Consultation Paper

Financial Reporting Council

November 2013

Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

Contents

Page

Preface

This guidance, which addresses supplementary considerations for the banking sector, should be read in conjunction with the *Guidance to Directors on Risk Management, Internal Control and the Going Concern Basis of Accounting* (the 'Integrated Code guidance') issued in [Month] 2014. The Integrated Code Guidance and this supplementary guidance reflect the recommendations of the Sharman Panel of Inquiry into *Going concern and liquidity risks: lessons for companies and auditors*[1] (the 'Panel') and replace the extant 2009 guidance[2]. The Panel was commissioned in the aftermath of the financial crisis to identify lessons for companies and auditors addressing going concern and liquidity risks and recommend any necessary improvements to the existing reporting regime and guidance for companies and auditors in relation to these matters.

The Panel addressed the particular issues relating to solvency and liquidity risks affecting banks. This supplementary guidance provides background information explaining the context of solvency and liquidity risk assessments for banks. It also provides supplementary guidance in relation to the identification and reporting of going concern material uncertainties in the financial statements and in relation to narrative reporting about significant solvency and liquidity risks in the case of a bank.

For banks that are required, and those that choose voluntarily, to report on how they have applied the Code, the Integrated Code Guidance and this supplementary guidance should assist the directors in meeting their Companies Act narrative and financial reporting responsibilities as well as their further solvency and liquidity risk management, internal control and related reporting responsibilities under the Code. They are applicable, adapted as necessary, for other banks.

This supplementary guidance should also assist others, such as shareholders and auditors, to understand the context of the responsibilities of a bank's board in relation to the assessment and reporting about solvency and liquidity risks and the going concern basis of accounting, following implementation of the recommendations of the Panel.

This supplementary guidance is based on the legislation and regulations in force at [Date]. It does not contain an exhaustive list of the obligations that banks and their auditors may have under the Financial Services and Markets Act, the Financial Services Act (2012), the PRA Handbook or other relevant legislation or regulations.

We are very grateful to the Bank of England for providing information about its role and responsibilities in developing this supplementary guidance.

The Integrated Code Guidance and this supplementary guidance are applicable for reporting periods commencing on or after 1 October 2014 but early adoption is encouraged.

---

[1] See http://www.frc.org.uk/Our-Work/Headline-projects/The-Sharman-Inquiry.aspx

[2] *Going Concern and Liquidity Risks: Guidance for Directors of UK Companies 2009*

SECTION 1: Introduction and Background

Introduction

1. The crisis affecting the banking sector that began in 2007 led to questions about whether banks should be treated differently from other companies in terms of the public disclosure regime that should apply to them and their auditors resulting from their going concern material uncertainty assessments. These questions arose from potentially conflicting public interests, given that banks' business models intensify their exposure to solvency and liquidity risks due to the maturity transformation that they undertake – as a result, the sustainability of their funding models is highly dependent on confidence in their solvency and liquidity.

2. There is a strong public interest in limiting systemic damage from bank failure – the financial transactions they facilitate underpin the smooth functioning of economic activity and their lending role supports economic growth. The key issue for banks is that in practice any signalling of uncertainties about their solvency or liquidity may undermine confidence in their ability to repay their debts and trigger a run on the bank.

3. In order to protect the public interest, one critical ingredient of the authorities' toolkit includes providing banks with liquidity insurance facilities to mitigate the temporary effects of system-wide or entity-specific liquidity shocks experienced by solvent and viable banks. However, there would also be a moral hazard in protecting banks at all costs. The Bank of England, amongst others, is responsible for protecting and enhancing the stability of the UK financial system. It works within a balanced framework which recognises not only the importance of stability but also that the possibility of failure engenders market discipline.

4. Where liquidity assistance can be justified, it is provided whilst seeking to avoid rewarding commercial failure. Protection from solvency issues arising from poor commercial performance cannot normally be justified and, when a bank is judged not to be solvent or viable, the regulatory objective is to minimise the impact of that failure on the financial system and the economy.

5. On the other hand, there is also a public interest in maintaining efficient markets for banks' capital, just as there is for other companies' capital, as this supports their investibility. Transparency is critical for achieving market efficiency – the requirements for annual and half year reports (including financial statements) and other obligations under the Listing Rules, the Disclosure and Transparency Rules and the Prospectus Rules of the UKLA seek to achieve that.

6. Where these public interests have been seen potentially to conflict was in relation to the question whether the actual or expected need for central bank liquidity insurance facility usage by a bank should be publicly disclosed in the interests of market transparency. Many believe that premature disclosure of such usage would almost inevitably give rise to a self-fulfilling prophecy and lead to a run on the bank. That prospect would simply force the hand of the authorities to refer the bank into the SRR, even in circumstances where this could have been avoided through deploying the liquidity insurance facilities available to a bank that is judged to be solvent and viable. The question raised is whether the public interest objective of financial stability should ever override the public interest objective of transparency in capital markets?

7. The Panel concluded that this was not necessary and set out the Panel's vision of how these objectives may be reconciled within the current framework for public disclosure about the principal solvency and liquidity risks applicable to all companies and their auditors. The Integrated Code Guidance and this supplementary guidance implement the recommendation of the Panel that the FRC should make clear that use of liquidity insurance provided by central banks may be a normal source of funding for a bank that is judged to be solvent and that, if so, the need to use those facilities does not necessarily mean that the bank is unable to continue as a going concern or that there are material uncertainties that need to be publicly disclosed by the bank and emphasised by its auditor.

8. The fundamental approach to the principal solvency and liquidity risks and related public reporting by banks is consistent with the general approach described in the Integrated Code Guidance. However, the remainder of this supplementary guidance explains how that approach is applied by banks in the context of: their exposure to potentially more intense solvency and liquidity risks; their greater vulnerability to confidence in the sustainability of their funding models; and the need for close co-operation between banks, their supervisors and their auditors in relation to these matters in the context of the significantly enhanced regulatory regime for monitoring and addressing these issues that has emerged in the aftermath of the financial crisis.

More intense liquidity and solvency risks and greater vulnerability

9. The business model of many banks involves performing the financial intermediation role known as maturity transformation – on the whole, channelling collective funds obtained through shorter term borrowing into longer term loans and investments. This creates a maturity mismatch between the dates on which the bank's liabilities fall due for payment and the dates on which it can call for repayment of its assets. This makes banks' funding models inherently unstable.

10. Confidence in a bank's solvency is what sustains this business model. Depositors and other lenders roll over their loans to the bank, or other lenders replace them, when they are confident that the bank will continue to be solvent and viable. On the other hand, fear about the future solvency of the bank may provoke expectations of delayed repayment or non-repayment and may result in withdrawal of loans by existing lenders as well as deterring others from replacing them. Gearing, wholesale market-based funding models, off-balance sheet exposures and other complexities in banks' operating models may further exacerbate these fears.

11. For example, because banks are highly geared, relatively small changes in the value of their risk assets would have a much more significant proportional effect on their net asset value, due to the multiplier effect of the gearing. Small changes in these values can therefore have quite significant impacts on net asset values.

12. Given that a bank has limited liquid resources compared to its liabilities, a run results from knowledge that its liquid assets will be insufficient to fund repayment to all lenders when due if called, exposing those who linger to increased risk of delayed repayment and a greater share of the risk that losses on the remaining assets will exceed capital. A bank's business model would likely not be sustained in these circumstances and it will likely fail. In the banking business, such failure can be infectious and rapidly spread to other banks.

13. The interconnectivity of transactions and obligations between banks underpins the banking system. The failure of one bank can therefore cause shocks in a number of other banks, and this propagation of shocks can have a serious impact across the whole banking network.

Co-operation between banks, supervisors, the Bank of England and auditors

14. In addition to their stewardship responsibilities for solvency and liquidity status of the bank, boards of banks have to meet both their regulatory and market transparency obligations in relation to monitoring, managing and reporting their solvency and liquidity risks. In forming their judgments, boards of banks consider the scale and likelihood of the threats to the bank's survival arising from such risks.

15. The auditors address these matters in meeting their audit responsibilities to consider how they are dealt with in the annual report and financial statements as well as in meeting their duty, and exercising their right, to report to the regulator in fulfilling that responsibility.

16. The Bank of England, including the PRA, has responsibility for interpreting the scale of the threat arising from these risks in the context of their financial stability and prudential supervision objectives.

17. The need for co-operation between banks, supervisors, central banks and auditors in relation to banks' liquidity and solvency risks arises primarily because there is a strong mutuality of interest between these parties in relation to understanding the assessment and management of the solvency and liquidity risks being faced and taken by the banks – and they can each contribute to the others' understanding. Although their duties and responsibilities are in some respects different, they overlap in others and there are legal and regulatory obligations for them to co-operate[3] in fulfilling them.

18. Examples of the ways in which co-operation can provide mutual benefit include the following:
    (a) Supervision is enhanced by obtaining information about the banks' exposure to such risks and the directors' plans for addressing them received through interaction with the directors and key management of the bank as well as the auditors;
    (b) The board and auditors benefit from understanding the regulators' perception of the risks the bank is taking and facing, including those in the wider financial system; and
    (c) The board benefits from challenge to their assessment of, and plans for managing, these risks by supervisors and auditors; auditors may provide boards with one source of assurance about the robustness of their assessment and its outcome, including the quality of their reporting.

19. In fulfilling their duty to promote the success of the company, the directors are responsible for the stewardship of the company's survival. They should focus on those risks, or combinations of risks, that can so seriously damage the sustainability of the company's cash flows, performance or future prospects that they would give rise to severe distress if they materialised. In doing so, their duty is not limited because the regulator sets minimum

[3] See Bank of England PRA Supervisory Statement LSS7/13: Code of Practice for the relationship between the external auditor and the supervisor (April 2013); ISA 250 (UK&I) Section B The Auditor's Right and Duty to Report to Regulators in the Financial Sector – paragraphs A1 to A8; Practice Note 19 The Audit of Banks and Building Societies in the United Kingdom – paragraphs 57 to 97 and Appendix 5

requirements either for their assessment process (eg specifying minimum stress testing) or for minimum risk mitigation (eg specifying minimum regulatory capital).

20. As the Panel noted in its preliminary report: *"The responsibilities of the directors of banks are not simply met by placing reliance on the minimum regulatory benchmarks but by being on top of their going concern assessment all year round by living and breathing it".*[4]

[4] The Sharman Inquiry, Preliminary Report, Paragraph 224.

Banking reforms relevant to solvency and liquidity

21. Following the financial crisis, wide ranging reforms have been, and are still being, introduced, that are designed to build the resilience of banks. These are all likely to be relevant to the assessment of the principal solvency and liquidity risks for banks. They include the following developments.

Governance requirements

22. <u>*Separate risk committees*</u> – the Walker report recommended that FTSE 100 financial services companies should have a separate Risk Committee.

23. In many non-financial companies risk governance will form part of the overall responsibilities of the audit committee or may be undertaken directly by the Board. In the banking sector, separate risk committees review, and report their conclusions to the board, on:
    (a) The bank's risk appetite and tolerance (ie the extent and categories of risk which the board regards as desirable and/or acceptable for the company to bear); and
    (b) The bank's risk management framework (for example, covering principles, policies, systems, processes, procedures and people).

24. The board will therefore need to review the work of the Committee in relation to the principal solvency and liquidity risks and provide challenge in assessing the quality of the assurance the board has obtained in adopting and responding to the Committee's conclusions and how these are integrated with other inputs to the going concern assessment.

25. <u>*Recommendations of the Independent Commission on Banking*</u> – *the UK Government has* published the Financial Services (Banking Reform) Bill, to implement the recommendations of the ICB, with the legislation intended to come into force in early 2014. The aim is to develop a more resilient, stable and competitive banking sector.

26. Key elements of these proposals include introducing a ring-fence to separate investment banking activities from the more traditional retail banking. The latter ring-fenced business would have its own board and risk committee. Other proposals focus on how to ensure that the ring-fenced bank has sufficient capacity in its capital structure to absorb losses to make banks more resilient to shocks and more resolvable and hence to reduce financial stability risks. These include increasing the level of equity held in relation to the value of risk-weighted assets and introducing a bail-in tool, a binding leverage ratio and measures, such as preferring insured depositors, to ensure that losses fall on those best placed to assess bank risks.

27. As these proposals develop they are likely to have significant implications for the assessment of the principal solvency and liquidity risks and reporting both for bank holding groups with such ring-fenced banks and for the ring-fenced banks themselves.

Minimum regulatory requirements for banks

28. <u>*More intense stress testing regimes*</u> – there are three elements to the stress testing regime: firms' own firm-wide stress tests of capital and liquidity and reverse stress tests (including assessing the adequacy of capital buffers to enable the bank to meet the minimum capital requirements at all times); supervisory stress tests of particular entities, which are firm-wide; and simultaneous supervisor led system-wide tests, the results of which are not generally

published. In addition to the PRA's stress tests, the EBA co-ordinates EU-wide stress tests as a supervisory tool designed to assess the resilience of European banks, as necessary – these are applied to banks covering a significant proportion of EU-wide banking assets and aggregated.

29. Reverse stress-tests require a bank to assess scenarios and circumstances that would render its business model unviable. A firm's business model is described as being unviable at the point when crystallising risks cause the market to lose confidence in the firm.

30. The results of each of these ranges of tests are relevant to a bank's assessment of its resilience to stress. A bank should not take unreasonable comfort from the results of stress testing against supervisory determined stress scenarios. The ultimate responsibility for setting appropriate scenarios to stress test rests with the bank.

31. *Individual bank Recovery and Resolution Plans* – requirements for banks to prepare Recovery and Resolution Plans are being developed by the PRA. These should assist banks to anticipate and build action plans for recovery from shocks as well as assisting the authorities in monitoring the triggers for implementing such plans and in executing the resolution of the bank in the event of failure. The draft core rules have been published[5] based on the experience gained from pilots.

32. The aim in finalising them is to seek to ensure that the final plans are internationally coordinated and aligned with other regulatory initiatives, including: the Key Attributes of Effective Resolution Regimes published by the FSB; the European Commission initiative on bail-in and a directive to establish a framework for recovery and resolution; and the ICB's proposals and the government response to them.

33. *PRA's liquidity regime* – the reformed rules are designed to enhance firms' liquidity risk management practices, based on lessons learned since the crisis began in 2007. They include quantitative requirements, with a narrow definition of liquid assets. There are also qualitative requirements which include: over-arching principles of self-sufficiency and adequacy of liquid resources; enhanced systems and controls requirements; granular and frequent regulatory reporting requirements; and a regime for foreign branches that operate in the UK.

Framework for regulatory response

34. *Proposed Proactive Intervention Framework* – the Proactive Intervention Framework[6] is part of the PRA's proposed monitoring and mitigating of risks to the safety and soundness of individual firms and sets out how and when the PRA will escalate its engagement as risks to a firm's viability increase. This is part of the PRA's move to forward-looking, proactive, judgment-based supervision under the regulatory reform programme. The overarching objective will be to seek to ensure the safety and soundness of firms and to avoid disorderly failure which has systemic consequences.

[5] See: http://www.fsa.gov.uk/pubs/discussion/fs12-01-draft-rules.pdf
[6] See joint paper issued by the Bank of England and the FSA: The Bank of England, Prudential Regulation Authority – Our approach to banking supervision – May 2011: http://www.bankofengland.co.uk/publications/other/financialstability/uk_reg_framework/pra_approach.pdf

35. *Major overhaul of the Bank of England's liquidity insurance facilities* – the primary responsibility for the prudent management of a bank's liquidity risk lies with the bank's directors and the costs of poor management in this regard primarily lie with its shareholders. Banks hold liquid assets such as high quality assets that can be exchanged rapidly for money in liquid markets as self-insurance against liquidity shocks.

36. However, the Bank of England also provides a range of liquidity insurance facilities for banks. The Bank of England's principal liquidity insurance facilities are part of the Bank's Sterling Monetary Framework, which is described in the "Red Book"[7]. Access to the Bank's liquidity insurance facilities is designed not to undermine banks' responsibility prudently to manage their business.

37. Access is also designed not to undermine the incentives for banks to manage their liquidity risk prudently in the market. Hence, an overarching condition of access is that the bank must be judged to be solvent by the Bank of England, meeting the PRA Threshold Conditions for authorisation, when it lends under the facility. When the Bank lends in its operations, it does so against collateral of sufficient quality and quantity to protect itself from counterparty credit risk. Furthermore, pricing of these facilities is designed to incentivise prudent liquidity management.

38. The Bank of England offers several facilities to provide liquidity insurance to the banking system as a whole. The Indexed Long-term Repo (ILTR) facility allows banks to bid for liquidity in the form of central bank reserves. The Extended Collateral Term Repo (ECTR) – to be renamed as the Contingent Term Repo Facility in 2014 – is a contingent facility which allows the Bank to provide liquidity against the widest collateral at any time, term and price it chooses. Both the ILTR and ECTR will operate through pre-announced market-wide auctions in which central bank reserves are allocated to banks according to the bids they offer against the full range of eligible collateral, including portfolios of "raw" (unsecuritised) loans.

39. The Bank also provides liquidity insurance against entity-specific liquidity shocks. The Discount Window Facility is available on-demand on a bilateral basis, rather than only when a market-wide operation is scheduled. DWF drawings have a maturity of 30 days, repayable at any point. For longer temporary liquidity needs, banks can apply to roll DWF drawings in order to achieve an effectively longer term of drawing. The DWF is structured as a swap of less liquid assets for high liquidity gilts which banks can then exchange for money in the markets. The range of collateral accepted is the same as for the Extended Collateral Term Repo facility.

40. These are the principal, permanent liquidity insurance facilities offered by the Bank of England. They are in the Bank of England's published frameworks and are designed to be offered on (collateralised) terms only to banks that are considered by the Bank of England to be solvent, meeting the PRA Threshold Conditions for authorisation.

41. Beyond this, there are some more exceptional ways in which a bank in difficulty may receive assistance from the Bank of England or HM Treasury. Decisions involving public funds are the sole responsibility of the Chancellor and HM Treasury. The Financial Services Act

[7] The most recent version of the Red Book can be found at: http://www.bankofengland.co.uk/markets/pages/sterlingoperations/redbook.aspx

clarifies the way in which such support is provided and who is in charge of what, and when, in the course of future financial crisis management[8]. In addition to the published facilities described above, the following may be provided:

(a) Emergency Liquidity Assistance (ELA, defined as support operations outside the Bank's published frameworks) to firms that have a sufficient probability of future insolvency, but which have some prospect of action to make them solvent, either at the Bank of England's proposal and subject to Treasury authorisation or on terms other than proposed by the Bank of England, if so directed by the Chancellor;

(b) ELA in a support operation going beyond the Bank's published frameworks to firms that are ***not judged*** by the Bank of England to be solvent and viable, if so directed by the Chancellor; and

(c) Special support operations for the financial system as a whole, going beyond the Bank's published frameworks, when so directed by the Chancellor.

42. Similar to the Discount Window Facility, the Bank of England would only make an advance without direction or guarantee when in its view there is a credible path to a point where access is no longer required. If the Chancellor directs the Bank of England to carry out a support operation, the Bank of England acts as agent of HM Treasury, setting up a special purpose vehicle to carry out the support operation. Such a vehicle would be indemnified by HM Treasury.

43. *Special Resolution Regime* – a bank's entry into the SRR is triggered when the PRA judges that the bank is failing or is likely to fail to meet the threshold conditions of authorisation and that it is not reasonably likely that alternative action will be taken by the bank that would enable it to satisfy those conditions[9]. The threshold conditions, which must be met by a bank both upon authorisation and on an on-going basis, include amongst others that it has sufficient liquidity and capital resources.

44. In effect, these conditions mean that reliance on Government support or on other than ordinary market assistance by the Bank of England, without which the bank would, or would be likely to, fail to meet the PRA's threshold criteria – would normally result in resolution powers being used or some other action of the sort being described in paragraph 41 being taken. Once a resolution power has been used, the Bank of England is required to make a public disclosure as soon as is reasonably practicable.

---

[8] See: *A new approach to financial regulation: securing stability, protecting consumers*, presented to Parliament by the Chancellor of the Exchequer by Command of Her Majesty, January 2012 at: http://www.hm-treasury.gov.uk/d/fin_fs_bill_policy_document_jan2012.pdf (see especially Appendix E – MOU on crisis management)

[9] The conditions under which such referral should occur is set out in the Banking Act 2009, Section 7, sub-sections (2) to (4):

(2) Condition 1 is that the bank is failing, or is likely to fail, to satisfy the threshold conditions (within the meaning of section 41(1) of the Financial Services and Markets Act 2000 (permission to carry on regulated activities)).

(3) Condition 2 is that, having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the bank that will enable the bank to satisfy the threshold conditions.

(4) The FSA shall treat Conditions 1 and 2 as met if satisfied that they would be met but for financial assistance provided by—

(a) the Treasury, or

(b) the Bank of England (disregarding ordinary market assistance offered by the Bank on its usual terms).

45. The concept of 'ordinary market assistance' is judgmental. As explained in the *Special Resolution Regime: Code of Practice*[10], the Bank of England provides banks with a spectrum of assistance in all types of different circumstances. Whether or not financial assistance from the Bank of England constitutes "ordinary market assistance... on its usual terms" will depend on a combination of factors, including the terms of the Bank's operation, the circumstances of the bank receiving liquidity from the Bank, and conditions in the relevant markets in which the firm was, or would otherwise be, seeking to access funding. Furthermore, these factors may vary during the period that any assistance is given.

46. Regulatory tools to address the problems once the SRR has been triggered fall into two categories, stabilisation tools and a new special insolvency regime for winding up banks (the *Bank Insolvency Procedure*).

Risk reporting

47. *BBA Code for Financial Reporting Disclosure* – the Turner Review[11] highlighted questions that the financial crisis had raised about the adequacy of financial disclosure by banks (particularly for complex financial instruments held by them) and the level of confidence that investors could place in their financial reports. In response, the BBA developed a voluntary code of disclosure, based on principles and supplementary guidance, and in October 2009 announced that the major UK-headquartered banks had agreed to adopt it. Following consultation by the FSA, and amendments made to the BBA Code in light of experience of applying it in 2009, it was finalised in 2010.

48. The BBA Code goes beyond the disclosure requirements of the accounting standards and capital markets disclosure requirements. It is based on an overarching principle that UK banks are "committed to providing high quality, meaningful and decision-useful disclosures to users to help them understand the financial position, performance and changes in the financial position of their businesses". It recognises that that there is a level of public interest in their disclosure that extends to other stakeholders in addition to investors.

49. *Financial Stability Board Enhanced Disclosure Task Force Report* – in October 2012, the FSB's Enhanced Disclosure Task Force published its report setting out principles and recommendations for improved bank risk disclosures and leading disclosure practices designed to provide timely information useful to investors and other users and in time to improve market confidence in financial institutions.

[10] See http://www.hm-treasury.gov.uk/d/bankingact2009_code_of_practice.pdf
[11] See: http://www.fsa.gov.uk/pubs/other/turner_review.pdf

SECTION 2: Supplementary Guidance

Addressing the implications of central bank and government assistance

Introduction

50. The interpretation of what constitutes a going concern material uncertainty under the accounting standards is a matter of judgment. In the Integrated Code Guidance and this supplementary guidance, consistent with the recommendation of the Panel, the interpretation adopted is that reliance on central bank and government liquidity assistance does not necessarily mean that the bank should not adopt the going concern basis of accounting or that a material uncertainty should be disclosed.

51. The following paragraphs address the circumstances in which reliance upon central bank or government assistance for a bank would or would not signal a material uncertainty, the necessary considerations in arriving at a conclusion on this matter and the reporting and other implications of such a conclusion.

Reliance on liquidity insurance

52. Appendix C of the Integrated Code Guidance sets out the interpretation of the purpose of material uncertainty disclosure in the Integrated Code Guidance and in this supplementary guidance.

53. This supplementary guidance further adopts the interpretation that central bank liquidity insurance is a normal funding source for a bank and should not be regarded as being outside the normal course of business[12] or as being provided on other than normal terms for a bank. If access to those facilities is judged necessary to maintain the viability of the bank, then as long as there is a high level of confidence that those facilities will be accessible by the bank to a sufficient extent and over a sufficient time period to enable them to withstand the anticipated liquidity shock, the board should be able to conclude that the bank will remain viable for the foreseeable future.

54. Given that the overarching conditions of access to these facilities include that the bank must be judged to be solvent by the Bank of England, when it lends under the facility, that the bank must provide sufficient collateral and that there must be a credible path to a point where access is no longer required, these are critical matters which will need to be considered in order to conclude that the bank will remain solvent and viable for the foreseeable future. There may be other conditions that have to be met too.

Assessing whether there is a going concern material uncertainty

55. As explained above, the Bank of England aims to provide adequate liquidity insurance facilities through published support operations for the market as a whole that are responsive to system-wide shocks. The Bank of England may also provide support operations outside

[12] For a discussion of what is within or outside the normal course of business, see the Integrated Code Guidance: Appendix C.

the published frameworks (ELA). Where a bank envisages a need to avail itself of such liquidity insurance facilities, the board should have a high level of confidence that, if needed:

(a) those facilities will be accessible by the bank to a sufficient extent and over a sufficient time period to enable them to conclude that the entity will remain viable for the foreseeable future; and

(b) there is a credible path to repayment without resorting to action outside the normal course of business to realise its assets or discharge its liabilities.

56. If they are able to draw those conclusions, they should be able to conclude that there is no going concern material uncertainty that is required to be disclosed by the bank. As for other companies, what constitutes action outside the normal course of business to realise a bank's assets or discharge its liabilities is a matter of judgment and should be considered in the context of the bank's financial flexibility and contingency planning, including its recovery plan.

57. These judgments are for the board alone insofar as they relate to the board's reporting responsibilities. However, there should be close dialogue with the Bank of England, the PRA and the auditor in these circumstances. The Code of Practice for auditors and supervisors signals the importance of those channels of communication between auditors and supervisors being familiar and effective in both normal and troubled times.

58. The approach to the issue being addressed by the bank should take appropriate account of the likely escalation of supervisory intervention under the Proactive Intervention Framework in response to the issue, that ultimately would result in the referral of the entity into the SRR if it is considered that the bank is failing (or is likely to fail) to satisfy its 'threshold conditions' and it is not reasonably likely that alternative action will be taken that would enable it to meet those conditions. The board should seek to understand the status of escalation, the factors giving rise to this and the actions being taken to address them. Whilst these matters may not be definitive in determining whether there is a material uncertainty, they should be taken into consideration.

59. Where access to the Bank of England's liquidity facilities and/or to ELA is envisaged, the directors and auditors should seek to understand how the Bank of England would assess the solvency of the bank and the credibility of the bank's plans to reach a point where access is no longer required. Without a sufficient understanding of this, the board may be unable to obtain a high level of confidence that, if needed, the facilities would be available to the bank.

60. If the board is unable to conclude that there is no going concern material uncertainty that is required to be disclosed (or if the auditors are unable to concur), the directors should seek to understand whether the regulator believes that the entity should be referred into the SRR and, if not, why not.

61. If the directors remain unable to conclude that there is not a going concern material uncertainty (or if the auditors are unable to concur), the directors may conclude that going concern material uncertainty disclosures are required and/or the auditors may conclude that an emphasis of matter or qualified opinion is required.

62. However, in these circumstances, either of these disclosures may be expected to result in a run on the bank. As a result, the mere expectation of such disclosure may lead to the conclusion that the proposed disclosure would be sufficient grounds to trigger the bank's

entry into the SRR and the circumstances should be discussed with the Bank of England and the prudential regulator. The directors and auditors should also consider whether there are any other reasons why public disclosure of the bank's actual or potential need to avail itself of liquidity insurance facilities should be made and, if so, the implications in this context.

Reporting and other consequences when a going concern material uncertainty exists

63. The directors and auditors are responsible for making their own judgments about the future solvency and viability of the bank and cannot simply defer to the judgment of the Bank of England or Ministers. The consequence is that it is possible that the directors or auditors may be unable to obtain the requisite level of assurance to conclude that there is not a going concern material uncertainty even though the Bank of England or the prudential regulator may be able to conclude that the bank meets or would meet the conditions for access to the facilities.

64. Whilst this situation will remain a possibility, it is highly desirable that close dialogue between the various players should explore whether there are other sources of assurance that would enable a consensus judgment to be reached because that may avoid the need for the bank's entry into the SRR, when this would not be necessary if the board and auditors were able to obtain the requisite level of assurance.

65. Where a bank is, or envisages that it may be, reliant on Government or Bank of England support but the Bank of England is, or would be, unable to conclude that the entity is solvent, it seems likely that entry into the SRR will be triggered, either on the facts or because the directors or auditors of the bank conclude that disclosure is necessary and the expectation of that disclosure is the trigger. In practice, subject to early public disclosure of the use of resolution powers or of other actions being taken of the sort described in paragraph 41, disclosure of a going concern material uncertainty by the directors or auditors may then become unnecessary or may be made in circumstances where the regulatory tools deployed to address the cause of entry into the SRR will protect the bank from the normal consequences of such disclosure.

Reporting

66. The general reporting responsibilities for a company described in the Integrated Code Guidance apply equally in the case of a bank.

67. Both the report of the Enhanced Disclosure Task Force and the BBA Code are useful reference sources to assist the board in assessing the effectiveness of its disclosures relevant to going concern – both those in the financial statements and in narrative and other financial reports. Each of these emphasises the importance of explaining the business model to provide context for the business and risk disclosures. Both contain a number of general principles for good disclosure and these have a degree of overlap.

68. The BBA Code sets out a number of key principles for disclosure and a protocol for the industry to work together in ensuring that disclosures are implemented in a manner which facilitates cross industry comparison.

69. The report of the Enhanced Disclosure Task Force specifically deals with enhancing risk disclosures by banks. It includes seven fundamental principles for enhanced disclosure,

which also includes a cross-industry comparison principle. In addition, it provides an extensive analysis of current risk disclosure practices and makes thirty two recommendations for enhanced disclosures. Four of these are of a general nature and the remainder are categorised across seven broad risk areas, which the report considers to be the major categories of risk for banks:

(a) Risk governance (and risk culture) and risk management strategies and the business model;
(b) Capital adequacy and risk-weighted assets;
(c) Liquidity;
(d) Funding;
(e) Market risk;
(f) Credit risk; and
(g) Other risks (including non-financial risks such as operational risk, reputational risk, fraud risk, legal risk and regulatory risk).

70. The general recommendations address the need to provide risk information in one place (or a navigation aid), to define terminology and measures, to describe and discuss top and emerging risks and to outline plans to meet new key regulatory ratios as their definitions are finalised.

71. In relation to top and emerging risks, the discussion suggests both that their nature is such that they are candidates for consideration as ‘principal risks’ (in terms of the business review disclosures) and that it may also be pertinent to consider whether they are risks that would threaten solvency and liquidity if they materialised:

> *“A top risk may be defined as ‘a current, emerged risk which has, across a risk category, business area or geographical area, the potential to have a material impact on the financial results, reputation or sustainability or the business and which may crystallise within a short, perhaps one year, time horizon’. An emerging risk may be defined as ‘one which has large uncertain outcomes which may become certain in the longer term (perhaps beyond one year) and which could have a material effect on the business strategy if it were to occur’.”*

72. Each of the identified broad risk areas clearly has the potential to give rise to ‘top and emerging’ risks and there is much detail in the report that helps understand current disclosure practice and enhanced disclosures that may assist in meeting user needs in these areas.

73. The EDTF report provides guidance on levels of disclosure that could be made about matters relevant to the assessment of the viability of the bank, such as: the risk management organisation processes and functions (recommendation 5); the risk culture (recommendation 6); key risks in the business model and the tolerance of risk and its management in the context of the business model (recommendation 7); stress testing (recommendation 8); regulatory capital management (and the role of risk weighted assets in that process) (recommendations 12 and 17); liquidity management (recommendation 18); Funding strategy (recommendation 21); and the management and governance of other risks (recommendation 31).

74. It also provides guidance on quantitative and qualitative disclosures that could be made about particular risks that may be relevant to the assessment of the viability of the bank such

as regulatory capital (recommendations 9 to 11), risk weighted assets (recommendations 13 to 16); funding risks and encumbrance analysis (recommendations 19 and 20); market risks (recommendations 22 to 25); credit risks (recommendations 26 to 30); and other risks (recommendation 32).

75. This general review of good and enhanced practice for risk disclosure should provide a strong base and an appropriate context within which to build the focus on the principal solvency and liquidity risks that will:
    (a) Enable the board's disclosures about the bank's solvency and liquidity to be set in the context of its explanation of the business model, strategy and principal risks, with links to key quantitative and qualitative disclosures about those risks;
    (b) Enable the annual report to set out the board's conclusions about the robustness of the bank's process to assess the principal risks that would threaten the solvency or liquidity of the bank if they materialised and its outcome including the related disclosures, in the context of the general disclosures about the bank's risk management and risk governance;
    (c) Enable the annual report to illustrate the effectiveness of the assessment process by explaining how the principal risks are being managed or mitigated, and indicating which, if any, are material uncertainties in relation to the bank's ability to adopt the going concern basis of accounting.

76. Boards should also consider how best to integrate the principal solvency and liquidity risk disclosures with other risk disclosures.

Glossary of Abbreviated Terms

BBA	British Bankers' Association
BIS	Department of Business, Innovation and Skills
Code	UK Corporate Governance Code, published by the FRC in [September 2012]
EBA	European Banking Authority
EDTF	Enhanced Disclosure Task Force, established by the Financial Stability Board
ELA	Emergency Liquidity Assistance
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FRS	Financial Reporting Standard
FRSSE	Financial Reporting Standard for Smaller Entities
FSA	Financial Services Authority
FSB	Financial Stability Board
Integrated Code Guidance	Guidance to Directors on Risk Management, Internal Control and the Going Concern Basis of Accounting, published [Month] 2014
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICB	Independent Commission on Banking
IFRS	International Financial Reporting Standards
ISA	International Standard on Auditing
Panel	Sharman Panel of Inquiry into Going Concern and Liquidity Risks
PRA	Prudential Regulatory Authority
SRR	Special Resolution Regime for banks introduced under the Banking Act 2009
UK GAAP	UK Generally Accepted Accounting Practice
UKLA	UK Listing Authority – The FCA acting as the competent authority under Part VI of the Financial Services and Markets Act 2000

Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

+44 (0)20 7492 2300

www.frc.org.uk