



The impact of IAS/IFRS on banks' regulatory capital and main balance sheet items

Executive summary

1. The introduction of International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) has been a source of concern to supervisory authorities, notably because of fears that these standards could jeopardise the criteria that regulatory own funds have to fulfil, namely that they be (i) permanent, (ii) readily available for absorbing losses, and (iii) reliable as to their amounts. There were also some concerns that the IAS/IFRS could introduce volatility into institutions' financial statements and, more particularly, into regulatory own funds, in ways which might not reflect the economic substance of institutions' financial positions.

2. In order to preserve the definition and maintain the quality of regulatory capital, the Committee of European Banking Supervisors (CEBS) has developed Guidelines on prudential filters for regulatory capital (hereinafter referred to as 'Guidelines'). The filters are designed to adjust regulatory own funds for changes appearing in the accounting equity of institutions that apply IAS/IFRS (or national generally accepted accounting principles (GAAP) that are similar to IAS/IFRS) for prudential purposes. This work drew on related analysis conducted under the auspices of the Basel Committee on Banking Supervision. The Guidelines were issued in December, 2004.

3. CEBS subsequently undertook an analysis of a sample of institutions' financial data to determine whether the supervisory concerns are justified and to what extent the Guidelines are effective.

Key results

4. The analysis of the aggregate sample data confirms that the Guidelines neutralise the negative impact on credit institutions' regulatory own funds that IAS/IFRS were observed to have at transition.

5. The results of this analysis – together with the conclusions of a survey that CEBS conducted in 2005 on the implementation of the Guidelines, which indicated that participating CEBS members complied satisfactorily with the Guidelines' recommendations – should help to mitigate supervisors' concerns. CEBS will continue to monitor the impact of IFRS on the banking sector.

6. CEBS recognises that the topic is still very new and that issues are still evolving. Indeed, some of the accounting standards (or some of their provisions) have only recently been endorsed at EU level and thus may have further influence on credit institutions' accounting and capital figures. Institutions, as well as supervisors, are still very much in a learning process when it comes to the application of IAS/IFRS, and this should be taken into consideration when interpreting the results of the analysis.

Coverage and methodology of the Analysis

7. The aggregate data cover 18 countries.¹ Five of these countries already apply IAS/IFRS (or national GAAP similar to IAS/IFRS), so that the impact of the standards on regulatory capital is relatively insignificant and that the differences related mostly to the first application of IAS 39. The results, aggregated from - in most cases - representative samples of the banking sectors of CEBS members that participated in the exercise, provide a snapshot of the impact of IAS/IFRS and of the effect of the adjusting mechanisms at the moment of transition. The balance sheet total of the aggregate data represents on average close to 50% of the banking sector of data-providing countries.

8. CEBS also collected data on the impact of the transition to IFRS on institutions' balance sheets and regulatory own funds, both before and after applying the recommendations in the Guidelines. The data collection permitted a comparison of credit institutions' positions as of 31 December 2004, reported under national GAAP, with their positions as of 1 January 2005, established according to IFRS. Prudential filters were applied by the different countries in accordance with decisions or intentions taken at national level for the application of the CEBS Guidelines.

Main findings

a) Balance Sheet

9. The results show an increase of 9% in the balance sheet total. This generally confirms the expectations of supervisors, whereas the magnitude of the negative impact on accounting equity (-5%) was less anticipated. The decrease in accounting equity can be explained by the effect of the first-time application of IAS/IFRS to post-employment obligations and (in two countries) by the effect on minority interest of the reclassification of preference shares held by third parties from equity to debt.

b) Own funds

10. The results confirm that the overall reduction in regulatory own funds is due largely to the reduction of reserves as a consequence of the first-time application of IAS/IFRS. This impact results in a permanent reduction of own funds that only some countries currently adjust. The decrease in minority interest is neutralised by the application of the CEBS guidelines, which state that these elements continue to be considered as regulatory own funds.

11. The results also indicate that, in the current economic environment (where unrealised gains exceed unrealised losses), the prudential adjustments eliminate from regulatory own funds the positive effect that 'Fair Value revaluation reserves' had on accounting equity - with the exception of the part that, in accordance with CEBS Guidelines, is permissible for inclusion in additional own funds.

12. The overall effect of transition to IAS/IFRS and of the application of the prudential filters results in a moderate decrease in 'Total Eligible Own Funds': 2% in the aggregate sample. The application of prudential filters to IFRS equity elements contributes to an upward correction of regulatory own funds that, apart from the neutralisation of the reclassification effect, is due mainly to the fact that 'Fair Value Revaluation Reserves' can be partially included in additional own funds.

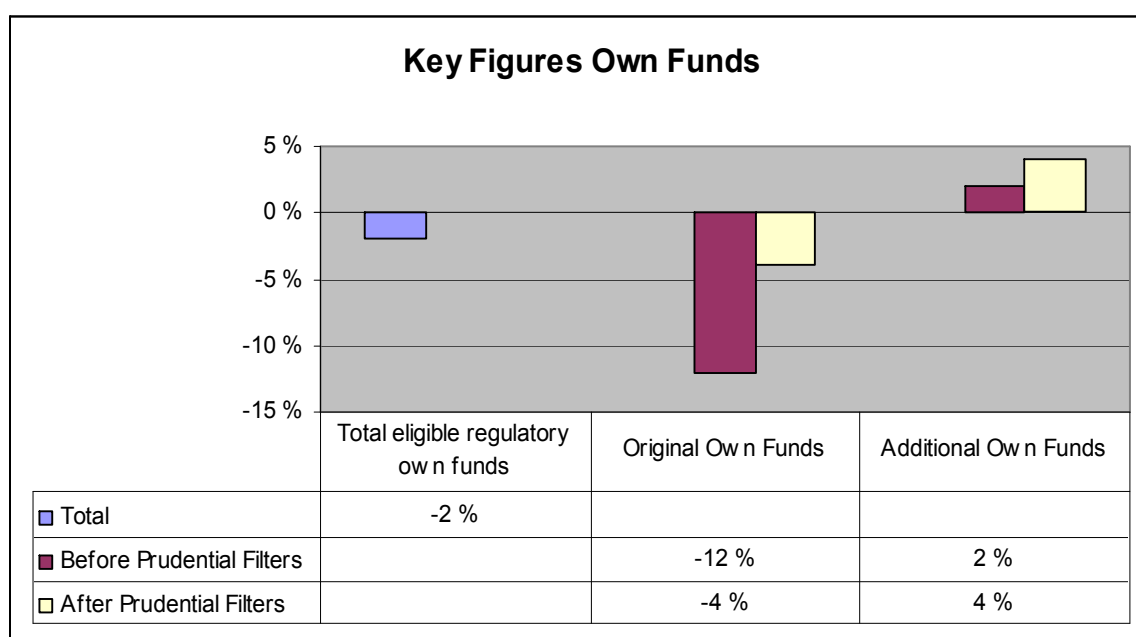
¹ The aggregate data cover Cyprus, Estonia, Finland, France, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, the Netherlands, Poland, Portugal, Slovak Republic, Spain, Sweden, the United Kingdom, and Norway. Of these, one provided data only on the impact on own funds. Various CEBS members did not participate in the study for the following reasons: IAS/IFRS (as well as some of the prudential filters) are already applied and the study would not have shown a difference; IFRS will be applicable only from 2006 and the requested data are not available or unreliable; the study is not applicable because IAS/IFRS are not applied for prudential purposes; involvement in EGAA activities started only recently.

13. The following tables provide an overview of the key findings of the analysis: ²

Key figures total balance sheet (Amounts in Billion EUR)	2004	2005	Change	% Change
Total balance sheet	7,473.7	8,153.5	679.8	+9%
Total assets	7,473.7	8,153.5	679.8	+9%
Financial assets held for trading	976.5	1,695.8	719.3	+74%
Financial assets designated at FV through P/L	58.3	288.2	229.9	+394%
Available-for-sale financial assets	690.0	810.3	120.3	+17%
Loans and receivables	4,870.3	4,717.3	-153.0	-3%
Held-to-maturity investments	173.7	63.0	-110.7	-64%
Total liabilities	7,109.1	7,806.9	697.8	+10%
Financial liabilities held for trading	568.7	1,198.2	629.5	+111%
Derivatives used for hedging	1.4	36.1	34.7	2,531%
Total equity and minority interest	364.5	347.8	-16.7	-5%
Minority interest	44.5	25.7	-18.8	-42%
Reserves	153.4	133.5	-19.9	-13%
Revaluation reserves	-4.6	20.7	25.3	+555%

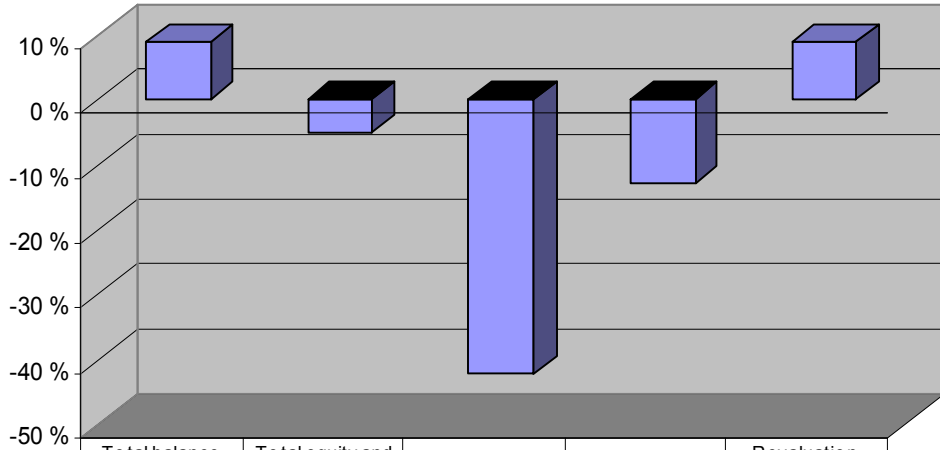
Key figures regulatory own funds (Amounts in Billion EUR)	2004	2005	Change	% Change
Total eligible regulatory own funds	383.6	375.3	-8.3	-2%
Original own funds before prudential filters	313.2	274.5	-38.7	-12%
Original own funds after prudential filters	313.2	299.5	-13.7	-4%
Additional own funds before prudential filters	93.7	95.9	2.2	+2%
Additional own funds after prudential filters	92.7	97.2	3.5	+4%

14. Charts A and B further illustrate the main findings:



² It should be noted that the observations made on the basis of the aggregate data are not in all cases confirmed by observations made at individual country level or even within countries.

Key Figures Balance Sheet - Equity and Minority Interest



	Total balance sheet	Total equity and minority interest	Minority interest	Reserves	Revaluation reserves
% Changes	9 %	-5 %	-42 %	-13 %	9 %