



Guidance Note: Impact of International Financial Reporting Standards (IFRS) on Banking Prudential Reporting

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1 Background

- 1.1 The JFSC has considered the impact of IFRS and will accept quarterly prudential returns from deposit takers where the measurements are in accordance with IFRS. However, as outlined below, in certain areas the JFSC will require modified treatments to maintain consistency with the prudential requirements of the current Basel Accord.
- 1.2 The JFSC considered the views of the Bank for International Settlements (“BIS”), particularly the consultative paper titled “Supervisory Guidance on the use of the fair value option by banks under International Financial Reporting Standards”, published in July 2005, including the earlier press releases on capital treatment published on 15 December 2004, 20 July 2004 and 8 June 2004.
- 1.3 The JFSC considers that the Financial Services Authority (“FSA”) policy statement PS 05/5 “Implications of a changing accounting framework” contains advice relevant to Jersey reporting requirements. The full statement should be read, but the key adjustments relevant to Jersey reporting requirements for banks are listed below.

Key Prudential Adjustments

The four main areas are:

- › Treatment of cash flow hedges under IAS 39;
- › Treatment of available for sale assets under IAS 39;
- › The use of the fair value option under IAS 39 with respect to a bank’s own liabilities; and
- › Accounting for defined benefit pension schemes.

2 Treatment of cash flow hedges under IAS 39

- 2.1 The reporting bank is required to eliminate from regulatory capital all fair value gains and losses arising from the fair valuation of derivatives that have been accumulated in equity.

3 Treatment of available for sale assets under IAS 39

- 3.1 The bank should report equities classified as available-for-sale at fair value, as required by IAS 39, but available-for-sale debt instruments should be written back to cost or amortised cost.

4 The use of the fair value option under IAS 39 with respect to a bank's own liabilities

- 4.1 Under IAS 39 there are already rules on the use of the fair value option with respect to a bank's own liabilities. The JFSC expects these to be strictly adhered to. Additionally, where the fair value option is used for a bank's own qualifying liabilities, unrealised gains or losses that relate to the bank's own credit risk should be eliminated from regulatory capital. Thus the only revaluation should be to reflect movements in the reference benchmark interest rates.

5 Accounting for defined benefit pension schemes

- 5.1 When accounting for defined benefit pension schemes, the accounting measure of actuarial deficit may be eliminated for regulatory purposes. If a bank takes this step then the deficit must be replaced by an actuarial best estimate of the level of additional funding that the bank will need to provide for its pension scheme over the next five years. Where a scheme is in surplus, it is required that any actuarial surplus is eliminated for regulatory purposes.

6 Local Report issues

- 6.1 **"Off Balance Sheet" items.** These may have a fair value assigned under IAS and hence a balance sheet impact. However, the "Off Balance Sheet" section of the prudential return already prescribes the regulatory treatment for arriving at the weighted asset amount relating to "Off Balance Sheet" items. Therefore, in order to avoid double counting, all on balance sheet assets resulting from the fair valuation of "Off Balance Sheet" transactions should be assigned a risk weight of zero. Assets of this nature will be shown in line 42. Similar nature liabilities will be shown in line 65, "Creditors & Accrued Interest".

7 Conclusion

- 7.1 The JFSC is aware that there may be prudential issues created by reporting under IFRS that have not been covered here or in the more detailed FSA paper. Where a material change results from such an issue, the reporting bank should consult with the JFSC. If necessary, the JFSC will issue further general guidance on any specific issues that arise.