Supervisory disclosure under Pillar 3 of Basel II

Comprehensive and timely transparency about all relevant activities of financial market participants is a fundamental precondition for ensuring that the financial markets can function properly. As supervisory disclosure under Pillar 3 of Basel II was first implemented in the 2008 financial year, it was unable to exert any market-disciplining effects either in the run-up to or during the outbreak of the crisis. It therefore comes as no surprise that the G20 countries placed the focus of their crisis resolution measures on disclosure as well. In addition, with the entry into force of Basel II with effect from 2008, supervisors now also need to oversee compliance with the new Pillar 3 disclosure requirements.

A representative analysis of Pillar 3 disclosure reports shows that, although most institutions are largely compliant with the new prudential requirements, in individual cases there is still room for improvement. One desirable improvement – even though the Basel Committee on Banking Supervision expressly avoided mandating a specific disclosure format – would be greater synchronicity in the form of information disclosure. Although the non-binding formats developed nationally are, in principle, suited to enhancing comparability of information, institutions and individual groups of institutions are using these application examples differently. Supervisors' efforts to achieve greater convergence in reporting practices are also an outgrowth of European activities; in that vein, the Committee of European Banking Supervisors (CEBS), identified certain "best practices" for adequate Pillar 3 disclosures in a cross-country comparison of disclosure reports. The Bundesbank believes that the only way for improvement will ultimately lie in making certain formats for the disclosure of quantitative information mandatory; institutions would then add the required qualitative annotations.

The provision of data also has room for efficiency gains. Institutions should comply with Pillar 3 disclosure requirements by structuring their data warehouses so as to create a one-stop technical platform which can meet the various reporting requirements for accounting, capital market regulation and prudential supervisory purposes. This provides an opportunity to convey information clearly and consistently. The informational value of Pillar 3 risk data can also be enhanced by ensuring that they are largely consistent with the contents of internal risk reports.

Disclosure as a new prudential requirement

Basel pronouncements on disclosure

The third pillar of the revised capital framework published on 26 June 2004 by the Basel Committee on Banking Supervision (BCBS) codified supervisory disclosure requirements for institutions and groups of institutions for the first time.[1] They are consistent with the idea of using market mechanisms as a complement to traditional banking supervision, which were already laid out in a very general form by the Basel Committee in September 1997 in its "Core Principles".[2] These principles identify the disclosure of meaningful, comprehensive, timely and accurate information permitting third parties to assess an institution's risk as a key feature of effective banking supervision. Market actors need this information so that market forces can exert discipline and stable and efficient financial markets can be promoted.

Supervisory disclosure requirements are geared to the provision of information on risks incurred (counterparty credit risk, market risk and operational risk) and institutions' risk-bearing capacity (the structure and adequacy of their own funds).

Disclosure requirements for external accounting purposes

Such aspects have also made inroads into external accounting. The binding international accounting standards[3] under which publicly traded companies in the EU are required to prepare consolidated financial statements also provide for the disclosure of information on the firm-specific risk situation so that investors can examine expected future profit, the feature at the centre of their interest, from a risk-oriented perspective. Consequently, IFRS 7 "Financial Instruments: Disclosures", which is particularly significant for banks owing to their business structure, requires the disclosure of information on the significance of financial instruments for the entity and on the nature and extent of the associated risks, such as credit risk, liquidity risk and market risk. Similar provisions can be found in the German Accounting Standard (*Deutscher Rechnungslegungs Standard* (DRS)) 5-10, "Risk Reporting by Financial Companies",[4] which was adopted by the German accounting standards setter Deutsches Rechnungslegungs Standards Committee e.V. (DRSC) in August 2000 and which served as a blueprint for the development of IFRS 7.[5]

Compatibility and differences

Supervisory disclosure requirements are fundamentally consistent with those for external accounting purposes. Supervisory disclosures of information on risk incurred should therefore also automatically largely meet external

1 On 4 July 2006, the BCBS issued a comprehensive version of the new capital framework containing the June 2004 Basel II Framework, the 1996 Amendment to the Capital Accord to Incorporate Market Risks, and the paper on the Application of Basel II to Trading Activities and the Treatment of Double Default Effects.
2 Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, September 1997, Disclosure. In October 2006, the Basel Committee published a revised version of its "Core Principles". Much like its predecessor, Principle 22 of the current version calls for regular publication of reports based on internationally accepted accounting standards that fairly reflect the institution's financial condition and profitability. This principle is also fleshed out by the "Core Principles Methodology" of October 2006.
3 OJ EU L 243, 11 September 2002, p 1.
4 Since January 2010, risk reporting with regard to the use of financial instruments has been governed by DRS 15.
5 See Deutsche Bundesbank, New transparency rules for credit institutions, Monthly Report, October 2005, pp 69-83.

accounting requirements. By contrast, disclosure under IFRS 7 or DRS 5-10 does not automatically meet supervisory requirements as the latter are more detailed and refer to internationally harmonised supervisory practices when defining the information to be disclosed. Both regulatory systems are oriented to internal management systems which, in the case of banks, are characterised by the Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement,* or MaRisk).[6] The idea is thus to be able to use a single, consistent pool of data.

Management approach

Moreover, putting the various risk reporting requirements on a consistent conceptual basis ensures, not least in the interest of consistent capital market communication, that internal and external corporate communication are in harmony with one another (management approach).

Transposition into national law in the German Banking Act

General requirements

The fundamental provisions governing disclosure are contained in section 26a of the German Banking Act (*Kreditwesengesetz*). This section was inserted in early 2007 with binding effect from the 2008 financial year. It transposes Chapter 5 (Disclosure by credit institutions) of the recast Directive 2006/48/EC (hereinafter referred to as the Banking Directive) into national law. Section 26a of the German Banking Act contains a general requirement that quantitative and qualitative information on capital, risk and risk management methods be disclosed regularly. It additionally requires credit institutions to draw up an internal policy for compliance with disclosure requirements, such as a "disclosure manual", including regular verification of disclosure practice.

Limits of disclosure

Where they have a legitimate interest in non-disclosure, institutions may be exempted from the requirement to disclose certain information. Legitimate interest of institutions may be constituted by those cases where the information is immaterial, protected by law or confidential. In cases of information that is protected by law or is confidential, the interest of the recipients in the disclosure of this information is subordinated to that of the institutions. Single entities within a group are also generally not subject to disclosure requirements. Only major subsidiaries are required to disclose their tier 1 and overall capital ratios.

Prudential supervisory sanctions

Compliance with disclosure requirements is monitored by banking supervisors. The Deutsche Bundesbank's Regional Offices represent the first link in the monitoring chain. If an institution fails to meet its disclosure requirements properly, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht,* or BaFin) may issue an order requiring disclosure. If this order is wilfully or negligently disregarded, this constitutes an administrative offence which is punishable by a fine of up to €150,000.

6 Bundesanstalt für Finanzdienstleistungsaufsicht, Mindestanforderungen an das Risikomanagement, RS 15/2009 (BA), 14 August 2009.

Disclosure provisions in the Banking Act

- Regular disclosure of qualitative and quantitative information on capital, risk and risk management procedures (section 26a (1) sentence 1 of the Banking Act)
- Existence of formal procedures and rules for compliance with disclosure requirements (section 26a (1) sentence 1 of the Banking Act)
- Regular review of the appropriateness and usefulness of disclosure (section 26a (1) sentence 2 of the Banking Act)
- Waiver of disclosure for immaterial, legally protected or confidential information (section 26a (2) of the Banking Act)
- Group disclosure at the highest consolidation level only (section 26a (4) of the Banking Act)
- Possibility of prudential sanctions with fines up to €150,000 (section 26a (3) in conjunction with section 56 (3) number 5 and (5) of the Banking Act)
- Formal compliance subject to audits and inspection (section 29 (1) sentence 2 of the Banking Act in conjunction with section 18 of the Audit Report Regulation)

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Audit requirement

Compliance with section 26a of the German Banking Act must be formally audited by the auditor of the annual accounts. Pursuant to the specific provisions of section 18 of the Audit Report Regulation (*Prüfungsberichtsverordnung,* or PrüfbV), the external auditor is required to assess the adequacy of the processes for obtaining and disclosing information. The auditor is also required to explicitly state in the audit report whether or not the institution is in compliance with the disclosure requirements.

Concretisation by means of the Solvency Regulation

General provisions

The fundamental statutory provisions on disclosure are concretised in Part 5 of the Solvency Regulation (*Solvabilitätsverordnung,* or SolvV). The part on disclosure spans sections 319 to 337 and is divided into three chapters. Chapter 1 contains fundamental provisions on the scope of application (section 319), the disclosure medium (section 320) and the disclosure frequency (section 321).

Content of disclosures

Chapter 2 contains general requirements regarding the information to be disclosed (sections 322 to 334). Mandatory disclosures usually include qualitative and quantitative information on own funds and the risk situation. Disclosures on own funds include the structure of own funds and capital adequacy. With regard to risk management, disclosures for each risk category should include the aim and methodology of risk management, along with its organisational structure, hedging strategies, and internal reporting lines and control functions. All these guidelines are intended to help understand and structure the quantitative information.

Supplementary information

Chapter 3 contains additional information requirements for disclosure when institutions use particular procedures or instruments recognised by supervisors (sections 335 to 337). They apply to institutions that use internal ratings-based (IRB) approaches to measure counterparty credit risk, comprehensive credit risk mitigation techniques to reduce risk or advanced measurement approaches (AMA) to calculate operational risk.

International enhancements and monitoring of disclosure requirements

When the financial crisis broke out in 2007, the rules on Pillar 3 disclosures had, for all practical purposes, not yet taken effect throughout the world. It also turned out that the disclosure requirements, especially those on securitisations, were not sufficiently specific to comprehensively and completely identify the transactions that triggered the financial crisis. That is also true of the disclosure requirements contained in international accounting standards. The lack of transparency, for its part, fostered an atmosphere of mutual distrust among market participants, causing the interbank market, which is vital for institutions' wholesale funding, to more or less grind to a halt. That, in turn, exacerbated the crisis.

Financial Stability Forum

Therefore, the Financial Stability Forum (FSF),[7] in its April 2008 report to the G7 finance ministers and central bank governors, identified enhanced transparency, especially in the area of securitisations, as a key precondition for restoring confidence among market participants and thus also for strengthening the resilience of the global financial system.[8]

Additional disclosure recommendations

The immediate response was to call on the institutions concerned to present meaningful disclosures of their on-balance sheet and off-balance sheet risks of particular relevance to the financial market crisis, beginning with the mid-year 2008 reports. With regard to the specific framing of this disclosure requirement, the FSF referred to the disclosure practices identified by the Senior Supervisors Group.[9]

The FSF regards its disclosure recommendations as a complement to, rather than as a substitute for, existing disclosure requirements for risk information, including the requirements under Pillar 3 of Basel II. They should be followed for financial reporting until the Basel Committee's enhancements to Pillar 3 have entered into force.

Recommendations of the Financial Stability Forum regarding disclosure

The FSF issued a total of three disclosure recommendations.

- FSF recommendation III.1 is directly addressed to institutions with immediate effect. It strongly encourages – beginning with the mid-year 2008 reports – robust disclosure of risk information in accordance with leading disclosure practices.
- FSF recommendation III.2 calls on investors, financial industry representatives and auditors, in the medium term, to work together towards improving disclosure practices. Principles for useful disclosures are to be developed to this end. In addition, the aforementioned groups should meet semi-annually to discuss the main risks to the financial sector and identify the most relevant and useful types of disclosure.
- FSF recommendation III.3 is addressed to supervisors and calls on the Basel Committee on Banking Supervision to strengthen Pillar 3 disclosure requirements likewise over the medium term for a predefined list of issues.

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7 At the G20 summit in London on 2 April 2009, the Financial Stability Board (FSB) was established as a successor to the FSF with an extended membership and mandate.
8 Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience, 7 April 2008.
9 Senior Supervisors Group, Leading-Practice Disclosures for Selected Exposures, 11 April 2008.

Thematic peer review

The FSB attaches great importance to the strict implementation of the FSF disclosure recommendations. It has therefore launched an institutionalised control procedure, known as a "thematic peer review", to obtain feedback on implementation by major financial institutions across the globe. The focus of the analysis is on risk disclosures relating to securitisation exposures. Specific information being requested covers special purpose entities (SPEs), collateralised debt obligations (CDOs), other subprime and Alt-A exposures, commercial mortgage-backed securities (CMBS) and leveraged finance. The eight institutions for Germany relevant for these business activities and included in the survey make up 58% of the national market in terms of the balance sheet total in 2009.

There is a wide variety of forms in which this information is disclosed. The information is disclosed both in the annual financial statement and in Pillar 3 reports. In addition, some institutions publish a separate FSB report. In terms of content, the key aspects are largely covered by all institutions. The FSB assessment requirements, however, are broken down to a high degree of detail. Some of the sub-items in the template are disclosed by only a very few surveyed institutions. However, this appears appropriate given the institutions' focus on issues of particular relevance.

CEBS

The Committee of European Banking Supervisors (CEBS), which entered into existence as an institution in 2004, has likewise been increasingly concerning itself with disclosure-related issues since the outbreak of the financial crisis. At the request of the Economic and Financial Affairs Council of the European Union (Ecofin Council), CEBS has published several papers examining the disclosure practices of European credit institutions in their financial reporting.[10]

Analysis of annual financial statements

An initial analysis identified, for European banks, "good practices for disclosures" based on 2007 annual financial statements. Although these practices are largely consistent with the FSF's disclosure recommendations, CEBS's observed good practices also include disclosures of the business model and on the balance-sheet treatment and valuation of the relevant exposures.

The recent evaluation of the 2009 financial statements indicates that the CEBS disclosure recommendations have been incorporated to a significant degree into the financial reporting practices of European credit institutions. This applies particularly to disclosures of the business model, risk management and business involvement in subprime mortgage activities. However, fair value accounting, the reclassification of financial instruments, the formation of provisions and the derecognition of exposures all contain room for improvement.

10 CEBS report on banks' transparency on activities and products affected by the recent market turmoil (18 June 2008); Follow-up review of banks' transparency in 2008 half year results (9 October 2008); Follow-up review of banks' transparency in their 2008 4th quarter and preliminary year-end results (24 March 2009); Follow-up review of banks´ transparency in their 2008 audited annual reports (24 June 2009); Follow-up review of banks' transparency in their 2009 audited annual reports (30 June 2010).

Analysis of Pillar 3 disclosure

Moreover, CEBS also analyses, at European level, supervisory disclosure practices.[11] The entry into force of Pillar 3 in the EU with effect from the 2008 financial year led to two comparative studies. The first such study likewise identified "CEBS best practices". The analysis for the 2009 financial year showed that institutions are taking these recommendations seriously, especially regarding disclosures of economic capital calculation, counterparty credit risk and operational risk. By contrast, there appears to be a need for improvement in disclosures of the composition of own funds, backtesting results for credit risk and the use of credit risk mitigation techniques and credit derivatives.

Strictly speaking, the guidelines and advice issued by CEBS are not formally binding. However, the publication of the results of the studies gives the CEBS recommendations an informal binding impact on institutions that should not be taken lightly.

Development of disclosure requirements

Adequate risk disclosures, especially in times of crisis, cannot be obtained by compulsory hard-and-fast disclosure rules. The causes of financial crises are different every time. Moreover, developing formal rules requires a certain lead-time, which means that they cannot be invoked for timely first-time disclosures. It would appear more appropriate, by contrast, to sensitise market participants to the importance of situation-specific adequate disclosure of up-to-date risk information. Based on this insight, CEBS additionally developed general requirements for adequate risk disclosures.[12]

European banking industry

The European banking industry is likewise interested in a certain convergence of disclosure activities. Negotiations on this issue have been conducted under the auspices of the European Banking Federation (EBF). Although the original goal of harmonising all Pillar 3 disclosure practices could not be achieved, four European banking associations (European Banking Federation, Association for Financial Markets in Europe, European Savings Bank Group and European Association of Public Banks and Funding Agencies) reached an agreement on good practice guidelines for quantitative and qualitative securitisation disclosures.[13]

National monitoring procedures

Implementation of the FSF recommendations

The national supervisory agencies have, from the very beginning, attached great importance to the proper implementation of the FSF disclosure recommendations. Regular evaluation of annual reports has shown that German institutions have complied with the spirit of the additional disclosure requirements in the wake of the financial crisis. Isolated cases show room for improvement in how the disclosures are presented.

Compliance with Pillar 3

Compliance with the Pillar 3 disclosure requirements in 2009 was assessed by analysing a sample of 14 publicly traded institutions which represent more than 70% of the total

11 CEBS, Assessment of banks' pillar 3 disclosures (24 June 2009); CEBS, Follow-up review of banks' transparency in their 2009 pillar 3 reports (30 June 2010).
12 CEBS, Principles for disclosures in times of stress – Lessons learned from the financial crisis (April 2010).
13 EBF, Industry good practice guidelines on pillar 3 disclosure requirements for securitisation (January 2010).

assets of the German banking industry. Disclosure reports were analysed using the criteria applied at European level. The results of the analysis showed that, overall, Pillar 3 of Basel II is being adequately complied with and that compliance is on a par with the rest of Europe.

All of the analysed institutions publish separate Pillar 3 disclosure reports on their websites; eight institutions also cross-reference information from their risk reports. In individual cases, however, clearer reference to the source would be desirable. The superiority of full supervisory disclosure in a separate report is also demonstrated by a comparison with practices in other European countries.

Disclosures should be made as soon as practicable in the light of the availability of data and roughly at the same time as the publication of the annual accounts. However, the flexibility granted with regard to the time of disclosure has been exploited by some institutions – also by comparison with practices elsewhere in Europe – in a manner unacceptable to supervisors. The "Guidelines for assessing compliance with disclosure requirements pursuant to section 26a of the German Banking Act" (*Leitlinien zur Bewertung der Erfüllung der Offenlegungsanforderungen nach § 26a KWG*) therefore require publication within four weeks after approval of the annual accounts.

Basel II mandates the semi-annual disclosure of information under Pillar 3, whereas the EU directive settles for annual disclosure. As it is the EU directive that is transposed into national law, it is the annual disclosure frequency that applies to German institutions. Four of the banks in the study have additionally voluntarily published a mid-year Pillar 3 report. Should this practice take root internationally, German institutions will be all but compelled to follow suit.

Methods of presenting the individual areas of disclosure have undergone a harmonisation of sorts. The use cases developed by the expert panel on disclosure requirements, composed of supervisors and financial industry representatives, have certainly played a role in this. This development is to be assessed positively, not least as it renders disclosures comparable, which is important to market participants.

The disclosed information is not subject to a mandatory external audit. Instead, it is up to the institution itself to verify the disclosed information and the full disclosure thereof. Although the formal procedures and rules for integrating disclosure requirements into the bank's internal control systems are themselves not disclosed, explicit details on the existence of a formal disclosure policy are expected – in the European context as well. Only three of the surveyed institutions commented on this issue.

The requirements for disclosures on own funds (own funds structure and capital adequacy) are adequately met by just over three-quarters of the institutions. In isolated cases, the qualitative presentation of the key features of capital components and the description of economic capital are too general.

Guidelines for assessing compliance with disclosure requirements

General guidelines

- Supervisors must object to the full waiver of disclosure under section 26a of the Banking Act for reasons of materiality.

- If key information that is fundamentally required to be disclosed is not disclosed, or not disclosed completely, supervisors must object unless the institution provides plausible and understandable reasons for non-disclosure of this information. In order to make disclosures uniquely assignable, institutions, if in doubt, should indicate the immateriality of disclosure requirements by explicitly stating "nil report".

- Errors found in the disclosure report are to be rectified.

Reference to section 26a (2) of the Banking Act

- Plausible and objectively understandable reasons must be given for non-disclosure if materiality and confidentiality are cited. The following reasons are insufficient.

  - Reference to the cross-offsetting option permitted pursuant to section 340f (3) and (4) of the German Commercial Code.

  - Reference to a hierarchy of rules, eg in connection with section 340f of the German Commercial Code.

  - Sole reference to exceptions from disclosure requirements under section 26a (2) of the German Banking Act; or

  - General reference to a potential weakening of competitiveness.

Publication

- Supervisors must object to any failure to comply with section 320 (2) of the Solvency Regulation requiring confirmation of publication in the electronic version of the Federal Gazette and the associated notification of supervisors.

- Information to be disclosed pursuant to Part 5 of the Solvency Regulation is to be published not later than four weeks after approval of the annual accounts.

- The disclosure report must be available until the next disclosure report has been published.

- If, in order to comply with disclosure requirements, an institution makes use of the option to refer to other disclosure media pursuant to section 320 (1) sentence 2 of the Solvency Regulation, these references must embrace and ensure clear access to the relevant information.

- Electronic access to the information pursuant to Part 5 of the Solvency Regulation must not be impeded by requiring prior registration by name.

- It must be ensured that an electronically available disclosure report can be printed out.

Specific guidelines

- Key definitions of terms such as "past due" and "impaired" (section 327 (1) number 1 of the Solvency Regulation) have to be requested.

- The description of risk management pursuant to section 322 of the Solvency Regulation may be waived only if reference is made to comparable disclosure elsewhere.

- Supervisors must object to the complete non-disclosure of information about the terms and conditions of the main features of all own funds items pursuant to section 324 (1) of the Solvency Regulation. The relevant information has to be released particularly with respect to hybrid tier 1 capital instruments.

- For regionally active institutions, a geographical breakdown of exposures into "Germany", "EU" and "Other" will generally be sufficient to meet the disclosure requirements pursuant to section 327 (2) number 2 of the Solvency Regulation (geographical distribution of exposures).

- Regarding the disclosure of exposures broken down by industry or counterparty type pursuant to section 327 (2) number 3 of the Solvency Regulation, a breakdown by industry is expected; it is not enough to classify counterparties as "individuals" and "corporates".

- Information on risk provisioning pursuant to section 327 (2) numbers 5 and 6 of the Solvency Regulation must be disclosed.

- If equities in the banking book are disclosed pursuant to section 332 (2) of the Solvency Regulation only at balance-sheet values, plausible and objectively understandable reasons for the non-disclosure of their present value or listed market price must be presented.

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Whereas most disclosure requirements are oriented to the relevant rules under Pillar 1, the general information on credit risk tends to be more closely related to accounting practices. Both the qualitative disclosures in this area and the quantitative breakdown of lending according to various criteria (eg geographical dispersion, business line, residual maturity, risk provisioning) are fully met by nearly all institutions. Although the study shows that, on an overall average, disclosure requirements for counterparty credit risk when using the IRB approach are being satisfactorily met, most institutions are still showing room for improvement in describing the internal rating process and also with regard to quantitative presentation. Up to and including 2008, the minimum requirement is a backtesting comparison of the bank's own estimated loss with actual losses over one period. From year-end 2009 onwards, disclosed backtesting results have to cover a longer period.

Banking supervisors will in future also continue to monitor compliance with the letter and the spirit of the Pillar 3 disclosure requirements. If individual details are not disclosed owing to their immateriality, banks will be required to enter an explicit "nil report" in cases of doubt.

Guidelines for disclosure

Institutions that are not publicly traded or which operate primarily regionally or locally are particularly likely to have questions concerning the proper application of Pillar 3. Although the vast majority of these institutions comply with Pillar 3 disclosure requirements to the proper extent and in the proper form, a relatively small number of institutions still have some problems regarding interpretation. In individual cases, institutions refuse to submit any disclosure at all, citing immateriality. In some cases, confidentiality is invoked as a reason for disclosing only part of the necessary information on risk. In the light of these deficiencies, supervisors have drawn up concrete good practices for disclosure, intended to be a yardstick for the internal review of sufficient disclosure by the Deutsche Bundesbank's regional offices. However, they are also designed to function as a starting point for any additional measures that supervisors may need to take.

Upcoming changes

Basel

The packages of regulatory measures tackled by the Basel Committee on Banking Supervision upon a recommendation by the FSF in response to the subprime crisis also deal with disclosure aspects. The three papers published in July 2009 contain changes to the Basel II framework, especially in the areas of securitisation and market risk rules ("enhancement project"). One of the outcomes is a significant extension of disclosure requirements for securitisation exposures in the trading book, the sponsorship of securitisation vehicles, resecuritisation exposures in the banking book, market valuation of securitisation exposures and pipeline and warehousing risk in connection with securitisation exposures. Another is that, in future, institutions using internal market price risk models will be required to disclose the "stress value at risk",

Enhancement project

"incremental risk charge" and "comprehensive risk measure".

Resilience project

Two papers – on enhancing the resilience of the banking industry and on regulating liquidity risk (the "resilience project") – additionally submitted for consultation in December 2009 as part of a medium-term revision and extension of the Basel supervisory approach likewise address the topic of disclosure. In future, detailed descriptions of the regulatory capital to be redefined and of the matching of regulatory capital with balance sheet capital will be required. In addition, institutions will also need to disclose the leverage ratio, which they will have to additionally calculate, as well as its components. Moreover, the proposals for the regulatory monitoring of liquidity risk provide for qualitative and quantitative disclosures of the short-term liquidity coverage ratio and the medium-term net stable funding ratio.

Remuneration project

It is additionally becoming apparent that the compensation rules[14] being advocated by the FSB, especially regarding members of staff whose activities have a major bearing on a bank's overall risk profile, should also be incorporated into Pillar 3 in future. At present, the requirements for disclosing compensation to supervisors and other parties with a legitimate interest are still governed by Pillar 2. As a result of the global review of the implementation of compensation rules as part of a "Thematic Peer Review on Compensation",[15] the FSB has suggested that this disclosure requirement be incorporated into Pillar 3 in future. This is ultimately expected to give teeth to the new regulatory measure.

European Union

The adoption of the multiple Basel activities in the European Union will proceed in several stages. In September 2009, the member states and the European Parliament ratified a directive amending the Capital Requirements Directive (CRD),[16] which contains *inter alia* stricter disclosure requirements for hybrid capital instruments, improvements in market risk disclosures and supplemental provisions for the disclosure of operational risk. Moreover, the Commission's directive[17] containing technical amendments to the CRD has been adopted. An additional Commission directive made technical amendments to the Capital Adequacy Directive (CAD).[18] These three amending directives are referred to collectively as CRD II. Nearing completion is the adoption of a further amending directive (CRD III) which addresses the disclosure of risks connected with the trading book, securitisation exposures in the trading book and incentive-based remuneration policies. The adoption of the Basel resilience project will be followed, lastly, by a further amending directive (CRD IV) which will legislate the EU-wide introduc-

14 FSF Principles for Sound Compensation Practices of 2 April 2009 and FSB Principles for Sound Compensation Practices – Implementation Standards of 25 September 2009.
15 FSB, Banking compensation reform – Summary report of progress and challenges commissioned by the Financial Stability Board (March 2010).
16 Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management.
17 Commission Directive 2009/83/EC of 27 July 2009 amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management.
18 Commission Directive 2009/27/EC of 7 April 2009 amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provisions concerning risk management.

Overview of the new disclosure rules

Basel

July 2009: Enhancements to the Basel II framework

Securitisation:

- Securitisation exposures in the trading book
- Sponsorship of off-balance sheet special purpose entities
- Resecuritisation exposures in the banking book
- Valuation of securitisation exposures
- Pipeline and warehousing risks with regard to securitisation exposures

July 2009: Revisions to the Basel II market risk framework

July 2009: Guidelines for computing capital for incremental risk in the trading book

Market price risk:

Qualitative and quantitative information on the stressed VaR, incremental risk charge and comprehensive risk measure

December 2009: Consultative Document – Strengthening the resilience of the banking sector

- Detailed description of regulatory capital
- Comparison of regulatory capital and balance-sheet capital
- Disclosure of the leverage ratio and its components

December 2009: Consultative Document – International framework for liquidity risk measurement, standards and monitoring

Liquidity risk: qualitative and quantitative information on the short-term liquidity coverage ratio and the medium-term net stable funding ratio

July 2010: Draft Document Basel SIGR – Pillar 3 disclosure requirements for remuneration

Disclosure of remuneration arrangements, especially for members of staff whose activities have a major influence on a bank's overall risk profile

EU

Dir 2009/27/EC of 7 April 2009
Dir 2009/83/EC of 27 July 2009
Dir 2009/111/EC of
16 September 2009 (CRD II)

- Quality of own funds (hybrid capital instruments)
- Market risk and operational risk

Proposal for a directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC (CRD III) – July 2009

- Market price risk
- Securitisations
- Remuneration policies

Consultation paper – Revision of the Capital Requirements Directive (CRD IV) – consultation period expired in April 2010

- Calculation of own funds ratio
- Own funds components
- Leverage ratio
- Liquidity ratios

National law

- **Banking Act *(Kreditwesengesetz)***
- Regulation governing the capital adequacy of institutions, groups of institutions and financial holding groups, also known as the Solvency Regulation *(Verordnung über die angemessene Eigenmittelausstattung von Instituten, Institutsgruppen und Finanzholding-Gruppen (SolvV))*
- Regulation governing supervisory requirements for remuneration systems of institutions *(Verordnung über die aufsichtsrechtlichen Anforderungen an Vergütungssysteme von Instituten (Instituts-Vergütungsverordnung: InstitutsVergV))*

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tion of disclosure requirements arising from the regulation of liquidity risk, the redefinition of regulatory own funds and the implementation of a leverage ratio.

National changes

The additional disclosure requirements will be transposed into national law quickly and likewise in stages. The deadline for transposing CRD II into the Banking Act and Solvency Regulation is 31 October 2010. Two steps for implementing CRD III are envisaged. In the short term, the disclosure requirements for remuneration policies should be transposed in the Regulation Governing Remuneration at Institutions (*Instituts-Vergütungsverordnung*); the latest deadline for the national transposition and entry into force of all other disclosure requirements contained in CRD III is 31 December 2011. The time schedule for transposing the disclosure requirements arising from CRD IV into national law, by contrast, has not yet been decided.