

operational loss event data, business environment and control factors, as well as scenario analysis. The institution would have to combine these elements in the manner that most effectively enables it to quantify its operational risk exposure. The institution would have to develop an analytical framework that is appropriate to its business model and risk profile.

Regulatory capital for operational risk would be based on the sum of EL and UL. There may be instances where an EL offset could be recognized, but the Agencies believe that this is likely to be difficult given existing supervisory and accounting standards. The Agencies have considered both reserving and budgeting as potential mechanisms for EL offsets. The use of reserves may be hampered by accounting standards, while budgeting raises concerns about availability over a one-year time horizon to act as a capital replacement mechanism. The Agencies are interested in specific examples of how business practices might be used to offset EL in the operational risk framework.

An institution would have to document how its chosen analytical framework accounts for dependence (for example, correlation) among operational losses across and within business lines. The institution would have to demonstrate that its explicit and embedded dependence assumptions are appropriate, and where dependence assumptions are uncertain, the institution would have to use conservative estimates.

An institution would be able to reduce its operational risk exposure by no more than 20 percent to reflect the impact of risk mitigants such as insurance. Institutions would have to demonstrate that qualifying risk mitigants meet a series of criteria (described in the supervisory guidance) to assess whether the risk mitigants are sufficiently capital-like to warrant a reduction of the operational risk exposure.

The Agencies seek comment on the reasonableness of the criteria for recognition of risk mitigants in reducing an institution's operational risk exposure. In particular, do the criteria allow for recognition of common insurance policies? If not, what criteria are most binding against current insurance products? Other than insurance, are there additional risk mitigation products that should be considered for operational risk?

An institution using an AMA for regulatory capital purposes would have to use advanced data management practices to produce credible and reliable operational risk estimates. These practices are comparable to the data maintenance requirements set forth

under the A-IRB approach for credit risk.

The institution would have to test and verify the accuracy and appropriateness of the operational risk framework and results. Testing and verification would have to be done independently of the firm-wide risk management function and the lines of business.

## VI. Disclosure

Market discipline is a key component of the New Accord. The disclosure requirements summarized below seek to enhance the public disclosure practices, and thereby the transparency, of advanced approach organizations. Commenters are encouraged to consult the New Accord for specifics on the disclosure requirements under consideration. The Agencies view enhanced market discipline as an important complement to the advanced approaches to calculating minimum regulatory capital requirements, which would be heavily based on internal methodologies. Increased disclosures, especially regarding a banking organization's use of the A-IRB approach for credit risk and the AMA for operational risk, would allow a banking organization's private sector investors to more fully evaluate the institution's financial condition, risk profile, and capital adequacy. Given better information, private shareholders and debt holders can better influence the funding and capital costs of a banking organization. Such actions would enhance market discipline and supplement supervisory oversight of the organization's risk-taking and management.

### A. Overview

Disclosure requirements would apply to the bank holding company representing the top consolidated level of the banking group. Individual banks within the holding company or consolidated group would not generally be required to fulfill the disclosure requirements set out below. An exception to the general rule would be that individual banks and thrifts within a group would still be required to disclose Tier 1 and total capital ratios and their components (that is, Tier 1, Tier 2, and Tier 3 capital), as is the case today. In addition, all banks and thrifts would continue to be required to submit appropriate information to regulatory authorities (for example, Report of Condition of Income (Call Reports) or Thrift Financial Reports).<sup>51</sup>

<sup>51</sup> In order to meet supervisory responsibilities, the Agencies plan to collect more detailed information through the supervisory process or

The Agencies are proposing a set of disclosure requirements that would allow market participants to assess key pieces of information regarding a banking group's capital structure, risk exposures, risk assessment processes, and ultimately, the capital adequacy of the institution. Failure to meet these minimum disclosure requirements, if not corrected, would render a banking organization ineligible to use the advanced approaches or would otherwise cause the banking organization to forgo potential capital benefits arising from the advanced approaches. In addition, other supervisory measures may be taken if appropriate.

Management would have some discretion to determine the appropriate medium and location of the required disclosure. Disclosures made in public financial reports (for example, in financial statements or Management's Discussion and Analysis included in periodic reports or SEC filings) or other regulatory reports (for example, FR Y-9C Reports), could fulfill the applicable disclosure requirements and would not need to be repeated elsewhere. For those disclosures that are not made under accounting or other requirements, the Agencies are seeking comment on the appropriate means of providing this data to market participants. Institutions would be encouraged to provide all related information in one location; at a minimum, institutions would be required to provide a cross reference to the location of the required disclosures.

The Agencies intend to maximize a banking organization's flexibility regarding where to make the required disclosures while ensuring that the information is readily available to market participants without unnecessary burden. To balance these contrasting objectives, the Agencies are considering requiring banking organizations to provide a summary table on their public websites that indicate where all disclosures may be found. Such an approach also would allow institutions to cross-reference other web addresses (for example, those containing public financial reports or regulatory reports or other risk-oriented disclosures) where certain of the disclosures are located.

Given longstanding requirements for robust quarterly disclosure in the United States, and recognizing the potential for rapid change in risk profiles, the Agencies intend to require that the disclosures be made on a

regulatory reports. Much of this information may be proprietary and accordingly would not be made public.