



CP11/30 Proposed Regulatory Prudent Valuation Return – Consultation Response
The Financial Services Authority
25 The North Colonnade
Canary Wharf
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14 February 2012

Dear Sirs

CP11/30 Proposed Regulatory Prudent Valuation Return – Consultation Response

We are responding to the invitation to provide views on the above consultation paper ('CP') on the proposed regulatory prudent valuation return. PwC welcomes the opportunity to comment on these proposals. We note that PwC was a member of the advisory group (led by the Bank of England and the FSA) that discussed these proposals last year pre-publication; many of the comments in this letter were discussed within that group.

Our comments are set out below. They primarily relate to questions 1, 2 and 3 raised in the consultation paper. We do not have significant comments on the remainder of the questions.

Cost benefit analysis (Qs 2, 3)

The proposed regulatory return would require firms to produce an assessment of valuation uncertainty both at an aggregate and portfolio level. These are clearly important data that are required, regardless of the existence of this reporting form, to fulfil the existing FSA requirements regarding prudent valuation contained within GENPRU1.3. Correspondingly, and as the CP notes, firms should already have most of the data required to complete the proposed regulatory reports.

However, our experience is that there are significant differences across firms in terms of the exact categorisation (into different portfolios or asset classes) that can be produced from current data systems. This means that for some firms changes may be required to produce the split of assets and liabilities required by the proposed FSA reporting form. This will, of course, translate into higher costs and a longer implementation timeline than would otherwise have been expected.

Therefore, at the least, we believe it would be helpful for the FSA to accept that for an initial period the forms might be reported on a best endeavours basis. Such a concession would also acknowledge that firms are currently investing significant amounts across a number of projects in order to meet heightened requirements and expectations around regulatory data.

However, we think an alternative solution would be to reshape the forms to leverage more closely off the current IFRS 7 hierarchy. Assets would (firstly) be categorised into Levels 1, 2 and 3. A greater level of granularity could then be required, although with less detail than is currently proposed. Firms already have processes that allow them to produce the Level 1, 2 and 3 split and hence the implementation costs would be lower. We note also that, if disclosed, data corresponding to the current IFRS hierarchy would be more easily understood by investors.

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Implementation costs could be even lower if the FSA were to allow flexibility in form completion such that firms defined their own detailed categorisation beneath the IFRS hierarchy. We also believe that data submitted in this manner would, initially at least, be of a higher quality as it would be sourced from existing, tested, systems. We note, however, that information thus obtained would be somewhat less comparable and we acknowledge the importance to the FSA of comparability across firms.

In earlier discussions, the FSA raised concerns that leveraging off the IFRS 7 hierarchy would not allow hedges to be incorporated in an appropriate manner, and that therefore the balance sheet and VaR numbers reported would not reflect the degree of risk that the bank is facing by portfolio. However, we think it would be possible to achieve the same result whilst still using the IFRS 7 hierarchy by including a column where banks would report VaR and balance sheet numbers net of applicable hedges.

Intended purpose for the return (Q2)

In the original discussions last year, one possibility was that the FSA would disclose these data (or request firms to disclose these data). We welcome the decision to refrain, at least initially, from requiring this.

As discussed above, firms already disclose (within IFRS requirements) detailed information on uncertainties in valuation methodologies, and the possible impact they might have on balance sheets and profit and loss accounts, in a manner that is commensurate with their business model, size and complexity. In the long-run it may be beneficial to investors to migrate to a form of disclosure that is more standardised across firms, to allow easier comparison across firms and time. However, given the significant changes to data systems that could be required, it is sensible to postpone disclosure of these data until a later date, when any changes to systems will be firmly established within the firm.

Additional guidance to assist firms in completing the return (Q1)

The collection of data on prudential valuation is a complex area. Therefore, detailed and clear guidance is of paramount importance. We acknowledge the work that the FSA has undertaken already and find that the majority of the guidance provided is clear and sufficiently detailed.

However, there are two particular areas where we think further guidance will be necessary on top of that provided in CP11/30, if the return is to produce good quality data that supervisors can understand and compare across firms: the calculation of the diversification benefit that can be incorporated into aggregate numbers; and the calculation of uncertainty on CVA/DVA. If it is not possible for the FSA provide more detailed guidance immediately, then we think it would be helpful for the FSA to augment the guidance as firms begin to report and best practice becomes clearer.

We would be pleased to discuss these issues further with you. If you would like to do so, please contact me on 020 7804 8123.

Yours faithfully


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