than audited annual reports and even interim reports.

As in previous assessments, not all aspects may have been covered extensively by all banks, although it is felt that CEBS's observed good practices were met by a

² The list of banks has been included in annex 2. The sample has changed in comparison to the previous assessment (of the 2008 Interim reports) mainly as a result of mergers and acquisitions or other structural changes. In addition 2 banks covered in the previous exercise did not provide 4th quarter or preliminary results. On the other hand the sample was expanded to cover two additional US banks in order to be in a better position to compare the disclosures of the EU institutions.

large majority of the banks in the sample. Nonetheless, for about 15% of the banks the information provided was not strictly in line with CEBS's good practices, although often the disclosures were still deemed commensurate with the impact incurred. Often this fact could have been made more explicit.

In comparison to previous assessments, the level of detail of the disclosures in this area has improved for about 35% of the institutions - previously 45% - included in the sample. For the remaining institutions the information is similar to the disclosures analysed in previous assessments.

While not a specific subject of this report, it is notable that there have been few examples of very elaborate and coherent disclosures about the impact on other activities affected by the crisis, such as retail and corporate lending or property-market related activities or even asset securitisations more generally.

ii) Exposure levels and types

The situation described under i) is very similar for the level of detail observed on exposure levels and types. Again, about two thirds of the institutions - around 75% previously - provided detailed information on elements covered in the exposure levels part of the good practices. As before this can be explained by the fact that the 4th quarter and preliminary results were generally less detailed than audited annual reports and even interim reports.

For about 15% of the banks, the good practices disclosures in this area have not been met, although in some cases this was achieved implicitly, given that the disclosures were commensurate with the exposure levels.

In comparison to previous assessments, the level of detail of the disclosures in this area has improved for about 30% of banks –previously 64% . For about half of the banks the information is very similar to the disclosures analysed in previous assessments, which for some had already been very detailed. For the remaining 20% of the banks it has been observed that the level of detail (both in relation to impacts and levels of exposures) has been somewhat reduced.

Whilst the disclosures on the activities covered by CEBS's good practices are, generally speaking, satisfactory, institutions have not always provided detailed disclosures with respect to areas that have more recently been affected by the financial crisis (such as retail and corporate lending or property-market related activities or even asset securitisations more generally).

iii) Accounting policies : valuation and reclassification issues

Valuation issues

About 58% - previously about 73% - of the banks covered in the sample provided detailed or some disclosures in these areas. For the banks that provided less detailed information it can be assumed that it relates to the fact that 4Q and preliminary YE reports do not usually comprise the same amount of descriptive information as annual reports. Some banks notably included references to the accounting disclosures in either previous or forthcoming reports.

The analysis indicates that the disclosures by about half – previously two thirds - of the institutions are in line with CEBS's observed good practices.

In comparison to previous assessments, the level of detail of disclosures in this area have improved for about 30 % - previously 27% - of the banks. In the other cases the information are either similar or less detailed than for the disclosures analysed in previous assessments.

Reclassification issues

For banks which reclassified financial assets during in 2008³, a large majority provided detailed information on such reclassifications. For the remainder, it is expected that the information will provided in the forthcoming annual report in line with the requirements of IFRS 7.

In some cases the information provided was somewhat unclear, particularly with regard to the calculation of the impact of the reclassifications results. For some banks, disclosure about the result impact consisted only of fair value gains or losses that would have been recognised if the financial assets had not been reclassified, while for others, the impact also included the income and expense that had been recognised following the reclassification.

iv) Business models.

As regards the level of disclosures in the area of business models about 58% - previously 54% - of the banks provided limited or no specific information on their business model. This applies to all the different aspects that CEBS identified as good practices in the June 2008 report (e.g. description of the business model including strategy and objectives, any changes made as a result of the crisis...). However about 10% of banks provided detailed information for all or nearly all aspects identified in CEBS's June 2008 report, whereas the remaining 32% provided some disclosures in this area.

For these 42% – previously 45%- of the analysed firms' the disclosures are considered to be in line with CEBS's observed good practices.

In comparison to previous assessments, the level of detail of disclosures in this area has improved for 12% - previously 32% - of the banks. For the remainder of banks the disclosures were either similar or less detailed in comparison to the previous assessment. As before, this observation can be explained by the fact that interim reports - which formed the basis for the previous assessment - are usually more detailed than 4Q or preliminary YE results.

On the other hand, CEBS considers that recent developments, particularly in light of the wave of government rescue plans, further increase the importance of these disclosures.

v) Risks and risk management

As regards the level of disclosures in the area of risks and risk management most firms provided some or little detail in this area. Many reports only included references to disclosures that will be provided in the audited annual reports. No institution provided detailed disclosures in this area.

³ Around one quarter of the banks within the sample did not resort to reclassification, in which case, this fact was not always clearly stated in the preliminary YE reports.

CEBS considers that the disclosures on the nature and extent of the risks that a bank incurs in relation to the activities affected by the crisis and the related risk management should go beyond generic considerations. Notably, for institutions that are heavily affected by the market turmoil, the risk management discussion should focus more on the specific problems and issues that the bank encountered and the ways to solve them. In particular, corrective measures taken in the aftermath of the sub-prime crisis could be better emphasised and developed.

Liquidity risk disclosures, which CEBS identified as an important area in its good practices, were in most cases not covered in great detail. In particular a discussion of the methods used to assess liquidity risk and the tools used to manage it would be of particular interest.

About 37% – previously 36%- of firms are deemed to be in line with the disclosure practices put forward in CEBS's June 2008 report. However for most banks there is room for improvement in particular as concerns the focus of the information on crisis-specific aspects.

In comparison to previous assessments, the level of detail of disclosures in this area has improved for about 18% - previously 27% - of banks. In the majority of instances the disclosures are similar to those provided in earlier periods.

vi) Other disclosure aspects

Only two banks included information on disclosure policies and principles. While the preliminary year-end results may not be the typical location for this information, taking into consideration the findings of the October 2008 report, improvements could be made in this area.

As concerns presentational issues, no significant changes have been noted. In some cases disclosures are still being provided in different places, although some institutions provide cross-references that allow the reader to navigate between the relevant disclosures. In some cases this cross-referencing could be improved. Paradoxically, in some cases (e.g. for the disclosures on reclassifications) with increasing level of detail it becomes increasingly difficult to reconcile the various figures.

In most cases the narrative disclosure was supplemented with clear and easily readable tables or graphs. Also banks often provided clear explanations for the terminology used or even specific glossaries. However for a few banks there was an absence of clear explanations.

There are a number of other aspects that arose from the analysis and that will be considered further in the June 2009 report.

- Banks should consider ways to improve the homogeneity between the information provided in the management discussion and analysis and in the notes to the financial statements. Similarly they should enhance disclosures on capital adequacy measures and risk weighted assets and link them to the risk information (under v) above).
- For some of the banks included in the sample the disclosures encompassed government interventions and relief programmes that they benefited from, although these disclosures varied as much as the interventions and programs themselves. The same applies to the level of detail with which the disclosures

were provided. In particular, disclosures on the background to the programmes, on the underlying reasons, on their terms and conditions, as well as on the impact and possible spillover effects for shareholders, would be useful.

Annex 1 – CEBS’s good practices (excerpt of 18 June report)

CEBS’s observed good practices

Business model

- Description of the business model (i.e. of the reasons for engaging in activities and of the contribution to value creation process) and, if applicable of any changes made (e.g. as a result of crisis).
- Description of strategies and objectives.
- Description of importance of activities and contribution to business (including a discussion in quantitative terms).
- Description on the type of activities including a description of the instruments as well as of their functioning and qualifying criteria that products/ investments have to meet.
- Description of the role and the extent of involvement of the institution, i.e. commitments and obligations.

Risks and risk management

- Description of the nature and extent of risks incurred in relation to the activities and instruments.
- Description of risk management practices of relevance to the activities, of any identified weaknesses of any corrective measures that have been taken to address these.
- In the current crisis, particular attention should be given to liquidity risk.

Impact of the crisis on results

- Qualitative and quantitative description of results, with a focus on losses (where applicable) and write-downs impacting the results.
- Breakdown of the write-downs/losses by types of products and instruments affected by the crisis (CMBS, RMBS, CDO, ABS and LBO further broken down by different criteria).
- Description of the reasons and factors responsible for the impact incurred.
- Comparison of i) impacts between (relevant) periods and of ii) income statement balances before and after the impact of the crisis.
- Distinction of write-downs between realised and unrealised amounts.
- Description of the influence the crisis had on the firm’s share price.
- Disclosure of maximum loss risk and description how the institution’s situation could be affected by a further downturn or by a market recovery.
- Disclosure of impact of credit spread movements for own liabilities on results and on the methods used to determine this

Exposure levels and types

- Nominal amount (or amortised cost) and fair values of outstanding exposures.
- Information on credit protection (e.g. through credit default swaps) and its effect on exposures.
- Information on the number of products
- Granular disclosures of exposures with breakdowns provided by:
 - level of seniority of tranches;
 - level of credit quality (e.g. ratings, investment grade, vintages);
 - geographic origin;
 - whether exposures have been originated, retained, warehoused or purchased;
 - product characteristics: e.g. ratings, share of sub-prime mortgages, discount rates, attachment points, spreads, funding;
 - characteristics of the underlying assets: e.g. vintages, loan-to-value ratios, information on liens, weighted average life of the underlying, prepayment speed assumptions, expected credit losses.
- Movement schedules of exposures between relevant reporting periods and the underlying reasons (sales, disposals, purchases etc.).
- Discussion of exposures that have not been consolidated (or that have been recognised in the course of the crisis) and the related reasons.
- Exposure to monoline insurers and quality of insured assets:
 - nominal amounts (or amortized cost) of insured exposures as well as of the amount of credit protection bought;
 - fair values of the outstanding exposures as well as of the related credit protection;
 - amount of write-downs and losses, differentiated into realised and unrealised amounts;
 - breakdowns of exposures by ratings or counterparty.

Accounting policies and valuation issues

- Classification of the transactions and structured products for accounting purposes and the related accounting

treatment.

- Consolidation of SPEs and other vehicles (such as VIEs) and a reconciliation of these to the structured products affected by the sub-prime crisis.
- Detailed disclosures on fair values of financial instruments:
 - financial instruments to which fair values are applied;
 - fair value hierarchy (a breakdown of all exposures measured at fair value by different levels of the fair value hierarchy and a breakdown between cash and derivative instruments as well as disclosures on migrations between the different levels);
 - treatment of day 1 profits (including quantitative information);
 - use of the fair value option (including its conditions for use) and related amounts (with appropriate breakdowns).
- Disclosures on the modelling techniques used for the valuation of financial instruments, including discussions of the following:
 - description of modelling techniques and of the instruments to which they are applied;
 - description of valuation processes (including in particular discussions of assumptions and input factors the models rely on);
 - type of adjustments applied to reflect model risk and other valuation uncertainties;
 - sensitivity of fair values; and
 - stress scenarios.

Other disclosure aspects

- Description of disclosure policies and of the principles that are used for disclosures and financial reporting.

Presentation issues

- Relevant disclosures for the understanding of an institution's involvement in a certain activity should as far as possible be provided in one place.
- Where information is spread between different parts or sources clear cross-references should be provided to allow the interested reader to navigate between the parts.
- Narrative disclosures should to the largest extent possible be supplemented with illustrative tables and overviews to improve the clarity.
- Institutions should ensure that the terminology used to describe complex financial instruments and transactions is accompanied by clear and adequate explanations.

Annex 2 - Banks covered in the survey

Banco Santander

Bank of America

Barclays

Citi

Commerzbank

Credit Agricole

Credit Suisse

Deutsche Bank

Dexia

ING

Intesa SanPaolo

JP Morgan

Nordea

Rabobank International

RBS

SEB

Société Générale

UBS

Unicredit Group