28 April 2010

Our ref: ICAEW Rep 43/10

Osman Sattar
Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Mr Sattar

Discussion Paper 09/5 Enhancing Financial Reporting Disclosures by UK Credit Institutions

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your request for comments on *Discussion Paper 09/5 Enhancing Financial Reporting Disclosures by UK Credit Institutions*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Dr Claire Stone ACA
Manager, audit & reporting

T +44 (0)20 7920 8446
E claire.stone@icaew.com

ICAEW REPRESENTATION

DISCUSSION PAPER 09/5 ENHANCING FINANCIAL REPORTING DISCLOSURES BY UK CREDIT INSTITUTIONS

Memorandum of comment submitted in April 2010 by the ICAEW, in response to Financial Services Authority discussion paper 09/5 'Enhancing Financial Reporting Disclosures by UK Credit Institutions' published in October 2009.

Contents **Paragraph**

INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the discussion paper *09/5 Enhancing Financial Reporting Disclosures by UK Credit Institutions* published by the Financial Services Authority (FSA).

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

4. The ICAEW's Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues and challenges facing the financial services industry, acting in the public interest. It draws together professionals from across the financial services industry and from the 25,000 members specialising in the sector. This includes those working for regulated firms, in professional service firms, intermediaries and regulators.

MAJOR POINTS

We support an international approach

5. Our major concerns with the discussion paper concern the FSA's role as a UK regulator, and whether it is the most appropriate body to be undertaking work on financial reporting disclosures, given the international environment in which the UK's major banks operate and the fact that other bodies such as the International Accounting Standards Board (IASB) and Financial Reporting Council (FRC) have a mandate to develop financial reporting standards. We are also unconvinced by the rationale given for undertaking the work, and consider that the contribution of financial reporting to the financial crisis is overstated. These concerns are set out in our response to question 1 below.

6. That said, the principles in the draft Code are reasonable and we would be happy to see it being taken up by UK credit institutions (CIs). We believe this approach to be far superior to a less flexible template approach.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree that it is appropriate for us to consider the issue of CI disclosures, and our rationale for doing so?

7. We recognise that as the regulator of credit institutions, the FSA has an interest in their public disclosures, particularly in the wake of the financial crisis that has affected not just credit institutions, but the whole economy. However, we consider that the increased focus on financial reporting is in places overstating its role in the crisis and measures taken to remedy perceived problems may result in ineffective regulation. In our opinion a more important contributor to preventing another financial crisis is improved regulation in respect of CIs' liquidity and capital requirements and we believe the FSA as a prudential regulator should focus on these matters, rather than on external statutory financial reporting.

8. We do not agree with all of the rationale given in the paper. For example it is not clear why the FSA in its supervisory capacity for CIs has chosen to conduct this very detailed review of CIs' external disclosures in accounts and would want to regulate disclosures made by CIs in the future. We understand that the House of Commons' Treasury Committee report suggested that the FSA should review financial reporting (the report is mentioned in 2.7 of the discussion paper), but in our view this task would be better dealt with by the FRC. We would encourage the FSA to cooperate fully with the FRC in this regard.

9. Chapter 5 looks at the economic rationale for market intervention, but we find this analysis unconvincing. CIs are not making disclosures within a vacuum but within the context of accounting standards, listing requirements and Companies Act requirements, including those for audit. In addition, there have been significant increases in disclosure by CIs in response to market demand and good practice guidelines issued by regulatory bodies. Therefore we do not believe that there is a market failure that requires intervention from the FSA.

10. The International Accounting Standards Board is in consultation with constituents on how to improve the financial reporting for financial instruments (including disclosures). We believe feeding into the Board's consultation process with comments is the most effective way to improve the accounting and disclosures for financial instruments.

Q2: Do you believe that market discipline is strong enough to ensure that appropriate improvements are made to CI public disclosures in a timely and consistent manner?

11. We believe the increased disclosures by CIs that were developed during the financial crisis are evidence that market discipline and competition can enhance public disclosures on a more timely basis than can be achieved via regulation. For public disclosures to be consistent, however, it is useful to have a shared framework, rather than rely on the market discipline alone. In the UK, accounting standards, listing requirements and Companies Act requirements provide such a framework.

Q3: Following our discussion on granularity, materiality and boilerplate disclosure and other sources of complexity in financial reporting, what elements of disclosure do you find most and least valuable, and why?

12. Whether certain disclosures in accounts are necessary or superfluous will depend on the perspective of the user of accounts. Since users' needs are not always the same there will be disclosures that appear to be redundant to one, but which are critical to the next. We see, however, a risk that disclosures that are useful and relevant on a temporary basis (including during or in the aftermath of the financial crisis) are embedded in regulation and will become a permanent requirement and will continue to apply even when users may no longer find the additional disclosures useful. There is a direct relationship between the quantity of disclosures required and their quality, as an emphasis on voluminous disclosures tends to result in poorer quality information.

13. In relation to CIs' accounts the feedback we have received from users is that cash flow statements, a required element of financial statements under International Financial Reporting Standards (IFRS), are less useful than for general corporates. For financial institutions, investors are keen to understand the risks faced by the entity, including those relating to liquidity, and would prefer to see improved presentation of information on such risks.

Q4: Do you agree that there is a need to improve the comparability of CIs disclosure, and if so what would improve the comparability of information in CIs disclosures?

14. The question could be interpreted as referring to year-on-year comparability of an individual institution's disclosure or comparability between different credit institutions; we assume it refers to the latter. Given that the UK's major banks compete internationally, we would prefer to see an internationally-agreed approach to their financial reporting disclosures. Achieving more comparability between banks and building societies internationally would, in our view, be more useful than working towards more comparability between credit institutions in the UK. We are not aware of specific issues where users have found it hard to draw comparisons and consider that the existing degree of consistency of disclosures by credit institutions preparing accounts in accordance with IFRS should not be underestimated.

15. Comparability is useful, but must not be achieved at the expense of giving meaningful information about the reporting entity: differences between business models should be captured in reporting rather than levelled out in a bid to make information readily comparable. It is not credible that disclosures can be somehow regimented into exact comparability between CIs without the loss of useful information about each specific institution. We note that developments around extensible business reporting language (XBRL) will provide new tools for comparing financial reporting information.

Q5: Do you believe that disclosure of period averages and highs and lows by CIs would be useful, and if so, for which particular asset and liability classes? How would you find this useful?

16. There are requirements in IFRS 7 *Financial Instruments: Disclosures* in relation to period averages and highs and lows which, in our opinion, are sufficient (IFRS 7, paragraph 42). In addition, UK credit institutions registered with the US Securities and Exchange Commission (SEC) are required to give an average balance sheet under requirements set out in Industry Guide 3.

Q6: Do you support the concept of a disclosure code for CIs and if so, should such a code be applied to the largest CIs only, or more widely?

17. We support the concept of a disclosure code for credit institutions, but we believe this should be a voluntary code supported by financial institutions (large and small). In our view, the British Bankers' Association's (BBA) draft code makes visible what many working in this group of preparers are already trying to achieve.

Q7: Do you believe that the BBA Disclosure Code as set out in Annex 2 will enhance the quality of disclosures and the ability to compare across the participating CIs?

18. Yes, given that the BBA disclosure code specifically mentions the quality of disclosures (principle 1) and increasing comparability (principle 4), it should help maintain efforts in these areas and enhance quality and comparability, to the extent it is beneficial, across participating UK credit institutions.

Q8: Do you have comments on particular aspects of the BBA Disclosure Code, especially on how it can best be expressed in order to fulfil its purpose?

19. The code could make it clearer from the outset that it applies to the whole annual report and not just to the financial statements.

Q9: As an alternative to a disclosure code, do you support the FSA developing mandatory disclosure templates for CIs?

20. No, we think that templates that provided meaningful information for all credit institutions (or even the larger ones) would be difficult to develop as is shown by the examples provided which do not appear to provide any more useful information than already given by CIs. Standardisation, which does not take into account differences in business models, could make financial reporting less useful by making different things look the same. Templates can clutter up the financial statements, are a diversion from more informative entity-specific disclosures and tend to be mechanical. We are also concerned that the FSA mandating disclosure could discourage directors from actively reassessing the appropriateness of disclosures each time financial statements are prepared and from providing timely disclosures in response to emerging issues, particularly if CIs come to believe that meeting the FSA disclosure templates is sufficient. We are not convinced that there are any benefits to the template approach that would outweigh the costs and risks of such an approach.

Q10: What benefits (including ones not specifically identified above) would you expect to flow from any new disclosure arrangements? We would particularly value indications of the extent of these benefits.

21. In our view, new specifically designed disclosure arrangements for UK credit institutions are not desirable. The draft BBA code does not represent fundamentally new disclosure arrangements. The Code should encourage those responsible for preparing the annual report to take a step back and assess whether the disclosures are relevant to users and provide a comprehensive picture of the CI's circumstances. It may also help users understand preparers' practices. Additional disclosures, to the extent necessary, are already required on a principles basis by International Accounting Standard 1.

Q11: Do you believe that significant costs (other than compliance costs) could arise from initiatives to secure better disclosure? If so, what are these costs, and how significant could they be?

22. Other than compliance costs, we are concerned that the template approach could result in a reduction in the usefulness of disclosure where it muddies the transparency of differences in business model or otherwise undermines the quality of existing disclosures.

Q12: What compliance costs do CIs expect to incur under any new disclosure arrangements (for example, those set out in chapter four)? Please provide broad quantitative estimates of their possible magnitude.

23. We will leave this question for the credit institutions to respond to.

Q13: Do you agree that our primary focus should be on disclosures in CIs' annual reports generally, rather than disclosures under Pillar 3?

24. We do not favour an industry-specific approach for CIs in respect of their general purpose external financial reporting. Information which is critical to understanding the entity's financial position and performance should be included in the annual report and accounts and not only in Pillar 3 disclosures.

25. Initiatives to improve external financial reporting should not be led by prudential regulators as there is a risk that the resulting reporting requirements will not remain focussed on investor needs. We therefore would prefer that the FSA's work on credit institutions' disclosures focussed more on Pillar 3 disclosures than the annual report.

Q14: If CIs and other CRD firms were required to disclose certain prudential returns, which returns would you currently consider most relevant for publication and why?

Q15: Are there any particular difficulties that such publication might bring?

Q16: What do you consider would be the additional costs involved in public disclosures of such returns?

26. We respond to questions 14, 15 and 16 together. We do not think that prudential returns for these firms should be publicly available. It may confuse the purpose of the return, which is to provide information to the regulator for regulatory purposes. In our view, expanding the Pillar 3 disclosures would be the appropriate route for putting any additional information into the public domain. We acknowledge that this approach does leave inconsistency within the financial services sector, as some firms are required to make regulatory returns public.

Q17: Would you support the publication of KPIs in a similar manner to Denmark?

27. No. We believe the existing requirement in the UK under the Companies Act 2006 for companies to disclose and describe their relevant key performance indicators is superior to the approach adopted in the Denmark. The discussion about key performance indicator is useful for users because it provides relevant information about the entity's internal management, an objective we believe will not be achieved by using pre-determined key performance indicators. Accordingly, credit institutions should provide information about the performance indicators they manage to, not a prescribed set.

Q18: Do you agree with our view that imposing additional rules for CIs' IMS reporting, such as a requirement for quarterly financial statements, is not desirable?

28. Yes, we agree that a requirement for quarterly reporting is unnecessary. Evidence gathered by the FSA suggests that the existing model of interim reporting is working effectively. We recognise that it is important that market-sensitive information is disclosed on a timely basis, but this is already a UK requirement for listed companies.

29. We have concerns that the costs of producing quarterly financial statements would be greater than the benefits accruing from it, especially since we think it could lead management to focus on short-term price movements, rather than the longer term prospects of the business.

E claire.stone@icaew.com