CENTRAL BANK OF NIGERIA

Guidance Notes on Pillar III

Market Discipline

TABLE OF CONTENTS

1.0 *INTRODUCTION*

The aim of Pillar III is to promote market discipline by allowing market participants to access information on risk exposure and risk management policies and procedures through disclosures. This section sets out the disclosure requirements under the guideline with respect to procedure, frequency and content of information to be disclosed.

1.1 General Disclosure Principle

Banks should have a formal disclosure policy approved by the board of directors that addresses the bank's approach for determining what disclosures it will make and the internal controls over the disclosure process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency of them. (BCBS June 2006, Par 821)

2.0 DISCLOSURE REQUIREMENTS

2.1 Organization of information and limitation of obligations

The information whose disclosure is governed by these regulations is listed in Annex A.

2.2 Content and procedures for disclosing information

- Banks shall disclose information relating to their core activities, risks profiles and methodologies used.
- In order to ensure the comprehensiveness of disclosures, references to other sources is not allowed.
- Banks are expected to make adequate disclosure consistent with their organizational complexity and the type of business they engage in, taking into account their internal reporting systems to the board and management.

2.3 Disclosure eligibility requirements

- For banks that adopt internal systems to calculate capital requirements for credit or operational risks and for those using credit risk mitigation techniques, compliance with specific disclosure requirements (Disclosure Eligibility Requirements) shall be a necessary condition for the recognition of such approach and the effects of such techniques for regulatory capital purposes. These disclosure requirements are marked by an asterisk in the annexed tables.

2.4 Derogations from disclosure requirements

- Banks may omit the disclosure of information that is not considered material, with the exception of information that represents a disclosure eligibility requirement.
- In exceptional cases, banks may omit the disclosure of proprietary or confidential information (including information that represents a disclosure eligibility requirement), provided that they specify the information that is not disclosed and the reasons for non-disclosure, and publish more general information on the matter in question.

2.5 Disclosure procedures and frequency

- Information shall be disclosed through the bank's website. Banks for whom such means of publication is difficult or onerous shall disclose information through the website of their respective industry association or in printed form.
- Banks shall make adequate pronouncement on the means of disclosure in their financial statements (in the notes to the financial statements).
- Disclosures shall be published on a bi-annual basis and within thirty days of publishing the financial statements.
- Banks may publish the information on a more frequent basis, taking into consideration their level of business, international affiliations and financial sectors dynamics. They should also consider their participation in the financial markets, international payment, clearing and settlement systems as well as the volatility of their exposure.

2.6 Organization and controls

- Banks shall adopt suitable organizational arrangements to ensure the compliance with disclosure requirement under these regulations. Board and management shall independently assess and verify the quality of information. The solutions adopted shall form part of the bank's system of internal controls.
- Within this framework, banks shall establish appropriate specific procedures for verifying disclosures that are yet to be subjected to verification by external auditors or the CBN.

Definitions of Terms

For the purposes of these regulations:

Confidential information shall mean information in respect of which the bank has obligations to customers or other counterparty relationships binding it to confidentiality.

Material information shall mean information which if omitted or misstated could change or influence the assessment or decision of a user relying on such information for the purpose of making economic decisions;

Proprietary information shall mean information which, if shared with the public, would undermine the bank's competitive position. It may include information regarding products or systems which, if shared with competitors, would render the bank's investment therein less valuable;

ANNEX A

Table 1: General requirements

		Description of disclosure
Qualitative disclosure		For each risk category (including those considered in the following tables), banks shall disclose risk management objectives and policies, including: • The strategies and processes for managing such risks; • The structure and organization of the relevant risk management function; • The scope and nature of risk measurement and reporting systems; • The policies for hedging and mitigating risk as well as strategies and processes for monitoring their continuing effectiveness.

Table 2: Scope of application

		Description of disclosure
Qualitative disclosure	(a)	The name of the bank to which the disclosure requirement applies.
	(b)	An outline of differences on the basis of consolidation for accounting and prudential purposes, with a brief description of the entities within the group which: i) Are fully consolidated; ii) Are proportionally consolidated; iii) Are deducted from the regulatory capital; iv) Are neither consolidated nor deducted.
	(c)	Any current or potential legal or substantive impediment to the prompt rapid transfer of regulatory capital or funds within the

		group.
	(d)	For groups, any reduction in individual capital requirements applied to the parent entity and the Nigerian subsidiaries.
Quantitative disclosure	(e)	The names of all subsidiaries excluded from consolidation and aggregate amount of their capital deficiencies with respect to any mandatory capital requirements.

Table 3: Regulatory capital structure

		Description of disclosure
Qualitative disclosure	(a)	Summary information on the main terms and conditions of the features of capital items, especially hybrid capital instrument and subordinated debt capital instruments.
	(b)	The total amount of Tier 1 capital, with separate disclosure of individual positive and negative items especially hybrid capital instruments.
	(c)	The total amount of Tier 2 capital
	(d)	Other deductions from regulatory capital, with separate disclosure – for banks using one of the IRB systems – of any negative differences between total value adjustments and expected loss.
Quantitative disclosure	(e)	Total regulatory capital.

Table 4: Capital adequacy

		Description of disclosure
Qualitative disclosure	(a)	Summary description of the bank's approach to assessing the adequacy of its internal capital to support current and future activities.

<table>
<tr><td rowspan="2">Quantitative disclosure</td><td>(b)</td><td>For banks calculating credit risk-weighted exposure amounts using the standardized approach, the capital requirement for each of the exposure classes.</td></tr>
<tr><td>(c)</td><td>For banks calculating credit risk-weighted exposure amounts using the IRB approach, the capital requirement for each of the exposure classes envisaged in these regulations.

For retail exposures, separate disclosure shall be made for each of the following categories: “exposures secured by residential property”, “qualifying revolving retail exposures” and “other retail exposures”.

For equity exposures, disclosure shall be made for:

i) Each of the methods envisaged (simple risk weight approach, PD/LGD approach, internal models approach); in the case of the simple risk weight approach, separate disclosure shall be made for the capital requirement for:

a) exchange-traded exposures;

b) private equity exposures in sufficiently diversified portfolios;

c) other exposures;

ii) Exposures subject to supervisory transition regarding capital requirements;

iii) Exposures subject to grandfathering provisions regarding capital requirements.</td></tr>
<tr><td></td><td>(d)</td><td>Capital requirements for market risks, with separate disclosure for:

- Assets included in the supervisory trading portfolio:

i) Position risk with specific evidence towards securitization;

ii) Settlement risk

- Entire balance sheet:

iii) Foreign exchange risk;

iv) Commodity risk;</td></tr>
</table>

	(e)	Capital requirement for counterparty risks.
	(f)	Total and Tier 1 capital ratios.

Table 5: Credit risk: general disclosures for all banks

		Description of disclosure
Qualitative disclosure	(a)	In addition to the general disclosure indicated in Table 1, the following information shall be disclosed for the exposure to credit risk and dilution risk:[1] i) The definitions of "past due" and "impaired" loans used for accounting purposes;[2] ii) A description of methods adopted for determining value adjustments[3].
Quantitative disclosure	(b)	Total and average gross credit risk exposures[4] over the period,[5] with separate disclosure by major types of exposure and counterparty.[6] The amount shall be net of permitted accounting offsets, regardless of the effects of credit risk mitigation techniques.
	(c)	Distribution of exposures by significant geographical areas, broken down by material exposure classes and further detailed if appropriate.
	(d)	Distribution of exposures by industry or counterparty type, broken down by type of exposure and further detailed if appropriate.

[1] Dilution risk shall mean the possibility that the amount owed by the assigned obligor in respect of purchased receivables is reduced through credits or allowances arising from returns, disputes regarding product quality, promotional or other discounts.
[2] Banks shall indicate that the definition used is the same as the supervisory definition.
[3] Value adjustments include specific and portfolio allowances as well as provisions to cover guarantees issued or commitments undertaken with third parties.
[4] Where the period-end position is representative of the bank's risk exposure during the period, the average gross exposures need not be provided.
[5] Where average amounts are disclosed in accordance with an accounting regulations or other requirement which specifies the calculation method to be used, that method shall be followed. Otherwise, the average exposures shall be calculated using the most frequent interval that the bank's systems generate for management, prudential or other reasons, provided that the resulting averages are representative of the bank's operations. The basis used for calculating averages shall be specified only if not on a daily average basis.
[6] This breakdown could be that applied under accounting rules.

	(e)	Distribution by residual contractual maturity[7] of the entire portfolio, broken down by type of exposure and further detailed if appropriate.
	(f)	By significant industry or counterparty type, the amount of: i) Impaired and past due exposures, shown separately; ii) Total value adjustments; iii) Value adjustments during the period.
	(g)	By significant geographical areas, the amount of: 1) impaired and past due exposures, shown separately; 2) value adjustments for each geographical area,[8] where possible.
	(h)	Reconciliation of changes in value adjustments for impaired exposures, show separately for specific and portfolio value adjustments. The information shall include: i) A description of the methods used to calculate the value adjustments; ii) The opening balance of total value adjustments; iii) Charge-offs taken during the period; iv) Value adjustments made during the period; v) Amounts reversed during the period; vi) Any other adjustment, for example exchange rate differences, business combinations, acquisitions and disposals of subsidiaries, including transfers between value adjustments; vii) The closing balance of total value adjustments. Charge-offs and recoveries recorded directly to the income statement should be shown separately.

[7] It is possible to use the same maturity groupings envisaged by accounting regulations.

[8] The portion of portfolio value adjustments that is not allocated to a specific geographical area shall be disclosed separately.

Table 6: Credit risk: disclosures for portfolios treated under the standardized approach, specialized lending and equity exposures treated under IRB approaches

		Description of disclosure
Qualitative disclosure	(a)	Banks calculating credit risk-weighted exposures using the standardized approach shall provide the following information for each exposure class: i) Names of the nominated external credit assessment institutions (ECAIs), and the reasons for any changes; ii) The exposure classes for which each ECAI is used; iii) A description of the process used to transfer the issuer or issue credit ratings to comparable assets not included in the supervisory trading book.
Quantitative disclosure	(b)	Banks calculating credit risk-weighted exposures using the standardized approach shall provide, for each exposure class, the exposure values, with and without credit risk mitigation, associated with each credit quality step as well as the exposure values deducted from the regulatory capital.
	(c)	For exposures subject to the supervisory risk weights in IRB approaches (specialized lending – equity exposures under the simple risk weight method), the exposures assigned to each credit risk class shall be provided.

Table 7: Credit risk: disclosures for portfolios treated under IRB approaches (*)

		Description of disclosure
Qualitative disclosure	(a)	Authorization from the CBN to use the approach selected and/or to use phased roll-out.
	(b)	Explanation of: i) The structure of internal rating systems and relation between internal and external ratings;

		ii) The use of internal estimates for purposes other than the calculation of risk-weighted exposure amounts in accordance with IRB approaches; iii) The process for managing and recognizing credit risk mitigation techniques; iv) The control and review mechanisms for the rating systems, including discussion of independence and accountability.
	(c)	Description of the internal ratings process, provided separately for the following exposure classes: i) Central governments and central banks; ii) Banks and other financial institutions; iii) Non-financial institutions, including SMEs, specialized lending and purchased receivables; iv) Retail exposures, for each of the categories envisaged (exposures secured by residential property; qualifying revolving retail exposures; other retail exposures); v) Equities.[9] The description shall include: • The types of exposure included in the exposure classes; • The definitions, methods and data for estimation and validation of PD and, where applicable, LGD and the credit conversion factors, including assumptions employed in the derivation of these variables;[10] • The description of deviations from the definition of default as permitted by prudential regulations, where these are determined to be material, also indicating for each class

[9] Equities shall only be disclosed here as a separate class where the bank uses the PD/LGD approach for equities held in the banking book.

[10] Banks shall provide a general overview of the system approach, describing definitions of the variables, and methods for estimating and validating those variables set out in the quantitative risk disclosures. This should be done for each of the classes indicated in the text. Banks should draw out any significant differences in the approaches used to estimate these variables within each class.

		the main categories of exposure affected by such deviations.[11]
Quantitative disclosure: risk assessment	(d)	Exposure values for each exposure class. Exposures towards central governments and central banks, banks and other financial institutions, and corporates, where the banks use the IRB advanced approach, must be shown separately from exposures for which the banks do not utilise this approach.
	(e)	For each exposure class – central governments and central banks; banks and other financial institutions; corporates; equities – provide the following information, with a sufficient breakdown between PD categories (including default) to allow a significant differentiation of credit risk:[12] i) Total exposures (for exposures towards central governments and central banks, banks and other financial institutions, and corporates, the sum of outstanding loans plus unutilised margins; for equities, outstanding amount); ii) For banks on the IRB advanced approach, exposure-weighted average LGD (percentage); iii) Exposure-weighted average risk-weight; iv) For banks on the IRB advanced approach, the amount of unutilised margins and relative exposure-weighted average EAD.[13]
	(f)	For retail exposures, provide for each category envisaged: i) The information referred to in point e) (if applicable, on a pool basis) or ii) Analysis of exposures (if applicable, on a pool basis) against a sufficient number of expected loss (EL) grades to allow for a

[11] Banks shall only describe the main areas where there has been material divergence from the reference definition of default such that it would affect the reader's ability to compare and understand the disclosure of exposures by PD grade.

[12] The PD, LGD and EAD disclosures below shall reflect the effects of collateral, netting and guarantees/credit derivatives, where recognized. Disclosure of each PD grade should include the exposure-weighted average PD for each grade. Where banks are aggregating PD grades for the purposes of disclosure, this shall be a representative breakdown of the distribution of PD grades used in the IRB approach.

[13] Banks shall only provide one estimate of EAD for each exposure class. However, where banks believe it is helpful, in order to give a more meaningful assessment of risk, they may also disclose EAD estimates across a number of EAD categories, against the undrawn exposures to which these relate.

		meaningful differentiation of credit risk.
Quantitative disclosure: historical results	(g)	Actual value adjustments (for example, charge-offs and specific write-downs) in the preceding period for each exposure class (showing each retail exposure category separately) and how this differs from previous years.
	(h)	Discussion of the factors that impacted on the loss experience in the preceding period (for example, has the bank experienced higher than average default rates, or higher than average LGDs and credit conversion factors).
	(i)	Banks' estimates against actual outcomes over a longer period. This should at least include information on estimates of losses against actual losses in each exposure class, over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each exposure class (for retail exposures, the information must be given for each of the categories provided). Where necessary, banks should further decompose this to provide analysis of PD and, for banks on the advanced IRB approach, LGD and credit conversion factor outcomes against estimates provided.

(*) Eligibility requirements for the use of particular instruments or methodologies

Table 8: Risk mitigation techniques [14](*)

		Description of disclosure
Qualitative disclosure	(a)	Policies and processes for, and an indication of the extent to which the bank makes use of, on- and off-balance sheet netting.
	(b)	Policies and processes for collateral evaluation and management.
	(c)	A description of the main types of collateral taken by the bank.
	(d)	The main types of guarantor and credit derivative counterparty and their creditworthiness.
	(e)	Information about market or credit risk concentrations under the credit risk mitigation instruments used.

[14] Credit derivatives treated as part of synthetic securitization transactions should be excluded from CRM disclosures and included within those relating to securitizations.

Quantitative disclosure	(f)	For banks calculating credit risk-weighted exposures in accordance with the standardized or foundation IRB approaches, separately for each exposure class, the total exposure value (if applicable, net of on-balance sheet netting and off-balance sheet netting agreements) that is covered by financial collateral and other eligible collateral, after application of haircuts.[15]
	(g)	For banks calculating credit risk-weighted exposures according to the standardized or foundation IRB approaches, separately for each exposure class, the total exposure (if applicable, net of on-balance sheet offsets and off-balance sheet offsetting agreements) covered by guarantees or credit derivatives. For equities such disclosure requirement applies to each method (simple risk weight method, PD/LGD approach, internal models method).

(*) Disclosure requirements for banks using credit risk mitigation techniques.

Table 9: Counterparty risk[16]

		Description of disclosure
Qualitative disclosure	(a)	Description of: i) The method used to assign the operating limits defined in terms of internal capital and credit for counterparty credit exposures; ii) Policies relating to guarantees and assessments concerning counterparty risk; iii) Policies with respect to wrong-way risk exposures; iv) The impact in terms of the amount of collateral that the bank would be required to provide given a credit rating downgrade.
Quantitative disclosure	(b)	i) Gross positive fair value of contracts; ii) Reduction in gross positive fair value due to netting; iii) Positive fair value net of netting agreements;

[15] If the comprehensive approach is applied, where applicable, the total exposure covered by collateral after haircuts should be reduced further to remove any positive adjustments that were applied to the exposure.
[16] Applicable to OTC derivatives (including credit derivatives) as well as securities financing transactions(repurchase agreements, securities or commodities lending and borrowing transactions, re-margining transactions based on securities or commodities, long settlement transactions).

		iv) Collateral held; v) Positive fair value of derivative contracts net of netting and collateral agreements; vi) Measures of EAD, or value of the exposure to counterparty risk, calculated in accordance with the methods used (internal, standardized, mark-to-market models) vii) Notional amount of credit derivative hedges for counterparty risk; viii) Distribution of positive fair value of contracts by type of underlying;[17] ix) Notional amount of credit derivatives in the banking book and the supervisory trading book, divided by product type,[18] further broken down according to the role played by the bank (buyer or seller of protection) within each product group; x) Estimated alpha if the bank has received authorization from the CBN to estimate alpha.

Table 10: Securitization transactions[19]

		Description of disclosure
Qualitative disclosure	(a)	i) Description of the bank's objectives with regard to securitization activity; ii) For positions towards re-securitizations and third parties, the type of risks in terms of: • level of subordination of position towards the underlying securitization, or underlying assets

[17] For example: interest rate contracts, FX contracts, equity contracts, credit derivatives, commodity/other contracts.

[18] For example: credit default swap, total rate of return swap.

[19] Except where otherwise specified, this information must be provided separately for positions in the trading book for supervisory purposes and for those in the banking book. The reference to securitization must be understood as including re-securitizations. Where the distinction is specified, the information must be provided separately for securitizations and for re-securitizations. Credit derivatives that are treated, for the purposes of these regulations, as part of synthetic securitization structures shall be excluded from the credit risk mitigation disclosures and included within those relating to securitization.

		• these positions towards the securitization iii)Description of procedures implemented to monitor changes in credit and market risks positions towards the securitization (e.g. the way in which the performance of the underlying asset affects those positions) and towards the re-securitization; iv) Description of the cover policies of the risks associated with securitization and re-securitization positions, including an indication of the main guarantee of security for each type of risk;
	(b)	Summary of bank's accounting policies for securitization activities, specifying: i) Whether the transactions are treated as sales or financings; ii) Recognition of gain on sale; iii) Key assumptions for valuing securitization exposures; iv) Treatment of synthetic securitizations, if this is not covered by other accounting policies (for example, on derivatives). v) The valuation criteria of awaiting securitization assets and if they are allocated or not in the trading book for supervisory purposes; vi) the accounting policies relating to arrangements that could require the bank to provide financial support for securitised assets (eg. liabilities in the financial statements).
	(c)	Names of ECAIs used for securitizations and the types of exposure for which each agency is used.
	(d)	The description of the 'Internal Assessment Approach', including: • The internal assessment process; • The relation between internal assessment and external ratings; • The use of the internal evaluation for purposes other than the calculation of capital requirements; • The control mechanisms of the internal assessment process including an independence, accountability, and internal assessment process review; • The exposure types to which is applied the internal

		assessment process; • The stress factors used to determine the levels of credit enhancement, by type of exposure.
	(e)	The explanation of significant changes to any of the quantitative information referred to in points f) to h) since the last reporting period.
Quantitative disclosure	(f)	state the following information broken down by exposure type: i) Total amount of securitization transactions to be carried out by the bank as originator, divided into traditional and synthetic, and those for which the bank acts only as a promoter; ii) Total amount of securitization positions in both balance sheet and off-balance sheet; iii) Total amount of awaiting securitization assets; iv) The amount of securitization positions deducted from regulatory capital or subject to risk weight of 1250%; v) Summary of the securitization activity in the period as originator, including the amount of the underlying assets, as well as the profits or losses from the sale.
	(g)	i) Total amount of own securitization positions or of third party and associated capital requirements, broken down between securitization positions and positions towards re-securitizations, and further broken down into a meaningful number of risk weight bands or capital requirements for each of the used approaches (standardized approach, supervisory Formula, etc.). ii) Total amount of own re-securitization positions or of third party, divided as follows: • By positions covered by credit risk mitigation (CRM) and positions not covered; • By creditworthiness or by name of any guarantor.
	(h)	Only for positions allocated in the banking portfolio and securitized assets by the bank, the underlying assets impaired and the losses recognized by the bank during the reporting period, both broken down by exposure type.

Table 11: Market risks: disclosures for banks using the internal models approach (IMA) for position risk, foreign exchange risk and commodity risk

		Description of disclosure
Qualitative disclosure	(a)	For each portfolio covered by the IMA: i) Characteristics of the models used; ii) A description of stress testing applied to the portfolio; iii) A description of the approach used for backtesting and/or validating the accuracy and consistency of the internal models and modeling processes.
	(b)	The scope of acceptance by the CBN regarding the use of the internal models approach.
	(c)	Description of the level of conformity with the rules governing the systems and controls used to ensure prudent and reliable assessments of the positions included in the supervisory trading portfolio, as well as the methods used to ensure compliance with such rules.
Quantitative disclosure	(d)	The maximum, minimum and average value in the reference period and the value at end of the period: i) Daily VaR data; ii) Stressed VaR data; iii) The capital requirements referred to in point (a). ii).
	(e)	For each sub-portfolio the capital requirements referred to in point (a).ii), together with the weighted average liquidity horizon for the nominal value of the exposure.
	(f)	The comparison of the daily closing VaR with the daily changes in the actual value of the portfolio, it must show the reasons behind the changes which have occurred during the reporting period.

Table 12: Operational risk

		Description of disclosure
Qualitative disclosure	(a)	A description of the approach used for operational risk capital assessment.
	(b)	A description of the advanced measurement approaches (AMA), if used by the bank, including a discussion of relevant internal and external factors considered in the approach adopted. In case of partial use of the AMA, the scope and coverage of the different approaches used should be indicated.
	(c)*	For banks using the AMA, a description of the use of insurance for the purpose of mitigating operational risk.

(*) Eligibility requirements for the use of particular instruments or methodologies.

Table 13: Equity exposures: disclosures for banking book positions

		Description of disclosure
Qualitative disclosure	(a)	i) Differentiation between exposures according to the objectives pursued (for example, capital gains, relationships with counterparties, strategic reasons); ii) Description of accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation, as well as significant changes in these practices.
Quantitative disclosure	(b)	Value disclosed in the balance sheet and fair value; in addition, for listed securities, a comparison with market quotation where it is materially different from fair value.
	(c)	Type, nature and amounts of exposures, distinguishing between: i) Exposures traded in the market; ii) Exposures in private equity instruments held in sufficiently diversified portfolios; iii) Other exposures.

	(d)	Total cumulative realised gains and losses arising from sales and liquidations in the reporting period.
	(e)	i) Unrealised gains/losses (recognised in the balance sheet but not taken to the income statement); ii) Amount of the above gains/losses included in Tier 1 or Tier 2 capital.

Table 14: Interest rate risk on positions in the banking book

		Description of disclosure
Qualitative disclosure	(a)	i) Nature of the interest rate risk; ii) Key assumptions used in measuring and managing risk, particularly as regards loans with prepayment option and the behaviour of non-maturity deposits; iii) Frequency of measurement of this type of risk.
Quantitative disclosure	(b)	Consistently with the method used by management to measure interest rate risk, the increase/decline in earnings or economic capital (or other relevant indicators) – broken down by main currencies[20] – in case of upward or downward rate shocks.

[20]Non-material currencies shall be treated as a single currency.