SURVEY OF DISCLOSURES ABOUT

TRADING AND DERIVATIVES ACTIVITIES

OF BANKS AND SECURITIES FIRMS

1996

Joint report by the
Basle Committee on Banking Supervision
and the
Technical Committee of the International Organisation of
Securities Commissions
("IOSCO")

November 1997

EXECUTIVE SUMMARY

Survey of disclosures about trading and derivatives activities of banks and securities firms 1996

This survey of disclosures about trading and derivatives activities presented in the annual reports of 79 large banks and securities firms located in the G-10 countries and one large securities firm located in Hong Kong, reveals that while trading and derivatives disclosures of many banks and securities firms have improved in recent years, there are still some institutions that disclose little or nothing about key aspects of their trading and derivatives activities.

Overall, the amount, detail and clarity of trading and derivatives-related disclosures in annual reports of banks and securities firms improved substantially over the 1993-1996 period; however, progress in disclosure practices was less pronounced in 1996 than in previous years. The most noteworthy improvements in 1996 annual reports were expanded discussions of operating and legal risks; more information about the valuation techniques for trading and derivatives activities; the accounting treatment for derivatives credit losses; and the increased amount of quantitative market risk disclosures. The Basle Committee and the IOSCO Technical Committee strongly encourage banks and securities firms to continue their efforts to develop more meaningful disclosures for their trading and derivatives activities.

Despite these improvements, there remain disparities, both within and across countries, as regards the type and usefulness of the information disclosed. Those institutions that continue to disclose little about their trading and derivatives activities are strongly encouraged to consider the quantitative and qualitative disclosures recommended by the two Committees. They should also consider disclosure initiatives by other national and international bodies, and the types of disclosures provided by their peers at the international level.

TABLE OF CONTENTS

SURVEY OF DISCLOSURES ABOUT TRADING AND DERIVATIVES ACTIVITIES OF BANKS AND SECURITIES FIRMS 1996

I. General remarks

(1) Introduction

The Basle Committee on Banking Supervision[1] (Basle Committee) and the Technical Committee of the International Organisation of Securities Commissions[2] (IOSCO Technical Committee) have undertaken their third survey[3] on the public disclosure of trading (on-balance-sheet instruments and off-balance-sheet derivatives) and non-trading derivatives activities[4] of banks and securities firms. This survey represents a continued effort by the two Committees to encourage banks and securities firms to provide market participants with sufficient information to understand the risks inherent in their trading and derivatives activities.

The Committees' efforts are consistent with, and reinforced by, the report of the G-7 Finance Ministers on promoting financial stability submitted to the G-7 Heads of State in conjunction with the Denver summit in 1997, which states that public disclosure can enhance market discipline by improving the information available to market participants. In their report, the G-7 Finance Ministers encourage supervisors to further promote disclosure. The role that appropriate disclosure can play is also stressed in the Basle Committee's Core Principles for Effective Banking Supervision, which note that banks should disclose information that is timely and sufficient for market participants to assess the risks inherent in any individual banking institution.[5]

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1 The Basle Committee on Banking Supervision is a committee of banking supervisory authorities which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basle, where its permanent Secretariat is located.

2 The Technical Committee of IOSCO is a committee of the supervisory authorities for securities firms in major industrialised countries. It consists of senior representatives of the securities regulators from Australia, Canada, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

3 The earlier surveys were published in November 1995 and November 1996, respectively.

4 From now on referred to as "trading and derivatives" activities.

5 The Core Principles for Effective Banking Supervision (the "Basle Core Principles") was issued by the Basle Committee in September 1997.

The results of this third survey show that the disclosure practices of 79 internationally active banks and securities firms improved in 1996 annual reports. This is particularly true with respect to the disclosure of value-at-risk data and the assumptions underlying value-at-risk models. Also, institutions expanded their discussion of operating and legal risks, and provided more information about the valuation techniques for trading and derivatives activities and the accounting treatment for derivatives credit losses.

Notwithstanding the aforementioned improvements, the types of disclosure provided by different banks and securities firms vary, and some firms continue to disclose little about their trading and derivatives activities. Therefore, institutions are strongly encouraged to consider the recommendations for quantitative and qualitative disclosures issued by the Basle Committee and the IOSCO Technical Committee; as well, firms should consider disclosure initiatives by other national and international bodies, and the types of disclosures provided by their peers at the international level.

(2) Objective

As with the previous reports, this document intends to provide a picture of the advances in disclosure practices of a sample of internationally active banks and securities firms for trading and derivatives activities and to encourage internationally active banks and securities firms to further enhance their disclosures. The Basle Committee and the IOSCO Technical Committee believe that meaningful public disclosure plays an important role in reinforcing the efforts of supervisors to encourage sound risk management practices and foster financial market stability. Improved disclosure should also benefit banks and securities firms themselves by enhancing their ability to evaluate and manage their exposures to other counterparties and reducing the likelihood that they become susceptible to market rumours and misunderstandings during periods of financial stress.

(3) Recommendations of the November 1995 report

In November 1995, the Basle Committee and the IOSCO Technical Committee issued a report on the public disclosure of trading and derivatives activities of banks and securities firms. It contained a series of recommendations for further improvement of qualitative and quantitative disclosure about how trading and derivatives activities contribute to the overall risk profile and profitability of large banks and securities firms with significant involvement in trading and derivatives activities, combined with information on their risk management practices and actual performance. These recommendations drew on the concepts developed in the *Discussion Paper on Public Disclosure of Market and Credit Risks by Financial Intermediaries* ("the Fisher Report"), released by the Euro-currency Standing Committee of the G-10 central banks in September 1994 and on the *Framework for Supervisory Information About the Derivatives Activities of Banks and Securities Firms* ("the

Supervisory Information Framework"), released jointly by the Basle Committee and the IOSCO Technical Committee in May 1995. The recommendations are reproduced in the annex to this paper and follow two main themes.

First, as recommended in the Fisher Report, institutions should disclose quantitative information, produced by internal risk measurement and management systems, on their risk exposures and their actual performance in managing these exposures. Drawing on internal systems would help to ensure that disclosure practices continue to improve with innovations in risk measurement and management techniques.

Second, institutions should provide financial statement users with a clear picture of their trading activities and their overall involvement in the derivatives market, as well as the impact of these activities on earnings. For guidance about meaningful types of information and fundamental disclosures about derivatives activities, institutions are encouraged to look to the catalogue and common minimum framework presented in the Joint Basle Committee / IOSCO Supervisory Information Framework paper, issued in May 1995. Disclosure of information that is consistent with the common minimum framework could improve the consistency and comparability of basic annual report disclosures about overall market activity in derivatives, and their credit risk.

Qualitative disclosures should offer an overview of the institution's overall business objectives, its risk-taking philosophy, how trading and derivatives activities fit into these overall objectives, as well as the principal internal control procedures that are in place for managing these activities. Also, qualitative disclosures should provide depth to the quantitative disclosures of these activities. Recommended qualitative disclosures include descriptions of major risks arising from trading and derivatives activities and the methods used to manage these risks, information about overall objectives and strategies for trading activities, and discussion of significant valuation and accounting policies.

Quantitative disclosures should include comprehensive summary information about an institution's involvement in trading and derivatives activity, its exposure to credit risk and market risk and its performance in managing these risks. Institutions should also disclose how trading and derivatives activities affect reported earnings. Recommended quantitative disclosures include summary information on the composition of trading portfolios, disclosures based on internal methodologies, value-at-risk data and major assumptions underlying value-at-risk estimates, and information on how trading activities affect earnings.

(4) National and international developments affecting disclosure

In addition to the recommendations issued jointly by the Basle Committee and the IOSCO Technical Committee on trading and derivatives disclosure in November 1995 and

reinforced in this report, several other national and international bodies have recently issued proposals or rules that have affected 1996 disclosures, and other such proposals are under development. Many of these initiatives are likely to influence future disclosures about trading and derivatives information. These initiatives include:

- *International Accounting Standard IAS 32 "Financial Instruments: Disclosure and Presentation".* IAS 32 was issued by the International Accounting Standards Committee (IASC) in June 1995, and includes requirements for disclosure of terms, conditions and accounting policies for financial instruments, interest rate risk and credit risk data, and the fair value of on- and off-balance-sheet financial instruments.

- *The IASC Discussion Paper "Accounting for Financial Assets and Financial Liabilities".* This discussion paper, published in March 1997, advocates using fair values instead of historical costs to account for financial assets and financial liabilities. The discussion paper is not a formal proposal, but it considers important arguments about the usefulness of financial information. It also recommends expanded disclosure about financial risks, and the objectives and strategies for managing those risks.

- *The Japanese Ministry of Finance's new regulations about market value accounting for trading activities.* As from 1 April 1997, Japanese banks and securities firms may adopt mark-to-market accounting for their trading activities (including derivatives), provided they meet certain approval standards on internal control, valuation and accounting procedures set by the Ministry. This change improves the information available to the public about banks' and securities firms' periodic performance in their trading and derivatives activities.[6]

  Furthermore, in July 1996, Japanese ministerial ordinances and circulars (e.g. Regulation concerning Terminology, Forms and Method of Preparation of Financial Statements, etc.) were revised to enhance derivatives disclosure of all firms. The revisions are effective from the period that ended in March 1997 and require firms to disclose qualitative information as well as notional amount information for all derivatives, including over-the-counter instruments. The revisions also include a recommendation for the disclosure of quantitative information on market risk and credit risk. Moreover, as from the period ending in March 1998, disclosure of market value information for over-the-counter instruments will be required.

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6 It should be noted that mark-to-market or fair value accounting for trading activities already is accepted practice for all or part of the trading book also in many other countries.

- *The UK Accounting Standards Board (ASB) Financial Reporting Exposure Draft 13 (FRED 13), with Supplement.* The ASB issued FRED 13 in April 1997, and its Supplement, which sets out modifications for banks and similar institutions, in September 1997. Some of the key proposals are that banks disclose their objectives, policies and strategies in holding or issuing financial instruments, specified information on interest rate, currency and liquidity risks as well as value-at-risk, sensitivity analysis or other market price measure figures with respect to the trading book. In addition, it is proposed that fair value information be given for all financial assets and liabilities held in the trading book and for some financial assets and liabilities held in the non-trading book, namely all derivatives and other financial assets and liabilities for which a liquid and active market exists.

- *The US Securities and Exchange Commission (SEC) "Market Risk" disclosure rule.* This rule was proposed in 1995 and was finalised by the SEC in January 1997. The rule affects the largest institutions in the US and all banks and savings associations beginning with statements filed after 30 June 1997. In addition to requiring specific quantitative and qualitative disclosures about market risk, it requires specific disclosures about an institution's accounting policies relating to derivatives. Although this rule was not in effect for the 1996 reports, it may have had some influence on market risk disclosures.

- *The Fédération des Experts Comptables Européens (FEE) report "Accounting Treatment of Financial Instruments - A European Perspective".* The report was published in December 1996 and recommends disclosure of qualitative information about the use of financial instruments and the management of related risks, and quantitative information about the exposure to credit and market risks in a form consistent with the bank's management of those risks.

- *The amended Basle Capital Accord for market risk capital rules and the EU capital adequacy directives.* The disclosure of information about the regulatory capital charges for market risks and their calculation became common in many countries in 1996. The amended Basle Capital Accord requires that market risk capital rules be implemented for internationally active banks in the G-10 countries as of January 1998. According to European Union law, market risk capital rules were to be effective by year-end 1995 for banks and securities firms in EU member states.

(5) Overall survey results and recommendations

The amount, detail and clarity of trading and derivatives-related disclosures in annual reports of banks and securities firms improved substantially over the 1993-1996 period. Overall, the banks and securities firms included in the survey significantly enhanced their disclosure of qualitative and quantitative information about credit and market risks associated with their trading and derivatives activities.

In comparison with 1995, progress in disclosure practices continued in 1996 annual reports, although the improvement was less pronounced than in previous years. The most noticeable improvement in 1996 was the sustained expansion of disclosure of value-at-risk data. There was a large increase in the number of institutions that provided quantitative disclosures drawn from their internal value-at-risk methodologies and of the major assumptions underlying their value-at-risk models. Management discussion of operating and legal risks also expanded. In addition, institutions provided more information about the valuation techniques for their trading and derivatives activities and the accounting treatment for derivatives credit losses. Furthermore, the number of institutions that distinguished between over-the-counter and exchange traded instruments in their disclosure of notional amounts increased. In other areas, the progress in disclosure practices from previous years was generally sustained. The Committees strongly encourage banks and securities firms to continue their efforts to develop more meaningful disclosures for their trading and derivatives activities.

Despite these improvements, there remain significant disparities, both within and across countries, as regards the type and usefulness of the information disclosed. For instance, only a few institutions in the sample related value-at-risk data to actual changes in portfolio value, as discussed in the Fisher Report, and less than half of the institutions provided information on trading income by risk exposure or line of business. Moreover, some institutions continue to disclose little, generally, about key aspects of their trading and derivatives activities. These institutions are strongly encouraged to consider the quantitative and qualitative recommendations contained in the November 1995 report, summarised in section I (3) and reproduced in the Annex. In addition, all banks and securities firms should consider disclosure initiatives by other national and international bodies, and the types of disclosures provided by their peers at the international level, as outlined in Tables 2-6 of this year's disclosure survey.

While the focus of this report is on trading and derivatives activities, the importance of enhancing disclosure of information in other areas should also be considered. The Basle Committee and the IOSCO Technical Committee will continue to study the issue of disclosure and monitor improvements in banks' and securities firms' disclosure practices for different activities and risk exposures over the coming years. Both Committees expect that

firms will continue to enhance - and where necessary expand - their disclosures in line with the growth in the level and complexity of their business activities.

II. Scope and methodological remarks

This survey of trading and derivatives-related disclosures focuses on the 1993-1996 annual reports of 67 banks and 12 securities firms, representing a sample of large, internationally active institutions in the G-10 countries (summarised in Tables 1-6). The 1995 and 1996 results also include one Hong Kong securities firm. It is reported separately in the last two columns of Tables 2-6 (not aggregated with the G-10 countries because only 1995 and 1996 financial statements were reviewed). For the most part, the institutions reviewed represent the largest banks and securities firms involved in derivatives in their countries, as measured by the total notional amounts of derivative instruments.[7] The institutions reviewed are listed in Table 1, which presents the notional amount of the institutions' off-balance-sheet derivatives positions in the national currency and in US dollars at the closing date of the financial statements.[8]

As was noted in the two earlier reports, the tabulation of disclosures is in part a subjective exercise and the review required criteria and judgement to determine whether or not an institution had made a particular disclosure. For example, one bank or securities firm might explicitly provide certain quantitative information, whereas in another bank's or securities firm's annual report, similar information might only be inferred from other complementary data. For purposes of this analysis, indirect communication of information was generally not included in the tables.

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7 The internationally active banks and securities firms included for each country were those headquartered in the country and not subsidiaries of foreign banks or securities firms. Luxembourg banks were not included in this analysis, since the large dealers and end-users of derivatives located in Luxembourg are subsidiaries of banks headquartered in other G-10 countries. Large, internationally active banks for which Luxembourg authorities carry out consolidated supervision tend to be moderate end-users of derivatives instruments.

In a number of jurisdictions, the largest institutions involved in securities activities are either universal banks or majority-owned subsidiaries of internationally active banks. Thus, in order to avoid double counting, the securities firm portion of this analysis focuses on the stand-alone securities firms of Hong Kong, Japan and the United States. In the case of Japan - where the close of the annual reporting cycle is 31 March 1997 - the choice of institutions included in Table 1 also depended on the availability of financial statements at the time of the writing of this report. For Canadian banks, the close of the annual reporting cycle is 31 October 1996.

In some cases, there were differences in the scope of disclosures provided in domestic as compared with foreign language annual reports.

8 The same banks and securities firms headquartered in G-10 countries were surveyed this year, as in the November 1996 survey. Since the release of that survey, however, there was one merger among the institutions included in the sample: in France, the Indosuez accounts are now incorporated in the consolidated accounts of Crédit Agricole. For consistency purposes, both banks have been retained in the sample. Also, one Hong Kong firm, Jardine Matheson Holdings Ltd, was removed from the sample since financial services only make up a small portion of its business. This deletion does not affect the aggregated figures, since Hong Kong firms are reported separately.

While the information on trading and derivatives disclosures included in Tables 2 through 6 is extensive, the tables are not intended to imply recommendations for "best practice" disclosures. The tables instead provide a relatively comprehensive overview of the types of trading and derivatives-related disclosures of large, internationally active banks and securities firms and the evolution of such disclosures over the 1993-1996 period.[9] The Committees believe that the survey should provide an important input to support banks' and securities firms' continued efforts to develop meaningful disclosures in this area.

For the vast majority of the institutions reviewed, disclosure about trading and derivatives activities is provided on a consolidated basis and appears in two main places in the annual report:

- **Management's discussion and analysis:** This is an analysis of the firm's financial condition and performance (including financial data) that typically includes a narrative of the firm's risk exposures and techniques for managing risk. This part of the annual report is not typically audited by independent accountants. In some countries, this portion of the annual report may be referred to as the financial review or management report.
- **Annual financial statements:** These financial statements generally include the statements of financial position (balance sheet), financial performance (income), changes in stockholders' equity and, in some countries, changes in financial position or cash flow. Footnotes, which present information on financial statement line items in narrative and tabular form, are also considered to be a part of the financial statements. The annual financial statements and their footnotes are audited by independent accountants.

This survey considers disclosures in both of these areas of the annual report.

The remainder of this report presents in greater detail the developments in qualitative and quantitative disclosures of trading and derivative activities since 1993. In reviewing quantitative trading and derivatives disclosures, the report addresses information about gross position indicators, credit risk, market risk and earnings. Market risk and earnings information is broken down by trading and non-trading (e.g., end-user) activities.[10] The qualitative and quantitative information is summarised in Tables 2-6 at the end of this section.

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9 The disclosure of information about the calculation of regulatory capital charges for market risks is not covered by the present survey. Such disclosures became common in some countries in 1996.

10 In some countries, it is customary to distinguish derivatives as being held for either trading or end-user purposes. Other countries identified derivatives as being held for dealing purposes or hedging purposes, or used other designations.

III. Survey results

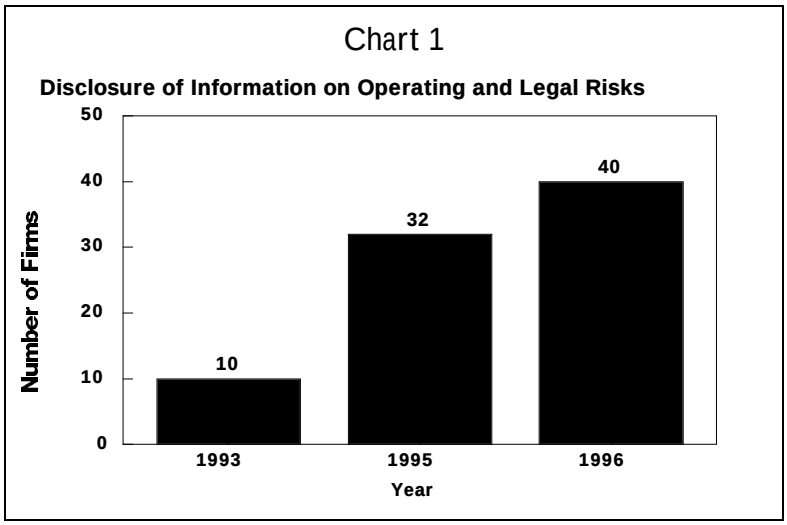
(1) Qualitative information

As illustrated in Table 2, the banks and securities firms included in the sample significantly expanded the qualitative, summary discussion of their trading and derivatives activities over the 1993-1996 period. This trend can be observed for all of the disclosure items reviewed in Table 2.

In comparison with 1995, progress continued in 1996 although improvements were generally less pronounced than in previous years. In particular, there was an increase in the number of institutions discussing operating and legal risks, market value adjustments and reserves, and the accounting treatment for derivatives credit losses. Moreover, institutions provided more ample discussions of risks, objectives and accounting policies. These improvements are not always visible from the survey results, since the numbers do not show when the quality of an institution's discussions of risks, objectives or accounting policies has improved.

Increasingly, internationally active banks and securities firms provide a comprehensive overview of the business objectives of their trading and derivatives activities, the associated risks, and the methods used to manage these risks. In 1996, the most noteworthy development was the increase in the number of institutions describing operating and legal risks. As shown in Chart 1, 40 institutions (51 %) provided such information in 1996, as compared with 32 in 1995 (41 %) and 10 in 1993 (13 %). In other areas, progress made in previous years was sustained. Seventy-four institutions discussed objectives and strategies for trading activities and 75 for non-trading activities, as compared with 71 and 66, respectively, in 1995, and 38 and 37 in 1993. The number of institutions discussing how credit and market risk arises increased from 34 and 35, respectively, in 1993 to 66 and 68 in 1995, and 68 and 69 in 1996. Forty-nine institutions discussed how liquidity risk arises compared with 46 in 1995 and 19 in 1993.

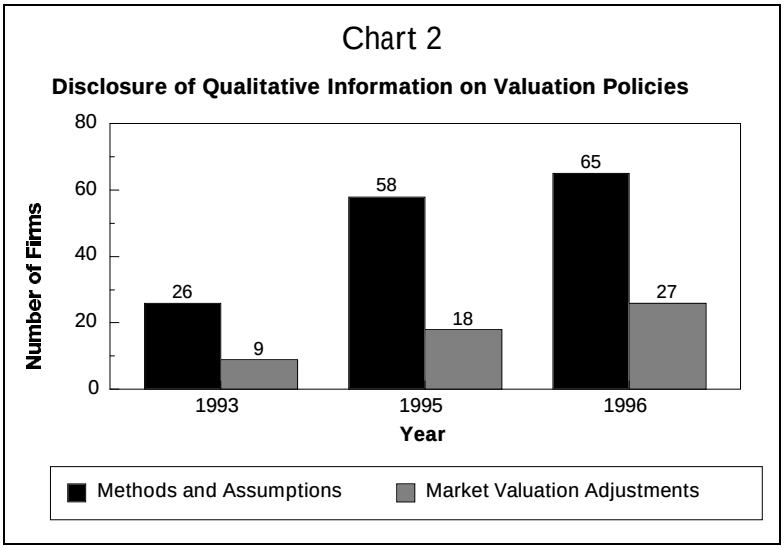
Chart 1



Disclosures of valuation policies also continued to expand in 1996, as shown in Chart 2. Sixty-five institutions (82 %) discussed the methods and assumptions used in valuing

financial instruments in 1996, compared with 58 in 1995 (73 %) and 26 in 1993 (33 %), and 27 institutions (34 %) provided a discussion of their market valuation adjustments or reserves, compared with 18 in 1995 (23 %) and 9 in 1993 (11 %). The number of institutions providing a general discussion of their accounting policies for derivative instruments increased from 63 in 1993 to 72 in 1995 and 1996. A significant number of institutions provided further detail on their accounting policies, for example, by distinguishing between accounting methods for different types of derivatives instruments (62) or by discussing hedge accounting criteria (49). In comparison to 1995, 1996 also saw an increase in the number of institutions discussing the accounting treatment for credit losses related to derivative instruments (27 in 1996, as compared with 19 in 1995 and 9 in 1993).

Chart 2

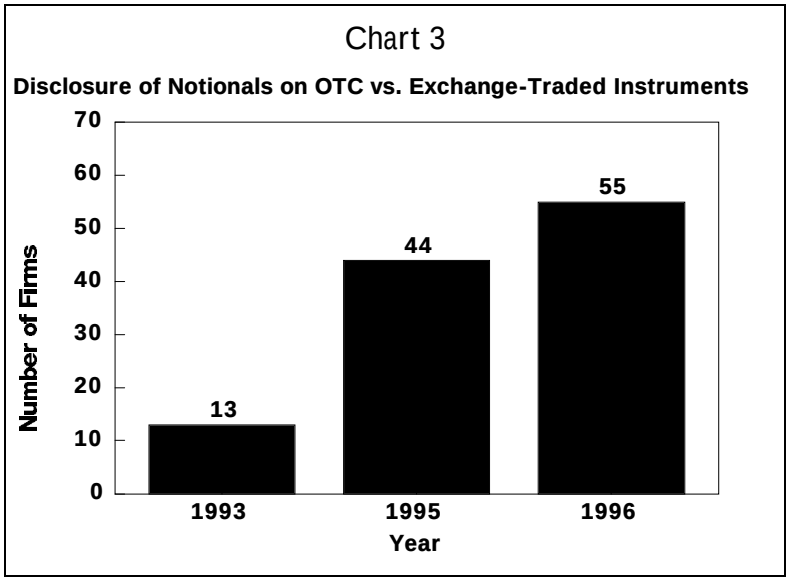


(2) Quantitative information

Table 3 presents an overview of disclosures about notional amounts and market values of instruments held for trading purposes (on- and off-balance-sheet) and derivatives held for non-trading purposes. These measures are indicative of an institution's involvement in derivative instruments. As Table 3 shows, disclosures of position indicators expanded considerably over the 1993-1996 period. There was a significant increase in the number of institutions disclosing information for almost all of the disclosure items reviewed in Table 3.

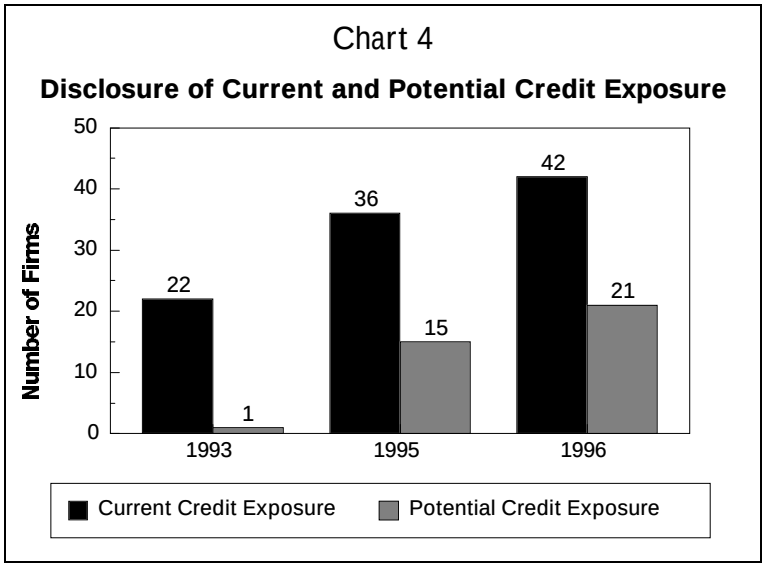
In comparison with 1995, the number of institutions disclosing information on notional amounts separately for over-the-counter and exchange-traded instruments increased in 1996, as shown in Chart 3. Fifty-five institutions (70 %) distinguished OTC from exchange-traded instruments in 1996, as compared with 44 in 1995 (56 %) and 13 in 1993 (16 %). All of the 67 banks and 12 securities firms provided information about the notional amounts of their derivatives holdings from 1994 and onwards. The number of institutions that separated trading from non-trading positions increased significantly, with a majority of institutions now providing this information. As regards market value data, there was expanded disclosure on the gross negative market value of derivatives, the market value of derivatives in the trading account, and the market values for different types of non-trading derivatives position in 1996. Thirty-seven institutions disclosed the gross negative market value for derivatives in 1996, as compared with 29 in 1995 and 13 in 1993. Fifty institutions disclosed the market values of derivatives in the trading account in 1996, compared with 44 in 1995 and 21 in 1993. The number of institutions disclosing information on the market values by type of derivative held outside of the trading account (for example for hedging purposes) increased from 5 in 1993 to 12 in 1995 and 22 in 1996.

Chart 3

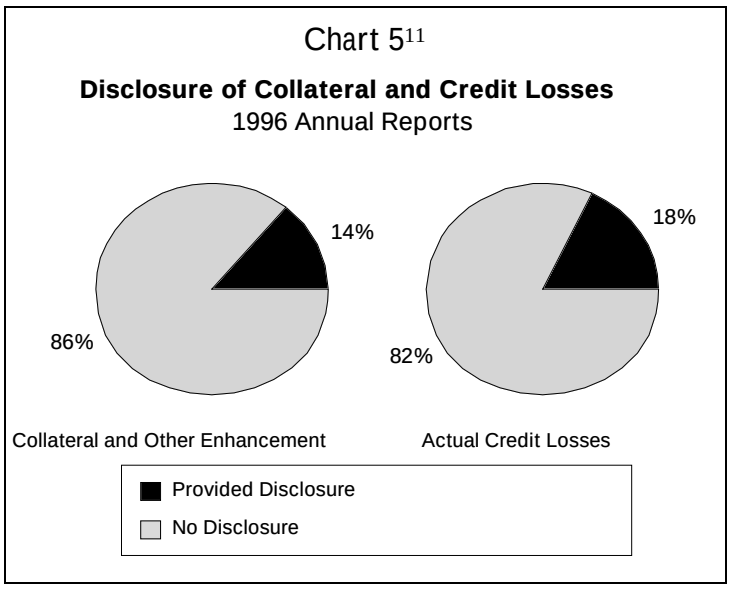


(a) Credit risk

Over the 1993-1996 period, banks and securities firms materially expanded the quantitative information provided on credit risk, as illustrated in Table 4. In some cases, this information was provided separately for derivatives instruments; in other cases, cash and derivatives-related disclosures were combined.



In 1996, there was an expansion in the disclosure of current and potential credit exposure, as shown in Chart 4. Forty-two institutions (53 %) disclosed data on current credit exposure, taking into account the effects of netting, as compared with 36 in 1995 (46 %) and 22 in 1993 (28 %). Twenty-one institutions provided information about the potential credit exposure (27 %), a measure of how much current credit exposure could increase in the future as a result of movements in underlying rates or prices, as compared with 15 in 1995 (19 %) and only one in 1993 (1 %).



Furthermore, survey institutions continued to provide more information on the credit quality of their trading and derivatives portfolios in 1996. For example, 50 institutions disclosed information on counterparty credit quality, as compared with 41 in 1995 and just 6 in 1993. The most common type of disclosure on credit

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11 This Chart and Chart 4 give examples of credit risk disclosures made by surveyed institutions. There are many other types of disclosure listed in Table 4, such as current credit exposure, gross positive market value, counterparty credit quality, information on concentrations, and risk based credit equivalent (for banks). The majority of the institutions surveyed provided these types of disclosure about their trading and derivatives activities.

exposure was information on gross positive market values (without netting), counterparty credit quality, and risk-based capital credit-equivalent amounts. Additionally, the number of institutions disclosing information on credit concentrations grew to 48 in 1996, compared with 46 in 1995 and 11 in 1993.

As in the two earlier surveys, no institution provided data on the volatility of credit exposure of its derivatives holdings over the reporting period, and, as shown in Chart 5, just 11 (14 %) firms provided information on collateral and other credit enhancements, and only 14 firms (18 %) disclosed information on actual credit losses.

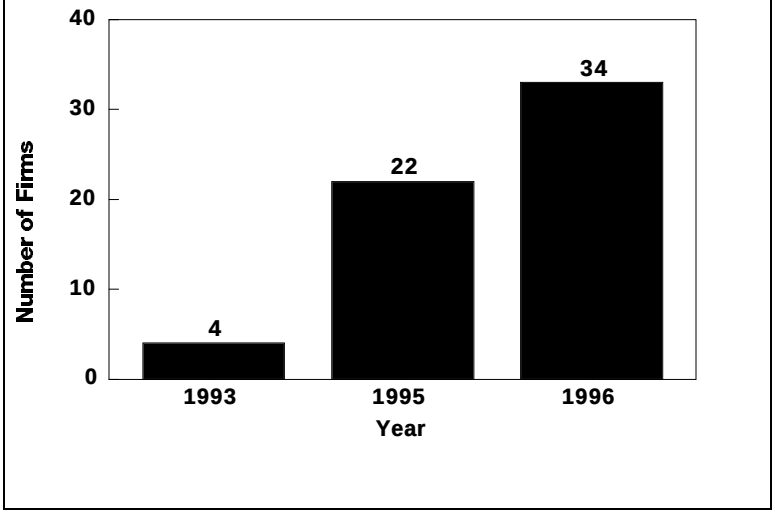
(b) Market risk

Trading activities

The number of institutions disclosing quantitative information on their exposure to market risk grew substantially over the 1993-1996 period, and the information provided amplified (Table 5). Also when comparing 1995 and 1996 annual reports, considerable progress is visible. Increasingly, the banks included in the survey are basing such disclosures on their internal value-at-risk methodologies.[12] Value-at-risk is an estimate of potential trading losses over a given time horizon, measured at a certain level of statistical confidence. In 1996, 50 institutions provided such value-at-risk-based disclosures, as compared with 36 in 1995 and 4 in 1993. Increasingly, value-at-risk figures are given for a holding period of one day. As shown in Chart 6, data on daily value-at-risk was disclosed by 34 institutions in 1996 (43 %), as compared with 22 in 1995 (28 %) and 4 in 1993 (5 %).

Chart 6

Disclosure of Information on Daily Value-at-Risk



In comparison with 1995, there was also a significant increase in 1996 in the number of institutions disclosing certain major assumptions underlying their value-at-risk estimates. This is an area where the Basle Committee/IOSCO November 1995 report

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12 In many countries capital adequacy rules for market risk were introduced in 1996. In some of those countries, disclosure of the capital requirement for market risk and its component parts became common in 1996. This type of disclosure was not surveyed.

identified the need for further improvements. In 1996 annual reports, 48 banks disclosed the confidence interval used, 47 the holding period, and 23 the method of aggregation across risk factors, as compared with 35, 33 and 14 in 1995, and 2, zero and zero in 1993. Chart 7 below illustrates examples of disclosures of the major assumptions underlying value-at-risk estimates presented in 1996 annual reports.[13]

Chart 7:
Illustrative examples of disclosures of major assumptions underlying value-at-risk estimates presented in 1996 annual reports

	Institution 1	*Institution 2*	*Institution 3*	*Institution 4*	*Institution 5*	*Institution 6*	*Institution 7*	*Institution 8*	*Institution 9*	*Institution 10*
Holding period	10 days	10 days	10 days	10 days	1 day	1 day	1 day	30 days	1 day	1 day
Confidence interval	99 %	99 %	99 %	99 %	97.7%	99 %	97.7%	99 %	98 %	95 %
Aggregation method	No corr.	Correlation	-	-	Correlation	Simulation	Correlation	Correlation	Correlation	No corr.
Average daily VaR	-	415	81	280	100	34	23	-	10	4.4
High (max.) daily VaR	80	471	121	-	118	47	30	1090	21	6.9
Low (min.) daily VaR	20	389	64	-	63	19	10	366	4	3.2

In addition to disclosing a point in time value-at-risk number for the end of the financial statement period, a number of banks also provided information on their value-at-risk exposures over the whole reporting period. For example, 27 banks disclosed the average value-at-risk number for the reporting period, as compared with 20 in 1995 and zero in 1993. Twenty-four banks disclosed the high and low value-at-risk numbers in 1996, compared with 17 in 1995 and zero in 1993. Moreover, 15 banks directly related daily value-at-risk estimates

13 It should be noted that value-at-risk estimates are not necessarily comparable among different institutions unless major underlying assumptions and parameters are comprehensively disclosed, such as information on the portfolios covered by the model and model parameters (holding period, confidence level, observation period, aggregation method).

to actual changes in portfolio value, compared with 10 in 1995 and zero in 1993, one of the key recommendations of the 1994 Fisher Report. Institutions typically used graphical means to compare daily value-at-risk estimates with actual portfolio outcomes.

In 1996, disclosure of the results of scenario analyses expanded. Thirteen institutions disclosed such information, in comparison with 6 in 1995 and one in 1993.

Historically, the major securities firms have not provided quantitative market risk disclosures of their trading and derivatives activities in their annual reports. As part of the Derivatives Policy Group's "Framework for Voluntary Oversight" on over-the-counter derivatives, released in March 1995, the securities firms that are major US derivatives dealers are providing to United States supervisors on a quarterly basis measures of "capital-at-risk", defined as the maximum loss expected to be exceeded with a probability of one per cent over a two-week period. In addition, these dealers provide supervisors with the results of a series of core risk factor stress tests of their over-the-counter derivatives portfolios.

Non-trading derivatives activities

In the 1993-1996 period, the most common form of disclosure by the surveyed banking institutions that used derivatives for non-trading purposes involved schedules of notional amounts, maturities and (for swaps) contractual rates paid and received. For the 1993-1996 period, the most prevalent means of conveying how derivatives are used to manage a bank's interest rate risk was a gap position schedule (used by 24 of the banks in 1996 as compared with 26 in 1995 and 23 in 1993).[14] Many banks publishing a gap schedule for interest rate risk cautioned that it represented only a point-in-time picture of risk and did not capture options risk and other dynamic characteristics of the balance sheet.

The number of banks that furnished quantitative information on their non-trading activities remained low. Sixteen banks provided a discussion of the effect on capital or earnings of a specified rate shock. A few of the banks providing information on their non-trading derivatives holdings described in varying detail whether the derivatives were linked to specific components of the balance sheet or were used to manage overall risk exposures.

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14 Gap schedules disclosed by banks organise financial assets and liabilities according to maturity in a number of time bands. The difference between assets and liabilities in each time interval ("gap" or net exposure) forms the basis for assessing interest rate risk. Derivatives of various maturities can be used to adjust the net exposure of each time interval to alter the overall interest rate risk of the institution. Historically, securities firms have not presented gap table disclosures in their annual reports.

(c) Earnings

Trading activities

As illustrated in Table 6, information on trading income has expanded since 1993. In 1996, 69 institutions (87 %) disclosed information on trading income, as compared with 64 in 1995 (81 %) and 48 in 1993 (61 %), as shown in Chart 8. While there was a significant increase in 1996 in the number of institutions providing some type of breakdown of their trading income, still only about half of the institutions (40 or 51 %) disclosed information by line of business or risk exposure and fewer than one-quarter (17 or 22 %) by instrument type, as shown in Chart 9. Twenty-one institutions provided information about trading income broken down between cash positions and derivative instruments in 1996, as compared with 18 in 1995 and 22 in 1993, while 33 institutions presented other information about trading income in 1996, as compared with 34 in 1995 and 29 in 1993.

Chart 8

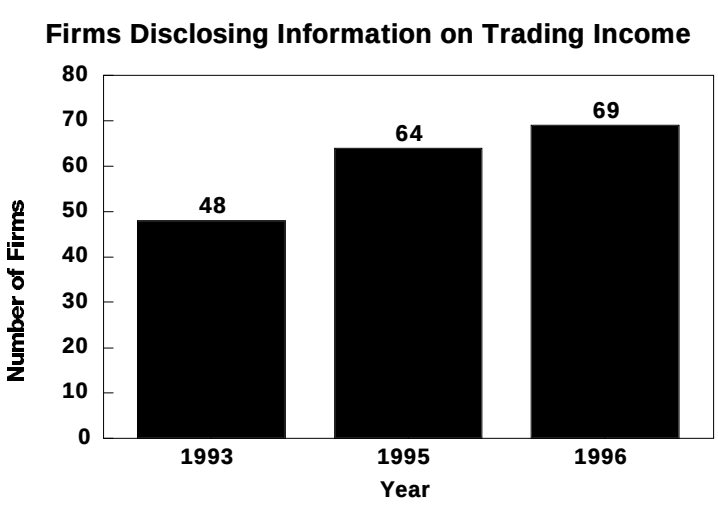
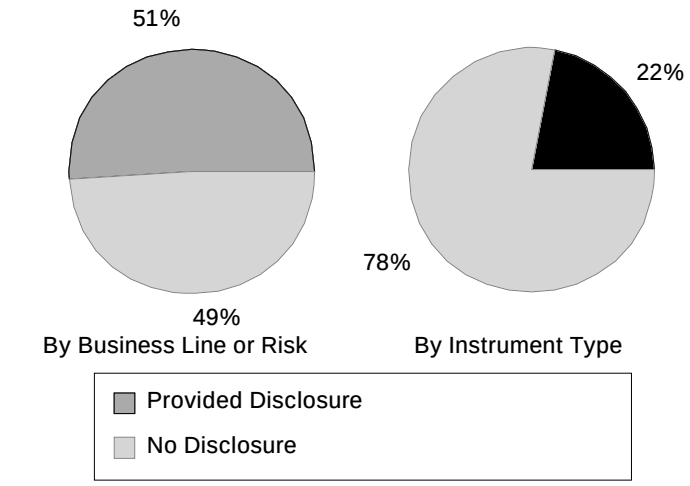


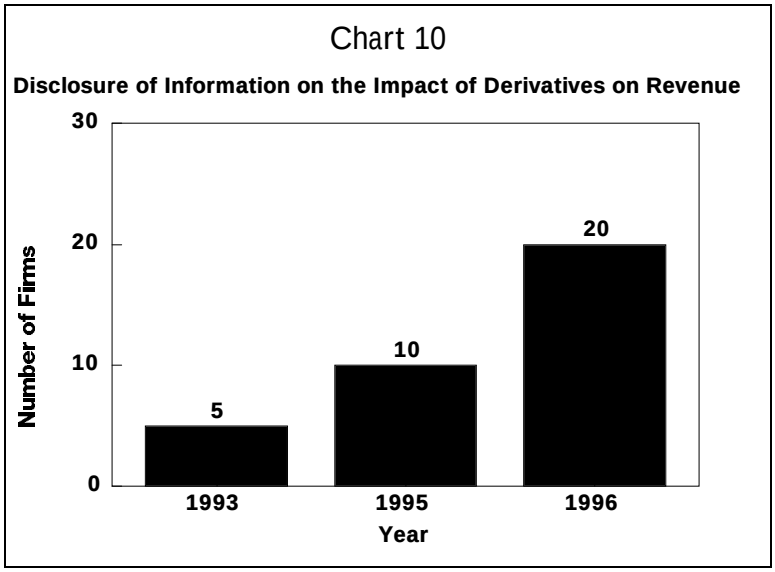
Chart 9



Non-trading derivatives activities

With regard to derivatives held for non-trading purposes, 1996 saw an increase in the number of institutions disclosing details about how derivatives affect accrual-based accounting income and expense (historical cost accounting), as shown in Chart 10. Twenty institutions reported the effect that derivatives accounted for on an accrual basis had on reve-

nue, compared with 10 in 1995 and 5 in 1993. Nine banks and 6 securities firms reported the overall effect on net interest margins of their non-trading derivatives activities. Twenty institutions disclosed deferred gains or losses on non-trading derivatives and 7 provided information on when the deferrals would be reflected in future earnings. Twenty-five banks and 3 securities firms disclosed the unrealised gains and losses associated with non-trading derivatives positions, compared with 21 and 3, respectively, in 1995 and 9 and 3 in 1993.



November 1997

Table 1
Banks and securities firms included in survey
31 December 1996 (except as noted)
In alphabetical order, by country

		Notional Amounts (Billions) (1)	
Country	**Institution**	**National Currency**	**US Dollars**
Belgium	Bank Brussels Lambert	10,462	326
	Generale Bank	8,311	259
	Kredietbank	13,039	407
Canada (2)	Bank of Montreal	663	487
	Bank of Nova Scotia	802	589
	Canadian Imperial Bank of Commerce	1,416	1,039
	National Bank of Canada	69	51
	Royal Bank of Canada	1,168	857
	Toronto-Dominion Bank	557	409
France	Banque Nationale de Paris	11,516	2,196
	Crédit agricole (3)	8,395	1,601
	Crédit Commercial de France	2,197	419
	Crédit Lyonnais	5,314	1,013
	Banque Indosuez (3)	4,774	910
	Compagnie Financière de Paribas	11,295	2,154
	Société Générale	14,211	2,710
	Union Européenne de CIC	2,177	415
Germany	Bankgesellschaft Berlin	642	413
	Bayerische Hypotheken- und Wechsel-Bank	377	242
	Bayerische Vereinsbank AG	958	616
	Commerzbank	1,683	1,082
	Deutsche Bank	4,547	2,922
	Dresdner Bank	1,388	892
	Westdeutsche Landesbank	716	460

(1) Notional amounts of off-balance-sheet derivative instruments
(2) Fiscal year-end (FYE) of 31 October 1996
(3) Because of the merger between Indosuez and Crédit Agricole in July 1996, the figure for Crédit Agricole includes Indosuez. Excluding the contribution of Indosuez, Crédit Agricole has a total notional amount of approximately 3,621 billion FRF (= 8,395 - 4,774), disregarding the effects of intra-group transactions.

Table 1(con't)
Banks and securities firms included in survey
31 December 1996 (except as noted)
In alphabetical order, by country

		Notional Amounts (Billions)	
Country	**Institution**	**National Currency**	**US Dollars**
Italy	Banca Commerciale Italiana	209,784	137
	Banca Cassa di Risparmio di Torino	23,228	15
	Banca di Roma	77,107	50
	Banca Nazionale del Lavoro	79,171	52
	Banco di Napoli	29,658	19
	Credito Italiano	143,422	94
	Istituto Mobiliare Italiano	147,720	97
	Istituto Bancario S. Paolo di Torino	471,935	309
Japan (4)			
Banks:	Bank of Tokyo-Mitsubishi	351,844	2,843
	Fuji Bank	250,380	2,023
	Industrial Bank of Japan	223,328	1,805
	Long-Term Credit Bank of Japan	86,220	697
	Sanwa Bank	217,927	1,761
	Sumitomo Bank	207,503	1,677
	Tokai Bank	139,094	1,124
Securities firms:	The Nikko Securities Co., Ltd.	10,736	87
	The Nomura Securities Co., Ltd.	11,666	94
Netherlands	ABN-AMRO Bank	2,103	1,205
	ING Bank	573	328
	Rabobank	855	490
Sweden	Nordbanken	1,263	184
	Skandinaviska Enskilda Banken	4,174	607
	Sparbanken Sverige (Swedbank)	1,722	250
	Svenska Handelsbanken	4,383	638
Switzerland	Credit Suisse First Boston	3,099	2,269
	Swiss Bank Corp.	4,557	3,336
	Union Bank of Switzerland	2,647	1,938

(4) FYE 31 March 1997

Table 1(con't)
Banks and securities firms included in survey
31 December 1996 (except as noted)
In alphabetical order, by country

		Notional Amounts (Billions)	
Country	**Institution**	**National Currency**	**US Dollars**
United Kingdom	Barclays	1,305	2,207
	Hambros (5)	96	157
	HSBC	893	1,510
	Lloyds	969	1,639
	National Westminster	1,691	2,859
	Royal Bank of Scotland (6)	205	320
	Schroders	92	156
	Standard Chartered	212	358
United States			
Banks: (7)	Bank of New York Co.	130	130
	BankAmerica Corp.	1,599	1,599
	Bankers Trust N.Y. Corp.	1,780	1,780
	Chase Manhattan Corp.	5,623	5,623
	Citicorp	2,430	2,430
	First Chicago NBD Corp.	1,035	1,035
	J.P. Morgan & Co.	4,670	4,670
	NationsBank Corp.	1,322	1,322
	Republic New York Corp.	285	285
	State Street Boston Corp.	65	65
Securities firms:	The Bear Stearns Companies, Inc. (8)	353	353
	Donaldson, Lufkin & Jenrette, Inc.	41	41
	The Goldman Sachs Group, L.P. (9)	1,383	1,383
	Lehman Brothers Holdings, Inc. (10)	1,517	1,517
	Merrill Lynch & Co., Inc. (11)	2,106	2,106
	Morgan Stanley Group, Inc. (10)	1,317	1,317
	Paine Webber Group, Inc.	39	39
	Prudential Securities, Inc.	29	29
	Salomon, Inc.	1,981	1,981
	Smith Barney Holdings, Inc.	81	81
Hong Kong			
Securities firm	Peregrine Investments Holdings Ltd.	213	28

(5) FYE 31 March 1997

(6) FYE 30 September 1996

(7) Source: Publicly available regulatory financial statements filed with the Federal Reserve

(8) FYE 30 June 1997

(9) FYE 29 November 1996

(10) FYE 30 November 1996

(11) FYE 27 December 1996

TABLE 2

QUALITATIVE INFORMATION

	1993 No.	1994 No.	1995 No.	1996 No.	1996													HK(1)	SF*
					BEL	CAN	FRA	GER	IT	JPN		NL	SWE	SWI	UK	US			
										Banks	SF*					Banks	SF*	1995	1996
	79	79	79	79	3	6	8	7	8	7	2	3	4	3	8	10	10	1	1
Discussion of Objectives:																			
Objectives & strategies for trading	38	58	71	74	2	6	8	7	8	7	2	0	4	3	8	9	10	0	1
Objectives & strategies for non-trading activities	37	57	66	75	2	6	8	7	8	7	2	2	4	1	8	10	10	0	1
Discussion of Risks :																			
Placed in context with balance sheet risks	37	58	72	76	2	6	8	7	8	7	1	2	4	3	8	10	10	0	1
Discussion of specific risks:																			
Credit risk - described how risk arises	34	55	66	68	2	6	7	7	4	7	2	2	2	3	6	10	10	0	1
* Risk management method described	30	56	71	75	2	6	8	7	5	7	2	3	4	3	8	10	10	0	1
Market risk - described how risk arises	35	56	68	69	3	6	8	6	4	7	2	1	3	3	6	10	10	0	1
* Risk management method described	29	58	74	76	3	6	8	6	6	7	2	3	4	3	8	10	10	0	1
Liquidity risk - described how risk arises	19	37	46	49	2	6	8	1	3	2	0	0	1	2	7	9	8	0	1
* Risk management method described	15	38	47	54	2	6	8	1	2	2	0	1	4	2	8	10	8	0	1
Operating & Legal Risks - described risks	10	26	32	40	2	6	2	3	3	7	1	0	1	2	2	3	8	0	1
* Risk management method described	8	21	31	43	1	6	2	3	3	7	1	1	2	1	4	4	8	0	1
Discussion of leveraged instruments	0	5	8	9	0	1	1	0	0	0	1	0	0	2	0	4	0	0	0
Discussion of How Market Values Estimated	26	45	58	65	1	5	8	5	5	7	2	1	3	3	5	10	10	0	1
* Disc. of market valuation adjustments/reserves	9	14	18	27	1	5	4	0	3	0	0	0	1	3	3	4	3	0	0
* Disc. of valuation where no quoted prices	27	31	45	50	1	5	7	1	5	2	2	1	1	1	4	10	10	0	1
Discussed - Accounting Policies for Derivatives	63	71	72	72	3	6	8	7	8	1	1	3	4	3	8	10	10	1	1
* Accounting methods for various types of derivatives	53	56	60	62	3	6	8	6	0	1	0	3	4	3	8	10	10	1	1
* Hedge accounting criteria	35	41	48	49	2	2	8	6	8	0	0	1	1	3	1	8	9	0	0
* Terminations of derivatives	12	28	33	36	0	4	2	0	8	7	0	1	0	1	2	8	3	0	0
* Netting of assets/liabilities arising from derivatives	12	21	27	36	0	5	0	5	0	0	0	0	1	3	6	10	6	0	0
* Accounting treatment for derivatives credit losses	9	9	19	27	0	5	6	6	3	0	0	0	0	2	0	5	0	0	0

BEL = Belgium, CAN = Canada, FRA = France, GER = Germany, IT = Italy, JPN = Japan, NL = Netherlands, SWE = Sweden, SWI = Switzerland, UK = United Kingdom, US = United States, HK = Hong Kong

* Securities Firms

(1) Hong Kong was included for the first time in 1995.

TABLE 3

GROSS POSITION INDICATORS

	1993 No.	1994 No.	1995 No.	1996 No.	1996													HK(1)	SF*
					BEL	CAN	FRA	GER	IT	JPN		NL	SWE	SWI	UK	US			
										Banks	SF*					Banks	SF*	1995	1996
	79	79	79	79	3	6	8	7	8	7	2	3	4	3	8	10	10	1	1
Information on Notional Amounts	67	79	79	79	3	6	8	7	8	7	2	3	4	3	8	10	10	0	0
Trading positions	32	43	62	63	3	6	7	7	8	1	2	2	1	0	6	10	10	0	0
Non-trading positions	30	36	53	53	3	6	7	0	8	1	1	2	1	0	6	10	8	0	0
Distinguished OTC vs. Exchange Traded	13	25	44	55	2	6	8	7	4	7	1	3	4	3	5	2	3	0	0
Maturity Schedule																			
Trading positions	6	16	17	15	0	1	1	1	0	0	0	0	0	0	3	1	8	0	0
Non-trading positions	9	16	18	19	0	1	1	0	0	0	0	0	0	0	3	8	6	0	0
Combined	15	31	41	47	2	6	1	6	8	4	1	3	4	3	5	4	0	0	1
Contract Rates:																			
Information on receive/pay rate levels	4	16	12	20	0	2	0	0	0	3	0	0	0	0	3	9	3	0	0
Information on receive/pay notionals	18	30	26	36	0	2	8	0	8	4	1	0	0	0	3	9	1	0	0
Market Value Data																			
Gross positive market value - derivatives	26	42	50	54	1	6	1	7	5	0	2	3	4	3	5	7	10	0	1
Gross negative market value - derivatives	13	25	29	37	0	6	0	0	4	0	2	0	4	3	5	3	10	0	1
Trading Account:																			
Separate trading assets from trdg. liabilities	27	39	38	39	0	1	7	0	0	1	2	0	0	0	8	10	10	0	0
Cash instrument detail: end-of-period (MV)	42	52	68	66	0	6	7	1	8	7	2	3	1	3	8	10	10	0	0
average for period (MV)	0	7	7	7	0	1	0	0	0	0	0	0	0	0	0	6	0	0	0
Derivative instrument detail: end-of-period (MV)	21	44	44	50	0	6	0	2	5	7	2	0	0	0	8	10	10	0	0
average for period (MV)	3	16	23	29	0	4	0	1	0	0	1	0	0	0	3	10	10	0	0
No detail of trading account - just totals	18	9	0	1	0	0	0	0	0	0	0	0	1	0	0	0	0	0	1
Non-trading Derivatives Positions:																			
Overall market value	16	21	29	31	0	6	0	0	4	7	0	0	0	0	3	8	3	0	1
By related asset/liability being hedged	6	13	11	9	0	0	0	0	0	0	0	0	0	0	1	4	4	0	0
By type of derivative	5	20	12	22	0	6	0	0	4	0	0	0	0	0	4	4	4	0	1

*Securities firms MV = market value

(1) Hong Kong was included for the first time in 1995.

TABLE 4

CREDIT RISK

	1993	1994	1995	1996	1996													HK(1)	SF*
	No.	No.	No.	No.	BEL	CAN	FRA	GER	IT	JPN		NL	SWE	SWI	UK	US			
										Banks	SF*					Banks	SF*	1995	1996
	79	79	79	79	3	6	8	7	8	7	2	3	4	3	8	10	10	1	1
Current credit exposure (i.e., with netting)	22	38	36	42	0	5	3	1	0	7	1	0	0	3	5	10	7	0	0
Volatility of credit exposure	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross positive market value	26	42	50	54	1	6	1	7	5	0	2	3	4	3	5	7	10	0	1
Potential credit exposure	1	9	15	21	0	6	1	2	3	0	0	3	0	2	0	4	0	0	0
Counterparty credit quality	6	27	41	50	1	6	5	7	4	0	0	2	2	3	8	6	6	0	0
By counterparty type	4	21	30	38	1	6	5	7	3	0	0	2	2	0	8	2	2	0	0
By internal or external credit rating	6	11	17	21	0	3	1	2	1	0	0	0	0	3	0	5	6	0	0
Information on Concentrations	11	31	46	48	1	6	4	7	8	0	0	3	0	0	7	4	8	0	0
Exposure by geographic area	8	20	21	23	1	3	4	7	0	0	0	1	0	0	2	1	4	0	0
Exposure by industry groups	11	30	36	38	0	5	4	7	0	0	0	3	0	0	7	4	8	0	0
Other (e.g., exposures > x% of capital)	8	15	8	13	0	0	0	2	8	0	0	0	1	0	1	1	0	0	0
Collateral & other credit enhancements	0	2	3	11	0	1	1	0	1	0	0	2	0	1	1	1	3	0	0
Allowances for OBS contract credit losses (2)				7	0	2	1	0	0	0	0	0	1	0	0	3	0		0
Actual credit losses	4	9	10	14	1	3	0	0	3	0	0	0	0	0	0	7	0	0	0
Nonperforming contracts	1	8	8	10	0	2	0	0	2	0	0	0	0	0	0	6	0	0	0
For banks, RBC credit equivalent - derivatives	34	45	45	47	0	6	3	7	7	7	0	3	3	2	2	7	0	0	0

* Securities Firms

(1) Hong Kong was included for the first time in 1995.

(2) This disclosure item was added to this year's survey to determine how institutions are disclosing potential credit losses on off balance sheet instruments. It identifies an emerging disclosure practice in some countries to separately distinguish potential credit losses on derivatives from other reserves specified in the balance sheet.

TABLE 5

MARKET RISK INFORMATION

	1993	1994	1995	1996	1996															
	No.	No.	No.	No.	BEL	CAN	FRA	GER	IT	JPN		NL	SWE	SWI	UK	US		HK(1)	SF*	
										Banks	SF*					Banks	SF*	1995	1996	
	79	79	79	79	3	6	8	7	8	7	2	3	4	3	8	10	10	1	1	
Trading Activities:																				
Disclosed Value-at-Risk Data:	4	18	36	50	0	5	6	6	6	7	0	1	2	3	6	7	1	0	0	
Provided data on daily VAR	4	18	22	34	0	4	3	0	4	7	0	1	0	3	5	6	1	0	0	
Provided data on VAR (holding period > daily)	2	4	16	16	0	0	3	6	2	1	0	0	0	2	1	1	0	0	0	
Those disclosing VAR also provided:																				
High/Low VAR	0	7	17	24	0	1	2	1	2	6	0	1	1	3	2	5	0	0	0	
Average VAR	0	10	20	27	0	1	2	3	2	5	0	1	1	2	4	6	0	0	0	
Daily change in value of portfolio	0	5	11	18	0	2	0	0	1	7	0	0	0	2	1	5	0	0	0	
Average daily change in value of portfolio	0	3	4	11	0	1	0	0	0	0	0	0	0	1	2	7	0	0	0	
Changes in portfolio value exceeding VAR	0	6	10	15	0	2	0	0	1	7	0	0	0	1	0	4	0	0	0	
Confidence interval	2	12	35	48	0	5	6	6	5	7	0	1	2	3	6	7	0	0	0	
Holding period	0	16	33	47	0	5	6	6	5	7	0	1	1	3	6	7	0	0	0	
Method of aggregation across risk factors	0	4	14	23	0	1	5	0	2	4	0	0	0	3	3	5	0	0	0	
Scenario analysis	1	2	6	13	0	4	1	3	1	2	0	0	0	2	0	0	0	0	0	
Other trading acct. market risk data	0	3	10	14	0	0	1	0	2	0	1	3	0	1	6	0	0	0	0	
Non-trading Derivatives																				
Effect of derivatives on duration	1	2	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Effect of derivatives on int. repricing 'gap' positions	23	25	26	24	0	6	0	0	8	1	0	0	0	0	3	6	0	0	0	
Quant. info. deriv. presented w. position hedged (2)				6	0	0	0	0	0	0	0	0	0	0	1	5	0		0	
Derivatives' expected cash flows by maturity dates	0	11	10	9	0	0	0	0	0	0	0	0	0	0	0	9	0	0	0	
Scenario analysis: impact of rate shock	5	14	15	16	1	6	1	0	2	0	0	0	0	0	0	6	0	0	0	
VAR for non-trading portfolios	0	4	5	7	0	0	0	0	3	0	0	0	0	0	0	4	0	0	0	

* Securities Firms

(1) Hong Kong was included for the first time in 1995.

(2) This disclosure item was added to the 1996 survey to help determine the extent in which quantitative information about derivatives is presented in relation to the position being hedged. The Basle Committee and IOSCO recognise that derivatives activities constitute only a part of the overall activities of banks and securities firms and that derivatives should not be evaluated in isolation from the overall risk exposure of the institution.

TABLE 6

EARNINGS INFORMATION

	1993	1994	1995	1996	1996													HK (1)	SF*
	No.	No.	No.	No.	BEL	CAN	FRA	GER	IT	JPN		NL	SWE	SWI	UK	US			
										Banks	SF*					Banks	SF*	1995	1996
	79	79	79	79	3	6	8	7	8	7	2	3	4	3	8	10	10	1	1
Trading Activities:																			
Information on trading income	48	59	64	69	3	5	7	7	8	2	1	3	4	3	8	10	8	0	0
By risk exposure/line of business	8	18	34	40	0	4	0	4	1	1	0	3	4	3	2	10	8	0	0
By instrument type	12	13	14	17	0	3	1	0	1	0	1	0	0	0	1	2	8	0	0
By cash positions vs. derivative instruments	22	23	18	21	0	4	1	0	8	0	0	0	0	0	0	5	3	0	0
Other	29	29	34	33	3	1	7	7	8	0	0	0	0	0	7	0	0	0	0
Net interest revenue from cash positions	29	35	26	27	0	3	5	0	8	1	0	0	0	3	2	5	0	0	0
Non-trading Derivatives Revenue impact (amount or %)																			
Of derivatives alone	5	11	10	20	0	1	1	0	5	1	0	0	0	0	2	6	4	0	0
Overall sensitivity of net interest margins	15	18	14	15	0	0	0	0	8	0	0	0	0	0	0	1	6	0	0
Amount of deferred gains/losses	7	8	13	20	0	2	0	0	7	0	0	0	0	0	4	4	3	0	0
Amortization period - deferred gains/losses	2	6	5	7	0	0	0	0	0	0	0	0	0	0	3	2	2	0	0
Unrealised gain or loss on derivatives	12	21	24	28	2	6	0	0	4	1	0	0	0	0	3	9	3	0	0

* Securities Firms

(1) Hong Kong was included for the first time in 1995.

Annex

Recommendations contained in the November 1995 Basle Committee/IOSCO report: *Public Disclosure of the Trading and Derivatives Activities of Banks and Securities Firms*

Recommendations

This section focuses on recommendations for further improvements in disclosure practices of large banks and securities firms with significant involvement in trading and derivatives activities. The recommendations may also be useful for other financial and non-financial companies with significant trading and derivatives activities.

The Basle Committee and the IOSCO Technical Committee encourage banks and securities firms to continue their efforts to improve disclosure practices by providing meaningful summary information, both qualitative and quantitative, about their trading and derivatives activities. Disclosures should provide a picture of the scope and nature of an institution's trading and derivatives activities, as well as information on the major risks associated with these activities, including credit risk, market risk and liquidity risk. Institutions should also disclose information on the actual performance in managing these risks, particularly with regard to exposure to market risk.[15] In addition, disclosures should provide meaningful, summary information on how trading and derivatives activities contribute to an institution's earnings profile.

As discussed in the Fisher Report, institutions are encouraged to disclose quantitative information on their risk exposures and on their performance in managing these exposures in a manner that is consistent with the methodologies employed in their internal risk measurement and performance assessment systems. This should help ensure that disclosure practices keep pace with innovations in risk management practices over time, particularly in areas undergoing rapid evolution such as market risk, where an increasing number of institutions are introducing or developing further their value-at-risk methodologies. Disclosures should focus on material risk exposures and the amount of information should stand in relation to the importance of the activity in the institution's overall business, risk profile and earnings.

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15 To date, statistical approaches for measuring performance in managing credit risk have not been developed as extensively in banks and securities firms as have market risk performance measures. Therefore, measuring an institution's performance in managing credit risk is generally more difficult than for market risk at this time. As these statistical techniques are developed further and become established, institutions should disclose summary information consistent with these performance measurement techniques.

For fundamental disclosures of an institution's derivatives activities (trading and non-trading, including related on-balance-sheet positions), institutions are also encouraged to look to the common minimum framework that is presented in the Supervisory Information Framework paper. The common minimum framework calls for information on an institution's overall derivatives market activity and exposure to credit and, to a certain extent, market liquidity risks. The minimum framework can serve as a reference point for institutions that currently provide little or no quantitative information on their derivatives activities. Furthermore, disclosure of information that is consistent with the common minimum framework could improve the consistency and comparability of basic annual report disclosures.

The remainder of this section discusses these various points in greater detail, focusing first on qualitative disclosures and then discussing quantitative disclosures.

(A) Qualitative disclosures

Qualitative disclosures should provide an overview of an institution's overall business objectives, its risk-taking philosophy, how trading and derivatives activities fit into these overall objectives, as well as the principal internal control procedures that are in place for managing these activities. In addition, qualitative disclosures provide management with the opportunity to elaborate on and provide depth to the quantitative disclosures provided in the annual report.

More specifically, banks and securities firms are encouraged to consider the following types of summary qualitative information about their trading and derivatives activities:

Risks and management controls

- An overview of key aspects of the organisational structure central to the institution's risk management and control process for its trading and derivatives activities.
- A description of each of the major risks arising from an institution's trading and derivatives activities (including credit risk, market risk, liquidity risk, operational and legal risk) and the methods used to measure and manage these risks (for example limit policies for exposures to market risk and credit risk and how value-at-risk measures are used to manage market risks). In addition, a discussion of how the institution assesses its performance in managing these various risks.
- Information about the overall objectives and strategies of trading activities (involving all on- and off-balance-sheet components) and whether the institution

is a wholesale market maker, engages in proprietary trading, or takes positions as an accommodation to customers.

- In the case of non-trading derivatives activities, a description of the general objectives for these activities. For example, in the case of banks, such disclosures could clarify how these instruments are being used to hedge risks inherent in banking activities such as foreign exchange or interest rate risk, or, where relevant, if they are being used for other risk management activities.
- A summary of activity in and the risks associated with high risk instruments or complex instruments such as leveraged derivatives.

Accounting and valuation methods

- A discussion of the accounting policies and methods of income recognition that apply to trading activities (involving both cash instruments and derivatives) and to non-trading derivatives activities. Disclosures about accounting polices should be sufficient to enable the user of financial statements to understand important distinctions that may exist in the accounting treatments of various types or uses of derivatives instruments. In the absence of clear accounting standards for many types of derivatives activities, it is particularly important that an institution discuss the accounting treatments applied to its various derivatives holdings. For example, it would be useful to summarise the methods used to account for derivatives, the types of derivatives accounted for under each method and the criteria to be met for each accounting method to be used (e.g. criteria for recognising hedges). Furthermore, institutions are encouraged to specify the accounting treatment applied if the criteria for a given method are not met. Other important types of information include the accounting treatments for terminations of derivatives contracts, derivatives that are hedges of anticipated transactions, balance sheet netting of assets and liabilities arising from derivatives and credit losses on derivatives instruments.
- A general discussion of the valuation methodologies used as well as information on whether adjustments are made after positions have been marked to market. In the case of instrument categories for which there are no quoted market prices, a general discussion of the market value estimation techniques used and a summary of the procedures for checking the accuracy of these estimates.

For background on the types of qualitative information about derivatives and related activities that may be appropriate for disclosure purposes, banks are encouraged to consider the report, *Risk Management Guidelines for Derivatives* and securities firms the

report, *Operational and Financial Risk Management Control Mechanisms for Over-the-Counter Derivatives Activities of Regulated Securities Firms.* These reports were issued, respectively, by the Basle Committee and the IOSCO Technical Committee with a joint cover note in July 1994 and they highlight key attributes of the risk management systems of banks and securities firms.

(B) Quantitative disclosures

(1) Market activity, credit risk and market liquidity

Large, internationally active banks and securities firms should provide summary information about the composition of their trading portfolios. This information could include the end-of-period and average market values of major categories of on- and off-balance-sheet instruments held for trading purposes. Moreover, this disclosure could distinguish between trading assets and trading liabilities.

With regard to derivatives activities (trading and non-trading), institutions should provide financial statement users with a clear picture of their involvement in the derivatives markets, both OTC and exchange-traded. Institutions could draw from the common minimum framework of the Supervisory Information Framework paper for guidance about basic disclosures of their derivatives activities and how these activities affect the overall risk profile of the institution. Where appropriate, institutions are encouraged to place information on derivatives in the context of related on-balance-sheet positions.

The common minimum framework is presented in detail in Section III and Annex 3 of the Supervisory Information Framework paper. It focuses primarily on meaningful summary information relating to overall market activity, credit risk and, to a certain extent, market liquidity. Information on market activity is provided by broad risk category (interest rate, exchange rate, precious metals, other commodities and equities), by broad instrument category (futures, forwards, swaps and options) and by maturity band (one year or less, over one year to five years, greater than five years). The minimum framework provides insight into whether derivatives are used primarily for trading or non-trading purposes (e.g. hedging) and whether an institution is primarily involved in exchange-traded or OTC derivatives activities. The framework also includes a variety of information on credit risk, taking into account counterparty credit quality as well as the availability of collateral and guarantees. Finally, the framework provides information on non-performing derivatives contracts and actual credit losses on these instruments.

Annex 4 of the Supervisory Information Framework paper presents definitions for the concepts used in the common minimum framework. For institutions that base their disclosures on the type of information contained in the common minimum framework, Annex 4 provides a basis for greater clarity and comparability of these disclosures. For example, for

basic disclosures of information such as replacement cost, it should be clear to the financial statement user whether or not this information takes account of legally enforceable bilateral netting agreements.

Institutions that have developed alternative, more sophisticated internal methodologies for the type of information contained in the common minimum framework could base their public disclosures on these methods. For example, some institutions have developed simulation models for measuring potential credit exposure, which may produce more precise estimates of exposure than the add-ons approach of the Basle Capital Accord included in the common minimum framework. Furthermore, where material, institutions are encouraged to consider disclosing additional summary information about credit and liquidity risks (such as information on credit concentrations and funding risk). The "catalogue" section of the Supervisory Information Framework paper, issued in May 1995 and the risk management guidelines released by the Basle Committee and the IOSCO Technical Committee in July 1994 discuss meaningful information that could be presented in annual report disclosures.

(2) Market risk

Currently, institutions employ a wide range of techniques to measure and manage their exposure to market risks, including value-at-risk methodologies, duration or gap analysis and scenario analysis. However, more and more large banks and securities firms are measuring and managing their market risk exposure based on a value-at-risk approach, which involves the assessment of potential losses due to adverse movements in market rates and prices of a specified probability over a defined holding period.

Given the diversity and rapid evolution of measurement and risk management techniques in the area of market risk, it does not now seem desirable to recommend a uniform approach for market risk disclosures. Instead and as argued in the Fisher Report, institutions should provide summary quantitative information on their exposure to market risk based on the methods they use for internal risk measurement purposes, together with information on their actual performance in managing these risks. The guidelines for managing the risks of derivatives, released by the two Committees in July 1994, stressed that dealer banks and securities firms should produce daily information on profits and losses on their trading activities for internal risk management purposes. Institutions are encouraged to draw from this internally-generated information for public disclosure purposes. Moreover, daily profit and loss disclosures should be combined with the corresponding daily value-at-risk numbers. The Fisher Report provides a detailed discussion, including a series of illustrative examples, on how institutions could disclose such quantitative, performance-based information on market risks.

Quantitative disclosures should be supplemented with information on the major assumptions and parameters necessary to understanding an institution's market risk disclosures. For example, in the case of market risk disclosures based on value-at-risk measures, institutions could specify the type of model used (variance/covariance, historical simulation, etc.), the portfolios covered by the model, as well as information on the model's parameters such as the holding period, confidence level and the observation period.

(3) Earnings

Institutions are encouraged to disclose information on how trading activities (derivatives and cash positions) affect earnings, as well as information on the earnings impact of non-trading derivatives activities. As with market risk information, the Committees encourage institutions to base these disclosures on their internal measurement and accounting systems. The Committees recognise that accounting standards and valuation techniques differ across member countries and that earnings disclosures are therefore not directly comparable at the international level. This makes it all the more important for institutions to provide additional qualitative information explaining the accounting and valuation techniques used in the financial statements (see qualitative section above).

For additional guidance on the type of earnings information that institutions could disclose, the Committees recommend that institutions refer to the "catalogue" section of the Supervisory Framework paper, which includes discussion of the following types of information:

- Revenues from trading activities: a summary of trading revenues, for cash and derivatives instruments combined, broken down by major risk category (interest rate, foreign exchange, equities, commodities and other). Alternatively, institutions could provide a breakdown by major product trading desk (i.e. bonds, swaps, foreign exchange, equities, etc.).
- Non-trading derivatives holdings: quantitative information about the effect on earnings of off-balance-sheet positions held by the organisation to manage interest rate risk, currency risk and other risks. This information provides insight into how derivatives are being used to manage non-trading risks (for example, exposure to interest rate risk) and the degree to which these efforts have been successful.
- Unrealised or deferred losses: for derivatives that are accounted for on a historical cost basis, summary information on the notional amounts, market values and unrealised losses on these instruments. In addition, information on the amount of realised losses on derivatives positions that have been deferred and the timing of their future recognition in the profit and loss account. This information provides

insight into how future earnings and capital may be affected by losses that have not yet been realised or that have been deferred.

- Derivatives valuation reserves and actual credit losses: information on the valuation reserves that an institution has established for derivatives activities, together with information on any material credit losses on derivatives instruments experienced during the period covered by the financial disclosures.