Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR)

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Thursday, 2 November 2017
Afternoon Session

Agenda item 4. The role of disclosure in risk assessment and enhancing the usefulness of corporate reporting in decision-making

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The role of disclosure in risk assessment –
A regulatory perspective

Thursday, 2 November 2017

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Purpose of the presentation

• To specifically highlight the following issues from the perspective of a bank regulator:
  o The main challenges in establishing harmonised standards for risk disclosures
  o The optimal level of disclosure
  o The balance between transparency and confidentiality – a regulator’s nightmare
  o How can we contribute to consensus-building on the topic of risk disclosure?
Some context & recent developments

• Banks face disclosure requirements dictated by Basel Pillar 3 and IFRS, notably IFRS 7 in this context
  o This implies the need for non-IFRS disclosures
• **IFRS Foundation and BCBS enter Memorandum of Understanding** (5 September 2017)
• IASB releases 100 comment letters received on DP/2017/1 'Disclosure Initiative — Principles of Disclosure’ – views are split (2 October 2017)
• IFRS Foundation releases “Better Communication in Financial Reporting” (October 2017)
Challenges (some of them)

• Banks (and their regulators) have to address investors’ AND depositors’ needs
• International financial reporting standards (FRS) are not aligned
• Countries opt for national FRS, which are “largely” aligned with IFRS
• Basel allows for national discretions (a matter receiving attention)
• Standard setters (at all levels) assume some level of financial literacy of users
• All standards are constantly evolving
Challenges (some of them)

After implementation, there is potential for an increase in the volatility of the income statement charge due to changes in the macroeconomic outlook as well as ‘cliff effects’ for clients moving between stage 1 and 2, however the actual long-run average credit losses will not be affected by IFRS 9, as client defaults and subsequent recoveries are not driven by accounting standards.

Source: Nedbank Group Limited 2016 Annual Report
Challenges (some of them)

Most Basel-style models will require adaptations:

- Removal of regulatory PD floors and minimum LGDs
- Inclusion of future economic forecasting - avoid 'double counting' through overlays
- Stressed/downturn LGDs must be unwound
- Removal of general collections costs in Basel LGDs
- Use of EIR (or other measure) as discount rate, not cost of capital
- Create term structure (PD, LGD and EAD) for lifetime EL calculations
- Only include contractually irrevocable undrawn commitments under IFRS 9, not 12 month behavioural draw-downs - adjust credit conversion factors (CCFs)
- Address current frequency of updates to PDs and ratings - some may currently be less frequent than external financial reporting cycles, or may not align with financial close timeframes
- Reconciliation between financial impairment and regulatory capital models
- Challenge of reconciling Finance and Risk data

Source: EY
Optimal level of disclosure

• Banks’ annual reports often exceed 500 pages!!
• Key, comparable metrics are essential
• Clutter must be avoided – reference explanatory or additional information, don’t garble it all up
• **Standardised** ratios contribute more to comparability than absolute numbers
• Judgement applied in material matters should be explained, with key assumptions where applicable
• Quarterly reporting encourages short-termism, yet ongoing [“live”] reporting might actually bridge this
Getting the balance right

- Regulators (e.g. financial regulators & stock exchanges) do not have unified requirements/definitions, even within national contexts
  - Accordingly these need to be explained (in simple language) by regulators and referenced by reporting entities
- Regular and frequent disclosures by regulators should be published at aggregate and entity levels
- Materiality thresholds must be made public by reporting entities and auditors
- Point-in-time disclosures do not suffice
Conclusions

• It’s not only the rules that matter, it’s also their application and enforcement
• Regulators have their own reporting burden
• Authorities must assist users (at all levels) to have access to understandable explanations and background information
• Authorities and reporting entities need to collaborate and cross reference each other
• KEY minimum reporting elements and risk measures must be set and monitored/enforced
• Get rid of the clutter!
Contributing to consensus-building

- Encourage coordination/alignment of reporting standards and disclosure at international and national regulatory levels, with adoption backed by effective enforcement
- Extend this to standardised performance measures across key industries / market segments & levels
- Source & share best practice / case studies
- Recognise and support the contribution of a strong audit culture
- Help shape a financial media that contributes meaningfully and critically
- Illustrate the benefits of all of the above
Shukran!