BANK FOR INTERNATIONAL SETTLEMENTS

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Financial Stability Institute

Pillar 3 framework – Executive Summary

The Basel Committee on Banking Supervision (BCBS) has long believed that it is important to encourage market discipline by way of meaningful disclosure of the key risks borne by internationally active banks. To that end, Pillar 3 of the Basel Framework lays out a comprehensive set of public disclosure requirements that seek to provide market participants with sufficient information to assess an internationally active bank's material risks and capital adequacy. The Pillar 3 standard is now part of the Basel Consolidated Framework that brings together all of the BCBS's requirements in a single document. The BCBS will continue to update Pillar 3 disclosures as and when the Basel Committee issues or modifies its requirements.

A comprehensive package for all prudential disclosures

The Pillar 3 framework provides a comprehensive package of all existing disclosure requirements, beyond those for regulatory capital requirements. For instance, disclosures related to regulatory liquidity ratios – the Liquidity Coverage Ratio and the Net Stable Funding Ratio – and those related to remuneration are now also part of the Pillar 3 framework. Unless otherwise specified, the framework applies to all internationally active banks at the top consolidated level.

Guiding principles for Pillar 3 disclosures

Pillar 3's revised disclosures are underpinned by the following five guiding principles that draw on lessons learned from the Great Financial Crisis of 2007–09.

- **Clarity:** Disclosures must be presented in a form that will be readily understood by key stakeholders, communicated through an accessible medium and easy to find.
- **Comprehensiveness:** Disclosures should describe a bank's main activities, all significant risks and changes in risk exposures between reporting periods, and management responses, while also providing sufficient qualitative and quantitative information on the bank's processes and procedures for identifying, measuring and managing risks.
- **Meaningfulness/usefulness:** Disclosure must highlight both significant current risks and emerging risks and how these are managed. References and/or linkages to balance sheet or income statement items that allow for reconciliations must also be disclosed.
- **Consistency over time:** This allows stakeholders to identify and understand trends and changes. Disclosures allow users to understand the bank's business, its risk profile and its management practices. Any significant change in disclosures must be highlighted and explained.
- **Comparability:** Comparable disclosures are critical for allowing stakeholders to assess the relative performance of banks and business activities and to compare prudential metrics, risks and risk management across banks and jurisdictions.

Templates, tables, formats, signposting and data assurance

Pillar 3 allows disclosures to be specified as either fixed or flexible format templates or tables. To facilitate navigation, the revised framework also provides linkages across templates and reconciliations with accounting items. A template generally contains quantitative data that are disclosed according to specified definitions and often accompanied by an explanatory narrative. While the narrative is discretionary, it should at least explain significant changes between reporting periods. Tables generally refer to qualitative data, although they may also include quantitative information.

A table or template with a fixed format is one where all rows, columns and fields are predetermined. A flexible format is one that is at the bank's discretion, provided that the required information is comparable and has a level of granularity similar to that specified in the disclosure requirement.

The Pillar 3 framework allows for "signposting" to limit duplications while providing banks with some flexibility. Signposting refers to cases where a document is disclosed separately from the bank's regulatory Pillar 3 report – for instance, in the bank's annual report. In such cases, the bank needs to indicate where the disclosure can be found. Signposting can only be used if the data quality assurance of the separate document is at least equivalent to that required for the Pillar 3 report.

To ensure data quality, the Pillar 3 framework defines a minimum data assurance level and requires banks to have a disclosure policy for Pillar 3 information. While there is no obligation to have these disclosures audited, these must, at a minimum, be subject to the same level of internal review and control as the information used for the management's discussion and analysis section in their financial reports.

Structure, frequencies and implementation dates of Pillar 3 disclosures

The enhanced Pillar 3 framework includes tables and templates covering all Basel disclosure requirements. The disclosures presented in the Basel Consolidated Framework are divided into multiple chapters arranged as follows:

- The first chapter refers to the scope of application of the standard, to definitions and to requirements on location, frequency and timing of disclosures, along with assurance considerations and guiding principles to promote high-quality disclosures.
- This is followed by chapters that present an overview of the bank's risk management, its prudential metrics and its risk-weighted assets (RWAs) that allows users to assess a bank's position "at a glance" and that discloses and compares modelled and standardised RWAs.
- Separate chapters relate to the composition of capital, links between financial statements and regulatory exposures, asset encumbrance and remuneration. These are followed by chapters presenting disclosure requirements for each risk type (credit risk, market risk, interest rate risk in the banking book, operational risk, leverage risk and liquidity risk) and its components (such as credit risk, counterparty credit risk, securitisation and credit valuation adjustment risk).
- Also included is a chapter describing disclosures related to macroprudential supervisory measures, such as the assessment methodology for global systemically important banks and the countercyclical capital buffer.

Each chapter includes qualitative disclosure tables – for instance, for describing the governance, organisation, risk management and policies for a specific risk type – and quantitative disclosures, which may be complemented by disclosures explaining the methodology and assumptions underpinning the data and showing how these data are reconciled with accounting data.

Disclosure frequencies vary between quarterly, semi-annual and annual, depending on the nature of the requirement. For instance, disclosures related to linkages between financial statements and regulatory exposures are generally annual; disclosures related to the composition of capital are semi-annual; and disclosures of RWAs are quarterly. Prescribed frequencies are minima. Implementation dates are aligned with those of the respective regulatory standards up to 2022.

This Executive Summary and related tutorials are also available in FSI Connect, the online learning tool of the Bank for International Settlements.