



Committee of European  
Banking Supervisors

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**18 June 2008**

### **CEBS PUBLISHES A REPORT ON BANKS' TRANSPARENCY ON ACTIVITIES AND PRODUCTS AFFECTED BY THE RECENT MARKET TURMOIL**

The Committee of European Banking Supervisors (CEBS) has published today the findings of an assessment of banks' transparency with regard to the activities and instruments affected by the recent market turmoil. This assessment has been carried out in accordance with the roadmap of the ECOFIN issued in October 2007 in response to the financial markets situation.

CEBS analysed the disclosures made by 22 large banks – 19 of which originate from the EU - in the context of their 2007 4th quarter and preliminary results and 2007 audited annual reports. The assessment not only covered disclosures on exposures and their impacts on results but also looked at information on business models, risk management practices and accounting and valuation practices.

The main findings of the analysis showed that institutions made:

- limited disclosures on the business models underlying the activities affected by the sub-prime crisis and the related risk management practices (especially liquidity risk);
  - diverse disclosures on exposures and on the impact of the crisis;
  - generic disclosures on the valuation of exposures affected by the market turmoil and their accounting;
- and
- varied presentations of disclosures.

The findings allowed to identify examples of disclosures which CEBS believes represent good practice. CEBS considers these disclosures to be particularly informative. They are set out in Annex 1 of the report. CEBS believes that these good practices provide examples of:

- comprehensive disclosures on business model and risk management;
- meaningful disclosures on exposures and impacts, with appropriate levels of granularity;
- useful disclosures on accounting policies; and
- improved presentation of the disclosures.

CEBS believes that these observed good practice disclosures contribute to the improvement of disclosures on exposures and activities affected by the market turmoil.

The practices are consistent with the recommendations made in the report of the Financial Stability Forum (FSF) 'Enhancing market and institutional resilience'. They are also in line with the 'Leading practice disclosures for selected exposures' identified by the Senior Supervisors Group (SSG).

CEBS's good practice disclosures in some areas develop and supplement those efforts. CEBS's practices promote disclosures that 'tell a coherent story' to help understand the background to an activity, its impact and importance, as well as its management.

CEBS recommends the application of the observed good practices by all banks, albeit in a manner commensurate with an institution's exposures and involvement in the activities affected by the crisis. As disclosure practices will develop over time, as will the 'high risk' areas that require specific attention, CEBS will investigate how the good practices should be applied in the longer run. CEBS will also closely monitor the disclosures by institutions in their forthcoming (i.e. half-year) reports before deciding on any further measures.

For more information, please refer to the full report which can be accessed on our website at <http://www.c-eps.org/publications/other>.

To discuss the findings of the report and the good observed practices with industry representatives and other interested parties CEBS will organise an open workshop in its premises in London on 3 July 2008 from 14:00 to 16:30. Please download the registration form [here](http://www.c-eps.org/keydates.htm). <http://www.c-eps.org/keydates.htm>.

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*Committee of European Banking Supervisors (CEBS) is comprised of high level representatives from the banking supervisory authorities and central banks of the European Union. CEBS main tasks are to advise the Commission in the field of banking activities, to contribute to the consistent implementation of Community Directives and to the convergence of supervisory practices and to enhance supervisory co-operation. The Committee is chaired by Ms Kerstin af Jochnick. The CEBS Secretariat is based in London. The Secretary General of the Committee is Mr Andrea Enria.*

18 June 2008

## **CEBS report on banks' transparency on activities and products affected by the recent market turmoil**

### **Executive summary**

In response to the request from the ECOFIN CEBS has carried out an assessment of the adequacy of banks' public disclosures on securitisation operations, structured products and illiquid assets affected by the recent market turmoil. In making its assessment CEBS analysed disclosures made in 2007 4<sup>th</sup> quarter and preliminary results as well as in the audited annual reports of 2007.

On the basis of the disclosures made by 22 large banks – 19 of which originate from the EU – CEBS analysed the information these institutions provided not only on their exposures to the instruments under review but also their impact, business model, risk management practices and accounting and valuation practices.

The main findings of the analysis showed that institutions made:

- limited disclosures on the business models underlying the activities affected by the sub-prime crisis and the related risk management practices (especially liquidity risk);
- diverse disclosures on exposures and on the impact of the crisis;
- generic disclosures on the valuation of exposures affected by the market turmoil and their accounting; and
- varied presentations of disclosures.

The assessment of the findings against observed disclosures that CEBS, on the basis of the analysis, considers to be particularly informative, allowed identifying a set of observed good practices for disclosures on activities affected by the market turmoil. These good practices cover disclosures on the business model, risk management, exposures and their impact as well as accounting policies and valuation issues.

The good disclosure practices in Annex 1 provide institutions with clear guidance for:

- comprehensive information on business model and risk management;
- meaningful information on exposures and impacts, with appropriate levels of granularity;
- useful disclosures on accounting policies; and
- improved presentation of the disclosures.

CEBS is of the opinion that the use these practices will contribute considerably to the improvement of disclosures on exposures and activities affected by the market turmoil.

The practices CEBS has identified are in line with the recommendations made in the report of the Financial Stability Forum (FSF) on 'Enhancing market and institutional resilience' which is based on the 'Leading practice disclosures for selected exposures' identified by the Senior Supervisors Group (SSG), even though the CEBS practices develop and, in some areas, supplement those efforts. In fact CEBS's practices reflect a holistic approach and promote disclosures that 'tell a coherent story' to help understanding the background to an activity, its impact and importance, as well as its management.

Although identified in the context of the sub-prime crisis, the observed good practices could easily be transposed for application in a different context and should prove helpful in the preparation of sensible and comprehensive disclosures for a broad range of activities and businesses in normal times and in crisis situations.

CEBS recommends that the good disclosure practices are applied by all banks in their first upcoming disclosures even though this does not mean that every single bank needs to comply with every single disclosure practice. Their application, for compliance with the short-term recommendations of the FSF, should be commensurate with an institution's exposures and involvement in the activities affected by the crisis.

The report identifies good practices observed as at May 2008. As the disclosures practices can be expected to develop, similarly to what will be considered as 'high risk' areas for which enhanced disclosures are necessary, CEBS will further investigate how these practices should be applied in the longer run to ensure that developments in the crisis are taken adequately reflected.

CEBS will carry out a follow-up review of the disclosures made by institutions following the publication of their mid-year results. The outcome of this assessment will be used to inform its decisions on any further measures that should be undertaken.

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## **I. Introduction**

1. After the start of the sub-prime crisis it quickly became clear that transparency on financial institutions' involvement in the activities and segments affected by the market turmoil was key to sustaining and rebuilding market confidence.

2. Unless market participants and stakeholders can be sure that they have adequate and accurate information about exposures to the activities and segments under review it is difficult to redress a loss of confidence.

3. Concerns about the appropriateness of the disclosures that had been made over the course of the crisis had been raised at an early stage. As a reaction to these concerns, various fora and organisations have carried out work on disclosure and transparency, covering the issue from a variety of different angles.

4. CEBS has prepared this report in response to a request from the ECOFIN and the Financial Stability Table of the Economic and Financial Committee (EFC-FST) calling for an assessment of the adequacy of banks' public disclosure on securitisation operations, structured products and illiquid assets affected by the market turmoil. In addition the ECOFIN invited CEBS to prepare an in-depth assessment of banks' transparency on the basis of their 2007 year-end results with the same focus.

## **II. Objective**

5. As set out in the mandate the objective of the present report is to provide an assessment of the disclosures made by banks in the context of the sub-prime crisis as well as an evaluation of their adequacy.

6. Based on the findings made in the context of the assessment, the report identifies the disclosures that an institution should consider making in order to provide clear, informative and comprehensive disclosure on its exposures affected by the market turmoil.

7. CEBS also aims to link its findings to the recommendations of the Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience.

## **III. Methodology**

8. To meet these objectives CEBS has over recent months as the crisis developed analysed in several stages the disclosures made by a number of large banks from the EU (and third countries).<sup>1</sup>

9. After a rough and ready review in late 2007 of the disclosures made by some 10 institutions in their 3<sup>rd</sup> quarter results and communications, CEBS carried out an extensive and systematic analysis of the disclosures made on securitisation activities and structured products affected by the market turmoil made in the context of institutions':

- 2007 4<sup>th</sup> quarter and/or preliminary full-year results; and
- 2007 audited financial statements and annual reports to supplement the findings made under the previous step.

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<sup>1</sup> The full list of institutions is included in Annex 2

10. This staged approach allowed CEBS to provide the EFC-FST with an update in early April before the annual reports were available.

11. For the second and third part of the analysis CEBS extended the coverage of the sample to include a more significant number of large banks from the EU. The 22 banks covered in the analysis are largely the same as the institutions represented in CEBS's Industry platform on operational networks<sup>2</sup>. The sample has been complemented with two institutions from Switzerland and one from the US.

12. The inclusion of the non-EU institutions some assessment of how the disclosures by the EU banks compare at an international level.

13. In addition to the extension of the scope, CEBS has adopted a systematic approach to analysing the disclosure made by banks using as a point of reference a list of possible disclosure topics and items. These reflect at a higher level the requirements for disclosures by credit institutions in Directive 2006/48/EC and in the IFRS 7 Financial Instruments Disclosures.

14. The main topics and items included in the list cover disclosures on the following:

- business model and extent of involvement;
- risks and risk management;
- impact of the market turmoil and the level of exposures;
- accounting policies and valuation issues; and
- other disclosures and presentation issues.

15. For each topic, the report discusses the findings against the observed disclosures which CEBS, on the basis of the analysis, considers to be particularly useful and informative. These observed disclosures do not necessarily reflect the information provided by one particular institution; in some instances they mirror the combined disclosures of a number of banks or even differing market practices.

16. CEBS considers these disclosures to be observed good practices that an institution should consider following if it aims to provide clear, informative and comprehensive disclosure on its exposures and activities affected by the market turmoil.

17. At the same time it should be borne in mind that, given the diverging involvement in and exposures of banks to the activities affected by the market turmoil, they are not necessarily appropriate for use by every single bank. Further guidance regarding the application of the good observed practices is included in part V. of the report.

18. The structure of the report follows the sequence of the list of topics that has been used to survey banks' disclosures. The findings cover all stages of the analysis, i.e. the disclosures made in the context of the presentation of the 2007 fourth quarter and/or preliminary full-year results as well as in their audited financial statements and annual reports of 2007. They are based not only on the published reports themselves but also take into consideration, as appropriate and where applicable, press releases and disclosures provided by means of web-casts and related presentations.

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<sup>2</sup> CEBS's industry platform on operational networks comprises 17 cross-border operating banks that are involved in the pilot project aimed to enhance the exchange of information and experiences between consolidating and host supervisors of cross-border banking groups.

19. The report first provides an overview of the state of transparency together with an assessment of the disclosures' comparability and consistency (section IV). As mentioned, these findings are discussed against the comprehensive disclosures provided by the institutions in the sample. The report then discusses the observed good practices to be made by institutions affected by the market turmoil (section V and Annex 1), which are linked and compared to the work of the SSG. Finally, the report concludes with a discussion of possible follow-up measures that CEBS should envisage taking to assess whether the recommendation ultimately contributed to the improvement of the situation (section VI).

20. The adoption of IFRS 7 can be expected to have contributed to increased disclosure, especially as regards risks related to financial instruments. However, the report does not address this issue directly but aims to discuss whether the observed disclosures were sufficient to address transparency concerns in relation to the market turmoil.

21. The report also does not discuss how the current disclosures would compare to disclosures prepared under Pillar 3, For one there is currently only little evidence of Pillar 3 and where these disclosures can be observed they are normally provided by banks that operate under the standardised approach and typically have little or no exposure to the activities affected by the sub-prime crisis.

#### **IV. Discussion of the findings**

22. Some of the findings can be explained by the fact that disclosure requirements provide considerable room for flexibility in terms of the presentation and organisation of the information provided.

23. Indeed, while IFRS accounting standards and the EU accounting and transparency Directives contain numerous requirements, they also give considerable leeway on the way this information is presented. More specifically the disclosure requirements for quarterly results or preliminary full-year results differ quite substantially and are subject in a lot of cases to additional national requirements and practices, which explains some of the differences that have been observed.

##### **IV.1. Business model and extent of involvement**

24. The analysis of the annual reports and of the fourth quarter and preliminary results shows that the disclosures on banks' business models and on the extent of their involvement in the activities affected by the market turmoil leave room for improvement. While a few banks provided detailed information in this respect, the majority only provided limited disclosure.

###### ***a) Business model and objectives***

25. Few institutions provided comprehensive discussion of their business model or objectives that govern the business segment in which securitisation and structured products are included. Where this information has been provided it only gives general information on the reasons for the firm engaging in particular activities and on the ways these contribute to the process of value creation for its clients and stakeholders.

26. In addition to the information on the nature of the business model, the findings show that the disclosures could be further developed to include information that allows the reader to understand how the activities in question

are contributing financially to an institution's business and whether they are compatible with an entity's strategy and objectives. On the whole, it has been noted that few institutions have disclosed information on their specific strategies with regard to securitisation or structured products and on the related objectives they pursue.

27. On the whole, the disclosures made in this context do not specifically cover the activities affected by the crisis but are generally provided in the context of the discussion of the business segment in which they are included in, i.e. in most cases the investment banking segment.

28. Very few institutions explicitly disclose whether they operate an originate-to-distribute, a buy-to-hold or a mixed business model. This information has to be inferred from the more or less detailed description of the types of activities that the institutions conduct in this business segment.

29. More commonly observed were disclosures about changes to the business model occasioned by the crisis and the effects it had on the institution. A number of banks mentioned that, as a result of the crisis, they reconsidered the types of activities they are engaging in or even discontinued certain activities. In that context, institutions generally provided a more or less detailed description of any corrective measures that had been adopted to address identified problems, be it in the trading desks, in risk management, in internal controls or in other areas.

***b) Importance of activities and contribution to business***

30. Few institutions made explicit and detailed disclosure on the importance or the significance of the activities in question for their business. In most cases this information has to be implicitly derived from the size of the exposure relative to other business activities or from the significance of the write-down or the losses for that matter). Only a very few banks have provided clear quantitative disclosure on the relative importance of the activities affected by the crisis.

31. Hardly any bank provided qualitative or quantitative disclosure on how the activities in question contribute to its business. In some cases banks only went so far as a breakdown by business segments. Only one bank disclosed the proceeds and the gains arising from its securitisation activities broken down by commercial mortgage backed securities (CMBS), residential mortgage backed securities (RMBS), collateralised debt obligations (CDO) and asset backed securities (ABS) transactions.

***c) Types of activities and role of the institution***

32. In the majority of cases the information on the types of activities was provided in the context of a general discussion of the business which makes it more difficult to assess the exact types of activities carried out with regard to sub-prime related exposures.

Observed good disclosure practices included:

- a discussion of the types of instruments they invested or originated;
- a detailed description of the instruments and their functioning;
- a brief description of the role and the extent of involvement of the institution;
- the risks incurred and how they are managed; and
- qualifying criteria that products/investments have to meet.

33. While the disclosure on the types of activities in general matches the level of involvement of the institution in the activities affected by the crisis, it appeared that it is very rarely accompanied by adequate disclosure on the risk profile of these activities.

34. Closely related to the observations made with respect to the types of activities carried out are disclosures on institutions' roles and involvement in the activities under consideration, since they are often provided together.

35. On the whole the information provided is rather general and the description of the activities rarely focuses on the sub-prime related activities. In most cases institutions have provided only basic information on the roles that they assume in the context of their securitisation activities in general or sub-prime related activities or products in particular. There is very little detailed disclosure on what the roles exactly encompass or on the predominant roles that an institution plays.

36. Only a few banks describe their involvement with and their links to any structures or disclose e.g. the types of credit enhancements or liquidity facilities that have been provided. Disclosure of exposures arising through the use of monoline insurance or commitments resulting from the provision of credit protection have also only been provided by a few banks. In some of these cases the disclosure could be further developed and structured.

## **IV.2. Risks and risk management**

37. The analysis shows that the disclosures on the nature and extent of the risks that a bank incurs in relation to the activities affected by the sub-prime crisis and the related risk management are on the whole rather generic.

38. Indeed most banks provide generic information on the risks they incur and the related risk management processes that are place, whereas specific disclosures on how these processes performed in the crisis have only been provided by a few institutions, mainly by banks that were more deeply affected by the crisis. These banks' disclosures in a few cases feature discussions of the weaknesses or failures that have been identified during the crisis as well as related corrective measures. On the whole this information is nevertheless rather unspecific, especially as concerns the discussion of the weaknesses.

39. All institutions provide at least basic disclosure on the processes and methodologies they rely on for the management of the risks incurred. Generally the risk management disclosures cover discussions of market risk, credit risk, operational risk and the related processes, methodologies, measures and controls that are in place.

40. The analysis reveals that only a very few banks provide specific information on the effects of the crisis on liquidity risk management. Where information has been provided, it is generally of a qualitative nature, occasionally supplemented with charts or graphs that illustrate a bank's funding structure. In quantitative terms IFRS 7 only requires a maturity analysis for financial liabilities showing the remaining contractual maturities and a description of how it relates to the liquidity risk inherent therein.<sup>3</sup>

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<sup>3</sup> It is worth noting in this context that the second part of technical advice to the European Commission on Liquidity risk management includes a discussion of possible disclosures (both qualitative and quantitative) that institutions could consider making in normal times and in times of stress. This advice can be accessed at <http://www.c-ebs.org/press/20080617.htm> .

41. On the whole, the disclosures only provide generic discussions on banks' risk management practices without specifically focussing (with a few exceptions) on activities affected by the market turmoil and the impacts they had. In particular for institutions that were heavily affected by the market turmoil, the risk management discussion should give more focus to the specific problems and issues that the bank encountered in the course of the sub-prime crisis.

Observed good disclosures practices on risks and risk management include:

- a description of the nature and extent of risks incurred in relation to the activities and instruments;
- a description of risk management practices of relevance to the activities under consideration, of any identified weaknesses of any corrective measures that have been taken to address these.
- in the current crisis, particular attention should be given to liquidity risk.

### **IV.3. Impact of the market turmoil and level of exposures**

#### ***a) Impact of the market turmoil on results***

42. In most cases the disclosures on the impact of the crisis on banks' results and performance appear to be adequate. On the whole the level of detail of the disclosure appears to match the size and amplitude of the impact that institutions have incurred.

43. At the same time there are some quite large differences in terms of the level of detail of the information and with regard to its presentation. Most institutions first provide a brief description of the overall financial results in a general performance review; this description is then further detailed and developed as the reports go on to discuss the different business segments.

44. *Institutions that were significantly affected by the turmoil provide* in most cases in the general discussion of their business performance a qualitative or even a quantitative discussion of the impact and the related write-downs<sup>4</sup>. In all cases, a more detailed description is provided in the discussion of the performance of the business segment incorporating the activities affected by the market turmoil, normally the investment banking segment. Many banks also disclose (directly or indirectly) the impacts that the market turmoil had on other segments.

Observed good disclosures practices on the impact of the crisis comprised:

- qualitative and quantitative discussions of the banks' results and, where applicable of losses, or else the write-downs impacting the results;
- a quantitative breakdown of the write-downs and losses (in absolute or relative terms) by types of products (CMBS, RMBS, CDO and ABS further broken down by different criteria/factors) and of other directly or indirectly related factors or activities;<sup>5</sup>
- a description of the reasons and the factors that can be held responsible for

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<sup>4</sup> Institutions used different terms e.g. write-downs, mark-downs or value corrections to designate the negative impact of the sub-prime crisis.

<sup>5</sup> E.g. consolidation of structured investments vehicles (SIVs) or purchases of assets to reflect implicit or explicit commitments towards structures affected by the crisis.

the impact incurred;

- comparative data on the impacts from one (relevant) period to another;
- a comparison of interim income statement balances before and after the impact of the crisis;
- a distinction of write-downs between realised and unrealised losses and a discussion of how a recovery in the market could affect the institution's situation;
- discussions of the influence the crisis had on the firms' share prices; and
- disclosures on maximum loss risk and a description how the institution's situation could be affected by a further downturn or by a market recovery.
- disclosure of the impact of credit spread movements for own liabilities on results and on the methods used to determine this impact.

45. While in most cases the disclosures covered the negative impact on the activities affected by market turmoil, there were only a few cases where institutions have provided disclosure on how these activities have contributed to the firm's revenues. In general, disclosures on revenues were rarely more detailed than by business segments or lines. Only one (non-EU) bank provided greater detail and disclosed the proceeds and the gains arising from its securitisation activities broken down by CMBS, RMBS, CDO and ABS transactions.

46. Less commonly observed were the aforementioned disclosures distinguishing between realised and unrealised losses and disclosures discussing share prices, maximum loss risk and the impact of credit spread movements for own liabilities.

47. As regards the distinction between realised and unrealised losses it is felt that institutions have not provided sufficient information to explain the significance of these valuation differences in a fair value environment in order to ensure that there is a clear understanding of their meaning and implications.

48. There is also little disclosure on potential losses and or on possible further write-downs that institutions could incur in the event of continued difficult market conditions. Where such information has been given it is mostly in qualitative terms and describes the possible drivers for further difficulties as well as the related impacts. Of the few banks that provide this information most limit the discussions to certain specific aspects such as exposures to monoline insurers or counterparty credit risk. Where quantitative information has been provided it generally covers the impact of further downturns on exposures as determined by simulation exercises or maximum exposures to loss for non-consolidated structures.

49. Little information was provided on the impact that widening credit spreads for institutions' own liabilities had had on results. Indeed, only a handful of institutions provided qualitative and/or quantitative information on the impact of changes in their own credit risk, and, of these even fewer banks explicitly described the methodology they have used to determine this impact. Quantitative disclosure, which was also only provided in a few cases, included breakdowns by types of liabilities even though this information was not directly geared to the activities under review.

50. *For the 5 banks in the sample that have or seem to have little or no involvement* in activities affected by the market turmoil and therefore suffered no or little impact, the level of disclosure varied. Some institutions explicitly mentioned their low or non-existent level of involvement. In one instance a bank

did not mention explicitly whether it had any, or any significant, exposures with respect to the activities affected by the crisis.

### ***b) Disclosure on the levels and types of exposures***

51. Most of the findings regarding the impact of the market turmoil also hold true for the disclosures on institutions' exposures, not least since this information is generally provided concurrently.

52. Even though there are some differences, the disclosures on the exposures affected by the crisis in most cases appear to be adequate. On the whole the level of detail of the disclosures appears to match the size and amplitude of the exposures that institutions have.

53. As had been observed for the disclosures of the impact, the information on the exposures has often been spread over various parts of banks' reports. A number of banks have devoted a separate chapter or section to the problems and effects incurred as a result of the crisis.

54. Institutions generally provided at least basic – and in some cases detailed - information on the outstanding exposures to the different type of instruments affected by the sub-prime crisis (CMBS, RMBS, CDO, other ABS, monoline insurers (through credit default swaps (CDS)), structured investment vehicles (SIVs), SIV-lites, conduits etc).

Observed good disclosures practices covered for each type of exposure:

- nominal amounts (or amortised cost) of outstanding exposures;
- fair values of the outstanding exposures;
- information on any related credit protection (e.g. through credit default swaps) and its effect on exposures; and
- number of products.

### ***c) Granularity of the disclosures***

55. Major differences have nevertheless been observed with regard to the levels of granularity of the disclosures. Indeed, banks disclose the information with varying breakdowns and different degrees of granularity. As previously mentioned, the level of detail of the disclosures and accordingly the degree of granularity often is related to the size and significance of the bank's involvement.

56. Comprehensive disclosures made a distinction between gross and net exposures, even though gross exposures have only been observed in rather exceptional cases. On the whole disclosures mostly provided net amounts; a few banks explained this by the fact that these products are managed on a net basis for risk management purposes.

57. Detailed disclosures distinguished the exposures according to whether they have been originated and retained, purchased or warehoused by the institution.

In terms of granularity observed good disclosures practices covered some or most of the following breakdowns:

- level of seniority of the different tranches (e.g. high-grade, mezzanine, other);
- level of credit quality (e.g. ratings, investment grade, vintages);
- geographic origin;
- whether exposures have been originated and retained, warehoused or purchased by the institution;
- product characteristics: e.g. ratings, share of sub-prime mortgages, and less often discount rates, attachment points, spreads, funding (i.e. provided liquidity facilities provided); and
- characteristics of underlying assets: e.g. vintages, loan-to-value ratios, information on liens, weighted average life of the underlying, prepayment speed assumptions, expected credit losses.

#### **d) Other disclosures**

Other observed good disclosures practices covered:

- movement schedules of exposures between relevant reporting periods and the underlying reasons (sales, disposals, purchases etc.).
- a discussion of exposures that have not been consolidated (or that have been recognised in the course of the crisis) and the related reasons.

58. Some banks have provided information on the movements of the exposures between periods. These movements can derive from sales, disposals or even from purchases of securities or exposures. A few banks disclosed in that context whether the purchases had been made to reflect commitments, credit enhancements or other involvements in structured products or special purpose entities (SPEs).

59. In a few cases banks provided information on exposures that have not been consolidated and/or on exposures that have been consolidated as the crisis developed. Generally this disclosure provides the reasons for consolidating (or not) the exposures and explains the nature of the involvement and commitments of the banks, such as guarantees provided and loan facilities granted.

60. In line with the findings for the disclosures on impact, the disclosures for *banks that have little or no involvement* in activities affected by the market turmoil varied. The majority of institutions did not provide more than the amount of exposures they held, which for the most part related to exposures purchased for investment purposes.

61. Similarly it is worth noting that one of the institutions that has no exposures affected by the crisis did not make any disclosures at all, not even to state this fact clearly. While this is certainly justifiable from the point of view of the proportionality or materiality principle, the question arises whether the institution should have made this fact clear in order to give a clear signal to the market.

### ***e) Specific case of exposures to monoline insurers***

62. A few banks have provided detailed disclosure on their exposures to monoline insurers. This disclosure generally focuses on the discussion of the insured exposures, the value of the credit protection, the next exposures as well as the rating of the credit protection.

Observed good disclosure practices covered the following:

- nominal amounts (or amortised cost) of insured exposures as well as of the amount of credit protection bought;
- fair values of the outstanding exposures as well as of the related credit protection;
- amount of write-downs and losses, differentiated into realised and unrealised amounts;
- breakdowns of exposures by ratings or counterparty.

63. A few institutions provided information on how they estimate the fair value of the credit protection, i.e. credit default swaps, and of the net exposures, even though the level of disclosure generally leaves room for improvement. Little information has in particular been provided on the characteristics of the structured products that have been insured (e.g. attachment points), on the quality of the assets underlying the protected exposures (e.g. vintages) or on the assumptions that had been used to determine the fair values.<sup>6</sup>

64. In line with what has been observed previously, there was relatively little information on gross amounts of exposures to monoline insurance (i.e. before the effect of the credit protection). Generally institutions disclosed net amounts and explained that these products are risk managed on a net basis.

65. There was also some discrepancy in the levels of granularity with which the information has been provided. Commonly observed breakdowns provided information on the ratings of the counterparties. Very few banks provided breakdowns of the exposures by individual counterparties.

66. In one case an institution discussed credit protection issues from a broader perspective without specifically referring to exposures to monoline insurance or the sub-prime context. While it can be assumed that this institution does not have any such exposures, the situation is not entirely clear and it would have been preferable to mention this explicitly.

67. By and large the disclosures observed do not provide a full picture of the outstanding risks incurred to monoline insurers. Often the problem stems from the fact that the disclosure does not sufficiently cover the assets underlying the structured products and does not allow for a proper assessment of the exposures.

#### **IV.4. Accounting policies and valuation issues**

68. Generally banks provide fairly detailed information on their accounting policies and practices even though the disclosure between institutions is not very comparable.

69. Disclosures that have been commonly observed often comprised general discussions of accounting standards and principles and related changes in the management discussions supplemented by more detailed discussions in the

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<sup>6</sup> A more thorough discussion on the latter issue is provided under point IV.4.

notes to the financial statements. Only in a few cases have institutions specifically identified accounting policies and practices that are of particular relevance for the sub-prime crisis.

Accounting-related good disclosure practices of relevance for the sub-prime crisis, covered, in a varying degree of detail, the following:

- classification of the transactions and structured products for accounting purposes and the related accounting treatment;
- consolidation of SPEs and other vehicles (such as variable interest entities (VIEs)) and a reconciliation of these to the structured products affected by the sub-prime crisis; and
- detailed disclosures on fair values of financial instruments.

70. In some cases the specific fair-value related disclosure was supplemented by exhaustive quantitative information on the use of the fair values and on the reliance on different fair value hierarchy levels.

71. Other fair-value related disclosure included information on:

- o financial instruments to which fair values are applied;
- o the fair value hierarchy (including in a number of cases a breakdown of all exposures measured at fair value by different levels of the fair value hierarchy and a breakdown between cash and derivative instruments as well as disclosures on migrations between the different levels);
- o the treatment of Day 1 profits (including in a number of cases quantitative information); and
- o the use of the fair value option (including its conditions for use) and related amounts (with appropriate breakdowns).

Observed good disclosures on modelling techniques used for the valuation of financial instruments included:

- a description of the modelling techniques and of the instruments to which they are applied;
- the valuation processes;
- the assumptions and input factors they rely on;
- the type of adjustments applied to reflect model risk and other valuation uncertainties;
- the sensitivity of fair values; and
- stress scenarios.

72. While institutions provided a good deal of qualitative information on the valuation methods and on the processes and on their use, information on the underlying assumptions was scarcer. As an example IFRS 7 cites that an entity should disclose information about its assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. Detailed information has only been provided in limited number of cases. Similarly banks provided little information on valuation control mechanisms (e.g. independent price verification mechanisms) that they had in place.

73. There was little evidence of other accounting-related disclosures of particular relevance to the sub-prime crisis even though, in limited cases, institutions disclosed information on credit losses and impairment that related to the crisis.

## IV.5. Other disclosures and presentation issues

### *a) Other disclosure aspects*

Other observed good practices provided:

- a description of disclosure policies and of the principles that are used for disclosures and financial reporting..

74. There was very little information on banks' general disclosure policies. Only one bank explained the principles it applies in its financial reporting and disclosure: transparency, consistency, simplicity, relevance and best practice.

75. On the whole the disclosures provided by banks mainly seem to serve accountability obligations towards immediate stakeholders, i.e. their shareholders. The practice of providing different (levels of) information in different sources seems to aim to satisfy the differing needs of different stakeholders, e.g. analysts. It should in any case be ensured that interested parties can easily access and locate the information that they are interested in.

76. It may also be worthwhile for institutions, in times of stress, to consider carefully their disclosure policy and its governing principles. While in normal times the application of criteria such as relevance should be considered in conjunction with proportionality or materiality, a crisis situation may justify that institutions communicate on certain issues irrespective of whether the related exposures are material or not.

### *b) Presentation issues*

Observed good practices with respect to presentation issues respected the following criteria:

- relevant disclosures for the understanding of an institution's involvement are provided in one place;
- where information is spread between different parts or sources, there are cross-references that allow the reader to navigate between the parts;
- narrative disclosures are supplemented with illustrative tables and overviews;
- institutions used clear terminology to describe complex financial instruments and transactions accompanied by clear and adequate explanations.

77. It has been mentioned on some occasions in the previous discussions that institutions often spread relevant information over various parts of their reports or over different sources. Indeed, it has been observed that significant parts of the qualitative and/or quantitative disclosure has been provided in the management discussion and analysis, whereas other parts have been provided in the financial statements section.

78. It has also frequently been observed that institutions first provide general disclosures for the whole institution and then go on to provide more detailed information in the discussion of the different business segments. This implies a certain amount of repetition especially for the narrative parts of the annual reports. In some cases banks provide parts of the disclosures in one source while other parts have been made in a different source. While it is acknowledged that there are pertinent reasons for these practices (such as segment reporting requirements or the wish to serve the information needs of different stakeholders) CEBS is of the view that practices can be improved.

79. Indeed, in order to avoid interested parties having to go through every single page of the sometimes considerable publications and disclosures, it is recommended that institutions cross-reference related disclosures provided in different parts of one source or in different sources. In crisis situations it might even be worthwhile bringing together in one place, at the risk of increasing the repetition, all the disclosure that is of relevance for the understanding of an institutions involvement in the affected activities. Alternatively an institution should provide clear cross-references that allow the interested reader to navigate within or between sources.

80. In addition, it was noted that there is quite some discrepancy with respect to the presentation of quantitative information. While in some cases facts and figures are largely provided in the context of a narrative description, other institutions supplement this narrative with illustrative tables or overviews. Banks should give careful consideration to how complex quantitative information is presented. Often such information is clearer if presented in tabular format.

81. Finally, CEBS notes that banks use different terminology for the same or similar concepts. While it is unrealistic to expect that all institutions apply the same terminology, they should to the largest extent possible explain the terms that are used, especially when it comes to complex transactions and activities.

### ***c) Disclosure by non-EU institutions***

82. On the basis of the disclosures of the 3 non-EU institutions included in the sample it can be said that their disclosures neither out- or under-perform in comparison with the EU institutions. Even though the level of quantitative disclosure is slightly higher, not least because these institutions are highly affected by the sub-prime crisis, there nevertheless seems to be a similar level of variance among institutions.

## **V. Conclusions**

83. The assessment made in response to the ECOFIN request allowed CEBS to identify in this report - and subsumed in Annex 1 - a set of observed good practices for disclosures on securitisation operations, structured products and illiquid assets affected by the market turmoil. These observed good practices either reflect disclosures that have been made by one or by more institutions or even a combination of disclosures by different institutions.

84. In light of the findings made in the previous section CEBS considers that the application of these observed good practices will contribute considerably to the improvement of the disclosures on exposures and activities affected by the market turmoil.

85. Banks should carefully consider these observed good practices in the preparation of their future disclosures on exposures and activities affected by the market turmoil. In particular the CEBS practices should prove helpful for the purpose of complying with the short-term disclosure recommendations put forward in the report of the Financial Stability Forum 'Enhancing Market and Institutional Resilience' which 'strongly encourages financial institutions to make robust risk disclosures using the leading disclosure practices of the SSG , at the time of their upcoming mid-year 2008 reports'.

86. The table in Annex 1 shows that CEBS's observed good practices are entirely in line with the leading practice disclosures for selected exposures identified by the SSG and as such complete and develop the FSF recommendations. In fact,

CEBS's practices develop and, in some areas, supplement the findings of the SSG in that they take a wider view.

87. The observed good practices go further in that they reflect a holistic approach and promote disclosures that 'tell a coherent story' that enables a market participant to understand not only the size of an institution's exposures and the related impact but also recommend disclosures on the business model that governs the activity. In addition, the observed good practices cover risk management, accounting and valuation aspects.

88. While these observed good practices have been identified for disclosures to be made in the context of the sub-prime crisis they could easily be transposed for application in a different context. In fact they should prove helpful to institutions in the preparation of sensible and comprehensive disclosures for a broad range of activities or businesses. In addition, they should be appropriate for application in crisis situations, as well as in a general manner, in normal times

89. Although the CEBS practices are considered to be comprehensive they should not be seen as an exhaustive list of disclosures.

90. Similarly institutions should bear in mind that good practice evolve over time. It can be expected that there are developments in the ways of presenting the disclosures of 'high risk' areas. Similarly there are bound to be developments about what is perceived as a 'high risk' area for which disclosure is important. Consequently the good practices observed as at May 2008 should not be applied in a mechanical manner even though the general principles underlying the observed good practices are of general validity.

91. In principle, the practices are applicable to all banks even though this should not be read to say that they need to be applied to the letter by each and every bank. To the extent that an institution has little sub-prime exposure, disclosure should provide a clear picture of what these are. The disclosure that an institution makes should always be commensurate with its level of involvement.

92. At the same time institutions should consider explicitly communicating, irrespective of materiality or proportionality considerations, the fact that an institution has no involvement in sub-prime related activities. Such a consideration should generally apply in times of crisis.

94. The efforts of the FSF and the SSG, the work carried out by CEBS as well as the work of the Basel Committee on Banking Supervision are a general expression of wider concerns that supervisors, central banks and regulators have regarding banks' disclosures. They are also clear indicators of a continued interest in appropriate and adequate disclosures by banks which is unlikely to subside in the future even if the crisis was soon to end completely. It is therefore in banks' own interest that they make due efforts to address in a timely manner any concerns and thus avoid the risk of overly prescriptive supervisory interventions.

## **VI. Follow-up**

95. As follow-up to this report CEBS will carry out in October a review of the implementation of the observed good practices on the basis of the disclosures made by institutions in their mid-year reports. The outcome of this review will be used to assess the need for possible further measures such as suggestions for amendments to the current Pillar 3 framework or for a review of IFRS 7.

## Annex 1 - CEBS Good observed good practices for disclosures on activities affected by the market turmoil (with mapping to the SSG Leading practices)

CEBS observed good practices	SSG Leading Practise Disclosures
<p><b>Business model</b></p> <ul style="list-style-type: none"> <li>• Description of the business model (i.e. of the reasons for engaging in activities and of the contribution to value creation process) and, if applicable of any changes made (e.g. as a result of crisis).</li> <li>• Description of strategies and objectives.</li> <li>• Description of importance of activities and contribution to business (including a discussion in quantitative terms).</li> <li>• Description on the type of activities including a description of the instruments as well as of their functioning and qualifying criteria that products/ investments have to meet.</li> <li>• Description of the role and the extent of involvement of the institution, i.e. commitments and obligations.</li> </ul>	<ul style="list-style-type: none"> <li>• Activities (SPE).*</li> <li>• Nature of exposure (sponsor, liquidity and/or credit enhancement provider) (SPE).</li> <li>• Qualitative discussion of policy (LF).</li> </ul>
<p><b>Risks and risk management</b></p> <ul style="list-style-type: none"> <li>• Description of the nature and extent of risks incurred in relation to the activities and instruments.</li> <li>• Description of risk management practices of relevance to the activities, of any identified weaknesses of any corrective measures that have been taken to address these.</li> <li>• In the current crisis, particular attention should be given to liquidity risk.</li> </ul>	
<p><b>Impact of the crisis on results</b></p> <ul style="list-style-type: none"> <li>• Qualitative and quantitative description of results, with a focus on losses (where applicable) and write-downs impacting the results.</li> <li>• Breakdown of the write-downs/losses by types of products and instruments affected by the crisis (CMBS, RMBS, CDO, ABS and LBO further broken down by different criteria).</li> <li>• Description of the reasons and factors responsible for the impact incurred.</li> <li>• Comparison of i) impacts between (relevant) periods and of ii) income statement balances before and after the impact of the crisis.</li> <li>• Distinction of write-downs between realised and unrealised amounts.</li> <li>• Description of the influence the crisis had on the firm's share price.</li> <li>• Disclosure of maximum loss risk and description how the institution's situation could be affected by a further downturn or by a market recovery.</li> <li>• Disclosure of impact of credit spread movements for own liabilities on results and on the methods used to determine this impact.</li> </ul>	<ul style="list-style-type: none"> <li>• Change in exposure from the prior period, including sales and write-downs (CMB/LF)</li> </ul>

### Exposure levels and types

- Nominal amount (or amortised cost) and fair values of outstanding exposures.
  - Information on credit protection (e.g. through credit default swaps) and its effect on exposures.
  - Information on the number of products
  - Granular disclosures of exposures with breakdowns provided by;
    - level of seniority of tranches;
    - level of credit quality (e.g. ratings, investment grade, vintages);
    - geographic origin;
    - whether exposures have been originated, retained, warehoused or purchased;
    - product characteristics: e.g. ratings, share of sub-prime mortgages, discount rates, attachment points, spreads, funding;
    - characteristics of the underlying assets: e.g. vintages, loan-to-value ratios, information on liens, weighted average life of the underlying, prepayment speed assumptions, expected credit losses.
  - Movement schedules of exposures between relevant reporting periods and the underlying reasons (sales, disposals, purchases etc.).
  - Discussion of exposures that have not been consolidated (or that have been recognised in the course of the crisis) and the related reasons.
  - Exposure to monoline insurers and quality of insured assets:
    - nominal amounts (or amortized cost) of insured exposures as well as of the amount of credit protection bought;
    - fair values of the outstanding exposures as well as of the related credit protection;
    - amount of write-downs and losses, differentiated into realised and unrealised amounts;
    - breakdowns of exposures by ratings or counterparty.
- Size of vehicle versus firm's total exposure (SPE / CDO).
  - Collateral: type, tranches, credit rating, industry, geographic distribution, average maturity, vintage (SPE/CDO/CMB/LF).
  - Hedges, including exposures to monolines, other counterparties (CDO). Creditworthiness of hedge counterparties (CDO).
  - Whole loans, RMBS, derivatives, other (O).
  - Detail on credit quality (such as credit rating, loan-to-value ratios, performance measures) (O)
  - Change in exposure from the prior period, including sales and write-downs (CMB/LF)
  - Distinction between consolidated and non consolidated vehicles. Reason for consolidation (if applicable) (SPE).
  - Funded exposure and unfunded commitments (LF)

<p><b>Accounting policies and valuation issues</b></p> <ul style="list-style-type: none"> <li>• Classification of the transactions and structured products for accounting purposes and the related accounting treatment.</li> <li>• Consolidation of SPEs and other vehicles (such as VIEs) and a reconciliation of these to the structured products affected by the sub-prime crisis.</li> <li>• Detailed disclosures on fair values of financial instruments: <ul style="list-style-type: none"> <li>• financial instruments to which fair values are applied;</li> <li>• fair value hierarchy (a breakdown of all exposures measured at fair value by different levels of the fair value hierarchy and a breakdown between cash and derivative instruments as well as disclosures on migrations between the different levels);</li> <li>• treatment of day 1 profits (including quantitative information);</li> <li>• use of the fair value option (including its conditions for use) and related amounts (with appropriate breakdowns).</li> </ul> </li> <li>• Disclosures on the modelling techniques used for the valuation of financial instruments, including discussions of the following: <ul style="list-style-type: none"> <li>• description of modelling techniques and of the instruments to which they are applied;</li> <li>• description of valuation processes (including in particular discussions of assumptions and input factors the models rely on);</li> <li>• type of adjustments applied to reflect model risk and other valuation uncertainties;</li> <li>• sensitivity of fair values; and</li> <li>• stress scenarios.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Valuation methodologies and primary drivers. (CDO).</li> <li>• Credit valuation adjustments for specific counterparties (CDO).</li> <li>• Sensitivity of valuation to changes in key assumptions and inputs (CDO).</li> </ul>
<p><b>Other disclosure aspects</b></p> <ul style="list-style-type: none"> <li>• Description of disclosure policies and of the principles that are used for disclosures and financial reporting.</li> </ul>	
<p><b>Presentation issues</b></p> <ul style="list-style-type: none"> <li>• Relevant disclosures for the understanding of an institution's involvement in a certain activity should as far as possible be provided in one place.</li> <li>• Where information is spread between different parts or sources clear cross-references should be provided to allow the interested reader to navigate between the parts.</li> <li>• Narrative disclosures should to the largest extent possible be supplemented with illustrative tables and overviews to improve the clarity.</li> <li>• Institutions should ensure that the terminology used to describe complex financial instruments and transactions is accompanied by clear and adequate explanations.</li> </ul>	

\* In the SSG Report, each feature refers to an specific type of SPE, or to all of them as a whole, being SPE (Special Purpose Entities in general), LF (Leveraged Finance), CMB (Commercial Mortgage-Backed Securities), O (Other sub-prime and Alt-A Exposures), CDO (Collateralised Debt Obligations)

## **Annex 2 - Banks covered in the survey**

ABN Amro

Banco Santander

Barclays

Citi

Commerzbank

Credit Agricole

Credit Suisse

Deutsche Bank

Dexia

Dresdner Bank

Erste Bank

Fortis

ING

Intesa SanPaolo

Nordea

Rabobank International

Raiffeisen Zentralbank

RBS

SEB

Société Générale

UBS

Unicredit Group