Definition of capital disclosure requirements

The ABI's Response to the Basel Committee on Banking Supervision's consultative document

Introduction

1. The Association of British Insurers (ABI) is pleased to have the opportunity to respond to ESMA's invitation to comment on its consultation paper on its endeavours to improve the quality and perspective afforded to users of financial reporting by banking entities.

2. The ABI represents the UK's insurance, investment and long-term savings industry, the largest in Europe and the third largest in the world. It has over 300 members, accounting for some 90% of premiums in the UK domestic market, and manages investments of £1.5 trillion.

3. As users of accounts we have a strong interest in ensuring that financial reporting addresses properly the information needs of shareholders, investors, creditors and other users of accounts. We would stress that both financial reporting and regulatory treatment need, as far as possible, to accord with economic reality and avoid overly-theoretical approaches to valuations of assets and, in turn, the recognition and treatment of capital. Long-term investors, such as our members, also have a shared interest with Governments and regulators in striking the right balance between promoting safety through capital strength and in ensuring the ability of the banking sector to support economic activity and growth.

Our comments

4. Bank capital strength, including how it is assessed by regulators, is a critical area for investors and analysts. The significance of this has been made abundantly clear through the period of the Banking Crisis. If users of banks' financial reporting have in the past had inadequate access to regulatory data and how this reconciles to accounting numbers, it is unlikely they will accept this in future. As Governments seek to sell down holdings acquired in recent years in major, systemically-significant, banking groups it will be essential that prospective investors have access, and can rely on continuing to have access, to the necessary quantity and quality of information in this regard.

5. Levels of banks' regulatory capital are of key relevance in understanding the constraints on the resources available to their managements. Understanding how this impacts on the business is therefore crucial and this needs to be reflected through corporate reporting, both numerically and through quality narrative reporting, in order to build a coherent picture, and improve the ability to analyse

returns and assess capital strength. Improved transparency of information on capital strength across the sector and nationally as well as globally, also has a key role to play in restoring the level of market confidence that is needed to increase financial stability.

6. Two particularly important aspects where regulatory capital accounting and mainstream financial reporting diverge are in the bases of consolidation and, for regulatory purposes, the risk-weighting of assets. We encourage the Committee to consider further steps on how reporting on both these aspects can be better highlighted.

7. As regards regulatory capital the key objective is to understand how this data reconciles back to the reported shareholders' equity amounts in the financial statements. We think there is probably scope for simplification of Annex 2 in a way that would achieve this with greater clarity. In terms of the detail of the disclosure, however, it would also be helpful to have greater distinction regarding the status of coupons and dividends that are entirely discretionary, partly discretionary or mandatory, together with information on the relevant governing law.

8. Subject to the above, we think there is some scope for simplification of the proposed data in order to ensure an appropriate balance between the costs to preparers and the needs of investors, and indeed to avoid information overload for users. Nevertheless we emphasise that enhanced transparency is necessary in order to increase the assurance for investors as to the financial status and prospects of the banks to which they have committed their resources.

9. Investors and other financial statement users in the banking sector consider that, to be useful, this information needs to be issued more frequently than once a year. We support the paper's proposal that disclosures should be published with the same frequency as publication of financial statements to the markets, in EU Members States consistent with the provisions of the Transparency Directive. We also consider it acceptable for this information not to be audited and treated, therefore, on a similar basis to Pillar 3 information rather than being included in the financial statements, as long as the information can be tied back to the financial statements. We suggest that banks make the information available at the same time as the financial statements are published.

10. Information disclosed elsewhere, such as on a bank's website and not in the annual report, may not be subject to any external assurance review at all. We think the right approach would be to accept that these disclosures are placed outside the annual report and accounts but that a summary reconciliation of the calculation of accounting to regulatory capital, which will be subject to audit review and be information of particular interest to investors, should then be included in banks' annual reports.

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