

quarterly basis. However, qualitative disclosures that provide a general summary of a banking organization's risk management objectives and policies, reporting system, and definitions would be able to be published on an annual basis, provided any significant changes to these are disclosed in the interim. When significant events occur, banking organizations would be required to publish material information as soon as practicable rather than at the end of the quarter.

The risks to which banking organizations are exposed and the techniques that they use to identify, measure, monitor, and control those risks are important factors that market participants consider in their assessment of an institution. Accordingly, banking organizations would be required to have a formal disclosure policy approved by the board of directors that addresses the institution's approach for determining the disclosures it will make. The policy also would have to address the associated internal controls and disclosure controls and procedures. The board of directors and senior management would have to ensure that appropriate verification of the disclosures takes place and that effective internal controls and disclosure controls and procedures are maintained.

Consistent with sections 302 and 404 of the Sarbanes-Oxley Act of 2002, management would have to certify to the effectiveness of internal controls over financial reporting and disclosure controls and procedures, and the banking organization's external auditor would have to attest to management's assertions with respect to internal controls over financial reporting. The scope of these reports would need to include all information included in regulatory reports and the disclosures outlined in this ANPR. Section 36 of the Federal Deposit Insurance Act has similar requirements. Accordingly, banking organizations would have to implement a process for assessing the appropriateness of their disclosures, including validation and frequency. Unless otherwise required by accounting or auditing standards, or by other regulatory authorities, the proposed requirements do not mandate that the new disclosures be audited by an external auditor for purposes of opining on whether the financial statements are presented in accordance with GAAP.

B. Disclosure Requirements

Banking organizations would be required to provide disclosures related to scope of application, capital structure, capital adequacy, credit risk, equities in the banking book, credit risk mitigation, asset securitization, market risk, operational risk and interest rate risk in the banking book. The disclosure requirements are summarized below.

The required disclosures pertaining to the scope of application of the advanced approaches would include a description of the entities found in the consolidated banking group. Additionally, banking organizations would be required to disclose the methods used to consolidate them, any major impediments on the transfer of funds or regulatory capital within the banking group, and specific disclosures related to insurance subsidiaries.

Capital structure disclosures would provide summary information on the terms and conditions of the main features of capital instruments issued by the banking organization, especially in the case of innovative, complex, or hybrid capital instruments. Quantitative disclosures include the amount of Tier 1, Tier 2, and Tier 3 capital, deductions from capital, and total eligible capital.

Capital adequacy disclosures would include a summary discussion of the banking organization's approach to assessing the adequacy of its capital to support current and future activities. These requirements also include a breakdown of the capital requirements for credit, equity, market, and operational risks. Banking organizations also would be required to disclose their Tier 1 and total capital ratios for the consolidated group, as well as those of significant bank or thrift subsidiaries.

For each separate risk area, a banking organization would describe its risk management objectives and policies. Such disclosures would include an explanation of the banking organization's strategies and processes; the structure and organization of the relevant risk management function; the scope and nature of risk reporting and/or measurement systems; and the policies for hedging and/or mitigating risk and strategies and processes for monitoring the continuing effectiveness of hedges/mitigants.

The credit risk disclosure regime is intended to enable market participants to assess the credit risk exposure of A-IRB banking organizations and the overall applicability of the A-IRB framework, without revealing proprietary information or duplicating the role of the supervisor in validating

the framework the banking organization has put into place.

Credit risk disclosures would include breakdowns of the banking organization's exposures by type of credit exposure, geographic distribution, industry or counterparty type distribution, residual contractual maturity, amount and type of impaired and past due exposures, and reconciliation of changes in the allowances for exposure impairment.

Banking organizations would provide disclosures discussing the status of the regulatory acceptance process for the adoption of the A-IRB approach, including supervisory approval of such transition. The disclosures would provide an explanation and review of the structure of internal rating systems and relation between internal and external ratings; the use of internal estimates other than for A-IRB capital purposes; the process for managing and recognizing credit risk mitigation; and, the control mechanisms for the rating system including discussion of independence, accountability, and rating systems review. Required qualitative disclosures would include a description of the internal ratings process and separate disclosures pertaining to the banking organization's wholesale, retail and equity exposures.

There would be two categories of quantitative disclosures for credit risk: those that focus on the analysis of risk and those that focus on the actual results. Risk assessment disclosures would include the percentage of total credit exposures to which A-IRB disclosures relate. Also, for each portfolio except retail, the disclosures would have to provide (1) a presentation of exposures across a sufficient number of PD grades (including default) to allow for a meaningful differentiation of credit risk,⁵² and (2) the default weighted-average LGD for each PD, and the amount of undrawn commitments and weighted average EAD.⁵³ For retail portfolios, banking organization would provide either⁵⁴ (a) disclosures outlined

⁵² Where banking organizations are aggregating PD grades for the purposes of disclosure, this would be a representative breakdown of the distribution of PD grades used in the A-IRB approach.

⁵³ Banking organizations need only provide one estimate of EAD for each portfolio. However, where banking organizations believe it is helpful, in order to give a more meaningful assessment of risk, they may also disclose EAD estimates across a number of EAD categories, against the undrawn exposures to which these relate.

⁵⁴ Banking organizations would normally be expected to follow the disclosures provided for the non-retail portfolios. However, banking organizations would be able to adopt EL grades at the basis of disclosure where they believe this can provide the reader with a meaningful differentiation of credit risk. Where banking organizations are