UNIVERSITAT JAUME I

SCHOOL OF LEGAL AND ECONOMIC SCIENCES

FINANCE AND ACCOUNTING DEGREE

Transparency on the third Pillar of Basel

Mentor: David Cabedo

Author: Silvia Molada Durbán

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SUMMARY

An action like providing information to the Market seems a simple task, however after the outbreak of the financial crisis of 2007 in which we are still immersed, has demonstrated the importance of this action over the outbreak of the crisis. So the objective of this work is the study of bank risks. In particular, risks different from those of the Pillar I, due to banks do not provide as much information as they should do. Therefore, it has been studied the banking regulation that supports the third pillar of Basel, and the requirements required. Furthermore, it has been accomplish the analysis of each bank about the type of information that is presented to the market, in relation to the aforementioned risks. As a conclusion, it has been observed the qualitative way in which banks presents the information and the lack of legislation in material of these risks.

CONTENT

LIST OF ABBREVIATIONS

PYG Gains and losses

IRB Internal Rating-Based Approach

BIA Basic indicator approach

TSA Standardized approach

AMA Advanced measurement approach

VaR Value at risk

GTM Global Timber Model

FSB Financial Stability Board

G-20 Group of Twenty

RWA Risk-weighted assets

INTRODUCTION

In many times mayor banks have been financial rescued by public funding, provided by the European Union through the banking restructuring fund. The financial crisis, in which we are immersed and whose origin took place in 2007, has evidenced the systemic risk owned by the banking system. Since the decline of this sector, initiated in the US by subprime mortgages, has triggered a global crisis of confidence in our institutions. The solution to this problem depends on the credibility that citizens give to the banks. The accounting information provided by the balance sheet, the PYG account and the banks' accounts is subject to uncertainties, that is the reason why risk information would help to a better understanding and clarity for its stakeholders. Then, this is an excellent way to recover lost confidence of citizens. Therefore, it has considered carrying out this study, mainly based on the analysis of bank risks offered by the main Spanish banks, in order to guess the information provided by banks to the market. The aim is to aware stakeholders of the necessity of this information and prevents horrible consequences for the economy.

Systems and mechanisms of control in terms of risk management have been improved through the Basel agreements, creating a common and more stringent regulation on banking transparency in terms of risk such as the Regulation (EU) No 575/2013 of the European Parliament of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending by the Regulation (EU) No 648/2012, the Regulation (EU) No 680/2014 of the Commission of 16 April 2014 laying down implementing technical standards for the communication of information for monitoring purposes by entities , in accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council, and the last one which complement these two Regulations is the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending by the Directive 2002/87/EC and repealing 2006/48/EC and 2006/49/EC Directives. Furthermore, as regards the Spanish jurisdiction: the Royal Decree 84/2015, of 13 February, which develops Law 10/2014, of June 26, on the management, supervision and solvency of credit institutions and the Bank of Spain Circular 2/2016 of February 2, to credit institutions, on supervision and solvency, complement the adaptation of the Spanish legal system to the Directive 2013/36 / EU and the Regulation (EU) No 575/2013.

At this time, in which any information is exposed through the internet and everyone is able to access, banks should reconsider their behavior and go in deep on the path of transparency to regain the credibility of their customers. According to (Claude Trichet, 2008) "If there is one lesson to be drawn from the current crisis is that transparency is a key to the future of our organizations. In all areas at stake, transparency will be one of the most important principles for one simple reason: opacity is a recipe for gregarious behavior and contagion of bad practices. "

Another point worth mentioning is the importance given to the operational, credit and the market risk, while banking regulation gives a very little detail to other risks such as reputational, structural interest rate, structural exchange rate, liquidity and financing, compliance and conduct, equity, business and concentration risk. This affirmation is reflected into the reports of prudential relevance of the principal Spanish banks. Even so, in recent times, transparency to the market has improved. Before 2004, there were no reports of prudential relevance, which are a fundamental tool to measure the degree of bank transparency.

The objective of this assignment is to analyze the level of transparency of the main Spanish banks in relation to the risks not included in the first pillar of Basel. It has been done through an analysis of the reports of prudential relevance, which are emitted annually. The analysis focuses on prudential relevance reports for the year ended, 31 December 2015. The remaining work is structured into the following sections: section two is shown an overview on Basel II and Basel III agreements, because these ones are the sources amending the banking supervision and control rules. Section three refers to the third Pillar of Basel, especially the emphasis on the content of the revised disclosure requirements. As stated in Circular 2/2016, of 2 February, the Bank of Spain, to credit institutions, regarding supervision and solvency, this requirements should be incorporated in the reports of prudential relevance. Besides, it is also explained the creation of the legal framework to strengthen the banking system and its evolution to the present. Section four analyzes the information about other risks those of Pillar I, issued by the main Spanish banks. Finally, the last section of this assignment is designated to the conclusions of the study.

OVERVIEW OF BASEL II AND BASEL III

BASEL II

Basel agreements are issued by the Basel Committee on Banking Supervision (BCBS), located in Switzerland. Nowadays it is constituted by 27 countries over the world, specifically members of the supervisory authority of each banking system. The BCBS regulations do not have legal force, each member are responsible for their implementation in their own countries. The first of the three Basel agreements was signed in 1988, called Basel I, which pay attention on the credit risk. The second one was published in June, 2004 called “International Convergence of Capital Measures and Standards: Revised Framework”, known by most economies as Basel II. The reason why Basel I disappeared was the inaccuracy of risk measurement, due to the obsolete issues compared to international models about risk measurement and management. In order to improve this situation Basel II was created to establish a regulatory capital more sensitive to some risks, creating international standards to control the amount of capital, which is needed to keep against the corporate, credit and market risks. All this new recommendations on the regulation and banking legislation were promoted to be applied in many countries as possible. As Field (2003) express, since BCBS published an initial set of proposals in June 1999, it has maintained a broad and ongoing dialogue with supervisors, banks and other stakeholders with the aim of expanding and perfecting the proposals. To sum up, it is important to mention the three basic pillars of Basel II: the first pillar; minimum capital requirements**,** the second pillar; supervisory review, and the third one; the market discipline,which complement and reinforce each other and whose ultimate goal is to promote the financial stability. Next, it is going to give a short explanation about this third pillars.

The first pillar: Minimum capital requirements

This is one of the most important parts of Basel II due to the introduction of the minimum capital requirements in order to cover the market, credit and operational risks. Moreover, it is also introduced a minimum capital ratio of 8% in relation to risk-weighted assets, in order to cover the counterparty credit risk. With the purpose of calculate these minimum capital requirements over the operational, market and credit risk, the agreement proposes different methods. The simpler and less expensive method in their initial implementation requires a higher capital; however, those ones more developed, with more capital requirements, have a lower contribution. The application of all this methods allows them its adequate management. Once clarified this point we will enumerate which methods can be employed to calculate the credit risk: standardized approach, which is a method based on external ratings, and internal methods such as Foundation IRB and Advanced IRB. Whereas for operational risk, they are named BIA, TSA, and AMA. Although the agreement proposes standard methods, some banks are able to apply their own risk measurement systems in order to calculate the capital requirements for operational and credit risks. Finally, in order to calculate the minimum capital requirements over the market risk, Basel II do not introduce any news, there are still having two different approaches: the standard method and the internal models such as the Var. Internal methods were not included in Circular 5/1993 until June 2003; although the GTM has been analyzing them since its inception.

The second pillar: Supervisory review

It consists in the evaluation of the overall risk in financial intermediation entities. On the one hand the bank's senior management is required to carry out a self-assessment of the capital needs through a permanent process. Moreover, national supervisory agencies are trained to increase the level of prudence, require corrective measures to entities that renege on the regulations, and intervene in those who do not obey with capital requirements. The aim of this second pillar is to stimulate the improvement of management and control the techniques applied by entities, ensure the reliability of internal processes and encourage an improvement on the supervisory review process.

The third pillar: The Market Discipline

It is necessary the periodic publication of information about banks' exposure to some risks and the adequacy of their own funds. That information is published for Stakeholders, who assess it and will act according to the perception acquired. It is known as transparency rules which allow the market participants to estimate the capital adequacy of an institution. This pillar has the aim to promote the market discipline.

BASEL III

After the liquidity crisis of 2008, FSB and the G-20 promoted a series of initiatives to strengthen the regulation, supervision and risk management of the banking sector. These initiatives became a new agreement, called Basel III, published on December 16, 2010, in order to solve the problems caused by the financial crisis and improve international cooperation. Basel III appeared as a revision of Basel II, supplementing its guidelines. In many countries the banking system was excessively leveraged and the quality of the capital in many entities was deteriorated. Therefore, Basel III focuses on liquidity, capital and leverage. This new agreement introduced several requirements for Pillar I, Pillar II and Pillar III:

Pillar I:

- It is demanded a growth of the minimum capital requirements. The composition is modified demanding a greater weight of high quality capital.
- Higher capital is required for trading and derivative activities, as well as complex degrees held in the trading book.
- It is required capital mattresses in good times of the cycle, whereby entities must operate with own funds above the minimum required and regulate in a better way their shareholder remuneration policies.
- Substantial strengthening of the counterparty credit risk framework.
- Leverage restriction

Pillar II:

- Complementary requirements for risk management and supervision, such as incentives for banks to better manage risk and long-term returns

Pillar III

- Revised Pillar III is a document in which are exposed new requirements in order to clarify some issues related with the securitization positions and the sponsorship of off-balance-sheet vehicles. Furthermore, it will be required a more detailed disclosure of the components of regulatory capital.

On the other hand, International liquidity standards will be introduced with this new agreement such as a leverage ratio in order to contain excessive leverage in the banking system, two liquidity ratios; the liquidity coverage ratio (CSF) and the stable net funding ratio (NSFR), to confront its short term obligations without selling assets in an accelerated manner. These ratios measure the short and long term liquidity of the risky banks.

To sum it up, all these measures pursue to avoid the systematic risk and try to seek a rise in the bank liquidity and a drop in the financial leveraged with the purpose of covering the potential losses that many important banks owned.

BASEL III

EUROPEAN AND SPANISH REGULATION

During the 2008 crisis, investors were unable to assess and compare the quality of capital owned by financial institutions because of the scarce information about the risks that banks published. Thus, the Basel Committee on Banking Supervision drafted a new regulatory framework to strengthen the banking system, named Basel III, completing the three pillars included in Basel II. This new agreement seeks to improve the risk management; the capacity of the banking sector to deal with disruptions caused by financial or economic tensions and enhance the transparency and disclosure of information provided to the market. It was in June 2013 when the European Council integrated this regulatory framework in the European legal order through the Regulation (EU) No 575/2013 of the European Parliament of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending by the Regulation (EU) No 648/2012 and the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending by the Directive 2002/87/EC and repealing 2006/48/EC and 2006/49/EC Directives. On the other hand, Royal Decree 84/2015, of 13 February, which develops Law 10/2014, of June 26, on the management, supervision and solvency of credit institutions and Bank of Spain Circular 2/2016 of February 2, to credit institutions, on supervision and solvency, which completes the adaptation of the Spanish legal system to the Directive 2013/36 / EU and the Regulation (EU) No 575/2013.

Beginning in 2014, the Basel Committee has continued to research and update the regulatory framework by placing new consultative documents in the hands of the market, such as: "Revision of the standard method for credit risk, December 2014", "Revision of Basel III leverage ratio framework, April 2016 "," Minimum capital requirements for market risk, January 2016 "," Third pillar revised disclosure requirements, January 2015 "and finally" Third pillar disclosure requirements - Consolidated and Improved framework , March 2016. According to the rule 59, chapter 8, Bank of Spain circular 2/2016 to credit institutions, on supervision and solvency, all requirements established will be incorporated by financial institutions into a report of prudential relevance. Its content is established in Article 13 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013.

RISK INFORMATION REQUIRED INTO THE PRUDENTIAL REPORT

These disclosure requirements of the third pillar seek coherence and comparability in the information. In order to achieve this goal a series of guides are introduced to carry out the report of prudential relevance in a correct way. Therefore, all credit institutions listed in article 13 of regulation 575/2013 will apply a series of basic questions such as the time, place and manner to be issued, the team who should review and approve it, the guiding principles to follow or the manner to present these requirements. In addition, according to the provisions of Title II, Chapter I of Royal Decree 84/2015, credit institutions will inform about a series of information requirements on the risks they possess. These are the following ones:

Presentation of risk management and RWA

Banks should give detailed information and characteristics about the method used to manage the risks, so that readers know the risks they are facing and banks show the position they take respect to their main activities. This information must be proposed annually as the bank estimates. In addition, it is also necessary to present an overall evolution of total risk-weighted assets dependent on counterparty, equity or market risk, among others.

Counterparty credit risk

Credit risk arises from the possibility that customers or counterparties will not be able to accomplish their payment obligations upon maturity. This situation causes a loss for the financial institution due to the insolvency of the debtor. Therefore, in accordance with Article 5 of Regulation (EU) 575/2013, relative to the requirements of own resources for credit risk, "exposure: any item of assets and any item included in memorandum accounts of the financial institution, which incorporate credit risk and has not been deducted from own resources. In this sense, it is included the main items of credit to customers with their corresponding available balances, guarantees and guarantees, debt and equity instruments, cash and deposits in central banks and credit institutions, acquisition and temporary sale of assets (Repos of assets and liabilities), financial derivatives and property, plant and equipment. "

It is demand a detailed description of the credit risk management policy, a distribution based on the business model of the bank, a comprehensive view of the credit quality of the assets, additional information on the exposures in arrears and value adjustments for impairment of assets and provisions for risks. Besides, any change in the stock of loans and debt securities in default situation must be identified in fixed format and semiannual. Lastly, banks are also required to report about the credit risk mitigation techniques they use, such as netting or the use of eligible instruments, including personal, real or credit derivatives. Netting works compensating all positions that a client owns. In case of default, the bank or the client must have a single net figure and not a set of positive or negative values belonging to each operation that has been closed with it. However, the legislation goes beyond, requiring the disclosure of the extent of use of these techniques, on the condition that the guarantees had an impact on capital requirements. These techniques will be presented through a form, where the original exposure covered by collateral and exposure category is detailed.

Now, it is going to study the requirements demanded for banks which apply different kinds of methods in order to calculate the regulatory capital. Those banks, which calculate regulatory capital using the standard method, should illustrate the effect of credit risk mitigation techniques utilizing quantitative data and tables with a fixed format. These tables show the effect of credit risk mitigation techniques above the calculation of capital requirements and exposures by asset classes and risk weights. In addition, banks are required to supplement qualitative information about the use of the standard method with data on its use of external ratings. On the other hand, those other banks that use the IRB model will be required to provide the market with more information because of the use of their own risk assessment mechanisms. In accordance with current regulations, they must present: additional qualitative information to compute the risk-weighted assets, the parameters used for calculating capital requirements, the effect of credit derivatives on the calculation of capital requirements and a cash flow statement, which explains the variations of capital by credit risk. In addition, they will add some tables already defined on exposures to credit risk for each portfolio and PD interval, being its objective verifying the reliability of the PD.

According to Chapter 6, Article 272 of Regulation (EU) No.575 / 2013, counterparty credit risk is "the risk that the counterparty in a transaction may incur in default before the definitive liquidation of the cash flows of that operation. It includes the following types of transactions: derivative instruments repurchase transactions, securities or commodities lending transactions, deferred settlement operations and collateral financing transactions. “In short, it is the current estimate of the possibility of default according to current market conditions, known as current exposure. The relevant prudential reports shall include qualitative information about internal methodologies used to assess counterparty risk exposures, objectives, scope, management policies and methods used to mitigate them. Moreover, as disclosure requirements revised for the third pillar, January 2015 say: "This risk includes all exposures of the investment portfolio and the trading portfolio subject to a capital requirement for Counterparty credit risk. Therefore, banks will include information on harmonized forms ":

- Risk-weighted assets and exposures in case of default.
- Exposures to counterparty credit risk calculated according to the standard method, for each portfolio and risk weighting.
- The relevant parameters used to calculate capital requirements for counterparty credit risk in IRB models.
- The types of collateral to reinforce or reduce exposures to counterparty credit risk related to derivative transactions or SFT.
- The degree of a bank's exposure to transactions with credit derivatives.
- An overview of bank's exposures to central counterparty's entities once it has been incorporated risk mitigation techniques.

Lastly, a cash flow statement will be presented in order to explain changes produced in risk-weighted assets for exposures associated with counterparty credit risk.

Securitization risk

Securitizations are complex elements, therefore it is dedicated a specific section. Banks, which maintain securitization positions in their investment or trading portfolio, should provide qualitative and quantitative information on these. In this paragraph we will study closer issues required such as the objectives in the management of the securitization activity, these may be several: diversification of funding sources, obtaining liquidity and reduction of credit risk concentrations through securitization and the subsequent sale of bonds to the market. Current requirements also require a detailed description of the securitization activity, the external credit assessment institutions (ECAIs) used for securitization and information on accounting policies. Moreover, it is essential to mention the bank's functions about the securitization activity because the bank may make take the role of originator or participate in loans' service, as well as in the granting of the subordinated loan. Besides, it may participate such as counterparty in the swap of interest rate in relation to the securitization fund, whose loans have been acquired. There is another possibility for the bank, being investor may obtain positions of securitization funds or acting as arranger and underwriter in their own securitizations and third parties.

In terms of quantitative information, it is required every six months reporting the accounting values of the securitization exposures located in its investment and trading portfolio.

Market risk

New modifications require a description of the methodologies and different metric forms used on market risk, the scope of the policies used to manage this risk, as well as their evolution by activities carried out in the company. On the other hand, both banks that use an internal model to calculate their capital requirements for market risk and those using the standard method will be obliged to fill this data in fixed tables located in the revised disclosure requirements for the third pillar, 2015. The main objective is providing meaningful information to readers about the use of internal models. In case of the standard method provide information on the components of the capital requirement calculated using this method. Only those banks using internal methods must submit the statement of cash flows of assets weighted for market risk and note the following values: maximum, minimum, middle and end of the period within the reporting period, resulting from the different types of models used to calculate these capital requirements. According to the revised document of 2016 will carry out a fundamental review of capital in the trading book on the standard model, the advanced model and the separation between the banking book and trading book.

Operational risk

Operational risk can be defined as the loss caused by human errors, failures in internal procedures or by defective processes. This risk may appear because of the activities, products, business areas and processes that are carried out in the normal course of business. The new modifications require a description of the objectives, policies, scope and control of this risk, including model risk, defined as the potential loss resulting from the decision making based on internal models. In addition, those banks using advanced measurement method should conduct an analysis of internal and external factors, which are relevant to the method used. According to Royal Decree 84/2015, of 13 February, which develops Law 10/2014, of June 26, on the management, supervision and solvency of credit institutions “Institutions shall establish emergency plans and business continuity to enable them to maintain their activity and limit losses in the event of severe business disruption”.

Interest-rate risk in the banking book.

It refers to the current or potential risk of capital, showing fluctuations derived from movements in interest rates. These fluctuations have an impact on the current value of the company and as a consequence on its cash flows, which shows a financial situation of the company that does not correspond to reality. The requirements presented in 2015 require quantitative disclosures on the increase (decrease) in economic value, due to fluctuations in interest rates. This should be presented with a methodology based on the proposed Pillar I approach for this risk. It is also necessary to mention the new update conducted by the Basel Committee " Risk interest rate in the accounting book, in April 2016," which presents the final proposal about the revision of regulatory treatment of interest rate portfolio. All banks should follow the standardized framework explained in section IV of this document.

Risk of financial leverage

Financial leverage rises up due to an increase of the debt, or other mechanisms, in order to raise the amount of money we can spend on an investment. In other words, it is the relationship between own capital and the one actually used in a financial transaction. Recently, the use of leverage has been very common in real estate operations giving rise to the real estate bubble experienced in many countries like Spain. Thus financial institutions should carry out monitoring of leverage through a series of indicators such as the leverage ratio and mismatches between assets and liabilities in order to correct the excess of the financial leverage. Moreover, they must report on the policies of identification, control and risk management.

Residual risk

This risk arises from the possibility of failures on mitigation techniques, described in Article 108 of Regulation (EU) No 575/2013 of 26 June. Therefore, entities must own policies and procedures already planned to avoid the possible inefficacy of this techniques. Although it is important to consider the fact that the level of risk owned in a company can never be completely eradicated.

Liquidity risk

Liquidity risk refers to the inability to convert the bank's assets into money to confront the demands arise at any given time. Therefore, banks are required to carry out strategies, policies and procedures to identify, manage, measure and control this risk depending on the complexity of their activities. According to Royal Decree 84/2015, banks should develop methods for monitoring funding positions, identifying free assets of available charges in emergency situations, taking into account possible legal limitations to eventual liquidity transfers and studying the impact of different scenarios on their liquidity profiles. The Bank of Spain will be responsible for overseeing risk management also demanding the application of mitigation techniques such as liquidity buffers or appropriate diversification in its funding sources.

Concentration risk

This is derived from the exposures that banks have with each of its clients or counterparties. Therefore the Circular 2/2016, of 2 February, the Bank of Spain requires banks to use measurement and control procedures on each of the counterparties. Entities shall seek an adequate diversification of risk and monitor their concentrations of risk, taking the measures they consider appropriate. In addition, this risk also arises from the application of techniques to reduce credit risk, so its use is carefully evaluated. Institutions may take appropriate action to correct situations where the risk of excessive concentration regardless of the provisions of Regulation quarter (EU) No 575/2013.

OTHER RISKS FROM THOSE OF THE PILAR I

TYPOLOGIES OF RISK

The aim of this chapter is the analysis of the information offered for the Spanish principal banks to the market, specifically risks different from the Pilar I, it means distinct from operation, market and credit risk. It has drawn up a table for each bank, which comprises defined stages by a previous study and reporting risks of the bank in question. This provides a snapshot of each bank on these risks. Then, stakeholders could know at a glance which are the risk and how accurate are defined by each bank. In other words, this section will be examined what the risks are, other than those addressed in Pillar I of Basel, reporting on major banks in their reports prudential relevance. During this study we have identified the following eight types of risk:

Structural risk in the equity portfolio: Mainly derived from holdings in industrial and financial companies with medium and long term investment horizons, including own shares, although the changes in value do not have an immediate equity effect in the latter case. Besides, the exposure to this risk is reduced with short net positions in derivative instruments on the same underlying assets.

Structural exchange-rate risk: Coming from the fluctuations of the exchange rates in the equity value of the international investments maintained by the bank, which are financed in another currency than the investment.

Structural interest-rate risk: it becomes due to the possibility of losses in the economic value and net interest income. It arises as a result of fluctuations in interest rates and their impact on the different balance sheet and off-balance-sheet assets (excluding the trading portfolio), including derivatives that act as hedges. The asymmetry in the maturity and reprising profiles of sensitive asset and liability items on the balance sheet causes a structural interest rate risk.

Liquidity and Financial risk: It arises from the possible difficulty of an entity to meet their payment obligations in time and manner provided, or having to resort to borrow funds under onerous conditions or that damages the image or reputation of the entity.

Compliance and conduct risk: The risk of receiving penalties for legal or regulatory breaches, suffer financial loss or loss of reputation for failure to comply with applicable laws, regulations, codes of conduct and standards of good practice.

Business risk: This risk is defined as the possibility that the gross margin may not be sufficient to cover fixed costs due to changes in the volumes of balance sheet items and fee income, caused in turn by changes in economic conditions.

Reputational risk: It comes from an action, situation, transaction or investment that causes a negative perception of the Entity to customers, shareholders, or employees and may reduce confidence in the integrity and competence of the Entity. This causes an adverse impact on capital, on the results or the development of businesses that constitute its activity.

Concentration risk: It is part of the credit risk since it is an extra portfolio risk that arises from a bad diversification of the credits. The Pillar I of Basel is fathomed the following conclusion: capital requirements for credit risk do not cover concentration risk, and those calculated under IRB approach exclude it. Then, banks should estimate and setting appropriate capital buffers, which supervisors are required to assess.

RISKS \ BANKS	BBVA	SANTANDER	BANCO POPULAR	CAIXABANK	BANKIA	CAJAMAR	IBERCAJA
Structural risk in the equity portfolio	X			X	X		
Structural exchange-rate risk	X						
Structural interest-rate risk	X	X	X	X	X	X	X
Liquidity and Financial risk	X	X	X	X	X	X	X
Compliance and conduct risk		X	X	X			
Business risk			X				
Reputational risk		X	X	X			X
Concentration risk		X					
TOTAL RISKS	4	5	5	5	3	2	3

Table: 4.1 Bank risks on which banks report. Year 2015.

The current legislation presents many requirements in terms of market, operational and credit risks, however on the risks mentioned in table 4.1 very few requirements exist. As it appears in Chapter I, Title II of Royal Decree 84/2015, of February 13, which develops Law 10/2014, of June 26, on the management, supervision and solvency of credit institutions, banks should report on these risks is their reports and describe the policies they carry out to manage them. However, according to Table 4.1 in which we have taken a sample of seven Spanish banks 3,375 average risk is incorporated into the relevant prudential reports. This average means that banks inform to the market about these risks approximately one third of what they should do. On the other hand, analyzing the table above we can observe that the two risks given mare importance by the banks are the interest rate risk and the liquidity and financing risk, considering that all the analyzed banks incorporate it in their reports. However, structural exchange-rate risk, business risk and concentration risk are incorporated into a bank of the entire chosen sample.

DETAILED EVALUATION OF THE TYPOLOGIES OF RISK ON THE INFORMATION OF RELEVANT PRUDENCE

It should be mentioned that even though the regulations do not indicate the way in which the information on these risks should be presented, there is a pattern followed by most banks. Many of these begin the chapter by giving a brief introduction of how the risk has been treated in the recent years, identifying the bank's aversion for this risk, defining it and reporting on the scope of risk. Next, banks focus on risk management, in some cases describe which metrics are used, who are responsible for managing it and what kind of management structure they own, it means; whether the management is centralized or not. Finally, it is mentioned the control mechanisms such as the hedging strategies used or the analysis of different stress scenarios and backtesting. Most of this information is presented in a qualitative way without indicating hardly quantitative data of the impacts in the management or control mechanisms. Therefore, the few quantitative data that are reflected in the information of prudential relevant refers to the impact of the risk analyzed on some balance sheet items.

In order to analyze the degree of transparency that may be assigned to each bank through the information they disclose about the risks, it have been defined the following nine stages:

- Defines the risk
- Generally explains the way it is managed
- Explains in detail the way it is managed
- A general qualitative detail of the techniques used to measure the risk
- Qualitatively it provides a thorough detail about the techniques used to measure the risk
- Provides quantitative information about the effect of risk over the income statement or equity
- Explains in a qualitative way the effectiveness of the control techniques or risk coverage
- Makes a qualitative description of the future prospects of the risk
- Quantifies the impact of certain items through the technique of scenario analysis

The tables for each bank are shown below:

BBVA	ESTRUCTURAL RISK IN THE EQUITY PORFOLIO	ESTRUCTURAL EXCHANGE-RATE RISK	STRUCTURAL INTEREST-RATE RISK	LIQUIDITY AND FINANCIAL RISK
DEFINES THE RISK	X	X	X	X
GENERALLY EXPLAINS THE WAY IT IS MANAGED				
EXPLNES IN DETAIL THE WAY IT IS MANAGED	X	X	X	X
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK	X	X		X
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK			X	
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY	X	X	X	X
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE				
MAKES A QUALITATIVE DESCRIPTION OF THE FUTURE PROSPECTS OF THE RISK				
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS		X		X

Table 4.2. Degree of transparency on risk information published to the market. BBVA 2015.

As we can see in the table 4.2, BBVA offers information to the market about four risks, this is not a very high number; however, the information have a large content and presents it clearly, in order and with a suitable language. Therefore, all audiences can understand this without any effort. In addition, Table 4.2 shows the mannerthat BBVA applies practically the same definite stages for each of its risks, for example: this bank follows the same structure of information for all of them. This is what the reader expects, the same type of information and the same way to be organized for each of the risks published. On the other hand, the information of prudential relevance is provided in both Spanish and English, which is helpful and interesting for international readers. Referring to the content, the information is mostly qualitative, nevertheless, BBVA provides quantitative information on the effect of risk on the income statement or equity in all of risks and quantifies the impact of certain items through the technique of scenario analysis in structural exchange-rate risk and liquidity and financial risk.

BANCO SANTANDER	LIQUIDITY AND FINANCIAL RISK	COMPILANCE AND CONDUCT RISK	REPUTATIONAL RISK	CONCENTRATION RISK
DEFINES THE RISK	X	X	X	
GENERALLY EXPLAINS THE WAY IT IS MANAGED			X	X
EXPLNES IN DETAIL THE WAY IT IS MANAGED	X	X		
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK				
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK	X	X		
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY	X			
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE				
MAKES A QUALITATIVE DESCRIPTION OF THE FUTURE PROSPECTS OF THE RISK	X			
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS				X

Table 4.3. Degree of transparency on risk information published to the market. Banco Santander 2015.

Banco Santander reports five risks. Firstly, this bank provides detailed and extensive information on liquidity risk, although the only quantitative data it presents are those related to the impact on the income statement. Besides Banco Santander also provides information about the risk of compliance and conduct, nevertheless the information is limited and qualitative. Regarding the reputational and concentration risk, it is shown a brief summary collecting very general aspects. These two risks are included in both sections compliance and conduct risk and credit risk respectively. Lastly, according to table 4.2 on the interest rate risk, Santander' bank only presents information about quantitative information on the effect of risk on the income statement or equity, which is perfect. Nevertheless, neither of the rest defined stages is included, which means it need background information to give stakeholders an overview about the risk. Santander bank includes other information about this risk such as the definition of shareholdings in partner institutions and the available-for-sale equity instruments, as well as accounting policies and valuation methods. Additionally, it is provided quantitative information of this equity instruments not included in the trading portfolio.

BANCO POPULAR	STRUCTURAL INTEREST-RATE RISK	LIQUIDITY AND FINANCIAL RISK	COMPILANCE AND CONDUCT RISK	BUSSINESS RISK	REPUTATIONAL RISK
DEFINES THE RISK	X	X	X	X	X
GENERALLY EXPLAINS THE WAY IT IS MANAGED				X	
EXPLNES IN DETAIL THE WAY IT IS MANAGED	X	X	X		X
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK					
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK	X	X		X	
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY					
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE					
MAKES A QUALITATIVE DESCRIPTION OF THE FUTURE PROSPECTS OF THE RISK					
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS					

Table 4.4. Degree of transparency on risk information published to the market. Banco Popular 2015.

According to Banco Popular report: "No metrics are established for this risk category because the metric that measures the evolution of operational risk (% of losses caused by operational risks over gross margin) already includes possible losses arising from claims of clients, judgments and other extraordinary events with reputational risk for

Banco Popular." The same situation occurs with compliance and conduct, which is the reason why four and five boxes of these two risks shown in Table 4.4 are not marked. In general terms, Banco Popular offers to the market through the information of prudential relevant very global information on these five risks and without any quantitative data.

CAIXABANK	ESTRUCTURAL RISK IN THE EQUITY PORFOLIO	STRUCTURAL INTEREST-RATE RISK
DEFINES THE RISK		X
GENERALLY EXPLAINS THE WAY IT IS MANAGED		
EXPLNES IN DETAIL THE WAY IT IS MANAGED		X
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK		
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK		
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY	X	
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE		
MAKES A QUALITATIVE DESCRIPTION OF THE FUTURE PROSPECTS OF THE RISK		
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS		X

Table 4.5. Degree of transparency on risk information published to the market. Caixabank 2015.

Caixabank presents an accounting approach to the structural risk of equity, reporting on the valuation and accounting of shares and quantifying the exposure and the gains and losses derived from equity investments and instruments. However, neither the definition nor the management nor the measurement is included. In terms of liquidity and financing, reputational and interest rate risk, both risk mitigation techniques and its management are detailed in a very precise, whereas for the risk of compliance and conduct accomplish a short and general recap.

BANKIA	ESTRUCTURAL RISK IN THE EQUITY PORFOLIO	LIQUIDITY AND FINANCIAL RISK	STRUCTURAL INTEREST-RATE RISK
DEFINES THE RISK		X	X
GENERALLY EXPLAINS THE WAY IT IS MANAGED			
EXPLNES IN DETAIL THE WAY IT IS MANAGED		X	X
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK		X	X
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK			
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY	X		X
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE			
MAKES A QUALITATIVE DESCRIPTION OF THE FUTURE PROSPECTS OF THE RISK			
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS			

Table 4.6. Degree of transparency on risk information published to the market. Bankia 2015.

Bankia includes three risks on its relevant prudential report, 2015. With respect to structural equity risk, it provides exclusively accounting information such as accounting policies and valuation methods of capital instruments, and gains or losses recorded in equity, it means presents information on shares in capital instruments not included in the portfolio of negotiation. As we observe in the table 4.6, Bankia only include one stage: providing quantitative information on the effect of risk on the income statement or equity. However, both the liquidity and the interest rate risk are explained in detail and in a qualitative perspective.

CAJAMAR	STRUCTURAL INTEREST-RATE RISK	LIQUIDITY AND FINANCIAL RISK
DEFINES THE RISK	X	X
GENERALLY EXPLAINS THE WAY IT IS MANAGED	X	X
EXPLNES IN DETAIL THE WAY IT IS MANAGED		
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK	X	
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK		
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY	X	
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE		
MAKES A QUALITATIVE DESCRIPTION OF THE FUTURE PROSPECTS OF THE RISK		
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS		X

Table 4.7. Degree of transparency on risk information published to the market. Cajamar 2015.

According to the information of prudential relevance of Cajamar, the information related to the management of these risks is set out in the Market Risk, Change, Liquidity and Interest Risk manual. Despite this, the report gives an overview of these risks in a qualitative way. In case of the interest rate risk, it provides information about the impact of the risk above the income statement or equity, while on liquidity and financing risk it quantifies the impact of certain items through the technique of scenario analysis.

IBERCAJA	STRUCTURAL INTEREST-RATE RISK	LIQUIDITY AND FINANCIAL RISK	REPUTATIONAL RISK
DEFINES THE RISK	X	X	X
GENERALLY EXPLAINS THE WAY IT IS MANAGED			X
EXPLNES IN DETAIL THE WAY IT IS MANAGED			
A GENERAL QUALITATIVE DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK			
QUALITATIVELY, IT PROVIDES A THOROUGH DETAIL OF THE TECHNIQUES USED TO MEASURE THE RISK			
PROVIDES QUANTITATIVE INFORMATION ABOUT THE EFFECT OF THE RISK OVER THE INCOME STATEMENT OR EQUITY		X	
EXPLAINS IN A QUALITATIVE WAY THE EFFECTIVENESS OF THE CONTROL TECHNIQUES OR RISK COVERAGE			
QUANTIFIES THE IMPACT OF CERTAIN ITEMS THROUGH THE TECHNIQUE OF SCENARIO ANALYSIS			

Table 4.8. Degree of transparency on risk information published to the market. Ibercaja 2015.

The prudential relevance report of Ibercaja defines the following three risks: interest rate risk, liquidity and funding risk and reputational risk. Regarding to the first one, it merely explains the potential sources of interest risk and carries out an analysis of the impact of the structural interest rate risk on the margin. For more information about this risk the report refers the reader to note 3.3 to the annual report integrated in the consolidated annual accounts for 2015 year. For the latter, it writes a brief synthesis in which analyze the perspectives and define the liquidity and funding risk. Finally, Ibercaja only defines the risk and explains in a general way how the reputational risk is managed.

Once the study of this chapter have been concluded, it can be explain the following ideas: as we have detailed in table 4.1, there are some differences between the principal Spanish banks, one of them is the decision to add information about the typologies of risk in their reports of prudential relevance. So, each bank informs about different types of risks. Furthermore, they do not inform in the same way since the intensity of the information varies depending on the bank in question. On the other hand, they also have some similarities, 95% of the information, provided to the market by banks, is given in a qualitative way, whereas the remaining 5% is quantitative. Some examples addressed in the qualitative information are the following ones: the objectives and principles of every risks, an inaccurate vision about the management, who are the directors of its management and its future prospects. The quantitative information, in most cases, focuses on the effect of risk on the income statement and the impact of certain items through the technique of scenario analysis. This shows how almost none of bank provides the market with quantitative information, however this few banks which do it, do not give quantitative information about every kind of risk they report. Furthermore, as it is observed in table 4.1, all Spanish principal banks include information about interest and liquidity and financing risks on its reports, which means that this ones are more important than the other six risks mentioned at the beginning of this chapter. On the contrary only one bank include structural exchange-rate, reputational and business risk**.** Despite of this affirmation, banks could improve the information provided to the market, detailing in the regulation the risks they should include, how they should do it and the quantitative information they should include, as easy as the regulation includes guides for Pillar I risks.

CONCLUSION

The aim of this report has been the analysis of the banking transparency in the main Spanish banks through a study of the information offered to the market by each one of them. The information analyzed is about the risks not collected in the pillar I of Basel, and is located on its prudential relevance reports. This theme has been chosen due to the connection with the current situation we are experiencing, since Spain, like the rest of the countries of the European Union, owns a constant uncertainty. This uncertainty is generated mainly by the financial crisis, due to systemic risk that this sector has affected the rest of the world economy. Therefore, the current transparency of banks deserves special attention, due to the lack of it has been contributing to the development of the crisis in which we are still immersed.

The regulation over the credit, market and operational risks, the Pillar I risks, is very meticulous. However, on other risks it is more generic regulation, so studying the degree of information transparency of banks on these risks is relevant for the purposes of conducting an investigation.

Once the study of this chapter have been concluded, it can be explain the following ideas: as we have detailed in table 4.1, there are some differences between the principal Spanish banks, one of them is the decision to add information about the typologies of risk in their reports of prudential relevance. So, each bank informs about different types of risks. Furthermore, they do not inform in the same way since the intensity of the information varies depending on the bank in question. On the other hand, they also have some similarities, 95% of the information, provided to the market by banks, is given in a qualitative way, whereas the remaining 5% is quantitative. Some examples addressed in the qualitative information are the following ones: the objectives and principles of every risks, an inaccurate vision about the management, who are the directors of its management and its future prospects. The quantitative information, in most cases, focuses on the effect of risk on the income statement and the impact of certain items through the technique of scenario analysis. This shows how almost none of bank provides the market with quantitative information, however this few banks which do it, do not give quantitative information about every kind of risk they report. Furthermore, as it is observed in table 4.1, all Spanish principal banks include information about interest and liquidity and financing risks on its reports, which means that these ones are more important than the other six risks mentioned at the beginning of this chapter. On the contrary only one bank include structural exchange-rate, reputational and business risk**.** Despite of this affirmation, banks could improve the information provided to the market, detailing in the regulation the risks they should include, how they should do it and the quantitative information they should include, as easy as the regulation includes guides for Pillar I risks.

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