KPMG
cutting through complexity

FSB Enhanced Disclosure Taskforce publishes its recommendations for banks

Improving risk disclosures in financial reports

October 2012, Issue 2012/14

IN THE HEADLINES

kpmg.com/ifrs

> “We support this important initiative in which preparers and users of financial information came together to discuss the inevitable trade-offs in financial reporting – simplicity and comprehensiveness, usability and comparability, transparency and confidentiality. We welcome the proposed improvements in this key area of banks’ financial reporting.”
>
> – Jeremy Anderson, Chairman, Global Financial Services

On 29 October 2012, the Enhanced Disclosure Task Force (EDTF) issued a report: *Enhancing the Risk Disclosures of Banks*.

The fundamental principles contained in the report apply to all banks. However, enhanced disclosures have been developed specifically for large international banks that are active participants in the equity and debt markets. Adoption of the recommendations in the report is voluntary.

Improving investor confidence

The purpose of the report is to help banks improve their communication with stakeholders in the area of risk disclosures with the ultimate aim of improving investor confidence. The recommendations apply to all financial reports, including:

- legal requirements – such as annual financial statements;
- public disclosures required by regulators – such as Basel Pillar 3 disclosures; and
- other communications with stakeholders – such as analyst presentations.

The report is the product of a collaboration between users and preparers of financial reports. The EDTF included members of the investor community, banks, accounting firms, analysts and ratings agencies.

Effective communication rather than a compliance exercise

One of the issues identified by the EDTF is that current extensive and sometimes overlapping disclosure requirements may contribute to a perception that financial reporting is a compliance exercise and to users finding it difficult to navigate long annual reports. The EDTF considers that adopting these recommendations will help banks to use their financial reports as a high-quality communication channel to explain:

- their business models;
- their liquidity position;
- the calculation of risk-weighted assets;
- the relationship between their market risk measures and their balance sheet, as well as risks that may be outside those measures; and
- the nature and extent of their loan forbearance and modification practices.

The recommendations

Fundamental principles and other risk disclosure recommendations

The report recommends that risk disclosures are based on the following seven fundamental principles:

- be clear, balanced and understandable;
- be comprehensive and include all of the bank’s key activities and risks;
- present relevant information;
- reflect how the bank manages its risks;
- be consistent over time;
- be comparable among banks; and
- be provided on a timely basis.

There are 32 main recommendations in the report across seven risk areas and some examples of how information may be presented. Also, the report identifies actual instances of best practice in public reports issued by a number of large international banks.

The report acknowledges that there may sometimes be tension between different principles. For example, Principle 1 states that disclosures should be clear, balanced and understandable, but users have differing views on the level of detail that is needed to achieve that objective.

Guidance and examples; not a checklist

The EDTF emphasises that its report is not intended to be a checklist of all possible risk disclosures but rather a recommendation of ways for banks to communicate important disclosures to users more effectively and efficiently.

Sensitive information or undue cost

The report recommends that banks provide disclosures only if they are material, reflect the bank's activities and risks and can be prepared at reasonable cost. If disclosure of particularly commercially sensitive or confidential information would unduly expose the bank to litigation or other risks, then the level of information provided will need to balance confidentiality and materiality.

Implementing the recommendations

The EDTF is suggesting that banks implement its recommendations in a way that most appropriately reflects their business and risks and how these change over time. The areas of focus should be dynamic, with redundant disclosures being removed.

The recommendations do not specify where the disclosures should be made, which means that banks will have flexibility in choosing the appropriate medium for communication. However, the EDTF thinks that several areas in the report would be disclosed more frequently than annually and that more risk disclosures would be included in interim reports than is currently the case.

The EDTF believes that the willingness of large international banks to proactively implement the recommendations is a critical success factor for this initiative.

Timing

The EDTF envisages that many of its recommendations may be gradually adopted by banks in 2012 or 2013. However, some enhancements, especially those affected by the timing of regulatory pronouncements, will take longer to develop and implement.

What needs to be done now?

Banks will need to decide on their strategic response to the report and initial decisions will have to be made in a relatively short space of time. The 2012 annual reporting season is approaching and so the first question would be how many of the recommendations should be reflected in the 2012 annual report. Should effort be made now to collect new data or should initial emphasis be more on re-organising the existing disclosures so that they may be easier to understand and interpret? Should more information be included in the audited financial statements? What will our competitors do? Should we open a dialogue with our stakeholders to obtain their views and explain our plans? What is the gap between the recommendations in the report and our approach to disclosure?

We recommend that banks start considering the report as soon as possible. A gap analysis between existing disclosures and the recommendations in the report may be an appropriate starting point in shaping the overall strategy for addressing the task of enhancing risk disclosures. After such analysis has been completed and considered by those charged with governance, banks should establish a formal project to implement the agreed plan of action.

> "Restoring the confidence of investors in complex banking groups is essential; the EDTF's recommendations for improved disclosures are an important part of this process. Disclosure should be about communication, not compliance."

– Martin Wardle, partner, Financial Services, KPMG in China; leader, Capital Adequacy and Risk-Weighted Assets workstream, EDTF

Basic facts

The EDTF was set up by the Financial Stability Board (FSB) on 10 May 2012 as a private sector task force to:

- develop fundamental principles for enhanced risk disclosures;
- recommend improvements to current risk disclosures, including ways to enhance their comparability; and
- identify examples of best or leading practice risk disclosures by global financial institutions.

The broad goals were to improve the quality, comparability and transparency of risk disclosures, while reducing redundancy and streamlining the process for bringing relevant disclosures to the market quickly.

The group had four plenary meetings and conducted a series of outreach meetings with regulators and standard setters. The report is the product of a collaboration between users and preparers of financial reports. It aims to help banks enhance their risk disclosures in financial reports to improve investor confidence.

Publication name: *In the Headlines – FSB Enhanced Disclosure Taskforce publishes its recommendations for banks*

Publication number: Issue 2012/14

Publication date: October 2012

KPMG International Standards Group is part of KPMG IFRG Limited.