Guidance

Corporate Governance

Financial Reporting Council

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

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## Contents

*Page*

## Preface

This guidance, which addresses supplementary considerations for the banking sector, should be read in conjunction with the *Guidance on Risk Management and Internal Control and Related Financial and Business Reporting* (the 'Risk Guidance') issued in September 2014. The Risk Guidance and this supplementary guidance reflect the recommendations of the Sharman Panel of Inquiry into *Going concern and liquidity risks: lessons for companies and auditors*[1] (the 'Panel') and replace the extant guidance on going concern and liquidity risks.[2]

The Panel was commissioned in the aftermath of the financial crisis to identify lessons for companies and auditors addressing going concern and liquidity risks and recommend any necessary improvements to the existing reporting regime and guidance for companies and auditors in relation to these matters. It addressed the particular issues relating to solvency and liquidity risks affecting banks.

This supplementary guidance provides background information explaining the context of solvency and liquidity risk assessments for banks. It also provides supplementary guidance in relation to the identification and reporting of going concern material uncertainties in the financial statements and in relation to wider business reporting about solvency and liquidity risks and viability in the case of a bank.

For banks that are required, and those that choose voluntarily, to report on how they have applied the Code, the Risk Guidance and this supplementary guidance should assist the directors in meeting their financial and business reporting responsibilities under the Companies Act and under the Code related to these matters. They are applicable, adapted as necessary, for other banks.

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

This supplementary guidance is based on the legislation and regulations in force at September 2014. It does not contain an exhaustive list of the obligations that banks and their auditors may have under the Financial Services and Markets Act, the Financial Services Act (2012), the PRA Handbook or other relevant legislation or regulations.

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

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

[1] See http://www.frc.org.uk/Our-Work/Headline-projects/The-Sharman-Inquiry.aspx
[2] *Going Concern and Liquidity Risks: Guidance for Directors of UK Companies 2009*

# Section 1: Introduction and Background

## Introduction

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

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

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

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

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

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

7. The Panel concluded that this was not necessary and set out the Panel's vision of how these objectives may be reconciled within the current framework for public disclosure about the principal solvency and liquidity risks applicable to all companies and their auditors. The Risk Guidance and this supplementary guidance implement the recommendation of the Panel that the FRC should make clear that use of liquidity insurance provided by central banks may be a normal source of funding for a bank that is judged to be solvent and that, if so, the need to use those facilities does not necessarily mean that the bank: is unable to adopt the going concern basis of accounting in its financial statements; or that there are material uncertainties that need to be disclosed by the bank in its financial statements and emphasised by its auditor; or that such use or expected use needs to be disclosed as a qualification or assumption to the bank's viability statement under Code Provision C.2.2.

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

**More intense liquidity and solvency risks and greater vulnerability**

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

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

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

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

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

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

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

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

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

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

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

19. In fulfilling their duty to promote the success of the company, the directors are responsible for the stewardship of the company's survival. They should focus on those risks, or combinations of risks, that can seriously affect the performance, future prospects or reputation of the entity. These should include those risks that would threaten its business model, future performance, solvency or liquidity. In doing so, their

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

duty is not limited because the regulator sets minimum requirements either for their assessment process (e.g. specifying minimum stress testing) or for minimum risk mitigation (e.g. specifying minimum regulatory capital).

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

**Banking reforms relevant to solvency and liquidity**

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

*Governance requirements*

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

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

24. The board will therefore need to review the work of the Committee in relation to those risks that would threaten the business model, future performance, solvency or liquidity if they materialised. The board will also need to provide challenge in assessing the quality of the assurance the board has obtained in adopting and responding to the Committee's conclusions and how these are integrated with other inputs to the board's assessments of: the bank's principal risks; its ability to adopt the going concern basis of accounting and whether there are material uncertainties thereto; and its viability for purposes of the board's statement under Code Provision C.2.2.

25. *Recommendations of the Independent Commission on Banking (ICB) – the UK Government has* enacted the Financial Services (Banking Reform) Act 2013, to implement the recommendations of the ICB, with the measures to come into force in early 2019. The aim is to develop a more resilient, stable and competitive banking sector.

26. Key elements include introducing a ring-fence to separate investment banking activities from the more traditional retail banking. The latter ring-fenced business would have its own board and risk committee. Other measures focus on how to ensure that the ring-fenced bank has sufficient capacity in its capital structure to absorb losses to make banks more resilient to shocks and more resolvable and hence to reduce financial stability risks.

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

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

*Minimum regulatory requirements for banks*

28. *Capital requirements* – as a result of the financial crisis, standards for both the quality and quantity of regulatory capital required by banks were overhauled by the Basel Committee on Banking Supervision. In the UK, these changes were implemented via domestic and EU legislation (some aspects of the regime are still under development). The Bank of England's Financial Policy Committee has powers of direction to adjust capital requirements in order to contain emerging threats to financial stability, while the PRA also has powers to impose additional firm-specific capital requirements against risks that are not captured or not adequately captured in the minimum Pillar 1 capital requirements.

29. *More intense stress testing regimes* – there are three elements to the stress testing regime: firms' own firm-wide stress tests of capital and liquidity and reverse stress tests (including assessing the adequacy of capital buffers to enable the bank to meet the minimum capital requirements at all times); supervisory stress tests of particular entities, which are firm-wide; and simultaneous supervisor led system-wide tests. In addition to the PRA's stress tests, the EBA co-ordinates EU-wide stress tests as a supervisory tool designed to assess the resilience of European banks, as necessary – these are applied to banks covering a significant proportion of EU-wide banking assets.

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

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

32. *Recovery and Resolution Plans* – Rules requiring banks to prepare Recovery Plans and submit Resolution information to enable the authorities to develop Resolution Plans have been in force since 1 January 2014 (P8/13). These Rules were published alongside two Supervisory Statements outlining the PRA's expectations for the contents of Recovery Plans (SS18/13) and Resolution Planning information (SS19/13). On recovery planning, the PRA will require banks to describe credible recovery options which would restore the bank to viability, and to test these options against stress scenarios. Recovery plans should assist banks to anticipate and build action plans for recovery from shocks as well as assisting the authorities in monitoring the triggers for implementing such plans. On resolution planning, banks will submit information which the Bank of England will use to draw up the bank's resolution plan. The resolution plan is the basis for executing a resolution of the bank in the event of failure.

33. These rules are in the process of being revised to implement the EU's Bank Recovery & Resolution Directive by 1 January 2015. This in turn builds on the FSB's Key Attributes of Effective Resolution Regimes.

34. *PRA's liquidity regime* – the reformed rules are designed to enhance firms' liquidity risk management practices, based on lessons learned since the crisis began in 2007. They include quantitative requirements, with a narrow definition of liquid assets. There are

also qualitative requirements which include: over-arching principles of self-sufficiency and adequacy of liquid resources; enhanced systems and controls requirements; granular and frequent regulatory reporting requirements; and a regime for foreign branches that operate in the UK. An EU wide liquidity Pillar 1 requirement, the Liquidity Coverage Ratio, is to be introduced in 2015 and will amend the PRA's current liquidity regime.

*Framework for regulatory response*

35. *Proactive Intervention Framework* – the Proactive Intervention Framework (PIF)[5] is designed to ensure that the PRA puts into effect its aim to identify and respond to emerging risks at an early stage. There are five clearly demarcated PIF stages, each denoting a different proximity to failure, and every bank sits in a particular stage at each point in time. When a bank moves to a higher PIF stage – i.e. as the PRA determines that the firm's viability has deteriorated – supervisors will review their supervisory actions accordingly. Senior management of banks will be expected to ensure that they take appropriate remedial action to reduce the likelihood of failure. And the authorities will ensure appropriate preparedness for resolution.

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

37. However, the Bank of England also provides a range of liquidity insurance facilities for banks. The Bank of England's principal liquidity insurance facilities are part of the Bank's Sterling Monetary Framework, which is described in the "Red Book".[6] Access to the Bank's liquidity insurance facilities is designed not to undermine banks' responsibility prudently to manage their business.

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

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

[5] See the PRA's approach documents (last published June 2014): http://www.bankofengland.co.uk/pra/Pages/supervision/approach/default.aspx
[6] The most recent version of the Red Book can be found at: http://www.bankofengland.co.uk/markets/pages/sterlingoperations/redbook.aspx

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

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

42. There are also means, in addition to the permanent published facilities described above, by which a bank in difficulty may receive assistance from the Bank of England. Decisions involving the use of public funds to provide liquidity assistance to banks are the sole responsibility of the Chancellor and HM Treasury. The Financial Services Act clarifies the way in which such support is provided and who is in charge of what, and when, in the course of future financial crisis management.[7] This support may include:
    (a) Emergency Liquidity Assistance (ELA), defined as support operations outside the Bank's published frameworks, either at the Bank of England's proposal and subject to Treasury authorisation or on terms other than proposed by the Bank of England, if so directed by the Chancellor; and
    (b) Special support operations for the financial system as a whole, going beyond the Bank's published frameworks, when so directed by the Chancellor.

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

44. *Special Resolution Regime* – a bank's entry into the SRR is triggered when the PRA judges that the bank is failing or is likely to fail to meet the threshold conditions of authorisation and that it is not reasonably likely that alternative action will be taken by the bank that would enable it to satisfy those conditions.[8] The threshold conditions,

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

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

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

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

(4) The PRA shall treat Conditions 1 and 2 as met if satisfied that they would be met but for financial assistance provided by—
(a) the Treasury, or
(b) the Bank of England (disregarding ordinary market assistance offered by the Bank on its usual terms).

which must be met by a bank both upon authorisation and on an on-going basis, include amongst others that it has sufficient liquidity and capital resources.

45. In effect, these conditions mean that if a bank would be judged failing or likely to fail to satisfy its threshold conditions without relying on Government support or on other than ordinary market assistance by the Bank of England, it would normally result in resolution powers being used, assuming that use of the powers satisfies the statutory public interest test. Once a resolution power has been used, the Bank of England is required to make a public disclosure as soon as is reasonably practicable.

46. The concept of ‘ordinary market assistance’ is judgmental. As explained in the *Special Resolution Regime: Code of Practice*,[9] the Bank of England provides banks with a spectrum of assistance in all types of different circumstances. Whether or not financial assistance from the Bank of England constitutes "ordinary market assistance... on its usual terms" will depend on a combination of factors, including the terms of the Bank's operation, the circumstances of the bank receiving liquidity from the Bank, and conditions in the relevant markets in which the firm was, or would otherwise be, seeking to access funding. Furthermore, these factors may vary during the period that any assistance is given.

47. The measures the authorities can take once the SRR has been triggered fall into two categories: stabilisation tools; and a special insolvency regime for winding up banks (the *Bank Insolvency Procedure*).

*Risk reporting*

48. *BBA Code for Financial Reporting Disclosure* – the Turner Review[10] highlighted questions that the financial crisis had raised about the adequacy of financial disclosure by banks (particularly for complex financial instruments held by them) and the level of confidence that investors could place in their financial reports. In response, the BBA developed a voluntary code of disclosure, based on principles and supplementary guidance, and in October 2009 announced that the major UK-headquartered banks had agreed to adopt it. Following consultation by the FSA, and amendments made to the BBA Code in light of experience of applying it in 2009, it was finalised in 2010.

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

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

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

## Section 2: Supplementary Guidance

### Addressing the implications of central bank and government assistance

*Introduction*

51. The interpretation of what constitutes a going concern material uncertainty under the accounting standards is a matter of judgment. In the Risk Guidance and this supplementary guidance, consistent with the recommendation of the Panel, the interpretation adopted is that reliance (or potential reliance) on central bank and government liquidity assistance does not necessarily mean that the bank should not adopt the going concern basis of accounting or that a material uncertainty should be disclosed, nor that that such reliance should be disclosed as a qualification or assumption to the bank's viability statement under Code Provision C.2.2.

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

*Reliance on liquidity insurance*

53. *Identifying a material going concern uncertainty* – Appendix A of the Risk Guidance sets out the basis for identifying a material going concern uncertainty. Uncertainties should be considered material, and therefore disclosed, if their disclosure could reasonably be expected to affect the economic decisions of shareholders and other users of the financial statements. This is a matter of judgement. Factors that the directors should consider in determining whether there are material uncertainties include:
    (a) the magnitude of the potential impacts of the uncertain future events or changes in conditions on the company and the likelihood of their occurrence;
    (b) the realistic availability and likely effectiveness of actions that the directors would consider undertaking to avoid, or reduce the impact or likelihood of occurrence, of the uncertain future events or changes in conditions; and
    (c) whether the uncertain future events or changes in conditions are unusual, rather than occurring with sufficient regularity to make predictions about them with a high degree of confidence.

54. *Qualification or assumption to the board's viability statement* – Appendix B of the Risk Guidance addresses the basis on which the board makes its viability statement, including the nature of a reasonable expectation, the selection of an appropriate time period for the assessment to support the statement and the nature of any qualifications and assumptions that should be disclosed. The board's consideration of whether a risk or combination of risks could lead to an inability to continue in operation should take full account of the availability and likely effectiveness of actions that they would consider undertaking to avoid or reduce the impact or occurrence of the underlying risks and that realistically would be open to them in the circumstances. Qualifications and assumptions should only include matters that are significant to the company's prospects and should not include matters that are highly unlikely either to arise or to have a significant impact on the company. Furthermore, Section 414C(14) of the Companies Act 2006 clarifies that the disclosure of information in the Strategic Report about impending developments or matters in the course of negotiation is not necessary if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company. This is the case even if that information is considered material.

*Assessing confidence as to availability of liquidity insurance*

55. This supplementary guidance implements the recommendation of the Panel that central bank liquidity insurance is a normal funding source and is not therefore unusual for a bank. If access to those facilities is judged necessary to maintain the viability of the bank, then the board will need to assess its level of confidence as to whether those facilities will be available to the bank to a sufficient extent and over a sufficient time period to enable them to withstand the anticipated liquidity shock, and as to whether the bank:
    (a) will continue to have realistic alternatives to liquidation and cessation of trading (and will therefore be able to continue to adopt the going concern basis of accounting) for the foreseeable future; and
    (b) will be able to continue in operation and meet its liabilities as they fall due over the period of assessment they have selected for purposes of the board's statement on viability under Code Provision C.2.2.

56. Given that the overarching conditions of access to these facilities include that the bank must be judged to be solvent by the Bank of England, when it lends under the facility, that the bank must provide sufficient collateral and that there must be a credible path to a point where access is no longer required, these are critical matters which will need to be considered in order for the board to conclude on these matters.

*Concluding on whether a material going concern uncertainty should be disclosed*

57. As explained above, the Bank of England aims to provide adequate liquidity insurance facilities through published facilities The Bank of England may also provide support operations outside the published frameworks (ELA). Where a bank envisages a need to avail itself of such liquidity insurance facilities, the board should be able to conclude that there is no going concern material uncertainty that is required to be disclosed by the bank if the board has a high level of confidence that, if needed:
    (a) those facilities will be accessible by the bank to a sufficient extent and over a sufficient time period to enable them to conclude that the entity will remain viable for the foreseeable future; and
    (b) there is a credible path to repayment without resorting to action outside the normal course of business to realise its assets or discharge its liabilities.

*Concluding on whether a qualification or assumption should be disclosed*

58. Where a bank envisages a need to avail itself of such liquidity insurance facilities, the board should be able to conclude that it is not necessary to disclose that matter as a qualification or assumption to its viability statement if the board has a reasonable expectation as to the matters referred to in paragraph 56 (a) and (b) above.

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

60. The approach to the issue being addressed by the bank should take appropriate account of the likely escalation of supervisory intervention under the Proactive Intervention Framework in response to the issue, that ultimately would result in the referral of the entity into the SRR if it is considered that the bank is failing (or is likely to fail) to satisfy its 'threshold conditions' and it is not reasonably likely that alternative action will be taken that would enable it to meet those conditions. The board should

seek to understand the status of escalation, the factors giving rise to this and the actions being taken to address them. Whilst these matters may not be definitive in determining whether a material uncertainty or a qualification or assumption should be disclosed, they should be taken into consideration.

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

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

63. If the directors remain unable to conclude that there is no going concern material uncertainty, and no qualification or assumption to the viability statement, that is required to be disclosed (or if the auditors are unable to concur), the directors may conclude that such disclosures are required and/or the auditors may conclude that an emphasis of matter or qualified opinion or other reference to the matter is required in the auditor's report.

64. However, in these circumstances, any of these disclosures may be expected to result in a run on the bank. As a result, the mere expectation of such disclosure may lead to the conclusion that the proposed disclosure would be sufficient grounds to trigger the bank's entry into the SRR and the circumstances should be discussed with the Bank of England and the prudential regulator. The directors and auditors should also consider whether there are any other reasons why public disclosure of the bank's actual or potential need to avail itself of liquidity insurance facilities should be made and, if so, the implications in this context.

*Reporting and other consequences of expected disclosure of reliance on liquidity insurance*

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

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

67. Where a bank is, or envisages that it may be, reliant on Government or Bank of England support but the Bank of England is, or would be, unable to conclude that the entity is solvent, it seems likely that entry into the SRR will be triggered, either on the facts or because the directors or auditors of the bank conclude that disclosure is necessary and

the expectation of that disclosure is the trigger. In practice, subject to early public disclosure of the use of resolution powers or of other actions being taken of the sort described in paragraph 41, disclosure by the directors or auditors may then become unnecessary or may be made in circumstances where the regulatory tools deployed to address the cause of entry into the SRR will protect the bank from the normal consequences of such disclosure.

**Reporting**

68. The general reporting responsibilities for a company described in the Risk Guidance apply equally in the case of a bank.

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

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

71. The report of the Enhanced Disclosure Task Force specifically deals with enhancing risk disclosures by banks. It includes seven fundamental principles for enhanced disclosure, which also includes a cross-industry comparison principle. In addition, it provides an extensive analysis of current risk disclosure practices and makes thirty two recommendations for enhanced disclosures. Four of these are of a general nature and the remainder are categorised across seven broad risk areas, which the report considers to be the major categories of risk for banks:
    (a) Risk governance (and risk culture) and risk management strategies and the business model;
    (b) Capital adequacy and risk-weighted assets;
    (c) Liquidity;
    (d) Funding;
    (e) Market risk;
    (f) Credit risk; and
    (g) Other risks (including non-financial risks such as operational risk, reputational risk, fraud risk, legal risk and regulatory risk).

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

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

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

*(perhaps beyond one year) and which could have a material effect on the business strategy if it were to occur'."*

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

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

76. It also provides guidance on quantitative and qualitative disclosures that could be made about particular risks that may be relevant to the assessment of the viability of the bank such as regulatory capital (recommendations 9 to 11), risk weighted assets (recommendations 13 to 16); funding risks and encumbrance analysis (recommendations 19 and 20); market risks (recommendations 22 to 25); credit risks (recommendations 26 to 30); and other risks (recommendation 32).

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

## Glossary of Abbreviated Terms

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

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