British Banking Association

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CEBS work on behalf of ECOFIN

Thank you very much for the invitation to address to you today the CEBS work on accounting on behalf of ECOFIN. I will focus especially on CEBS' work on disclosures.

As you may know, CEBS is the Committee of European Banking Supervisors. CEBS has been heavily involved in dealing with accounting issues surrounding the current crisis situation.

I can vividly remember the weekend conference calls that we had with all the supervisory authorities in Europe, now already two months ago, discussing the reclassification of assets from the trading portfolio. In around three days, the banking supervisors in Europe – including the UK FSA, the German Bafin, the French Commission Bancaire and others - presented their advice on the possibility for reclassifying assets from trading. This coincided with some severe and acute stress at some of the EU banks, even before the rescue packages of the different EU Member States were developed. This non-public advice presented a number of remedial actions that could be taken up by governments. This was just before the end of the third quarter figures of banks, which now seems quite some time ago.

You all know the follow-up. Discussions took place at the ECOFIN, and at the EU Commission, together with a number of other stakeholders who liaised with the IASB. After intense discussions an amendment was made. At CEBS we did a quick survey recently on reclassifications that have taken place, based upon publicly available data. More concretely we looked at 30 banks. The outcome was that about €250 billion reclassifications have occurred from trading into held for maturity and available for sale. Our back on the envelope calculation showed that as a result of this, about €5.8 billion of losses did not go through profit and loss.

Also we heard of course about the criticism of this very rapid change from the departure of the valuation of these toxic assets from treatment under fair value accounting. But let me be clear on this: all bank supervisors felt this change was only acceptable given the extreme situation for adequate valuing these assets and we all agreed that this should only occur for exceptional situations and together with full and meaningful disclosures.

In respect to valuation, some extra items have now been identified that are under further evaluation by the IASB and the EU Commission, as the body that proposes the endorsement of such changes in the international accounting standards within the EU. CEBS, together with its sister committees CEIOPS and CESR, issued its advice on future steps in this regard. These deal more specifically with 1) the fair value option – and more particularly whether financial instruments under the fair value option should be allowed under specific circumstances to be reclassified – 2) the treatment of embedded derivatives – and in that context the question whether for the reclassification of financial instruments that contain an embedded derivative, the latter has to be split from the host contract, and 3) there is the issue of impairment of available for sale financial assets – which has two sub-aspects: i) on the one hand the question of the reversal of impairment losses for available for sale equity instruments (to align with the treatment of debt instruments) and ii) on the other hand for available for sale debt instrument, the fact that when impairment is identified, the impairment amount is the entire fair value reduction [while some say it should only be the credit risk element].

Valuation, especially of illiquid assets, will stay as a topic on our CEBS agenda. It will still be part of the roadmap that is now being drawn up by the ECOFIN for next year, to remedy the financial crisis. CEBS will also stay on the ball of this topic in 2009, monitor the follow-up to its June 2008 report on valuation issues, and we will surely update you in due course of further developments.

Let me now turn to disclosures.

Good disclosures are key. From the moment the crisis was evolving, CEBS has emphasised continuously the need for good disclosures. The reason for this is that in our view good disclosures can contribute to increased trust amongst banks and towards banks, which of course is very important at the moment, given the situation for instance at the interbank market.

More specifically, CEBS has carried out several assessments of the adequacy of banks' public disclosures on securitisation operations, structured products and illiquid assets affected by the crisis.

The benchmark for doing these assessments, was based upon a set of observed good practices for disclosures on activities affected by the crisis. We developed these observed good practices during the first half year of 2008 and presented them in the middle of this year to the market.

These observed good practices cover disclosures on the business model, risk management, exposures and their impact as well as accounting policies and valuation issues.

In CEBS' view, these good disclosure practices provide you as institutions with clear guidance for:

- comprehensive information on business model and risk management;
- meaningful information on exposures and impacts, with appropriate levels of granularity;
- useful disclosures on accounting policies; and
- improved presentation of the disclosures.

CEBS is of the opinion that the use these practices will contribute considerably to the improvement of disclosures on exposures and activities affected by the crisis.

The practices CEBS has identified have in essence a global scope. They are in line with the recommendations made in the report of the Financial Stability Forum (FSF) on ‘Enhancing market and institutional resilience’ and consistent with the ‘Leading practise disclosures’ as identified by the Senior Supervisors Group. In some areas the CEBS’ practices supplement the FSF and SSG efforts and are meant to put some more practical guidance and flesh on the bones.

In fact we aimed for a more holistic approach and promote disclosures that ‘tell a coherent story’ to help understanding the background to an activity, its impact and importance, as well as its management.

The main focus now is on good practices as observed as of mid 2008. As the disclosures practices can be expected to develop, similarly to what will be considered as ‘high risk’ areas for which enhanced disclosures are necessary, CEBS will further investigate how these practices should be applied in the longer run, to ensure that developments in the crisis are adequately reflected.

Coming back to the EU process: CEBS presented these observed good practices mid this year to the ECOFIN, who in turn endorsed them. In addition, we have been asked by the Ministries of Finance of the EU to closely monitor the use of these practices by EU banks, and to report back to them, if necessary, together with policy recommendations for improved compliance.

On the assessments: a first round of assessments has been done when developing the observed good practices, which were based upon the end 2007 information towards the market.

For this assessment we took into account the disclosures made by 22 large banks, 19 of which are headquartered in the EU. CEBS analysed the information that you as institutions provided, not only on your quantitative exposures to illiquid instruments, but also on their impact, link with the business model, risk management practices and accounting and valuation practices.

The main findings of this first analysis showed the following:

- limited disclosures on the business models underlying the activities affected by the sub-prime crisis and the related risk management practices (especially liquidity risk);
- diverse disclosures on exposures and on the impact of the crisis;
- generic disclosures on the valuation of exposures affected by the market turmoil and their accounting; and
- varied presentations of disclosures.

So surely quite some room for improvement. A follow-up review has been done of the banks' half year 2008 disclosures.

Our general conclusion was that the disclosures have improved certainly since the last assessment. In particular, improvements have been observed with regard to the levels of details of the information. For these areas, the disclosures are considered to be in line with the good practices, as endorsed by the ECOFIN.

Also, differences in disclosures between the banks included in the analysis, are considered to be commensurate with the varying levels of their involvement in the activities under consideration.

By contrast, disclosures on business models - and to a lesser extent, disclosures on risks and risk management practices - are less detailed and have not improved to the same extent. Some of the institutions analysed, have incorporated CEBS' good practices for these areas, but the majority of institutions still have to make further efforts to bring their disclosures up to this standard.

CEBS is of course aware that interim reports – as the ones we analysed - typically do not contain the same amount of qualitative discussion about institutions' business and activities, but nevertheless considers that there is a need for enhanced disclosures and for further efforts to align institutions’ disclosures with the CEBS’ good practices.

In addition, we realised that the timing of the ECOFIN endorsement of the observed good practices may not have allowed all institutions to take the CEBS’ good practices wholly into account. Therefore we have high expectations of the forthcoming annual reports. We have urged our members – the supervisors in the EU – to push for implementation and really expect that CEBS’ good practices will be adequately reflected in the 2008 year end reports coming to the market.

Another assessment of this is planned for the beginning of 2009. And we have already received an explicit request from the EU political institutions to do this and to report back to them before the middle of next year on the compliance with the observed practices. CEBS is committed to do so, and will if needed, also present follow-up policy recommendations. In addition, CEBS will also have a close look at the upcoming Pillar 3 disclosures. A first assessment will be done as soon as these disclosures will be made public and the outcome will be ready by mid 2009.

Adequate disclosures are key and we will do our utmost to promote them.

Thank you very much for your attention.