Mme NOUY

Date
19 June 2001

Le Président

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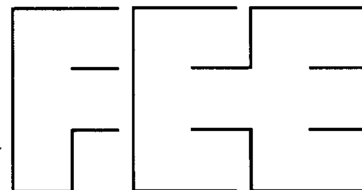
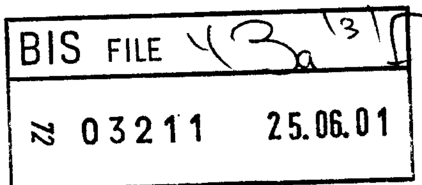




Dear Sir or Madam,

Re: Consultative Document – The New Basel Capital Accord

Over the past few years FEE (Federation des Expert Comptables Européens, European Federation of Accountants) has reviewed Basel proposals on various issues and issued their observations in writing. We have also reviewed the consultative document on the New Basel Capital Accord issued in January 2001. In view of our background our comments focus on the accounting and auditing issues set out in the consultative document and in particular those of Pillar 3 to promote market discipline.

General comments

We endorse the Committee's three-pillar approach of a minimum capital requirement, the process of supervisory review, and the operation of market discipline (Pillars 1, 2 and 3, respectively) and the efforts to promote safety and soundness in the financial system. We welcome the availability of a menu of approaches allowing each bank to use the method best suited to its circumstances and the level of sophistication of its operations. We share your general view that market discipline is promoted by proper disclosure to the general public and supports the supervisory process.

We have in other instances questioned whether the Basel Committee should be the institution to issue accounting guidance and we continue to express those reservations. We have expressed the view that the regular standard setters like IASB should be the parties to prepare and distribute new disclosure standards. In that respect we are aware of discussions that have taken place with the IAS 30 Steering Committee. We urge that – given the purpose of the Pillar 3 proposals – consultation and cooperation with the IAS 30 Steering Committee and IASB would continue to be of the highest importance. We therefore welcome the statement in Basel II that the Committee intends to enter into consultation with accounting standard setters on appropriate disclosures. We strongly recommend that rules on public financial reporting information are set by the IASB. The primary responsibility for determining the final set of disclosure requirements to support Pillar 3 should be given to the IASB, and in particular the IAS 30 Steering Committee.

Below we are setting out our detailed comments on Pillar 3 which we consider useful to be included in the discussions between the Basel Committee and the IASB/IAS 30 Steering Committee.

Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

Pillar 3 - main comments

As set out in the introduction, the main thrust of our reply concerns Pillar 3, since that is the area that is most directly relevant to our work.

1. We have commented in previous submissions on the different emphases of banking supervision and the preparation of financial statements, and have firmly expressed the view that the former should not dictate the latter. This being said, there is much common ground between the interests of supervisors in a full and public disclosure of the risks to which a bank is exposed and the interests of the public in the overall truth and fairness of financial statements. Where those interests may differ is in the degree of detail and of balance that is needed to achieve those ends.

2. In discussion with the IASB/IAS 30 Steering Committee as emphasised in the general comments, it would be appropriate to take the following steps:

   - Compare the proposed disclosures set out in Pillar 3 with the current disclosure requirements of IAS 30, 32 and 39

   - Identify disclosures not required by IAS and determine whether these disclosures:

     - Are relevant for general purpose financial statements, or

     - Are not relevant for financial statements but may be relevant for management discussion and analysis[1], or other parts of the annual report, or

     - Are relevant for neither management discussion and analysis nor other parts of the annual report - but may be relevant for supervisors, in which case the information ought in our opinion be collected by other means.

3. In all of the cases set out above under 3 consideration should be given to the level of detail provided.

   We draw your attention in particular to paragraphs 10 and 11 of the IAS Framework, which record that financial statements cannot meet the information needs of every user, but should seek to meet those needs that are common to all users. Paragraph 11 also states too that the reporting of information used for management's planning, decision making and control responsibilities would be beyond the Framework's scope. It is in this area that Pillar 3 risks loading the financial statements with excessive detail that may confuse the user rather than help in the proper understanding of risks undertaken by the bank.

4. It is suggested in Pillar 3 that the incremental costs of preparing the proposed disclosures will be limited, given that the information needs to be available for management. On the contrary, we expect that significant extra time and costs would be required just for presenting and auditing the information.

[1] While management discussion and analysis is not within the scope of IAS, and the annual report is subject to general IAS guidance only, both documents are becoming increasingly well known, and have an important role to be considered in this context.

5. In general it is our feeling that the disclosures are developed from a supervisory perspective. While we see that the information included in the proposed disclosures in their proposed level of detail are important for the understanding of the supervisors of the banks capital structure and risk management, we wonder whether that level of detail would be relevant to and meet the needs of all of the users of general purpose financial statements. Many of the disclosures required are different as to detail and format compared to current reporting formats under IAS.

6. We agree with the Basel Committee that the subjects capital, credit risk, market risk, interest rate risk and operational risk as well as capital adequacy are important and relevant for users of financial statements.

7. Closely related to a critical analysis of proposed disclosures is the determination of which of them are factual and can properly be included within the scope of the auditors' examination, and which are subjective, or are expressions of management policy or intent, which usually cannot.

8. We are not aware that users of financial statements (for example, rating agencies and analysts) have been consulted by Basel on the relevance of the proposed disclosures. Their views will be important in the determination of general purpose disclosures.

9. In some instances, for example credit risk disclosure by type of facility, the pillar 3 includes proposals to provide information that is already included in the face of the balance sheet, through presentation or through measurement of positions. In our view repeating the information in the notes is then not necessary.

10. While it is mentioned in the text of Pillar 3 that the templates are setting out the disclosure requirements in an example format and other formats could be used, they give a rather prescriptive impression. A more general approach that would provide possibilities for development of industry practices while at the same time allowing for differences in emphasis based on differences between banks, would in our view be preferable. Furthermore, the distinction between core disclosure requirements and additional disclosures could be more balanced for any area other than credit risk.

Pillar 3 - detailed comments

We have not sought to comment in detail on the appropriateness of every disclosure suggested in Pillar 3. As we have made clear earlier in this letter, we believe that these issues need to be assessed by an accounting standard setter, i.e. the IASB and may be used in that discussion.

Para 12 indicates that banks should disclose to the public information that is comprehensive and not misleading. Especially the comprehensive nature of disclosure seems to conflict with the detailed disclosure requirements and/of recommendations set out in the appendices to this section.

The distinction between core and supplementary disclosures as set out in para 18 in combination with required and recommended disclosure does not seem to be followed in all sections equally strongly.

Para 22 suggests that internationally active banks prepare quarterly disclosures. Outside the USA, semi-annual disclosures are more customary. The frequency of reporting should be left to the market regulators in each of the countries.

Para 24 indicates that two years' information should be disclosed. For new disclosures, transitional arrangements should be contemplated.

Where para 25 speaks of contingency planning in relation to capital adequacy it would be our understanding that such type of disclosure might be of a proprietary nature that banks would not like to make known as this could just destroy such access to alternative sources.

Para 27 gives guidance on the scope of application. It may be anticipated that many international banks would select more advanced methods for their capital adequacy determination also within individual legal entities operating in a country. It would seem to be overly demanding to require that also such legal entities disclose the same level of detail in their financial statements as required at the parent level. Some relief would seem to be justified for legal entities within a group.

Para 31 refers to the distinction between realised and unrealised gains and losses. Given the current movements in the direction of a full fair value model of accounting (already complete, in the case of banks' trading portfolios) this distinction is in part (and may become completely) irrelevant, and may in the meantime be differently interpreted by different interests. Further consideration is required.

Capital disclosures

We have some difficulty to understand how goodwill (and other amounts) deducted from tier I should be treated when goodwill is amortised by the entity.

Disclosure of "Undisclosed" reserves would automatically make them disclosed by nature.

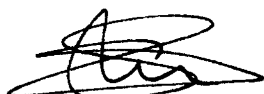
Credit risk disclosures

The appendix leaves it undecided whether the maturity breakdown should be by original maturity or remaining maturity. We would anticipate the latter would be expected.

The manner in which the allowances for credit losses are described to be able to absorb further charge-offs of bad debt in the future seems to conflict with the requirements under IAS 37 which would prohibit provisions for future losses.

The tables, which are aimed as an example, leave it undecided whether they apply to the core of supplementary disclosures.

We would be pleased to discuss with you any aspects of this letter and look forward to any opportunities that may arise for working together with the Basel Committee on Banking Supervision.



Göran Tidström
President