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Standard & Poor's view of Pillar 3 disclosures' benefits and limitations

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Agenda

- **Pillar 3 offers very valuable information…**

- **But, in our opinion, data lack comparability and the level of granularity is very different from one bank to the other**

- **As users, we would like to see more factual and comparable information (qualitative and quantitative) to support the computed Basel 2 estimates**

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We view Pillar 3 disclosures as offering very useful information

- **For securitization exposures:**
  - details on liquidity lines to off-balance sheet vehicles;
  - Breakdown by external ratings;
  - Equity tranches deducted from regulatory capital
- **Holdings of Private Equity investments**
- **Off-balance sheet commitments on corporate exposures or on credit cards…**
- **Breakdown of exposures by internal ratings buckets**
- **Expected loss by asset classes…**

In our opinion, data lack comparability

- One critical example: credit risk exposures
- Some banks do not publish the exposures after application of Credit Conversion Factors
- For exposures under the standardized approach, some banks do not disclose the breakdown of exposures by asset classes (they only disclose the breakdown of exposures by regulatory risk-weight bands)
- For some other banks, we do not know whether exposures at default are before or after Credit Risk Mitigation
- Other example: impact of transition Basel 1 “floors”

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The level of granularity varies significantly from one bank to the other

- We note that the breakdown of items deducted from own funds (Equity tranches, Participations in unconsolidated FI subs, Participation in insurance subs, shortfall of provisions to cover Expected losses …) is rarely provided
- Information on credit risk mitigation (in general, good granularity of information for UK banks, poor granularity for French banks)
- Information on off-balance sheet commitments

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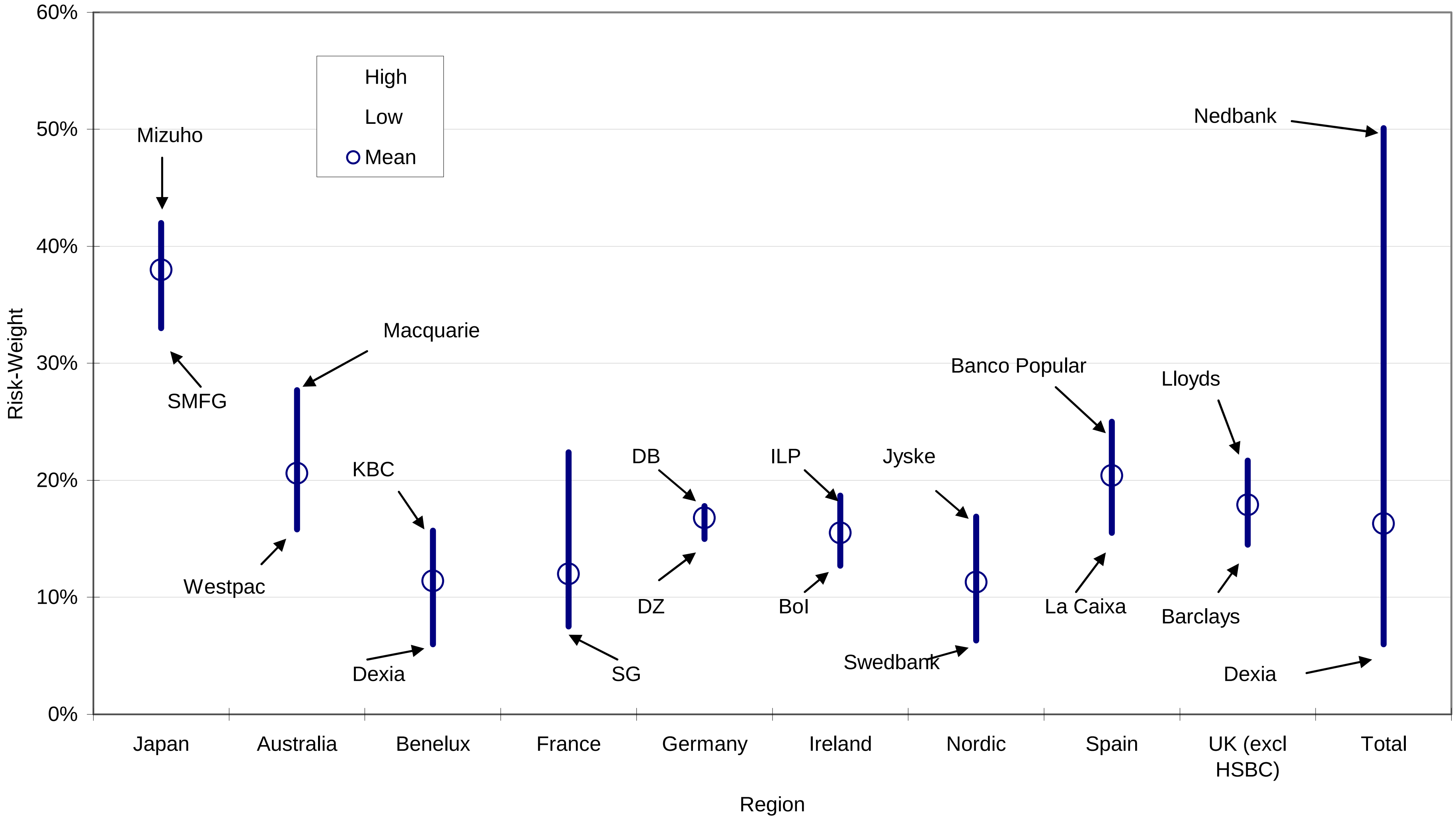
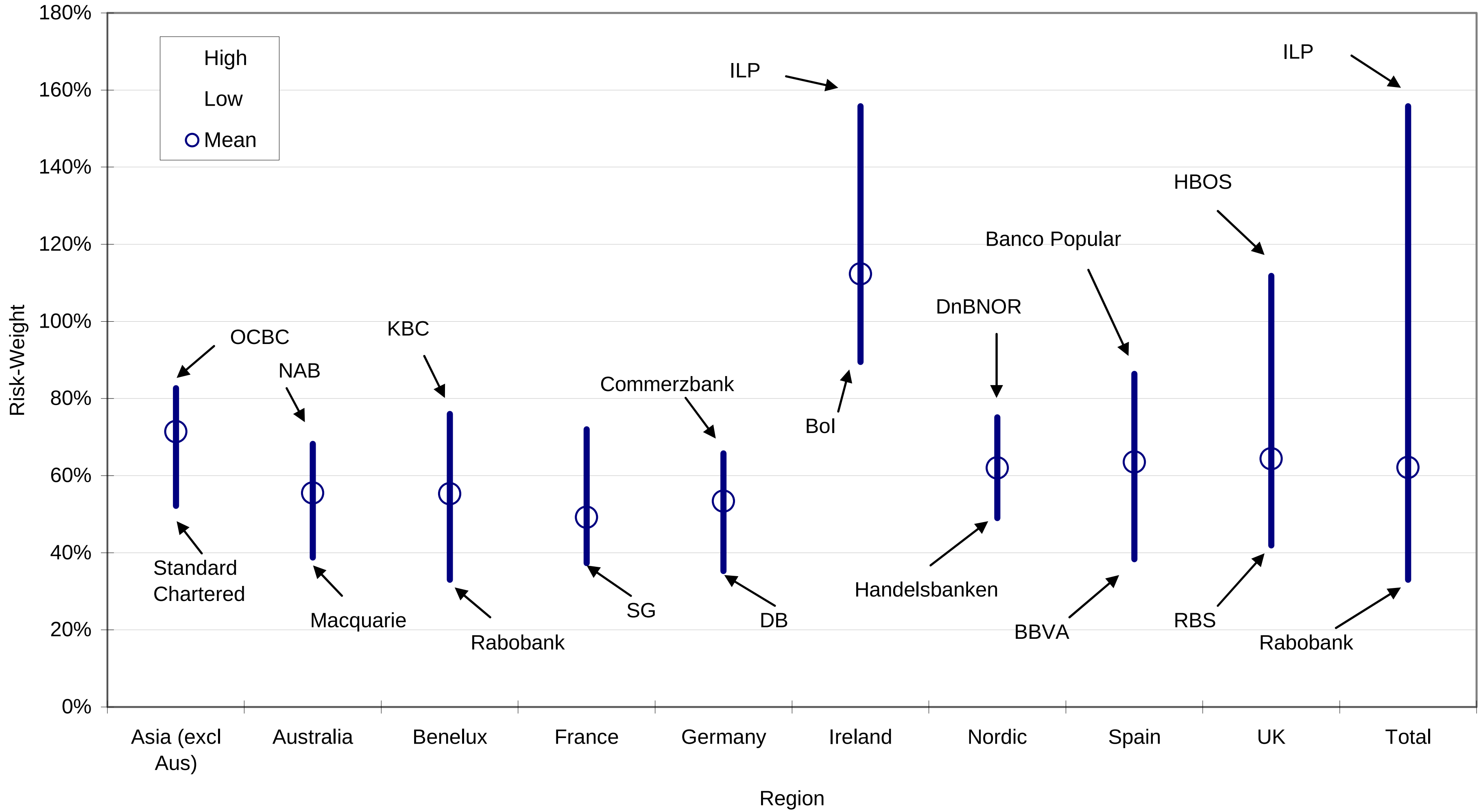
As users, we would like to see more factual and comparable information to support Basel 2 IRB estimates

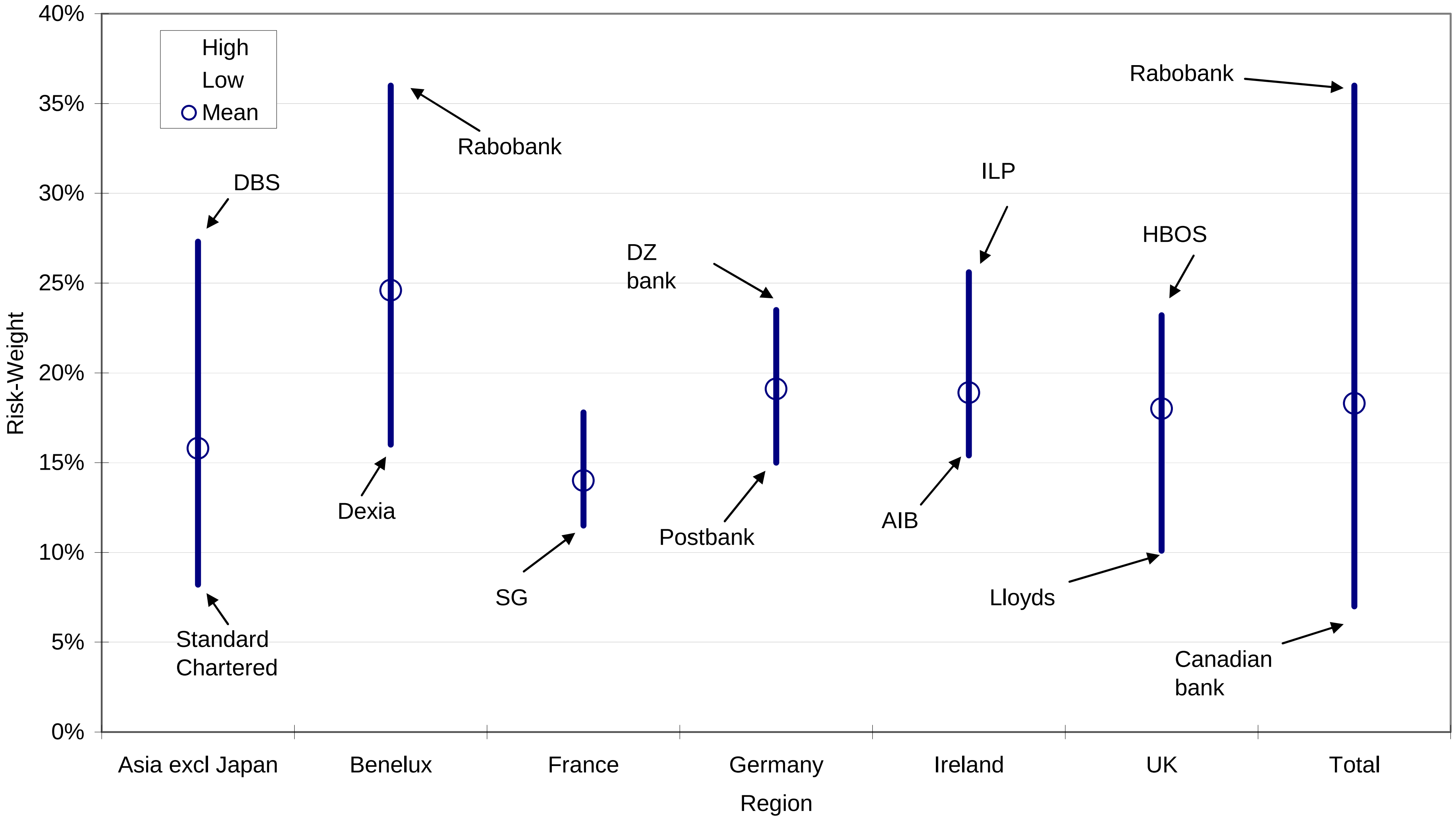
Residential Mortgages Under The IRB Approach



Corporate Exposures Under The IRB Approach



Financial Institutions Exposures Under The IRB Approach



We believe more information is needed

- **We would need more factual and comparable information to support these estimates**
- **It would help market participants to disentangle RWA differences between:**
  - National discretions / Methodological options and approaches;
  - real differences in risk profiles due to the quality of underwriting criteria / credit risk mitigation …

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Impact of National Discretions: Commonwealth Bank of Australia

	Tier 1 capital
Reported risk-weighted capital ratios at 30 June 2009	8.1%
RWA treatment - mortgages and margin loans	1.2%
IRRBB risk weighted assets	0.3%
Future dividends	0.4%
Equity investments	0.3%
Others	0.7%
Total adjustments	**2.9%**
30 June 2009 - Normalised - FSA	**11.0%**

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More information: Credit Risk mitigation

- **Despite CRD guidelines, we believe information on credit risk mitigation is rather poor in average**
  - In particular, information by type of guarantors are almost never provided;
  - Likewise, the differentiation between financial collateral and non-financial collateral is rarely made
  - Information on financial collateral under the IRB Advanced approach is particularly important for:
    - Banks with large Lombard loans portfolio;
    - Banks for which financial collateral on Repo-style transactions are reflected through LGD estimates (and not EAD)

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More information: Equity holdings in the banking book

- **One of the asset classes for which the impact of national discretion and approaches is the highest**
- **A reconciliation table between balance-sheet exposures and regulatory exposures would be very useful:**
  - Impact of the differences in scope (exposures deducted from regulatory capital, exposures treated using the « look-through » approach…);
  - Impact of unrealized gains
- **Indication on the granularity of the portfolio by countries of exposures, sectors and number of stocks could be useful too**

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More information: counterparty risk in the trading book

- **It would be helpful to have:**
  - the breakdown of EAD by external / internal ratings of the counterparties
  - the concentration of exposures on some single-names (e.g. EAD for the Top 10 exposures versus for the Total)

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More information: securitization

- **For the exposures under the Ratings Based Approach, we think it would be helpful to systematically have the breakdown by external ratings. In some cases, the only breakdown available is the one by regulatory risk-weight bands (aggregating exposures under different approaches: SF, IAA, RBA)**

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More information: Back-testing / Pro-cyclicality

- **Data on back-testing is too often absent from Pillar 3 disclosure:**
  - Credit risk: back-testing of credit risk IRB expected loss against actual losses by asset classes:
  - Market risk: back-testing of Value-at-Risk daily figures against daily P&L (hypothetical and « actual »)
- **It would be helpful to have the estimated change in regulatory RWA within two Pillar 3 report dates between:**
  - Change in scope (i.e. acquisitions…);
  - Change in business volume;
  - Pro-cyclicality

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Selected Related S&P Publications

- S&P Ratio Highlights Disparate Capital Strength Among the World's Biggest Banks. November 27, 2009
- Proposed Basel II Rules Would Require Banks To Hold More Capital Against Trading Risk. May 4th, 2009
- Methodology And Assumptions: Risk-Adjusted Capital Framework For Financial institutions, April 21st, 2009
- Credit FAQ: S&P Responds To Market's Questions About Its Risk-Adjusted Capital Framework For Banks, December 2nd, 2008
- Trading Losses At Financial Institutions Underscore Need For Greater Market Risk Capital, April 15th, 2008
- Request For Comment: Standard & Poor's Risk-Adjusted Capital framework For Financial Institutions, April 15th, 2008
- Transition To Basel II Creates A Need For A Consistent, Comparable Measure Of Bank Capital, February 21, 2008
- Greater Basel II Pillar III Disclosure would Enhance Transparency and Comparability In the Global Banking Sector, July 10, 2007
- Japan's Banks Rethink Fund Investments As Basel II Dawns, February 20, 2007
- Where do the Key Formulas Come From?, February 15, 2007
- Basel II In EU Gives Banks Greater Incentive To Invest In High-Quality Fixed-Income Funds, January 3, 2007
- Assessment Of The Basel II Framework: Incentive To Securitize Corporate Exposures Remains, December 14, 2006
- Different Wines from the Same Grape: Implementing Basel II in Brussels and Washington, November 2, 2006

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