

Mr J Brockmeijer
Chairman of the Transparency Group
Basel Committee on Banking Supervision
Bank for International Settlements
4002 Basel

7 February 2003

Draft Pillar 3 - Market Discipline (December 2002)

Dear Mr Brockmeijer

UBS welcomes the decision of the Transparency Group (TG) to invite the industry to comment on the proposed changes to Pillar 3 prior to the release of CP3.

As an exponent of transparency in banks' financial statements, and of disclosure as a means to promote market discipline, we support the philosophy of Pillar 3, i.e., we continue to be convinced that comprehensive, high quality, consistent and comparable disclosure across the industry:

- would promote safety and soundness in the financial system because it allows the investor to make informed and well founded investment decisions, which in turn can lead to improved discipline,
- would foster best risk management practice, as it is in the interest of every market participant to be able to disclose the best possible figures,
- could, as a result, be an essential complement to, if not a substitute for, regulation.

UBS welcomes the principles articulated in paragraphs 1 to 11 of the draft Pillar 3, in particular:

- the flexibility offered in the way information may be made available,
- the avoidance of duplication of disclosure required under accounting and listing rules,
- the reference to materiality, and
- the need to protect proprietary and confidential information.

Unfortunately, these principles are not generally carried through to the detailed disclosure requirements which follow those paragraphs. We particularly regret that the TG has not taken into account previous reactions by our Firm and, more broadly, by the industry.

This has been the case with respect to the amount and the nature of the detailed disclosure, which has been consistently considered excessive and counterproductive, and in relation to the need to align Pillar 3 to International Accounting Standards.

In addition, we would like to emphasise that disclosure cannot be seen in isolation from the rest of the Accord (see our position on the draft Pillar 1 paper included in the QIS 3 documentation and submitted to the Secretary General of the Basel Committee).

1. The prescriptive, one-size-fits-all, detailed quantitative requirements for IRB and asset securitisation approaches continue to be excessive and likely to confuse rather than illuminate the external audience.

The development of Pillar 1 IRB and asset securitisation approaches over the past two years has been such that they now lend themselves to a broad variety of interpretations, let alone the fact that more than 40 areas of national discretion are defined in relation to IRB approaches alone. An even greater flexibility characterises the operational risk AMA and interest rate risk in the banking book practices (Pillar 2).

Consequently, the implementation of the Pillar 1 framework across jurisdictions and firms will differ. Under these circumstances, no level of detailed disclosure of Pillar 1 parameters under Pillar 3 can possibly deliver the desired level of comparability across banks.

Moreover, being detailed and rigid, the set of disclosure requirements will not be responsive to evolving risk management practice at individual banks. Ultimately, it will impose the maintenance of multiple, costly, disclosure frameworks on banks with no discernible risk management benefit and with doubtful market discipline enhancements.

UBS believes that the TG should **simplify quantitative IRB and asset securitisation disclosure requirements** and develop comprehensive, high quality, consistent and comparable disclosure, capable of truly promoting the key mechanism of market discipline, instead.

As far as operational risk is concerned we think that any requirement beyond a description of the advance measurement approach (AMA) used by the bank would imply disclosure of confidential information that may be commercially and competitively sensitive or add little valuable information for assessing the bank's operational risk management.

Along similar lines, we deem Interest Rate Risk in the Banking Book disclosures exaggerated when it comes to model assumptions for portfolios with embedded optionality (e. g. loan prepayments and behaviour of non-maturity deposits) and the development of the economic value for interest rate shocks.

Regarding market risk, most banks publish maximum, minimum, average and period-end VaR. Average is usually taken to be the mean, but the Group's proposal refers to the median. Is this change deliberate and, if so, what is the reason for it, given that mean is the generally adopted measure of average?

2. Disclosure requirements under IAS and Pillar 3 are not aligned. This further aggravates the costs (parallel disclosure system, reconciliation procedure), consistency and intelligibility issues.

In general, accounting and disclosure policies are based on accounting frameworks applied by the bank (e. g. IAS, US GAAP). Reference to these standards should be made instead of separate reporting.

This would allow the necessary flexibility in the regulatory framework while ensuring consistency of information to the external audience. It would also avoid banks incurring in substantial costs associated with compliance with the present proposal and generated by it.

To conclude, UBS believes that the TG should, as a principle, ask for a meaningful minimum disclosure and let market discipline work for more, rather than to request a maximum, prescriptive, disclosure with breakdowns along all possible dimensions. It should simplify the quantitative requirements for IRB and asset securitisation, and revise the disclosure applicable to operational risk and interest rate risk in the banking book.

The framework should be more closely tailored to a bank's internal risk management structure and provide more meaningful information to the markets. It should integrate on-going developments in International Accounting Standards and remain open for discussion throughout this year accordingly. Pillar 3 should be reviewed by auditors. However, for practical reasons it should not be covered by the audit report.

Much more than now, the required set of disclosures should be the result of a co-ordinated initiative involving supervisors, regulated firms and representatives of the users of the published statements, since it would be they who would be the principal source of the market discipline which the TG is rightly seeking to strengthen.

We look forward to the CP3 document and further news regarding the development of the draft paper. If you have any questions on the matters we have raised in this letter or the attachments or would like to discuss any of them further with us please contact:

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Yours sincerely,

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