TRADING AND DERIVATIVES DISCLOSURES

OF BANKS AND SECURITIES FIRMS

RESULTS OF THE SURVEY OF 1997 DISCLOSURES

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

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of the Basle Committee on Banking Supervision

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The publication of this fourth annual survey report on the trading and derivatives disclosures of major G-10 banks and securities firms represents a continued effort by the Basle Committee on Banking Supervision and the IOSCO Technical Committee to encourage financial institutions to enhance transparency of their trading and derivatives activities. Transparency through public disclosure is crucial to effective market discipline and can reinforce supervisory efforts to promote high standards in risk management. The two Committees consider transparency of banks' and securities firms' activities and risks to be a key element of an effectively supervised financial system.

This year's survey reveals that many leading banks and securities firms have continued to expand and improve their trading and derivatives disclosures in line with the recommendations issued by the two Committees in 1995. Viewed over the period from 1993 to 1997, the amount, detail and clarity of trading and derivatives-related disclosures in annual reports of banks and securities firms have improved substantially. During the same period, the derivatives activities of banks and securities firms have expanded considerably. For instance, the notional amount in US dollars of derivatives activities of banks and securities firms included in the sample has grown 80% since the issuance of the first survey report in 1995.

The most noteworthy improvements in the 1997 annual reports were:

- expanded discussions of operational and legal risks;
- an increase in disclosures of market values and their estimation;
- more information about counterparty credit quality and concentrations; and
- enhanced disclosures of market risk information, e.g., model assumptions.

The Basle Committee and the IOSCO Technical Committee note that, for the past four years that this survey has been conducted, there have been disparities, both within and across countries, as regards the type and usefulness of the information disclosed. Moreover, certain institutions still disclose very little about key aspects of their trading and derivatives activities, including risk profile and related risk management practices. These institutions are

urged to improve their disclosures of trading and derivatives activities to enhance transparency and facilitate effective market discipline.

Institutions should consider the quantitative and qualitative disclosures recommended by the two Committees in 1995, disclosure standards and recommendations issued by other national and international bodies, and the types of disclosures provided by their peers at the international level.

TRADING AND DERIVATIVES DISCLOSURES OF BANKS AND SECURITIES FIRMS

RESULTS OF THE SURVEY OF 1997 DISCLOSURES

I. General remarks

(1) Introduction

1. Since 1995, the Basle Committee on Banking Supervision[1] (Basle Committee) and the Technical Committee of the International Organization of Securities Commissions[2] (IOSCO Technical Committee) have conducted an annual survey of the public disclosure of trading and derivatives activities[3] of banks and securities firms and issued a public report on the findings.[4] This survey follows disclosure recommendations contained in the 1995 report and has been periodically adjusted to take into account market developments. 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.

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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, France, Germany, Hong Kong, Italy, Japan, Mexico, Ontario, the Netherlands, Quebec, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

3 "Trading and derivatives" activities comprise trading activities (on-balance-sheet instruments and off-balance-sheet derivatives) and non-trading derivatives activities.

4 The earlier survey reports were published in November 1995, November 1996 and November 1997, respectively.

2. This report was prepared in collaboration between the Transparency Group of the Basle Committee and the IOSCO Working Party on the Regulation of Financial Intermediaries.[5]

3. The Committees' efforts are consistent with, and reinforced by, public statements made by the G-7 Heads of State and Finance Ministers on the importance of transparency in promoting financial stability. These statements recognise that improved transparency of institutions' financial condition, performance, business activities, risk profile and risk management practices, facilitates effective market discipline and sound and efficient functioning of financial markets. Thus, transparency can reinforce supervisory efforts to promote safety and soundness in individual institutions and financial systems as a whole. The Basle Committee has recently issued a report on *Enhancing Bank Transparency* ("the Krause Report") that provides an elaboration of the role of disclosure and transparency in effective banking supervision and market discipline, in part by referring to the Core Principles for Effective Banking Supervision.[6]

(2) Objective

4. 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 transparency around their trading and derivatives activities. The Basle Committee and the IOSCO Technical Committee believe that transparency, based on meaningful public disclosure, plays an important role in reinforcing the efforts of supervisors in encouraging sound risk management practices and fostering financial market stability.[7] Enhanced transparency should also benefit banks and securities firms themselves by enhancing their ability to evaluate and manage their exposures to counterparties and reducing the likelihood that they become susceptible to market rumours and misunderstandings during periods of financial stress.

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[5] The Basle Committee's Transparency Group is chaired by Ms. Susan Krause of the US Office of the Comptroller of the Currency, and the IOSCO Working Party on the Regulation of Financial Intermediaries by Mr. Richard Britton of the UK Financial Services Authority.

[6] Reference can also be made to the Reports on the International Financial Architecture issued in October 1998, in particular the Report on Transparency and Accountability, prepared by three working groups consisting of representatives of central banks and finance ministries of developed and emerging market economies.

[7] The role of disclosure and transparency in fostering safe and sound banking systems is discussed in the Krause Report, issued in September 1998.

(3) Contents of the report

5. This report has two parts. The first part of the paper briefly discusses recent disclosure initiatives by regulators, standard-setters and industry groups with respect to trading and derivatives activities. The second part of the paper presents the results of the 1997 survey of trading and derivatives disclosure practices of major internationally active banks and securities firms.

6. The results of this year's survey show that disclosure practices of 78 internationally active banks and securities firms continued to improve in 1997 annual reports. Progress is particularly noticeable with respect to the disclosure of market risk data, such as the assumptions underlying value-at-risk models. It is also interesting to note the emerging trend among banks to disclose market risk capital charge data following the introduction of market risk capital requirements in the Basle Capital Accord. In addition, institutions expanded their discussion of operational and legal risks, disclosed more information about counterparty credit quality and concentrations, and provided more information about the market value of their derivatives activities and its estimation.

7. While these improvements should be acknowledged, it should also be noted that 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 urged to implement the recommendations for quantitative and qualitative disclosures issued by the Basle Committee and the IOSCO Technical Committee. In addition, 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.

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

9. When the Basle Committee and the IOSCO Technical Committee in 1995 issued their first 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 trading and derivatives disclosure of banks and securities firms.[8] The recommendations followed two main themes.

- First, 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.[9] 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.[10]

10. While these two principles still are valid, various developments have taken place since the recommendations first were issued. First of all, there has been a significant increase in financial institutions' use of derivatives.[11] Credit derivatives have become more common. There have also been developments in the use and design of risk management techniques, such as market risk modelling. In addition, disclosure practices have continued to evolve.

11. Second, since the release of the 1995 recommendations, the two Committees have continued their efforts to promote transparency in banks and securities firms. The Basle Committee in September 1998 issued the Krause Report on Enhancing Bank Transparency, which discusses the rationale for transparency and ways to achieve enhanced transparency in

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8 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"), originally released by the Basle Committee and the IOSCO Technical Committee in May 1995.

9 As recommended in the Fisher Report.

10 For guidance about meaningful types of information and fundamental disclosures about derivatives activities, institutions were encouraged to look to the catalogue and common minimum framework presented in the Joint Basle Committee / IOSCO Supervisory Information Framework paper.

11 The notional amount of derivatives in banks and securities firms increased by 80% over the period from 1994 to 1997.

banks. In particular, the report contains guidance on the characteristics and types of information banks should provide to the public.[12] Moreover, the two Committees in September 1998 issued a revision of the Framework for Supervisory Information about trading and derivatives activities, which, while primarily addressing supervisory information needs, also can be of assistance to institutions in designing useful disclosures. This revision was motivated in part to update the framework to reflect the 1996 amendment to the Basle Capital Accord to address market risk.

12. Third, in many jurisdictions accounting standard-setters and rule-making bodies have required banks, securities firms and other entities to increase the level of disclosure of trading and derivatives activities. A representative list of such initiatives is below.

13. Due to these developments, the two Committees believe that banks and securities firms should ensure that their trading and derivatives disclosures reflect not only the 1995 recommendations, but also the additional disclosure guidance issued by the Committees and by other standard-setters. Moreover, firms must ensure that their disclosures appropriately reflect the level, type and complexity of their trading and derivatives activities.

14. In addition to the Basle Committee and the IOSCO Technical Committee, several other national and international bodies have issued standards, proposals or rules relating to trading and derivatives disclosures. Many of these initiatives have affected current disclosure practices or are likely to influence future practices. Where these disclosure initiatives go beyond mandatory local requirements, institutions are encouraged to consider them in order to improve the comparability and quality of their trading and derivatives disclosures.

- *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. In June 1998, the IASC issued the *Proposed International Accounting Standard E62 "Financial Instruments: Recognition and Measurement"*. The proposed standard introduces disclosure requirements for financial risk management objectives and policies.

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[12] The Krause Report recommends that banks make meaningful disclosure in six broad areas: financial performance; financial position (including capital, solvency and liquidity); risk management strategies and practices; risk exposures (including credit risk, market risk, liquidity risk, and operational, legal and other risks); accounting policies; and basic business, management and corporate governance information.

- *French guidance on market risk disclosures.* In 1998, the National Accounting Council (CNC)[13] issued two documents on market risk disclosures. *Advice n°98.05* contains best practice guidance regarding disclosure of information on market risk items in the notes to the accounts. This document requires banks and investment firms supervised by the Banking Commission to disclose information on accounting principles and rules, profitability of banking activities, counterparty risk in derivatives activities, and off-balance sheet items (especially derivatives). *Recommendation n°98.R.01* requires information relating to business strategies (to be provided by sector and geographic breakdown), interest rate risk and foreign exchange risk, as well as qualitative and quantitative information relating to market risk exposures.

- *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.[14]

  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 is required.

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[13] While the National Accounting Council (Conseil National de la Comptabilité, CNC) is responsible for defining best accounting practice in France, the Accounting Regulations Committee (Comité de la Réglementation Comptable, CRC) is the national accounting standard-setter with power to put the guidance adopted by the CNC into mandatory regulations.

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

- *Swiss Bankers' Association's "Guidelines Concerning Risk Management in Trading and Use of Derivatives."* This paper, issued in 1996, indicates that banks should provide appropriate qualitative and quantitative information (value-at-risk, confidence interval, credit risk, gross and net positive replacement values, add-on, breakdown according to the quality of counterparts, etc.) and recommends the use of international standards.

- *The UK Accounting Standards Board's (ASB) Financial Reporting Standard (FRS) 13 "Derivatives and Other Financial Instruments: Disclosure".* FRS13, which was issued in September 1998, requires UK entities to provide a comprehensive range of information about the risks arising from their financial instruments and their attitude and response to those risks. The FRS comes into force for periods ending on or after 23 March 1999 and applies to listed companies other than insurance undertakings and to all banks. The main disclosures will be interest rate risk disclosures, currency disclosures and liquidity and maturity disclosures, information on fair values and the effects of any use of hedge accounting.

- *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 for fiscal years ending after 15 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 and reasons for material quantitative changes in market risk exposures between current and previous years. Companies can use one or more of three alternatives in disclosing quantitative information about market risk:

    - A table of contract terms and other information, including fair value of market risk sensitive instruments, expected cash flows for each of the next five years and in the aggregate thereafter, effective rates or prices;

    - A sensitivity analysis of a hypothetical loss in earnings, fair values, or cash flows due to a reasonably possible near term change from current interest rates, foreign exchange rates, commodity prices, and other market rate or price changes;

    - Value-at-risk disclosures for derivative and financial instruments expressing the potential loss in fair values, earnings, or cash flows of

market risk sensitive instruments that might arise from market movements of a given likelihood of occurrence over a time interval.

- *The US Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 133* entitled *Accounting for Derivative Instruments and Hedging Activities*. This statement, effective 15 June 1999, establishes accounting and disclosure standards for derivative instruments and for hedging activities. In summary, it requires that an entity recognise all derivatives as either assets or liabilities and measure them at fair value. The entity must disclose its objectives for holding or issuing derivatives and indicate the entity's risk management policies, including a description of the items or transactions for which risks are hedged. For derivative instruments not designated as hedging instruments, the description shall indicate the purpose of the derivatives. The Statement specifies the accounting treatment based on the designated use of the derivative and requires disclosure of the resulting earnings effects.

- *The amended Basle Capital Accord for market risk capital rules and the EU capital adequacy directive.* 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 market risk capital rules to 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.

III. Survey of 1997 disclosures

(1) Overview of survey results

15. In 1997, many leading banks and securities firms continued to expand and improve their trading and derivatives disclosures in line with the recommendations issued by the two Committees in 1995. In comparison with earlier years, the most noteworthy improvements in 1997 annual reports were:

- enhanced discussions of operational and legal risks by management;
- increase in disclosures of market values and their estimations;
- more information about counterparty credit quality and concentrations; and
- expansion of disclosure of market risk information. 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.

16. It is interesting to note the emerging trend of disclosure about market risk capital charge data following the amendment of the Basle Capital Accord to incorporate market risk in the calculation of capital requirements for banks.

17. Viewed over the 1993-1997 period, the amount, detail and clarity of trading and derivatives-related disclosures in annual reports of banks and securities firms have improved substantially. In particular, banks and securities firms have significantly enhanced their disclosure of qualitative and quantitative information about credit and market risks associated with their trading and derivatives activities.

18. Despite these improvements, there remain significant disparities, both within and across countries, as regards the type and usefulness of the information disclosed. For instance, less than half of the institutions in the sample related value-at-risk data to actual changes in portfolio value, as discussed in the Fisher Report. Moreover, some institutions continue to disclose little, generally, about key aspects of their trading and derivatives activities.

(2) Scope and methodological remarks

19. The survey of trading and derivatives-related disclosures focuses on the 1993-1997 annual reports of 67 banks and 11 securities firms, representing a sample of large, internationally active institutions in the G-10 countries. 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.[15] 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.

20. As was noted in the 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 not generally included in the tables.

21. 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 provide instead 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 1993-1997 period. The Committees believe that the survey should provide an important impetus to support banks' and securities firms' continued efforts to develop meaningful disclosures in this area.

22. 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:

i) ***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.

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[15] The same banks and securities firms headquartered in G-10 countries were surveyed this year, as in the 1996 survey, with the following exceptions: Cassa di Risparmio di Torino was replaced in the survey by UNICREDITO S.p.A., following its entry into the UNICREDITO Group. The Long-Term Credit Bank of Japan was replaced by the Mitsubishi Trust and Banking Corporation due to the delayed release of its annual report. Sparbanken Sverige merged with Föreningsbanken to form FöreningsSparbanken. Hambros PLC disposed of its banking business in 1997, and is replaced by Abbey National plc. Salomon, Inc. and Smith Barney Holdings, Inc. merged to become Salomon Smith Barney Holdings, Inc.

ii) ***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.

23. It should be noted that the fact that an institution does not disclose a surveyed item sometimes is due to the fact that the information is not material to an assessment of that firm. Information is material if its omission or misstatement could change or influence the assessment or decision of a user relying on that information. Thus, a low frequency of disclosure for certain items, e.g., derivatives credit losses and the use of credit derivatives, should not necessarily be interpreted as a sign of poor transparency in these areas. Instead, the low frequency of disclosure might be explained by a fact that few institutions have incurred derivatives credit losses and use credit derivatives, respectively.

24. The remainder of this report presents in greater detail the developments in qualitative and quantitative disclosures of trading and derivative activities in 1997. 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.[16] The qualitative and quantitative information is summarised in Tables 2-6 at the end of this section.

(3) Survey results – Qualitative information

25. As illustrated in Table 2, banks and securities firms continued to improve the qualitative, summary discussion of their trading and derivatives activities in 1997. Viewed over the 1993-1997 period, this trend can be observed for all of the disclosure items reviewed in Table 2. In comparison with 1996, there was a significant increase in the number of institutions discussing:

- operational and legal risks (+7 percentage points),

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[16] 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.

- details of the estimation of market values (• +13 percentage points), and
- accounting policies for derivatives (• +9 percentage points).

However, the 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. In other words, expanded descriptions of accounting or risk management policies may not always be reflected in the results.

26. Increasingly, internationally active banks and securities firms provide a comprehensive overview of the business objectives of their trading and derivatives activities, associated risks, and methods used to manage these risks. Sometimes, these disclosures were also given specifically in the context of derivatives. In 1997, 99% discussed objectives and strategies for their trading and non-trading activities (+4 percentage points as compared with 1996). Ninety-one percent discussed how credit and market risk arises (+5 percentage points and +4 percentage points, respectively). Sixty-five percent of the institutions discussed how liquidity risk arises (+3 percentage points). This year, progress was particularly visible with respect to the number of institutions describing operational and legal risks. Fifty-eight percent of the institutions provided such information in 1997 (+7 percentage points).

27. The disclosure of the details of firms' valuation policies also expanded in 1997. While 87% discussed how market values had been estimated in general (+5 percentage points), 41% discussed market valuation adjustments and reserves (+7 percentage points), and 76% discussed their valuation methods where no quoted prices are available (+13 percentage points).

28. The number of institutions providing a general discussion of their accounting policies for derivative instruments increased with 8 percentage points to 99% in 1997. Many institutions provided further detail on their accounting policies, for example, by distinguishing between accounting methods for different types of derivatives instruments (87%, +9 percentage points), or by discussing hedge accounting criteria (67%, +5 percentage points).

(4) Survey results – Quantitative information

29. 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 1993-1997 period, and progress was also visible when comparing 1996 and 1997 disclosures.

30. From 1994 onwards, all of the 67 banks and 11 securities firms provided information about the notional amounts of their derivatives holdings. In comparison with 1996, the most noteworthy improvement in 1997 was the very significant increase in the number of institutions providing various types of market value data. Eighty-three percent disclosed the gross positive market value for derivatives (+15 percentage points), and 64% disclosed the gross negative market value for derivatives (+17 percentage points). Sixty-eight percent disclosed the market values of derivatives in the trading account (+5 percentage points). There was also an increase in the number of institutions providing separate disclosure of trading assets and trading liabilities (58%, +9 percentage points). The number of institutions disclosing information on the overall market value of derivatives held outside the trading account (for example for hedging purposes) increased with 12 percentage points to 51% in 1997.

(a) Credit risk

31. Over the 1993-1997 period, banks and securities firms materially expanded the quantitative information provided on credit risk, as illustrated in Table 4, and increases are also visible when comparing 1996 and 1997. In some cases, this information was provided separately for derivatives instruments; in other cases, cash and derivatives-related disclosures were combined.

32. In 1997, institutions continued to provide more information on the credit quality of their trading and derivatives portfolios. Seventy-one percent disclosed data on counterparty credit quality (+8 percentage points), e.g., by counterparty type (54%) or by internal or external rating (29%). Other common types of disclosure on credit exposure were information on gross positive market values (without netting) (79%, +11 percentage points) and risk-based capital credit-equivalent amounts (55%, -4 percentage points). Fourteen percent disclosed their average credit exposure or the volatility of their credit exposure.

33. Disclosure about concentrations also expanded in 1997. Seventy-one percent of banks and securities firms provided information about concentrations (+10 percentage points), e.g., by geographic area (42%) or industry groups (51%). In addition, there was an increase in the number of institutions providing information about potential credit exposure, a measure of how much current credit exposure could increase in the future as a result of movements in underlying rates or prices (36%, +9 percentage points).

34. Twenty-one percent provided information on collateral and other credit enhancements (+7 percentage points), and 17 % disclosed information on actual credit losses (-1 percentage point).

(b) Market risk

Trading activities

35. The number of institutions disclosing quantitative information on their exposure to market risk grew substantially over the 1993-1997 period, and the information provided improved (Table 5). Also when comparing 1996 and 1997 annual reports, considerable progress is also visible. Increasingly, the banks included in the survey are basing such disclosures on their internal value-at-risk methodologies. Value-at-risk is an estimate of potential trading losses over a given time horizon, measured at a certain level of statistical confidence. In 1997, 81% provided such value-at-risk-based disclosures, an increase with 18 percentage points since 1996. Most of these institutions also provided the results of their value-at-risk calculations. In some cases, value-at-risk information was provided separately for currency, interest rate and equity contracts, with a separate deduction for diversification effects.

36. In comparison with 1996, there was also an increase 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 identified the need for further improvements. In 1997 annual reports, 81% disclosed the confidence interval used (+20 percentage points), 76% the holding period (+17 percentage points), and 27% the method of aggregation across risk factors (-2 percentage points).

37. In addition to disclosing a point-in-time value-at-risk number for the end of the financial statement period, a number of institutions also provided information on their value-at-risk exposures over the whole reporting period. For example, 41% disclosed the average value-at-risk number for the reporting period (+7 percentage points). Forty-six percent disclosed the high and low value-at-risk numbers in 1997, an increase with 16 percentage points since 1996. Moreover, 27% directly related daily value-at-risk estimates to actual changes in portfolio value (+8 percentage points), 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.

38. In 1996, disclosure of the results of scenario analyses expanded. Twenty-six percent disclosed such information (+10 percentage points).

39. An emerging trend is the disclosure of information about market risk capital charge data following the Amendment to the Basle Capital Accord. Forty percent provided such information.

40. 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 percent 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

41. In 1997, the most prevalent means of conveying how non-trading derivatives are used to manage a bank's interest rate risk was a gap position schedule (used by 31%).[17] 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. Also, twenty-four percent disclosed the impact of a rate shock (+4 percentage points). Fifteen percent presented quantitative information on derivatives together with information on hedged positions (+7 percentage points). Several institutions also disclosed the value-at-risk or earnings-at-risk for non-trading portfolios (33%).

(c) Earnings

Trading activities

42. In 1997, disclosures on trading income of trading activities expanded (95% in 1997, +8 percentage points), e.g., by risk exposure or line of business (51%, no change) or by cash positions vs. derivative instruments (50%, +23 percentage points). Thirty-seven percent disclosed their net interest revenue from cash positions in their trading activities (+3 percentage points).

Non-trading derivatives activities

43. Thirty-five percent presented information about the revenue impact of non-trading derivatives positions (+10 percentage points), while 26% reported the overall effect on net

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[17] 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.

interest margins of their non-trading derivatives activities (+7 percentage points). Twenty-seven percent disclosed the amount of deferred gains or losses of their non-trading derivatives (+2 percentage points). Forty-five percent disclosed the unrealised gains and losses associated with non-trading derivatives positions, an increase with 10 percentage points since 1996.

November 1998

Table 1
Banks and securities firms included in survey
31 December 1997 (except as noted)
In alphabetical order, by country

		Notional Amounts (Billions) (1)	
Country	**Institution**	**National Currency**	**US Dollars**
Belgium	Bank Brussels Lambert	17,973	487
	Generale Bank	12,633	342
	Kredietbank	19,695	534
Canada (2)	Bank of Montreal	715	507
	Bank of Nova Scotia	988	702
	Canadian Imperial Bank of Commerce	1,887	1,339
	National Bank of Canada	110	78
	Royal Bank of Canada	1,269	901
	Toronto-Dominion Bank	626	444
France	Banque Nationale de Paris	14,490	2,421
	Compagnie Financière de Paribas	14,835	2,479
	Crédit Agricole	9,292	1,553
	Crédit Agricole Indosuez	9,846	1,645
	Crédit Commercial de France	3,169	530
	Crédit Lyonnais	8,126	1,358
	Société Générale	19,270	3,220
	Union Européenne de CIC	4,000	668
Germany	Bankgesellschaft Berlin	1,383	773
	Bayerische Hypotheken- und Wechsel-Ba	556	311
	Bayerische Vereinsbank AG	1,291	722
	Commerzbank	2,622	1,466
	Deutsche Bank	7,141	3,993
	Dresdner Bank	1,964	1,098
	Westdeutsche Landesbank	1,772	991

(1) Notional amounts of off-balance-sheet derivative instruments
(2) Fiscal year-end (FYE) of 31 October 1997

Table 1(con't)
Banks and securities firms included in survey
31 December 1997 (except as noted)
In alphabetical order, by country

Country	Institution	Notional Amounts (Billions) National Currency	US Dollars
Italy	Banca Commerciale Italiana	595,304	339
	Banca di Roma	105,542	60
	Banca Nazionale del Lavoro	78,827	45
	Banco di Napoli	31,033	18
	Credito Italiano	192,110	109
	Istituto Bancario S. Paolo di Torino	458,634	261
	Istituto Mobiliare Italiano	201,557	115
	UNICREDITO S.p.A.	36,053	21
Japan (3)			
Banks:	Bank of Tokyo-Mitsubishi	394,881	2,991
	Fuji Bank	337,789	2,559
	Industrial Bank of Japan	232,265	1,760
	Mitsubishi Trust and Banking Co.	47,278	358
	Sanwa Bank	252,043	1,909
	Sumitomo Bank	252,833	1,915
	Tokai Bank	77,718	589
Securities firms:	The Nikko Securities Co., Ltd.	6,992	53
	The Nomura Securities Co., Ltd.	106,542	807
Netherlands	ABN-AMRO Bank	3,072	1,524
	ING Bank	879	436
	Rabobank	1,312	651
Sweden	Nordbanken	1,346	171
	Skandinaviska Enskilda Banken	4,815	611
	FöreningsSparbanken (Swedbank)	2,017	256
	Svenska Handelsbanken	5,355	679
Switzerland	Credit Suisse First Boston	4,666	3,170
	Swiss Bank Corp.	4,906	3,332
	Union Bank of Switzerland	3,385	2,299

(3) FYE 31 March 1998

Table 1(con't)
Banks and securities firms included in survey
31 December 1997 (except as noted)
In alphabetical order, by country

Country	Institution	Notional Amounts (Billions) National Currency	US Dollars
United Kingdom	Abbey National plc	138	229
	Barclays PLC	1,671	2,767
	HSBC Holdings plc	993	1,644
	Lloyds TSBGroup	983	1,628
	NatWest Group	2,196	3,636
	Royal Bank of Scotland Group plc (4)	184	305
	Schroders	161	267
	Standard Chartered	193	320
United States			
Banks: (5)	Bank of New York Co.	201	201
	BankAmerica Corp.	1,585	1,585
	Bankers Trust N.Y. Corp.	2,107	2,107
	Chase Manhattan Corp.	7,656	7,656
	Citicorp	2,929	2,929
	First Chicago NBD Corp.	1,246	1,246
	J.P. Morgan & Co.	6,126	6,126
	NationsBank Corp.	1,715	1,715
	Republic New York Corp.	270	270
	State Street Boston Corp.	92	92
Securities firms:	The Bear Stearns Companies, Inc. (6)	494	494
	Donaldson, Lufkin & Jenrette, Inc.	51	51
	The Goldman Sachs Group, L.P. (7)	2,242	2,242
	Lehman Brothers Holdings, Inc. (8)	1,856	1,856
	Merrill Lynch & Co., Inc. (9)	2,637	2,637
	Morgan Stanley, Dean Witter, Discover &	2,529	2,529
	Paine Webber Group, Inc.	59	59
	Prudential Securities, Inc.	55	55
	Salomon Smith Barney Holdings, Inc.	3,294	3,294

(4) FYE 30 September 1997
(5) Source: Publicly available regulatory financial statements filed with the Federal Reserve
(6) FYE 30 June 1998
(7) FYE 28 November 1997
(8) FYE 30 November 1997
(9) FYE 26 December 1997

TABLE 2

QUALITATIVE INFORMATION

	1993 %	1996 %	1997 %	1993 No.	1996 No.	1997 No.	1997												
							BE	CA	FR	DE	IT	JP Ban	JP Sec	NL	SE	CH	UK	US Ban	US Sec
				79	79	78	3	6	8	7	8	7	2	3	4	3	8	10	9
Discussion of Objectives:																			
Objectives & strategies for trading and non-tradi	48%	95%	99%	38	75	77	3	6	8	7	8	7	2	2	4	3	8	10	9
Discussion of Risks :																			
Placed in context with balance sheet risks	47%	96%	97%	37	76	76	3	6	8	7	8	7	1	2	4	3	8	10	9
Discussion of specific risks:																			
Credit risk - described how risk arises	43%	86%	91%	34	68	71	3	6	7	6	5	7	2	2	4	3	7	10	9
* Risk management method described	38%	95%	92%	30	75	72	2	6	8	6	5	7	2	3	3	3	8	10	9
Market risk - described how risk arises	44%	87%	91%	35	69	71	3	6	8	6	5	7	2	1	4	3	7	10	9
* Risk management method described	37%	96%	96%	29	76	75	3	6	8	6	6	7	2	3	4	3	8	10	9
Liquidity risk - described how risk arises	24%	62%	65%	19	49	51	2	6	8	2	3	4	0	0	1	1	8	10	6
* Risk management method described	19%	68%	68%	15	54	53	2	6	8	1	3	3	0	1	4	1	8	10	6
Operational & Legal Risks - described risks	13%	51%	58%	10	40	45	2	6	4	1	3	7	0	2	2	3	3	6	6
* Risk management method described	10%	54%	60%	8	43	47	2	6	4	1	3	7	0	2	3	3	4	6	6
Discussion of How Market Values Estimated	33%	82%	87%	26	65	68	1	6	8	5	7	7	2	1	3	3	6	10	9
* Disc. of market valuation adjustments/reserves	11%	34%	41%	9	27	32	1	5	4	0	6	0	0	0	0	3	3	9	1
* Disc. of valuation where no quoted prices	34%	63%	76%	27	50	59	1	6	7	2	6	7	2	1	2	1	5	10	9
Discussed - Accounting Policies for Derivatives	80%	91%	99%	63	72	77	3	6	8	7	8	7	1	3	4	3	8	10	9
* Accounting methods for various types of deriva	67%	78%	87%	53	62	68	3	6	8	7	0	7	0	3	4	3	8	10	9
* Hedge accounting criteria	44%	62%	67%	35	49	52	2	4	8	3	8	0	0	1	2	3	3	10	8
* Terminations of derivatives	15%	46%	54%	12	36	42	1	5	3	0	8	7	0	1	0	1	4	9	3
* Netting of assets/liabilities arising from derivativ	15%	46%	47%	12	36	37	2	4	-	4	0	0	0	0	1	3	8	10	5
* Accounting treatment for derivatives credit loss	11%	34%	36%	9	27	28	1	5	6	6	5	0	0	0	0	2	0	3	0

BE = Belgium, CA = Canada, FR = France, DE = Germany, IT = Italy, JP = Japan, NL = the Netherlands, SE = Sweden, CH = Switzerland, UK = the United Kingdom, US = the United

TABLE 3

GROSS POSITION INDICATORS

	1993	1996	1997	1993	1996	1997	1997											
	No.	No.	No.	No.	No.	No.	BE	CA	FR	DE	IT	JP Bank	JP Sec firm	NL	SE	CH	UK	US Bank	US Sec firm
				79	79	78	3	6	8	7	8	7	2	3	4	3	8	10	9
Information on notional amounts for trading and non-trading positions	85%	100%	100%	67	79	78	3	6	8	7	8	7	2	3	4	3	8	10	9
Maturity Schedule			77%			60	3	6	2	7	4	6	1	3	0	3	8	9	8
Market Value Data																			
Gross positive market value - derivatives	33%	68%	83%	26	54	65	2	6	3	7	5	7	2	3	4	3	7	7	9
Gross negative market value - derivatives	16%	47%	64%	13	37	50	1	6	0	0	5	7	2	1	4	3	7	5	9
Trading Account:																			
Separate trading assets from trdg. liabilities	34%	49%	58%	27	39	45	0	2	7	0	0	7	2	0	0	0	8	10	9
Cash instrument detail: end-of-period (MV)	53%	84%	81%	42	66	63	0	6	7	1	8	7	2	3	1	3	8	8	9
average for period (MV)	0%	9%	13%	0	7	10	0	3	0	0	0	0	0	0	0	0	0	7	0
Derivative instrument detail: end-of-period (MV)	27%	63%	68%	21	50	53	3	6	1	2	5	7	2	1	0	0	8	9	9
average for period (MV)	4%	37%	33%	3	29	26	0	4	0	1	0	0	1	1	0	0	0	10	9
Non-trading Derivatives Positions:																			
Overall market value	20%	39%	51%	16	31	40	1	6	0	0	5	7	1	0	0	1	5	10	4

MV = Market value

TABLE 4

CREDIT RISK

	1993 No.	1996 No.	1997 No.	1993 No.	1996 No.	1997 No.	1997												
							BE	CA	FR	DE	IT	JP Ban	JP Sec	NL	SE	CH	UK	US Ban	US Sec
				79	79	78	3	6	8	7	8	7	2	3	4	3	8	10	9
Current credit exposure (i.e., with netting)	28%	53%	55%	22	42	43	1	6	3	0	0	7	0	1	0	3	6	10	6
Average credit exposure or Volatility of credit exposure			14%			11	0	3	0	1	0	0	0	0	0	0	3	4	0
Gross positive market value	33%	68%	79%	26	54	62	2	6	3	7	5	7	2	3	4	3	7	7	6
Potential credit exposure	1%	27%	36%	1	21	28	3	6	1	1	4	0	0	3	0	3	0	5	2
Counterparty credit quality	8%	63%	71%	6	50	55	3	6	5	7	5	1	0	2	4	3	7	6	6
By counterparty type	5%	48%	54%	4	38	42	2	6	5	7	4	1	0	2	4	0	7	3	1
By internal or external credit rating	8%	27%	29%	6	21	23	0	3	2	1	1	1	0	0	0	3	1	5	6
Information on Concentrations	14%	61%	71%	11	48	55	2	6	4	7	8	1	0	3	1	0	8	8	7
Exposure by geographic area	10%	29%	42%	8	23	33	1	4	4	7	0	1	0	3	0	0	3	7	3
Exposure by industry groups	14%	48%	51%	11	38	40	0	6	4	7	0	1	0	3	1	0	7	4	7
Collateral & other credit enhancements	0%	14%	21%	0	11	16	1	1	1	0	3	0	0	2	0	1	1	2	4
Allowances for OBS contract credit losses		9%	13%		7	10	1	0	1	0	0	0	1	0	1	0	0	6	0
Actual credit losses	5%	18%	17%	4	14	13	1	2	0	0	4	0	0	0	0	0	0	6	0
Nonperforming contracts	1%	13%	14%	1	10	11	1	1	0	0	4	0	0	0	0	0	0	5	0
For banks, RBC credit equivalent - derivatives	43%	59%	55%	34	47	43	0	6	3	5	7	7	0	3	4	2	1	5	-
Use of credit derivatives			14%			11	0	0	1	4	1	0	0	0	0	0	2	2	1

TABLE 5

MARKET RISK INFORMATION

	1993 No.	1996 No.	1997 No.	1993 No.	1996 No.	1997 No.	1997												
							BE	CA	FR	DE	IT	JP Ban	JP Sec	NL	SE	CH	UK	US Ban	US Sec
				79	79	78	3	6	8	7	8	7	2	3	4	3	8	10	9
Trading Activities:																			
Disclosed Value-at-Risk Data:	5%	63%	81%	4	50	63	3	5	7	6	4	7	1	2	2	3	6	10	7
Those disclosing VAR data also provided:																			
High/Low VAR	0%	30%	46%	0	24	36	1	2	2	4	3	6	1	2	1	3	4	7	0
Average VAR	0%	34%	41%	0	27	32	1	0	2	3	4	5	1	2	1	2	5	6	0
Daily change in value of portfolio	0%	23%	27%	0	18	21	0	2	0	2	1	6	0	0	0	3	1	6	0
Changes in portfolio value exceeding VAR	0%	19%	27%	0	15	21	0	2	0	1	1	7	0	0	0	3	0	7	0
Confidence interval	3%	61%	81%	2	48	63	3	5	7	6	4	7	1	2	2	3	6	10	7
Holding period	0%	59%	76%	0	47	59	3	4	7	6	4	7	1	1	2	3	6	8	7
Method of aggregation across risk factors	0%	29%	27%	0	23	21	0	1	6	0	2	3	0	0	0	1	3	5	0
Scenario analysis	1%	16%	26%	1	13	20	0	5	1	2	1	3	0	0	3	2	1	2	0
Market risk capital charge data			40%			31	0	4	4	0	3	7	0	3	4	2	1	3	0
Non-trading Derivatives																			
Effect of derivatives on int. repricing 'gap' posit	29%	30%	31%	23	24	24	0	6	0	0	8	0	0	0	0	0	4	6	0
Quant. info. deriv. presented w. position hedged		8%	15%		6	12	0	1	0	0	3	0	1	0	0	0	2	5	0
Scenario analysis: impact of rate shock	6%	20%	24%	5	16	19	0	6	1	0	0	2	0	0	0	0	1	9	0
VAR or EAR for non-trading portfolios	0%	9%	33%	0	7	26	0	6	0	0	5	5	0	0	0	0	2	4	4

TABLE 6

EARNINGS INFORMATION

	1993	1996	1997	1993	1996	1997	1997												
	No.	No.	No.	No.	No.	No.	BE	CA	FR	DE	IT	JP Ban	JP Sec	NL	SE	CH	UK	US Ban	US Sec
				79	79	78	3	6	8	7	8	7	2	3	4	3	8	10	9
Trading Activities:																			
Information on trading income	61%	87%	95%	48	69	74	2	5	8	7	8	7	2	3	4	3	8	10	7
By risk exposure/line of business	10%	51%	51%	8	40	40	0	5	0	6	1	1	0	0	4	3	3	10	7
By cash positions vs. derivative instruments	28%	27%	50%	22	21	39	0	5	1	0	8	6	1	0	0	0	2	9	7
Other			40%			31	1	0	8	7	8	0	0	0	0	0	5	2	0
Net interest revenue from cash positions	37%	34%	37%	29	27	29	0	3	5	0	8	1	0	0	0	3	4	5	0
Non-trading Derivatives																			
Revenue impact (amount or %)																			
Of derivatives alone	6%	25%	35%	5	20	27	0	1	1	0	8	1	0	0	0	1	3	6	6
Overall sensitivity of net interest margins	19%	19%	26%	15	15	20	0	0	0	0	8	0	0	0	0	0	0	6	6
Amount of deferred gains/losses	9%	25%	27%	7	20	21	0	2	0	0	8	0	0	0	0	0	5	4	2
Unrealised gain or loss on derivatives	15%	35%	45%	12	28	35	2	6	0	0	4	7	0	0	0	0	4	9	3