PRESS RELEASE

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Momentum building to deliver prudent bank accounting

Since the introduction of Steve Baker MP's Bill to require financial institutions to produce parallel prudent accounts, it has emerged that the IMF and Irish Central Bank are exploring mitigating the problems of IFRS accounting.

The Bank is sufficiently worried about the impact of IFRS on the overstatement of bad loans, that it is taking advice on moving loan loss provisioning off the IFRS system from July 2011. Sources: Daily Telegraph and Irish Independent articles:

http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8555745/Irish-banks-may-have-to-declare-extra-losses-under-accounting-rules-change.html

http://www.independent.ie/business/irish/banks-may-be-forced-to-frontload-billions-in-losses-2665095.html

That is what Steve Baker's draft legislation, the Financial Services (Regulation of Derivatives) Bill, would achieve if enacted in the UK.

We have also learned that the IMF has expressed concern that UK banks are understating bad loans. This is because IFRS masks loans in forbearance situations from provisioning, irrespective of how likely losses are.

http://www.telegraph.co.uk/finance/economics/8560840/IMF-warns-on-UK-banks-masking-bad-debts.html

Noting that French banks do not use IFRS and that there has been no systemic collapse of the French banking system, Steve Baker MP said,

"Accounting Standard setters have partly owned up to their standards being 'procyclical'. However procyclical is an inaccuracy. It implies that IFRS-using banks get back to where they started. A more accurate description is that IFRS creates a death spiral. Banks silently destroy their capital under the guise of profit, then they require taxpayer support, then the process starts again. The prolonged destruction of banking capital is disturbing normal credit intermediation and once again threatening the financial system."

Steve Baker's Bill would deliver prudent accounts for financial firms, enabling sound decisions based on a true and fair view of these troubled institution's positions.

ENDS

Notes to editors

About Steve

Steve Baker is Conservative MP for Wycombe following his election in May 2010. He is a director and co-founder of The Cobden Centre (www.cobdencentre.org), an educational charity for social progress through honest money, free trade and peace. He is Chairman of the All-Party Parliamentary Group on Economics, Money and Banking.

Previously, Steve served in the Royal Air Force as a fast-jet engineer officer before reading for an MSc in Computer Science and becoming a consulting software engineer. Steve has worked with banks and their regulators in the UK, USA and Europe. His last contract was as Chief Architect of two global programmes at Lehman Brothers in the months and years leading up to its failure.

He says it wasn't his fault.

Steve's website is www.stevebaker.info.

About the Bill

The Financial Services (Regulation of Derivatives) Bill:

- Requires preparation of "prudent accounts of true capital and true profits",
- Provides a right to return to preparing Companies Act individual accounts,
- Ceases to have effect if EU-IFRS provides for prudent accounts.

Further details of the Bill and its text may be found here:

> http://services.parliament.uk/bills/2010-11/financialservicesregulationofderivatives.html
>
> or http://bit.ly/k9VSvw

Timothy Bush, Gordon Kerr and Kevin Dowd of Cobden Partners prepared the Bill and advised Steve. Cobden Partners is a new sovereign advisory business which emerged from amongst The Cobden Centre team.

Steve Baker's speech seeking leave to introduce the Bill may be found here:

> http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110315/debtext/110315-0001.htm#11031569000001
>
> or http://bit.ly/k1N50a

Support for the Bill

Steve Baker, Douglas Carswell, Andrea Leadsom and Chris Heaton-Harris introduced the Bill to Parliament on 15 March 2011. Further Parliamentary support is expected from within both Houses.

Lord Flight stated his unhappiness with IFRS in a letter to the House of Lords Economic Affairs Committee on 22 February 2011, which may be found here:

> http://www.publications.parliament.uk/pa/ld201011/ldselect/ldeconaf/119/11917.htm#note214

The second of three conclusions of the 30th March 2011 Report of the House of Lords Economic Affairs Committee, *Auditors: Market concentration and their role*, was:

> *"that prudence should be reasserted as the guiding principle of audit" (page 6).*

The document may be found here:

> http://www.publications.parliament.uk/pa/ld201011/ldselect/ldeconaf/119/119.pdf
>
> or http://bit.ly/jMaZ5g

Relevant paragraphs are as follows:

193. We accept that standards for use in many countries need clear rules which all can apply. It follows that IFRS is more rules-based than UK GAAP. **But we are concerned by evidence that, by limiting auditors' scope to exercise prudent judgment, IFRS is an inferior system which offers less assurance.** IFRS also has specific defects, such as its inability to account for expected losses. The **weaknesses of IFRS are especially serious in relation to bank audits**. (para 130)

194. We recommend that the profession, regulators and the Government should all seek ways to defend and promote the exercise of auditors' traditional, prudent scepticism. **The Government should reassert the vital role of prudence in audit in the UK, whatever the accounting standard**, and emphasise the importance of the going concern statement. (para 131)

195. Achieving general agreement on IFRS could be a long and uncertain process. In the meantime, **we recommend that the Government and regulators should not extend application of IFRS beyond** the larger, listed companies where it is already mandatory. **Continued use of UK GAAP should be permitted elsewhere, so that the basis of a functioning, alternative system remains in place** in case IFRS do not meet their aims. (para 132)

196. As it revises banking regulation, we recommend that the Government should have the importance of accounting standards at the forefront of its mind. **It should promote a prudent interpretation of IFRS as applied to banks. This would include sober valuation of complex financial instruments**. At present IFRS permits recognition only of incurred losses, not expected losses. So it is essential that banks put aside reserves in good times to provide against downturns. This would have the incidental advantage of reducing the scope for banks to pay bonuses on the basis of profits struck without taking account of possible losses. We recognise that a fully satisfactory outcome depends on international negotiation and believe that the Government should give a lead.

And

124. Mr Peter Wyman, formerly of PwC, [former global head of public policy and former President if the Institute of Chartered Accountants in England & Wales] recently said: "The rules allowed banks to pay dividends and bonuses out of unrealised profits—from profits that were anything but certain. The system is still in place now—we can't tell if similar problems are building up because there is no requirement to separate realised from unrealised profits."

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