

Box 348, Commerce Court West 199 Bay Street, 30<sup>th</sup> Floor Toronto, Ontario, Canada M5L 1G2 www.cha.ca

Marion G. Wrobel Vice-President Policy and Operations Tel: (416) 362-6093 Ext. 277 mwrobel@cba.ca

September 25, 2012

Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 USA

Dear Ms. Cosper:

Re: Exposure Draft – Disclosures about Liquidity Risk and Interest Rate Risk

The Canadian Bankers' Association<sup>1</sup> (CBA) would like to thank the Financial Accounting Standards Board (the Board) for the opportunity to comment on the Exposure Draft (ED) of the Proposed Accounting Standards Update (ASU), *Financial Instruments (Topic 825)*, *Disclosures about Liquidity Risk and Interest Rate Risk*. We support the Board's objective of providing users of financial statements with decision-useful information and enhancing consistency and comparability among disclosures. However, in order to achieve the Board's objective more effectively in the context of liquidity and interest rate risk disclosures, we believe that certain changes are needed in the ED.

#### Risk Management Practices

In order to provide financial statement users with an understanding of an entity's liquidity and interest rate risk, the disclosures should be reflective of an entity's risk management practices, which would also aide in minimizing incremental information technology costs. Liquidity and interest rate risk disclosures should not be prescribed in such detail as currently proposed in the ED as each entity manages its liquidity and interest rate risks differently. Streamlining these disclosures may result in incomplete information that may not be meaningful to financial statement users. For example, the time intervals specified by the ED may not be reflective of an entity's liquidity management framework as longer dated information becomes less relevant. This is further illustrated in ASU 825-10-55-5A(e), which indicates that entities should allocate the fair value of a derivative to the time interval that corresponds with its contractual maturity rather than when the expected contractual cash flows will occur. This does not align with the purpose of liquidity risk management, which is to ensure that sufficient and appropriate funds are available to cover financial obligations. Furthermore, the liquidity gap maturity table may not

<sup>&</sup>lt;sup>1</sup> The Canadian Bankers Association works on behalf of 54 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 274,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness.

provide users of financial statements with meaningful information if entities have managed the gap through their risk management procedures. If the methods used to manage these risks are not reflected in the disclosure, the table would present an incomplete view of an entity's liquidity risk exposure as further described in our detailed response to Question 3.

# Alignment with Existing Regulatory and Accounting Requirements

The ED introduces new disclosure requirements that are similar in concept to existing liquidity and interest rate risk disclosure requirements from various regulatory bodies such as the Office of the Superintendent of Financial Institutions (OSFI) Canada, the U.S. Securities and Exchange Commission (SEC) and the Basel Committee on Banking Supervision, as well as existing International Financial Reporting Standards (IFRS). Although there are similarities, enough differences exist to require an entity to prepare two sets of disclosures to comply with both accounting and regulatory requirements and we strongly believe that the cost-benefit of these incremental disclosures is questionable. This can be quite burdensome particularly for those entities that operate in different global jurisdictions.

# Effectiveness and Comparability of Financial Statements

The proposals in the ED may overcomplicate the financial statement disclosures and reduce their effectiveness. This is not aligned with the FASB's *Disclosure Framework* Discussion Paper (issued July 12, 2012), which states the following:

The objective and primary focus of this project is to improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each entity's financial statements. Although reducing the volume of notes to financial statements is not the primary focus, the Board hopes that a sharper focus on important information will result in reduced volume in most cases. Achieving the objective of improving effectiveness will require development of a framework that promotes consistent decisions about disclosure requirements by the Board and the appropriate exercise of discretion by reporting entities.

Additional multiple quantitative disclosures in tabular form on the same topic of deposits, interest rates and maturities can confuse the users more than providing them with a better understanding of the underlying liquidity and interest rate risks and the ways they are being managed. Instead, we encourage the Board to continue to work towards convergence with existing IFRS and other regulatory requirements.

Also, such prescriptive requirements may result in divergent practices, thereby decreasing comparability among entities. For example, the expected maturity concept may be challenging for entities to apply and would likely lead to diversity in practice. However, there are aspects of the ED that we agree with, such as the inclusion of sensitivity analysis, only to the extent that it does not impede with an entity's competitive advantage.

## Geography and Costs to Comply with the Requirements

Under the ED, the incremental disclosures will be required in the audited financial statements. Most public entities currently present liquidity and interest rate risk disclosures in the Management's Discussion & Analysis (MD&A). Our view is that moving these disclosures to the financial statements does not make information more useful to financial statement users. In order to present an accurate view of an entity's liquidity and interest rate risk exposure, the information presented in the disclosures should reflect management's view, which may not necessarily agree with financial statement metrics, and should therefore remain in the MD&A. Further, by including the disclosures in the financial statements, the information will be subject to audit. As a result, new systems and processes, such as internal controls over financial reporting,

2012-200 Comment Letter No. 118

may be required and will increase the cost of producing the disclosure for entities as well as audit costs.

Further, many of the proposed disclosures require a significant amount of judgment and assumptions and contain forward-looking information. For example, the liquidity gap table includes an entity's expectation of when a financial asset or financial liability is expected to mature. By including these disclosures in the financial statements, there will be challenges in auditing management's assumptions (e.g., run-off rate assumption for demand deposits), resulting in higher costs for entities. Therefore, we do not agree that the disclosures proposed by the Board belong in the audited financial statements and are better suited in the MD&A.

We have expressed our primary concerns in our letter and in Appendix A, we have provided comments on the specific questions on which the Board requested feedback. Comments have only been provided for those questions addressed to preparers, auditors, and all respondents. We look forward to participating in further dialogue related to liquidity and interest rate risk disclosures with the Board.

Sincerely,

Attachment: Appendix A

# Appendix A

# Questions for Preparers and Auditors - Liquidity Risk

#### Question 1

For a financial institution, the proposed amendments would require a liquidity gap table that includes the expected maturities of an entity's financial assets and financial liabilities. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

## Comments:

A liquidity gap table by expected maturity would be operationally difficult for entities to produce and will likely pose significant implementation challenges and costs relating to information technology improvements, collection of data, and development and implementation of controls. Entities would be required to make assumptions to determine the expected maturity of financial instruments, which can be a complex process. For example, an entity would have to make assumptions on behavioral patterns such as when a mortgage holder is expected to prepay their mortgage, either partially or in full. Our concerns around disclosing expected maturities, even though somewhat meaningful, are further discussed in our comments to Question 3.

The ED also requires an entity to disclose the assumptions made to estimate the expected maturity of financial instruments if it differs significantly from the instrument's contractual maturity. Disclosing these assumptions and the expected amounts could be sensitive for an entity and could also result in the loss of its competitive advantage. For example, by disclosing when a financial institution expects its deposits to mature, it is revealing the "permanency" of its deposits. Further the level of detail disclosed for the assumptions made may vary across entities, as well as the interpretation of what is considered "significant", resulting in diversity in practice.

In our comments to Question 3 we acknowledge the benefits of using contractual maturities, which would be operationally easier to implement, ensure consistency among entities, and require fewer assumptions to be made, resulting in more objective and auditable information.

As discussed under Question 3, the meaningfulness of either approach would depend on the robustness of the qualitative discussion in the MD&A accompanying the liquidity gap table.

### Question 2

For an entity that is not a financial institution, the proposed amendments would require a cash flow obligations table that includes the expected maturities of an entity's obligations. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

## Comments:

We have not provided a response to this question as it is not applicable to members of the CBA.

## Question 3

The proposed amendments would require information about expected maturities for financial assets and financial liabilities to highlight liquidity risk. Expected maturity is the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than an entity's expected timing of the sale or transfer of the instrument. Do you agree that the term expected maturity is more meaningful than the term contractual maturity in the context of the proposed liquidity risk disclosures? If not, please explain the reasons and suggested alternative approach.

#### Comment:

We believe that neither the use of expected nor contractual maturity would provide the user of financial statements with a primary source of meaningful information. Given that management of liquidity risk and the liquidity gap is a key aspect of identifying residual liquidity gap risk, we believe that qualitative information provides more meaningful information and context.

We acknowledge that expected maturity provides a better foundation for arriving at meaningful information around liquidity risk disclosures, if the barriers of inconsistent application through diversity in practices and lack of comparability across entities can be overcome. In particular, for financial assets and financial liabilities that can be called or put back at any time, determining the expected date of the call or put being exercised involves significant judgment and assumptions. For example, it is unclear how an entity would treat a mortgage-backed security and, specifically, whether the carrying amount would be allocated to the time interval in which the weighted average life falls or to all of the time intervals in which it expects to receive payments based on its prepayment assumptions. Further, the expected life of an entity's demand deposits would be based on expected run-off rates, which can be subjective.

Disclosures based on contractual maturities are the most straightforward to compile, would result in more objective and auditable information, and aligns with regulatory requirements, thereby avoiding the wide diversity in application, particularly for those entities that operate on a global level across multiple jurisdictions. For example, a contractual maturity analysis is required by the SEC *Industry Guide 3: Statistical disclosure by bank holding companies* (SEC Guide 3). In addition, the contractual maturity mismatch (CMM), a monitoring tool required by the *Basel III: International framework for liquidity risk measurement, standards and monitoring* (Basel III) set forth by the Basel Committee on Banking Supervision, is also based on asset or liability's contractual maturity.

In light of this context, we believe that qualitative, and not prescriptive quantitative information will drive the usefulness of the liquidity gap disclosures, in particular as it can be used to bring the management of liquidity risk into context, rendering the table in itself, as well as the basis it was prepared on unnecessary.

In addition, as per our cover letter, we question the benefit obtained by imposing additional requirements without clear, incremental benefits to the user, especially in this area where there is already overlapping guidance. For example, the inconsistency in international accounting standards results in diversity in application for global entities. IFRS 7 *Financial Instruments: Disclosures* requires entities to present an analysis of its financial assets and financial liabilities by contractual maturity. However, International Accounting Standard ("IAS") 1 *Presentation of Financial Statements* requires an entity to provide an analysis of its assets and liabilities by

expected maturity. The analysis required by IFRS 7 is also similar to the maturity analysis required by SEC Guide 3 referred to above and the CMM required by Basel III.

We have also noted some inconsistencies in the implementation guidance on how to allocate a financial instrument into the appropriate time intervals. The implementation guidance (ASU 825-10-55-5A(e)) states that the allocation of a derivative is based on its contractual maturity and not on the expected contractual cash flows. By allocating the entire derivative into the time interval that corresponds with its contractual maturity, users will not be provided with any information on the contractual cash inflows and outflows of that derivative, which is important to an understanding of liquidity risk. It could be argued, on the other hand, that the derivative should be allocated to the earliest time interval as entities could close out the derivative in its entirety at any time. Therefore, rather than allocating the entire derivative as described above, more decision useful information would be provided if entities allocate the cash inflows and outflows based on the dates stipulated in the terms of the derivative contract. The implementation guidance for derivatives is also inconsistent with that of insurance liabilities, which is to be based on an entity's expectation of the timing of the payout of the liabilities (ASU 825-10-55-5A (g)).

## Question 4

The proposed amendments would require a quantitative disclosure of an entity's available liquid funds, as discussed in paragraphs 825-10-50-23S through 50-23V. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

### Comment:

We do not foresee significant operational concerns or constraints in complying with this requirement. However, we do not agree that this would be decision-useful information for financial statement users. Qualitatively describing the types of available borrowings an entity has access to under stress scenarios, is more useful information than the quantitative disclosure, which only provides financial statement users with point-in-time information that can change significantly day-to-day.

In ASU 825-BC13, the Board indicates that "most users who participated in the outreach indicated that they attempt to track and analyze an entity's available liquid funds (including available borrowings), especially when circumstances dictate that this information is vital to understanding the health of the entity." This suggests that financial statement users are primarily interested in liquid funds under extreme stress scenarios. However, it is not clear in the ED and its illustrative examples, whether the intent of the liquidity disclosures is to identify all available liquid assets under the normal course of business or under extreme stress scenarios. This is particularly important as the ED indicates that available liquid funds would include an entity's available borrowings. An entity's available borrowings under the normal course of business are not generally the same as those available under liquidity stress scenarios. For example, under stress conditions, it is common that available credit facilities will be withdrawn. Without clarification by the Board, the disclosure of available borrowings may not provide users with an accurate view of the liquidity resources available to entities as these may not be available or relied upon by entities in liquidity stress scenarios.

As discussed above, the Board has indicated in ASU 825-BC13 that users have expressed an interest in the available liquid funds of an entity under stress scenarios. We believe that the liquidity coverage ratio (LCR) required by Basel III achieves this goal and that the Board should consider aligning its requirements with Basel III. The purpose of the LCR is, "to ensure that a bank maintains an adequate level of unencumbered, high-quality liquid assets that can be converted into cash to meet its liquidity needs for a 30 calendar day time horizon under a significantly severe liquidity stress scenario specified by supervisors". Basel III also provides guidance on what constitutes a liquid asset and the stress scenario that should be used by management in calculating the LCR3. The requirements of Basel III will provide financial statements users with an accurate view of the funds available to entities in crisis situations and by aligning with Basel III, the comparability in disclosures would be enhanced and the objective of financial statement users as described in ASU 825-BC13 would be met.

Furthermore, the quantitative disclosure of restrictions that could limit the transferability of funds among entities is sensitive information for an entity. For entities with foreign operations that cross multiple jurisdictions, the amount of disclosure could also be significant. We propose that only narrative disclosures be provided where such restrictions apply.

## Question 5

For depository institutions, the proposed Update would require a time deposit table that includes the issuances and acquisitions of brokered deposits during the previous four fiscal quarters. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

# Comment:

We do not foresee significant operational concerns or constraints in complying with the proposed requirement.

### Question 6

As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to develop an understanding of your entity's exposure to liquidity risk? If not, what other information would better achieve this objective?

## Comment:

For the most part, financial institutions already provide sufficient information about exposure to liquidity risk and we do not agree that the incremental disclosures proposed in the ED would enhance the understanding of financial statement users of an entity's exposure to liquidity risk for the reasons discussed in the questions above. Many of the proposed disclosures are similar in nature to existing accounting and regulatory requirements. Therefore, rather than requiring incremental disclosures, we recommend that the FASB align its disclosure requirements to existing requirements, in an effort to promote convergence and to prevent duplication in the

<sup>&</sup>lt;sup>2</sup> Basel Committee on Banking Supervision, *Basel III: International framework for liquidity risk measurement, standards and monitoring*, December 2010, p. 3.

<sup>&</sup>lt;sup>3</sup> The stress scenario specified incorporates many of the shocks experienced during the 2007 crisis to help ensure that financial institutions have sufficient liquidity on hand to survive up to a 30-day calendar period.

financial statements, which would also align to the FASB's *Disclosure Framework* Discussion Paper. This is discussed in further detail in our comments for Question 22.

# **Questions for Users – Liquidity Risk**

Questions 7 through 12 have not been addressed as they are specific to users of the financial statements.

# **Questions for Preparers and Auditors – Interest Rate Risk**

#### Question 13

The interest rate risk disclosures in this proposed Update would require a repricing gap table. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

## Comment:

There may be some operational difficulties and significant effort required for entities to provide the duration of each class of financial instrument as the calculation of duration may not be currently performed by some entities and their subsidiaries. Certain business units in a financial institution calculate the duration of financial instruments on a regular basis (for example, the treasury group for Asset Liability Management purposes); however, other business units do not calculate duration because it is not considered a pertinent metric for their business. Further, duration is a concept that may not be widely understood by average users of the financial statements and, therefore, may not be the most relevant information for them and may only overcomplicate the financial statements. Lastly, duration is typically used to manage only an entity's non-trading portfolio, rather than the entire balance sheet. We recommend that if duration disclosures are required, it should only apply to the non-trading portfolio. Alternatively, all items that are carried at fair value can be grouped into a single bucket in the repricing gap table similar to the requirement for the liquidity gap maturity table (ASU 825-10-50-23F).

# Question 14

The interest rate risk disclosures in this proposed Update would include a sensitivity analysis of net income and shareholders' equity. Do you foresee any significant operational concerns or constraints in determining the effect of changes in interest rates on net income and shareholders' equity? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

# Comment:

We do not foresee significant operational concerns or constraints in determining the effect of changes in interest rates on net income and shareholder's equity, as most entities already provide interest rate sensitivity analyses in their MD&A in accordance with regulatory requirements and IFRS (i.e., IFRS 7 *Financial Instruments: Disclosures*) and for internal stress testing purposes. However, as the ED prescribes specific interest rate shocks on both net income and shareholders' equity, entities will be required to build the systems capability to produce this disclosure, which could be a significant effort.

We agree that a sensitivity analysis on net income and shareholders' equity would be useful information for users. We believe that this sensitivity analysis is meaningful. Similar to the disclosure of value-at-risk (VaR) for purposes of assessing market risk in trading activities, the sensitivity analysis provides a benchmark metric for users when comparing financial institutions and the amount of interest rate risk a bank is willing to undertake. In addition, as entities move towards complying with Basel III, the impact of changes in interest rates on shareholders' equity becomes more significant due to the higher capital requirements. For example, if interest rates increase, the fair value of a fixed rate available-for-sale (AFS) security will decrease and other comprehensive income (OCI) may also decrease depending on the balance. This may result in entities holding additional capital as a buffer in response to capital volatility from changes in interest rates on its AFS securities in order to meet the Basel III requirements. Therefore, this information would be helpful for users as they evaluate an entity's regulatory capital position.

However, most U.S. and international financial institutions currently perform a sensitivity analysis on its non-trading book, which aligns with how interest rate risk is managed. The interest rate shocks, as proposed by the ED, would be applied to an entity's entire portfolio of financial instruments regardless of whether or not those instruments are held for trading purposes. A financial institution's non-trading book is used for interest rate risk management whereas its trading book is not. By ignoring the differences in a financial institution's trading and non-trading books, the disclosure of the interest rate sensitivity will not provide financial statement users with information relevant for decision-making. We propose that the sensitivity analysis on net income be limited to the impact on the non-trading book.

Lastly, we ask the Board to clarify the requirements in paragraph 23AD. It is unclear whether "shareholders' equity" refers only to the retained earnings of an entity or to both the retained earnings and accumulated other comprehensive income of an entity.

## Question 15

As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to understand your entity's exposure to interest rate risk? If not, what other information would better achieve this objective?

#### Comment:

We believe that for the most part, financial institutions already provide sufficient information for financial statement users to develop an understanding of an entity's exposure to interest rate risk as required by regulatory and accounting requirements. Certain components of the interest rate risk disclosures proposed in the ED overlap with existing regulatory requirements (and to a certain extent, IFRS) that are disclosed in the MD&A. Other than the sensitivity analysis, we do not believe that the requirements in the proposed ED provide any marked improvement over the existing requirements, especially if the additional information is not used for any management decision-making and analyses. If such information is not useful for management decision-making and analyses, it is unlikely that it would be considered decision-useful information for users.

Therefore, we recommend that the FASB instead align its proposals with these existing regulatory requirements rather than impose further, possibly redundant, requirements. Refer to our comments for Question 22 on certain areas of overlap and our recommendation.

## Questions for Users—Interest Rate Risk

Questions 16 through 19 have not been addressed as they are specific to users of the financial statements.

# **Questions for All Respondents**

## Question 20

The amendments in this proposed Update would apply to all entities. Are there any entities, such as nonpublic entities, that should not be within the scope of this proposed Update? If yes, please identify the entities and explain why.

# Comment:

Given the systems build required and operational concerns previously noted, we do not believe that these disclosures should be required of nonpublic entities since the disclosures may not provide any additional useful decision-making information to financial statement users.

# Question 21

Although the proposed amendments do not have an effective date, the Board intends to address the needs of users of financial statements for more information about liquidity risk and interest rate risk. Therefore, the Board will strive to make these proposed amendments effective on a timely basis. How much time do you think stakeholders would require to prepare for and implement the amendments in this proposed Update? Should nonpublic entities be provided with a delayed effective date? If so, how long of a delay should be permitted and why? Are there specific amendments that would require more time to implement than others? If so, please identify which ones and explain why.

# Comment:

The effective date of the proposed amendments should coincide with the effective date of the Basel III liquidity requirements (i.e., January 2015). Also, given the systems build and/or enhancements and additional resources required to produce the disclosures in the proposed amendments, entities should be provided with significant lead time to properly design, test, and implement the disclosures. This is particularly important for entities that operate across multiple jurisdictions, given the amount of coordination that would be required to compile each disclosure.

#### Question 22

Do you believe that any of the amendments in this proposed Update provide information that overlaps with the SEC's current disclosure requirements for public companies without providing incremental information? If yes, please identify which proposed amendments you believe overlap and discuss whether you believe that the costs in implementing the potentially overlapping amendments outweigh their benefits? Please explain why.

### Comment:

Certain of the proposed amendments overlap with current disclosure requirements from the SEC, as outlined below.

# Liquidity Gap Maturity Analysis

The ED requires entities to provide a tabular maturity analysis of its financial instruments. Similarly, SEC Guide 3, Section III.B requires financial institutions to provide a maturity schedule of its loans by contractual maturity and segregated into the following time intervals: due in one year, due after one year through five years, and due after 5 years. SEC Regulation S-K Item 303(a)(5) also requires tabular disclosures of an entity's known contractual obligations.

# Interest Rate Sensitivity

SEC Regulation S-K Item 305 require entities to disclose the potential loss in future earnings, fair values, or cash flows of market risk sensitive due to hypothetical changes in rates. In addition, SEC Guide 3 also prescribes certain statistical disclosures about interest rate risk. SEC Guide 3 requires entities to provide disclosure of the amount of interest income attributable to both changes in volumes and rates and disclosure of the average balance sheets with an analysis of net interest income. As outlined in the response to Question 14, we believe that a sensitivity analysis on net income and shareholders' equity would provide useful information to users but should be limited to parallel shifts in the yield curve and to an entity's non-trading book.

# Other Overlaps: International Accounting Standards

As discussed throughout the responses to the questions above, we have noted that the proposed amendments also overlap with IFRS requirements, with some differences in the application of the requirements. For those banks that report under IFRS but have a reporting U.S. subsidiary, several operational challenges would arise in the application of the proposed amendments and IFRS. For example, under IFRS 7, the time intervals are judgment based; however, the proposed ED has prescribed time intervals that may not be representative of actual risk management practices. We propose that the Board should consider not only aligning the ED with existing regulatory requirements, but also to existing international accounting standards. This would reduce the amount of similar disclosures and help streamline the financial statements so that they provide more useful information for users.

The time intervals prescribed by the ED are extensive (i.e., 7 time intervals for annual reporting and 8 time intervals for interim reporting) and differ from those required by the SEC for similar disclosures. We believe that the costs of implementing the processes and procedures to compile the information required by such specific and extensive time intervals will outweigh the benefits. For example, as it relates to liquidity, the time intervals specified by the ED may not be reflective of an entity's liquidity management framework as longer dated information becomes less relevant, and management's actions more prominent.