



European Securities and
Markets Authority

Review of Accounting Practices

Comparability of IFRS Financial Statements
of Financial Institutions in Europe

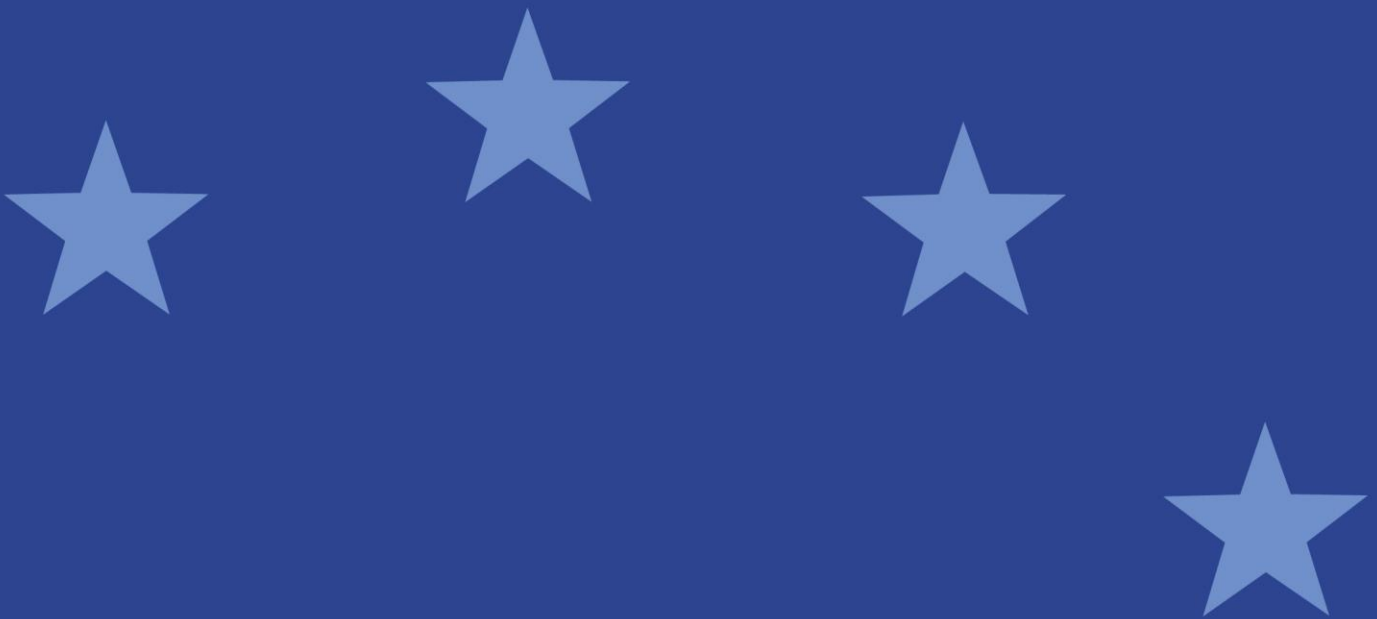


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List of acronyms used

AFS	Available-For-Sale
CDS	Credit Default Swap
CVA	Credit Valuation Adjustment
DVA	Debit Valuation Adjustment
EBA	European Banking Authority
ECB	European Central Bank
EDTF	Enhanced Disclosure Task Force
EECS	European Enforcers Coordination Sessions
ESRB	European Systemic Risk Board
EU	European Union
FSB	Financial Stability Board
FVTPL	Fair Value Through Profit or Loss
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IBNR	Incurred But Not Reported
IFRS	International Financial Reporting Standard(s)
IFRS IC	International Financial Reporting Standards Interpretations Committee
IRB	Internal Rating-Based Approach
NPLs	Non-Performing Loans
OCI	Other Comprehensive Income
OTC	Over-The-Counter
PSI	Private Sector Involvement

Executive Summary

This report provides an overview of accounting practices of financial institutions in Europe in selected areas related to financial instruments. It evaluates the level of comparability and quality of the disclosures in the 2012 IFRS financial statements of a sample of 39 major European financial institutions and includes recommendations to enhance the transparency of financial information through the application of the IFRS provisions.

Transparent financial information plays a key role in maintaining market confidence, improving markets' efficiency by allowing investors to identify risks in a timely manner, contributing to financial stability and is a pre-requisite in creating premises for sound economic growth. As an effect of market turbulences resulting from the financial crisis, transparency and comparability of the financial statements of financial institutions have gained increased importance for market participants. In this context, ESMA has intensified its reviewing activities, with an increased focus on the financial statements of financial institutions and together with EBA and ESRB has undertaken further initiatives to improve the level of confidence in the financial sector by asking financial institutions to provide better disclosure of financial and risk information in financial reporting.

Overall ESMA found that disclosures specifically covered by requirements of IFRS 7 – *Financial Instruments: Disclosures* were generally provided and acknowledges the efforts made by financial institutions to improve the quality of their financial statements. Yet, ESMA observed a wide variability in the quality of the information provided and identified some cases where the information provided was not sufficient or not sufficiently structured to allow comparability among financial institutions. Some financial institutions provided disclosures that were not specific enough, lacked links between quantitative and narrative information, or provided disclosures that could not be reconciled to the primary financial statements. ESMA urges issuers to take a step back and consider the overall objectives of IFRS 7 against their specific circumstances when preparing disclosures.

When information was provided outside financial statements (e.g. in a risk report or business review), in some cases it was unclear whether it was incorporated by reference. In general, users of financial information would benefit if information provided in different sections of the financial report were linked to each other and if information provided across these reports was consistent or major differences in bases used to provide this information were explained.

As a result of this review, ESMA believes quality and comparability of IFRS financial statements could be enhanced in relation to some aspects as provided below.

Structure and content of the income statement

As a result of this review, ESMA noted deviating structures of the income statement and different content of the line items, divergent disclosures in the notes in terms of content and detail and the lack of concise yet comprehensive accounting policy disclosures. In particular, ESMA found significant diversity in components included in interest income and interest expense and presentation of net gains or net losses by category defined by IAS 39 – *Financial Instruments: Recognition and Measurement*.

ESMA urges financial institutions to enhance the transparency in this area by providing sufficiently granular disclosures identifying all significant components included in individual line items accompanied by concise yet comprehensive accounting policy disclosures and by making the link between the line items in the income statement and the statement of financial position more transparent. Comparability of net gains or net losses on financial instruments could be achieved when presented in a single note containing a break-down of total net gains or net losses by IAS 39 category and income statement line item. ESMA reminds issuers to present significant elements of income and expense in individual line items consistently over time and to explain the impact of any changes related to presentation of these elements in comparison with the previous reporting period.

Furthermore, ESMA believes that additional guidance in IFRS on individual income statement line items, especially interest income and expense, could help to enhance comparability.

Liquidity and funding

Although all financial institutions provided disclosures about liquidity risk and its management, their quality varied considerably. ESMA encourages financial institutions to provide comprehensive joined-up and entity specific disclosures that convey a clear and interlinked view of maturity analysis of financial instruments, liquidity position, funding sources and the way in which the entity manages its liquidity risk. Where relevant, ESMA expects disclosure of concentration of liquidity and funding sources by significant currencies and identification of major restrictions on funding sources.

ESMA recommends that financial institutions, where relevant, further develop their disclosure on contingent funding needs and provide an assessment of their potential impacts as, depending on market conditions, these can generate significant and immediate liquidity needs for some financial institutions.

Asset encumbrance

Only a limited number of financial institutions provided comprehensive quantitative information related to encumbered and unencumbered assets, detailed by asset type. For those financial institutions that did not provide such information, the distinction between unpledged and unencumbered assets was not always obvious and it was not always clear which assets of the financial institution could be freely used to meet future liquidity needs.

ESMA welcomes the work of EBA in developing a common definition of asset encumbrance for supervisory reporting and its mandate to develop disclosure guidelines on this issue. ESMA urges financial institutions to provide in their financial statements sufficient and sufficiently granular information to identify those assets that are readily available for liquidity purposes or to meet funding needs, and to complement such information with clear definitions of the terms used.

Hedging and the use of derivatives

Although most financial institutions disclosed that they entered into derivative transactions for different purposes - to benefit from short term market fluctuation, to service clients' needs and to hedge risks - very few distinguished risk management practices for the different purposes.

ESMA believes that the quality of disclosure should be improved by providing qualitative information on the use of derivatives for different purposes and clearly linking them with their classification in the financial statements (i.e. as derivatives held for trading or as hedging instruments). ESMA expects financial institutions that use derivatives extensively to hedge their risks to provide sufficient information to enable users to understand the impact of hedging activities on the financial position and performance. Moreover, ESMA expects that financial institutions explain in their financial statements whether and to which extent they apply the EU carve-out.

ESMA is of the view that the new proposed disclosure requirements related to hedge accounting envisaged by the IASB in developing IFRS 9 – *Financial Instruments* would better explain the accounting treatment of derivatives and its link to the overall risk management strategy.

ESMA expects that financial institutions will enhance their disclosures on measurement methodologies and inputs to measurement of fair value of derivatives, including the effects of counterparty and non-performance risks (CVA and DVA adjustments) in light of the requirements of IFRS 13 – *Fair Value Measurement* mandatory for 2013 IFRS financial statements.

Credit risk

All financial institutions provided information about the credit quality of their financial assets. However, the lack of structured disclosure can cause the information to obscure comparability. Furthermore, ESMA sees the need for particular improvement in several areas of credit risk disclosure.



ESMA believes enhanced disclosure should be provided on exposure to credit risk, its mitigation (e.g. by collateral, guarantees or credit default swaps), analysis of specific concentrations of credit risk and disclosure of impairment policies in order to enable investors to assess the overall credit risk.

The disclosure requirements in IFRS 7 distinguish between credit quality of financial assets that are neither past due nor impaired, past due but not impaired and those individually determined to be impaired. Clear and transparent disclosures for each of these categories are necessary to comply with the standard. Furthermore, ESMA also expects issuers to provide an unambiguous description of the accounting policy applied to collective assessment for financial assets that were assessed individually for impairment but for which no objective evidence of impairment was identified through individual assessment. These disclosures are necessary to enable investors to assess the effects of credit risk on the entity's financial position and its performance.

Although the level of disclosures related to credit derivatives improved in comparison with previous periods, in some cases, it was still unclear whether credit derivatives increased or decreased credit exposure, or whether credit derivatives were used for trading purposes or for credit risk management. ESMA believes that transparency related to use of credit derivatives in managing credit risk could still be improved.

ESMA urges financial institutions to adapt their disclosures related to concentration of credit risk so as to enable users to identify main changes of the credit risk profile over time. To provide transparent information and to facilitate comparability, regard must be given to what are generally considered to be enhanced areas of risk, such as credit risks related to certain geographical areas (e.g. countries) or asset types (e.g. real estate exposures).

With regards to country concentration risk, most financial institutions reflected continuing concerns about sovereign exposures in their disclosures. Some financial institutions also reflected growing concerns about the quality of non-sovereign exposures in certain countries that they considered at risk by providing enhanced disclosures, but the information about impairment levels was limited.

Forbearance

Although ESMA has noted progress in respect of disclosures relating to forbearance practices compared to 2011 IFRS financial statements, with more financial institutions providing information on forborne financial assets, ESMA expects financial institutions to provide in their 2013 financial statements more granular quantitative information on the effects of forbearance that would enable investors to assess the level of credit risk related to forborne assets and their impact on the financial position and performance as recommended by the ESMA Statement published in December 2012.

Impairment of equity securities classified as available-for-sale

A number of financial institutions did not disclose any accounting policy regarding the impairment assessment for a potentially material portfolio of equity instruments classified as AFS. Others disclosed how they applied the 'significant or prolonged criteria' in an ambiguous manner that suggests the use of a combination of significant *and* prolonged criteria. ESMA reminds financial institutions that such an accounting policy is not compliant with IFRS requirements and urges financial institutions to disclose the specific criteria used in applying judgement to determine when a decline in the fair value of an AFS equity instrument is significant *or* prolonged as indicated in the July 2009 IFRIC Update.

More than half of the financial institutions quantitatively disclosed what they consider significant or prolonged. However, ESMA found ranges from 6 to 36 months in relation to the period and from 20% up to 50% in relation to the decline in fair value were used. In light of the wide range of application of these criteria, ESMA expects financial institutions to exercise careful judgement and assess realistically the criteria for significant or prolonged decline in fair value. To provide more transparency on the risk of impairment, financial institutions should consider separate disclosure of the amount of positive and negative AFS reserve related to equity instruments.



Next steps

ESMA expects financial institutions and their auditors to consider the findings of this review when preparing and auditing the IFRS financial statements. Through the recommendations provided in this report, ESMA seeks to improve compliance with IFRS, enhance comparability of financial statements across Europe and overall to contribute to improving the quality of financial reporting and to financial stability.

When this report points to a breach of IFRS requirements and where this breach is considered material, ESMA expects that national competent authorities will take or have already taken appropriate enforcement actions. ESMA will monitor the progress of those actions.

As indicated in the European common enforcement priorities¹, ESMA together with national competent authorities will focus on monitoring the level of impairment of financial assets and improving the level of transparency in the area of forbearance, liquidity risk, asset encumbrance and fair value measurement.

In areas where ESMA believes additional guidance in IFRS is needed to improve the quality and transparency, ESMA will provide suggestions resulting from this review to the IASB.

¹ Public Statement: 2013 European Common Enforcement Priorities, European Securities and Markets Authority, 11 November 2013 (ESMA/2013/1634)

I. Introduction

1. Transparent financial information plays a key role in maintaining market confidence, improving markets' efficiency by allowing investors to identify risks in a timely manner, contributing to financial stability and is a pre-requisite in creating premises for sound economic growth. As an effect of market turbulences resulting from the financial crisis, transparency and comparability of the financial statements of financial institutions have gained increased importance for market participants.
2. In this context, ESMA has intensified its reviewing activities, with an increased focus on the financial statements of financial institutions. Recent ESMA studies, mainly in relation to the application of IFRS 7 – *Financial instruments: Disclosures*, indicate that there are areas where the financial statements of some European financial institutions could be improved. ESMA has contributed to promote the objective of transparency of financial reporting of financial instruments by issuing public statements relating to sovereign debt exposures and forbearance practices and by publishing extracts of relevant enforcement decisions from the EECS database.
3. EBA and ESRB have undertaken further initiatives to improve the level of confidence in the financial sector by asking financial institutions to provide better disclosure of financial and risk information in financial reporting. ESMA closely cooperates with EBA and ESRB in their efforts to make financial reporting more transparent and thus contribute to financial stability.
4. Other key stakeholders, such as the FSB, have also expressed concerns about the lack of transparency of disclosures in the banking sector and set up a group in charge with providing recommendations for improvement. In order to address such concerns, the EDTF published a report² in October 2012 and a follow-up report³ in August 2013 that aimed at improving disclosure practices about risk exposures and management.
5. As indicated in previous reports and public statements, ESMA has continued monitoring compliance and transparency of financial reporting of listed companies in the financial sector and consequently has decided to undertake this review on a sample of European financial institutions with the aim of assessing and recommending actions to improve the quality and comparability of financial reporting practices by financial institutions.

² Report: Enhancing The Risk Disclosures Of Banks, Enhanced Disclosure Task Force, 29 October 2012

³ Progress Report: Implementation Of Disclosure Recommendations, Enhanced Disclosure Task Force, 21 August 2013

II. Objectives and scope of the report

Objectives

6. The main objective of the report is to review some of the key areas of the financial statements prepared by financial institutions across the EU in order to assess the level of comparability taking into account the definition in the *Conceptual Framework for Financial Reporting*.
7. Comparability is a qualitative characteristic that enhances the usefulness of information between entities or about the same entity from one period to another. Paragraph QC21 of the *Conceptual Framework for Financial Reporting* defines comparability as ‘qualitative characteristics that enable users to identify and understand similarities in, and differences among, items.’ Paragraph QC 23 further explains that comparability is not uniformity and that for information to be comparable, like things must look alike and different things must look different.
8. A necessary pre-requisite for comparability of IFRS financial statements is that they comply with IFRS. The review assesses compliance but also considers matters, whether or not explicitly required by current IFRS, on which additional transparency would be useful. In order to achieve comparability issuers should consider both the disclosure objectives of IFRS 7 and IAS 1 – *Presentation of Financial Statements* and the overall transparency of financial information.
9. Issuers should consider how to best portray economic transactions so that their presentation and disclosure is relevant and faithfully representative to users of financial statements while applying IFRS recognition and measurement principles.
10. Paragraph 1 of IFRS 7 specifies the objective of financial instruments disclosures and indicates that these should be sufficient to enable users to evaluate the significance of financial instruments for the entity’s financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks. In addition, paragraph 112 (c) of IAS 1 states that the notes shall provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.
11. ESMA acknowledges that IFRS 7 is a principle-based standard which requires that information given should be driven by the exposure to the risk and the way the entity manages its risk internally. Even though an economic event could be faithfully represented in more than one way, ESMA is of the view that financial statements of financial institutions would be enhanced if investors would be able to assess this economic event based on comparable information.
12. When performing this review, ESMA identified some examples of disclosure of financial reporting and included them in the Appendix as an illustration of possible ways how selected requirements addressed in this report are implemented in practice. These examples should not be seen as exhaustive or unique, as there might be different ways for meeting IFRS requirements based on individual facts and circumstances of each financial institution. Accordingly, certain elements of these examples might be further developed in order to better reflect individual circumstances of respective financial institutions. By including these examples in this report, ESMA does not express any view on whether the disclosed information therein is complete and accurate or on whether it might not be further questioned as part of regular review by national enforcers.

Scope of the report

13. In defining the areas to be reviewed, ESMA considered matters arising from risk-assessment analysis, experience of national enforcers when reviewing financial statements and previous ESMA activities. The resulting selected areas of the review included:
 - a) Structure and content of the income statement,
 - b) Liquidity and funding including the effects of asset encumbrance,
 - c) Hedging and the use of derivatives,
 - d) Credit risk with a focus on credit risk management, forbearance practices, non-performing loans and country concentration risk; and
 - e) Criteria used to assess impairment of equity securities classified as AFS.
14. The sample was based on the 2012 IFRS consolidated financial statements of 39 large European financial institutions from 16 jurisdictions, mostly consisting of banks that were included in the latest EBA stress-test exercise. The sample provided a balanced geographical coverage across Europe.
15. The review was performed on the basis of publicly available information mainly from the IFRS financial statements and information that was incorporated by reference in these financial statements. To some extent the information in all sections of the annual report was taken into account even if clear references were missing in order to capture the objective of the review to assess the comparability. Due to the inherent limitations of a desk-top review, ESMA could not determine in all circumstances whether disclosures identified as missing for certain financial institutions were simply not applicable or whether amounts were immaterial.

III. Results of the review

16. This section sets out the detailed findings and conclusions for each of the areas of the review. ESMA acknowledges the efforts made by financial institutions in improving the quality of their financial statements.
17. ESMA found that although most banks provide information required by IFRS 7 in the notes to their financial statements, in many cases certain information required by IFRS 7 was included in different sections of the annual report (e.g. management report, business review, Pillar III disclosures⁴) outside the audited financial statements section of the annual report. Moreover, it was not always clear whether and to what extent the information presented outside was incorporated by reference into the financial statements and consequently, whether it was audited or what was the level of assurance. Where such information is presented outside the financial statements ESMA considers that it should be clearly referenced and marked as audited.
18. Users of financial information might also benefit if entities linked information provided in different sections of the annual report and explained any differences in the bases used to provide this information.
19. ESMA noted that most financial institutions in the sample provided references to national laws, recommendations and regulations that deal with the preparation of the financial statements. In most of the cases, this reference was limited to a general statement making a link with prudential regulation. Some financial institutions specifically mentioned specific national laws and regulations (Banking Act, Commercial Code or circulars from prudential regulators) but very few of them clearly stated the subjects covered by these local laws and regulations and their impact on IFRS financial statements. Considering the fact that these financial institutions act in a global environment, ESMA believes users would benefit if financial institutions provided a concise explanation of the impact of these national rules on the IFRS financial statements, accompanied where relevant by additional explanations of possible impact of planned changes of these rules.

A. Structure and content of the income statement

IFRS requirements

20. The requirements on the structure and content of the income statement in IAS 1 are generic in nature and do not provide industry specific guidance. Paragraph 82 of IAS 1 includes a list of minimum line items to be presented that according to paragraphs 85 and 86 of IAS 1 should be supplemented with additional line items when such presentation is relevant to an understanding of the entity's financial performance. Disclosure on the face of the income statement or in the notes is required by paragraph 97 of IAS 1 for material items of income or expense and by paragraph 35(b) of IAS 18 for each significant category of revenue.
21. Furthermore, IFRS 7 contains various disclosure requirements related to the income statement. Paragraph 20 of IFRS 7 requires entities to disclose some information on net gains or net losses, interest income and interest expense, fee income and expense as well as impairment losses either in

⁴ Public disclosures of the prudential information. Pillar III reports were in some cases presented as part of the annual report, however, in most cases they were presented outside of the annual report as a separate document. To some extent, this difference has an impact on the comparability.

the income statement or in the notes. A general requirement to disclose significant accounting policies is set forth in paragraph 117 of IAS 1 and paragraphs 21 and B5 of IFRS 7.

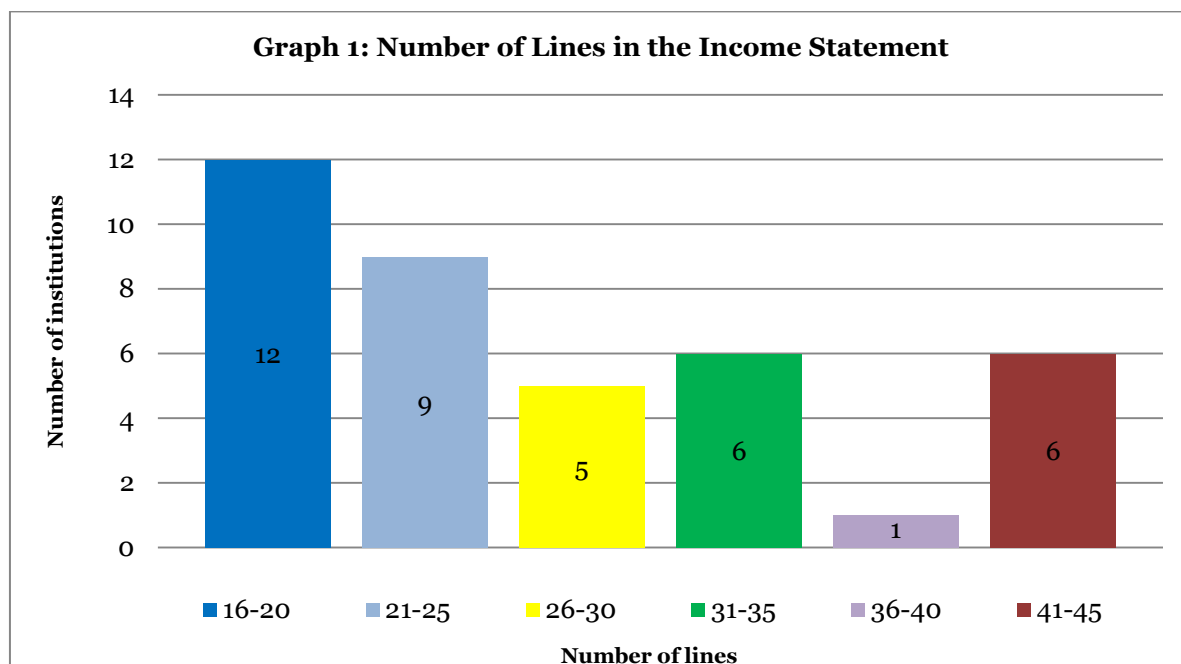
22. Paragraphs 20(b) and 20(c) of IFRS 7 require financial institutions to disclose total interest income and total interest expense (calculated using the effective interest method) for financial instruments not at fair value through profit or loss as well as fee income and expense arising from (i) financial instruments that are not at fair value through profit or loss and (ii) trust and other fiduciary activities.
23. Disclosure of net gains or net losses on financial instruments by category in IAS 39 is required by paragraph 20(a) of IFRS 7; however, a definition of net gains or net losses is not provided. Guidance in IFRS 7 is limited to a specific example on financial instruments at fair value through profit or loss in paragraphs B5(e) and BC34. Section G.1 of the implementation guidance on IAS 39 suggests that either disclosure of a single amount per category or separate disclosure of its components is appropriate.
24. Paragraph 20(a)(ii) of IFRS 7 requires disclosure of net gains or net losses on financial assets categorised as AFS, showing separately the amount of gain or loss recognised in OCI during the period and the amount reclassified from equity to profit or loss for the period. Paragraphs IG7 to IG9 of IAS 1 suggest that gains and losses from fair value changes are always initially recognised in OCI, even if immediately thereafter transferred to profit or loss due to impairment or derecognition of the underlying asset.

Findings

Structure of the income statement

25. All financial institutions in the sample opted to present the income statement separately from the statement of other comprehensive income. However, given the lack of specific provisions or guidance in IFRS, ESMA found significant diversity in the structure and content of the income statement. This diversity was most pronounced in respect to the level of detail provided on the face of the income statement, content and order of the individual line items and the presentation of the income statement line items on a gross or net basis. Graph 1 included below illustrates this diversity by indicating the number of lines included in the income statement (including subtotals) for the 39 financial institutions in the sample⁵:

⁵ The line count includes all lines (including subtotals) from interest income to after tax profit or loss. Lines referring to the allocation of profit or loss to non-controlling interests and owners of the parent were not included



26. The structure of the income statement and order of the individual line items seems to be heavily influenced by the national accounting standards and/or the prescribed structure by prudential regulators, as evidenced by similar income statement structures for financial institutions from the same jurisdictions. For example, apparently under the influence of national accounting standards, in some countries impairment of financial assets is presented directly after net interest income, whereas in other countries it is presented at the bottom of the income statement immediately before tax.

Interest income and interest expense

27. All financial institutions under review presented gross interest income and interest expense on the face of the income statement but some also included a subtotal for net interest income.
28. ESMA noted significant diversity in the components included as part of interest income/expense. All financial institutions included interest income/expense generated from financial instruments *not* measured at fair value through profit or loss (FVTPL) in interest income/expense. However, a number of them omitted to separately disclose the total interest income and total interest expense for financial assets or financial liabilities *not* measured at FVTPL as required by paragraph 20(b) of IFRS 7.
29. Diversity equally exists whether interest on financial instruments of the trading portfolio and on financial instruments designated as at FVTPL is included in interest income/expense. Of the financial institutions under review, two thirds included interest income/expense on non-derivative financial instruments of the trading portfolio in interest income/expense rather than in net trading income. Three quarters of the financial institutions included interest income/expense on financial instruments designated as at FVTPL in interest income/expense and usually provided quantitative information when disclosing detailed analysis of interest income/expense.
30. IFRS does not contain specific presentation requirements with regard to funding/refinancing costs related to non-derivative financial assets of the trading portfolio or designated as at FVTPL. From

the financial institutions in the sample, more than 10% mentioned that funding costs were included in interest expense, while the interest income on these portfolios was instead included in net trading income or net gains or losses on these portfolios (the latter being presented as a separate line item). The remainder either did not provide any information or indicated that these costs were presented consistently with the presentation of the respective interest income either in interest expense or in net trading income/net gains or losses.

31. The policy of including interest income/expense on derivative financial instruments was diverse. Based on ESMA's observations, the presentation of the interest component of derivatives that do not qualify for hedge accounting (alternatively only for instruments labelled as '*economic hedges*' or '*banking book derivatives*') was fairly mixed between interest income/expense and net trading income. For some financial institutions, however, it was not possible to determine where interest income/expense on non-hedging derivatives was recognised.
32. ESMA also noted that some financial institutions included other items which are not usually expected to be part of interest income/expense, such as results from investments in investment property. However, amounts included were not significant.

Net fee and commission income

33. All financial institutions in the sample presented fee and commission income on the face of the income statement with the vast majority choosing a gross presentation. Additionally, in almost all cases net fee and commission income was detailed in the notes, mostly by type of activity. Some financial institutions provided an analysis by a combination of type of activity and product. Notably, approximately 10% of the sample provided this break-down in the notes on a net basis only.
34. As outlined above, IFRS 7 requires the disclosure of the amount of fee income and expense which arises from financial instruments that are not at fair value through profit or loss. Almost three quarters of the financial institutions in the sample did not provide an explicit disclosure of these items.
35. With respect to the requirement to provide the amount of fee and commission income and expense arising from trust and other fiduciary activities, approximately 40% of financial institutions in the sample explicitly provided the required information. However, lack of disclosure for the remaining institutions could result from the fact that at least some financial institutions in the sample may not perform any material trust or fiduciary services.

Net trading income

36. All financial institutions presented a '*net trading income*' line, but the presentation varied as the respective line included alternatively (i) income related to an entity's trading activities, (ii) income from the financial instruments held for trading or (iii) income from all financial instruments measured at FVTPL (i.e. also including financial instruments designated as at FVTPL). Partly this could be inferred from the name of the line items which were for example labelled as '*net trading income*', '*held for trading*' or '*net income from financial instruments recognised at fair value through profit or loss*'.

Dividend income

37. Approximately one fifth of the sample did not provide information about the amount of dividend income recognised in the reporting period. It is unclear to what extent dividend income was not

considered significant by those financial institutions. In the remaining cases, quantitative information about dividend income was almost equally split between disclosure as a separate line item on the face of the income statement and in the notes. Only about one third of the financial institutions provided a separate breakdown of dividend income per IAS 39 category in the notes.

38. Presentation of dividend income from AFS equity instruments varied between financial institutions. A separate line item in the income statement was provided in almost half of the financial statements. Almost one fifth of financial institutions included this dividend income in ‘*net investment income*’ or similar line items and few financial institutions included it in either interest income or in other operating income. In an additional fifth of the cases the line item in which dividends were included was not clear or the financial institutions did not categorise any equity instruments as financial assets AFS.
39. The situation for dividend income from financial assets held-for-trading was different: more than one fifth of financial institutions presented dividend income in a separate line item in the income statement. More than 40% of financial institutions in the sample included dividend income from trading assets in net trading income. Less frequent was a presentation in net investment income or similar and in interest income. In some cases the line item in which dividend income from financial assets held-for-trading was included was not clear from the financial statements or the notes.

Repurchase of financial liabilities

40. ESMA found divergence in the accounting treatment of the gain on repurchase of financial liabilities carried at amortised cost. Whereas most of the financial institutions presented this gain as ‘*other income*’ or presented it as a separate line in the income statement, a few financial institutions reported this gain as interest income /expense or net trading income.

Net gains or net losses

41. ESMA noticed that in practice the term ‘*net gains or net losses*’ is understood differently. A major difference relates to impairment losses which some institutions included in the presentation of net gains or net losses while others did not. For the purpose of this analysis, ESMA has considered the term ‘*net gains or net losses*’ to include impairment losses.
42. Although all financial institutions disclosed accounting policies for major components of ‘*net gains or net losses*’, the term itself was rarely defined and the level of details on components varied significantly. Whereas some financial institutions stated explicitly in which line items gains and losses were recognised, others did not. Regarding completeness, ESMA noted that in some instances accounting policies did not state all components that would be expected to be included in net gains or net losses, such as gains or losses from the disposal of instruments carried at amortised cost.
43. Only one tenth of financial institutions disclosed net gains or net losses recognised in profit or loss for all IAS 39 categories in a single note. Example 1 in the Appendix illustrates this type of disclosure. Approximately 40% of these financial institutions presented more detailed analysis of net gains or net losses than analysis per IAS 39 category.
44. Other financial institutions followed a component-based approach for at least some IAS 39 categories. For example, with regard to financial assets classified as ‘*loans and receivables*’, some financial institutions recognised impairment losses and disposal gains in different line items and disclosed in

the note on each line item a breakdown per IAS 39 category, showing separately the amount relating to loans and receivables. Alternatively, components such as impairment losses were separately disclosed per IAS 39 category in the income statement. An analysis in the notes was the predominant practice for the financial institutions in the sample.

45. When a component-based approach was followed, not all components were always presented separately, even though other information suggested they might have been material. For example, although other disclosures suggested that financial liabilities carried at amortised cost were repurchased, related gains or losses were not disclosed in all instances.
46. From ESMA's analysis it appeared that the recognition pattern for net gains or net losses on AFS financial assets suggested in the implementation guidance of IAS 1 was not always followed consistently. Some financial institutions seem to have recognised specific elements of net gains or net losses directly in profit or loss, whereas the remaining elements were initially recognised in OCI and subsequently transferred to profit or loss. However, the difference in accounting treatment was not clearly disclosed in the accounting policies section.

Conclusions

47. Overall, comparability of the income statement across different financial institutions was found to be limited, mainly due to:
 - a) the deviating structure of the income statement and different content of the line items,
 - b) divergence in the content and detail of the notes, and
 - c) a lack of concise, yet comprehensive accounting policy disclosures.

While the deviating structure can be partly explained by the use of different business models, especially in case of financial conglomerates, the other two elements made it difficult or even impossible to determine comparable amounts for different financial institutions.

48. The significant diversity in practice in the composition of interest income/expense resulted in limited comparability of interest income/expense (and net interest margin) reported by financial institutions. ESMA noted that comparison of interest income/expense (and net interest margin) of different financial institutions in most cases, if possible at all, at least required additional steps. Similar diversity was noted when analysing net trading income.
49. ESMA believes that additional guidance in IFRS on specifying the content of individual line items (e.g. on interest income/expense) could help enhancing comparability. Consequently, ESMA will suggest the IASB to address the issue so that transparency and comparability of income statements of financial institutions could be enhanced.
50. ESMA urges financial institutions to identify all significant components included in individual line items accompanied by concise yet comprehensive accounting policy disclosures making the link between line items in the income statement and the statement of financial position more transparent.
51. With regard to disclosure of net gains or net losses, comparability can best be achieved if they are disclosed in a single note. Ideally, in addition to a single amount for each of the IAS 39 categories required in paragraph 20(a) of IFRS 7, the note should contain a break-down by income statement line items or be clearly reconcilable with the notes on individual line items.

52. Financial institutions that do not follow the recognition pattern for AFS instruments in paragraphs IG7 through IG9 of IAS 1 should state in their accounting policy disclosures under which circumstances gains or losses are (i) directly recognised in profit or loss and (ii) initially recognised in OCI and subsequently transferred to profit or loss and the respective amounts should be easily identifiable from the primary financial statements and the notes.
53. Financial institutions might consider whether the effects of some transactions are sufficiently material to warrant presentation as a separate line item in the income statement instead of being disclosed in the notes. This could be applicable, for example for items such as the effects of changes in own credit risk for financial liabilities designated as at FVTPL or net gains or net losses on financial liabilities measured at amortised cost.
54. Based on our review, we noted that some aspects of comparability are highest within jurisdictions where specific reporting requirements for financial institutions were set. However, ESMA acknowledges that prescribed reporting formats may entail the risk that different business models are not adequately reflected. Consequently this may result in a decrease rather than an increase in comparability across Europe.
55. With the planned introduction of a common format for supervisory reporting (FINREP) in Europe by EBA, ESMA expects the structures of the income statement of financial institutions will align in the IFRS financial statements.

B. Liquidity and funding

IFRS requirements

56. IFRS 7 requires qualitative and quantitative disclosures on liquidity risk. Paragraph 33 of IFRS 7 specifies the disclosure of qualitative information that describes exposures to risk and how they arise, as well as the entity's objectives, policies and processes for managing the risk and the methods used to measure the risk. Paragraph 34(a) of IFRS 7 requires disclosure of quantitative information that comprises data about an entity's exposure to liquidity risk at the end of the reporting period.
57. Paragraphs 32A and 39(c) of IFRS 7 ask entities to consider the interaction between qualitative and quantitative disclosures, so as to enable users to evaluate an entity's exposure to risks and get an overall picture of these risks and the way the entity manages them.
58. Paragraph 39 of IFRS 7 requires entities to disclose a remaining contractual maturity analysis of non-derivative and derivative financial liabilities, including issued financial guarantee contracts and a description of how entities manage the liquidity risk. Paragraphs B11E to B11F of IFRS 7 provide additional guidance on factors to be considered when providing such disclosures. This encompasses, but is not limited to, a list of relevant matters such as:
 - a) Maturity analysis of financial assets held for managing liquidity risk, e.g. financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities
 - b) Deposits held at central banks to meet liquidity needs
 - c) Diversification of funding sources
 - d) Commitment received for liquidity access if needed
 - e) Concentration of liquidity risk in the assets or in the funding sources

- f) Contingent funding needs, such as instruments with accelerated repayment terms, covenants, or collateral requirements.

- 59. Paragraph B10A of IFRS 7 requires the information provided to be based on information provided internally to key management personnel. An explanation on how these quantitative data are determined should be provided.

Findings

Qualitative disclosures on liquidity risk

- 60. Nearly all the financial institutions in the sample provided narrative disclosures about liquidity risk covering information on how liquidity risk arises, the policy and internal control processes for managing it and the methods used to measure it. One third of the sample disclosed additional information on contingency plans for managing liquidity risk.
- 61. However, ESMA found that the quality of the information provided varied among the financial institutions. Some financial institutions provided only generic information, while others disclosed in-depth entity-specific information on their liquidity risk, their policy and strategy for the management of their liquidity.

Maturity analysis of financial assets and financial liabilities

- 62. All financial institutions in the sample disclosed a maturity analysis of financial liabilities. Categories provided in the analysis were generally aligned to the categories disclosed on the face of the statement of financial position, and some financial institutions provided more specific analysis (e.g. by type of instrument or by counterparty). Although explicitly required by IFRS, one tenth financial institutions in the sample did not provide maturity analysis for derivatives liabilities and approximately 40% of financial institutions in the sample did not include information about off-balance sheet commitments (loan commitments and financial guarantee contracts).
- 63. Additionally, whereas paragraph B11D of IFRS 7 is clear that the maturity analysis of financial liabilities should be based on contractual undiscounted cash flows, a third of the sample disclosed a maturity analysis based on discounted cash flows.
- 64. Most of the financial institutions used the time-bands suggested by paragraph B11 of IFRS 7. Half of the sample added 'on demand' and/or 'undetermined maturity' time-bands to the analysis, however not all of them explained the principles used to classify financial instruments into these two categories. For examples, ESMA observed that practices varied for the classification of trading derivatives liabilities in the respective time-bands.
- 65. Assumptions used in the maturity analysis for specific instruments were not systematically provided. For example, only a few financial institutions provided information on how they dealt with callable instruments (instrument that can be redeemed or paid off by a financial institution prior to its maturity date). In particular, ESMA found that practices varied for the classification of subordinated debts with repayment option held by the issuer.
- 66. Half of the sample provided a maturity analysis for all financial assets, usually disaggregated by line items of the statement of financial position and using the same time-bands as for financial liabilities.

ties. One third of the financial institutions provided the maturity analysis specifically for those financial assets held for managing liquidity risk as suggested by paragraph B11E of IFRS 7.

67. ESMA found that narrative and qualitative disclosures were sometimes lacking, in terms of analysis of the liquidity position stemming from the maturity analysis provided, as required by paragraph 39(c) of IFRS 7, and the way entities intend to manage these positions and the associated risks.

Managing liquidity risk: liquidity reserves, funding sources and contingent funding needs

68. Although most financial institutions disclosed information on what they consider as liquidity reserves, not all of them provided the definition and criteria for assets to qualify as liquidity reserves. More than half of the sample included a breakdown of their liquidity reserves by asset type whereas very few financial institutions provided the detail by currency. Financial institutions only rarely disclosed the liquidity reserves distinguishing the parent company from its (foreign) subsidiaries. Example 2 in the Appendix illustrates quantitative and qualitative disclosures related to liquidity reserves.
69. As regards funding sources, most of the sample included quantitative information on the main funding sources including funding types, such as wholesale versus retail sources, and/or secured (e.g. covered bonds) versus unsecured funding sources (e.g. customer deposits). A minority of the sample reported further breakdowns of funding sources by currency, geographical area or business line or pointed out to concentration in the funding sources.
70. Information on any funding restrictions within a consolidated group of entities, such as restrictions on subsidiaries' ability to transfer funds to the parent in forms of dividend or repayments of loans, due to local regulatory rules or exchange controls laws, was rarely provided as part of the disclosures on liquidity risk within the financial statements.
71. A limited number of financial institutions provided entity-specific information on their contingent liquidity and funding needs. Approximately 40% of financial institutions in the sample mentioned the existence of margin requirements for derivatives. Financial institutions provided only rarely as part of the financial statements details of instruments that include accelerated repayment terms or additional collateral requirements in case of a downgrade by a rating agency. Usually, these financial institutions did not provide any quantitative information on the contingent needs. Half of the financial institutions reported information on off-balance sheet instruments they can access to meet contingent liquidity needs (e.g. committed borrowing facilities or other credit lines).
72. Two thirds of the sample disclosed the fair value of collateral held that it was permitted to sell or repledge as required by paragraph 15 of IFRS 7. This included both collateral held as security for assets or that was received for derivatives transactions. The fair value of collateral already sold or repledged was reported by less than half of the sample. Information regarding the quality and liquidity of the collateral held was provided by few financial institutions, e.g. by identifying central financial institutions eligible assets.
73. The link between quantitative and qualitative information provided by financial institutions was found to be limited, although required by paragraphs 32A and 39(c) of IFRS 7. Quantitative data provided by some financial institutions was not always complemented with narrative information: for example, when data on maturity tables or other key indicators or internal metrics (e.g. loan to deposit ratio, scenario analysis) were provided, these were not always accompanied with explanato-

ry disclosures that would link them with the overall funding and liquidity strategy. Conversely, narrative developments were not always supported by quantitative data; for example, when reference to stress tests practices was made, the quantitative impacts and underlying assumptions were not provided to support the narratives. As a consequence, links and interdependence between the different quantitative and/or narrative information provided in liquidity and funding areas were not sufficiently apparent, giving an impression of dispersed information.

Asset encumbrance

74. Most of the financial institutions disclosed quantitative information regarding financial assets pledged to secure liabilities as required by paragraph 14 of IFRS 7, with variable level of details: financial institutions mostly provided an analysis by type of assets, or by IAS 39 category. A majority of financial institutions detailed such assets by nature of the operations or liabilities involved. The terms and conditions of the pledge were indicated only by a third of the sample.
75. Only a limited number of financial institutions provided quantitative information related to encumbered or unencumbered assets detailed by asset type. For the remaining issuers of the sample, the distinction between unpledged and unencumbered assets was not always obvious and it was not always clear which assets of the financial institution could be freely used to meet future liquidity needs. Example 3 in the Appendix illustrates a way to disclose an analysis of encumbered and unencumbered assets.

Conclusions

76. Overall, although financial institutions provided disclosure on liquidity and funding, ESMA observed that comparability of information provided was limited due to the fact that the quality of quantitative and qualitative details provided by issuers varied widely.
77. Accordingly, ESMA encourages financial institutions to provide comprehensive disclosures that would convey a clear and interlinked view of maturity analysis of financial instruments with liquidity position and funding sources.
78. ESMA reminds financial institutions to complement quantitative data with narrative disclosures and explain narrative information with quantitative elements. Enhancing the overall quality of disclosures could be achieved by providing definition of key terms, disclosing inputs and assumptions for indicators used to assess liquidity and funding positions, providing narrative commentary on contractual maturity analysis of financial assets and liabilities and figures and linking them with the entity's strategy and objectives in terms of funding and liquidity.
79. When disclosing the contractual maturity of financial liabilities, IFRS requires financial institutions to disclose undiscounted cash flows and include derivative liabilities and off balance sheet commitments. ESMA expects financial institutions to provide maturity analysis of financial assets. ESMA encourages financial institutions to use on-demand maturity bucket in such maturity tables and to provide criteria for the allocation of certain specific instruments in the different time bands.
80. ESMA encourages financial institutions to provide information on concentrations in the liquidity and funding sources, including where relevant an analysis by significant currencies. They should be sufficiently detailed and identify significant restrictions on funding sources either within the group

(e.g. foreign subsidiaries subject to regulatory constraints for transfer of funds to their parent) or based on individual circumstances of the entity (e.g. as a condition when state aid was provided).

81. ESMA recommends that financial institutions further develop their disclosure on contingent funding needs as well as contingent funding sources. Experience has shown that in periods of difficult market conditions, contingent funding needs can generate significant and immediate cash draw-downs for some financial institutions.
82. ESMA urges financial institutions to provide sufficient and sufficiently granular information to identify those assets that are readily available for liquidity purposes or to meet funding needs, and to complement such information with clear definitions of the terms used. ESMA notes that EBA is currently developing a harmonised measure of asset encumbrance for supervisory reporting⁶. EBA has obtained legal mandate to develop disclosure guidelines on this issue⁷ following the recommendation of the ESRB⁸. Once finalised, ESMA would encourage financial institutions to use this definition of asset encumbrance for external reporting as well in order to provide the market with a harmonised approach to reporting the level of asset encumbrance.

C. Hedging and the use of derivatives

IFRS requirements

83. Mandatory disclosures in IFRS 7 refer to hedge accounting and description of financial instruments designated as hedging instruments. Paragraph 22 of IFRS 7 requires entities to provide information for each type of hedges used, including a description of these hedges, the nature of risks being hedged, and disclosure of the fair values of hedging instruments at the end of the reporting period.
84. Paragraph 24 of IFRS 7 requires disclosures of the effect of hedge accounting on the income statement and on OCI and in particular with respect to ineffectiveness recognised on profit and loss arising from each type of hedge. For fair value hedges gains and losses on the hedging instrument and on the hedged item attributable to hedged risk need to be disclosed separately. For cash flow hedges, the requirements of paragraph 23 of IFRS 7 include disclosure of periods when cash flows are expected to occur, and the amounts recognised on OCI during the period, or recycled from OCI to profit and loss during the period.
85. IFRS 7 contains specific requirements related to the use of derivatives. These include guidance in paragraphs 25 – 27 related to measurement of fair value but are also included in disclosure requirements in paragraphs 33 - 42 on evaluation of the nature and extent of risks arising from financial instruments.
86. Apart from these, IFRS 7 does not include specific requirements relating to hedging activity. However, based on the general objective of the standard and the general requirements related to management of the risks, entity should provide qualitative disclosures on derivative exposures supported or further illustrated by quantitative information.

⁶ Consultation Paper: Draft Implementing Technical Standards on Asset encumbrance reporting under article 95a of the draft Capital Requirements Regulation, European Banking Authority, 26 March 2013

⁷ Regulation (EU) 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, Part Eight, Article 443

⁸ Recommendation ESRB/2012/2 on funding of credit institutions, European Systemic Risk Board, 20 December 2012

Findings

Type of (accounting) hedges and derivatives used

87. Specific disclosures regarding the types of hedge accounting applied, the types of instruments used and the corresponding fair values of derivatives at the end of the reporting period were provided in nearly all cases.
88. Almost all financial institutions in the sample included a breakdown of the fair value of derivatives held at the end of the reporting period by nature of the underlying risk (e.g. interest rate instruments, foreign exchange instruments, equity instruments) and disclosed the related notional amounts. The financial institutions that applied hedge accounting distinguished in these disclosures derivatives accounted for as hedging instruments in accordance with IAS 39 and derivatives held for trading. Around half of the financial institutions reviewed distinguished between OTC and exchange traded instruments. Only a few financial institutions provided analysis of derivative financial instruments by counterparty.
89. Disclosure on how hedge accounting is applied as required by IFRS 7 varied between financial institutions. Some provided a general description while others gave more extensive and entity-specific disclosure, including description of the hedging instruments and the different purposes for holding derivative financial instruments.

Impact of hedge accounting on financial statements

90. Ineffectiveness arising from the different types of hedges was sometimes reported in a single line item for all types of hedges, without further disclosure about whether such ineffectiveness stems from fair value, cash flow or net investment hedges. Most financial institutions disclosed the effect of fair value hedges on the income statement; however, some provided a net amount without distinguishing the effects of hedging instruments and the revaluation of hedged items attributable to hedged risk. Presentation and disclosure of the impact of derivatives that were not designated in hedge accounting relationship varied as well. (Please refer to the section III.A on Structure and content of the income statement).
91. For cash-flow hedges, the amounts recognised in OCI during the period, and those recycled from OCI to profit and loss were generally disclosed. However, only a third of the sample provided information on the periods in which the cash flows are expected to occur, although required by IFRS 7.
92. Only a few financial institutions complemented their quantitative data on hedge accounting with narrative explanations or other further quantitative breakdown, for example, on the nature of gains and losses by underlying risk hedged or on sources of ineffectiveness.

Use of 'macro hedging' and the EU carve-out

93. Only around a third of the sample reported in their financial statements the use of the fair value hedge accounting for a portfolio hedge of interest rate risk. Financial institutions did not specifically disclose whether they apply cash-flow 'macro-hedging' (e.g. cash-flow hedging practices based upon large volumes of individual hedge relationships or related to groups of items). In addition, only a

minority of financial institutions disclosed information as to whether they make use of the provisions of the EU-carve out⁹.

Derivative transactions

94. Many financial institutions indicated that they entered into derivative transactions for speculative purposes, to service clients' needs and/or to hedge risks. Where qualitative disclosure was provided, it was not complemented with quantitative disclosures. Only a few financial institutions included a statement that they did not enter into derivatives financial transactions for speculative purposes or disclosed the use of derivatives as '*economic hedges*'. However, very few reported separately the risk management procedures for the different purposes derivative and/or hedging transactions. Others stated that trading derivatives include transactions on behalf of clients. Some financial institutions referred to the regulatory distinction between trading book and banking book, or used the term '*economic*' hedging, yet only rarely providing definitions of the terms used.
95. As part of this review, ESMA assessed disclosures for some specific measurement aspects related to impact of credit risk/own credit risk on the fair value of derivatives. Despite the importance of determining fair value of derivative financial instruments, less than a quarter of financial institutions in the sample included qualitative and/or quantitative information regarding the impact of the Credit Value Adjustment - CVA and/or Debit Value Adjustment - DVA on the calculation of fair value and only a few provided specific information on valuation methodologies and inputs used.

Conclusions

96. Although most entities in the sample provided the specific disclosures required by IFRS 7, ESMA found that their level and depth varied significantly and that improvement in some areas would be welcome. In particular, ESMA would encourage financial institutions to link the quantitative and qualitative disclosures provided.
97. ESMA expects financial institutions to provide more granular qualitative information on the use of derivatives for different purposes (e.g. hedging of own risks, trading on own account, client trades and related risk management) and to link these purposes with the accounting treatment. ESMA encourages financial institutions to provide the level of detail that would enable users to understand the impact of hedging on the financial position and performance and its relation to the hedging strategy.
98. ESMA urges financial institutions that use derivatives extensively to hedge their risk exposures to disclose qualitative and quantitative information on the effectiveness of these hedging activities.
99. ESMA expects improvement of disclosures provided on measurement methodologies and inputs for fair value of derivative financial instruments, including where relevant the impact of CVA and/or DVA adjustments. ESMA believes that the application of IFRS 13 – *Fair Value Measurement* in 2013, which is more specific on valuation adjustments than previous requirements in IAS 39 and the development of more sophisticated models to capture the counterparty and own credit risks represent an opportunity to enhance disclosure related to fair value measurement of derivative financial instruments.

⁹ Modification of the IAS 39 as issued by the IASB through European endorsement process that among others relaxes the hedging effectiveness testing and allows portfolio hedging of core deposits

100. As application of ‘*macro-hedging*’ strategies or the EU carve-out can have a significant effect on OCI and net income, ESMA urges financial institutions to clearly disclose in their financial statements whether and to which portfolios they apply ‘*macro hedging*’ and whether they have applied the EU carve-out to hedge accounting.

D. Credit risk

D.1 Credit risk management

IFRS requirements

101. Paragraph 33 of IFRS 7 requires qualitative information to describe exposures to risk and how they arise, as well as the entity’s objectives, policies and processes for managing the risk and the methods used to measure the risk. According to paragraph IG 15(b) of IFRS 7, this includes but is not limited to a narrative description of the entity’s impairment policies and processes for accepting, measuring, monitoring and controlling risk.
102. Paragraph 34 of IFRS 7 specifies that quantitative information includes data about entities’ exposure to credit risk and that the disclosure shall be based on the information provided internally to key management personnel of the entity. Paragraph B10 of IFRS 7 provides a list of activities that give rise to credit risk.
103. Paragraph 36 of IFRS 7 requires entities to provide the amount that best represents the maximum exposure to credit risk as well as a description of collateral held as security and other credit enhancements, and their financial effect in respect of the amount that best represents the maximum exposure to credit risk. Paragraph IG 22 of IFRS 7 gives examples of how an entity might meet the latter requirement. In addition, an entity shall disclose information on the credit quality of financial assets that are neither past due nor impaired.
104. Paragraphs 34(c) and B8 of IFRS 7 specify that information given shall also include the concentration of risk with a description of how management determines concentrations and the shared characteristic(s) identifying each concentration (e.g. counterparty, geographical area, currency or market).
105. According to paragraphs 37(a) and (b) of IFRS 7 an entity shall disclose by class of financial asset, as at the end of the reporting period, an ageing analysis of those financial assets that are past due but not impaired and those that are individually determined to be impaired, including the factors considered in determining that they are impaired.
106. Paragraphs 58-65 and AG84-AG92 of IAS 39 include detailed requirements for measurement of impairment of financial assets, both individually and at a portfolio level. Paragraphs 20(d) and (e) of IFRS 7 require disclosure either in the statement of comprehensive income or in the notes, of interest income on impaired financial assets accrued, as well as the amount of any impairment loss for each class of financial asset. According to paragraphs 21 and B5(f) of IFRS 7 an entity shall include in its disclosure of accounting policy the criteria used to determine that there is objective evidence that an impairment loss has occurred.

107. Along with the discounted cash flow method, formula-based approaches or statistical methods may be used to determine impairment losses collectively as long as methods used are consistent with the IFRS requirements.

Findings

Managing credit risk: credit risk exposure, concentration and mitigation of credit risk

108. All financial institutions in the sample provided an analysis of exposure by internal rating or by external rating. Half of the sample detailed the exposure by both internal and external ratings while most of the other half provided the exposure according to internal ratings only. Only a very few financial institutions detailed their exposure by external ratings only. ESMA understands that the internal rating system is the most relevant way to assess credit risk. Nonetheless, as the description of the internal rating system provided in the financial statements was often very general, ESMA found it difficult to compare them between the financial institutions.
109. Three quarters of the sample provided further analysis of the credit risk exposure by industry sector, by geographical area and by counterparty in addition to the analysis by type of financial assets. Usually these financial institutions provided the analysis (also required by Pillar III). When provided, this analysis enables users to assess better the concentration of credit risk as illustrated by paragraph IG 18 of IFRS 7.
110. For some financial institutions of the sample, the disclosure of the maximum exposure to credit risk was not reconcilable to the line items or amounts recognised in the statement of financial position. The further analysis of the credit risk exposure was more often difficult to connect to other relevant disclosures as well as to the statement of financial position. ESMA found explanations related to concentration of credit risk general. Although most of the financial institutions provided information on concentration of sovereign exposures, only a few of them indicated specific sectors or industries that were more closely monitored (e.g. real estate exposures). In many cases, financial institutions did not provide narrative disclosures about how they manage credit risk concentration and did not provide specific information to enable users to assess the level of credit risk the financial institution tolerates (i.e. its risk appetite in this area). For specific information on country concentration risk, please refer to Section D.4 of this report.
111. Almost all financial institutions provided a description of collateral held and its financial effect. The financial effect was presented in different ways as some financial institutions disclosed all collateral received (e.g. at fair value) whereas others provided collateral information on the basis of Basel 2 rules (i.e. only some collateral using the value used for Basel 2 purposes). The majority of the sample provided information on the allocation of collateral to financial assets but for one third of the financial institutions it was not evident whether financial assets were over or under-collateralised. Example 4 in the Appendix illustrates the quantification of the extent to which collateral and other credit enhancements mitigate credit risk.
112. Half of the sample referred to the use of credit derivatives in managing credit risk. Nevertheless, it was often only a general statement mentioning the use of CDS and that these instruments were used both for trading and for managing credit risk. Financial institutions in the sample provided only seldom quantitative disclosures related to CDS specifically used for managing credit risk.

Disclosure of financial assets that are past due or impaired

113. In general, financial institutions in the sample disclosed their objectives, policies and processes for managing credit risk and the criteria used to assess whether financial assets are impaired. Example 5 in the Appendix illustrates the disclosure of accounting policies on impairment. However, these disclosures were in most cases either brief or boilerplate (e.g. disclosing criteria of impairment using wording almost directly from IAS 39 without providing entity-specific considerations).
114. Financial institutions disclosed similar methodologies to group loans and receivables based on the credit risk characteristics and incorporate statistical models for the calculation of collective impairments. The accounting policies provided tended to describe the general framework without presenting details on the specific criteria and factors incorporated in different methodologies for calculation of collective impairment. Many financial institutions in the sample referred in their accounting policies to ‘*incurred but not reported*’ losses (IBNR). Most of these financial institutions did not define sufficiently the differences in methodologies between IBNR and the other types of portfolio assessment (e.g. for financial assets that were considered not to be individually significant) and did not provide details on calculation of portfolio-based loan loss provisions.
115. Financial institutions used in their disclosures a wide variety of terminology when describing impairment. These practices might have an impact on the transparency and comparability of the financial statements among financial institutions. When referring to formula-based or statistical methods used in calculating portfolio based loan loss provisions according to IFRS requirements, ESMA identified financial institutions often referred to Basel 2 but provided insufficient disclosure to identify and understand the adjustments made to Basel 2 parameters or provided the information on adjustments in an unclear manner.
116. Almost 90% of financial institutions disclosed ageing analysis of financial assets that are past due but not impaired per class of financial assets.
117. One third of the financial institutions provided disclosure on individually impaired assets as a total figure covering both collectively and individually impaired loans which is not compliant with IFRS requirements. Also, one third of the financial institutions didn’t disclose the amount of interest recognised in respect of impaired loans.

Conclusions

118. Although the reviewed financial statements generally complied with specific quantitative disclosure requirements, ESMA considers that the quality of information and its presentation could be improved.
119. Difficulties in reconciling disclosures about credit risk exposure provided in the notes with the line items or amounts provided on the face of the statement of financial position may dilute understanding of financial position. ESMA therefore urges the financial institutions to provide clear and structured disclosures to enable users to understand the connections between the exposure to credit risk and the statement of financial position.
120. ESMA considers that disclosures which set out the exposure to credit risk using different types of analysis is useful to understand concentration of credit risk but more specific information is often needed. ESMA therefore urges financial institutions to further detail how they manage credit risk concentration to enable users to assess the level of credit risk.

121. In the area of mitigation of credit risk, ESMA encourages financial institutions to provide more comparable information on collateral as well as more detailed information on the allocation of collateral to financial assets to enable users to assess whether financial assets are over or under-collateralised. In addition, where relevant, transparency related to use of credit derivatives in managing credit risk could be improved by specifying whether credit derivatives are used for trading purposes or for credit risk management.
122. The disclosure requirements in IFRS 7 distinguish between credit quality of financial assets that are neither past due nor impaired (paragraph 36(c) of IFRS 7), past due but not impaired (paragraph 37(a) of IFRS 7) and those individually determined to be impaired (paragraph 37(b) of IFRS 7). Clear and transparent disclosures for each of these categories are necessary to comply with the standard. Furthermore, ESMA expects issuers to provide an unambiguous description of the accounting policy applied to collective assessment for financial assets that were assessed individually for impairment but for which no objective evidence of impairment was identified through individual assessment. These disclosures are necessary to enable investors to assess the effects of credit risk on the entity's financial position and its performance.
123. ESMA encourages financial institutions to describe their internal rating system and provide information that would enable users to understand the level of credit risk e.g. by explaining the relationship between internal and external rating systems as suggested by paragraph IG25(c) of IFRS 7 or for institutions using the IRB approach for regulatory purposes by mentioning their Pillar III report where additional details are provided. This may be the most practical way to improve comparability between financial institutions.
124. ESMA considers that the disclosure of accounting policies regarding the impairment assessment is an important part of IFRS financial statements. The comparability of financial statements is weakened by the use of boilerplate language and the lack of specificity of impairment criteria, credit risk methodologies and unclear disclosure of adjustments made to the Basel 2 parameters when these are used as a basis for calculation of portfolio based loan loss provisions. In this context, ESMA urges financial institutions to provide specific disclosures in these areas.

D.2 Forbearance

IFRS requirements and other guidance

125. Disclosure of the extent of forbearance practices and its impact on financial position and performance is needed to meet the overall objectives of IFRS 7 where a financial institution extends significant forbearance measures as part of its credit risk management.
126. Paragraph B5(g) of IFRS 7 requires entities to disclose their accounting policy for financial assets that are the subject of renegotiated terms, when terms of financial assets that would otherwise be past due or impaired have been renegotiated.
127. In December 2012, ESMA issued a Public Statement¹⁰ which deals with the definition of forbearance practices, their impact on the impairment of financial assets and identifies qualitative and quantitative disclosures regarding forbearance practices that financial institutions engaged in significant

¹⁰ Public Statement: Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions, European Securities and Markets Authority, 20 December 2012

forbearance should include in their annual IFRS financial statements in order to enable users to evaluate the impact of forbearance measures on the credit risk profile of their loan portfolios and their financial position and performance.

128. In 2013, EBA issued draft Implementing Technical Standards¹¹ which set out a single definition of forbearance for use in the EU. ESMA worked closely with EBA to ensure that the definition in supervisory reporting is consistent with the financial reporting requirements as included in the ESMA Statement and expects that the common definition would be used for financial reporting as well.

Findings

129. More than half of the sample included an explicit mention of '*forbearance practices*' either in the accounting policies or credit risk sections of the financial statements and defined forbearance in the context of providing concessions as a result of financial difficulties of a borrower. An additional fifth of the sample referred to the practices undertaken in respect of restructuring or renegotiating loan terms without explicitly referring to these as forbearance practices.
130. ESMA noted that less than one third of the financial statements reviewed provided clear quantitative information as to the extent to which forbearance measures were applied. However, this information is particularly useful when assessing the overall quality of the loan portfolio. An illustration on the qualitative information disclosed in practice is provided in Example 6 in the Appendix.
131. Approximately one quarter of those financial institutions, which defined forbearance in the context of financial difficulties of a borrower, provided details on the nature of the forbearance measures extended. Among financial institutions referring to restructuring or renegotiation only very few provided details of the nature of the measures extended.
132. Approximately one fifth of the financial institutions, which defined forbearance in the context of financial difficulties of a borrower, clearly identified the nature of the risks related to forbearance measures undertaken and provided information on how these risks were managed. Almost the same portion disclosed criteria as to when financial assets to which forbearance measures had been extended would no longer be considered to be forborne.
133. ESMA noted that it was not always possible to distinguish between the loans on which forbearance measures have been extended in the context of financial difficulties and those that were renegotiated for commercial reasons and are therefore not indicative of an increased credit risk.
134. From a quantitative point of view, one quarter of those financial institutions, which defined forbearance in the context of financial difficulties of a borrower, provided the carrying value of loans subject to forbearance measures and one tenth disclosed the proportion of forborne loans against the overall loan book. Financial institutions in the sample only rarely distinguished between specific and collective impairment provisioning attributable to forborne loans. Quantitative information was only rarely provided by those financial institutions, which referred to restructuring or renegotiation without mentioning forbearance. Reconciliation of the movements over the reporting period on forborne loans was rarely provided.

¹¹ EBA FINAL draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013, European Banking Authority, 21 October 2013

Conclusions

135. Although progress has been noted in respect of the overall level and quality of disclosures relating to forbearance measures compared to 2011 annual IFRS financial statements, ESMA expects that financial institutions will provide more granular quantitative information in their 2013 financial statements that would enable users to assess the level of forbearance measures extended and evaluate their impact on the financial statements.
136. In the interest of providing high quality information, financial institutions should distinguish between forbore loans and loans that have been renegotiated for commercial reasons to better allow users assessing the risk attached to each type of loan. ESMA is concerned that aggregate disclosures combining (i) loans to which forbearance measures have been applied due to financial difficulties and (ii) loans that were renegotiated for commercial reasons and are not indicative of increased credit risk may be misleading as to the nature of the risks associated with the loan book as a whole.
137. ESMA expects financial institutions to disclose in their accounting policy clear criteria as to what point they would no longer consider the affected loans to be forborn.

D.3 Non-performing loans

IFRS requirements

138. The extent to which loans are considered to be no longer performing is an important measure when considering the quality of a financial institution's loan portfolio. Accordingly its disclosure in the financial statements can be seen as addressing the general requirements of paragraphs 33 and 34 of IFRS 7. When assessing impairment of a financial asset or a group of financial assets, one of the indicators set out within paragraph 59 of IAS 39 to identify a loss event is a breach of contract, such as default or delinquency in interest or principal payments.

Findings

139. Approximately three quarters of the financial institutions reviewed included a reference to non-performing loans ('NPLs'). Certain financial institutions made reference to defaulted loans but often such loans were similar to those classified as NPLs in other sets of financial statements. When both terms were used the distinction between them was not always clearly disclosed. Of the financial institutions that referred to NPLs, around a third did not define what they considered to be NPLs.
140. Although the majority of financial institutions, which provided a definition of NPLs, made reference to such loans being in arrears for at least 90 days or to the definition of NPL as provided under Basel 2, in a minority of cases no definition of NPL was disclosed. Such variance or missing definitions could lead to lack of comparability across different sets of financial statements.
141. Approximately two thirds of financial institutions that referred to NPLs included an explanation of the relationship between NPLs and impaired loans. Generally this disclosure was limited to a comment that NPLs are considered to be impaired. Where provided, the disclosure of the amount of impairment loss charged in respect of NPLs broadly follows a similar format across all of the reports reviewed. Example 7 in the Appendix illustrates a disclosure of analysis of NPLs.

Conclusions

142. When referring to NPLs in their financial statements, ESMA encourages financial institutions to provide a clear definition and explain the relationship between NPLs, defaulted and impaired loans. Clear presentation of this relationship enhances comparability and provides users with valuable information regarding the quality of the loan book as a whole. ESMA encourages financial institutions to use the common definition of NPLs set out in EBA Implementing Technical Standards¹².

D.4 Country concentration risk including sovereign exposures

IFRS requirements

143. Paragraph 34 (c) of IFRS 7 requires disclosure of concentration risk and paragraphs B8 and IG 18 of IFRS 7 further explain that concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgement on the specific circumstances in which an entity operates. Disclosure should include a description of how management determines concentrations, a description of the shared characteristics that identify each concentration (e.g. counterparty, geographical area, currency or market) and the amount of the risk exposure associated with all financial instruments sharing that characteristic.
144. Further disclosures such as fair value measurement within the fair value hierarchy should be provided separately for concentrations of risk, where relevant for the understanding of the financial information.
145. In 2011 ESMA considered sovereign debt holdings in specific countries to fall under the category of risk concentration and published a Public Statement¹³ that stressed the need for transparency and the importance of consistent application of IFRS principles. It highlighted the elements of IFRS requirements that should be considered by financial institutions and their auditors in relation to exposure to sovereign debt when preparing their annual financial statements. These principles remain valid for other categories of significant risk concentration based on actual economic development (e.g. for non-sovereign exposures).

Findings

146. By the 2012 year end, governments' and ECB's actions had led to a fall in yields on periphery Eurozone sovereign debt, lessening the significance of many of the issues which had been of key importance to users of financial statements the previous year. At the same time, there was a heightened concern about the quality of non-sovereign exposures in certain 'at risk' countries. The countries generally considered to be at risk changed, with additional countries coming under economic pressure.

Countries 'at risk'

147. There can be no generally accepted definition of what constitutes an exposure subject to enhanced risk as this will depend on the individual circumstances of each financial institution, but considera-

¹² EBA FINAL draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013, European Banking Authority, 21 October 2013

¹³ Public Statement: Sovereign Debt in IFRS Financial Statements, European Securities and Markets Authority, 25 November 2011

tion should be given to what are known to be general market expectations and information related to the restrictions of the access of a country to the financial markets, for example in 2012, to those countries generally termed as ‘peripheral Eurozone’. Variation was found within the sample of the countries identified as being ‘at risk’. Exposures to Greece, Portugal, Ireland, Spain and Italy were most often identified as subject to increased risk, but some financial institutions also identified a number of other countries, including Cyprus, some of the Baltic countries and Hungary. While most financial institutions provided enhanced disclosures for these countries only, others provided the same level of disclosures for all Eurozone countries. This review looked primarily at disclosures about holdings of both sovereign and non-sovereign exposure in the peripheral Eurozone.

Sovereign exposures in countries ‘at risk’

148. Almost two thirds of the sample had significant levels of sovereign exposure to peripheral Eurozone countries. Of these, almost all provided disclosure of exposures by IAS 39 category. In most cases, only the carrying value (net amount) was disclosed, but a minority also provided the gross or nominal amount. Where there was no impairment, gross and net would be the same, but where a significant impairment was recognised, additional disclosure would have been useful for understanding the extent to which these holdings had already been written down.
149. About a third of the sample disclosed that impairment had been charged during the year, with half of these providing explanations of how/why it was recognised. In all cases the impairment related to the Greek Private Sector Involvement (PSI) and Greek Government Bonds buybacks occurred over the reporting period. There were no findings of impairment on any other country’s sovereign exposures.
150. Disclosures related to credit protection on sovereign exposures were varied. ESMA observed that about half of those financial institutions with significant holdings of sovereign debt indicated having credit protection on sovereign exposures and provided details of the protection written and in most of the cases also the amounts of the exposure. Some financial institutions made a general disclosure about CDS but it was not possible to identify if this was related to sovereign or other exposures.
151. Not all financial institutions provided reconciliations between their maximum exposure and the exposure after credit protection. In a number of cases it was still not possible to assess the extent to which financial institutions had either increased or decreased their exposure to sovereign debt with CDS. Nevertheless, the level of disclosures seen did represent an improvement compared to disclosures provided in 2011 financial statements, with more financial institutions providing detailed information about CDS on sovereign exposures.
152. Very few financial institutions provided any specific disclosure about classification of fair value measurement of sovereign exposures in the fair value hierarchy. This information would be particularly important in situations when fair value measurement of the sovereign debt was not classified as level 1 of the fair value hierarchy.

Non-sovereign exposures in countries ‘at risk’

153. Disclosures on non-sovereign exposures related to the countries ‘at risk’ were found to be of variable depth and quality. Exposures in the home country of the financial institution (if considered ‘at risk’) were ignored for this part of the review. A majority of financial institutions that were active in the

peripheral Eurozone area provided some information, but where there was no disclosure, it was not always clear whether the financial institution had relevant exposures.

154. Almost half of the financial institutions disclosed separately non-sovereign exposures in countries 'at risk' and just over half of those recognised impairment, but disclosures about this impairment were vague and divergent in practice. Almost half of the financial institutions did not disclose separately the amounts of impairment associated with non-sovereign exposures in countries at risk, even when the exposure was significant and existence of impairment might have been expected. It was therefore not possible to assess the extent to which these financial institutions had reflected the enhanced risk in assessing the impairment of these portfolios, thus hampering comparability.

Conclusions

155. Whilst 2011 financial statements had focussed on Greek sovereign debt, disclosures in 2012 reflected a more varied approach to country concentration risk, reflecting the progress that had been made in addressing the Greek sovereign debt and the concerns that had arisen over sovereign and non-sovereign exposure to various other countries.
156. Although ESMA acknowledges improvements in some areas, such as more clarity in the disclosures about CDS and providing gross non-sovereign exposures in countries considered to be 'at risk', further disclosures related to impairment of non-sovereign exposures and impact of CDS on these exposures would have been helpful. When the fair value measurement of the sovereign debt was not classified as level 1 of the fair value hierarchy, ESMA believes specific disclosure about fair value measurement of sovereign debt with the fair value hierarchy together with the basis for its determination might be required.
157. ESMA considers it to be important that financial institutions take a fresh look each year at what their concentration risk is, and what disclosures are important, rather than simply continuing with the previous year's disclosures in areas that may have lessened in importance.
158. As the level of risk can vary between countries in the same region, ESMA believes it is most relevant to provide information by country when the exposure to that country is significant to the financial institution.
159. Comparability is not lessened by a lack of uniformity in the concentration exposures disclosed by various financial institutions, as long as these disclosures reflect their individual risk profile. Comparability is compromised where financial institutions which do have exposures to areas generally considered to be at risk, do not disclose them, or where the disclosures about such exposures are too narrow, for example by providing no information about impairment or credit protection.
160. As pointed out in the ESMA Statement, IFRS requirements regarding disclosures on impairment, asset categories and the extent of credit protection related to sovereign debt or to other areas of country concentration risk should be applied so that financial institutions provide explanations on the amount of risk exposure relating to these portfolios, thus enhancing comparability between financial statements.

E. Impairment of equity securities classified as available-for-sale

IFRS requirements

161. Paragraph 61 of IAS 39 indicates that one indicator of objective evidence of impairment is a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost. Paragraph 67 of IAS 39 specifies that when a decline in the fair value of an AFS financial asset has been recognised in OCI, and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised in OCI shall be reclassified to profit or loss as a reclassification adjustment even though the financial asset has not been derecognised.
162. Paragraph 21 of IFRS 7 requires disclosure of the measurement basis and other accounting policies used in preparing the financial statements and paragraph B5(f) of IFRS 7 requires specific disclosures of the criteria an entity uses to determine that there is objective evidence that an impairment loss has occurred.
163. The IFRIC agenda decision from July 2009¹⁴ indicates that determination of what constitutes a significant or prolonged decline is a matter that requires judgement. The IFRIC agenda decision states that disclosure of judgements an entity has made in determining the existence of objective evidence and the amounts of impairment would be provided in accordance with paragraphs 122 and 123 of IAS 1 and paragraph 20 of IFRS 7.
164. The disclosure of the separate amount of the gross negative AFS reserve related to equity instruments may be relevant. This figure could be seen as an indicator of the potential losses that could be charged against profit or loss in case of impairment or derecognition. This is not a specific IFRS disclosure requirement but it should be disclosed to the extent it is relevant to an understanding of the financial statements.

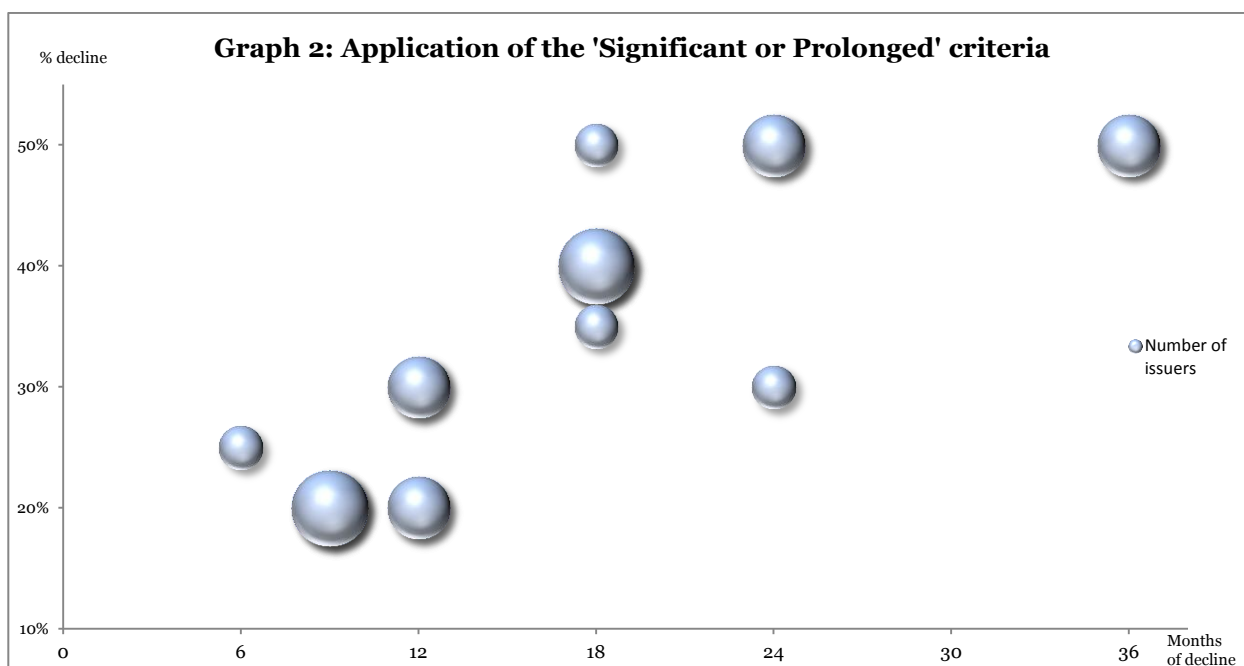
Findings

165. Almost 20% of the financial institutions in the sample seemed not to comply with the IFRS requirements regarding accounting policy on impairment of equity investments classified as AFS. These financial institutions did not disclose any accounting policy for a potentially material portfolio of equity instruments classified as AFS or used the terms 'significant and prolonged', 'significant or permanent' or applied the term '*significant or prolonged*' in an equivocal or ambiguous manner.
166. Nearly half of the financial institutions did not disclose either the percentage that constitutes a significant decline, or the time period that constitutes the prolonged decline in the fair value of such instruments. For approximately half of these financial institutions, materiality of the equity instruments held in the AFS portfolio could provide an explanation of the missing disclosure.
167. For half of the financial institutions that disclosed their judgement on what they consider a significant or prolonged decline, ESMA found a wide range of quantitative criteria indicating diversity in practice. With respect to the time period (prolonged) criterion, ESMA found that financial institutions applied a range from 6 to 36 months and in relation to the significant criterion, a range of decline from 20% up to 50% was used. Even though part of the variation could be explained by differ-

¹⁴ IFRIC Update – July 2009, International Accounting Standards Committee Foundation, July 2009

ent nature of the underlying instruments, this wide range of criteria applied could lead users of financial statements to question whether reasonable judgement has been applied.

168. Graph 2 illustrated diversity in application of the significant or prolonged criteria:



169. One-third of the financial institutions that described their judgement on what they consider a significant or prolonged decline used a two-step approach in determining impairment of these financial instruments. In the first step, they used an indicator of decline that would require additional analysis in order to evaluate whether there was objective evidence of impairment. The indicator used related usually to a lower threshold for significant or prolonged or a combination of significant and prolonged criteria.
170. Subsequently these financial institutions used and disclosed a backstop for significant or prolonged criteria that would automatically trigger impairment of AFS equity instruments. These backstop criteria necessarily implied higher thresholds. By using a two-step approach, financial institutions can identify at an early stage AFS equity instruments that may be impaired, but if these backstop criteria are set at an unreasonable level, the financial institution might classify certain instruments as not impaired despite substantial decline of fair value over a longer time span.
171. Almost 20% of financial institutions in the sample disclosed the amount of accumulated positive and negative AFS reserve related to AFS equity instruments.

Conclusions

172. ESMA believes that disclosures referring to the use of the significant or prolonged criteria should be improved by describing the relevant accounting policy and clearly stating judgements made in determining the existence of objective evidence of impairment for AFS equity instruments.
173. ESMA urges financial institutions holding material portfolios of equity instruments classified as AFS to present the specific criteria used in applying judgement to determine when a decline in the fair value of an equity instrument is significant or prolonged as stated by July 2009 IFRIC Update. Financial institutions are encouraged to disclose the amounts of accumulated positive and negative AFS reserve related to these equity instruments in order to evaluate future possible impacts on profit or loss.
174. ESMA noted a wide range of application of the 'significant or prolonged' criteria among financial institutions. For those financial institutions that use very high thresholds, ESMA doubts whether those judgements could be seen as reasonable. ESMA urges these financial institutions to carefully assess and disclose the judgements made and provide sufficiently disaggregated information to enable users of financial statements to assess impact of these thresholds on financial performance of the financial institution.

Appendix: Examples of application of the IFRS requirements

Example 1: Analysis of 'net gains or losses' on financial instruments by IAS 39 category

a) Disclosure of net gains or net losses in a single note

(70) Net profit or loss from financial instruments

The net profit or loss from financial instruments in each category incorporates the gains or losses from measurement and realisation.

EUR million	2012	2011
Financial assets or financial liabilities at fair value through profit or loss	299	341
• Held for trading financial instruments ¹	355	320
• Financial instruments measured at fair value through profit or loss (fair value option)	-56	21
Loans and receivables	-369	-800²
Available for sale financial assets	-340	65
Financial liabilities measured at amortised cost	190	-8

¹ Including gains or losses from currency translation.

² Adjusted as per IAS 8.42 (see note 2).

Gains or losses from the fair value measurement of available for sale financial assets in the amount of EUR 635 million (FY 2011: EUR 191 million) were reported in the revaluation surplus in equity (see note 64).

Source: Bayern LB, Consolidated Financial Statements, Annual Report 2012, p. 253

NOTE 38: NET GAIN OR LOSS REALIZED ON FINANCIAL INSTRUMENTS

(in HUF mn)

As at 31 December 2012

	Net interest gain and loss	Net non- interest gain and loss	Provision for impairment	Other comprehensive income
Cash, amounts due from banks and balances with the National Banks	6,749	-	-	-
Placements with other banks, net of allowance for placements losses	9,457	-	(40)	-
Securities held for trading	1,827	(3,546)	-	-
Securities available-for-sale	78,624	2,798	490	59,481
Loans, net of allowance for loan losses	787,646	6,952	(226,940)	-
<i>From this: Consumer loans</i>	<i>372,603</i>			
<i>Housing loans</i>	<i>178,050</i>			
<i>Corporate loans</i>	<i>153,448</i>			
<i>Mortgage backed loans</i>	<i>65,687</i>			
<i>Municipality loans</i>	<i>17,858</i>			
Securities held-to-maturity	20,204	(87)	15	-
Derivative financial instruments	56,302	(7,376)	-	-
Amounts due to banks, the Hungarian Government, deposits from the National Banks and other banks	(18,814)	-	-	-
Deposits from customers	(230,574)	123,141	-	-
Liabilities from issued securities	(54,033)	-	-	-
Subordinated bonds and loans	(11,923)	-	-	-
	<u>645,465</u>	<u>121,882</u>	<u>(226,475)</u>	<u>59,481</u>

Source: OTP Bank, Consolidated Financial Statements, Annual Report 2012, p. 139

(1) Income statement according to measurement categories

€ 000	2012	2011
Net gains (losses) on financial assets and liabilities held-for-trading	510,363	753,816
Financial assets and liabilities at fair value through profit or loss	246,228	378,660
Interest income	404,513	331,852
Net gains (losses) on financial assets and liabilities at fair value through profit or loss	(158,285)	46,808
Financial assets available-for-sale	107,644	(68,373)
Interest income	22,152	67,354
Net realized gains (losses) on financial assets available-for-sale	185,897	14,092
Impairment on financial assets available-for-sale	(100,404)	(149,818)
Loans and advances	4,519,218	4,455,115
Interest income	5,549,908	5,554,362
Net realized gains (losses) on financial assets not measured at fair value through profit and loss	8,894	8,147
Impairment on financial assets not measured at fair value through profit and loss	(1,039,584)	(1,107,395)
Financial assets held-to-maturity	226,212	532,430
Interest income	225,324	442,806
Net realized gains (losses) on financial assets not measured at fair value through profit and loss	1,062	91,793
Impairment on financial assets not measured at fair value through profit and loss	(174)	(2,169)
Financial liabilities	(2,961,564)	(3,010,384)
Interest expenses	(3,071,364)	(3,010,384)
Income from repurchase of liabilities	109,801	0
Derivatives (hedging)	8,392	23,729
Net interest income	(190)	(6,104)
Net gains (losses) from hedge accounting	8,582	29,834
Net revaluations from exchange differences	105,219	78,309
Other operating income/expenses	(1,857,183)	(1,999,504)
Profit before tax from continuing operations	904,530	1,143,798

Source: Raiffeisen Zentralbank, Consolidated Financial Statements, Annual Report 2012, p. 67

b) Definition of net gains or net losses in the accounting policies section

c) **Net gains** or losses

Net gains or losses include fair value measurements recognised in the income statement, impairments, impairment reversals, gains realised on disposal, and subsequent recoveries on written-down financial instruments classified in the respective IAS 39 categories. The components are detailed for each IAS 39

category in the notes on net interest income, loan loss provisions, net trading income and net investment income.

Source: Commerzbank, Consolidated Financial Statements, Annual Report 2012, p. 199

Example 2: Analysis of liquidity reserve

Liquidity pool (audited)

The Group liquidity pool is held unencumbered against contractual and contingent stress outflows in the LRA stress tests and is not used to support payment or clearing requirements. As at 31 December 2012, the Group liquidity pool was £150bn (2011: £152bn). During 2012 the month-end liquidity pool ranged from £150bn to £173bn and the month-end average balance was £162bn (2011: £156bn).

Barclays does not include any own-name securities in its liquidity pool.

Composition of the Group liquidity pool as at 31 December 2012 (audited)

	Liquidity pool £bn	Liquidity pool of which FSA eligible £bn	Liquidity pool of which Basel 3 LCR eligible	
			Level 1 £bn	Level 2A* £bn
Cash and deposits with central banks ^b	85	82	82	–
Government bonds ^c				
AAA rated	40	39	40	–
AA+ to AA- rated	5	4	5	–
A+ to A- rated	1	–	–	1
Total government bonds	46	43	45	1
Other				
Supranational bonds and multilateral development banks	4	4	4	–
Agencies and agency mortgage-backed securities	7	–	5	2
Covered bonds (rated AA- and above)	5	–	–	5
Other	3	–	–	–
Total Other	19	4	9	7
Total	150	129	136	8

The Group liquidity pool is well diversified by major currency and the Group monitors LRA stress scenarios for major currencies.

Liquidity pool by currency

	USD £bn	EUR £bn	GBP £bn	Other £bn	Total £bn
Liquidity pool	26	66	25	33	150

Management of the Group liquidity pool (audited)

The composition of the Group liquidity pool is efficiently managed. The maintenance of the liquidity pool increases the Group's costs as the interest expense paid on the liabilities used to fund the liquidity pool is greater than the interest income received on liquidity pool assets. This cost can be reduced by investing a greater portion of the Group liquidity pool in highly liquid assets other than cash and deposits with central banks. These assets primarily comprise government bonds and their inclusion in the liquidity pool does not compromise the liquidity position of the Group.

The composition of the liquidity pool is subject to limits set by the Board, Treasury Committee and the independent credit risk and market risk functions. In addition, the investment of the liquidity pool is monitored for concentration risk by issuer, currency, asset type and country. Given the incremental returns generated by these highly liquid assets, the risk and reward profile is continuously managed.

As at 31 December 2012 the portion of the Group liquidity pool comprised of cash and deposits with central banks reduced to £85bn (2011: £105bn) as a result of a reallocation to government bonds and other highly liquid assets.

Barclays manages the liquidity pool on a centralised basis. As at 31 December 2012, 90% of the liquidity pool was located in Barclays Bank PLC (2011: 94%) and was available to meet liquidity needs across the Group. The residual liquidity pool is held predominantly within Barclays Capital Inc. (BCI). The portion of the liquidity pool outside of Barclays Bank PLC is held against entity-specific stressed outflows and regulatory requirements. To the extent the use of this portion of the liquidity pool is restricted due to regulatory requirements, it is assumed to be unavailable to the rest of the Group.

For more information on the governance framework for investing the Group liquidity pool see page 337.

Source: Barclays, Risk Review, Annual Report 2012, p. 175

Example 3: Analysis of encumbered assets

*Analysis of on-balance sheet encumbered and unencumbered assets
(Unaudited)*

	Encumbered	Unencumbered		Unencumbered – cannot be pledged as collateral		Total US\$m
		Assets pledged as collateral US\$m	Readily realisable assets US\$m	Other realisable assets US\$m	Reverse repo/stock borrowing receivables & derivative assets US\$m	
At 31 December 2012						
Cash and balances at central banks	–	139,963	220	–	1,349	141,532
Items in the course of collection from other banks	–	–	–	–	7,303	7,303
Hong Kong Government certificates of indebtedness	–	–	–	–	22,743	22,743
Trading assets	143,019	116,395	10,330	134,752	4,315	408,811
– Treasury and other eligible bills	2,309	23,973	–	–	–	26,282
– debt securities	97,157	47,311	205	–	4	144,677
– equity securities	5,592	35,420	622	–	–	41,634
– loans and advances to banks	20,588	1,909	2,582	50,376	2,816	78,271
– loans and advances to customers	17,373	7,782	6,921	84,376	1,495	117,947
Financial assets designated at fair value	–	447	610	–	32,525	33,582
– Treasury and other eligible bills	–	14	–	–	40	54
– debt securities	–	431	128	–	11,992	12,551
– equity securities	–	2	482	–	20,384	20,868
– loans and advances to banks	–	–	–	–	55	55
– loans and advances to customers	–	–	–	–	54	54
Derivatives	–	–	–	357,450	–	357,450
Loans and advances to banks	1,191	4,722	81,802	35,461	29,370	152,546
Loans and advances to customers	40,792	85,626	827,903	34,664	8,638	997,623
Financial investments	46,678	300,255	7,990	–	66,178	421,101
– Treasury and other eligible bills	2,024	84,991	156	–	379	87,550
– debt securities	44,654	214,545	4,112	–	64,451	327,762
– equity securities	–	719	3,722	–	1,348	5,789
Assets held for sale	–	–	19,269	–	–	19,269
Other assets	1,600	18,601	11,621	–	22,894	54,716
Current tax assets	–	–	–	–	515	515
Prepayments and accrued income	–	–	–	–	9,502	9,502
Interest in associates and joint ventures	–	–	17,480	–	354	17,834
Goodwill and intangible assets	–	–	–	–	29,853	29,853
Property, plant and equipment	–	–	6,772	–	3,816	10,588
Deferred tax	–	–	–	–	7,570	7,570
	233,280	666,009	983,997	562,327	246,925	2,692,538

Source: HSBC, Report of Directors 2012, Operating and Financial Review – Risk, Annual Report 2012, p. 213 (unaudited)

Example 4: Reconciliation of *Credit Risk Exposures*

Maximum Exposure to Credit Risk

The maximum exposure to credit risk table shows the direct exposure before consideration of associated collateral held and other credit enhancements (netting and hedges) that do not qualify for offset in our financial statements for the periods specified. The netting credit enhancement component includes the effects of legally enforceable netting agreements as well as the offset of negative mark-to-markets from derivatives against pledged cash collateral. The collateral credit enhancement component mainly includes real estate, collateral in the form of cash as well as securities related collateral. In relation to collateral we apply internally determined haircuts and additionally cap all collateral values at the level of the respective collateralized exposure.

Maximum Exposure to Credit Risk

in € m. ¹	Maximum exposure to credit risk ²	Netting	Collateral	Credit Enhancements	
				Guarantees and Credit derivatives ³	Total credit enhancements
Due from banks	27,885	–	–	1	1
Interest-earning deposits with banks	119,548	–	2	35	37
Central bank funds sold and securities purchased under resale agreements	36,570	–	36,341	–	36,341
Securities borrowed	23,947	–	23,308	–	23,308
Financial assets at fair value through profit or loss ⁴	1,119,100	657,826	211,397	3,968	873,191
Financial assets available for sale ⁴	47,110	–	1,287	703	1,990
Loans ⁵	401,975	–	208,529	37,841	246,370
Other assets subject to credit risk	85,806	69,546	6,653	12	76,211
Financial guarantees and other credit related contingent liabilities ⁶	68,361	–	7,810	8,444	16,254
Irrevocable lending commitments and other credit related commitments ⁶	129,657	–	4,771	10,558	15,329

¹ All amounts at carrying value unless otherwise indicated.

² Does not include credit derivative notional sold (€ 1,274,980 million) and credit derivative notional bought protection. Interest-earning deposits with banks mainly relate to Liquidity Reserves.

³ Credit derivatives are reflected with the notional of the underlying.

⁴ Excludes equities, other equity interests and commodities.

⁵ Gross loans less (deferred expense)/unearned income before deductions of allowance for loan losses.

⁶ Financial guarantees, other credit related contingent liabilities and irrevocable lending commitments (including commitments designated under the fair value option) are reflected at notional amounts.

Source: Deutsche Bank, Risk Review 2012, Annual Report 2012, p. 152-153

Example 5: Disclosure of accounting policies related to impairment

Impairment

If objective evidence of impairment of a loan, an advance or an amount due exists, and the effect of the impairment event or events on the expected cash flow is reliably measurable, the Group determines the impairment charge individually.

Objective evidence of impairment of loans and advances exists if at least one of the following events has occurred:

- The borrower is experiencing significant financial difficulty.
- The borrower's actions, such as default or delinquency in interest or principal payments, lead to a breach of contract.
- The Group, for reasons relating to the borrower's financial difficulty, grants to the borrower a concession that the Group would not otherwise have granted.
- It becomes probable that the borrower will enter bankruptcy or other financial restructuring.

Significant loans, advances and amounts due are tested individually for impairment at the end of each reporting period.

Customers with loans and advances for which objective evidence of impairment exists, including loans and advances for which no impairment charges have been recognised, for example because adequate collateral has been provided, are placed in rating category 10 or 11. If a customer facility is 90 days or more past due, the customer is placed in rating category 11 and an impairment charge is recognised for the customer's total exposure.

The impairment charge equals the difference between the carrying amount of the loan or advance and the present value of the most likely future cash flows from the loan or advance and is assessed by credit officers. The present value of fixed-rate loans and advances is calculated at the original effective interest rate, whereas the present value of loans and advances with a variable rate of interest is calculated at the current effective interest rate.

The customer's debt is written down to the amount that the borrower is expected to be able to repay after financial restructuring. If financial restructuring is not possible, the writedown equals the estimated recoverable amount in the event of bankruptcy. If the borrower's ability to repay depends significantly on the assets that have been provided as collateral (asset financing), the customer's debt is written down to the fair value of the collateral.

Loans and advances without objective evidence of impairment are included in an assessment of collective impairment at portfolio level. Collective impairment is calculated for portfolios of loans and advances with similar credit characteristics when impairment of expected future cash flows from a portfolio has occurred but no interest rate change has been agreed on to adjust the credit margin. The collective impairment charge reflects the lowering of customer ratings over time (migration). The loans and advances are divided into portfolios on the basis of current ratings. Calculation of charges also factors in portfolios of loans held by customers with improved ratings.

The cash flows are specified by means of parameters used for solvency calculations and historical loss data adjusted for use in the financial statements, for example. The adjustment reflects the loss identification period shown by the Group's empirical data. This period is the period from the first evidence of impairment to the determination of a loss at customer level.

Collective impairment charges are calculated as the difference between the carrying amount of the loans and advances of the portfolio and the present value of expected future cash flows.

The collective impairment charge based on migration is adjusted if the Group becomes aware of market conditions at the balance sheet date that are not fully reflected in the Group's models. In times of favourable economic conditions, adjustments will reduce the impairment charge, while it may increase in an economic downturn. Examples of factors that determine economic conditions are levels of unemployment, housing prices and freight rates.

Source: Danske Bank Group, Consolidated Financial Statements, Annual Report 2012, p. 119-120

Example 6: Overview of Forbearance Measures

b) Quantitative information on refinancing and restructuring operations.

BALANCE OF FORBEARANCE (a)														
BBVA GROUP DECEMBER 2012 (Millions of euros)	NORMAL (b)						POTENTIAL PROBLEM LOANS							
	Real estate mortgage secured		Rest of secured loans (c)		Unsecured loans		Real estate mortgage secured		Rest of secured loans (c)		Unsecured loans		Specific coverage	
	Number of operations	Gross amount	Number of operations	Gross amount	Number of operations	Gross amount	Number of operations	Gross amount	Number of operations	Gross amount	Number of operations	Gross amount		
1 Government agencies	112	5	14	87	11	707	2	227	1	12	4	220	7	
2 Other legal entities and individual entrepreneurs	10,046	3,225	1,002	400	24,996	2,762	3,485	2,436	732	653	10,173	1,347	866	
<i>Of which: Financing the construction and property development</i>	2,312	1,688	93	106	984	421	702	1,287	77	422	221	75	600	
3 Other individuals	76,040	3,845	3,742	434	331,051	487	32,440	2,684	3,458	590	23,876	253	289	
4 Total	87,098	7,075	4,758	921	356,058	3,956	35,927	5,348	4,191	1,254	34,053	1,820	1,162	

BBVA GROUP DECEMBER 2012 (Millions of euros)	IMPAIRED							TOTAL		
	Real estate mortgage secured		Rest of secured loans (c)		Unsecured loans		Specific coverage	Number of operations	Gross amount	Specific coverage
	Number of operations	Gross amount	Number of operations	Gross amount	Number of operations	Gross amount				
1 Government agencies	14	19	1	7	-	-	1	159	1,284	9
2 Other legal entities and individual entrepreneurs	7,665	3,873	1,566	1,133	12,516	907	2,131	72,171	16,736	2,997
<i>Of which: Financing the construction and property development</i>	2,790	2,764	392	818	746	361	1,800	8,317	7,942	2,400
3 Other individuals	30,646	1,998	2,224	370	103,796	300	863	608,173	10,961	1,151
4 Total	38,325	5,890	3,781	1,511	116,312	1,207	2,995	680,503	28,981	4,157

(a) Includes all forbearance operations as defined in paragraph 1.g) of Annex IX of Circular 4/2004 of the Bank of Spain
(b) Risks rated as normal in special monitoring as stated in paragraph 7.a) of Annex IX of the Circular 4/2004 of the Bank of Spain.
(c) Includes mortgage-backed real estate operations not full, ie loan to value greater than 1, and secured operations, other than transactions secured by real estate mortgage, of whatever their loan to value.

The BBVA Group's total refinancing operations as of December 2012 amounted to €28,981 million. Of this figure, 68% corresponded to BBVA S.A., 12% to Unnim and 20% to the rest of the BBVA Group.

The refinanced debt in a normal risk situation in BBVA S.A. (€7,367 million) accounts for 3% of total credit. A further 3% is classified as substandard risk (€6,402 million), with a coverage of 14.5%.

The risk figure for refinanced debt in the commercial portfolio (developers and other companies) includes not only refinanced debt but also the total position associated with the customer.



Example 7: Overview of Non-Performing Loans

In the tables below the non-performing loans and advances to customers subdivided by business segment are contrasted with loan loss provisions and the collateral for non-performing loans (NPL) as of 31 December 2012 and 31 December 2011, respec-

tively. The NPL ratio, the NPL coverage ratio and the NPL total coverage ratio are also included. The NPL total coverage ratio specifies the coverage of non-performing loans by loan loss provisions and collateral for non-performing loans.

Non-performing loans and advances to customers by business segment and coverage by risk provisions and collateral in 2012

in EUR million	Non-performing	Loans and advances to customers	Loan loss provisions	NPL ratio	NPL coverage ratio	Collateral for NPL	NPL total coverage ratio
Retail & SME	10,766	113,573	6,681	9.5%	62.1%	5,107	109.5%
Austria	3,643	65,738	2,251	5.5%	61.8%	1,578	105.1%
EB Österreich	1,058	28,052	696	3.8%	65.7%	442	107.5%
Savings Banks	2,585	37,687	1,556	6.9%	60.2%	1,137	104.2%
Central and Eastern Europe	7,123	47,834	4,429	14.9%	62.2%	3,529	111.7%
Czech Republic	956	17,891	690	5.3%	72.2%	365	110.4%
Romania	3,021	10,682	1,771	28.3%	58.6%	1,630	112.6%
Slovakia	437	6,598	369	6.6%	84.3%	249	141.2%
Hungary	1,572	6,185	1,008	25.4%	64.1%	731	110.7%
Croatia	1,069	5,909	534	18.1%	50.0%	520	98.6%
Serbia	68	569	58	12.0%	84.1%	34	134.0%
Group Corporate & Investment Banking	1,330	17,928	893	7.4%	67.2%	494	104.3%
Group Markets	0	77	0	0.0%	6,439.9%	0	6,439.9%
Corporate Center	2	350	0	0.5%	26.9%	0	26.9%
Total	12,098	131,928	7,574	9.2%	62.6%	5,601	108.9%

Source: Erste Group Bank, Consolidated Financial Statements, Annual Report 2012, p. 176