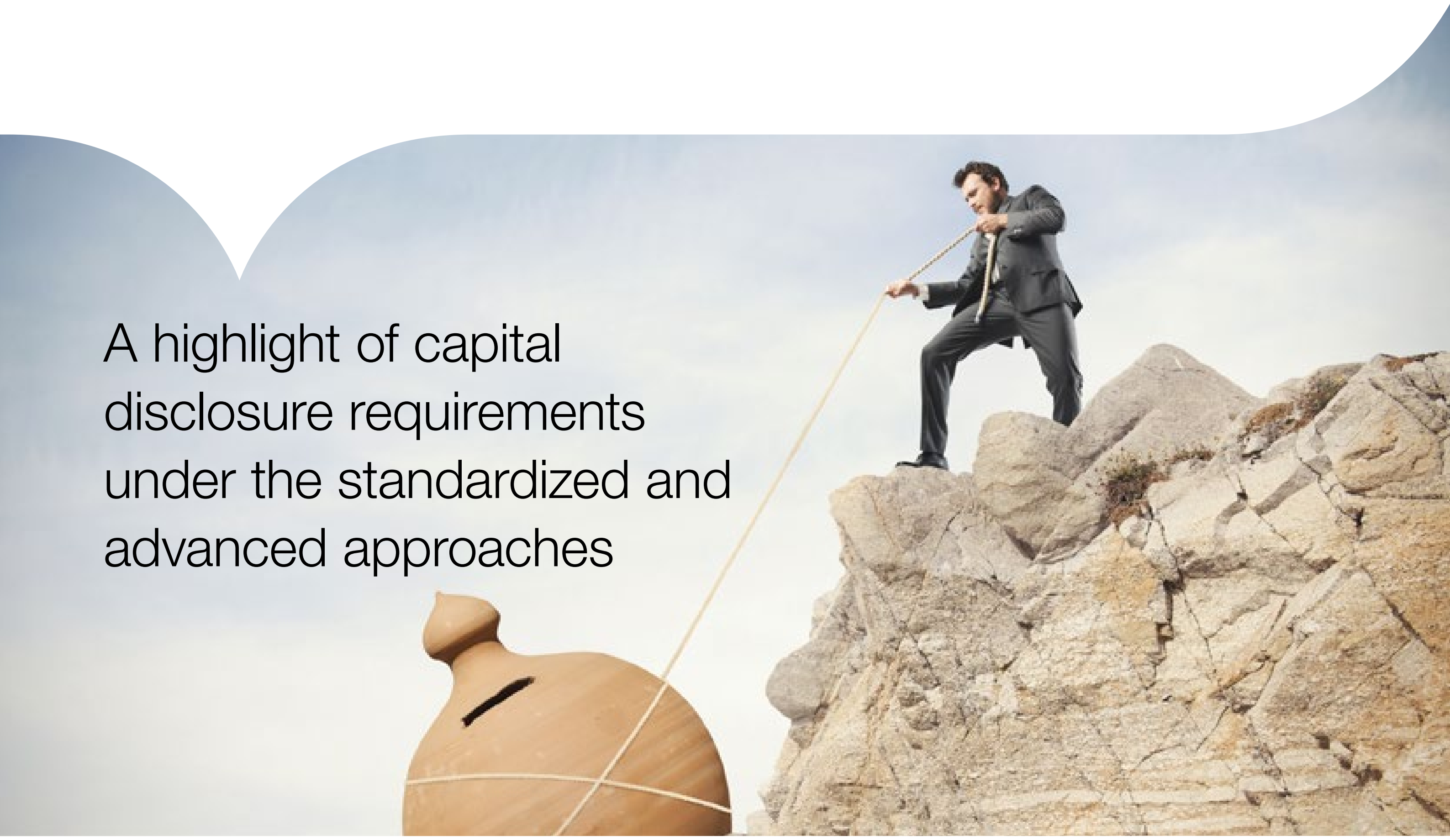
Basel III Capital Disclosure Requirements



A highlight of capital disclosure requirements under the standardized and advanced approaches

Basel III has introduced detailed mandatory regulatory requirements to enhance the risk management process in banking.

During the financial crisis of 2008–9, regulators and market participants, alike, failed to make accurate and complete assessments of banks' liquidity and capital positions—the metrics that were most important in gauging the health of financial institutions during that period. Inconsistencies in reporting standards and variations in the level of detail within disclosures were identified as the primary causes for misinformation. The abstruse quality of capital and the apparent illiquidity in the banking system were arguably the strongest contributors to uncertainty during the financial crisis. There are two key objectives to the Basel III enhanced requirements:

- The primary aim is to ensure that banks' risk exposures are backed up by an adequate amount of high-quality capital.
- Another key objective is to enhance market discipline by improving the transparency of capital reporting via common disclosure templates.

This research brief discusses risk-weighted assets (RWA) and capital disclosure requirements for banks, by providing a comparison of such requirements under both the standardized and advanced approaches.

Scope

We have limited our discussion in this research brief to cover Basel III capital disclosure requirements only. However, most US banking institutions have other (extensive) reporting requirements as part of the Comprehensive Capital Analysis and Review (CCAR) regulation.

The information in Table 1 highlights RWA/capital disclosure requirements. This information is based on sections 61–63 and 171–173 of the Basel III US Final Rule, *Federal Register*, Volume 78, Issue Number 198, October 11, 2013.

Only high-level capital disclosure requirements have been outlined in Table 1. Complete details are available at: http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

Table 1: Overview of Disclosure Requirements

<table>
<tr><th>Standardized Approach</th><th>Advanced Approaches</th></tr>
<tr><td colspan="2">Purpose and Scope</td></tr>
<tr><td>Sec. 61., p.182
The corresponding sections in this table describe public capital disclosure requirements for US banks that have adopted the standardized approach, have total consolidated assets of $50 billion or more, and are not a consolidated subsidiary or a subsidiary of a non-US organization that is subjected to comparable requirements in their home jurisdiction.</td><td>Sec. 171. & 172., p. 228
The corresponding sections in this table establish public disclosure requirements related to the capital requirements of advanced approaches banks that are not a consolidated subsidiary or a subsidiary of a non-US organization that is subjected to comparable requirements in its home jurisdiction.</td></tr>
<tr><td colspan="2">Disclosure Requirements</td></tr>
<tr><td colspan="2">Sec. 62. (a) & Sec. 172. (c) (1), p.183, 228
These sections outline the requirements for a bank to provide timely public disclosures each calendar quarter in specified templates. Qualitative disclosures that do not change often may be declared annually at the end of the fourth calendar quarter. A brief discussion on any significant change in the facts presented in the disclosures and its likely impact must also be disclosed as soon as practical. The bank's management may provide the disclosures on the bank's public website or may provide the disclosures in more than one public financial report or other regulatory reports. The bank must publicly provide a summary table indicating the locations of such disclosures.</td></tr>
<tr><td colspan="2">Sec. 62. (b) & Sec. 172. (c) (2), p.183, 228
A bank must have a formal disclosure policy that addresses the approach to disclosures and the associated internal controls and procedures. It is also mandated that one or more of the senior officers of the bank must attest that the disclosures meet the requirements of the disclosure policy.</td></tr>
<tr><td colspan="2">Sec. 62. (c) & Sec. 172. (c) (3), p.183, 228
If any piece of information is exempted from disclosure requirements under the Freedom of Information Act, then the bank must disclose more general information about the subject matter of the requirement, along with a reason for nondisclosure.</td></tr>
<tr><td>Sec. 63. (a), p. 183
A bank must make publicly available the disclosures in specified templates for the last three years (or 12 quarters) beginning January 1, 2015.</td><td>Sec. 173. (a), p. 229
A bank must make publicly available the disclosures in specified templates for the last three years (or 12 quarters) beginning January 1, 2014.</td></tr>
<tr><td colspan="2">Sec. 63. (a) & 173. (b), p. 183, 230
These sections set the general qualitative disclosure requirement for a bank to describe its risk management objectives and policies for each separate risk area. This includes (1) strategies and processes, (2) structure and organization of the relevant risk management function, (3) scope and nature of the risk reporting and/or measurement systems, (4) policies for hedging and/or mitigating risk, and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.</td></tr>
<tr><td>Sec. 63. (b), p.183
Each quarter, a bank must disclose its: (1) common equity or additional tier 1 capital, tier 2 capital, tier 1 and total capital ratios, (2) total RWAs, (3) regulatory capital ratios during any transition periods, and (4) a reconciliation of regulatory capital elements as they relate to the balance sheet.</td><td>Sec. 172. (a), p. 228
On a quarterly basis, advanced approaches banks that have successfully completed parallel run must disclose their total and tier 1 risk-based capital ratios.</td></tr>
</table>

Table 2 outlines key aspects of standardized and advanced approaches reporting requirements. For more detailed information, please refer to Basel III US Final Rule, *Federal Register*, Volume 78, Issue Number 198, October 11, 2013, http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf

- Standardized approach, pgs. 183–188
- Advanced approaches, pgs. 229–234

Table 2: Standardized and Advanced Approaches Disclosures— Key Aspects and Differences

<table>
<tr><th>Standardized Approach</th><th>Advanced Approaches</th></tr>
<tr><td>Table 1: Scope of Application (qualitative)</td><td>Table 1: Scope of Application (qualitative and quantitative)</td></tr>
<tr><td colspan="2">Requires a brief description of the corporate entity, including a description of the basis for consolidating entities for accounting and regulatory purposes, and disclosure of total capital amounts where they are less than the required minimums.</td></tr>
<tr><td>Table 2: Capital Structure (qualitative and quantitative)</td><td>Table 2: Capital Structure (qualitative and quantitative)</td></tr>
<tr><td colspan="2">Requires that institutions provide summary information about the terms of their regulatory capital instruments and disclose the amounts of their common equity tier 1, tier 1, and total capital amounts, as well as the amounts of their constituent components.</td></tr>
<tr><td>Table 3: Capital Adequacy (qualitative and quantitative)</td><td>Table 3: Capital Adequacy (qualitative and quantitative)</td></tr>
<tr><td colspan="2">All institutions must summarize their approach to capital adequacy assessment, disclose their RWA (for credit and market risk exposures) and their regulatory capital ratios. Advanced approaches institutions must also include operational risk and enhanced market risk metrics in their disclosures.</td></tr>
<tr><td>Table 4: Capital Conservation Buffer (quantitative)</td><td>Table 4: Capital Conservation and Countercyclical Capital Buffers (quantitative)</td></tr>
<tr><td colspan="2">Requires that all institutions make quarterly disclosures regarding their capital conservation buffer. In addition, advanced approaches institutions will also need to make quarterly disclosures regarding their countercyclical capital buffer.</td></tr>
<tr><td>Table 5: Credit Risk: General Disclosures (qualitative and quantitative)</td><td>Table 5: Credit Risk: General Disclosures (qualitative and quantitative)</td></tr>
<tr><td colspan="2">Institutions must make qualitative disclosures about their policies and definitions regarding credit risk exposures. Institutions are also required to provide detailed quantitative information regarding the total and average amounts of their credit risk exposures, along with details about the concentration of these exposures.</td></tr>
<tr><td>N/A</td><td>Table 6: Credit Risk: Disclosures for Portfolios Subject to IRB Risk-Based Capital Formulas (qualitative and quantitative)</td></tr>
<tr><td colspan="2">Institutions must disclose qualitative information regarding the structure and methods of their internal ratings systems, both at a consolidated level and for each category of exposures. This must include a discussion of their controls and a comparison of their internal estimates against actual outcomes.</td></tr>
<tr><td>Table 6: General Disclosure for Counterparty Credit Risk-Related Exposures (qualitative and quantitative)</td><td>Table 7: General Disclosure for Counterparty Credit Risk of OTC Derivative Contracts, Repo-Style Transactions, and Eligible Margin Loans (qualitative and quantitative)</td></tr>
<tr><td colspan="2">All institutions must disclose their methodologies and policies regarding OTC derivatives, eligible margin loans, and repo-style transactions. Advanced approaches institutions must discuss the methodologies used to assign economic capital and credit limits to counterparties and reveal the notional amounts of credit derivatives.</td></tr>
<tr><td>Table 7: Credit Risk Mitigation (qualitative and quantitative)</td><td>Table 8: Credit Risk Mitigation (qualitative and quantitative)</td></tr>
<tr><td colspan="2">All institutions must disclose their policies and processes for managing and valuating collateral, describing the amounts and types of collateral and counterparty creditworthiness. Advanced approaches institutions must also disclose the policies and procedures used to govern on- or off-balance sheet netting.</td></tr>
<tr><td>Table 8: Securitization (qualitative and quantitative)</td><td>Table 9: Securitization (qualitative and quantitative)</td></tr>
<tr><td colspan="2">All institutions must disclose details regarding their policies and procedures, with respect to securitization, detailing their objectives, the risk-based capital approach, and any special purpose entities used.</td></tr>
<tr><td>N/A</td><td>Table 10: Operational Risk (qualitative)</td></tr>
<tr><td colspan="2">Advanced approaches banks must make general qualitative disclosures regarding operational risk, describing their use of the advanced measurement approach, as well as their use of insurance for mitigating operational risk.</td></tr>
<tr><td>Table 9: Equities Not Subject to Subpart F of this Part (qualitative and quantitative)</td><td>Table 11: Equities Not Subject to Subpart F of this Part (qualitative and quantitative)</td></tr>
<tr><td colspan="2">Institutions must disclose the policies and procedures covering the valuation and accounting of equity holdings not subject to the market risk rule. Banks must also detail the value of these investments on their respective balance sheets, describing the nature of these types of investments, and the capital requirements categorized by equity grouping.</td></tr>
<tr><td>Table 10: Interest Rate Risk for Non-trading Activities (qualitative and quantitative)</td><td>Table 12: Interest Rate Risk for Non-trading Activities (qualitative and quantitative)</td></tr>
<tr><td colspan="2">Banks must disclose their key assumptions for non-trading activities, including loan payments, detailing the nature of interest rate risk for such activities. Banks must also disclose the change in their earnings or economic value for upward or downward rate shocks.</td></tr>
</table>

CONSULTING.TECHNOLOGY.OUTSOURCING

www.capgemini.com/risk

About the Authors

Dr. Varun Agarwal is a principal within the risk and compliance practice of Capgemini Financial Services. He has more than 19 years of experience in areas that span from enterprise risk management, credit, market, and country risk management; financial modeling and valuation; and international financial markets research and analyses.

Prior to Capgemini, Varun worked in the risk strategy area of HSBC. Previously, he has also worked in the global business consulting practice at IBM, the capital markets group of Deloitte & Touche, and at JP Morgan Chase in its global risk management area.

Varun has presented at numerous industry and trade conferences at both national and regional levels. His academic background includes a PhD in financial economics, an MS in quantitative economics and a bachelor's degree in engineering.

Mayank Pandya is a business analyst at Capgemini's Financial Services business information management practice specializing in risk analytics and corporate banking. He has more than six years of industry experience and has completed an International Certificate in Banking Risk & Regulation (ICBRR) through GARP. He is currently a CFA Level 1 candidate and holds an MBA with an undergraduate degree in engineering.

About Capgemini

With more than 130,000 people in 44 countries, Capgemini is one of the world's foremost providers of consulting, technology and outsourcing services. The Group reported 2013 global revenues of EUR 10.1 billion.

Together with its clients, Capgemini creates and delivers business and technology solutions that fit their needs and drive the results they want.

A deeply multicultural organization, Capgemini has developed its own way of working, the Collaborative Business Experience™, and draws on Rightshore®, its worldwide delivery model.

Learn more about us at **www.capgemini.com**

For more information, contact us at: **riskmgmt@capgemini.com**
or visit: **www.capgemini.com/risk**

FS201405131104CS

People matter, results count.