



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: commentletters@ifrs.org

Mr Hans Hoogervorst
Chairman
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Exposure Draft: General Presentation and Disclosures

Dear Mr Hoogervorst

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the International Accounting Standards Board's (IASB) exposure draft on General Presentation and Disclosures (the ED).

The Committee has a strong interest in high-quality financial reporting by banks and is supportive of the IASB's work on primary financial statements, as we noted in our response to the IASB's 2015 Agenda Consultation. The Committee supports the IASB's objective of improving how information is communicated in the financial statements, and its focus on the statement of profit or loss.

The Committee expects that the ED's proposals will deliver improvements in the comparability and transparency of financial statements for most entities. We expect that many of the proposals will bring benefits to reporting for banks. However, we note that a key benefit of the proposals – a more structured and comparable statement of profit or loss – will probably not be realised for banks. Bearing in mind that the IASB does not issue sector-specific standards, the Committee is concerned that the IASB has chosen to develop proposals on a fundamental issue like general presentation principles without addressing the issues arising in the financial reporting for banks as fully as it has for the issues arising for other companies.

We have considered the ED and have provided detailed responses to most of the questions it poses in the Annex to this letter. We wish to draw your attention in particular to the following points.

Structure of the statement of profit or loss for banks

As noted above, the Committee has observed that the proposals in the ED risk not delivering a key outcome of the primary financial statements project for banks – ie a structured and comparable statement of profit or loss. Banks provide financing to customers as part of their main business activities, make investments in the course

of their main business activities, and recognise gains and losses on derivatives used to manage risk to income and expenses expected to be classified in the operating category (both as part of designated hedging arrangements and otherwise). As a result, the defined subtotals that have been introduced will have limited impact on the statement of profit or loss for banks, with most income and expenses expected to be classified in the operating category. Further, banks as providers of finance as a main business activity would be granted a “free” accounting policy choice, as noted below.

The Committee notes that the IASB has sought to define subtotals that are of relevance to users in interpreting the financial performance of most entities. The IASB has done so to improve comparability by reducing diversity of practice. However, for banks, the IASB has only gone so far as to permit key subtotals such as “net interest income” and has not sought to address how they should be prepared. In the Annex, we set out subtotals that are relevant to the performance of banks that we believe could help to address this point.

Optionality in classification of financing income and expenses for banks

The Committee considers that a free choice of accounting policy is not consistent with the objective of comparability between financial statements set out in paragraph 20 of the ED. This is the case for the proposal to classify as a main business activity the financing of income and expenses for entities that provide financing to customers. The Committee recommends that the IASB further consider the costs and benefits, particularly for banks, of requiring financing income and expenditure to be allocated to the operating category where it relates to the provision of financing to customers (ie the IASB should reconsider only allowing the current paragraph 51a approach). If the costs of requiring the 51a approach are not found to justify the benefits, but the IASB considers that the optionality related to financing income and expenses is required, the Committee recommends that the option not be made a “free” policy choice and that a default approach be designed, as set out in the Annex.

Unusual income and expenses

The Committee supports the objective of highlighting where components of profit or loss have low predictive value. However, we are concerned that the proposals may lead to confusion and inconsistent application, particularly as in common usage the term “unusual” is not only reflective of items that have limited predictive value, and may have wider connotations.

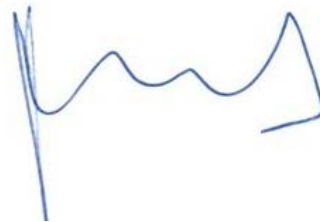
Further, the Committee is concerned about the scope for judgment and management bias in determining what is and is not unusual, and how this, coupled with the forward-looking nature of the definition, could lead to limited consistency in implementation.

Management performance measures

The Committee supports the transparency that the management performance measure proposals will introduce. However, we are concerned about the potential for confusion with other non-GAAP measures, particularly other performance measures, for both users of financial statements and users of other communications made by the entity that include non-GAAP measures. The Committee also questions whether the scope of the proposals is appropriate given that, for the banking industry, metrics such as net interest margin and changes in regulatory metrics such as capital and liquidity ratios are key management measures for presenting financial performance.

We hope that you find our comments constructive and helpful. This letter has been prepared by the Committee's Accounting Experts Group, chaired by Mr Fernando Vargas Bahamonde, Associate Director General, Bank of Spain. If you have any questions regarding these comments, please contact Mr Vargas (+34 913 38 61 04), or Mr Matt Feroze (+44 20 3461 8752) and Mr Bruno Mastroianni (+39 64 792 5282) as co-chairs of the General Presentation and Disclosures drafting team, or Mr Puneet Pancholy (+41 61 280 8673) or Ms Joanne Marsdon (+41 61 280 8541) of the Basel Committee Secretariat.

Yours sincerely

A handwritten signature in blue ink, consisting of a series of connected loops and a final downward stroke.

Pablo Hernández de Cos

Annex: Detailed comments on the General Presentation and Disclosures Exposure Draft

The Operating Category (Q1 - Q6)

1. The Committee expects that the general proposals will provide increased structure to the Statement of Profit or Loss of most entities and will significantly reduce diversity of practice. We note however, that the disaggregation of income and expenses into the various categories described is more useful for non-financial entities. For entities, such as banks, whose main business activities include provision of financing to customers and who make investments in the course of their main business activities, the proposals have considerably less benefit as financing and investing categories are expected to collapse into the operating category. To mitigate this concern, we encourage the IASB to define sub-totals for entities that provide financing to customers. We consider adequate and consistent disaggregation in the primary financial statements to be of importance for all entities that apply IFRS.
2. The Committee finds that illustrative example II-3 (the Statement of Profit or Loss for a retail and investment bank) is a helpful start for comparability for banks. However, without the prescribed disaggregation into categories seen for other companies, banks will have greater flexibility in presentation, which will limit improvements in comparability.
3. The Committee notes that data collected and published by banks for supervisory purposes in many jurisdictions is presented in a standardised format, with defined sub-totals that are meaningful to supervisors. We believe that the IASB could leverage on such supervisory practices and work with supervisors in order to enhance comparability in the financial sector. It seems feasible to introduce defined subtotals in the Statement of Profit or Loss for entities that provide financing to customers, which would provide some of the comparability benefits expected for other sectors.
4. From a supervisory perspective, the most important subtotals would be “net interest income” and “gross income”. We expect that other users of bank financial statements would equally find these subtotals important in understanding the performance of a bank, and suggest that the IASB considers whether it can define them and base a disaggregation framework for banks on those sub-totals. The IASB might also consider whether to give guidance on the positioning of IFRS 9 impairment charges, since these are an important component of performance.
5. Net interest income is the difference between interest income and expenses. We note that the definition would need to clarify the components of interest income and expenses other than the interest accrued using the effective interest rate method. For example, it is common – although not as far as we are aware universal – practice to include in this subtotal also a part of the re-measurements of certain financial instruments such as debt instruments at fair value through profit or loss, or interest rate hedging derivatives.
6. We expect that gross income would include net interest income, dividend income, fees and commissions income and expenses, as well as gains and losses from financial instruments (excluding loan loss provisions) and gains and losses from hedge accounting. This subtotal would give a comparable picture of the results of the different core financial activities (loans, trading, hedge accounting and other financial services provided) ensuring a certain level of comparability in the sector and would emphasize the main and most relevant numbers for assessing the performance of a financial entity.

The Operating Category (Q2, Q3 and Q4)

7. The Committee supports the proposal to classify in the operating category all income and expenses not classified in other categories. Treating the operating category as a default category appears to be a reasonable response to the difficulty in finding a definition of operating profit or loss that is appropriate for all possible business activities.

8. The Committee also supports the proposal to present income and expenses that meet the financing classification requirements in the operating category where linked to “main business activities”.

9. However, the provision of the accounting policy choice to entities that provide financing to customers as main business activity (i.e. to reclassify into the operating category either “all income and expenses from financing activities”, or “only those relating to the provision of financing to customers”) would reduce comparability across entities. We find this inconsistent with the objective of increased comparability.

10. The Committee recommends that the IASB further consider the costs and benefits, particularly for banks, of requiring the allocation of financing income and expenditure to the operating category where it relates to the provision of financing to customers (i.e. the IASB should reconsider only allowing the current paragraph 51a approach). If the costs of requiring the 51a approach are not found to justify the benefits, but the IASB considers that optionality is required to allow different entities to present their performance, the Committee suggests that this optionality is not given effect through a ‘free’ policy choice. For example, the IASB should consider requiring the reallocation of all income and expenses to the operating category (paragraph 51b) for any entity that provides financing to customers as a main business activity, unless this would not result in a faithful representation of entity’s business activities that are unrelated to that to the provision of financing to customers. Where “faithful representation” is not delivered, the entity would be permitted to perform an allocation in line with the current 51a approach.

The Investing Category (Q5)

11. The Committee recognises the need for a specific approach to the classification of fair value gains and losses on derivatives within the proposals. However, the classification approach to such gains and losses set out by the IASB is complex and contains exceptions that could reduce comparability. The IASB should consider whether this level of complexity is helpful in supporting consistent application of the proposals and understandability of the primary financial statements of banks. In addition, the Committee does not agree with the principle that gains and losses on derivatives managing risks should be reported in the same category as the gains and losses on the instrument whose risk is being managed (paragraph 58).

12. For banks, we understand that the proposals would result in the gains and losses on derivatives used for risk management and non-derivatives used for risk management (in both cases whether designated as hedging instruments, or not) being classified in the operating category. This would be either because the gains and losses are classified in accordance with the category of the income and expenses whose risk they manage (where hedge accounting is applied, or a derivative is used to manage risk without hedge accounting) or because they relate to a main business activity (a non-derivative used to manage risk but not designated as a hedging instrument). Therefore, for banks we expect the proposals to have limited impact. However, the proposals also envisage scenarios where gains and losses on such instruments would not be classified in the operating category, and would instead default to presentation in the investing category. These scenarios are where classification would require grossing up (paragraph 57), or if classification would impose undue cost or effort in the case of derivatives used to manage risk that are not designated as hedging instruments (paragraph 58).

13. It may be that banks do not often need to gross up gains and losses, or benefit from the exemption in the case of undue cost or burden. However, we recommend that the IASB consider whether, if these situations do arise, it would be appropriate for a bank to present those gains and losses in the investing category, which might not otherwise be used. The IASB should also consider whether entities may be incentivised to use the exemption in relation to undue cost or burden to manage whether or not certain gains and losses fall within the operating profit subtotal.

14. The Committee questions the proposal in paragraph 58 that gains and losses on derivatives used to manage risk (but which are not designated as hedging instruments) should be classified in the same category as the income and expenses whose risk they are used to manage. Without hedge accounting, linking the gains and losses on the hedging instrument to unhedged income and expenses can result in a position that is neither hedged, nor unhedged, which is arguably not a faithful representation. The Committee nevertheless notes that if subject to the standard requirements of paragraphs 45-55, gains and losses on such derivatives may be classified in the operating category for a bank in any case, if considered to be in the course of, or part of, a main business activity. Therefore, removing the proposals in paragraph 58 would not give a different result for banks. That would not of course be the case for non-banks, and so this proposal made in paragraph 58 of the ED is important for the IASB to consider.

15. The proposals also introduce a distinction between classification of the gains and losses on derivatives versus non-derivatives where those instruments are used to manage risk without being designated as a hedging instrument. We consider that this distinction adds unnecessary complexity and we question its rationale, particularly as the difference in treatment appears to hinge on potential undue cost or effort in relation to non-derivative financial instruments, a factor for which an exemption is applied in the case of derivative financial instruments used to manage risk but which are not designated as hedging instruments.

Unusual income and expenses (Q10)

16. The Committee supports the objectives of the proposals for the definition of unusual income and expenses, and for comprehensive disclosure requirements. However, we note that understanding performance, and what might be considered usual versus unusual performance, requires consideration of the components of performance and their respective drivers such as likelihood of re-occurrence, repeatability, controllability etc. The IASB's focus on predictive value could lead users to believe that items that are not 'unusual' are repeatable when this may not be the case. The Committee notes the importance of clear definitions and good disclosure for unusual income and expenditures. It is quite possible that operating profit before unusual items will become an important figure for users, and so preparers will have strong incentives in this area.

17. The Committee notes that the proposed guidance to identify unusual income and expense is subjective as the identification relies exclusively on expectations about the future (see paragraph B70). This subjectivity could lead to reduced comparability among entities. To tackle this problem, additional guidance to identify unusual income and expenses and more detailed criteria may be required.

18. The Committee notes that as the IASB's focus is on the predictive nature of the item, it may reduce confusion for users if the IASB were to find a new term for 'unusual' that more closely reflected that. For example: "Items with low predictive value". The Committee is also unclear on the relevant unit of account for considering unusual items – would consideration of whether legal cases are unusual be at the level of one legal case, or all similar legal cases, or

all legal cases? If unusual items are identified with varying levels of granularity then application may be inconsistent between entities.

19. The IASB acknowledges in paragraph BC122 that entities are biased towards disclosing unusual expenses, rather than unusual income. The application guidance could unintentionally accentuate this bias when it gives in paragraph B68 to B70 examples of expenses (fire, litigation cost, etc.) that are unusual but not unusual items of income. We recommend that the IASB addresses this bias in the text of the standard (preferably) or in its application guidance to emphasize neutrality between unusual income and unusual expense.

20. Paragraph B75 of the application guidance allows the option to disclose unusual items either in a separate note or as part of the management performance measures note. We suggest that this option should not be permitted as combining the notes would result in mixing IFRS figures with non-IFRS figures and may adversely affect the clarity and diminish the significance of this important disclosure.

21. We further query whether in paragraph 100, the ED should refer to similarities in “type or amount”, rather than “type and amount” as drafted. This would appear more consistent with the examples provided in B68 and B69.

Management performance measures (Q11)

22. Overall, the Committee welcomes the added transparency expected from the introduction of “management performance measures” (MPMs) in the proposal, and supports the IASB’s decision not to restrict MPMs to measures based on amounts recognised and measured in accordance with IFRS. These proposals will allow banks to present their management view in a way that is meaningful to their users, while introducing some rigour into their calculation and disclosure. We note however that the current proposals may lead to confusion for users, and we have concerns around the scope of the MPM definition.

23. In many jurisdictions, comprehensive disclosure frameworks have been developed by securities regulators for public filers in relation to non-GAAP and other financial measures (often known as Alternative Performance Measures). These frameworks apply to a broader range of performance measures than the subtotals of income and expenses that would meet the MPM definition, including measures related to the financial position or cash flows of an entity (as well as other relevant metrics). It seems quite feasible that firms could present to users, or investors, a range of different alternative performance measures that include some measures that meet the MPM criteria, and some that do not. We question whether the relevance of the distinction, and differences in assurance over the calculation of measures that are MPMs and measures that are not MPMs, will be understood by users. Confusion in this area may be compounded through use of different terminologies and definitions across different jurisdictions.

24. The current definition of MPMs excludes net interest margin and other ratios, including those whose changes over time are considered key measures of performance by management. For example, for the banking industry, regulatory metrics such capital and liquidity ratios (and changes in these) are key management measures for financial performance.

25. We ask that the IASB consider whether the scope of MPMs could be revised to capture ratios that are important in communicating performance. For example, if the scope were extended to cover ratios where the numerator or denominator is an IFRS total or subtotal, this would bring in net interest margin for a bank and revenue per square metre for a retailer – both important measures of performance.

26. As a minimum, in order to retain the benefits of added transparency while not creating confusion for the users of financial statements, the IASB should consider using a term other than “Management Performance Measures” to make it more distinctive from the broader definitions of performance measures as commonly understood and used in different jurisdictions.

27. We support the IASB’s decision not to restrict MPMs to measures based on amounts recognised and measured in accordance with IFRS (BC155). However, an implication of this approach is the potential to bring more ‘inventive’, and arguably misleading, measures into the financial statements. For example, EBITDAC (EBITDA adjusted for Covid-19 impact) or reflecting other hypothetical adjustments to performance. We recommend that the IASB consider whether, and to what extent, it believes this to be a desirable outcome, and to clarify its position and provide examples within the standard.

28. If the IASB does not consider bringing more inventive measures into the financial statements a desirable outcome, we note that the recognition criteria for MPMs may only have limited effect in preventing potentially misleading measures from being included within the MPM note. In particular, we recommend that the IASB carefully consider whether the requirement that “MPMs shall faithfully represent aspects of the financial performance of the entity” (105a) would actually prevent misleading MPMs from meeting the recognition criteria – arguably an accurate description is a faithful description regardless of the nature of the item being described. We would also recommend that the IASB consider whether the “complements” requirement (103b) has any real effect in restricting recognition.

29. The IASB could help preparers understand where the line is to be drawn for recognising MPMs through further implementation guidance and examples of what does, and does not, meet the “faithful representation” requirement. Another option could be introducing a focus on “relevance” to indicate that some of the more hypothetical figures are neither predictive nor confirmatory.