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Pillar 3 of the CRD - Disclosure requirements

The third Pillar of the CRD sets out the disclosure requirements for all firms. This report will outline what firms are required to disclose and in how much depth and detail this disclosure needs to be.

Scope

These rules are relevant to all BIPRU firms.

In order to meet their disclosure requirements, firms must disclose the relevant information below at least annually and, in general, as soon as possible. Firms should also consider if disclosure should take place more regularly. Disclosure can take place in any appropriate medium, if possible via one medium located in the same place. Equivalent disclosures made by a firm under accounting, listing or other requirements may be deemed to constitute compliance. If disclosures are not included in the financial statements, a firm must indicate where they can be found.

Exemptions

1. A firm may omit information not deemed to be 'material'. Information is material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

2. Information may also not be included if it is regarded as 'proprietary' or 'confidential'.

- A firm must regard information as proprietary information if sharing that information with the public would undermine its competitive position.
- Proprietary information may include information on products or systems which, if shared with competitors, would render a firm's investments less valuable.
- A firm must regard information as confidential if there are obligations to customers or other counterparty relationships binding the firm to confidentiality.

If any of the above exemptions are used then the firm must disclose in general what information they are not detailing, the reason for non-disclosure and publish as much general information on the area as possible.

List of areas for disclosure

The key disclosure areas are set out in more detail below with references to the original BIPRU text.

1. Risk management objectives and policies.
2. Scope of application of directive requirements.
3. Capital resources.
4. Compliance with BIPRU 3, 4, 6, 7, 10 and the overall pillar 2 Rule.
5. Credit Risk and dilution risk.
6. Firms calculating risk weighted exposure amounts in accordance with the standardised approach.
7. Firms calculating risk weighted exposure amounts using the IRB approach.
8. Market Risk.
9. Use of a Value at Risk (VaR) model for calculation of market risk capital requirement.
10. Operational risk.
11. Non trading book exposures in equities.
12. Exposures to interest rate risk in the non trading book.
13. Securitisation.

Risk management Objectives and Policies

A firm must disclose its risk management objectives and policies for each separate category of risk. It needs to disclose four things:

1. The strategies and procedures in place in order to manage these risks.
2. The structure and organisation of the relevant risk management function, or other appropriate arrangements.
3. The scope and nature of risk reporting and measurement systems; and
4. The policies in place for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants.

Scope of application of directive requirements

The Banking consolidation Directive requires firms to disclose:

1. The name of the firm.
2. An outline of the differences in the basis of consolidation for accounting and prudential resources. This must include a brief description of the entities that are fully consolidated, properly consolidated, deducted from capital resources and neither consolidated nor deducted.
3. Anything material, practical or legal that may prevent the quick transfer of capital resources or repayment of liabilities among the present undertaking and its subsidiary undertakings.
4. Where subsidiary undertakings are not included in the consolidation, the firm must disclose the amount the capital resources are less than the required minimum. The firm must also provide the names of any of these subsidiary undertakings.
5. Where it applies, what the circumstance is for making use of the provisions found in BIPRU 2.1 concerning Solo consolidation.

Capital resources

A firm must disclose

1. A summary of the terms and conditions of the main features of all capital resources items and their components.
2. Tier one capital resources, minus any innovative (see below) tier one capital resources, with separate disclosure of all positive items and deductions.
3. The total amount of tier two capital resources plus any innovative tier one capital resources and tier three capital resources.
4. Deductions from tier one capital resources and tier two capital resources (disclose separately items referred to in GENPRU 2.2.236 R).
5. Total capital resources (not including deductions in GENPRU 2.2 and limits laid down in GENPRU 2.2.25 to GENPRU 2.2.30 R and GENPRU 2.2.42 R to GENPRU 2.2.50 R).

'Innovative tier one capital resources' in this in stance refers to the amount of capital resources calculated at stage C of the capital resources table. See the link below for the capital resources table for firms deducting material holdings.

http://fsahandbook.info/FSA/html/handbook/GENPRU/2/Annex4

Compliance with BIPRU 3, 4, 6, 7, 10 and the overall pillar 2 rule

BIPRU 11.5.4
A firm must disclose

1. A summary of the firm's approach to assessing the adequacy of its internal capital to support current and future activities.
2. 8% of the risk weighted exposure amounts for each of the standardised credit risk exposure classes, where a firm calculates risk weighted exposure in accordance with the standardised approach to credit risk.
3. 8% of the risk weighted exposure amounts for each of the IRB exposure classes, where a firm calculates risk weighted exposure amounts in accordance with the IRB approach.
4. In respect of its trading-book business, the firm's minimum capital requirements for the interest rate PRR, equity PRR, Option PRR, Collective Investment schemes PRR, Counterparty risk capital component, concentration risk capital component.
5. In respect of all of its business activities, the firm's minimum capital requirements for commodity PRR and foreign currency PRR.
6. Its operational risk capital requirement calculated in accordance with the basic indicator approach, the standardised approach and the advanced measurement approach and disclosed separately.

For retail exposures, the requirement under BIPRU 11.5.4R (3) applies to each of the following categories:

1. Exposures to retail SMEs.
2. Retail exposures secured by real estate collateral.
3. Qualifying revolving exposures.
4. Other retail exposures.

For equity exposures, the requirement under BIPRU 11.5.4R applies to:

1. Each of the approaches provided for in BIPRU 4.7.5, 4.7.6, 4.7.9, 4.7.11, 4.7.14, 4.7.16, 4.7.24, and 4.7.25.
2. Exchange traded exposures, private equity exposures in sufficiently diversified portfolios and other exposures.
3. Exposures subject to supervisory transition regarding capital requirements.
4. Exposures subject to grandfathering provisions regarding capital requirements.

Exposure in this case relates to the maximum loss which the firm might suffer if a counterparty or a group of connected counterparties fail to meet their obligations, or it realises assets or off-balance sheet positions.

Regarding its exposure to counterparty credit risk, a firm must disclose the following information:

1. A discussion of the methodology used to assign internal capital and credit limits for counterparty credit exposures.
2. A discussion of policies for securing collateral and establishing credit reserves.
3. A discussion of policies with respect to wrong way risk exposures.
4. A discussion of the impact of the amount of collateral the firm would have to provide given a downgrade in its credit rating.
5. The total positive fair value of
    - contracts,
    - netting benefits,
    - netted current credit exposure,
    - collateral held and
    - 'net derivatives credit exposure', where this is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements.
6. Measures for exposure value under either
    - the CCR mark to market method,
    - the CCR standardised method, or
    - The CCR internal model method.
7. The notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure.
8. Notional credit derivative transactions, segregated between use for the firm's own credit portfolio, as well as in intermediation activities, including the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group.
9. The estimate of alpha if the firm's CCR internal model method permission permits it to estimate this. The CCR internal model method permission is an Article 129 implementing measure, Article 129 permission, a requirement or a waiver that requires a BIPRU firm or an institution to use the CCR internal model method.

Credit risk and dilution risk

A firm must disclose the following information:

1. The definitions for accounting purposes of past due and impaired.
2. A description of the approaches and methods adopted for determining value adjustments and provisions.

3. The total amount of exposures after accounting offsets and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes.
4. The geographic distribution of the exposures, broken down in significant areas by material exposure classes.
5. The distribution of the exposures by industry or counterparty type, broken down by exposure classes.
6. The residual maturity breakdown of all the exposures, broken down by exposure classes.
7. The amount of (by significant industry or counterparty type).
   - Impaired exposures and past due exposures.
   - Value adjustments and provisions, and
   - Charges for value adjustments during the period.
8. Provided separately, the amount of impaired exposures and past due exposures, including the amounts of value adjustments and provisions related to each geographical area.
9. The reconciliation of changes in the value adjustments and provisions for impaired exposures (shown separately).
10. Value adjustments and recoveries recorded directly to the income statement must be disclosed separately.

All of this information must comprise:
1. A description of the type of value adjustments and provisions.
2. The opening balances.
3. The amounts taken against the provisions during the period.
4. The amounts set aside or reversed for estimated probable losses on exposures during the period, any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of subsidiary undertakings, and transfers between provisions.
5. The closing balances.

Firms calculating risk weighted exposure amounts in accordance with the standardised approach

The following information must be disclosed for each of the standardised credit risk exposure classes.
1. The names of the nominated external credit assessment institution ECAI's and export credit agencies and the reasons for any changes.
2. The standardised credit risk exposure classes for which ECAI or expert credit agency is used.
3. A description of the process used to transfer the issuer and issue credit assessments onto items not included in the trading book.
4. The association of the external rating of each nominated ECAI or export credit agency with the credit quality steps prescribed in BIPRU 3, taking into account that this information need not be disclosed if the firm complies with the credit quality assessment scale.
5. The exposure values and the exposure values after credit risk mitigation associated with each credit quality step prescribed in BIPRU 3, as well as those deducted from capital resources.

Firms calculating risk weighted exposure amounts using the IRB approach

A firm must disclose which exposures are assigned:
1. To each category of the table in BIPRU 4.5.9R.
2. To each risk weight mentioned in BIPRU 4.7.9 to BIPRU 4.7.10.

Market risk

A firm must disclose its capital resources requirements separately for each risk referred to in 1 and 2 as follows.
1. In respect of trading book business, its interest rate PRR, equity PRR, option PRR, collective investment schemes PRR, counterparty risk capital component and concentration risk capital component.
2. In respect of all of its business activities its commodity PRR and foreign currency PRR.

Use of VaR model for calculation of market risk capital requirement

The following information must be disclosed by a firm using the VaR model
1. The characteristics of the models used a description of stress testing, and a description of the approaches used for back testing and validating the accuracy and consistency of the internal models and modelling processes for each sub-portfolio covered.
2. The scope of the firms VaR model permission.
3. A description of the extent and methodologies for compliance with the requirements set out in GENPRU 1.3.13 R (2 AND 3) and GENPRU 1.3.14 – 34.

Operational risk

Concerning operational risk, a firm must disclose:
1. How the firm will asses the operational risk capital requirement that the firm qualifies for.
2. If the firm uses the advanced measurement approach the firm must include in their disclosure a description of the methodology used in the advanced measurement approach, including a discussion of relevant internal and external factors considered in the firm's measurement approach, and in the case of partial use, the scope and coverage of the different methodologies used.

Non trading book exposures in equities

For exposures in equities not included in the trading book a firm must disclose:
1. The differentiation between exposures based on their objectives, including for capital gains relationship and strategic reasons, and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices.
2. The balance sheet value, the fair value, and, for those exchange traded, a comparison to the market price where it is materially different from the fair value.

3. The types, nature and amounts of exchange traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures.
4. The cumulative realised gains or losses arising from sales and liquidations in the period.
5. The total unrealised gains or losses, the total latent revaluation gains or losses, and any of these amounts included in tier one, tier two or tier three capital resources.

Exposures to interest rate risk in the non trading book

For exposure to interest rate risk on positions not included in the trading book a firm must disclose:

1. The nature of the interest rate risk and the key assumptions (including assumptions regarding loan repayments and behaviour of non-maturity deposits), and frequency of measurement of the interest rate risk.
2. The variation in earnings, economic value or other relevant measure used by the management for upward and downward rate shocks according to management's method for measuring the interest rate risk, broken down by currency.

Securitisation

A firm that calculates the risk weighted exposure amounts in accordance with BIPRU 9 must disclose the following information.

1. A description of the firm's objectives in relation to securitisation activity.
2. The roles played by the firm in the securitisation process.
3. An indication of the extent of the firm's involvement in each of them.
4. The approaches to calculating risk weighted exposure amounts that the firm follows for its securitisation activities.
5. A summary of the firm's accounting policies for securitisation activities, including:
    - Whether the transactions are treated as sales or financings.
    - The recognition of gains on sales.
    - The key assumptions for valuing retained interests.
    - The treatment of synthetic securitisations if this is not covered by other accounting policies.
6. The names of the ECAIs used for securities and the types of exposure for which each agency is used.
7. The total outstanding amount of exposures securitised by the firm and subject to the securitisation framework (broken down into traditional and synthetic), by exposure type.
8. For exposures securitised by the firm and subject to the securitisation framework, a breakdown by exposure type of the amount of impaired and past due exposures securitised, and the losses recognised by the firm during the period.
9. The aggregate amount of securitisation positions retained or purchased, broken down by exposure type.
10. The aggregate amount of securitisation positions retained or purchased.
    - Broken down into a meaningful number of risk weight bands, and
    - With separate disclosure of positions that have been risk weighted at 1250% or deducted.
11. The aggregate outstanding amount of securitised revolving exposures segregated by the originator's interest and the investors' interest.

12. A summary of the securitisation activity in the period, including the amount of exposures securitised, and recognised gain or loss on sale by exposure type.