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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**02 October 2008, London**
Project:	**Consolidation**
Subject:	**Off-balance Sheet Risk: Proposed amendments to Disclosure Requirements (Agenda paper 3)**

1. The purpose of this paper is to outline the disclosure requirements we are proposing to include in the new consolidation standard, in relation to what is loosely referred to as 'off-balance sheet' activities. They have been developed after a review of financial reports, an analysis of the good practice reviews undertaken for parties such as the Financial Stability Forum, discussions with representatives from preparers, auditors and users and analysis of the equivalent requirements (both proposed and recently required) in the US.

2. The paper has been written to set out what it is we are trying to achieve with the proposed disclosures and illustrate the type of information that we anticipate would be provided by entities complying with the proposals. The proposals are not set out using the language that in the way that we would expect to find in an

IFRS. If the Board agrees with the proposals we will draft the relevant sections for the exposure draft.

3. Our assessment is that our proposals would require entities to disclose information similar to that recently requested of US registered public entities by the SEC. Additionally, we have not identified any requirements in the proposed FIN 46(R) that are not reflected in our proposals. The requirements are not identical. The SEC and FASB requirements reflect the FIN 46(R) notion of a variable interest entity and primary beneficiary. We do not have identical concepts in IFRSs.

Scope

4. The disclosures are designed to inform users of an entity's financial statements about risks to which the entity is exposed as a consequence of its off-balance sheet activities. The term 'off-balance sheet' is a term often used with the intention of describing activities such as securitisations, setting up structured investment vehicles, SPE's or conduits. Undefined, however, and the term could be taken to mean any activity that is not reflected on the balance sheet of an entity.

5. The first step is, therefore, to identify the population of risks to which these requirements are intended to apply. In developing the proposals we introduced the term 'significant involvement'. It is a term used by some investment banks to refer to those circumstances in which they retain a contractual interest in an off-balance sheet vehicle such as an entity set up to manage securitisation activities. Unfortunately, as we started to define the term it became entangled with the concept of significant influence as defined in IAS 28 *Accounting for Associates*.

6. To avoid that confusion, the proposals do not use a defined term such as 'significant involvement', but describe the type of entity, relationship and risk that they are intended to capture. The type of risks for which we are trying to improve the disclosure requirements are those risks related to interests the reporting entity has, or had, with entities that are established for the purpose of housing securitisation (borrowing) and investment arrangements.

7. Many entities that are used as secutitisation or investment vehicles will operate without a normal governance structure that relies on voting interests. Entities that are within the scope of SIC-12, or are classified as variable interest entities in accordance with US GAAP, would fall within this set. The contractual arrangements that the reporting entity has with these entities are likely to be financial instruments, which would cause them to be within the scope of IFRS 7 *Financial Instruments: Disclosure*. The existence of a contractual arrangement means that the sponsoring entity has retained an interest in the sponsored entity.

8. However, our target set for disclosure is wider than those structured entities in which the reporting entity currently has a contractual interest. Our target set includes entities that were established for the purpose of housing securitisation and investment arrangements that the reporting entity sponsored (set up) but in which it does not have a current contractual interest (asset or liability). The credit crisis has shown that the earlier relationship between the reporting entity and such entities can create risks that persist beyond the period in which a contractual relationship exists. We have observed cases of entities providing support to entities they had previously sponsored, sometimes to the extent that they obtain control over those entities. These actions are perceived by many to be a consequence of the reputational risks that were created when the sponsor established the entity.

9. For the remainder of this paper, the terms off-balance sheet activities and structured entities refer to those activities in unconsolidated entities of the nature described in paragraphs 7 and 8.

Disclosure objective

Disclosure requirement proposed

10. We propose that a reporting entity be required to disclose information that enables users of its financial statements to evaluate the nature of, and changes in, the significant market (interest rate, prepayment, currency and other price) risk, credit risk and liquidity risk to which it is exposed as a consequence of its activities with structured entities.

11. The information a reporting entity provides must enable a user to assess the current and potential financial effects its involvement with such entities on its financial position, financial performance, and cash flows.

12. To achieve the objective described in paragraph 10, a reporting entity would be required to disclose qualitative and quantitative information about its involvement with structured entities, including details of the nature, purpose, size and type of activities in structured entities:

    a. that it created or sponsored;

    b. in which it has an investment or to which it has an obligation.

13. The specific disclosure requirements are set out in the next sections of this paper. In addition to those requirements, we propose that a reporting entity would be required to assess whether they have met the disclosure objective in paragraph 10. If there are aspects of the reporting entity's relationship with structured entities or risks that are not explained adequately, even though the reporting entity has provided the information specified in the proposed IFRS, the reporting entity would be required to provide whatever additional information is necessary to meet the disclosure objective.

Questions for the Board:

1. **Do you support the disclosure objective described in paragraph 10?**
2. **Do you agree that a 'catch-all' requirement, as described in paragraph 13, is appropriate?**

Structured entities created or sponsored by the reporting entity

Scale of off-balance sheet activities relative to consolidated activities

14. As a first step, we think it is helpful to provide users of the financial statements with information about the relative scale of on- and off-balance sheet activities that the reporting entity has set up and sponsored.

15. In suggesting such a proposal we are not attempting to provide users with information about what the statement of financial position would look like if these off-balance sheet entities were consolidated. These entities are not controlled by the reporting entity, which is the reason they are not consolidated.

Our objective is to provide users with information that helps them assess the extent to which the reporting entity has been involved in sponsoring such entities.

Disclosure requirement proposed

16. We propose a requirement to present, in tabular form unless another format is more appropriate to the circumstances of the reporting entity, a summary of the gross fee income from securitisation and asset management activities (as recognised in the reporting entity's statement of comprehensive income) and the value of the assets securitised, at the date the securitisation transactions were established—for the current period and the preceding two periods.

17. The summary would need to separate the sponsorship activity into:

    a. relevant categories (by type of vehicle or the type of assets securitised) because different types of structure or different types of assets can expose the reporting entity to different levels of risk; and

    b. identify the extent to which the sponsorship activities relate to vehicles in which the reporting interest has retained an interest and those in which it has not.

18. It might be necessary to present more than one table to provide this information.

19. Our assessment is that the information should be available to the reporting entity because of their close involvement with the sponsored vehicle when it was established. We are not proposing that asset values be required, for the purposes of this particular disclosure, at a date other than the date the securitisation was completed. We acknowledge that some entities might not currently be capturing this information in the management systems they use for external reporting purposes. It is possible that we will need to consider a transition period for which comparatives, for periods before the requirements are published, would not be required.

Illustrative example

Securitisation and other asset management activities

We are a market leader in mortgage- and asset-backed securitisations and other structured financing arrangements. We establish separate entities for the securitisation of commercial and residential mortgages, home equity loans, municipal and corporate bonds, and lease and trade receivables.

Total entities we set up and sponsored

The following table summarises our involvement with securitisation and other asset management activities, by asset type. The table provides an indication of the scale of our involvement in entities that we have set up and sponsored. The table identifies the related fee income we recognised in each period, and the value of the assets securitised at the date the securitisation transactions were completed. In some cases we retain an interest in the entities used to manage securitisation activities, in the form of residual interests, credit guarantees or liquidity commitments. The table below relates to both those transactions in which we have retained an interest in the securities issued by the entity, or have another contractual agreement, such as a liquidity commitment, and those in which we have not.

CU Million	**2008**		**2007**		**2006**	
	Fee income	Assets securitised	Fee income	Assets securitised	Fee income	Assets securitised
Collateralised debt obligations	1,026	14,650	820	11,720	697	9,962
Residential mortgage-backed securities	6,055	86,500	4,844	69,200	4,117	58,820
Commercial mortgage-backed securities	878	12,546	703	10,037	597	8,531
Municipal bond securitisations	623	8,907	499	7,126	424	6,057
Principal-protected notes	332	4,739	265	3,791	226	3,223
Asset repackagings and credit-linked notes	189	2,695	151	2,156	128	1,833
Total	**$9,103**	**$130,037**	**$7,282**	**$104,030**	**$6,190**	**$88,425**

In all cases the entities that manage the securitisations are not controlled by us and therefore are not consolidated. Of the total securitisation and asset management business undertaken, the following table provides a split between those transactions in which we have retained an interest and those in which we have not.

CU Million	**2008**		**2007**		**2006**	
	Fee income	Assets securitised	Fee income	Assets securitised	Fee income	Assets securitised
Retained interest	3,183	45,478	2,547	36,383	2,165	30,925
No retained interest	5,919	84,559	4,735	67,647	4,025	57,500
Total	**$9,103**	**$130,037**	**$7,282**	**$104,030**	**$6,190**	**$88,425**

Retained interests

The following table summarises, by asset type, our involvement with securitisation and other asset management activities, in which we have retained an interest in the entity. The table identifies the related fee income we recognised in each period, and the value of the assets securitised at the date the securitisation transactions were completed.

CU Million	**2008**		**2007**		**2006**	
	Fee income	Assets securitised	Fee income	Assets securitised	Fee income	Assets securitised
Collateralised debt obligations	410	5,860	328	4,688	279	3,985
Residential mortgage-backed securities	2,422	34,600	1,938	27,680	1,647	23,528
Commercial mortgage-backed securities	351	5,018	281	4,015	239	3,413
Total	**$3,183**	**$45,478**	**$2,547**	**$36,383**	**$2,165**	**$30,925**

Additional disclosures

20. In addition to the quantitative information, a reporting entity would be required to explain how its involvement with structured entities fits into its business model, such as whether these entities are used to facilitate the securitisation of its own

assets, for internal risk management purposes, for tax reasons, to obtain liquidity, to achieve favourable capital treatment or to offer investment opportunities to customers.

Questions for the Board:

1. **Do you agree with the disclosures proposed for reporting the relative scale of on- and off-balance sheet activities?**
2. **Is it clear, and do you agree, that the amounts should be based on values at the date the sponsoring or set-up activities were established?**
3. **Is a requirement to show two periods of comparables appropriate and adequate?**
4. **Do you support providing a transition period concession for comparative information? Should any concession be on the basis of undue cost or effort?**

Risks

21. Having established the extent to which the reporting entity has been involved in sponsoring such entities, we turn to the risks to which the reporting entity is exposed as a result of this involvement.

Off-balance sheet relationships within the scope of IFRS 7

22. The first category of risks are those related to unconsolidated entities in which the reporting entity has a continuing interest and that, as such, are likely to be within the scope of IFRS 7 because of the financial instruments that support their involvement. Such instruments would include guarantees, credit and liquidity support agreements, buy-back arrangements and so on, which may be on-balance sheet.

Disclosure requirement proposed

23. We propose a requirement to present, in tabular form unless another format is more appropriate to the circumstances of the reporting entity, a summary of:

    a. the total value of the assets held by the unconsolidated structured vehicles (measured at the reporting date of the reporting entity);

b. the maximum loss to which the reporting entity is exposed; and

c. the carrying amount of any interest the reporting entity holds.

The information would need to be classified into categories that are appropriate to the reporting entity (such as by type of vehicle or the type of assets securitised) and by class of retained interest.

Illustrative example

Total retained and acquired interests

The following table summarises our involvement with securitisation and other asset management activities, by asset type. In some cases we retain an interest in the entities that manage securitisation activities, in the form of residual interests, credit guarantees or liquidity commitments. This table below relates to both those transactions in which we have retained an interest in the securities issued by the entity, or have another contractual agreement, such as a liquidity commitment, and those in which we have acquired an interest or other contractual agreement. The table identifies the maximum exposure to loss in relation to these interests, as well as the total assets held by the unconsolidated entities. The second table provides information as to where these interests appear in the financial statements of the reporting entity.

CU Million		Maximum Exposure to Loss					
Type of asset in unconsolidated entity	**Assets held by unconsolidated entities**	**Total**	**Loans, Receivables and Investments**	**Credit Guarantees**	**Liquidity Commitments**	**Repurchase Options and Obligations**	**Net Carrying Amount on Statement of Financial Position**
Originated by us							
Collateralised debt obligations	13,080	**4,316**	2,354		1,962		2,256
Real estate, credit-related and other investing	79,801	**51,871**			11,970	39,901	(599)
Municipal bond securitisations	13,939	**3,206**	2,509	697			2,467
	106,820	**59,393**	**4,863**	**697**	**13,932**	**39,901**	4,125
Originated by other entities							
Collateralised debt obligations		**1,437**	784		653		751
Real estate, credit-related and other investing		**17,273**			3,986	13,287	(199)
Municipal bond securitisations		**1,068**	836	232			822
Credit card receivables			1,250				1,250
		19,778	**2,869**	**232**	**4,639**	**13,287**	2,624
Total		**$79,171**	**$7,733**	**$929**	**$18,572**	**$53,188**	$6,749

Carrying amount of assets and liabilities in unconsolidated entities recognised in statement of financial position

Class of financial instrument	**Loans, Receivables and Investments**	**Credit Guarantees**	**Liquidity Commitments**	**Repurchase Options and Obligations**	**Total**
Avaliable for sale securities	784				784
Commitments and guarantees		(56)	(929)	0	(984)
Loans and investments	6,949				6,949
Total	**$7,733**	**($56)**	**($929)**	**$0**	**$6,749**

Questions for the Board:

1. **Do you support the quantitative disclosures described in paragraph 23?**
2. **Those disclosures require values at the reporting date (not the date the structured entities were established), do you agree that this is appropriate?**

Additional quantitative and qualitative disclosures

24. Supporting the quantitative summary would be a requirement to disclose information that will enable a user to assess the risks to which the reporting entity is exposed as a consequence of its involvement with structured entities.

Disclosure requirement proposed

25. A reporting entity would be required to disclose information about the following matters if such disclosure is relevant to an assessment of the risks to which the reporting entity is exposed as a consequence of its involvement with structured entities:

    a. In relation to the assets the unconsolidated entities hold:

        i. their categories and rating;

        ii. weighted-average life; and

        iii. significant write-downs or downgrades.

    b. In relation to funding and loss exposure:

        i. the forms of funding (commercial paper, medium-term notes, etc) and the weighted-average life of the funding the structured entities hold;

        ii. any difficulties the structured entities have experienced in financing their activities during the period;

        iii. losses the reporting entity has been exposed to during the reporting period; and

        iv. whether the reporting entity is required to bear any losses ahead of other investors in the structured entity, the nature of such preferential losses and the maximum limit of such losses.

    c. The types of returns the entity receives from the instruments it holds in structured entities.

    d. In relation to liquidity facilities for which the reporting entity has an obligation:

        i. a description of any triggers associated with obligations to fund;

        ii. whether there are any terms that would limit its obligation to provide liquidity support;

        iii. whether there are any other parties that are providing liquidity support and, if so, how its obligation ranks with those other parties.

    e. In relation to support that has been provided by the entity to structured entities:

i. whether any commercial paper or other securities issued by the structured entities has been purchased by the reporting entity, and whether any agreement required the reporting entity to make these purchases; and

ii. whether any other assistance was provided to the off-balance sheet entity in obtaining any other type of support, or whether there are any current intentions to do so.

Questions for the Board:

1. **Are there any disclosures requirements proposed here that are not appropriate?**

2. **Are there any additional disclosures you think should be required?**

3. **We sometimes use the term 'significant' in relation to specific disclosure requirements. Is this appropriate?**

Off-balance sheet relationships outside the scope of IFRS 7

26. The other class of entities of interest is those structured entities that it established or sponsored but:

    a. has no current involvement; or

    b. if there is some current involvement, the entity does not have an associated financial instrument that would cause the reporting entity to fall within the scope of IFRS 7.

27. There can be risks for the reporting entity if investors in those vehicles perceive that the reporting entity is providing implicit support for the investment vehicle. During the credit crisis some entities that sponsored investment vehicles (set them up or arranged their financing, or both) took steps to support the investment vehicles even though they may not have had a contractual obligation to do so.

28. Such actions are viewed by some as being related to the reporting entity taking control of the vehicles to protect its (ie the reporting entity's) credibility or reputation. The extent to which a reporting entity has been involved in transactions that expose them to such risks is widely perceived as being information that improves transparency.

Disclosure requirement proposed

29. A reporting entity would be required to disclose the extent to which it has provided support to such entities, despite the absence of a contractual obligation to do so. This may apply where there is no current involvement or where the reporting entity has a retained interest of, for example, five percent and has provided non-contractual support, beyond what it was contractually obligated to provide. Additional information would be required for those circumstances in which the support provided resulted in the reporting entity controlling the vehicle.

30. The reporting entity must disclose the type, including situations where it assisted the structured entity in obtaining another type of support, and the amount of financial support it provided.

31. The reporting entity must also explain the primary reasons for providing any support that it was not obliged to provide.

Illustrative example

The following table summarises our involvement with securitisation and other asset management activities, in which we have not retained or acquired an interest in the underlying entity. The table identifies the related fee income we recognised in each period, and the value of the assets securitised at the date the securitisation transactions were completed.

CU Million	2008		2007		2006	
	Fee income	Assets securitised	Fee income	Assets securitised	Fee income	Assets securitised
Collateralised debt obligations	615	8,790	492	7,032	418	5,977
Residential mortgage-backed securities	3,633	51,900	2,906	41,520	2,470	35,292
Commercial mortgage-backed securities	527	7,528	422	6,022	358	5,119
Municipal bond securitisations	623	8,907	499	7,126	424	6,057
Principal-protected notes	332	4,739	265	3,791	226	3,223
Asset repackagings and credit-linked notes	189	2,695	151	2,156	128	1,833
Total	**$5,919**	**$84,559**	**$4,735**	**$67,647**	**$4,025**	**$57,500**

Non-contractual support provided

In February this year, because of disruption in the supply of Commercial Paper (CP) funding, we provided CU17.5B of funding in the form of CP purchases to Entity X (founded in 2007). As a consequence, we concluded that the provision of the funding caused us to control Entity X. Consolidating Entity X resulted in CU20B of BBB rated mortgage receivables being recognised in the group financial statements. We decided to acquire the CP as an act of good faith to the clients who had invested in the fund on the basis of our advice.

In May 2006, we were approached by the administrators of the fund, Entity Y (founded in 2004), which was having difficulties obtaining short-term funding from other sources. We provided CU3M of short term liquidity support to Entity Y. The full amount was repaid within fourteen days of the funding being advanced and no additional support has been provided since this date.

Questions for the Board:

1. **Do you support the disclosure requirements proposed for non-contractual support?**
2. **Do you agree that the proposals should not include a requirement for an entity to make a general statement about its reputational risk management policies?**