16 February 2012

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Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

By e-mail: baselcommittee@bis.org

Dear Sir or Madam

Definition of Capital Disclosure Requirements

ICAEW welcomes the opportunity to comment on the consultation paper *Definition of capital disclosure requirements* published by the Basel Committee on Banking Supervision on 19 December 2011.[1]

Who we are

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest professional, technical and ethical standards are maintained.

The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services including a monthly magazine *FS Focus*.

Our views on your proposals were developed following consultation with members of our Banking Committee, which includes senior bankers and bank auditors, along with significant input from users of the financial statements including investors, credit and equity analysts.

Major comments

Financial statements are prepared primarily for shareholders, potential investors and other capital providers. They are not prepared specifically for regulators, who generally have the power to require the information they need, in a form suitable for their purposes. However, the regulatory capital position of banks is of great interest to investors, lenders and those who support them (such as equity and credit analysts) in their assessment of banks' financial position and performance, because of the interplay between regulatory capital strength and capacity for generating returns.

[1] www.bis.org/publ/bcbs212.pdf

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In that context, ICAEW strongly supports the Basel Committee's proposals for increased consistency of disclosure of regulatory requirements. High standards of transparency around financial information are a prerequisite to restoration of confidence in the banking sector. They may also serve to increase market discipline. We think the proposals would enable users to achieve a higher level of comparability across banks within and between countries. While it is often preferable to frame disclosure requirements on the basis of clear principles rather than detailed templates, in view of the complexity of the accounting and regulatory definitions of capital, and the features of capital instruments, we consider the template approach proposed for the primary reconciliation, as set out in Annex 1, will be helpful to users. However, we question the merits of requiring a detailed balance sheet comparison as set out in Annex 2.

The Basel Committee is one of a number of bodies working to improve the regulatory regime and the proposals in this consultation paper are part of a wider set of regulatory initiatives aimed at increasing the transparency of banks and other financial services companies. It will be important for the Basel Committee to work with governments, regulators and standard setters to co-ordinate disclosure requirements so that as far as possible, they are managed on a consistent basis internationally. The aim should be to ensure that the publicly-available information is coherent and facilitates clear communication with stakeholders.

Regulators clearly have a vital role in promoting good-quality disclosure on regulatory capital issues by the banks in their jurisdictions. The Basel Committee's proposals are a valid approach for increasing the amount of information made available by banks, but the ways in which regulators can work to promote better disclosure of regulatory information are various. Arguably a stronger regulatory tool would be prompt and interventionist direction. This would need to occur at appropriate times when, in the view of regulators, it is most needed for either individual institutions or on particular issues, for the market to be fully informed.

We comment on a number of particular issues raised by the proposals below.

Usefulness of the information

In the light of the financial crisis, there is intense interest amongst banks' stakeholders in their regulatory capital resources. We agree with the Committee that at present it can be difficult to assess capital positions from publicly-available information for many institutions around the world. That said, there has been substantial progress in disclosure around regulatory capital by many of the UK banks and users generally consider these to be of a high standard. We also agree that understanding material differences between capital measured in accounting and for regulatory purposes would be a key benefit for many users of financial statements. Currently, information about individual capital instruments is usually summarised in financial statements, with full details in prospectuses. It may be useful for stakeholders to additionally have access to consistently-presented information on the key features of individual capital instruments as the consultation paper sets out. However, users would need to appreciate that such information would provide an incomplete basis for decisions around whether to invest in a particular instrument.

Comparison of capital on an accounting and regulatory basis requires an understanding of differences between the accounting and regulatory scopes of consolidation. Some banks already include this type of information in their annual report, and in the UK such disclosures are consistent with the guidance issued by the British Bankers' Association, the BBA Code for Financial Reporting Disclosure. We understand that the proposed balance sheet comparison in Annex 2 aims to provide information to assist users in comparing accounting and regulatory capital. Following consultation with users, our view is that the Annex 2 requirements are too detailed and may not provide the clearest information. We recommend that a comparison of total assets and total equity be provided instead, including more detail of specific items that differ notably and reference to the companies or types of companies these relate to. Both quantitative and qualitative information about the key differences between accounting and regulatory capital would be useful, and together could enable users to identify the main differences and understand the reasons for them. Materiality does not figure prominently in the consultation paper. We believe that more consideration needs to be given as to how preparers can be supported in disclosing material information relating to significant amounts or topical matters. The proposals as currently drafted are too prescriptive and detailed, and will require information to be reported which may be of little interest to many stakeholders.

Regarding key features of capital instruments, it can take time and effort for users to extract these from the documents detailing the full terms and conditions, and so we agree banks should be required to make this information available in a standard template. This could be in the form of a spreadsheet for all current instruments or a template could be completed for each instrument as it is issued and stored in the same place on the website, along with links to prospectuses. It will be important that a row is included in the template for banks to enter any other information they regard as key to understanding the terms of an instrument.

Template approach

We agree that, in this instance, a template approach would make it easier for users to compare different banks. Nevertheless, as indicated above, preparers should be able to apply judgment so that individual line items will either not be given or may be combined if they are not material. This will help ensure that the information provided on key matters is clear and not obscured by excessive detail.

Templates are also likely to promote consistency among institutions in preparation of the data, particularly in view of the explanations of the rows in Annex 1 provided in the paper. Nonetheless, the Basel Committee should consider establishing a central process to deal with technical queries on the templates. Publication of frequently asked questions would contribute to consistency of practice.

Narrative information

In order to help users appreciate the data which would be set out in the capital template (Annex 1), additional narrative information will be useful. This could give an overview of the capital position, outlining high-level changes from period to period in the bank's capital position as well as providing narrative explanation of the differences between regulatory and accounting capital to help readers understand the relevance and importance of the information disclosed. It will be helpful for users to understand the types of legal entities that are within the accounting, but not regulatory, consolidation (paragraph 16), or vice versa. Whilst a list of all legal entities that represent the differences in accounting and regulatory consolidation would be of limited use to readers, an indication of the type, purpose and size of the subsidiary or – where there are many with a similar purpose – groups of subsidiaries is useful and relevant. For example, differences in consolidation may be explained by the fact that the entities in question are engaged in providing insurance or connected to securitisation transactions. Consideration should be given to how these disclosures should dovetail with those under International Financial Reporting Standard 12 *Disclosure of Interests in Other Entities,* which becomes effective from 2013.

Frequency of disclosures

Financial statement users such as credit and equity analysts have indicated to us that the data set out in the consultation paper would be most useful if it were to be issued more frequently than once a year. During times of economic stress in particular, recent information is most relevant. Annual disclosure was considered to be too infrequent for this reason. We support the paper's proposal that disclosures should be published with the same frequency as publication of financial statements (paragraph 10).

Location of disclosures and external audit assurance

We are concerned that the current length of banks' annual reports may reduce the accessibility of key information provided. Consistent with a 'cutting clutter' approach, it would be preferable for the full Annex 1 template and key features of capital instruments information – which will be lengthy and not of interest to all users – to be placed separately on banks' websites. A summary reconciliation of the calculation of accounting to regulatory capital should then be included in banks' annual reports. Any such summary should be prepared having proper regard to the principle of materiality. Financial statements users we have spoken to indicated that they would be content with the information discussed in the consultation paper being made available online and largely outside of the scope of the annual report. The location of the additional information should be disclosed in the financial statements.

Consideration should be given to whether it would be sufficient to have up-to-date templates on the website or whether there would be benefits in maintaining an historic record.

Although regulatory data is subject to scrutiny by banking supervisors, the exact location of the information will affect the extent to which it is subject to additional external assurance scrutiny. For example, in the UK information included in the notes to the financial statements is included within the statutory external audit whereas information disclosed in other parts of the annual report are only reviewed for consistency with other information disclosed in the financial statements. Information disclosed elsewhere, such as on a bank's website but outside of the annual report, may not be subject to any external assurance review at all. In our view, having the full templates outside of the annual report, with only appropriate summaries within, would be the most effective solution from an external assurance cost-benefit perspective.

Implementation timing

Banks and national regulatory authorities will need sufficient time to prepare for these proposed changes. In view of the fact that a number of other regulatory initiatives are currently being implemented, we recommend that any transitional disclosure should not be effective until 1 January 2014, but early implementation should be encouraged. A consideration which will be relevant to the timing of your proposals is that in Europe the European Commission and the European Banking Authority are still finalising the Capital Requirements Regulation and Capital Requirements Directive (CRD 4), and the eligibility of new capital instruments still remains unclear (for example, contingent capital).

Other issues

Enhanced information about the calculation of banks' capital resources, on a basis more consistent across banks, would enhance the transparency of banks' financial position. However, two key questions about the calculation of banks' capital adequacy will remain.

First, accounting data relevant to capital is affected by the accounting framework under which it is prepared. Differences across GAAPs can be important. In addition, there are of course differences in the regulatory requirements of different jurisdictions which serve to reduce the ease with which comparisons can be made. We consider that narrative disclosure by the banks alongside quantitative information will be useful in highlighting these issues. Second, banking analysts have raised questions about the reliability and comparability of measures of risk-weighted assets, especially when derived from the internal models (IRB) approach. We recommend further work by the Basel Committee in both of these areas.

I hope that you have found our comments useful. ICAEW would be willing to convene a meeting of different stakeholders to discuss your proposals with you in more detail, if you would find this useful. Please do not hesitate to contact me or my colleague Ian Michael (ian.michael@icaew.com) should you wish to take up our offer or discuss any of the matters in this letter further.

Yours faithfully

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