16 Annex 31BG   Guidance notes for data items in SUP 16 Annex 31AR

This return provides the *appropriate regulator* with a point-in-time estimate of the valuation uncertainty around a *firm's* fair-value positions in the context of the size and risk of its positions. The value of the positions at the downside end of the spread of valuation uncertainty will be equivalent to the prudent valuation of the *firm's* positions as determined using the *rules* laid out in *GENPRU* 1.3.4R and *GENPRU* 1.3.14R to 1.3.34R.

The fair values of financial instruments are represented as point estimates for the purpose of the primary financial statements. However, at the balance sheet (B/S) date it is likely that there will be a range of plausible estimates of the valuation of many financial instruments. The choice of a point estimate is influenced by a range of factors including different market data points and valuation methodologies. This range will change over time and will tend to widen for markets that are less liquid or lack transparency.

Valuation

Firms should follow their normal accounting practice wherever possible when reporting the gross and net B/S.

Consolidation

When reporting on a *UK consolidation group* basis, *firms* should where possible treat the consolidation group as a single entity (i.e. line-by-line) rather than on an aggregation basis.

Currency

Firms should report in the currency of their annual audited accounts e.g. Sterling, Euro, US Dollars, Canadian Dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in millions.

Data Elements

These are referred to by row first, then by column, so data element 2B will be in row 2 and column B.

Prudent Valuation Return

Column A-C Gross B/S Assets, Gross B/S Liabilities and Net B/S

The gross B/S assets, gross B/S liabilities and net B/S are the raw figures extracted from the front office systems, after fair value adjustments and adjustments taken following independent price verification, rather than the B/S amounts that would be produced under IFRS. They nevertheless allow a completeness check by reconciling back to the total fair-value positions on the B/S as set out in the 'Reconciliation to Financial Statements' table. Both assets and liabilities are input as positive balances.

The gross B/S figures give a sense of the overall size of the positions, as large uncertainty and/or VaR figures may otherwise appear inconsistent if the net B/S is small.

Column D   1-Day 99% VaR Equivalent

The VaR equivalent measure is used in the return to indicate the relative market risk in different *firms* and portfolios and to provide important context to the valuation uncertainty measures. However, as this includes risks not in VaR and VaR on non-Trading Book positions for which the fair-value option has been chosen, it will not be directly reconcilable to the market risk measures shown in financial statements or the regulatory VaR.

The split of the VaR equivalent measure between the different asset classes may be on an approximate basis due to the difficulty in fairly distributing the diversification benefit gained from trading across those asset classes.

In certain cases, e.g. non-Trading Book positions for which no VaR is currently produced, it may be allowable for a firm to use an alternative metric to VaR while still estimating the 1 day loss which is expected to occur on no more than 1% of days. If a *firm* wishes to use an alternative metric, it must be requested and agreed with the *appropriate regulator*.

Column E/F   Downside/Upside Valuation Uncertainty

Prudent valuation will constitute an assessment at a risk parameter/product level of the upper and lower ends of the range of plausible valuations at a defined confidence interval (e.g. 90th percentile) based on the judgment of management. This represents the uncertainty of the valuations on the B/S date taking into account all available market data and based on market conditions at the B/S date, using valuation methods which could reasonably be deemed appropriate for each asset or class of assets. It requires a comprehensive view of the possible valuation range for the whole product and portfolio, including the impact of different valuation techniques and models.

The 'Downside Valuation Uncertainty' in the return represents the amount by which the correct fair value might be lower than the 'Net B/S' figure supplied (that is, there is 90% confidence (or alternative confidence interval defined by the *firm*) that the actual value is greater than the 'Net B/S' less the 'Downside Valuation Uncertainty'). The 'Upside Valuation Uncertainty' similarly represents the amount by which the correct fair value might be higher than the 'Net B/S' figure supplied (that is, there is 90% confidence (or alternative confidence interval defined by the *firm*) that the actual value is lower than the 'Net B/S' plus the 'Upside Valuation Uncertainty').

The prudent valuation assessment is not constrained by accounting standards. For example, the uncertainty created by large concentrated positions will be reflected in the return, whereas concentration adjustments to Level 1 positions are not allowed by accounting standards.

The uncertainty estimates at asset class level may include a diversification benefit rather than simply summing the uncertainty for each position. There is currently no formal policy on the aggregation of prudent valuation by asset class; hence *firms* should determine an approach to be assessed by the *appropriate regulator* for reasonableness.

Column G   Explanation

There are a number of rows where the *firm* has a choice of whether and how many rows to add. In this case, a short description of the row will be required and this should be included in column G.

Row 1-12   Asset Class Granularity

The asset class granularity selected for the main part of the table is to avoid making the return unduly lengthy or confusing. Where particularly significant, any additional disclosures should occur through narrative tied to the 'Portfolios of Particular Interest' in row 25.

The split between 'Exotic' and 'Vanilla' positions is defined in the same way that products are categorised for the purposes of CAD2 recognition. The definition of a portfolio type is based on the regulatory classes for CAD2 recognition, split by asset class. 'Vanilla' positions are those positions referred to in *BIPRU* 7.10.21G(1) and (2) and include products with linear pay-offs in the underlying risk factor (whether securities or derivatives) and products with European, American and Bermudan put and call options (including caps, floors and swaptions). All other fair-valued positions are included within the 'Exotic' portfolios and the broad classes of positions are set out in *BIPRU* 7.10.21G(3) and (4). *BIPRU* 7.6.18R provides further granularity on the definitions used in *BIPRU* 7.10.21G.

This delineation corresponds to the way in which the instruments are traded. Where a portfolio is disclosed as 'Exotic', it may also include vanilla hedges. Although a traded portfolio should normally not be split between 'Vanilla' and 'Exotic' or between two asset classes, where a portfolio includes significant positions of a type that would normally be reported in an alternative classification and are not present to hedge other products in the portfolio, these positions should be included within that other classification.

Row 13-14   CVA and DVA

CVA and DVA are adjustments that may be made at a *firm* rather than portfolio level. Consequently, the B/S and valuation uncertainty figures may be reported on a separate line.

Row 15   Other Portfolios

There may be other cross-portfolio fair-value reserves or other portfolios not represented in rows 1-14. Additional lines should be included for each of these numbered 1 to n as shown. The figures for columns A-F should be included as for rows 1-14 and a short description of the portfolio included in column G.

Row 16   Aggregate Portfolios Included

The sum of the B/S and valuation uncertainty figures in columns A-C and E-F from rows 1-15.

Row 17   Less Diversification Benefit

The uncertainty assessments disclosed by asset class are the sum of the uncertainty measures calculated at a risk parameter/product level, before allowing for diversification/correlation benefits. As a result the sum of the individual portfolio valuation uncertainty estimates will not necessarily reflect the aggregate-level valuation uncertainty the *firm* faces at the B/S date as this does not allow for diversification benefits that will invariably exist. The diversification benefit represents the total benefit taken between portfolios when summing up for the regulatory Prudent Valuation Return. There is currently no formal policy on the *firm*-wide aggregation of prudent valuation; hence *firms* should determine an approach that would be assessed by the *appropriate regulator* for reasonableness.

Row 18   Total

The 'Aggregate Portfolios Included' from row 16 less the 'Diversification Benefit' from row 17.

Row 19   Portfolios Excluded due to Extreme Valuation Subjectivity

The 'Portfolios Excluded' section allows *firms* to scope out those portfolios where they feel that there is an absence of market data or there is some other reason why it is not possible to ascertain the plausible range of valuations with any confidence. This can be due to a one-way market in which there is limited ability to exit positions that have been entered into (e.g. PRDCs), although there may be other reasons. This portion of the disclosure is important as it clearly identifies portfolios for which there is extreme valuation subjectivity. For these portfolios, it may not be possible or meaningful to disclose VaR figures, but the gross and net B/S positions being disclosed impart important information to the users of the accounts. The *firm* should therefore propose a suitable regulatory prudent valuation adjustment that would not benefit from diversification and will be assessed for reasonableness by the *appropriate regulator*.

Additional lines should be added here for each of these portfolios numbered 1 to n as shown. A short description of the portfolio should be included in column G.

Row 20   Total Portfolios Excluded

The sum of all excluded portfolios from row 19.

Row 21   Total Value of Fair-Valued Portfolios

The sum of the gross B/S and net B/S figures in columns A-C from row 18 and row 20.

Row 22   Total Downside Valuation Uncertainty

The sum of the downside valuation uncertainty in column E from row 18 and row 20.

Row 23   Less Regulatory Capital Offsets

The 'Total Downside Valuation Uncertainty' from row 22 shows the total difference between using the accounting fair value and the regulatory prudent value for valuations of all fair-valued financial instruments positions on the B/S. In order to arrive at the net adjustment to regulatory capital that would occur from using fair value instead of prudent value, there may be several offsets that need to be taken into account. These may include, for example, the reduction in the tax liability that would occur on adjusting the valuations in the B/S and therefore reducing P&L, regulatory capital adjustments that are already taken for elements of valuation uncertainty or situations where the capital requirement for a position is already at a level such that a prudent valuation adjustment would imply a capitalisation of more than 100%.

Additional lines should be added here for each of these types of offset numbered 1 to n as shown. A short description of each type of offset should be included in column G.

Row 24   Prudent Valuation Adjustment

The 'Total Downside Valuation Uncertainty' from row 22 less the 'Regulatory Capital Offsets' from row 23.

Row 25   Portfolios of Particular Interest

The 'Portfolios of Particular Interest' section allows specific disclosures for portfolios where there is a general market interest at any particular time (as there has been with ABS and monoline positions previously) and also allows *firms* the discretion to identify those portfolios that they feel constitute significant proportions of the valuation uncertainty disclosed for the asset classes (e.g. CVAs). The responsibility for ensuring the appropriate selection of portfolios and the appropriateness of the disclosure for each of these portfolios rests with senior management of the *firms*. These portfolios form a subset of the information previously provided by asset class, rather than being in addition to the uncertainty disclosed by asset class.

Additional lines should be added for each of these portfolios numbered 1 to n as shown. The figures for columns A-F should be included as for rows 1-14 and a short description of the portfolio included in column G.

Reconciliation to Financial Statements

Row 26   Total Value of Fair-Valued Portfolios

The 'Total Value of Fair-Valued Portfolios' is copied directly from row 21 for columns A-C.

Row 27   Reconciliation to Financial Statements Amounts

There may be a number of reasons for differences between the gross and net B/S figures taken from front office systems, after fair value adjustments and adjustments taken following independent price verification, that were used in the valuation uncertainty disclosure and the gross and net B/S figures in the financial statements. The *firm* should report the reconciliation amounts and briefly state the reason for the difference. An additional line should be included for each major class of reason, for example, netting of internal trades or counterparty netting agreements.

Row 28   Fair-Valued Portfolios per Financial Statements

The sum of the 'Total Value of Fair-Valued Portfolios' in row 26 and the differences to the financial statements shown in row 27. The figures for 'Gross B/S Assets', 'Gross B/S Liabilities' and 'Net B/S' (columns A-C) should equal the total fair-valued assets and liabilities in the *firm's* financial statements.

Row 29   Definitions of Portfolio Type

This is a narrative box which allows the *firm* to define the positions that are included in certain portfolios, e.g. Emerging Markets, Hybrid Instruments or Other Portfolios the *firms* has chosen to disclose in row 15.

Row 30   Portfolios Subject to Valuation Uncertainty Assessment

This is a narrative box allowing *firms* to choose to provide some narrative such as outlining the most material methodologies that underlie a significant proportion of the calculation of valuation uncertainty.

Row 31   Portfolios Excluded due to Extreme Valuation Subjectivity

This is a narrative box which allows the *firm* to provide details of each 'Portfolio Excluded due to Extreme Valuation Subjectivity' the *firm* has chosen to disclose in row 19. Information provided should include, but not necessarily be limited to, a description of the products and why an effective assessment of valuation uncertainty cannot be performed, details of the extent to which the portfolio is classified as AFS or fair-value option in the Banking Book and a historical description of how the portfolio was built up together with a description of what the strategy is for the portfolio for the future (e.g. whether there is still new trading or whether this is a legacy portfolio being sold off over time).

Row 32   Portfolios of Particular Interest

This is a narrative box which allows the *firm* to provide details of each 'Portfolio of Particular Interest' the *firm* has chosen to disclose in row 25. Information provided should include, but not necessarily be limited to, a description of the products, details of the extent to which the portfolio is classified as AFS or fair-value option in the Banking Book, why it is of particular interest, the basis of the methodology used to calculate the uncertainty and a historical description of how the portfolio was built up together with a description of what the strategy is for the portfolio for the future (e.g. whether there is still new trading or whether this is a legacy portfolio being sold off over time).

Row 33   Reporting Currency

This is a box in which the *firm* should declare the reporting currency used.

Internal Validations

Validation Number	Data Element		Data Element(s)
1	1C	=	1A-1B
2	2C	=	2A-2B
3	3C	=	3A-3B
4	4C	=	4A-4B
5	5C	=	5A-5B
6	6C	=	6A-6B
7	7C	=	7A-7B
8	8C	=	8A-8B
9	9C	=	9A-9B
10	10C	=	10A-10B
11	11C	=	11A-11B
12	12C	=	12A-12B
13	13C	=	13A-13B
14	14C	=	14A-14B
15	15C	=	15A-15B
16	16A	=	1A+2A+3A+4A+5A+6A+7A+8A+9A+10A+11A+12A+13A+14A+Sum(15A)
17	16B	=	1B+2B+3B+4B+5B+6B+7B+8B+9B+10B+11B+12B+13B+14B+Sum(15B)
18	16C	=	16A-16B
19	16E	=	1E+2E+3E+4E+5E+6E+7E+8E+9E+10E+11E+12E+13E+14E+Sum(15E)
20	16F	=	1F+2F+3F+4F+5F+6F+7F+8F+9F+10F+11F+12F+13F+14F+Sum(15F)
21	18A	=	16A
22	18B	=	16B
23	18C	=	18A-18B
24	18E	=	16E-17E
25	18F	=	16F-17F
26	19C	=	19A-19B
27	20A	=	Sum(19A)
28	20B	=	Sum(19B)
29	20C	=	20A-20B
30	20E	=	Sum(19E)
31	21A	=	18A+20A
32	21B	=	18B+20B
33	21C	=	21A-21B
34	22E	=	18E+20E
35	24E	=	22E-Sum(23E)
36	25C	=	25A-25B
37	26A	=	21A
38	26B	=	21B
39	26C	=	26A-26B
40	27C	=	27A-27B
41	28A	=	26A+Sum(27A)
42	28B	=	26B+Sum(27B)
43	28C	=	28A-28B

External Validations

There are no external validations for this data item.