Focus on transparency
Trends in the presentation of financial statements and disclosure of information by European banks
2009
FINANCIAL SERVICES
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Foreword

Another 12 months have passed since the last report, and the financial crisis has entered a new phase, with the stability of the world economy still in doubt. That the banking sector underpinned much of the stability in the world economy was widely understood; that it was the bedrock was perhaps not fully comprehended until some financial institutions collapsed. Therefore it is fully understandable that this year, more so than in the prior years, the issuance of banks’ annual reports has made front page news. What used to be of interest, seemingly, only to investors and analysts is now hotly discussed by a much wider audience.

More scrutiny than ever is being placed on the type of information presented in the annual reports, and how it is presented. It has become apparent that although the banks have provided the information required by International Financial Reporting Standards (IFRS), fully understanding what has been disclosed is another matter. As such, we have reviewed the annual reports and presented key areas of interest in our report ‘Focus on Transparency’. We are again pleased to share the results of our survey with you; and as in previous years, the results of the survey make for interesting discussion.

Our opening chapter compares the volume and structure of the financial reports. Despite some commentators complaining about the length of the 2007 reports, the average volume increased again in 2008, a result in part of additional disclosure requirements introduced by the IASB and by pressure from non-accounting bodies (e.g. CEBS, FSB and other bodies) to reflect banking specific information despite not being mandatory. Many banks have acquiesced and moved to address this non-mandatory information. That increased disclosures do not necessarily result in more transparency is highlighted by a conclusion published in a recent report of the Treasury Committee of the House of Commons in the UK: “At the moment, financial reports can be used for finding specific bits of information, so are useful for reference, but they do not tell the reader much of a story. We would like them to read less like dictionaries and more like histories”.

Overall the structure of the annual reports is unaltered with comments to the financial crisis being an integral part of the report as opposed to a separate commentary. Whether this implies the current economic state is now regarded as ‘business as usual’ or whether the integrated commentary results in a more cohesive review of the year with explanations to period variations providing better insight it not clear; either way the format is consistently applied.
An area of interest is the critical accounting policies and key estimations as these indicate the areas where the most judgement is applied – hence the areas where the reader should focus. We note that in accordance with 2007, the banks did not significantly alter the areas they considered to be key accounting or judgement areas. Additionally, the presentation also remained true to the prior year with some banks clearly defining the critical accounting policies from the overall policies, and distinguishing the key judgements from general judgements, whilst others did not make a clear distinction.

We have not delved into the implications of the asset protection schemes offered by various governments given the structures and consequent implications are too different. However the presence of the implicit governmental support may have encouraged the spate of acquisitions by various banks (e.g. Dresdner Bank by Commerzbank, and HBOS by Lloyds TSB). In turn, these acquisitions have resulted in expanding the balance sheets. Generally, banks balance sheets have grown in spite of acquisitions; this appears opposed to the banks’ intentions of shrinking the balance sheet. We believe this is a key point that requires mentioning as it is not fully clear from the financial statements why the loans to customer balances have increased, despite the disclosures. Interpreting the reasons for the increase is difficult to do, ie whether the banks are lending again and organically growing their balance sheet or whether the increase is due to acquisitions and growth is inorganic. Historically banks have sourced their income from fees, and margins on interest rates, therefore insight into how the banks balance sheets are evolving will go a long way in forecasting income over the next few periods.

In October 2008 the IASB introduced new guidance that permitted the reclassification of certain assets; with resultant impact to the income statement. Consequently, a superficial analysis of the income statement that compares the periodic variation in income flows (net interest income, trading income and fees) may indicate there is a marginal decrease in trading income. However caveat lector: the reader should be careful to distinguish between variations caused by a decrease in trading to those resulting from other factors (such as reclassifications and accounting policy choice) so as not to misinterpret the banks’ ability to generate income.
The three key areas of risk: liquidity, market and credit, are awarded separate chapters. This was the second year for the IFRS 7 disclosures on liquidity, and the disclosures consisted of largely the same information as for 2007. Overall there was a similar level of detail provided both on a yearly comparative and within the peer group. The area with the most divergence in presentation was the treatment of derivatives and trading liabilities.

Market risk disclosures, in comparison, were less standardised not only due to relatively less prescribed guidance but also due to the banks’ business models. The banks surveyed range from large global banks to smaller European-focused banks; consequently the risks faced, and therefore disclosed, reflect this. Furthermore, of the three key risks, disclosures around market risk are the area where there appear to be the biggest variability.

Credit risk disclosures reflect the risk of default faced by the banks, which has become of heightened importance in the current economic climate. The chapter on credit risk compares how banks provide between individual and collective impairment, which appears relatively unchanged between the years. In addition, the requirements to disclose maximum credit risk exposure is compared to 2007; despite the write-downs over the period the maximum credit risk exposure increased in 2008. To mitigate credit risk exposures, it is common for banks to take collateral. Disclosure in respect of collateral received varied across the banks.

Another area where there had been additional focus during the year was disclosures related to capital. With hindsight it appears that presentation of information of capital was not a key area of focus prior to the market decline. As the Tier 1 and Tier 2 capital balances eroded, with additional questions raised to the adequacy of liquidity, regulatory requirements were thrust into the limelight and the national regulatory regimes called into question. Comparing the 2008 results to those of 2007 we can surmise that the banks have reacted to the market moves by building its buffer of Tier 1 and Tier 2 capital.
We also looked at the impairment of available for sale assets and goodwill, plus deferred tax assets. We have included a chapter on these topics in part due to the subjectivity to the valuation of these items and potential impact to the p&l. In affluent times the presence of goodwill and deferred tax assets bolster the financial statements. In declining times the write down of these assets hits the profit and loss. In both scenarios the impact to the profit and loss is based on assumptions and judgement. The results of our survey indicate that the market conditions have had varied impact on the three assets groups: available for sale assets appear to have significant declines, although not necessarily deemed impaired; deferred tax assets and goodwill remained reasonably constant, except for a few significant write-downs for goodwill. These will be key areas to note over the coming periods, however the implicit assumptions that they will still generate future cash flows is a positive indicator by the banks.

We believe that the results of our distillation of the financial statement are as interesting as ever. We hope that this will further the quest for clarity in presenting financial information of ever more complex and large financial institutions.

In the interest of constructive dialogue we would of course be happy to receive your comments and suggestions.

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For the third consecutive year, KPMG firms have surveyed the annual reports of some of the largest European banks and produced this summary publication of our findings. In line with the two previous years, this survey has key chapters on areas the banks found challenging (for example disclosure and presentation of credit risk and liquidity risk) in addition to information about the format and presentation of the annual report. The results of our survey again show interesting differences between how the banks are reacting to the continuing market conditions.

We have also seen how the International Accounting Standards Board reacted to requests for additional guidance and re-evaluation of current guidance, in particular for the classification and measurement of financial instruments. Guidance was issued in October 20081 that allowed certain non-derivative assets previously held at fair value to be reclassified as assets held at amortised cost. This guidance was intended to bring IFRSs in line with the US accounting guidance (US GAAP). Our survey attempts to shed some light on which banks applied the amendment, and the effect on the financial statements.

Our survey has been tailored to reflect a large demographic of European banks that report under IFRS. With the various restructurings which have taken place over the last 12 months, three banks are not in this year’s survey: Intesa Sanpaolo (Italy), Fortis (Belgium), Dresdner Bank (Germany), however there are an additional two: Standard Chartered and Nordea, which brings our sample to 16:

- France: BNP Paribas, Société Générale
- Germany: Commerzbank, Deutsche Bank
- Italy: Unicredito
- Netherlands: ING
- Spain: BBVA, Santander
- Sweden: Nordea
- Switzerland: UBS
- UK: Barclays, HBOS, HSBC, Lloyds TSB, Royal Bank of Scotland, Standard Chartered

1 Reclassification of financial assets: “Amendments to IAS 39 Financial Instruments Recognition and Measurement and IFRS 7 Financial Instruments Disclosures.”
The results of our survey are graphically represented in the following chapters, with corresponding narrative.

The following people made significant contributions to this publication:

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1. Volume and structure of financial reporting

1.1 Key messages

- The volume of financial information once again increased, with some annual reports exceeding 400 pages. The average volume of the annual reports is 317 pages, an increase of three percent compared to the prior year. The core sections of the annual reports (accounting policies and main body of the financial statements, including notes) significantly increased by 20 percent.

- As in prior years, the annual reports contain additional disclosures going beyond that required by IFRS, driven by local regulatory and legal requirements plus recommendations issued by various supervisory committees (for example CEBS, Basel Committee, FSB).

- Most of the banks do not disclose the impact of the financial market crisis separately, but in various chapters of their annual reports. This diversity allows the banks to retain the structure of the prior years’ annual reports, but inhibits detailed comparison and analysis of the effect of the crisis on the banks.

- The average period from closing date to attestation date increased from 67 calendar days in 2007 to 70 calendar days in 2008. This should be seen in context of result announcements that are often earlier than the attestation date to reassure the market. The shortest period from closing date to attestation date is 40 calendar days.

1.2 Background

Under IFRS a complete set of financial statements is comprised of the balance sheet, an income statement, a statement of changes in equity (or statement of recognised income and expense), a cash flow statement and notes including a summary of significant accounting policies. From 2009 entities will be required to disclose a statement of changes in equity and either (i) an income statement and statement of recognised gains and losses or (ii) a statement of comprehensive income.

The survey also analysed whether there is an impact of the financial crisis on the volume and structure of the annual reports and the attestation date.
1.3 Result of analysis

1.3.1 Volume and structure of the annual reports

The volume of financial information provided by the banks is high. All annual reports contain more than 140 pages, four annual reports contain more than 400 pages. The average volume of the annual reports is 317 pages (2007: 307 pages).

The graph illustrates that the volume of the annual reports of the banks ranges from 140 pages to 631 pages. The volume of HBOS annual report decreased significantly by 84 pages which could be a result of the acquisition of HBOS by Lloyds TSB in January 2009.

Compared to 2007 the volume of 10 of the 16 annual reports has increased. Most banks included further information about the business, risk management, financial data, individual accounts and corporate governance that are not required by IFRS, although the volume and the substance of these sections differ from bank to bank. As some banks (i.e. BBVA, UBS) issued separate reports for some of this information the number of pages of the annual reports is not strictly comparable. The disparity in the length of the annual report can be attributable to other regulatory and oversight requirements in the relevant jurisdiction of the banks, including the oversight of the SEC for US filers.

The accounting policy disclosures remain on the same level as in the last year. The volume of the core financial statements, comprising the financial statements, accounting policies and notes, increased again from a high last year level. 11 banks enlarged their financial statement disclosures.

Figure 1: Volume and Structure of Financial Reporting 2008

The change of the volume of the annual report compared to 2007 is presented next to the bars in the graph.
1.3.2 Disclosures regarding the impact of the financial crisis

Although most investors and the public might have a particular interest in the impact of the financial market crisis this is not disclosed in a separate section in the notes by most banks.

Only a few banks have a separate note on financial instruments affected by the financial crisis. In this section Société Générale discloses the accounting treatment of Residential and Commercial Mortgage Backed Securities, Collateralized Debt Obligations and the exposure to monolines.

All other banks retained the structure of their notes as in previous years and disclose the impact of the financial market crisis in several sections of their annual reports (e.g. in segment reporting, Deutsche Bank, in the Report of Directors, HSBC, in the risk report, UBS). This ensures consistency but inhibits detailed comparison and analysis of the implications.

1.3.3 Period from balance sheet date to attestation

The graph illustrates the period from balance sheet date to attestation date as well as the volume of the annual reports. Some banks make preliminary announcement of their results before the publication of their annual report. In some cases the announcement may also precede the attestation date.

Figure 2: Attestation date and pages

The dashed lines describe the changes in the number of pages or length of time until attestation date compared to 2007. The starting point of each dashed line marks the position of the bank in 2007.
The average period from closing date to attestation date increased from 67 days in 2007 to 70 days in 2008. BBVA took the shortest period with 40 days and Nordea second at 49 days. Unicredito took the longest time (99 days) but its annual report was also the most voluminous.

Several banks at the same time significantly increased the volume of their annual reports and shortened the period from balance sheet date to attestation date.

As in 2007 BBVA and HSBC are the banks with the ratio of the shortest period compared to the volume of the annual report.
2. Disclosure of judgements in applying accounting policies and sources of estimation uncertainty

2.1 Key messages

- The level of disclosed detail varies significantly among the banks, ranging from as little as one paragraph to more than six pages. For those that disclosed little information, the banks simply listed the areas of judgements and uncertainty, while at the high end each topic was discussed at length with detailed statements about potential future events that may impact the financial position of the bank.

- Six banks disclose their judgements and estimates in a separate section. Two banks disclose this information under a distinct heading of Critical Accounting Policies. The remaining banks, apart from one (which does not identify critical accounting policies) include this information either as a distinct subset (one bank) or a short paragraph (six banks) within the Accounting Policy section.

- All the banks remained consistent in considering as judgements and estimates the valuation of financial instruments and impairment of financial assets. However, one bank did not consider impairment of financial assets as a significant judgement. Other common topics include provisions and taxes (ten banks), goodwill and goodwill impairment (11 banks) and pensions and employee benefits (ten banks).

2.2 Background

For a thorough understanding of financial statements, it is important that the basis of preparation including the critical accounting policies is disclosed.

The carrying values of the assets and liabilities reported will not be understood if the basis for deriving these values is not specified. As such, IFRS requires the basis for these numbers to be disclosed – both how the numbers are calculated (estimates) and how management has applied the bank’s accounting policies (judgements).

IAS 1.122 requires entities to disclose the judgements that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Judgements made include, for example, whether to hold an asset to maturity, or for trading and any reclassifications. This decision affects the timing of the impact on the income statement as the asset may, respectively, be accounted for at amortised cost or at fair value through profit or loss.

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Additionally, as required by IAS 1.125, entities are also required to disclose assumptions it made about the future and other major sources of estimation uncertainty. Disclosure is required of estimates that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

With the increased levels of illiquidity and declined market trading volumes resulting from worsening market conditions, there is a significant decrease in observable market quotes. These results in the assets and liabilities identified as being measured at fair value using non-observable prices being more at risk of adjustment in the following financial year.

It is important to note that these disclosures are two distinct requirements, and in addition to the general requirement to disclose accounting policies. However, IAS 1 allows the entities to decide the level of detail and the placement of these disclosures.

### 2.3 Result of analysis

Similar to 2007, there was divergence in the length of disclosures of judgements and estimates. Six banks presented two to five pages of disclosures, only two banks presented six or more pages of disclosures; other banks mainly had a few paragraphs on the topic.

In both 2008 and 2007 only one bank clearly distinguished between the significant accounting judgements and the significant accounting estimates. The most likely reason for this is that the judgements and estimates tended to relate to the same significant accounting policies, and were also closely intertwined.

The presentation of the disclosure for six of the banks was in a separate section, often in the management review or equivalent or in an introductory paragraph to the financial statements. Three banks have presented separate disclosure on judgements and estimates applied. One bank did not disclose any information about the judgements or estimates but rather a general statement in the accounting policies on the risk and uncertainty due to use of estimated figures. The remaining six banks presented the disclosures in a section within the accounting policies, and most of these banks provided a paragraph listing those policies and/or estimates which the banks considered critical with some additional detail either in the accounting policy section or in the specific note.

Apart from reclassification of financial instruments, almost all of the banks kept the disclosures for the judgements and the estimates used the same with some exceptions mentioned below. Only one bank presented as a critical accounting policy the reclassification of financial instruments. However all the banks remained consistent in considering as a significant account policy the valuation of financial instruments and impairment of financial assets. The disclosures surrounding fair value measurement focused on the methods used to calculate the values. Some banks provided detailed explanations of when quoted market prices were used, compared to using models; others described this at a high level and did not provide further information in the notes. Interestingly, compared to 2007 more banks have designated insurance liabilities, intangible assets and provisions and taxes as significant judgements and estimates.
The graph below summarises the key judgements and estimates as presented by the banks.

**Figure 3: Disclosure of judgments and estimates in applying accounting policies**

- Valuation of financial instruments
- Impairment of financial assets
- Pensions and employee benefits
- Goodwill and goodwill impairment
- Provisions and taxes
- Intangible assets and impairment of intangible assets
- Insurance liabilities and DAC
- Residual values and useful lives of assets
- Derecognition of financial assets and consolidation of SPEs
- Share based payments
- Effective interest rates
- Day 1 profit recognition
- Reclassification of financial instruments
- Hedge accounting
- Syndication
- Unarranged overdraft fees
- Events after the balance sheet date
- Impairment of assets other than financial assets, goodwill and intangibles
- Fair value of real estate

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3. Fair value measurement

3.1 Key messages

- There is large variability between the banks in respect of financial assets and financial liabilities measured at fair value as a percentage of total financial assets and total financial liabilities respectively – for financial assets ranging from in excess of 70 percent to less than 20 percent. The range is consistent compared to 2007.

- Although the reclassification amendments allowed entities to carry more financial assets at amortised cost, for the majority of banks, the proportion of financial assets valued at fair value increased compared to 2007. This is interesting given the general aversion to measuring financial instruments at fair value in the current market environment.

- In relative terms, most fair value financial assets and fair value financial liabilities are measured either using quoted prices (level 1) or observable inputs (level 2), so that for all the banks except one approximately less than ten percent of fair value financial assets and fair value financial liabilities are measured using unobservable parameters (level 3 inputs). There is significant variability between the relative importance of level 1 and level 2 inputs.

- Five banks recorded more than €1 billion of gains each on own debt in the income statement.

- For most banks the amount of deferred Day one P&L recognised during the period in profit was not significant. However, five banks reported amounts of €200 million or more.

3.2 Background

IAS 39 introduced and significantly extended the use of fair values, creating controversy as entities argued that the volatility reported in the financial statements would impact the perception of risks. The current market situation has reinvigorated this discussion as some market participants and politicians have publicly called for a reconsideration of the requirements to measure financial instruments at fair value.
Fair value accounting impacts the financial statements, most significantly the income statement, as all changes in fair value should be recognised in the income statement for the trading book and derivatives (other than cash flow hedging instruments). In addition, entities can select to apply fair value accounting if certain conditions are met (see below). Changes in fair value could also be recognised directly to reserves for some financial assets; arguably this is as important as recognising fair value changes in the income statement but typically attracts less attention. The following table summarises the different categories and where changes in fair value are recognised.

<table>
<thead>
<tr>
<th>Category</th>
<th>Changes in fair value are recognised in</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available for sale assets</td>
<td>Equity</td>
</tr>
<tr>
<td>Non-derivative assets/liabilities held for trading</td>
<td>Profit or loss</td>
</tr>
<tr>
<td>Derivative assets/liabilities (hedging and non-hedging)</td>
<td>Profit or loss (if hedge accounting is applied)</td>
</tr>
<tr>
<td>Financial assets/liabilities designated at fair value</td>
<td>Profit or loss</td>
</tr>
<tr>
<td>(profit or loss)</td>
<td>(fair value option).</td>
</tr>
</tbody>
</table>

Under the fair value option an entity may designate any financial instrument as at fair value through the income statement, subject to meeting any one of the following criteria:

- The designation will eliminate or significantly reduce a measurement or recognition inconsistency; or
- A group of financial assets or liabilities (or both) is managed and its performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy; or
- A financial instrument contains one or more embedded derivatives, unless the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract, or it is clear with little or no analysis that separation is prohibited.

Own debt can also be accounted for at fair value through the income statement (FVPL), if the requirements of the fair value option of IAS 39 are met. The fair value option is often used as an alternative to hedge accounting as it eliminates an accounting mismatch between the debt and an economic hedging derivative of interest rate risk. However, if an entity suffers a credit downgrade (or if credit spreads widen) on own debt a gain would be recorded in the income statement because the derivative doesn’t have an equally offsetting effect of credit risk. This effect is partially mitigated by extensive disclosure requirements. Many banks recorded significant credit-risk related gains on own debt in the 2008 and 2007 reporting periods. Such gains will reverse in future years as it approaches maturity if the debt is not repurchased at the lower value.

IAS 39 requires the use of quoted prices to measure the fair value of financial assets or financial liabilities which are traded on an active market as these are the best evidence of fair value (so called ’level 1’). However, if the market for a financial instrument is not active, an entity establishes fair value by using valuation techniques. If quoted market prices are not available banks should derive market
values either from similar instruments for which a market value is available or use models based on observable market parameters (so called 'level 2'). If the models require input parameters which are not observable in the market the so determined fair values are called ‘level 3’. ‘Level 3’ fair values are the most subjective as they are not supported by observable transactions. It is important to note that the terminology is from US GAAP, and that IFRS 7 does not currently require the disclosure of the split between level 1, 2 and 3. However, some banks presented this information voluntary. For financial years commencing 1 January 2009, entities will be required to disclose extensive level 1, level 2, and level 3 disclosures under IFRS 7.

If fair values are measured by using models with unobservable input parameters there might be a difference between the transaction price and the valuation at initial recognition. This so-called ‘Day one P&L’ has to be deferred on the balance sheet and can only be recognised in the p&l using four common methods: deferral (1) over the life of the transaction, (2) until market data becomes observable, (3) until the transaction matures or is closed out or (4) until the bank enters into an offsetting transaction. If the Day one P&L was a loss it would generally be recognised immediately.

This section aims to explore the extent fair values were used, detail the differing measurement methods applied and consider the impact fair values had on the income statement. Investment contract liabilities are not included in this analysis.

3.3 Result of analysis

3.3.1 Financial instruments at fair value

All of the banks included in this survey made use of all of the categories and all banks applied the fair value option to financial assets and financial liabilities. The majority of the banks (nine) disclosed all of the three criteria of IAS 39 as reason for designating the instruments at fair value.

3.3.2 Carrying value of financial assets at fair value as a percentage of total financial assets

For ten banks the financial assets measured at fair value as a percentage of total financial assets had increased since 2007, and for six banks there was a decrease in financial assets measured at fair value compared to the previous year.

The relative use of the different categories of financial assets varies significantly between the banks, which is influenced by the business model and the chosen accounting designation.

Non-hedging derivative assets held for trading constituted the largest group of financial assets for 11 of the banks in the survey compared to two banks in the prior year. In 2007, the largest category was non-derivative assets at fair value through profit or loss.

For three banks, available for sale assets formed the largest group of financial assets.

BNP Paribas and Santander were the only banks to report non-derivative financial assets at fair value through profit or loss as the largest category within financial assets measured at fair value.
• A higher proportion of financial assets measured at fair value can generally be observed for those financial institutions with significant investment banking activities.

Figure 4: Financial assets at fair value as percentage of total financial assets

The percentage of financial liabilities measured at fair value as a percentage of total financial liabilities increased for 15 banks and for one bank there was a decrease in financial liabilities measured at fair value compared to the previous year.
The main fair value categories on the liability side of the balance sheet are as follows:

- For 15 banks the non-hedging derivatives category was the largest of the liabilities at fair value;

- ING was the only bank for which the percentage of non-derivative financial liabilities in the trading category was higher than the percentage related to non-hedging derivatives. However, the difference between those two categories was only marginal.

Figure 5: Financial liabilities at fair value as a percentage of total financial liabilities
3.3.4 Fair value measurement of financial instruments using unobservable parameters

The percentage of financial assets/liabilities measured using observable parameters and non-observable parameters, compared with instruments measured using quoted prices varies significantly among the banks.

Level 1 and level 2 instruments remain the most important measurement categories. Last year six banks measured more than 50 percent of their assets using quoted prices and three banks measured more than 50 percent of their liabilities using quoted prices compared to two banks and one bank respectively for the current year. Some banks have focused on specific instrument groups, resulting in some graphs not adding up to 100 percent.

Figure 6: Proportion of financial assets measured using quoted prices/models

Information disclosed by Unicredito, Commerzbank and Standard Chartered in respect of the levelling of financial instruments did not lend to detailed analysis.
3. Fair value measurement

Figure 7: Proportion of financial liabilities measured at fair value using quoted prices/models

The graphs seem to indicate that all the banks report that roughly less than ten percent of fair value financial assets and fair value financial liabilities are measured using unobservable parameters (level 3 inputs). This result should be interpreted alongside the number of financial assets reclassified to non-fair value categories.

3.3.5 Day one P&L

If a bank derives the fair value of financial instruments by using a model with non-observable market parameters there might be a difference between the initial transaction price and the valuation on day one. This so-called Day one P&L cannot be taken to the income statement immediately but has to be deferred.

The detail of disclosure in respect of recognition of Day one P&L varies between the banks. Only two banks listed all four methods for the recognition of Day one P&L as described in the background section. Eight other banks presented different levels of details with:

- Four banks disclosing that they recognise the deferred gain over the life of the transaction (method 1), when previously unobservable parameters become observable (method 2), and when the financial instrument matures or is closed out (method 3),
• Two banks disclosing the use of method 2 and 3 only,

• One bank disclosing the use of method 1 only and one bank disclosing the use of method 2 only.

Six banks did not provide any disclosure in this respect.

Five banks recording amounts in excess of €200 million in respect of Day one P&L released to the income statement. Compared to prior years, Société Générale, UBS, Barclays, BNP Paribas and Deutsche Bank recorded amounts in excess of €200 million. Generally the amounts are lower than prior years.

Figure 8: Day 1 P&L released to P&L during the year

For four banks amounts reserved on the balance sheet (for release in future years) range from €400 million to €850 million. Four banks disclosed amounts reserved on the balance sheet (for release in future years) ranging from €100 million to €150 million. For the final two the amounts are below €10 million.
3.3.6 Changes in fair value of financial liabilities designated at fair value through the income statement

With all banks having designated financial liabilities at fair value through profit or loss, eight banks disclosed a credit-risk related fair value gain on financial liabilities designated at fair value through the profit or loss. Of these eight banks, five reported a gain of more than €1 billion. Deutsche Bank has reported gain of €4.7 billion, of which €4.3 billion relates to consolidated special purpose entities (SPEs). BNP Paribas disclosed the fair value gain which relates to both own credit-risk and liquidity observed during the second half of 2008. Three banks disclosed credit-risk specific losses on their financial liabilities designated at fair value through profit or loss.

Five banks did not disclose whether credit-risk specific gains or losses were recognised during the reporting period.

Figure 9: Fair value gain/(loss) on financial liabilities designated at FVPL in the income statement

For those banks who made a profit the gains on own debt as a percentage of total profits range from 4.5 percent to 50.9 percent. For those banks who presented an overall loss the gains on own debt as percentage of total loss range from 283.9 percent to 0.2 percent.
4. Presentation of credit risk

4.1 Key messages

- There is significant variability in respect of the spread of individual vs. collective impairment; it is difficult to make any inference as to the reason for this spread. Four banks identified more than 80 percent of their loan impairments on an individual basis, and on the other side of the spectrum two banks identified around 30 percent or less of their loan impairments on an individual basis. Little change has been observed compared to 2007 in respect of the assessment process of credit losses.

- Almost all the banks included in this research clearly disclosed information about their maximum credit risk exposure, including off-balance sheet items and their contribution to credit risk.

- All the banks disclosed information on the credit rating structure of their financial assets using mainly internal ratings, although 11 banks included a credit rating disclosure about their retail portfolio. Only four banks who based disclosure on internal ratings presented a mapping of internal to external ratings. Additionally five banks disclosed a reconciliation between their internal ratings and the associated probability of default.

- Like in 2007, five banks provided full disclosure of the fair value of collateral held against past due or impaired assets. The remaining banks provided limited information of which seven provided no information.

- Certain banks opted to disclose more quantitative and qualitative information on their exposures affected by the financial crisis (e.g., CDO, monoline insurers exposures, RMBS) compared to 2007, in accordance with recommendations of supervisory bodies like the Financial Stability Board (FSB).

4.2 Background

Credit risk constitutes one of the major risks for the banking industry, and loans represent a large proportion of the total assets and as such, the magnitude of loan impairment could have a significant impact on the financial statements. As evaluating loan impairment is a judgemental process, IAS 39 contains specific guidance for assessing impairment, and distinguishes between specific and collective assessment.
Under IFRS 7 entities have to disclose information on the nature and extent of credit risk arising from financial instruments to which they are exposed. Qualitative and quantitative information should be both provided based on the information provided internally to the entity’s key management personnel.

Based on the Leading Practice Disclosures for Selected Exposures in the FSF (now FSB) report dated 7 April 2008, banks were strongly encouraged to provide disclosures related to high-risk exposures including collateralised debt obligations (CDOs), monoline exposures and residential mortgage-backed securities (RMBS) as the financial turmoil heightened the need for more transparency in the financial reports.

There is a difference between regulatory provisioning which is based on probability of default, loss given default and exposure at default, while the IFRS impairment loss is determined with reference to objective evidence of impairment existing at year end.

4.3 Result of analysis

4.3.1 Individual versus collective assessment

IFRS 7 requires the disclosure of the reconciliation of an allowance account for financial assets per class, if such an account is used rather than directly reducing the carrying value of the relevant financial asset. There was still significant divergence in practice for how the banks determine loan impairment allowances on an individual or a collective basis. However there was little change compared to 2007 in respect of the split between collective and individual impairments. Collective allowance as a percentage of total allowances ranged from 0.8 percent (UBS) to 86 percent (HSBC). Only RBS and Santander in 2008 reported a significant increase regarding the proportion of individual impairment vs. collective impairment. Generally the amount of loan loss provisions increased since last year, much of it as a result of the deterioration in the credit markets (increase of delinquency rates) and in certain cases due to the increased volume of loans (for example the addition of new assets through acquisition).

The majority of the banks (12 out of 16) disclosed information on the accounting treatment including information concerning the classification between homogeneous groups of loans that are not considered individually significant (such as personal loans), and individually significant accounts that were generic in nature.
Figure 10: Individual vs collective impairment

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4.3.2 Maximum credit risk exposure

IFRS 7.36(a) requires the disclosure of the amount that best represents the entity’s maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of any amounts offset in accordance with IAS 32, and any impairment losses recognised in accordance with IAS 39. The maximum exposure to loss may differ from the amount recognised in the balance sheet. For written guarantees the maximum credit risk exposure is not the carrying amount but the maximum amount the entity would have to pay should the guarantee be called upon. For loan commitments, if the issuer is not in a position to settle its commitment net in cash or any other financial instrument, the maximum credit risk exposure equals the full amount of the commitment.

Most of the banks provided data on their maximum exposure to credit risk. The total amount of the maximum credit risk exposure increased compared to 2007. Additional information provided on the maximum credit risk exposure predominantly focused on off-balance sheet items.
Contribution of off-balance sheet items to the maximum credit risk exposure varies significantly from one bank to another ranging from 40.8 percent (Nordea) to 4.9 percent (UBS).

The majority of the banks disclosed this information in the notes to the financial statements and five banks presented the disclosures in the risk management report.

IFRS 7.34 (c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. Information of credit risk concentrations was provided by industrial sector for fifteen banks and by geographical sector for thirteen banks essentially for the loans and receivables category.

4.3.3 Certain high risk exposure disclosures

4.3.3.1 Collateralized Debt Obligations

Examples of leading practice disclosures in current market conditions on collateralized debt obligations provided in the report of the FSF include the total of the firm’s exposure to CDOs and a breakdown of this exposure by type, tranche and by the nature of underlying collateral (e.g., subprime residential mortgages).

Apart from two banks that mention limited CDO exposures, eleven banks disclosed the amount of their exposure to CDOs including the gross and the net exposures. Among them, one bank did not distinguish its CDO exposures from other ABS exposures. One bank also did not disclose any impairment allowances related to its CDOs exposures as the risk from CDOs was considered to be hedged with a portfolio of credit default swaps.

Compared to 2007, the banks provided more details on breakdowns of collateral by type (e.g., high grade, mezzanine) and by nature (e.g., the portion of subprime mortgage CDO). Nine banks disclosed these types of information. Additionally, six banks provided a breakdown of subprime mortgage exposure by vintage. Only two banks disclosed information regarding cumulative loss rates applied to subprime mortgage exposure in the estimation of the fair value of the CDO. Furthermore two banks disclosed a sensitivity analysis of the valuation of its exposure to changes in key assumptions.

The disclosures were usually presented in the management report of the banks.
4.3.3.2 Exposures to monoline insurers

Banks are encouraged to disclose information related to hedges, including exposures to monolines and other counterparties. Many banks have insured ABS, CDOs, CLOs and other securities with credit default swaps purchased from monoline insurers. Those credit default swaps are derivative contracts which are carried at fair value.

Ten banks provided their net exposure to monolines after hedging and credit valuation adjustment. Among them, nine banks disclosed the amount of credit valuation adjustment as at the end of 2008. Due in part to the deterioration of credit quality of those counterparties resulting in the widening of credit spreads, the amounts of credit valuation adjustments have globally increased compared to 2007. Furthermore, eight banks also disclosed a breakdown of exposures by credit rating of monolines.

In respect of hedges bought from other financial guarantors (e.g., credit derivative product companies), four banks provided some quantitative information related to their exposures with those guarantors (gross or net exposure and credit valuation adjustment).

4.3.3.3 Residential mortgage-backed securities (RMBS)

The leading practice disclosures include RMBS exposures before and after hedging and before and after write-downs, details on credit quality and breakdown of subprime mortgage exposure by vintage.

Only one bank followed the leading practice disclosures in full. Three banks (with limited subprime structured exposures) did not disclose any information whereas ten banks disclosed their net exposures as of 31 December 2008. Among them, six banks provided quantitative information on the losses recognised in 2008. Compared to 2007, RMBS net exposures have been reduced for all banks. Moreover six banks disclosed explicitly the accounting portfolio of their exposures.

Information on the credit quality of the RMBS exposures was disclosed by a large majority of the banks. Nine banks disclosed information on the credit rating of their exposures. Eleven banks provided details on the nature of collateral (e.g., subprime, Alt-A) whereas six banks disclosed a breakdown of collateral by vintage.

4.3.4 Past due

Under IFRS 7.37, an entity shall disclose by class of financial asset, an age analysis of financial assets that are past due but not impaired as at the end of the reporting period. This provides users with information about financial assets that are more likely to be impaired and helps to estimate the level of future impairment losses. The Standard does not include further requirements regarding, for instance, the maturity bands to be disclosed.

The majority of the banks disclosed information on their past due assets, but the presentation varied from one bank to another. Only one bank disclosed this information for its total assets while most banks limited their disclosures to loans to customers. Six banks included this information for loans to banks.

Overall the information was disclosed in the financial statements; however six banks presented it in the risk management report. Furthermore, two banks did not disclose information on past due over 90 days since those assets are considered as impaired.
The banks segregated their past due into specified time periods. The majority of the banks split their past due assets from one to 30 days, 31 to 60 days, and 61 to 90 days, whereas few only disclosed an aggregate amount for all their past due assets for less than three months.

4.3.5 Credit quality

Under IFRS 7.36 an entity shall disclose, by class of financial instrument, information about the credit quality of financial assets that are neither past due nor impaired. No specific method is defined by the Standard, however using internal or external credit ratings is presented as an example; all the banks disclosed credit quality information using a rating classification, whether internal or external. Like in 2007, internal credit ratings are principally used to assess credit risk of the exposures.

- Almost all of the banks provided rating information regarding corporate and bank exposures, and eleven banks also presented credit rating information for their retail customer loans.

- Of the eleven banks that disclosed information on the credit quality of their retail loan portfolio, nine used their internal rating, and only two used both internal and external ratings.

- Of the twelve banks that disclosed information regarding internal rating for their various exposures, four provided a mapping with an external rating (like in 2007). Among them, one bank provided information about the loss given default associated with its internal ratings. Additionally, five banks provided information about the probability of default associated with their internal ratings.

4.3.6 Collateral on past due or impaired assets

Banks have to disclose a description of their collateral held as security, and other credit enhancements. This disclosure relates to the general mitigation of credit risk and also to assets that are past due or impaired.

All banks provided qualitative information regarding collateral policies and management including the different nature of collateral owned. Nine banks disclosed the fair value of collateral held against impaired assets, of which five also provided the fair value of their collateral for past due but not impaired assets.

4.3.7 Collateral and other credit enhancements obtained

Under IFRS 7, entities have to disclose the nature and the carrying amount of the assets obtained as collateral, if these assets qualify under the general recognition criteria. Nine banks provided such information compared to four banks in 2007. This increase could be mainly explained by the deterioration in the economic situation of credit counterparties.
4.3.8 Renegotiated financial assets

Banks have to disclose the carrying amount of financial assets that would otherwise be past due or impaired and whose terms have been renegotiated. Eleven banks presented disclosures in this respect compared to eight in 2007. As a general rule, amounts disclosed increased compared to 2007.

Five of these banks provided the information for assets renegotiated within the past 12 months; the six others presented their cumulative outstanding assets renegotiated as at year-end. Five banks among the eleven presented the information by type of renegotiated loans. The retail banking sector was more concerned by restructuring activity.

Five banks did not disclose any information on the carrying amounts of their renegotiated assets.
5. Presentation of market risk

5.1 Key messages

- All banks disclosed VaR, although the banks use different assumptions and parameters in calculating VaR. The assumptions and parameters did not change significantly from prior years. The underlying scope of the portfolios for which the risks were measured was not always clear or consistently applied across the banks.

- The banks disclosed market risk sensitivities for the non-trading book in a variety of ways, and the types of market risks disclosed also varied widely.

- As a consequence, despite often detailed and extensive information presented, the market risk disclosures are difficult to understand in an easy and concise way and are not directly comparable between the banks listed in this report.

- In spite of the perceived limitations of VaR it remains the most common method to capture and control market risk exposure.

5.2 Background

Risk taking forms the basis of financial institutions’ business, but those risks need to be managed properly. The effects of the credit crisis have emphasised that robust risk management is critical for continued profitability and stability of financial institutions. Together with increased complexity of financial instruments and the effect of the market dislocation on their valuation, the financial crisis has triggered increased stakeholders’ focus on adequate risk disclosures. The most commonly used risk management technique that attempts to quantify market risk exposure is Value at Risk (VaR).

Focusing on VaR and other sensitivity analyses, this section examines the extent of market risk disclosures by the banks in this survey.

IFRS 7 requires disclosure of risks arising from financial instruments and how the entity manages those risks. In addition, sensitivities to market risks are required to be disclosed. The Standard allows two methodologies to fulfil the disclosure requirements regarding the quantification of sensitivities:
5. Presentation of market risk

(i) A sensitivity analysis for each type of market risk that the bank is exposed to at the reporting date. The sensitivity analysis should take into account reasonably possible changes in the market risk variable. In addition, the impact of those changes on profit or loss and equity should be disclosed separately. For example, changes in interest rates can affect profit or loss due to the effect on floating rate debt issued, while the effect on available for sale securities will be recognised in the reserves.

(ii) Alternatively, a method reflecting interdependencies between risk variables that is used by the bank to manage financial risks can be employed. The most common example for such an alternative method is VaR. If risk disclosures are based on this alternative method, disclosures of the effect on profit or loss and equity are not required.

The above two methods can be used simultaneously, for example if VaR only covers the trading book, the simplified sensitivity analysis is typically used for the banking book, with methods such as net interest margin sensitivity most commonly applied.

5.3 Result of analysis

There is variety between the banks in how market risk disclosures were presented. A slight majority presented the disclosures in the financial statements, whilst others provided the information as part of the management report and some banks provided information in both places.

All banks provided VaR information as the main source of information to describe market risk. However, the underlying assumptions for the VaR calculations and the method of calculation varied between the banks. Parameters such as the holding period and the confidence level have a direct impact on the VaR numbers reported, with the VaR numbers being larger for longer holding periods and higher confidence levels.

With application in twelve banks, the most common confidence interval used was 99 percent. Standard Chartered used 97.5 percent confidence interval, and Lloyds TSB and RBS applied a 95 percent confidence interval for the Group. For the trading book, RBS applied at 99 percent level, which will be applied for the Group from the year 2009 onwards. Barclays changed the confidence level from 98 percent to 95 percent in 2008 due to the existing measure being more volatile and less effective for risk management purposes caused by an increasing incidence of significant market movements. However, for 2008 Barclays disclosed the VaR both at 95 percent and 98 percent confidence intervals.

Twelve banks assumed a holding period of 1 day. Whilst RBS assumed a 1 day holding period on Group level, a 10 day holding period was applied for the trading book market risk. The remaining four banks in the survey applied a 10 day holding period. All banks applied a historical simulation in determining VaR, with some banks also applying Monte-Carlo simulation or a variance-covariance model.

Fifteen of the banks also provided market risk sensitivity disclosures in addition to VaR. Ten of those showed the impact on equity or the income statement.

The most common additional market risk measure disclosed was interest income sensitivity as disclosed by 14 banks, though only three disclose both the effect on equity and the income statement. Of the four banks presenting information in respect of credit spread risk, two banks disclosed both the effect on equity and the income statement. Five banks disclosed equity price risk (though only two of the five split the effect between equity and income statement effect) and six banks disclosed currency risk (though only two of the six split the effect between equity and income statement effect, one by stating the income statement effect and that equity is not affected).
6. Presentation of liquidity risk

6.1 Key messages

- IFRS 7 is not an industry specific standard and meaningful information in respect of the liquidity position of financial institutions would require more than the minimum disclosures mandated by the Standard. In this context, 11 banks voluntarily presented a maturity analysis for their financial assets in addition to the required disclosure for financial liabilities.

- Qualitative information is provided by all of the banks and focused on general liquidity management and measurement. In the context of the liquidity crisis almost half of banks presented information about the liquidity ratio.

- Eight banks presented a liquidity analysis based on remaining contractual maturities and undiscounted cash flows in accordance with IFRS 7. The other banks chose to present a liquidity analysis using discounted or expected cash flows for some of the instruments, taking into account the methods banks use to manage their liquidity.

- Certain banks opted to disclose quantitative and qualitative information on their liquidity risk exposures in accordance with recommendations in accordance with the Basel Committee published in September 2008.

6.2 Background

An amendment to IFRS 7 was issued in March 2009 with first application for financial periods commencing on 1 January 2009. Hence requirements for 2008 in respect of liquidity risk information are the same as for 2007.

Currently, IFRS 7.39 requires a qualitative description of how the entity manages its liquidity risk. The qualitative disclosures are supplemented by a quantitative contractual maturity analysis for financial liabilities per time band (IFRS 7B11) based on undiscounted cash flows (IFRS 7B14). This should be distinguished from the expected remaining expected maturity of such instruments. Expected remaining maturity is mostly used by banks to control liquidity risk, and very often this is more relevant than contractual maturities.

Presentation of an analysis of the maturity of financial assets is not required, but it is a pre-requisite for understanding the liquidity risks of banks.
The amendment to the IFRS 7.39 requires a distinction between non-derivative financial liabilities and derivative financial liabilities. For non-derivative financial liabilities, the maturity analysis should be presented using contractual maturity, including issued financial guarantee contracts. For derivative financial liabilities, the maturity analysis should be based on expected maturity. A contractual maturity analysis is only required for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of cash flows (interest rate swaps in cash flow hedge).

6.3 Result of analysis

6.3.1 Qualitative description and impact of liquidity crisis

All of the banks presented general information – either in the Risk Report or in the Notes to the Financial Statements – on their liquidity risk management techniques. Generally the banks concentrated more on the general procedures and processes than on the assumptions used to set up their cash flow analysis. In the context of the liquidity crisis, banks presented information about tools and indicators used to manage their liquidity risk.

6.3.2 Contractual undiscounted cash flows

The presentation of liquidity risk information in IFRS 7 specifically requires that the maturity analysis be based on the remaining contractual undiscounted cash flows. Therefore these numbers would differ from the amounts included in the balance sheet. Only eight of the banks clearly presented the remaining maturities of their liabilities accordingly. Seven banks presented the liquidity analysis on a contractual basis, but using discounted cash flows for some items. The other bank did not clearly state whether the cash flows are on a contractual basis, with all of them using discounted cash flows.
6.3.3 Time bands used

IFRS 7 suggests four possible time bands for the disclosure of the remaining contractual maturities. The banks used 25 different time bands. The number of time bands the banks used varied from four to ten, compared to nine in 2007.

Figure 12: Number of time bands used by the banks

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Some time bands are widely used but no general trend can be observed.

**Figure 13: Main bands used by the banks**

- **not applicable**: 4 (2008), 4 (2007)
- **on demand**: 10 (2008), 10 (2007)
- **up to 1 m**: 7 (2008), 8 (2007)
- **1 m – 3 m**: 10 (2008), 8 (2007)
- **up to 3 m**: 8 (2008), 8 (2007)
- **3 m – 12 m**: 14 (2008), 14 (2007)
- **> 5 y**: 16 (2008), 16 (2007)

*Time bands suggested by the standard*
6.3.4 Disclosure of assets

While the disclosure of liquidity information for financial assets is not explicitly required, twelve banks voluntarily presented the remaining contractual maturities of their assets, in addition to their liabilities, either in the liquidity risk template itself or within the maturity analysis of their balance sheet items. Eight of the banks disclosed the information on a discounted cash flow basis.

6.3.5 Contractual maturity analysis (IFRS 7.39(a))

The majority of the banks did not disclose specific information on the presentation of their undated or prepayable liabilities. Three banks specifically disclosed their undated liabilities (for example perpetual debt) or long-dated liabilities with an option to redeem by including them in their longest term-dated bucket. On the other hand one bank excluded them from its liquidity risk analysis. In contrast, four banks allocated the undated liabilities to an ‘undetermined’ category. Moreover, five banks classified contracts with undetermined maturity into a category “on demand” or in a “short term” category.

All banks analysed their customer deposits within the relevant time buckets. Among them, ING aggregated customer deposits and other fund deposits and Deutsche Bank identified non-interest bearing deposits (disclosed in the ‘on demand’ column).

6.3.6 Treatment of derivative and trading liabilities

Derivatives should be analysed separately from non-derivative financial instruments. Hedging derivatives and trading instruments pose particular challenges to present remaining contractual undiscounted liquidity information. The graphs below analyse the banks’ approach to this challenge.

Figure 14: Hedging derivatives

Treatment of hedging derivatives in the Liquidity Risk analysis

Two banks clearly excluded its hedging derivatives from its liquidity risk analysis.

Of the other 14 banks, ten specifically identified the breakdown of their hedging derivatives.
Four banks clearly excluded their trading derivatives from their liquidity risk analysis.

The breakdown of the trading derivatives in the liquidity risk analysis for the twelve other banks is analysed in the accompanying graph.

Six banks excluded their trading liabilities from their liquidity risk analysis.

Of the ten other banks, four specifically identified the breakdown of their trading liabilities in their liquidity risk template, as is shown on the accompanying graph.

If the cash flows arising from the financial instruments are settled gross insofar as the cash outflow may be accompanied by a related gross inflow (for example currency swaps), IFRS 7 recommends the presentation of the information on this basis. Only one bank disclosed its derivatives outflows and inflows separately on a gross basis.

Off-balance sheet items (e.g., loan commitments) were included in the liquidity risk analysis template by eight banks.
7. Classification and reclassification of financial instruments

7.1 Key messages

- All but three banks surveyed have taken advantage of the amendments to IAS 39 to reclassify trading items to amortised cost categories. Most banks reclassified trading assets and available for sale assets to loans and receivables. Only five banks have reclassified trading or held to maturity assets into the available for sale category, and only one bank have reclassified trading assets to the held to maturity category.

- The net effect of the reclassification on the income statement varies significantly depending on the type of the assets reclassified and the dates when these reclassifications were made, with seven banks disclosing an effect of more than €1 billion.

- Most of the financial assets fall within two main categories of “loans and receivables” and “fair value through profit and loss.” Overall the banks have a negligible amount of assets that are held to maturity. The split of the financial assets between the categories has been consistent compared to 2007.

7.2 Background

7.2.1 Categories of financial assets and liabilities

As required by IFRS 7.8, details of the carrying amount of the IAS 39 categories should be disclosed. The intention is to differentiate between those financial assets and liabilities carried at fair value, and those at amortised cost. This should be contrasted with the disclosure of fair value per class of financial assets, which is considered in chapter 3 of this report.

IFRS 7.8 identifies and compares the amount of financial assets and liabilities measured at fair value to those measured at amortised cost. It also requires that financial assets and liabilities designated as such upon initial recognition and those classified as held for trading is disclosed separately. The disclosures will also indicate if a bank has a significant level of mismatch between fair value and amortised cost categories.

7.2.2 Reclassification of financial assets

Reclassification between categories was usually rare, which included a ban on reclassifying into or out of the fair value through p&l categories.
In October and November 2008, the IASB issued amendments to IAS 39 allowing reclassifications out of the trading and the available-for-sale category under certain conditions. The IASB responded to concerns expressed by European Union leaders regarding differences between IFRS and US GAAP, potentially disadvantaging European financial institutions compared to their international competitors.

The amendments permit entities to reclassify non-derivative financial assets that are not designated upon initial recognition as fair value through profit or loss out of the fair value (trading book) category if certain conditions are met. Entities applying IFRS now have the possibility to reclassify assets on a similar basis than those competitors who apply US GAAP.

In addition to reclassifications out of the trading category, the amendments permit transfer from the available-for-sale-category to the loans and receivables category for financial assets that would have met the definition of loans and receivables had the financial asset not been designated as available for sale. The reclassification to loans and receivables is only available if the entity has the intention and ability to hold that financial asset for the foreseeable future.

The effect of the reclassifications on the income statement make for interesting reading and indicates the quantum of fair value losses experienced by financial institutions recently. However, in spite of the reclassification the economic position remains unchanged.

7.3 Result of analysis

7.3.1 Categories of financial assets and liabilities

Categories of financial instruments are defined in IAS 39, and is not the same as classes as set out in IFRS 7. For example, an investment security may be categorised as ‘loans and receivables’, ‘fair value through p&l’, ‘held to maturity’ or ‘available for sale’ under IAS 39. The same security can also be classified under loans and advances or investment securities on the face of the balance sheet. Most of the banks had a distinct IFRS 7 disclosure section in the notes to reconcile classes with categories and two banks used the IFRS 7 terms in their balance sheet classification.

Asset and liability categories within the respective banks did not change significantly in 2008 compared to 2007. The relative size of the categories between the banks is impacted by the type of activities the banks undertake and their accounting policy selection. Almost all the banks categorised less than 5 percent of their assets as held to maturity and less than 10 percent of their assets as designated at fair value through profit and loss. The most common categories were loans and receivables constituting on average 30 to 80 percent of total financial assets, and trading assets which on average constituted 15 to 50 percent of the total financial assets. The increase in the loans and receivables is the result of the reclassifications based on amendments to IAS 39. Even after the reclassification, five banks categorised trading financial assets ranging from 50 to 60 percent of their total financial assets. The predominant liability category was ‘liabilities measured at amortised cost’.
Figure 18: Carrying values of categories of financial assets

7.3.2 Reclassification of financial assets

Following the amendments to IAS 39, 13 banks have taken advantage of the amendments and have made reclassifications out of the trading and the available-for-sale category under certain conditions.

Almost all the banks have reclassified trading assets and assets available for sale into the loans and receivables category. Of all banks, five have reclassified trading assets into the available-for-sale category. Only one bank has reclassified any assets into the held to maturity category.

The graph represents the fair values of the reclassified financial assets at the date of the reclassification and at the end of the year. It also shows the carrying values of loans and receivables and the fair values of available for sale assets as percentage of total financial assets.
Figure 19: Carrying values of categories of financial liabilities

- BBVA 2007
- BBVA 2008
- Lloyds TSB 2007
- Lloyds TSB 2008
- HBOS 2007
- HBOS 2008
- ING 2007
- ING 2008
- Santander 2007
- Santander 2008
- Unicredito 2007
- Unicredito 2008
- Commerzbank 2007
- Commerzbank 2008
- Standard Chartered 2007
- Standard Chartered 2008
- HSBC 2007
- HSBC 2008
- Nordea 2007
- Nordea 2008
- Société Générale 2007
- Société Générale 2008
- UBS 2007
- UBS 2008
- RBS 2007
- RBS 2008
- Barclays 2007
- Barclays 2008
- BNP Paribas 2007
- BNP Paribas 2008
- Deutsche Bank 2007
- Deutsche Bank 2008

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The data in percentages is the carrying value of loans and receivables, plus the fair value of AFS assets, as a percentage of total financial assets.

The range of the reclassified assets varies from bank to bank and is a result of the relative size of their balance sheets. Most of the banks have reclassified leveraged finance and corporate loans as well as ABSs, CMBSs, RMBSs, CDOs and other debt securities from trading assets and available for sale assets into the loans and receivables category amounting to €10-30 billion. The fair value of these assets have not declined much as of the year end and in the instance of three banks, even though marginally, have been higher than at the date of the reclassification. One of the banks has not disclosed the fair value of the reclassified assets as of the year end.
Commerzbank has done reclassifications amounting to a fair value of €78 billion. These are available for sale securities issued by public sector borrowers including European and North American local authorities and publicly guaranteed ABSs. Only five banks have reclassified assets into the available for sale category, mainly debt securities such as different types of ABSs.

The graph represents the net effect of the reclassification on the income statement. This is the combination of the avoided loss assuming no reclassification and the income and expense that was taken to the income statement post reclassification. Most of the banks have significantly improved their results as a result of the reclassifications. For Commerzbank, the reclassification was from available for sale to loans and receivables and consequently there was no effect on the p&l, although the effect would have been recorded in the reserves.

Where the banks have mainly reclassified available for sale securities into loans and receivables the net effect of the reclassification is not significant.
8. Impairment of available for sale assets and goodwill and valuation of deferred tax assets

8.1 Key messages

- Most banks recognised a significant negative income statement impact on available for sale financial instruments in 2008.

- Ten banks carried goodwill in excess of €5 billion in their 2008 balance sheets. Only three banks recognised significant goodwill impairment in the income statement.

- Most banks surveyed recorded deferred tax assets in excess of €1 billion in 2008. Write-offs on deferred tax assets were only disclosed by a few banks, implying sufficient future profits to support the current carrying values.

8.2 Background

The financial crisis affected the fair values of securities. Securities are often been classified as financial assets available for sale under IAS 39. Available for sale instruments are recorded at fair value on balance sheet with changes in the fair value recognised directly in equity until realised or the instruments are considered impaired. If an available for sale financial instrument is determined to be impaired, the cumulative unrealised loss previously recognised in equity is included in profit or loss for the period. Although, depending on future changes in fair value of the instruments, the amount currently recorded in the available for sale reserve can be seen as potential future gains or losses in the income statement.

Goodwill arises on business combinations when the cost of acquisition exceeds the fair value of the assets and liabilities acquired. Goodwill is allocated to cash-generating units for the purpose of impairment testing which is executed by comparing the value from a cash-generating unit with the carrying amount of its net assets, including attributable goodwill. If goodwill is impaired according to IAS 36, this amount should be recorded in profit or loss. Due to the financial crisis, goodwill resulting from acquisitions of other banks might be impaired and thus affect the 2008 results of the banks.

Deferred tax assets and liabilities are recognised for future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, unused tax losses and unused tax credits. Deferred tax assets can only be recognised under IFRS to the extent that it is probable that sufficient taxable profit will be available in the future.
8. Impairment of available for sale assets and goodwill and valuation of deferred tax assets

8.3 Result of analysis

8.3.1 Available for Sale financial assets

In 2008 only BBVA (€0.96 billion, €3.5 billion in 2007), UBS (€0.2 billion, €1 billion in 2007) and Santander (€79 million, €1.4 billion in 2007) have a positive balance in the available for sale reserve, as all other banks except Nordea presented negative balances in the available for sale reserve. The amount of Nordea’s available for sale reserve is zero in 2008. HSBC (€14.5 billion, €0.6 billion in 2007) and ING (€10.1 billion, €4.1 billion in 2007) have the highest negative balances recognised in equity. 10 banks recorded losses in equity in 2008 that recognised gains in equity in 2007.

Figure 22: Available for Sale Reserve

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The following graph illustrates that most banks recognised a negative profit or loss impact on available for sale instruments in 2008. BBVA and Santander are the only banks that recorded gains in available for sale instruments through profit or loss in both 2007 and 2008, while ING recorded significant gains for 2008. Deutsche Bank (€4.5 billion) and Commerzbank (€3.1 billion) had the largest negative impact resulting from available for sale securities on profit or loss in 2008.

Figure 23: Impact of AFS Reserve to the income statement
8. Impairment of available for sale assets and goodwill and valuation of deferred tax assets

8.3.2 Goodwill Impairment

The following graph illustrates the amount of goodwill recorded in the balance sheet and the impairment recorded in profit or loss in 2008. Ten banks carried goodwill exceeding €5 billion on their 2008 balance sheets after all impairments. Unicredit has the highest amount of goodwill (€20.9 billion, €20.3 billion in 2007) with Santander second (€18.8 billion, €13.8 billion in 2007) and RBS third (€16 billion, €44.1 billion in 2007). Commerzbank has the lowest goodwill (€1 billion, €0.9 billion in 2007).

RBS and HSBC are the only banks with a significant goodwill impairment recorded in profit or loss for 2008. The goodwill impairment of RBS amounted to €31 billion in 2008 (2007: no impairment) or 70 percent of total goodwill. For HSBC the goodwill impairment amounted to €7.5 billion caused by a write off of goodwill carried on the balance sheet in respect of the Personal Financial Services business in North America. Seven other banks recorded impairments of less than €1 billion in profit or loss.

The current financial crisis did not seem to have a material impact on the carrying value of goodwill except for a few banks. As goodwill is supported by expected future earnings, this implies that most banks still see future value in their acquired businesses.

Figure 24: Carrying amount of Goodwill and amount of Impairment 2008
10.3.3 Valuation of deferred tax assets

Most banks recorded deferred tax assets higher than €1 billion except Standard Chartered and Nordea. Santander (€14.6 billion, €10.9 billion in 2007) and Unicredit (€10.5 billion, €7.8 billion in 2007) had the highest amount of deferred tax assets. Much of the increase of deferred tax assets might be due to carried forward tax losses.

Only seven banks disclosed information about write-offs in 2008 on deferred tax assets recorded in previous years ranging from €971 million to €176 million. Furthermore most banks did not disclose information about the amount of unrecognised deferred tax assets. IAS 12 doesn’t mandate a time period over which the future cash flows should be determined, and consequently only one bank disclosed the time period over which such future cash flows are determined.

Most banks assumed future (tax) gains as they recorded significant deferred tax assets in 2008 because the carrying value of deferred tax assets must be supported by future taxable profits in accordance with IFRS.

**Figure 25: Deferred Tax Assets**
8. Impairment of available for sale assets and goodwill and valuation of deferred tax assets
9. Disclosure and presentation of the impact of the financial crisis

9.1 Key messages

- The balance sheet item “loans to customers” increased for most banks in 2008 compared to 2007 and 2006. This seems to be the opposite effect of the general effort by banks to shrink balance sheets, but it has to be considered that this includes not only lending but in some cases also some types of securities. Furthermore recent acquisitions might also have increased loans to customers.

- Only seven of the annual reports surveyed include statements concerning the entity’s ability to continue as a going concern. Nine banks do not disclose any information about the going concern assessment.

- The impact of the financial crisis on interest income, fee income and trading income is mixed. Net interest income seems to be relatively unaffected by the crisis as all banks increased their net interest income in 2008 compared to 2007. Net fee income decreased in 2008 compared to 2007 for two thirds of the banks. Net trading income was negatively impacted in 2008, as only two banks slightly increased their trading result in 2008 compared to 2007.

9.2 Background

One of the defining points of the “credit crunch” was demonstrated by a lack of loans and credit in general. Some of this may be discerned in banks reporting lower lending and trying to shrink balance sheets, and may be visible due to reduced reported loans. Under IAS 39 loans and receivables are defined as financial assets with fixed or determinable payments that are not quoted in active markets. In addition to credits originated by the enterprise certain securities can be classified as loans and receivables.

When preparing the financial statements IAS 1 requires management to make an assessment of the entity’s ability to continue as a going concern. Furthermore IAS 1 requires disclosures if the entity has material uncertainties regarding the ability to continue as a going concern. The financial crisis might have an impact on this assumption.

The financial crisis affects the entire business of the banks, in particular the three key sources of income being interest income, fee income and trading income.
9.3 Result of analysis

9.3.1 Loans and advances growth

The balance sheet item “loans to customers” increased for most banks in 2008 compared to 2007, with a similar result for 2007 and 2006. However this assumed decrease of credit due to a “credit crunch” could appear in future balance sheets. The decrease might not yet be visible in this year’s balance sheets as it contains not only credits to customers but also include certain securities, and could be further complicated by significant reclassifications from the trading book (as allowed under IAS 39 further to recent amendments to the standard). Furthermore recent acquisitions of other banks might have increased loans to customers of some banks; RBS and Santander are good examples.

Figure 26: Amount of loans to customers
9.3.2 Disclosures about government support and going concern in light of the financial crisis

Governments and central banks undertake various interventions designed to stabilise the global and domestic financial systems, to stimulate new lending and to support systemically important institutions at risk of failing. Government support is disclosed in several parts of the annual reports depending on the relevant instruments (loans, ordinary or preference shares, financial guarantees). Most banks do not disclose detailed information about the reasons for claiming governmental support.

Only seven of the annual reports include statements concerning the entity’s ability to continue as a going concern. Nine banks do not disclose any going concern assessment. Three banks only disclose that they adopted the going concern assumption without further discussions. Four banks state in detail that they continue to adopt the ‘going concern’ basis for preparing accounts as they are satisfied that the bank have adequate resources to continue in business for the foreseeable future.

9.3.3 Impact of the financial crisis on the results

9.3.3.1 Net interest income

Net interest income did not seem to be significantly affected by the crisis as all banks increased their net interest income in 2008 compared to 2007. An assumption of this analysis is that interest income mainly depends on the amount of loans to customers; this result might be caused by the above mentioned increase of the item loans to customers. It should be noted that offsetting effects such as lower interest rates and a mix of products, as well as the selection of an accounting policy in respect of classification of financial instruments (for example designating some instruments as trading or fair value through p&l) would have an effect on the result. Other effects could also include acquisitions.

Figure 27: Net Interest Income
9. Disclosure and presentation of the impact of the financial crisis

9.3.3.2 Net fee income

Net fee income decreased in 2008 compared to 2007 for 11 banks. Only five banks slightly increased their net fee income.

Figure 28: Net Fee Income
9.3.3.3 Net trading income

Net trading income seems to have been affected more by the financial crisis than net interest income and net fee income. Only two banks increased their trading result in 2008 compared to 2007. Nine banks had a negative trading result in 2008. Deutsche Bank (€33.8 billion) had the largest negative impact on profit or loss in 2008. Due to different allocation of gains and losses the trading result of the banks is not fully comparable.

It should be noted that generally the financial results are affected by many other events and circumstances apart from the financial crisis in isolation, inhibiting further detailed analysis.

Figure 29: Net Trading Income
10. Disclosure of capital

10.1 Key messages

- The banks surveyed generally focused the disclosures on their regulatory capital to comply with the IAS 1 disclosure requirements. Like in 2007, capital disclosures focused on regulatory capital which is always higher than the accounting capital.

- Information presented in respect of capital increased significantly compared to 2007, with an emphasis on capital management policies and on the Core Tier 1 capital ratio, which is disclosed by 75 percent of banks.

- There were significant movements in regulatory and accounting capital between 2007 and 2008 mainly due to impacts of the financial crisis. Six banks increased their solvency ratio by 2 basis point: four banks through significant capital raising and two banks through extensive risk weighted assets decrease.

- Information related to Pillar 2 and Pillar 3 is not presented in the financial statements except for three banks.

- Five banks voluntarily disclosed a leverage ratio, although the definition and calculation methods are different.

10.2 Background

Paragraph 124A-C of IAS 1 “Presentation of Financial Statements” requires entities to disclose information with regards to their capital. The disclosures shall cover objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and compliance with any external capital requirements during the period.

Banks have to comply with various regulatory capital requirements. These requirements have also influenced the form and substance of the capital disclosures, as banks consider the management of their regulatory capital to be of high priority.
In Europe, local regulatory bodies had implemented the Basel I Capital Accord which imposed on banks a minimum requirement of 8% of own funds to risk-weighted assets. The Basel Committee on Banking Supervision published a framework for International Convergence of Capital Measurement and Capital Standards, commonly referred to as Basel II, which replaced the original 1988 Basel I Accord.

From 1 January 2008, banks adopted the Basel II framework. Hence, in their 2008 financial statements, banks disclosed this “new” Basel II solvency ratio.

The financial crisis has already highlighted some deficiencies in the Basel II framework such as the inadequate capital requirements against trading books, inherent high leverage, procyclicality and a lack of capital buffers.

On 30 March 2009, the Basel Committee published initiatives in response to the financial crisis. The objective is to produce a more robust supervisory and regulatory framework. Concerning capital requirements, the Basel Committee underscores the need for a combination of initiatives:

- Improve risk coverage for securitisation activities, trading book exposures and complex financial instruments exposures;
- Strengthen the quality, consistency and transparency of the highest forms of Tier 1 capital through a clear definition (common equity and reserves);
- Introduce a counter-cyclical capital adequacy regime with capital buffers which increase in economic upswings and decrease in recessions;
- Implement a maximum gross leverage ratio as a backstop discipline against excessive growth in absolute balance sheet size.

10.3 Results of analysis

10.3.1 Enhancement of information given on capital

Information related to capital management policies was disclosed by all banks, whereas 13 banks out of 17 gave this information in 2007. Seven banks compared to four banks in 2007 disclosed detailed information including their objectives (e.g. capital ratio target), their strategy and their allocation process for regulatory capital.

Ten banks presented capital management information in the management report, and six banks presented this information split among management report and notes to the financial statements.
10.3.2 Comparison between regulatory capital and accounting capital

Like last year, many banks considered their regulatory capital disclosures to meet the IAS 1 requirements, resulting in less specific information on accounting capital compared to regulatory capital.

Figure 30: Regulatory and accounting capital

The above graph compares 2008 Basel II regulatory capital to 2008 accounting capital.
Capital from an IFRS perspective consists of all amounts within shareholders equity, which includes share capital, share premium, retained earnings and reserves such as the AFS reserve, hedge accounting reserves and other reserves. Anything defined as a liability from an IFRS perspective is excluded from capital.

For all the banks of the sample, the regulatory capital is greater than the accounting capital.

The most significant deductions to the accounting capital relate to goodwill and intangible assets, supervisory deductions, and unconsolidated investments in insurance companies. On the other hand, the regulatory capital was increased through the addition of innovative Tier 1 capital, preference shares and preferred securities or subordinated debt, and also through the revaluation of property and unrealised gains on available for sale equities.

There are significant movements in capital between 2007 and 2008, much of which could be explained by the consequences of the financial crisis (loss absorption, capital raising, mergers).

Seven banks provided reconciliation between accounting and regulatory capital in a tabular format, whereas there were ten in 2007.

10.3.3 Analysis of changes in regulatory capital, risk weighted assets and solvency ratios

The figure above shows the comparison of relative changes between 2007 and 2008 on regulatory capital, risk weighted assets and solvency ratio (without impact of foreign exchange rates variations).
Six banks increased their solvency ratio by 2 basis points; four banks through a significant raising in regulatory capital and two due to an extensive decrease in risk weighted assets.

10.3.4 Adoption of the Basel II solvency ratio

All banks disclosed a Basel II capital adequacy ratio as at 31 December 2008, ranging from 9.5 percent to 15.6 percent for total capital. Tier 1 capital ratios ranged from 6 to 11 percent and Core Tier 1 capital ratios from 4.1 to 7.6 percent.

Seven banks did not present a Basel II ratio for 2007.

Six banks seem to favour Core Tier 1 capital since their solvency ratio on Core Tier 1 capital represents more than 50 percent of their total solvency ratio.

Twelve banks have already anticipated forthcoming capital requirements from the Basel Committee and presented more information than in 2007 on the Core Tier 1 capital ratio. Following the financial crisis, Core Tier 1 capital, composed of common shares and retained earnings, became more important as it is considered as the highest quality of capital.

Four banks gave information on Pillar 2 of Basel II with an explanation of their ICAAP (Internal Capital Adequacy Assessment Process) approach.

Three banks disclosed Pillar 3 information in financial statements, whereas the majority of banks only mentioned that this information is available on their web sites.

**Figure 32: Basel II capital adequacy relative weightings**

The above graph shows the relative weight in total solvency ratio of Core Tier 1, other Tier 1 and Tier 2 solvency ratios.

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10.3.5 Presentation of a leverage ratio

Five banks voluntarily disclosed their leverage ratios although the definitions and details vary from bank to bank.

For Barclays, the adjusted gross leverage ratio is defined as the multiple of adjusted total assets over qualifying Tier 1 capital. In 2008, this ratio was 28 and 33 in 2007.

Deutsche Bank defined the ratio of shareholders’ equity to total assets. It stood at 28 at the end of 2008 year.

Nordéa did not define its leverage ratio, which increased from 22.7 in 2007 to 26.6 in 2008.

For ING, the definition refers to “equity investments into Bank and Insurance from Group minus adjusted Group equity.” It increased from €5 billion to €7 billion or from 9.5 percent to 13.5 percent.

In respect of UBS, the minimum leverage ratio as defined by the Swiss Federal Market Supervisory Authority, FINMA, is the minimum amount of Tier 1 capital required for a given balance sheet size. Some adjustments are made to the IFRS balance sheet. FINMA will require a minimum leverage ratio of 3 percent on the Group level, and as at 31 December 2008 the leverage ratio of UBS stood at 2.46 percent.

For all banks, little information is given in respect of 2009 for changes in capital and the allocation thereof.
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