January 11, 2001

The Honorable Laurence H. Meyer
Member, Board of Governors
Federal Reserve System
Mail Stop 49
20th & C Streets, N.W.
Washington, D.C. 20551

Dear Governor Meyer:

On behalf of the Working Group on Public Disclosure, I want to thank you and your colleagues at the Federal Reserve, the OCC and the SEC for engaging with us in a constructive dialogue over the last several months on enhancing public disclosure, culminating in our meeting on November 17th. We believe our interaction will help ensure that market disclosure practices and related public policies evolve appropriately.

As I think you know, the private sector’s practices have long recognized the legitimate role that appropriately structured approaches to public disclosure can play in helping to create and maintain shareholder value and market discipline, thereby contributing to the stability of the financial system as a whole. It is important to stress, however, that public disclosure, in and of itself, is only one of many practices and policies that are essential to the safety of individual firms and financial markets. With these thoughts in mind, we wish to convey the outcome of our deliberations, which we believe creates a common platform to move ahead with suitable steps towards enhanced public disclosure.

Let me briefly stress four key points at the outset:

First, our analysis of well-run firms that already disclose at high levels clearly indicates that they have very different, but equally valid, approaches to risk management and monitoring because they approach managing risks differently. Accordingly, meaningful comparisons across firms are difficult to achieve.
Second, the private sector is concerned by the apparent overlap of initiatives related to public disclosure that are emerging simultaneously in the international regulatory community, and we would encourage rationalization of these efforts.

Third, efforts related to public disclosure can most effectively be facilitated by means of a consensus in the public and private sectors on broad principles for enhanced public disclosure.

Fourth, consistent with the three observations above, we believe that the process of enhanced public disclosure must continue to be evolutionary as it has been in the past.

**Principles for strong disclosure practices**

The Working Group believes the following principles should be at the centerpiece of any effort to enhance public disclosure:

1. **Disclosures should reflect information that is consistent with management’s approach to risk management.** There should be as strong a link as possible between the framework relied upon by senior management to evaluate the risks and returns of the business and the information that is disclosed. Such a linkage provides insight into management practice, financial performance, and risk discipline. Such a linkage also helps ensure that the information disclosed will be meaningful. At the same time, the information that is disclosed needs to be easily understood, non-proprietary and based on a mature risk framework. As such, the information may not be as detailed as the information that senior management uses to evaluate risk.

2. **Disclosures should focus on how risk within a firm changes over time.** While comparable data across firms is conceptually appealing, it is difficult to achieve, as noted above. Because risk information is based on inherently imprecise estimations, having frequent information to relate the earnings volatility of a business over time to the estimates will be the best way for a user to assess the quality of those estimates.

3. **Disclosures should be responsive to changes in internal practices.** Maintaining continuous and comparable prior period data is less important than having the best currently available view of a firm’s risk profile. We expect the pace of innovation and modifications to risk management and measurement practices to be rapid and believe the changes should be reflected as quickly as possible in public disclosures. A discussion of material changes in risk measurement and how those changes may affect the trend in disclosed information should accompany significant changes.

4. **Disclosures should be properly balanced between quantitative and qualitative information.** "Best practice" disclosures incorporate clear and informative discussions about a firm’s risk management processes. Such disclosures would include defining the various risk factors, discussing the framework for the management of each risk factor (responsible groups, committees, types of limits, etc.), and describing the main elements of risk assessment, including key metrics. These qualitative disclosures combined with quantitative information around each risk factor and the performance of risk estimates are aimed at providing a well-balanced view of the firm’s overall risk profile.

**Recommendations for enhanced disclosure**

In the context of a disclosure framework that emphasizes changes within a firm over time, we do see a value in developing some additional guideposts for firms to follow. Accordingly, we propose the following recommendations that we believe can be implemented consistent with the principles above. In the area of market risk, we note the recommendations especially support the second principle in that we are suggesting quarterly disclosure of
information that, heretofore, has been reported mostly on an annual basis. In the area of credit risk, we are suggesting quarterly disclosure of information that we believe will provide better insight into the wholesale credit quality of a firm's portfolio than is required today. The information would be furnished based on a firm's internal methodologies and exposure categories. We wish to emphasize that meaningful differences are likely in how firms will implement these recommendations, again reflecting legitimate differences in their internal practices. We expect firms will include these disclosures as soon as it is practical for them to do so.

1. Aggregate high, average and low trading VAR over the quarter.
2. High, average and low trading VAR by major risk category (e.g. fixed income, currency, commodity and equity) over the quarter, including diversification effects.
3. Quantification of how well market risk models performed (e.g., histogram of daily trading revenues compared to average VAR over the quarter).
4. Current credit exposures by internal rating, reflecting the effects of netting, collateral and other credit protection. Firms should provide explanatory information on their ratings, including, if appropriate, how they compare to external ratings. Recognizing that it might be inappropriate or not feasible to include certain credit products in this disclosure (e.g., debt securities in trading inventory), firms should make it clear which products are included. Distinguishing between loan and other credit exposures also would be helpful.
5. Information about the maturity profile of transactions giving rise to material current credit exposures.
6. Insight into credit concentrations (e.g., industry sector and country risk).

Future efforts

Looking ahead, there are additional areas that might benefit from enhanced public disclosure that were reviewed by the Working Group but not deemed appropriate at this time. You too have highlighted areas such as better disclosure of residual interests in asset securitization that would also be appropriate for further review. We also believe it is important to move as rapidly as possible to eliminate currently mandated disclosures that have become unnecessary or redundant. To deal with these and other evolving issues, we recommend that you and your colleagues in the regulatory community create an ongoing advisory group, patterned after the Working Group. Members of the Working Group have expressed a desire to work with you in this regard.

In closing, I wish to thank you and your colleagues again for your interest in this important topic and the time you have devoted to the Working Group's efforts. If you would like to follow-up on any aspect of this letter, please do not hesitate to contact me.

Sincerely,

Walter V. Shipley

cc: Mr. Arthur J. Levitt, Jr., Securities and Exchange Commission
    The Honorable John D. Hawke, Jr., Office of the Comptroller of the Currency