Investor view

Seven principles for effective risk disclosure

Insight from the investment community

Seven principles for effective risk disclosure

The Financial Stability Board's Enhanced Disclosure Task Force has published its recommendations on how banks can improve their risk reporting. While the report is aimed at the banks, the key messages can be applied across all sectors. In this 'Investor view', PwC looks at how all companies can apply these principles to their risk reporting.

The Enhanced Disclosure Task Force (EDTF) was formed by the Financial Stability Board and comprised representatives from the investment community and banks, along with regulators, ratings agencies and the audit profession. The full EDTF report is available here.

The report includes seven principles for effective risk disclosures. Whilst their original purpose was to offer a pragmatic framework for thinking about risk reporting in a bank, we believe they offer valuable insight to management in all sectors.

1. Clear, balanced and understandable

The EDTF tells us that it appreciates granularity, but it is also important to ensure risk information is summarised in a straightforward way, fairly representing both the risks in your business and the strategy in place to manage them.

A balance of qualitative and quantitative information is valuable, with narrative explanations adding helpful insight and clarity to the quantitative disclosures.

2. Comprehensive

How do you identify, manage, measure and report your risks? The EDTF wants to see an overview of a company's key activities and risks, with significant changes highlighted.

Policies and procedures are important here too, so ensure your disclosures enable investors to understand your risk management operations and the related governance structure.

Sensitivity analysis is another fundamental part of the picture. Investors need to understand the sensitivity of the business in both quantitative and qualitative terms.

3. Relevant

An exhaustive list of risks is not always helpful, and neither are 'boiler plate' definitions.

Talk about the current or prospective risks that really matter to your business. Set your risks in the context of your business model and discuss the different risks that apply to different segments.

4. Reflect how your risks are managed

Base your disclosure on the information that is used for risk management internally, by the board and by key management.

Provide an explanation of your risk and reward profile, and ensure disclosure is representative of the risks during the period, as well as at the period end.

The level of information needs to balance confidentiality and materiality.

5. Consistent over time

The EDTF seeks to understand how companies evolve over time. Core disclosures should therefore remain fairly consistent, so the development of business, risk profile and risk management is transparent.

If your disclosures need to change, highlight the reasons why; for example: emerging risks, new practices or changing external requirements. Apply some simple ground rules, explain the reason for the change and provide restated comparative information where possible.

6. Comparable

Every company is different, but where possible, the EDTF would like companies to use similar risk disclosure principles to facilitate comparisons between companies in similar industries.

7. Timely

Risks are continually changing and evolving, so make sure you are updating your investors on a timely basis.

Consider using a variety of channels, including earnings releases and your website as well as your annual report.

A difficult balance to achieve – but an important one

The EDTF recognises in its report that sometimes a tension may exist between some of these principles, for example keeping disclosures consistent over time and reflecting relevant information about how you manage your risks.

However, as investors tell us they value good risk disclosure, it is clear that all companies need to think about how to best reflect their own risks, in the context of a market that values consistency and comparability between companies.

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