Basel Committee
on Banking Supervision

Working Paper on Pillar 3 – Market Discipline

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BANK FOR INTERNATIONAL SETTLEMENTS

Basel Committee on Banking Supervision Transparency Group

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Working Paper on Pillar 3 – Market Discipline

The purpose of this paper prepared by the Transparency Group of the Basel Committee is to further the Committee's dialogue with the industry on the disclosure regime under Pillar 3 of the New Basel Capital Accord. Comments on the issues outlined in this paper would be welcome, and should be submitted to relevant national supervisory authorities and central banks and may also be sent to the Secretariat of the Basel Committee on Banking Supervision at the Bank for International Settlements, CH-4002 Basel, Switzerland, by 31 October 2001. Comments may be submitted via e-mail: BCBS.capital@bis.org[1] or by fax: + 41 61 280 9100. Comments on working papers will not be posted on the BIS website.

SECTION 1

Introduction

1. The New Basel Capital Accord is based around three complementary elements or "pillars". Pillar 3 recognises that market discipline has the potential to reinforce minimum capital standards (Pillar 1) and the supervisory review process (Pillar 2), and so promote safety and soundness in banks and financial systems. Market discipline imposes strong incentives on banks to conduct their business in a safe, sound and efficient manner, including an incentive to maintain a strong capital base as a cushion against potential future losses arising from risk exposures. This paper sets out the current thinking of the Transparency Group (the Group) on a revised set of disclosure requirements under Pillar 3 of the New Basel Capital Accord.

2. In its January 2001 Consultative Package, the Basel Committee on Banking Supervision (the Committee) set out proposals for Pillar 3. The Committee received numerous comments on the package and this revised paper is intended to take account of both those responses and the on-going analysis in the Group itself. This paper sets out revised proposals for disclosure in three broad categories: scope of application of the Accord, capital and capital adequacy, and risk exposure and assessment. Reflecting the objective to limit the burden associated with disclosure, and in light of the comments received, the Group has considered carefully the possibilities for streamlining the proposals. As a result, the amount of disclosure in these revised proposals shows a significant reduction compared to the document published in January 2001. The current disclosures are considered essential and support the Pillar 3 objective of facilitating market discipline. Given this reduction in volume and focus on essential information, the Group believes that all of the revised Pillar 3 disclosures should be considered requirements. This re-focusing of Pillar 3 is discussed further in the following section.

3. The Group wishes to stress that the streamlined requirements set out in this paper represent neither a full nor final statement of the relevant disclosures for banks. Banks provide financial statements and disclosures in accordance with requirements of securities regulators, accounting standards setters, and/or other authorities, and Pillar 3 is not intended

[1] Please use this e-mail address only for submitting comments and not for correspondence.

to repeat all of these disclosures. In addition, over recent years the Committee has published a series of disclosure recommendations, covering areas such a credit risk and trading and derivative activity. This work remains as an important complement to the requirements set out under Pillar 3 and the Group encourages banks to consider these recommendations in developing their disclosures[i]. Furthermore, work continues on the Pillar 1 framework for the New Basel Capital Accord, including, for instance, the treatment of equity investments held in the banking book, various aspects of the internal rating based (IRB) approach to credit risk (including, retail, project finance and specialised lending portfolios), credit risk mitigation, securitisation (including synthetics) and operational risk. As a result, alternative or additional disclosure requirements may need to be introduced in the full and final consultation on the New Basel Capital Accord, planned for early 2002.

The revised structure of Pillar 3

Disclosure requirements

4. The Group believes that the rationale for Pillar 3 is sufficiently strong to warrant the introduction of disclosure requirements, with clear remedial actions in the case of non-disclosure. This argument is further strengthened by the need to have complementary pillars in the New Basel Capital Accord, which are mutually reinforcing. In streamlining the current shape of Pillar 3, the Group has therefore set forth a more limited number of disclosures in various topics, and supervisors will use all means available to them to ensure such disclosures are made. Some of these disclosures will be qualifying criteria for the use of particular methodologies or the recognition of particular instruments and transactions.

Ensuring appropriate disclosure

5. The Group is aware that supervisors have different powers available to them to ensure that disclosure requirements are achieved.[ii] Market discipline can promote a safe and sound banking environment, and supervisors can require firms to operate in a safe and sound manner. Under safety and soundness grounds, supervisors could require firms to disclose information. Alternatively, supervisors have the authority to require firms to provide information in regulatory reports. Some supervisors could make some or all of the information in these reports publicly available. Further, there are a number of existing mechanisms by which supervisors may enforce requirements. These vary from country to country and range from “moral suasion” through dialogue with the bank’s management (in order to change the latter’s behaviour), to reprimands or financial penalties. The nature of the exact measures used will depend on the legal powers of the supervisor and the seriousness of the disclosure deficiency. However, it is not intended that direct additional capital requirements would be a response to non-disclosure (see below).

6. In addition to the general intervention measures outlined above, the New Basel Capital Accord also anticipates a role for specific measures. Where disclosure is a qualifying criterion under Pillar 1 in order to obtain lower risk weightings and/or to apply specific methodologies, there would be a direct sanction (not being allowed to apply the lower weighting or the specific methodology). An example is the use of internal ratings methodologies, the acceptance of which will be conditional upon the disclosure of information on key characteristics and reliability of the internal rating system. Accordingly, institutions will not be permitted to use the internal ratings based approach for credit risk unless the disclosure requirements are met. The Group anticipates that an important part of Pillar 2 will consist of a supervisory review of on-going compliance with requirements to use particular

capital treatments, including disclosures, as well as a more general compliance by the institution with the Pillar 3 requirements.

Interaction with accounting disclosures

7. Although it is expected that a bank will disclose all of the information specified in Pillar 3, if material, management should use its discretion in determining the appropriate medium and location of the disclosure. In situations where the disclosures are made under accounting requirements or are made to satisfy listing requirements promulgated by securities regulators, banks may rely on them to fulfil the applicable Pillar 3 expectations. In these situations, banks should explain material differences between the accounting or other disclosure and the supervisory basis of disclosure. This explanation does not have to take the form of a line by line reconciliation.

8. For those disclosures that are not mandatory under accounting or other requirements, management may choose to provide the Pillar 3 information through other means (such as on a publicly accessible internet website or in public regulatory reports filed with bank supervisors), consistent with requirements of national supervisory authorities. However, institutions are encouraged to provide all related information in one location to the degree feasible. In addition, if information is not provided with the accounting disclosure, institutions should indicate where the additional information can be found.

9. The recognition of accounting or other mandated disclosure in this manner is also expected to help clarify the requirements for validation of disclosures. For example, information in the annual financial statements would generally be audited and additional material published with such statements must be consistent with the audited statements. In addition, supplementary material (such as Management's Discussion and Analysis) that is published to satisfy other disclosure regimes (e.g. listing requirements promulgated by securities regulators) is generally subject to sufficient scrutiny (e.g. internal control attestations, etc.) to satisfy the validation issue. If material is not published under a validation regime, for instance in a stand alone report or as a section on a website, then management should ensure that appropriate verification of the data takes place, in accordance with the overarching principles set out below. Accordingly, Pillar 3 disclosures will not be required to be audited by an external auditor, unless otherwise required by accounting standards setters, securities regulators or other authorities.

10. An important dimension to the relationship between Pillar 3 disclosures and accounting requirements is the on-going revision to the IASB disclosure standard for banks, IAS 30.[iii] The Group intends to maintain an ongoing relationship with the accounting authorities, including the IAS30 Advisory Group, to promote consistency between disclosure frameworks and so increase the potential for reliance on accounting disclosure. Furthermore, the Group intends to review the Pillar 3 proposals in light of the exposure draft IAS30.

Materiality

11. In light of the comments received on the January 2001 Consultation Package, the Group wishes to re-emphasise that an institution should decide which disclosures are relevant for it based on the materiality concept. Information would be regarded as material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information. This definition is consistent with International Accounting Standards and with many national accounting frameworks. Further, it is helpful in the context of market discipline, as it conveys clearly that the purpose of the disclosure is to allow market participants to reach a view on the risk profile of the organisation. Nevertheless, the Group

recognises the need for a qualitative judgement of whether, in light of the particular circumstances, a “reasonable investor” would consider the item to be material. The Group does not intend to set specific thresholds for disclosure as these can be open to manipulation and are difficult to determine, and it believes that the “reasonable investor” test is a useful benchmark for ensuring that sufficient disclosure is made. Furthermore, it is important to note that the full scope of Pillar 3 would only apply to banks that engage in the full range of banking activities and that use the most sophisticated risk assessment techniques in each regard. For many institutions, disclosures will not be necessary simply because they do not engage in particular activities to any significant extent or make limited use of advanced capital assessment approaches and instruments.

Proprietary and confidential information

12. In response to previous consultations, the need to protect proprietary and confidential information has been raised by numerous respondents. The Group recognises that it is important to determine the right level of detail for disclosure, in light of the proprietary and confidential nature of information held by banks. Proprietary information encompasses information (for example on products or systems), that if shared with competitors would render a bank’s investment in these products/systems less valuable, and hence would undermine its competitive position. Information about customers is often confidential, in that it is provided under the terms of a legal agreement or counterparty relationship. This has an impact on what banks should reveal in terms of information about their customer base, as well as details on their internal arrangements, for instance methodologies used, parameter estimates, data etc. The Group believes that the proposals set out in this paper strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information. Where banks consider that any disclosures set out in this paper would require the publication of proprietary or confidential information, and can explain why, the Group would welcome specific alternative suggestions to its proposals.

Frequency

13. The frequency of disclosure is an important consideration in the promotion of market discipline. In many cases, annual disclosure is insufficiently frequent to allow market discipline to operate with its full effect, since the participants would be responding to information which could be many months old and may no longer reflects the true situation of the institution. The Group therefore confirms its belief that the disclosures set out in Pillar 3 should be made on a semi-annual basis, subject to the following exceptions. Qualitative disclosures that provide a general summary of a bank’s risk management objectives and policies, reporting system and definitions may be published on an annual basis. The Group proposes that, in recognition of the increased risk sensitivity of the New Basel Capital Accord and the general trend towards more frequent reporting in capital markets, large internationally active banks and other significant banks (and their significant bank subsidiaries) must disclose their Tier 1 and total capital adequacy ratios, and their components[iv], on a quarterly basis. Furthermore, if information on risk exposure or other items is prone to rapid change, then banks are encouraged to also disclose information on a quarterly basis. In all cases, banks are encouraged to publish material information as soon as practicable.[v] The Group believes that this frequency regime strikes a suitable balance between the need to ensure that market participants are able to respond in a timely way to relevant information whilst ensuring that undue burden is not placed on banks in making information public.

Scope

14. The Group wishes to clarify that Pillar 3 applies at the top consolidated level and that individual banks within the groups would not generally be required to fulfil the disclosure requirements set out below. An exception to this arises in the area of disclosure of capital adequacy, where an analysis of individual banks within the group is appropriate, in order to recognise the need for bank to comply with the Basel Accord and other applicable limitations on the transfer of funds or capital within the group. This focus for Pillar 3 is intended to reflect the level of consolidation where effective market discipline will operate. Nevertheless, national supervisors will still have the discretion to require additional disclosure at a sub-consolidated level, and to enforce this through the means available to them.

SECTION 2

The proposed disclosure requirements[2]

15. Following a discussion of the overarching principles for disclosure by banks, this section of the paper sets out in tabular form the revised disclosure proposals under Pillar 3. Additional definitions and explanations are provided in a series of endnotes, along with templates demonstrating a means for fulfilling certain disclosures. These templates are presented for illustrative purposes and are thus optional but, if used, would enhance comparability between institutions. Nevertheless, the Group recognises that there are a number of other suitable formats through which information can be presented. These include text, bar charts, and other graphical depictions. These are, of course, acceptable in fulfilling disclosures set out below.

Overarching principles

16. The Group believes that a general disclosure principle relating to qualitative information should form an integral part of Pillar 3. A number of studies relating to bank disclosure, including reports by the Multi-Disciplinary Working Group on Enhanced Disclosure and the Private-sector Working Group on Public Disclosure (‘Shipley Report’), have stressed the importance of qualitative disclosure and the Group shares this view. Furthermore, the qualitative elements of disclosure provide a vital context in which to understand the quantitative elements. Accordingly, the following general disclosure principle is proposed:

For each separate risk area (e.g. credit, market, operational, banking book interest rate risk, equity) banks must disclose their risk management objectives and policies, including:

- **strategies and processes;**
- **the structure and organisation of the relevant risk management function;**

[2] In this section of the paper, disclosures that are qualifying criteria for the use of particular instruments or methodologies are marked with an asterisk

- **the scope and nature of risk reporting and/or measurement systems;**
- **policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.**

17. The Group believes that meaningful public disclosure is such an important component of the New Basel Capital Accord and critical to an institution's safety and soundness that it is introducing the following explicit disclosure principle: **Banks should have a formal disclosure policy approved by the board of directors. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency of them.**

Scope of application

18. This set of disclosures allows market participants to assess how the New Basel Capital Accord applies to a banking group and how the various entities within the group are treated for capital adequacy purposes. Furthermore, it is useful for market participants to understand how certain entities may not be included in a consolidated capital calculation. The qualitative disclosure provides an important context for relying on accounting disclosures for regulatory purposes. This section therefore provides a context for the disclosures on capital and risk exposure and assessment contained in the subsequent sections.

Qualitative Disclosures	An outline of differences in the basis of consolidation for accounting and regulatory purposes, plus an explanation of them.
	Any restrictions, or other major impediments, on transfer of funds or regulatory capital within the group.
Quantitative Disclosures	The name of the top corporate entity in the group to which regulatory capital requirements apply
	The entities[vi] within the group (a) that are fully consolidated; (b) that are pro-rata consolidated; (c) that are given a deduction treatment;[vii] and (d) from which surplus capital is recognised[viii]
	The aggregate amount of surplus capital[ix] of insurance subsidiaries (whether deducted or subjected to an alternative method) included in the capital of the consolidated group and the quantitative impact on regulatory capital of using this method versus using the consolidation or deduction approach.
	The name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power for any entity (significant minority position or subsidiary) which is neither included within the consolidated approach nor deducted from capital, (e.g., where the entity is not consolidated and the investment then risk-weighted), together with the firm's total investment (e.g., current book value) in that subsidiary. In addition, indicate the valuation basis for the investment (e.g., historical cost, equity method, or fair value) plus an explanation for the treatment and impact on regulatory capital (e.g. revaluation reserve)
	The name of any subsidiary not included in the consolidation, i.e. that are deducted, that does not meet its regulatory capital requirements and the aggregate amount of capital deficiencies[x] in all such subsidiaries

Capital

19. Disclosure about the amount, components and features of capital provides market participants with important information about a bank's ability to absorb financial losses. Information on the terms and conditions of capital instruments provides additional

background on the loss absorbing capacity of capital instruments and provides a context for the analysis of the capital adequacy of the institution.

Qualitative Disclosures	Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments
Quantitative Disclosures	The amount of tier 1 capital, with separate disclosure of: • paid-up share capital/common stock • reserves • minority interests in the equity of subsidiaries • innovative instruments • other capital instruments • surplus capital • goodwill and other amounts deducted from tier 1
	The total amount of tier 2 and 3 capital
	Deductions from tier 1 and tier 2 capital
	Total eligible capital

Capital adequacy

20. In order to provide market participants with a link between the disclosure of capital and risk exposure and assessment, it is important that a bank publishes information about its capital adequacy, based on the New Basel Capital Accord.

21. Under Pillar 2, the Committee recommends that all banks have an internal process for assessing their capital adequacy and for setting appropriate levels of capital. This process should be objective and overseen by senior management and all banks should be able to demonstrate that the results of their internal processes are credible and reliable. One method used by some banks is economic capital allocation. Information provided about a bank's capital allocation process assists market participants in gaining a better understanding of the risks and rewards inherent in the bank's activities.

Qualitative disclosures	A description of the bank's capital strategy and its approach to assessing the adequacy of its capital to support current and future business including: • information about contingency planning and • other factors impacting on capital adequacy
Quantitative disclosures	Basel Capital Accord requirements for credit risk: • Standardised approach • Foundation IRB approach (must be summarised by aggregated portfolio) • Advanced IRB approach (must be summarised by aggregated portfolio) • Standardised approach for equity • Risk sensitive approach for equity • Total risk-weighted assets for credit risk
	Basel Capital Accord requirements for market risk: • Standardised approach • Internal models approach • The equivalent of risk-weighted assets for market risk
	Basel Capital Accord requirements for operational risk: • Basic indicator approach • Standardised approach • Advanced measurement approach • The equivalent of risk-weighted assets for operational risk
	Total and Tier 1[xi] capital ratio: • For the top consolidated group • For significant bank subsidiaries (stand alone or sub-consolidated depending on how the Capital Accord is applied)

Risk exposure and assessment

22. The risks to which banks are exposed and the techniques that banks use to identify, measure, monitor and control those risks are important factors market participants consider in their assessment of an institution. In this section, several key banking risks are considered: credit risk, market risk, interest rate risk and equities in the banking book and operational risk. Also included in this section are disclosures relating to credit risk mitigation and asset securitisation, both of which alter the risk profile of the institution. Where applicable, separate disclosures are set out for banks using different approaches to the assessment of regulatory capital.

Credit risk

23. Credit risk is the most significant risk for many banking institutions and therefore forms an important part of the disclosure regime. General disclosures provide market participants with a range of information about overall credit exposure. Disclosures on the capital assessment techniques give information on the specific nature of the exposures, the means of capital assessment and data to assess the reliability of the information disclosed.

Credit risk: general disclosures for all banks

24. This section sets out general credit risk disclosures for all banks, regardless of which regulatory capital assessment technique they use. The aim is to give an overview of the size and nature of the institution's credit risk exposure and to provide a context for information on how a bank assesses and manages that risk.

Qualitative Disclosures	The qualitative disclosure requirement with respect to credit risk, including: • Definitions of past due, impaired and default • Definitions of specific and general allowances – statistical methods.
Quantitative Disclosures	Total credit risk exposures, plus average gross exposure over the period[xii] broken down by different types of credit exposure[xiii]
	Geographic distribution of exposures, broken down by different types of credit exposure
	Industry/counterparty type distribution of exposures, broken down by different types of credit exposure
	Maturity breakdown of the whole portfolio, broken down by different types of credit exposure
	Amount of past due/impaired loans, broken down by geographic distribution and counterparty type/industry sector, including analysis by days overdue
	Amount of allowances for credit losses, including information on: allowances (opening and closing balances and movements during the period, with specific distinguished from general); and recoveries and charge-offs (differentiating among amounts credited or charged to the profit and loss account and those treated as adjustments to allowances).
	Amount of credit risk transferred through credit derivatives or into securitisation vehicles (regardless of whether this is recognised for regulatory capital purposes)

Credit risk: disclosures for banks on the standardised approach[xiv]

25. Disclosures in this section allow market participants to assess asset quality by providing a breakdown of a bank's exposures in the standardised framework. Furthermore, this provides market participants with a sense of the suitability of the standardised approach for the particular institution (i.e. that the resulting weights for capital purposes properly

reflects the risk exposure of the underlying asset) and provides a basis for comparative analysis of institutions.

Qualitative Disclosures	Names of ECAIs and ECAs used, plus reasons for any changes
	Types of exposure for which each agency is used
	A description of the process used to transfer public issue ratings onto comparable assets in the banking book
	The alignment of the alphanumerical scale of each agency used with risk buckets[xv]
Quantitative Disclosures	Amount of a bank's outstandings in each risk bucket broken down by each agency's assessments

Credit risk: disclosures for banks on the IRB approaches[3]

26. An important part of the New Basel Capital Accord is the introduction of an Internal Ratings Based (IRB) approach for the assessment of regulatory capital for credit risk. To varying degrees, banks will have discretion to use internal inputs in their regulatory capital calculations. In this section, the IRB approach is used as the basis for a set of disclosures intended to provide market participants with information about asset quality. In addition, these disclosures are important to allow market participants to assess the resulting capital in light of the exposures. There are two categories of quantitative disclosures: those focussing on an analysis of risk exposure and assessment (i.e. the inputs) and those focussing on the actual outcomes (as the basis for verification of the likely reliability of the disclosed information). These are supplemented by a qualitative disclosure regime which provides background information on the assumptions underlying the IRB framework, the use of the IRB system as part of a risk management framework and the means for validating the results of the IRB system. The disclosure regime is intended to enable market participants assess the credit risk exposure of IRB banks and the overall application and suitability of the IRB framework, without revealing proprietary information or duplicating the role of the supervisor in validating the detail of the IRB framework in place.

Qualitative disclosures*	Supervisor's acceptance of approach/ supervisory approved transition
	For each portfolio[xvi], with subdivision as necessary: • whether an own estimate or a supervisory vector for LGD and/or EAD is used • describe the methods and data for estimation and validation of PD, [LGD and EAD] including assumptions employed in the derivation of these variables • employed definitions of PD, [LGD, and EAD] • mapping of internal and reference definitions of default
	Explanation and review of the: • structure of internal rating system and relation between internal and external ratings • use of internal estimates besides for IRB capital purposes • process for managing and recognising credit risk mitigation • methodology for and results of the validation of the overall IRB system

3 Items marked in square brackets [] apply only to banks using the advanced IRB approach for that portfolio

Quantitative disclosures: risk assessment*	Amount of total exposures (drawn plus EAD on the undrawn, or credit conversion factor for standardised and IRB foundation) covered by the each approach broken down into coverage under standardised, IRB foundation[xvii], and IRB advanced
	Current portfolio[xviii] analysis, for corporate, bank and sovereign combined, against a minimum of 6 PD grades (plus default)[xix] showing: • Total exposure (outstanding loans and EAD on commitments) • [Weighted average percentage LGD values] • [Weighted average maturity] • Granularity adjustment (overall)[xx]
Quantitative disclosures: verification*	Default information over past year for corporate, bank and sovereign combined, against a minimum of 6 PD grades showing: • Total value of all defaulted exposures (i.e. drawn amounts), by PD grade at the start of the year (or inception if within year) • Default rate, based on number of borrowers[xxi] • Charges for specific allowances and charge-offs by portfolio.
	[LGD outcomes against a minimum of (3) LGD bands, for corporate, bank and sovereign combined, for the reporting year and two previous years, showing: • Exposure • % LGD – based on estimated final value of recoveries][xxii]
	[EAD outcomes for corporate, bank and sovereign combined, broken down by EAD category, showing: • Gross amount of undrawn, but committed, exposures on reporting date • Percentage EAD estimates • Percentage average EAD on defaulted loans during the year][xxiii]
	[EL for retail[xxiv] information required per EL band: • Amount of drawn & undrawn (using EAD) exposures on reporting date[xxv] • Total loss on retail loans expressed as a percentage of average drawn exposures during the year

Equities in the banking book

27. In its Working Paper on 'Risk Sensitive Approaches for Equity Exposures in the Banking Book for IRB Banks' the Models Task Force of the Basel Committee set out its current thinking on approaches to the capital treatment of equity exposures. These disclosures are consistent with that framework and aim to ensure that market participants are able to assess the significance of these exposures in the overall risk profile in the institution and the mechanisms used to assess capital at a particular institution. Nevertheless, as the Models Task Force continues its work on the capital treatment of equity, these disclosures will necessarily change to reflect the most current thinking. At this time, we are soliciting specific comments from the industry on the proposed set of disclosures outlined below.

Equities: disclosures for banking book positions at all banks

Qualitative Disclosures	The qualitative disclosure requirement with respect to equity risk, including: • differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; • discussion of important policies covering the valuation and accounting of equity holdings in the banking book. This includes the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices
Quantitative Disclosures	Carrying value and fair value of investments, and for quoted securities, comparisons to publicly quoted share values (where materially different from fair value)
	The types and nature of investments, including the amount that can be classified as: • Direct or indirect (e.g. funds) • Publicly traded and privately held
	The realised gains (losses) arising from sales and liquidations, and unrealised or latent revaluation gains (losses) included in Tier 2 capital on existing holdings

Equities: disclosures for banks using a risk-sensitive approach

Qualitative Disclosures*	Supervisor's acceptance of approach and a description of which portfolios are covered under the approach
Quantitative Disclosures*	Amount of equity exposures, broken down into coverage under standardised, PD-LGD, and market-based approaches
	For those investments for which the PD/LGD approach to regulatory capital is utilised, a breakdown of equity investments by rating grade (i.e., the assumed probability of default used to derive the risk weights for each investment)
	For those investments for which the internal models market-based approach to regulatory capital is utilised, results of the calculation broken down by appropriate groupings, consistent with the bank's methodology
	The aggregate amounts and the specific investments subject to any supervisory transition or grandfathering provisions regarding regulatory capital requirements

Credit risk mitigation techniques

28. The New Basel Capital Accord recognises an enlarged range of credit risk mitigation techniques for regulatory capital purposes. The disclosure regime is intended to allow market participants to assess the types of mitigation employed and their impact on risk and regulatory capital levels. Qualitative disclosures provide the context in which credit risk mitigation takes place by setting out the policies and management of the mitigation process. The exact nature of the Pillar 1 treatment of credit risk mitigation techniques is still subject to further development and the disclosure regime associated with it may need to be amended accordingly.

Qualitative Disclosures*	The overall qualitative disclosure requirement with respect to credit risk mitigation, covering collateral valuation and management, guarantees and credit derivatives including credit worthiness of protection providers, and on-balance sheet netting. This must include a description of the main types of collateral taken by the bank and of the main types of guarantor/credit derivative counterparty, plus information about particular concentrations
Quantitative Disclosures*	Total gross credit exposure
	Exposure covered by: • on-balance sheet netting • collateral[xxvi] • guarantees/credit derivatives, disclosed separately[xxvii]
	Risk weighted assets before and after the effect of all recognised credit risk mitigation

Asset securitisation

29. In recognition of the advances in the asset securitisation market, the New Basel Capital Accord includes a regulatory capital regime for both traditional and synthetic securitisations. In order to gain preferential capital treatment with respect to asset securitisation, a bank must disclose information about the size, type and features of securitisations to allow market participants to assess the resulting impact on the bank's risk profile. In view of the on-going work underway on asset securitisation, the proposed disclosures outlined below will necessarily change to reflect the most current thinking, as well as specific industry comment on these proposed disclosures. Furthermore, disclosures for synthetic securitisations will be established, as the Pillar 1 regime for such transactions is developed.

Qualitative disclosures*	The overall qualitative disclosure requirement with respect to asset securitisation, including: • The institution's reliance on securitisation as a source of funding • Discussion of the roles played by the bank in the securitisation process (e.g., originator, servicer, provider of credit enhancement, sponsor of asset backed commercial paper facility, third party liquidity provider, swap provider, etc.)
	Summarise the bank's accounting policies for securitisation activities, including: • Satisfaction of clean break criteria (e.g., whether the transactions are treated as sales or financings) • Recognition of gain on sale • key assumptions and procedures for valuing retained interests
Quantitative disclosures*	The aggregate amount of securitised loans and commitments outstanding (broken down into synthetic/traditional securitisation categories), by asset type (e.g. credit cards, home equity, auto, etc.)
	Summary of current year's securitisation activity, including the amount of assets securitised (by asset type), and recognised gain on sale by asset type.
	Aggregate amount of credit exposure retained arising from credit enhancement provided to the transactions, (including I/O strips, cash collateral accounts, liquidity facilities and other subordinated assets), by asset type (e.g. credit cards, home equity, auto, etc.) plus a declaration that support is limited to these contractual obligations.
	Performance data for securitised assets including amounts more than 30 days past due and the amount of charge-offs and recoveries.

Market risk

30. The New Basel Capital Accord will incorporate a charge for market risk, based on the 1996 requirements contained in the *'Amendment to the Capital Accord to incorporate market risks'.* The disclosure regime will allow market participants to assess the exposure of the bank to market risk and review the accuracy of internal estimates.

Market risk: disclosures for banks using the standardised approach

31. The disclosure regime for the standardised approach is based on the capital charge as a proxy for the risk indicator allowing a comparison between different types of risks and between different institutions.

Qualitative disclosures	The overall qualitative disclosure requirement for market risk, including the portfolios covered by the standardised approach
Quantitative disclosures	The capital requirements for: • interest rate risk • equity position risk • foreign exchange risk • commodity risk
	The capital charge for options positions

Market risk: disclosures for banks using the internal models approach (IMA)

32. The disclosure regime for the IMA is based on the Value-at Risk (VaR) concept, the common metric in internal market risk models. Market participants can judge the exposure to market risk and verify the results of the model, in broad terms, compared to actual outcomes. The qualitative disclosure of portfolios covered by the IMA allows market participants to evaluate the sophistication of the bank's risk measurement and management based on the qualifying criteria for the IMA.

Qualitative disclosures	The overall qualitative disclosure requirement for market risk, including the portfolios covered by the IMA
	For each portfolio covered by the IMA: • the characteristics of the models used • a description of stress testing applied to the portfolio
	The scope of acceptance by the supervisor
Quantitative disclosures	The aggregate value-at-risk (VaR) for the IMA portfolios
	The high, median and low VaR values over the reporting period and period-end
	A comparison of VaR estimates with actual outcomes, with analysis of important "outliers" in backtest results

Operational Risk

33. An important feature of the New Basel Capital Accord is the introduction of a regulatory capital charge to cover operational risk.[xxviii] The metric to assess exposure, across all capital calculation types, is the capital charge itself. The disclosure of the regulatory capital approach that a bank qualifies for – Basic Indicator Approach, Standardised Approach or an Advanced Measurement Approach – provides useful information to market participants about the quality of risk identification, measurement, monitoring and control, as incremental standards apply to each of the three capital assessment techniques. The Risk Management Group of the Basel Committee, which is developing the framework for an operational risk capital charge, will consider if additional disclosures under the Advanced Measurement Approaches are appropriate.

Qualitative disclosures	In addition to the general qualitative requirement, the approach(es) for operational risk capital assessment that the bank qualifies for
	Description of the advanced measurement approach, if used by the bank
Quantitative disclosures	Operational risk capital charge per business line (if available)

Interest Rate Risk in the Banking Book

34. Interest rate risk in the banking book does not attract a minimum regulatory capital charge in Pillar 1 of the New Basel Capital Accord, but rather is dealt with under Pillar 2 - the supervisory review process. This places considerable importance on the disclosure of comparable information by banks to allow market participants to assess the current and potential level of interest rate risk in the banking the book, the means by which the bank identifies, measures, monitors and controls the risk, and the results of this process.

Qualitative disclosures	The overall qualitative disclosure, including the nature of IRRBB and key assumptions and frequency of IRRBB measurement
	The empirical or judgmental assumptions employed to model portfolios with embedded optionality, such as assumptions regarding loan prepayments and behaviour of non-maturity deposits.
	Brief description of methodology chosen to incorporate the supervisory rate scenario: the standardised parallel rate shock or actual rate moves over the past 6 years
Quantitative disclosures	The size of the standardised/actual interest rate shock by currency
	The increase (decline) in economic value for the upward and downward rate shocks, in absolute terms amounts and relative to total regulatory capital

[i] The Committee published *Sound Practices for Credit Risk Disclosure* (September 2000). The Committee - in collaboration with the International Organization of Securities Commissions (IOSCO) - published guidance on trading and derivatives disclosures (October 1999). See also: *Enhancing Bank Transparency* (September 1998) and *Sound Practices for Loan Accounting and Disclosure* (July 1999)

[ii] The future Directive on Capital may well provide for powers to enforce disclosure within the EU and, to the extent that the Directive is aligned with the Accord, will also provide a basis for ensuring the requirements are met.

[iii] *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, International Accounting Standards Committee, 1990 (reformatted 1994).

[iv] These components include Tier 1 capital, total capital and risk weighted assets.

[v] For some small banks with stable risk profiles, annual reporting may be acceptable. Where a bank publishes information on only an annual basis, it should state clearly why this is appropriate.

[vi] Entity = securities, insurance and other financial subsidiaries, commercial subsidiaries, significant minority equity investments in insurance, financial and commercial entities.

[vii] May be provided as an extension (extension of entities and/or extension of information on entities) to the listing of significant subsidiaries in consolidated accounting (e.g. IAS 27.32).

[viii] May be provided as an extension (extension of entities and/or extension of information on entities) to the listing of significant subsidiaries in consolidated accounting (e.g. IAS 27.32).

[ix] Surplus capital in unconsolidated regulated subsidiaries is the amount by which the subsidiary's capital exceeds its regulatory capital requirements.

[x] A capital deficiency is the amount by which actual capital is less than the regulatory capital requirement. Any deficiencies which have been deducted on a group level in addition to the investment in such subsidiaries are not to be included in the aggregate capital deficiency.

[xi] Including proportion of innovative capital instruments

[xii] Where average amounts are disclosed in accordance with an accounting standard or other requirement which specifies the calculation method to be used, that method should be followed. Otherwise, the average exposures should be calculated using the most frequent interval that an entity's systems generate for management, regulatory or other reasons, provided that the resulting averages are representative of the bank's operations. The basis used for calculating averages need be stated only if not on a daily average basis.

[xiii] This breakdown could be that applied under accounting rules, and might, for instance, be (a) Loans, Commitments and other non-derivative off balance sheet exposures (b) securities and (c) OTC derivatives

[xiv] A *de minimis* exception would apply where ratings are used for less than [1%] of the total loan portfolio.

[xv] This information need not be disclosed if the bank complies with a standard mapping which is published by the relevant supervisor.

[xvi] To the extent that this information is the same disclosure for certain portfolios (e.g. corporate, bank and sovereign) then this would not have to be replicated.

[xvii] This information is required for corporate, bank, and sovereign together, residential mortgages, other retail and project finance. Additional items may be included pending the outcome of work in progress in the Models Task Force. This information enables the user to understand the relative significance of subsequent information as a measure of asset quality.

[xviii] A portfolio for disclosure purposes is defined as a group of assets that are covered by the same methodological approach under the new accord; for example, corporate/bank/sovereign exposures would be considered one portfolio for disclosure purposes under Pillar 3.

[xix] Where banks are aggregating PD grades for the purposes of disclosure, this should be a representative breakdown of the distribution of PD grades used in the IRB approach.

[xx] These items, plus the first set of items in the verification section, may be presented using template 1:

Template 1: Current portfolio distribution and defaults over the past year: (corporate, bank, and sovereign together, for both foundation and advanced IRB portfolios)

(i) PD Grade (%)	(ii) Exposure	(iii) Weighted Average % LGD(for advanced banks only)	(iv) Weighted Average Maturity (for advanced banks only)	(v) Value of exposures defaulting in the last year	(vi) % Default Rate
PD1					
PD2					
PD3					
PD4					
PD5					
PD6					
Default1					
Default2					

[xxi] In all instances, the Basel definition of default is to be employed. Default rate = the ratio of the number of borrowers who defaulted during the year to the number of borrowers at the beginning of the year. Realised default rates enable the market to assess the validity of PD estimates as a basis for asset quality disclosure.

[xxii] The aim of these disclosures is to enable assessment of the actual loss incurred in the event of default compared to the bank's own LGD estimates. As the timing of recoveries is uncertain, it may take some time for losses to be fully worked out. For this reason data is required over 3 years, including the current year. The % LGD is based on the estimated final value of recoveries for all complete and incomplete workouts, where estimates are included for those exposures not yet fully worked out. All recoveries are measured taking into account the time value of money and the costs of workout. This disclosure may be presented using template 2:

Template 2: LGD Outcomes for advanced banks - corporate, bank, and sovereign combined

Corporate, Bank, Sovereign Combined LGD Band	(i) Exposure	(ii) %LGD – based on estimated final value of recoveries, year t_0	(iii) %LGD – based on estimated final value of recoveries, year t_{-1}	(iv) %LGD – based on estimated final value of recoveries, year t_{-2}
Band 1				
Band 2				
Band 3				

[xxiii] The commitment breakdown is at the discretion of the bank and is expected to be representative of the banks' use of commitments. The percentage EAD estimate at the reporting date is compared with the percentage average EAD on defaulted loans during the year (i.e. a comparison of ex ante assessments and ex post outcomes). The percentage average EAD on defaulted loans is calculated as the percentage of undrawn

facilities at the start of the year, that were actually drawn at the time of default (i.e. total drawn at time of default – drawn at start of the year/ total undrawn at the start of the year). The EAD category should be that used internally by the bank, which may be commitment type or another classification. This disclosure may be presented using template 3:

Template 3: Exposure at default (EAD) for advanced banks - corporate, bank, and sovereign together

By EAD category	(i) Amount of undrawn, but committed, exposures on reporting date	(ii) EAD Estimates (%)	(iii) Average EAD on defaulted loans during the year (%)
Total			

xxiv For retail portfolios, banks can use either EL bands or PD bands. Where banks are using PD*LGD then the corresponding EL should be slotted into the relevant EL band.

xxv This is measured as drawn plus a measure of undrawn, unless a bank chooses to reflect the possibility of further drawn in its LGD estimates.

xxvi The item collateral and the RWA before and after the effects of CRMT will not be applied to banks using the advanced IRB approach, as this information is assessed through the components of the IRB calculation and adequately covered in the IRB disclosures

xxvii The quantitative requirements can be presented in Template 4:

Template 4: Mitigation effects on exposure and regulatory capital (items marked † do not apply to advanced IRB banks)

	Exposure/RWA
Total Exposure	
Amount of exposure secured by on-balance sheet netting contracts	
Amount of exposure covered by collateral†	
Amount of exposure covered by guarantees/credit derivatives	
Risk weighted assets before the effect of all recognised credit risk mitigation†	
Risk weighted assets after the effect of all recognised credit risk mitigation†	

xxviii Operational risk is defined as: the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.