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Pillar 3 Disclosures: The Perspective of a User

CEBS Public Roundtable on Pillar 3 Disclosures

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Agenda

1. How does Moody’s use/would like to use Pillar 3 disclosures
2. Disclosures that “could” be useful
3. View of current status of Pillar 3 disclosures
4. Challenges in comparing Pillar 3 disclosures
5. Incentives, enforcement and way forward

How does Moody's use/would like to use Pillar 3 disclosures

- Robust risk disclosures are key to external stakeholders, including Moody's
- Pillar 3 "principles" provide material improvement to risk disclosures
- Current use of Pillar 3 disclosures is hampered by weaknesses in implementation by banks
- Would like to use as input to own stress testing analysis, but insufficient granularity and lack of comparability are an issue
  - "*Pillar 3 disclosures must be failing if there is not enough information provided to run a very high level stress test without having to go back to the bank for further information*" (Moody's banking analyst)

Disclosures that “could” be useful – A selection

- Disclosures on capital structure and capital adequacy
- More comprehensive information on certain credit portfolios/credit risk
  - Information on avg PD, LGD and risk weights for IRB portfolios
  - Better information on concentrations by geography and industry
  - Counterparty credit risk
- Qualitative disclosures
  - Risk management policies and processes
  - Risk mitigation
  - Internal rating process
  - Characteristics of models used

View of current status of Pillar 3 disclosures / what we would like to see

- Qualitative disclosures provided by banks often rely on boilerplate language
- Information we would like to see includes:
  - Stress testing analysis (both market and credit), with results and main assumptions
  - Single name concentration
  - Comprehensive disclosures on VaR backtesting analysis
  - Information on tail risk
  - More detailed information needed on ICAAP
    - Including information on risk appetite and quantification of risk profile/economic capital
- Even when banks comply with the letter of the requirements, they often fail to "join the dots" of the information provided

Persistent lack of transparency of risk disclosures

Challenges in comparing Pillar 3 disclosures

- Insufficient frequency of Pillar 3 disclosures
- Lack of consistency of quantitative information presented
  - Need common standards/templates with additional qualitative/quantitative information where appropriate
- Very uneven quality of qualitative disclosures
- Language availability
  - Not all large EU banks make Pillar 3 disclosures available in as many languages as those used for their financial reports

Incentives, enforcement and way forward

- Emphasis on banks' responsibility for "conveying their actual risk profile to market participants" (in amended BII/CRD) is key!
- But what are the incentives for banks to provide more meaningful and better information?
- Not clear what is the enforcement mechanism for non-compliance to Pillar 3 disclosures requirements

Without clear enforcement of disclosure requirements, it is unlikely that banks' risk disclosures will improve materially

Moody’s Related Research (Selection)

- “U.K. FSA May Impose New Rules On Banks' Disclosures”, 9 Nov 2009
- “Basel's Trading Book Capital Charge Expected to Triple: Long-Term Credit Positive”, 26 Oct 2009
- “EU Financial Disclosure Guidelines May Be Undermined Without Enforcement”, 19 Oct 2009
- “Stress Testing: Essential Risk Management Tool, But Effective Implementation Is Key”, 15 Oct 2009
- “Managing Risk in Light of the Financial Crisis: Some Initial Lessons Learned”, 13 Oct 2009
- “EU Stress Test Result: Upbeat for 22 Large EU Banks, But Not to Be Extrapolated to the EU Banking System”, 12 Oct 2009
- “G20 Concerned About Inconsistent National Implementation of New Banking Regulation”, 5 Oct 2009
- “Recent Changes to Basel II and the EU “CRD”: Roadmap for Investors ahead of the Pittsburgh G20 Meeting”, 17 Sep 2009