EY UK IFRS Banking Conference
London
18 June 2019

Building a better working world

Introduction

The EY annual UK International Financial Reporting Standards (IFRS) banking conference on 18 June 2019 in London was attended by banks, regulators and standard-setters from across the country. The discussions included the ongoing challenges arising from the changes to accounting and regulatory rules, and other developments affecting the banking industry.

The event featured sessions on a number of topics, including points of view from banks, regulators and standard-setters, as follows:

- An update from the International Accounting Standards Board (IASB) on recent activities impacting banks and financial institutions
- Through the looking glass: FS regulatory developments
- IBOR Transition for banks and corporates - A panel discussion
- An analyst view of IFRS 9 impairment / What did banks disclose in 2018?
- IFRS hot topics and accounting in the digital age
- Insight into the finance function of the future
- Integrated reporting and climate risk
- Brexit for financial services

This document provides a high-level summary of insights from discussions with leading specialists and peers across the banking industry, as well as the findings of real-time polls undertaken during the conference.

We hope that you find the contents useful in planning and managing these forthcoming changes.

International Accounting Standards Board (IASB)

Kumar Dasgupta, IASB Technical Staff

“The Board decided to address IBOR’s pre-replacement issues as a priority”

IBOR Reform

The IASB has identified two groups of accounting issues regarding the Interest Rate Benchmark Reform (IBOR Reform). The first are Phase I pre-replacement issues, affecting financial reporting before the replacement of an existing benchmark with a risk-free-rate (RFR). The second are Phase II replacement issues, affecting financial reporting once the benchmark is replaced with a RFR.

The IASB exposure draft (ED) issued in May 2019 addresses issues related to Phase I, proposing exceptions to specific hedge accounting requirements in IAS 39 and IFRS 9 to provide relief during the period of uncertainty. The ED proposes reliefs on three areas, to ensure that hedge accounting will continue until when IBOR is replaced with a RFR:

- Highly probable requirement
- Prospective assessments
- Risk components

Applying the exception to the Highly probable requirement, an entity would assume that the interest rate benchmark on which the hedged cash flows are based is not altered when assessing whether the future cash flows are highly probable. Therefore the entity would assume that no amendments will be made to the IBOR-based cash flows.

Similarly, on Prospective assessments the entity would perform such assessments assuming no amendments will be made to future cash flows as a result of interest rate benchmark reform.

Regarding Risk components that are not contractually specified, there may be a challenge in identifying components that may change. For example, when hedging mortgages at prime using LIBOR, if the LIBOR curve were to disappear it would become difficult to identify a risk component. Consequently the exception proposes that assessing whether a risk is separately identifiable should be performed only at inception of the hedging relationship.

Amendments to IFRS 17 – Insurance contracts (IFRS 17)

Due to the overlap with many banking and insurance contracts, the exposure draft issued in June proposes additional scope exclusions for IFRS 17.

- The first item would be loans that transfer significant insurance risk or allow the borrower to settle by ceding the asset to the lender. The proposal is to permit an entity to choose either IFRS 17 or IFRS 9 in the circumstances, but not to split the two items out separately.

- Another consideration is Credit cards, which often contain insurance coverage. The proposal is that an entity would not apply IFRS 17 to credit cards for which the fee charged to the customer does not reflect an assessment of the insurance risk associated with that individual customer. Instead, the entity would apply other relevant and applicable IFRS standards (e.g. IFRS 9, IFRS 15, or IAS 37)

Kumar noted that the timeline for this particular area is longer, considering that IFRS 17 will become effective as of 1st January 2022.

Agenda Decision published by the IFRS Interpretations Committee

Kumar noted that the proposed amendments to the IFRS Foundation Due Process Handbook reflect that entities should be entitled to ‘sufficient time’ to consider an agenda decision published by the IFRS Interpretations Committee and if necessary, implement an accounting policy change. As a rule of thumb it is fair to say that the IASB had in mind a matter of months rather than years.

Dynamic risk management

In July a complete package will be brought to the Board. It is planned to be in the form of a slide pack and not a white paper, although it will be rather extensive. The pack provides detailed information on how the dynamic risk management model is proposed to work, and considers a number of simplifications. During the second half of 2019, the IASB plan to conduct an outreach exercise on the core model asking for inputs and feedback on the core model. Based on the feedback received, the IASB will determine the next steps.

Financial Instruments with Characteristics of Equity (FICE)

The project remains important, but is receiving reduced attention from the Board, given the need to focus on the IBOR reform and dynamic risk management projects. The IASB has received 126 comment letters on this item to date. Key topics arising from the feedback included:

- Support for the idea of changing the current liability or equity classification guidance, but a lack of agreement on the nature and extent of the changes
- Support for enhanced disclosure
- Support for having only two categories — liability or equity
- Concern about the ‘amount’ feature

The Staff will present the feedback to the Board during the upcoming IASB meetings, following which the project direction will be decided.

Regulatory developments and priorities

John Liver, Ernst & Young LLP

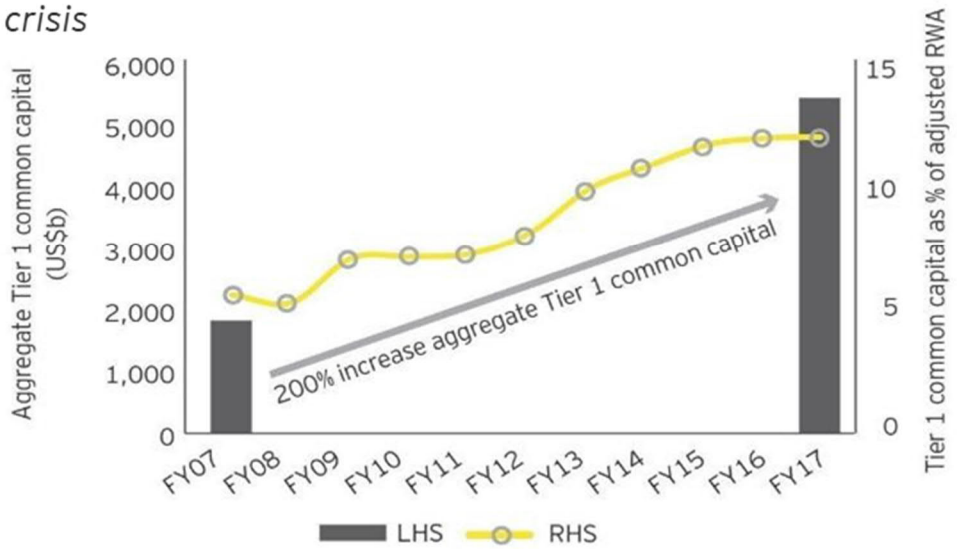
"Given the complexity of administration for regulation covering multiple global jurisdictions, there is a shift in prioritisation in favour of local resolution"

Regulatory developments

For roughly a decade the financial services industry has been dominated by regulatory and supervisory responses to the systemic weaknesses exposed during the financial crisis. Post-crisis reforms have significantly raised standards across four key themes – financial condition, structural reform, conduct, and governance and controls.

Following the significant efforts expended globally to finalise and complete the implementation of these reforms, many vulnerabilities have been addressed.

The largest banks in the world have significantly improved their capital position in the years since the crisis



Source: SNL Financial database; EY analysis of largest 200 banks globally

Regulators have recognised that implementation of these reforms and jurisdictions' responses to the crisis have led to fragmentation across the industry. Focus is now shifting to a finalisation of implementation as a desired outcome and consistency across multiple jurisdictions.

Regulatory and supervisory bodies are now assessing the effectiveness of the response and contemplating potential changes and reflecting the priorities of the industry.

Naturally market transparency is seen to continue to remain a major priority, with the Markets in Financial Instruments Directive II (MiFID II) having recently gone live. In addition there are huge implications for institutions regarding focus on compliance, conduct and anti-money laundering, with a renewed focus on these themes in Europe and the UK. There is a sense that institutions need to be seen as clean as possible.

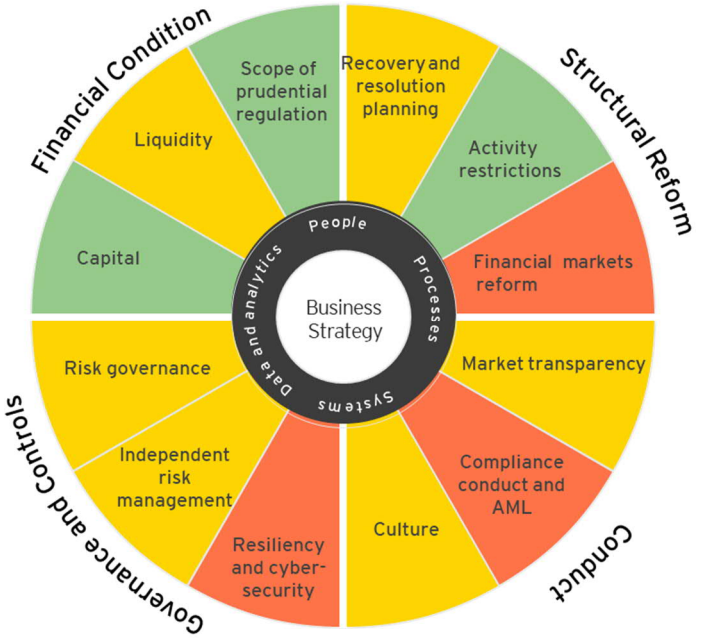
UK conduct priorities seek to ensure that the market works well for the participants and that where there are issues, dysfunction or an inability to meet consumer's need occurring, that steps are taken to remedy the situation.

Financial Conduct Authority (FCA) Cross-sector priorities	Prudential Regulation Authority (PRA) Strategic goals
EU withdrawal [with international engagement for FCA]	
Operational resilience	
► Financial crime (fraud, scams) and AML	► Robust prudential standards and supervision
► Demographic change	► Adapting to market change and horizon scanning
► Firms' culture and governance	► Financial resilience
► Fair treatment of existing customers	► Recovery and resolution
► The future of regulation	► Competition
► Innovation, data and data ethics	► Efficiency and effectiveness [of PRA]

Given the complexity of administration for regulation covering multiple global jurisdictions, there is a shift in prioritisation in favour of local resolution.

When assessing the fundamental nature of regulation in markets, priorities will increasingly reflect the risks associated with drivers of business transformation. This understandably has a broad scope and could include thematic topics such as;

- Responses to rapid technologically-driven change in risk and compliance processes
- Increasing focus on new balance sheet risks
- New standards for 'new' risks
- New licensing, regulatory requirements and 'indirect' regulation of new entrants
- Fragmentation or integration in response to customer priorities and digitisation



No discussion on regulatory priorities would be complete without at least addressing the UK's withdrawal from the European Union (EU), commonly known as 'Brexit'. Leading up to the withdrawal, the UK has rationalised a significant number of EU rules, as well as setting up a temporary regime for European banks participating in the UK. However there are still many concerns regarding the impact and functioning of the withdrawal, unsurprisingly with most concerns arising from the UK side. The European Commission feels in a comfortable position, with most of the key points sorted and therefore it is time for the politicians to resolve the matter and finalise the withdrawal.

The PRA's priorities for the near term include the supervision of ring-fenced banks and the effectiveness of ring-fences in practice. Quite a lot of focus is directed towards financial resilience and ensuring firms have adequate capital and liquidity resources for the environment. Stress testing forms an integral component to this requirement and the impact of climate change on assets will need to be considered.

Adaptation to market changes and horizon scanning remain key. A recent example is the monitoring of crypto-assets, and whilst they are not a systemic risk at the moment, the regulator is still paying attention to ongoing developments.

The capability for firms to address recovery and resolution is being assessed. Ensuring firms develop capabilities to wind down trading and derivative businesses, implementing a Risk Assessment Framework and ensuring the new lens of focus is public with firms being capable of being self-assessed. The regulator will publish their assessment of major institutions in 2 years' time. At present the area is relatively underplayed, and will receive increasing focus.

IBOR Panel session

Yolaine Kermarrec,
Ernst & Young LLP

Steve Bullock,
Lloyds Banking Group

Fiona Thomson,
Goldman Sachs

Shaun Kennedy,
Associated British Ports

Yolaine Kermarrec, from Ernst & Young LLP, hosted a panel discussion around how to address the challenges related to the replacement of IBOR – A conversation between a corporate and two banks

The GBP RFR Working Group expects market participants to cease issuing new products referencing GBP LIBOR by Q3 2020. Associated British Ports is a first mover in the market via the recent restructuring of £65m LIBOR-linked FRNs due 2022 to reformed SONIA-linked FRNs announced on 11 June 2019

"ABP has about £4bn exposure to GBP LIBOR in notional. We started to look at this seriously about two years ago and are proactively transitioning existing instruments to Reformed SONIA.

We received a lot of questions on how the spread for the recent restructuring of our FRNs had been determined. Ultimately this was not controversial - The challenge was not to determine the spread, but to make the conversion easily understandable and replicable." – Shaun Kennedy, Associated British Ports

What do you think will be the biggest impediment to adopt new Alternative Reference Rates (ARRs)?

"To some extent it is dependent on clients and what will work best for them. There's still some level of inertia, especially with some of the smaller banks. We expect the resolution of the ISDA consultations will move the market ahead."– Fiona Thomson, Goldman Sachs

"At a money market forum I recently attended, around two thirds of attendees felt LIBOR would still be around beyond 2021."– Steve Bullock, Lloyds Banking Group

A number of market participants tell us that they need a term rate benchmark. What are your views on this?

"At ABP we did not feel we needed term benchmarks. Overnight SONIA has plenty of liquidity and there are no issues with compounded rates." – Shaun Kennedy, Associated British Ports

"The ARRC cautioned that Term structures might be more expensive because they're not exactly natural rates for the market to use, but are instead priced rates."– Steve Bullock, Lloyds Banking Group

"We would stand ready for it if the clients wanted term rate structures, but it's not something we're hanging on for in either SONIA or SOFR"– Fiona Thomson, Goldman Sachs

Yolaine Kermarrec, from Ernst & Young LLP, hosted a panel discussion around how to address the challenges related to the replacement of IBOR – A conversation between a corporate and two banks

What are your plans to issue SONIA term loans?

"It is on the agenda. There is a real challenge with infrastructure providers since the market hasn't agreed upon a single market convention."– Steve Bullock, Lloyds Banking Group

"We are in discussions with clients across a range of products and that likely includes SONIA term loans. But there is no hard line in the sand."– Fiona Thomson, Goldman Sachs

Do you see a competitive advantage to being a first mover?

"There is also almost a sense of corporate responsibility in being an early mover." – Steve Bullock, Lloyds Banking Group

"It takes a lot more time and effort to be a first mover, as well as the associated legal costs, however this is an opportunity to influence the debate and steer the market practice to a more favourable state. Being involved allows you to be active and not passive."– Shaun Kennedy, Associated British Ports

Your IBOR programme in a few key numbers

"We have identified thousands of models and systems with a LIBOR touch point. It is important to prioritise the remediation."– Fiona Thomson, Goldman Sachs

"We have a large scale programme across the entire group. Hundreds of models are impacted ."– Steve Bullock, Lloyds Banking Group

"The impact on systems should not be underestimated. We have a single treasury system, and it still took us 9 to 12 months of efforts to make it ready for the transition" – Shaun Kennedy, Associated British Ports

"We have set up a 5-FTE central programme office in Corporate Treasury, but we have about 10 global workstreams with many more individuals involved. Each workstream has a dual leadership, from the US and from another region"– Fiona Thomson, Goldman Sachs

Yolaine Kermarrec, from Ernst & Young LLP, hosted a panel discussion around how to address the challenges related to the replacement of IBOR – A conversation between a corporate and two banks

What are some of the key focus areas and deliverables for the finance function?

"There is a big role for the broader finance function to play in the monitoring of the risk and exposure management. We are looking at how to cut exposures down, using a risk-based sensitivity measure. We'll be looking at the funding curve and understanding when other risk free rates should become a larger input to that. Hedging is another consideration and we've been assessing what options we have for executing on that, including layering on, terminating, etc. We've also been focusing on external advocacy and driving forward the accounting and tax agenda in particular.
Also worth mentioning the capital and Volker perspectives to consider" – Fiona Thomson, Goldman Sachs

What are the implications for the Fair Value hierarchy?

"We have executed our first fixed rate to SOFR hedge, and spent a long time thinking about this to ensure it would be classified as a level 2 and not level 3. We were comfortable with a 2.5-3 year tenor at the time. As liquidity increases, we will likely see tenors and positions move out further quite quickly."– Fiona Thomson, Goldman Sachs

When should expect disclosures on the financial impact of the transition or the exposure to IBORs?

"Quantitative disclosure is a very interesting question. Firms have taken quite different views on granularity and simplicity versus complexity so comparability will be a consideration. As a market maker our exposure changes all the time depending on client demand, so therefore any point in time estimate changes rapidly."– Fiona Thomson, Goldman Sachs

"IBOR discontinuation is currently disclosed as one of our emerging risks. A big question is the exposure point, and we are now building a solution to address this regularly and routinely."– Steve Bullock, Lloyds Banking Group

Yolaine Kermarrec, from Ernst & Young LLP, hosted a panel discussion around how to address the challenges related to the replacement of IBOR – A conversation between a corporate and two banks

How do you describe the level of engagement between corporate treasurers and banks with regards to IBOR transition?

"Banks should be doing more in this space and they could be moving faster given the timelines we're working to. At ABP, we have been driving the majority of discussions with banks"– Shaun Kennedy, Associated British Ports

What is the role of your Treasury function in your IBOR transition programme?

"Treasury is leading on overall responsibility of the programme across the bank. Facing to the board, and bringing the right story to the senior stakeholders. Treasury have been identifying key risks, emerging risks and innovations, such as being the first commercial bank to issue a SONIA bond."– Steve Bullock, Lloyds Banking Group

One of the biggest challenges for a Treasury function is the increased basis risk during the transition

"Our biggest concern is the risk of having some products stuck in LIBOR and others in alternative risk free rates. Additionally, the rate at which we transition shifts, since we cannot move all our exposure at one time or at a single rate, so we need to manage this transition over time." – Shaun Kennedy, Associated British Ports

"What we haven't yet seen to date is how those rates will react in a stressed scenario." – Steve Bullock, Lloyds Banking Group

"There is no 2021 gun on the Euribor. The different trajectory on implementation in Europe is an additional challenge."– Steve Bullock, Lloyds Banking Group

IFRS Disclosures from banks

Justin Bisseker (Equity Analyst at Schroders)

Tony Clifford (Partner – Ernst & Young LLP)

An analyst's view (Justin Bisseker)

The Investment management industry needs to consider taking a closer look at which banks they would like to have exposure to. When assessing the performance of banks over the last 20 years against the overall market, it is surprising to see that there is zero total return over the period and a 64% underperformance relative to the UK stock market.

However credit losses are currently at a cyclical low, despite the impact of IFRS 9 and despite Price-to-Earnings (P/E) multiples being in line with the rest of the UK market. As such analysts are interested in understanding two key aspects:

(1) the sensitivity of EPS to credit losses
(2) comparability of Probability-of-Default (PD) disclosures

Sensitivity of EPS to credit losses

UK domiciled banks have reported additional information to support staging and sensitivity disclosures compared to their European counterparts, however as the reporting is not uniformly consistent, the level of comparability between banks is challenging. This has resulted in reduced comparability and consistency between banks, which is challenging as investors use these disclosures to better understand risk and future expected losses sensitivity.

In particular, a grey area for consideration is how banks differentiate between exposure to Stage 2 assets which are high-risk versus those assets which are still considered to be of better quality but have experienced a Significant Increase in Credit Risk (SICR) since origination. Critical questions to consider in response to the above are:

- How risky are the assets within each stage? A particular focus on Stage 2 assets.
- How well collateralised are assets within each Stage and PD bucket?
- How might this impact the banks' capital and dividends?
- How and why has credit risk changed from one period to another?
- How volatile are future credit loss charges likely to be?
- Has transitional relief been applied to capital reductions? If so, what are the 'Fully loaded' capital numbers?
- How have assets deemed to be of a low credit risk been treated in Staging?
- Which assets are considered as Stage 2 and what are the drivers behind this classification?

Comparability of PD disclosures

When assessing disclosures for sensitivity and scenario analysis the following is noted:

- The scenarios are not based on the same up or downside swing, nor probability of occurring, which limits comparability
- It is not always clear whether the PDs generated in the scenarios are for a Point-in-Time (PiT) estimate on a high or a low point in the business cycle
- There is a wide range of Stage 2 assets as a percentage of book even though some are considered good quality assets
- Long term capital impacts are not clear
- Given the current business cycle and economic conditions are positive there appears to be less emphasis from the industry on Stage 2 and 3 assets and their sensitivity to shocks

The following are areas to consider as enhancements to existing disclosures:

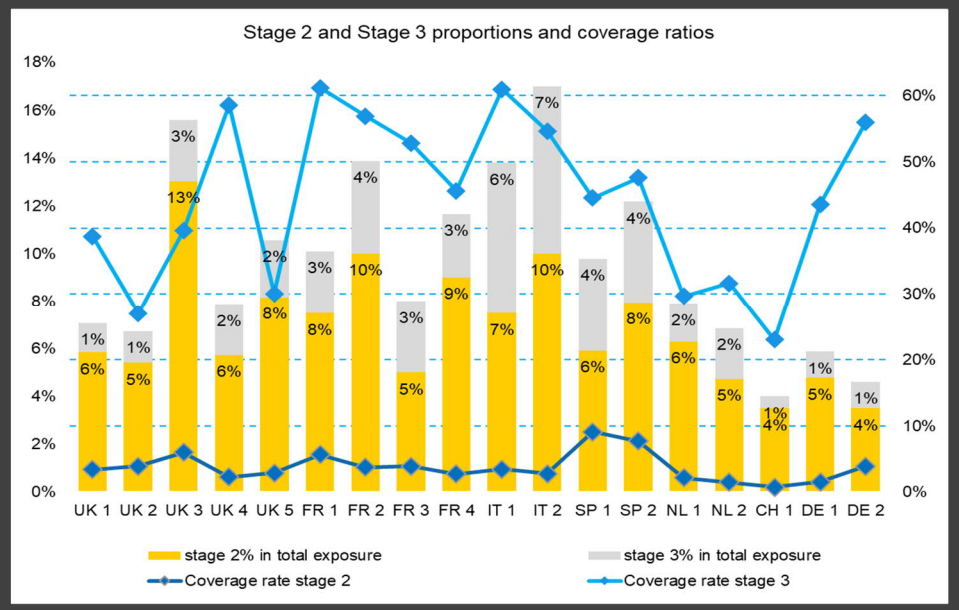
- Understanding of Loan-to-Values (LTVs) and collateral held against Stage 2 and Stage 3 loans
- Cured assets and where they have impacted the ECL numbers is not yet clear
- An analysis of the time of assets spent in Stage 3

IFRS 9 Disclosures 2018 (Tony Clifford)

An analysis of how the ratios compared across the banks including stage allocation, coverage ratio, and the overall proportion of loans is presented here

It is noted from this graph that there is a large variability around the disclosed figures. Overall, UK domiciled banks are leading their European counterparts in the quality of their disclosures.

Key observations from the 2018 disclosures are included below.



Movement of loans between stages

When assessing the migration of loan exposures between the stages and most notably the movement from Stage 2 back to Stage 1 it can be seen that this is higher in the UK at a cure rate of 63% in 2018, whereas banks domiciled in the EU had far lower churn between stages and therefore only 39.3% healed from Stage 2 into Stage 1.

Observations regarding the variability in the coverage ratios

Tony performed a more detailed analysis of the retail portfolios of four UK banks, most of the variability for the coverage ratios arises from non-mortgage lending and other retail lending. However disclosures for non-mortgage lending portfolios include less information. One bank disclosed the ECLs as if they had Purchased or Originated Credit Impaired loans (POCI), which helped to allow comparison between the banks.

The level of Stage 3 ECLs also depends on how long such loans are held before they are written off. This is also affected by the level of forbearance, which is particularly high for Irish portfolios.

Disclosure on staging

The analysis on staging is better in some banks than others, where they include useful information such as how the staging is performed and details around which assets are in included in each respective stage.

It would be useful to understand from these disclosures the approximate proportion of 'good loans' in Stage 2, given that whilst the banks do disclose the PDs by stage, the disclosure bands differ and so the information is not easily comparable. Additionally, whilst the banks do disclose Loan-to-value (LTV), this factor in particular has a large impact on ECLs and especially on the mortgage book and highlights how secured lending is overall much less likely to require a high ECL provision than unsecured facilities

Multiple Economic Scenarios (MES)

When considering the impact of using forward looking Multiple Economic Scenarios (MES) on the book, users are able to examine the composition of the provisions, although to varying extents. A positive takeaway from the MES analysis is that management are exercising their discretion to ensure sufficient coverage by applying suitable overlays

IFRS hot topics and accounting in the digital age

Marek Walendowski
Jane Hurworth Ernst & Young LLP

Hedge accounting disclosures

Ahead of the conference a benchmarking exercise has been carried out assessing the risk management strategy and disclosures from 16 banks (all applying IAS 39 hedge accounting requirements) all indicated a high level of compliance with IFRS 7 financial instruments disclosures and 44% presented this information in a single note. A similar number referenced into the risk report, which on occasion may be up to 50 pages in length, therefore including specificity in any cross referencing would be helpful.
A number of disclosures remain boiler plate and some disclosures were often more geared towards what was explicitly asked for, as opposed to voluntarily providing more information in order to better explain the entity's risk management strategy and its effect on the financial statements.

Regarding sources of ineffectiveness (where there was 100% compliance with disclosure requirements), 31% took a more generic approach, whilst 44% provided some specifics and 25% were highly specific.

Other points for improvement which Jane highlighted were:

- Hedge ratios were often not disclosed, perhaps because the ratio is 1:1, however greater clarity on these ratios would be useful
- Disclosures on the sources of ineffectiveness could be improved by better tailoring to the specific hedging relationships
- Variation in practice exists around the requirement to disclose average prices of hedging instruments, in particular for fair value hedges where only 44% of those surveyed provided the information.

IFRS 16 Leases

Most banks applied IFRS 16 using the modified retrospective approach, with the Right-of-Use (ROU) asset equal to the lease liability, and only few adjusted the measurement of the ROU asset. Although the extent of disclosure provided by banks varied across the industry, the majority provided the description of initial measurement principles, but only some commented on the type of discount rate used, explained subsequent measurement principles and other key judgements.

The reduction in the banks' common equity tier (CET) 1 ratio due to implementation of IFRS 16 ranged from 0.05%-0.22%, although the impact on total assets and total liabilities is likely to be far larger. The impact tended to be larger for banks which leased rather than owned large items of property plant and equipment (PPE) such as head offices or datacenters.

Despite the standard being effective, the there are still ongoing discussions and IFRS Interpretations Committee (IFRIC) recently discussed questions from the European Securities and Markets Authority (ESMA) who noted diversity in practice regarding:

1) How a lessee determines the lease term and useful life leasehold improvement for renewable or cancellable leases, and
2) Whether a lessee's incremental borrowing rate must reflect the interest rate in a loan with similar maturity and payment profile to the lease payments.

To answer the first questions, the lessee needs to first assess whether or not the lease contract is enforceable, and subsequently determine whether it is reasonably certain to utilise any optional periods. With regards to the useful life of non-removable leasehold improvements, it would generally be expected that both terms are aligned.

Both issues are still pending final IFRIC conclusion. It is however important to remember that the lessee's weighted average incremental borrowing rate needs to be disclosed, which increases transparency of its impact on the measurement.

IT operating infrastructure

In the new digital world, many banks are moving away from traditional, asset-driven IT infrastructure and implement outsourced or cloud based IT services. The focal points for accounting in this environment are:

- The appropriateness of assets' useful lives
- Accounting for flexible third-party cloud computing services
- The approach to capitalisation of development costs for software developed using an agile approach

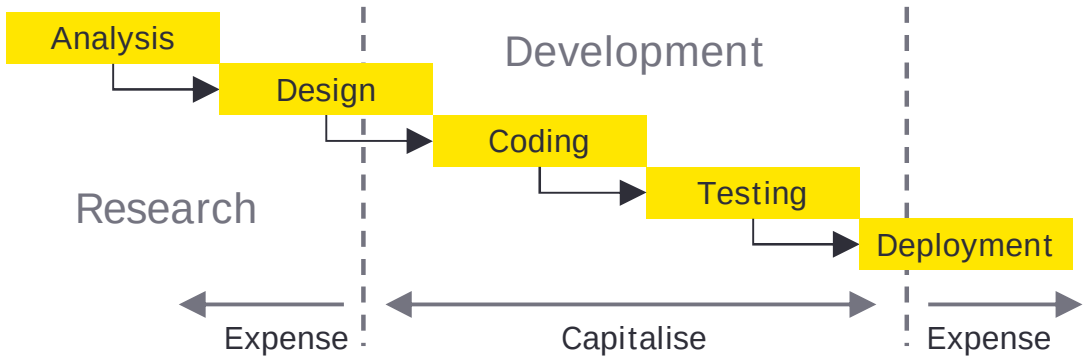
Marek noted that there is a variety of cloud computing services available to banks. In general, as vendor managed options become more off-site, it is harder to justify capitalisation of costs relative to these services. To reiterate this point, he referred participants to the IFRIC's conclusion in March 2019 that contracts conveying the right to receive access to software in the future are services, not leases.

- Capital Requirements Directive (CRD) V or Capital Requirements Regulation (CRR) 2 introduces changes to the regulatory capital treatment of capitalised software recognised as intangible assets under IFRS
- Prudently valued software assets, whose value is not negatively affected by resolution, insolvency or liquidation will be excluded from the scope of deduction from the CET1 capital
- The European Banking Authority (EBA) has been tasked to specify the application guidance, which is expected in late 2019 or early 2020
- Changes to regulatory capital treatment will likely result in additional scrutiny of capitalised balances
- Existing processes and controls may require enhancing

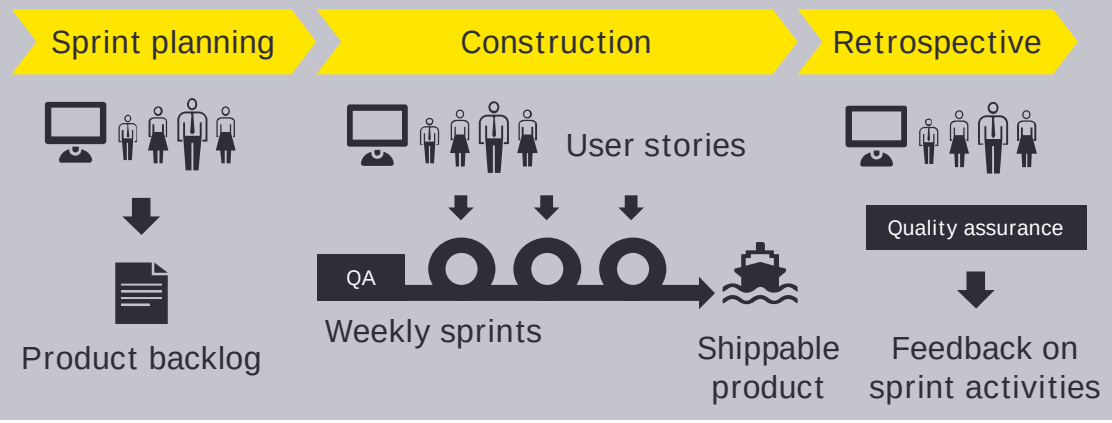
IT operating infrastructure

On agile approaches to software development, the key accounting challenge under the current standards is to demonstrate which costs are incurred during a development phase rather than in a research phase as no clear lines separating these phases exist under an agile project approach. Initial indications from banks implementing these services are that they either rely on detailed time tracking by development teams or they attempt to estimate capitalisation ratios per user story (a description of a software feature from an end-user perspective which defines what they want and why) prior to the project and then they re-assess the ratio as the project progresses. This remains an area where practice, and possibly accounting standards, will probably evolve over time.

Waterfall project approach



Agile project approach



Marek briefly took participants through the March 2019 IFRIC tentative agenda decision regarding the accounting for cryptocurrencies which are:

- Not issued by a jurisdictional authority or other party
- Don't give rise to contracts between the holder and the other party

The IFRIC concluded that accounting treatment depends on whether the asset is held for sale in the ordinary course of business. This decision was subsequently confirmed after the conference at the June 2019 IFRIC meeting.

Cryptocurrency is not held for sale in the ordinary course of business

Apply IAS unless the holding meets the definition of a financial asset or is within the scope of another standard

- Cryptocurrency is not cash
- Cryptocurrency is not a financial asset

Cryptocurrency is held for sale in the ordinary course of business

Apply IAS 2 to inventories of intangible assets held for sale in the ordinary course of business

Commodity broker-traders who buy or sell commodities for others, or on their own account, to generate profit from price fluctuations or margin measure inventories at FV less costs to sell

Finance function of the future

Francois Rossouw, Ernst & Young LLP

“Finance Transformation is more than just new technology”

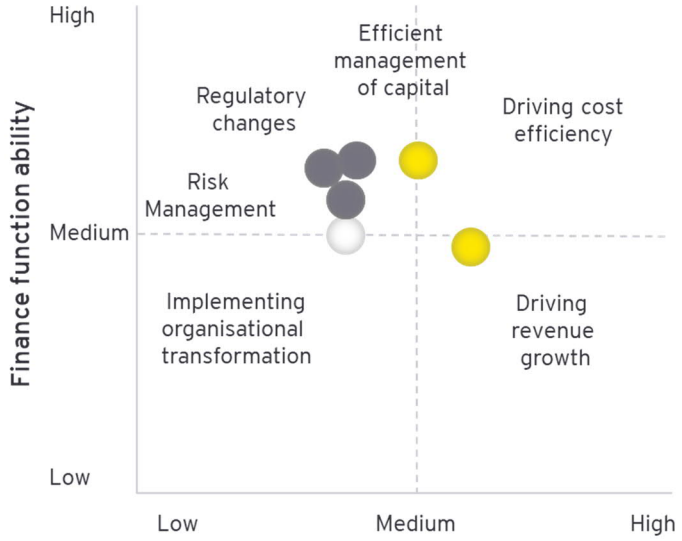
Finance function of the future

The finance function is transforming from focusing mainly on financial reporting and control, to being a value-added business partner which provides real-time and forward looking financial and non-financial information.

However finance functions are still challenged by manually intensive processes, poor data quality, legacy systems and time intensive reporting tasks. This is limiting their capacity to focus on transforming the finance function and supporting the wider strategic agenda across the business.

EY is currently undertaking a CFO survey with our banking clients to understand how business priorities are changing and whether the finance function is well equipped to deliver against these priorities. The survey also seeks to understand the potential limitations to transforming their finance function as well as the technology and workforce impact. Key observations from those participants who we have been surveyed are included below:

How well equipped is your finance function to deliver against the organisational strategic priorities?



With the pace of mandatory change slowing, finance functions need to support a change in focus, driving value for customers though innovative product and technology offerings

The top strategic priority for Banks is driving revenue growth, followed by driving cost efficiency and efficient management of capital. However the majority of respondents feel that the finance function is only somewhat equipped to deliver against these priorities.

A key initiative for the finance function in the short term will be to understand how they can better support the business in its ambition to drive revenue growth while balancing this with greater cost efficiency. The finance function must be able to perform a robust business analysis and provide insight on pricing decisions.

Industry changes could have a significant impact on how the finance function provides value

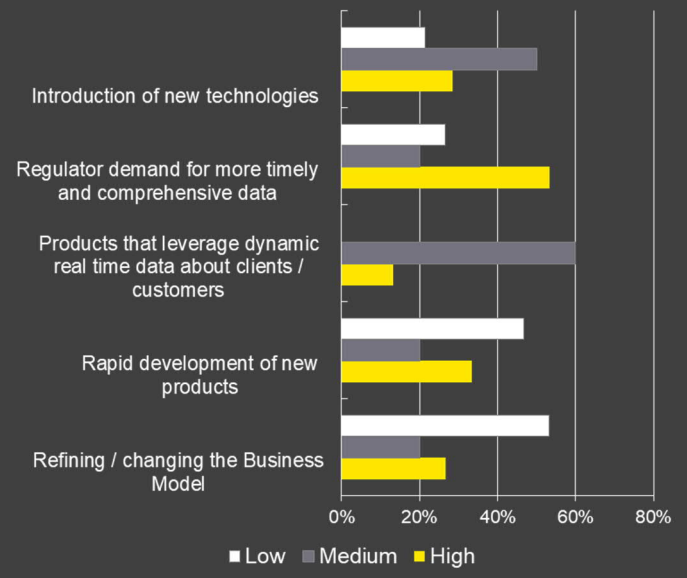
Finance leaders have highlighted three areas that will have the largest impact on the finance function over the next few years, being:

- Introduction of new technologies;
- Development of new products; and
- Meeting regulatory demands for more timely and comprehensive reporting

The finance function's current value proposition aligns to this by recognising the importance of scenario and profitability analysis, regulatory confidence and the role it plays in reducing the costs of business.

The introduction of new technology will have implications on how the finance function performs its role as a control function as well as its ability to support the business. These new technologies will also provide the finance function access to ever increasing information to allow them to provide insights and support strategic decision making.

What changes to the industry will have the largest impact on your finance function?



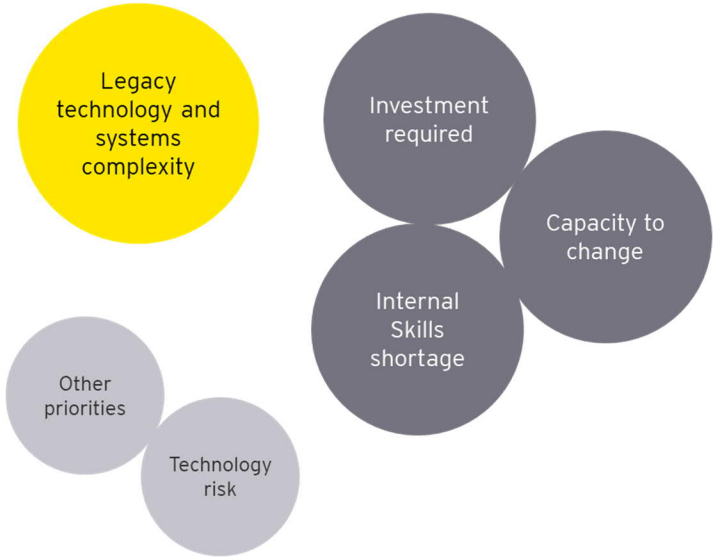
The finance function will need to overcome historical barriers to transform and innovate

Finance functions acknowledge that there are still manually intensive processes supported by legacy technology and infrastructure. As such, a large percentage of their time is focussed on resolving data quality issues.

Whilst finance functions commonly highlight that they need to free up their time to focus on being a business enabler, this shift is largely reliant on the use of technology solutions.

However many industry participants still indicate that legacy technology and system complexity, lack of internal skills and level of investment required are the top three barriers to re-shaping their finance functions.

What are the barriers to transforming your finance function



To transform the finance function, it will need to change the way it develops and organises talent

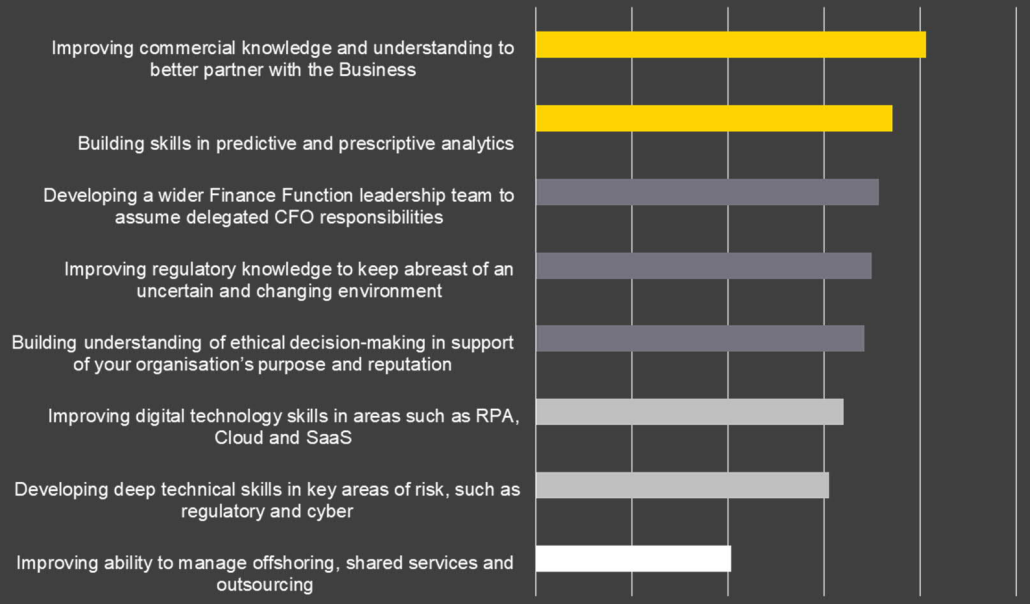
Recognising that revenue growth is the organisation's top priority, respondents see the requirement to develop commercial knowledge and increase predicative and prescriptive analytics skills as the top priority for the next 5 years.

The increasing demand placed on the finance function is recognised through the need to widen the capabilities of the leadership team, and to allow CFO's to delegate responsibilities.

Although regulatory focus is expected to be less of a strategic priority, respondents still recognise the need to have a strong knowledge base to support regulatory compliance.

Improvement in digital technology skills ranks as a lower initiative. However given the large impact that technology will have on strategic priorities, this may be an important skill in aiding the finance function to adapt to technological changes.

Looking ahead five years from now, how important will the following people and skills initiatives be for your finance function?



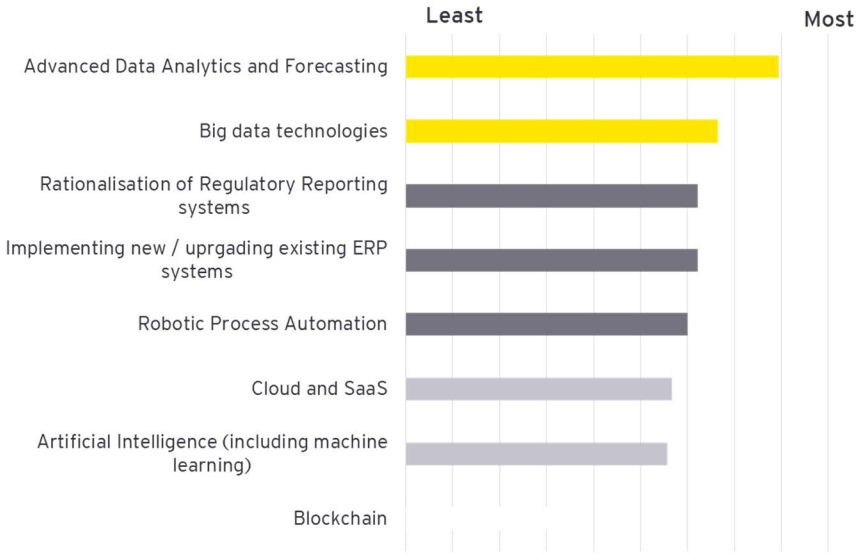
Leveraging the right technologies to accelerate the pace of the finance function transformation

A number of technology levers will enable the finance function transformation, which based on the responses received, are at various stages of implementation. Respondents noted that Big Data and Advanced Data Analytics are the most critical technology enablers for the finance function.

Whilst Advanced Data Analytics will enable the finance function to provide value added support to business through providing forward looking analysis, further progress must still be made to bring this to a mature stage.

Most big banks, whist having mature ERP systems, are now investigating the implementation of cloud based ERP solutions. Blockchain is a relatively nascent technology and few finance functions have begun any substantial activity using this technology.

Technology is critical to enable finance function transformation, and to deliver the required speed, efficiency and cost benefits



Responding to climate risk

Rebecca Self, HSBC

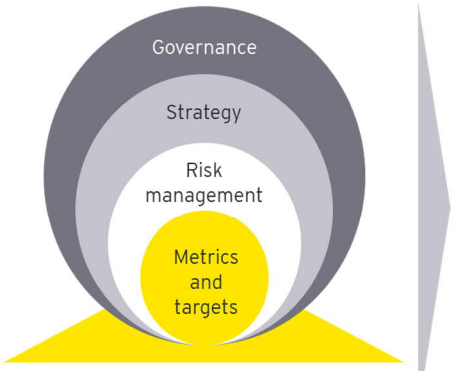
Mark Fisher, Ernst & Young LLP

Responding to climate risk

Climate change is likely to have profound effects on business operations and the wider economy. However, given the perceived long term nature of the risk, many businesses have not prioritised short term responses. Typically individuals see climate change in the context of energy intensive industries but there is much more to this. In the banking sector, it can impact the type of clients we lend to and the industry sectors we choose to invest in.

Post the 2015 Paris agreement on climate change, the banking industry has started to take action on climate change. Regulatory bodies such as the Prudential Regulatory Authority ('PRA'), Financial Conduct Authority ('FCA') European Securities and Markets Authority ('ESMA') (amongst others) are proposing that banks and insurers disclose and manage climate-related financial risks and integrate sustainability into their reporting requirements.
As such, to help address the above, the Task Force on Climate-related Financial Disclosures ('TCFD') are designed to provide guidance on the assessment and disclosure of climate related risks, using forward-looking and scenario based analysis.

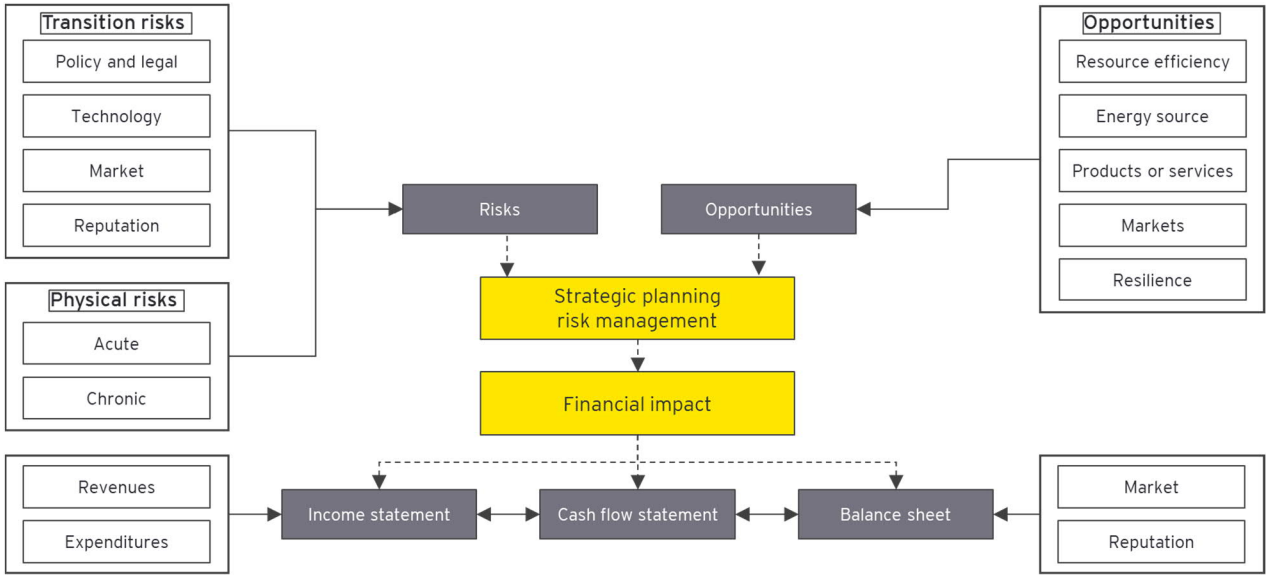
Task Force on Climate-related Financial Disclosures ('TCFD')



Core elements of the TCFD recommendations

Governance	The organization's governance framework for climate-related risks and opportunities
Strategy	The actual and potential impacts of climate-related risks and opportunities associated with the organization's businesses, strategy and financial planning
Risk management	The processes used by the organization to identify, assess and manage climate-related risks
Metrics and targets	The metrics and targets used to assess and manage relevant climate-related risks and opportunities

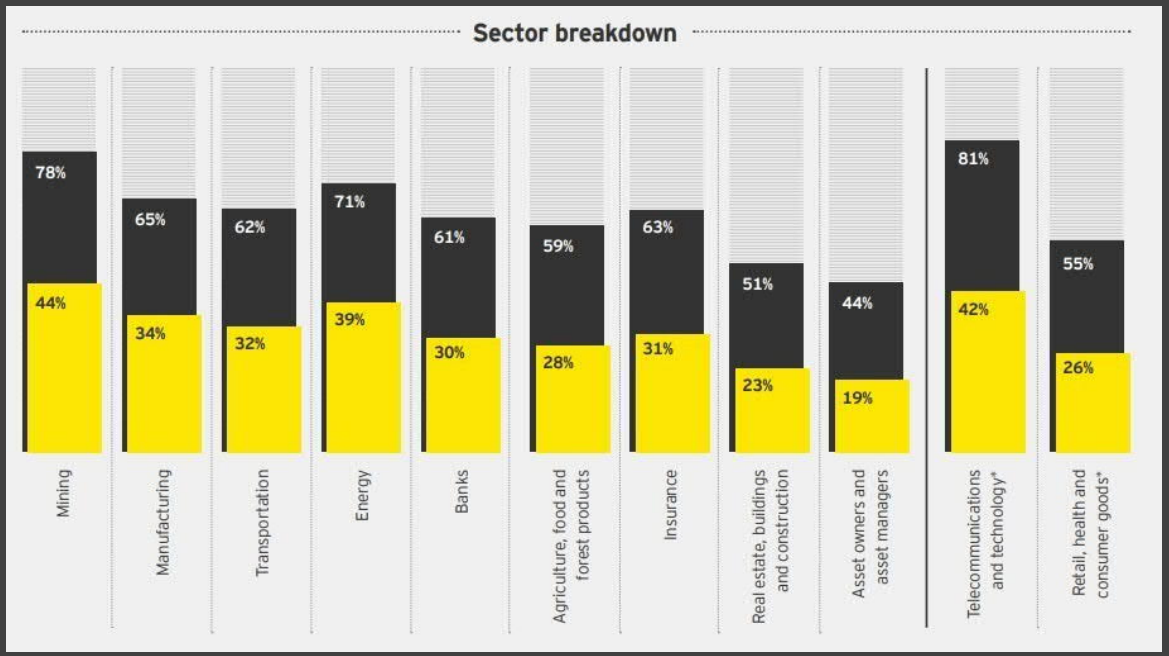
Climate change risks can affect several areas of the business, but can also provide opportunities



Climate risk disclosures

How are industries performing against the TCFD recommendations?

EY teams have developed the Climate risk disclosure barometer to provide an annual snapshot of the uptake of the TCFD recommendations across highly impacted sectors. This provides analysis of current corporate disclosures to compare the high-risk sectors listed in the recommendations against each proposed TCFD disclosure.



Source: EY climate risk disclosure barometer 2018

HSBC

- HSBC recognise that they have responsibility not only to their shareholders, employees and customers, but also to the countries and communities which they operate in
- HSBC have defined their ESG (Environmental, Social and Governance) strategy
- They aim to support the transition to a low carbon economy
- They currently have a team looking at how to incorporate the above into the day-to-day operations of employees
- For two years they have included TCFD in their annual report which includes qualitative disclosure on governance, strategy and risk management
- Their next steps include developing transition metrics and disclosures and to consult with academia & industry experts to price transition and physical risk

More than 240 of our largest suppliers have accepted our Ethical and Environmental Code of Conduct.

HSBC is a signatory to or has expressed public support for:

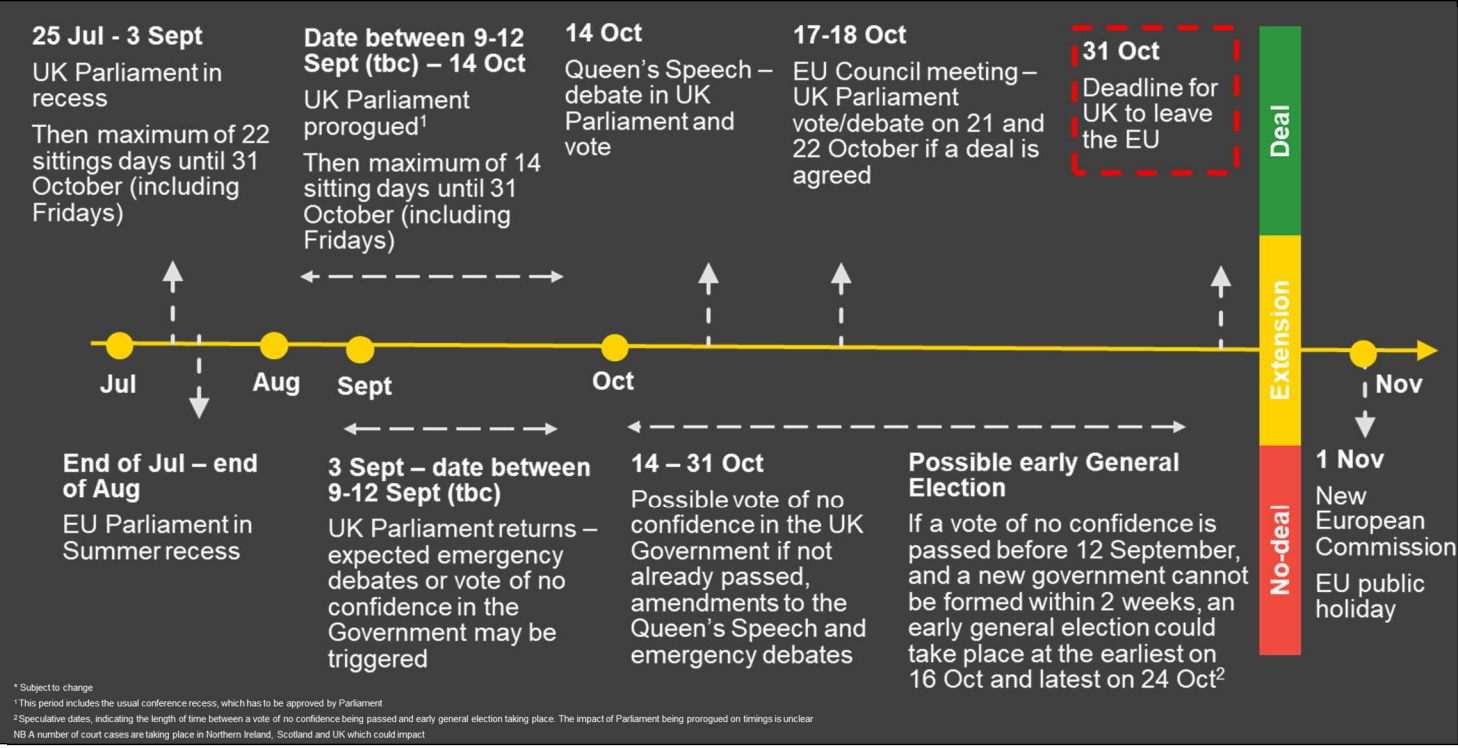
- The Global Sullivan Principles
- The OECD Guidelines for Multinational Enterprises
- The UN Global Compact
- The UN Principles for Responsible Investment
- The UN Principles for Sustainable Insurance
- The UN Sustainable Development Goals
- Paris Agreement and Taskforce on Climate-related Financial Disclosures (TCFD)

Brexit for Financial Services

Andrew Pilgrim, Ernst & Young LLP

Brexit calendar and preparation

Boris Johnson's election as Conservative Party leader and Prime Minister has brought the real possibility of a no-deal withdrawal from the European Union (EU), known as 'Brexit', back into light. The financial services sector has spent the last few years preparing for Brexit, and now it appears those efforts have not been without benefit



Most institutions in the United Kingdom (UK) are prepared for a 'no-deal' Brexit. With contingency plans no longer the core focus, attention is shifting to managing any market volatility resulting from Brexit and optimisation of European and global operating models.

The European Commission has confirmed that short-term equivalence will be granted in the event of a no-deal for UK Central Counterparty Clearing Houses (CCP) and Depositories (CSD) but other contingency measures have been delegated to member states.

Informal polling indicates most firms see the biggest risks of a 'no-deal' as market impacts and contract continuity. Continuing access to financial market infrastructure is also of concern.

European Supervisory Authorities (ESAs) - recent focus

- Closely monitoring Brexit developments and possible risks of a no deal, including through stress tests
- Joint Committee of the ESAs Spring 2019 report on risks and vulnerabilities in the EU financial system – timely contingency plans "crucial"
- Actions include:
  - UK CCPs / CSDS - conditional 12m equivalence decisions
  - Over-the-counter (OTC) contracts - 12-month transition period to allow UK counterparties to be replaced without triggering clearing requirement
  - ESMA guidance to EU27 National Competent Authorities (NCAs) on non-EU branches providing investment services/activities

Memoranda of Understanding (MoUs)

- MoU between European Economic Area (EEA) NCAs and Financial Conduct Authority (FCA) – multilateral MoU covers supervisory cooperation, enforcement and information exchange
  - "will allow certain activities, such as fund manager outsourcing and delegation, to continue to be carried out by UK- based entities on behalf of EEA counterparties"
- MOU between ESMA and Bank of England - for recognition of UK CCPs and UK CSD
- MoU between ESMA and FCA - covers supervision of credit rating agencies and trade repositories
- European Banking Authority (EBA) template for bilateral MoUs between NCAs and Prudential Regulation Authority (PRA)/FCA - covers information exchange and supervisory cooperation

European Central Bank – recent focus

- Third country branch assessments
- UK Temporary Permissions Regime – European Central Bank (ECB) permission may be needed for third country branches
- Booking models, access to Financial Market Infrastructure (FMI) and business plans - no key function holders, systems or services from third country branch

Further consideration of…

- Dual listed companies and MiFID II Share Trading Obligation (STO)
- Depositor protection in EEA branches of UK credit institutions
- Secondary market data exchange
- Accelerated reconsideration of third country regulation and supervisory arrangements / revised EU equivalence regime
- Recalibration of MiFID rules when UK not in calculation of metrics

PRA / FCA regulation / supervision

- FCA has published final rules and Binding Technical Standards
- Bank of England / PRA have published final policy materials including EU Exit Instruments, Supervisory Statements and a Statement of Policy
- EU MoUs

Temporary Permission Regime (TPR)

- FCA notification window still open (closes 30 Oct 2019) but PRA notification window closed on 11 April 2019
- PRA/FCA note on application of the Senior Managers and Certification Regime (SMR) to TPR firms - clarifies how proposals interact

Financial Services Contracts Regime

- For EEA firms that do not enter the TPR or exit the TPR without UK authorisation
- To enable EEA firms to wind down UK regulated activities in an orderly manner

Accounting and corporate reporting

- Department for Business, Energy and Industrial Strategy (BEIS)/Financial Reporting Council (FRC) no deal letters on accounting and corporate reporting
- Statutory instrument transfers EU's powers to adopt International Accounting Standards (IAS) to the Secretary of State
- Will delegate to Independent UK IAS endorsement body being established during 2019

Temporary transitional power

- Statutory Instrument provides UK regulators with a temporary transitional power (TTP) to make transitional directions to mitigate disruptions to firms' obligations
- FCA has published final TTP Directions (may publish a further set later in year)
- Bank of England / PRA have not publishing final TTP Directions yet

UK financial services equivalence framework

- Statutory instrument makes provisions for elements of the UK financial services equivalence framework in the event of a no-deal
- HM Treasury has temporary power to make equivalence and exemption directions for EEA Member States with guidance from UK regulators