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To The Basel Committee on Banking Supervision

Consultative Document

Standards

Review of the Pillar 3 disclosure requirements

M&G has £250bn Assets under Management across equities, fixed income, multi-asset and property. We are major investors in bank equity and debt across the world.

This response has been led by James Alexander. He is Head of Equities Research at M&G with a special responsibility for the banking sector. He has worked closely with several members of the Financials Institutions Research team in the M&G Fixed Income division in preparing this response.

We very much welcome the Review and all of its recommendations. We also applaud the way in which the Review group has built on the recommendations of the EDTF private sector initiative. It is very important that there continues a strong interaction between users of disclosure and preparers of disclosure, to cooperate on agreeing what is useful and what is possible.

That said, there are times when disclosure needs to be enhanced even more than can be agreed between users and preparers. Regulatory accounts are one such area. If users are to rely on regulatory accounts, capital measures and risk weighted assets, then there has to be transparency on their calculation. Clearly, many calculations rely on a large number of inputs and fairly complex calculations, but the data to make these calculations must exist and therefore must also be, in principle, publishable.

We believe that this is so especially for FIRB and AIRB calculations of risk-weighted assets, where capital requirements are almost always lower than for Standardised measurements. The users, and the regulators, must be prepared to “prove it” or lose it, when it comes to the credibility of IRB vs Standardised. Of course, the same also applies to Standardised calculations over accounting measurements of assets.

We particularly welcome the Pillar 3 Review as a useful guide to help users understand better where risks within banks reside and to draw users’ attention to particular areas of interest.

We would prefer to see a fixed, as opposed to flexible format approach, in order to ensure that flexibility does not result in non-disclosure, or dispersion of the results to many different parts of

company reporting. We would also prefer not to have excessive flexibility on table formatting; comparability is a very important goal for users. The case of major cross-border exposures, such as derivatives and repo, is particularly important here, so all counterparties report on the same basis no matter which particular jurisdiction they happen to be reporting in or regulated by. A proper assessment of idiosyncratic or, especially, systemic risk cannot be made unless like is compared to like, in this area

Detailed comments:

("no comment" does not imply "no agreement": we think **all** recommendations are very useful, but merely want to emphasise strong agreement with, or comment on, a few in particular)

OVA – Must ensure that these qualitative overviews are not boilerplate, but contain real content specific to the particular bank.

OV1 – An additional column with nominal assets would be very useful, for quick reference and because it can be difficult to find nominal exposure in these categories elsewhere in reported information.

LI1 – Columns a, b and h are especially useful – f and g also useful as give a better indication of the composition of the trading book. The rows for off-balance sheet items and securitisation exposures are also very helpful as these aid investors' process of modelling leverage ratios or considering deductions from common equity.

LI2 – Column a is especially useful, but all columns will be necessary to explain major differences from column a. – An additional row could be added below with total RWA amount for each of the columns.

CR1 – We especially like the row 3, for off-balance sheet exposures, and more generally like the useful split of defaulted and impaired exposures, by type, in one place – and an accumulated write-off figure is also not always provided in normal bank disclosure

CR2 – Very helpful; especially rows 2, 3 and 5, for assessing the development of new problem exposures and management's attitude towards write-offs Some banks already provide this information so is should be available for all banks. If this is to be a quarterly table, then would it be best to define 'New defaulted loans...' with reference to the last 12 months rather than last financial year. Line 4 is also interesting, if accompanied by some description of the bank's requirements for reclassifying a previously defaulted loan as performing so that we understand how easily the bank can adjust their non-performing exposures.

CRB – Quantitative exposures will be very useful, only banks in a very small number of distressed countries provide this information at present. The breakdown of restructured impaired vs. not impaired is new and very useful. We would like to know whether "restructured" definitely includes all types of negative forbearance? The current ECB/EBA AQR process should provide some standardisation of what counts as a performing restructured loan, but the more detail here the better. (Spanish banks are required to report restructure loans by NPL, Substandard and Performing.)

CR3 – Very useful, as corporate/wholesale lending books and debt securities are normally something of a "black hole" in terms of this disclosure. This table could be improved by stating when the collateral was last valued, perhaps by annual buckets (eg <12m, 1-3yrs, >3 yrs). A better breakdown of row 1 Loans into a broad category (Retail, SME, Corporate) would be more useful, and a breakdown of the type of loan combined with the age of collateral valuation will give a better understanding of the appropriateness of the collateral valuations.

CR4 – Very useful, as collateral values, especially on corporate exposures, are crucially important in assessing coverage ratios, but are often impossible to find. We think the ratio should take the same form in both halves of the table, so that rows 8 onward read "100% to 110%", "110% to 120%" etc. There is no problem in saying that the exposure/protection ratio is 100%, 110%, 120% etc. Same comment as for CR3 on breaking out by borrower – although the table could become somewhat unwieldy.

CR5, CR6 – We don't place a lot of value on guarantors, or external ratings, but these are still useful tables. However, if there is significant RWA mitigation from this source of credit support, then it must be disclosed. Perhaps, it is more relevant to show internal ratings rather than external ratings. Or both, if available.

CR7 & CR8 – Please split corporates into financial and non-financial corporates as, in general, financial corporates will be more geared than non-financial corporates and have more systemic risk.

CRE – Difficult tables to work with, but very necessary if users are to trust the figures produced by the preparers and agreed by the regulators.

CR9 – It would be helpful to have some idea of historic RWA densities, even though the history should build up over time.

CR10 – Potentially, a somewhat confusing overlap with CR5 and CR6 but CR10 is quite a useful summary. Columns c and d overlap with CR5 and CR6, respectively, but the rows are different, so should be OK.

CR11 – This is very helpful in assessing the reasons for RWA movements. Perhaps banks should be required to specify the main components of the "other" line 8 It would be great to have the change by type of RWA somehow included – so a movement of table OV1 due to the factors in CR11.

CR13 – In Section 1, the term structure of exposure, and indication of source of expected losses is useful. Section 2 on Equity Exposures is very welcome, a source of much confusion and doubt at present.

CCR2 – If there are capital charges for CVA then they have to be explained, so this is very helpful. A column before a, a-1(?) with EAD pre-CRM would be helpful to understand the original values.

CCR3 – This is a good table. Need to add a column for sum of exposure multiplied by risk-weight bracket, which would mean we can see the total credit exposure and RWA exposure for each row.

CCR5 – Very useful in assessing collateral quantum and asset encumbrance, and we would ideally like to have an additional column showing the segregated/unsegregated amounts of collateral that are “hypothecatable”. And, further split into collateral pledged, and collateral received. We would also request the SFTs be split into segregated and unsegregated.

CCR6 – Excellent to get further detail and extent and type of these exposures (we get little/no disclosure on this currently).

CCR7 – Very useful, as before, in assessing the contributors to the change. Main constituents of “other” should be specified in row 8. And again could this be enlarged similar to OV1 as mentioned in our response to CR11?

CCR8 – A good table in terms of showing quantum of usage and to highlight potential sector inter-linkages, but should have a column before a, a-1(?), showing EAD pre-CRM.

SECA – We had thought (hoped) that this area had been reduced as a producer of RWAs, but if it does give rise to significant RWAs then we do need to know about the data and the calculations.

SEC1&3 – Very useful; particularly the split between sponsor/investor and traditional/synthetic, and even more useful if the accompanying SEC2&4 done.

MR3 – It will be very helpful to know the key drivers and the contribution of CRM.

MR5 – Very useful, and important to see both actual and hypothetical charts. Specifying 99% confidence interval is very important, but it would be interesting to hear why just a 1-day holding period and not 10-day holding period was specified. 10-day periods may more accurately reflect situations where many participants have similar positions, so leading to systemic risk as opposed to mere idiosyncratic risk.

EDTF Recommendation 29 – We believe that gross notional amounts of derivatives are very important for assessing the overall starting point of exposure – given the immense leverage that derivatives entail, and are designed to entail. Obviously, these exposures are then subject to a

variety restatement and risk mitigation, but the gross notional needs to be kept in mind as a starting point, rather like the way the leverage ratio is meant to be used. We think the quantification specified in EDTF Recommendation 29 should be clearly incorporated into Pillar 3 as a handy reference point before entering into the complexities of presenting them as regulatory RWAs. The fact that the bulk of interest rate swaps, for instance, do not even generate Positive and Negative Replacement Values (due to their being bilateral and daily marked to market and but only sometimes margined) shows the limitations of statutory accounting in accurately capturing the risks. Linkages from statutory accounting, both on the balance sheet (and in key notes to the accounts) to regulatory reporting are very important for users, given the audited nature of statutory accounts versus only unaudited, though regulatory-approved, regulatory figures.

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