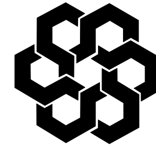

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards. These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**16 September 2008, London**
Project:	**Consolidations**
Subject:	**Credit Crisis Proposed Disclosure Requirements for off-balance sheet entities (Agenda paper 2Cii)**

[Appendix 2 omitted from Observer Notes]

CONTENTS

1 This paper contains three appendices, which should be read in conjunction with agenda paper 2Ci.

2 **Appendix 1** provides a detailed analysis of disclosures made in the 2007 annual reports in the financial services sector carried out by IASB staff and other organisations, including PwC, KPMG, and the Committee of European Banking Supervisors (CEBS). It also provides some additional information on disclosure requirements issued by regulatory bodies.

3 **Appendix 2** [This has been omitted from the Observer Notes.]

4 **Appendix 3** provides a brief summary of the existing disclosure requirements to be found in IFRS 7 *Financial Instruments: Disclosures* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

APPENDIX 1

Analysis of disclosures made in 2007 annual reports and 'good practise'

<u>Observations made by IASB staff</u>

Citigroup (2007)

1 Citigroup, in its 2007 annual report, included the following disclosures:

(a) their involvement in both consolidated and significant unconsolidated VIEs, presented in tabular format, along with maximum exposure to loss. We used this as the basis of illustrative table 2 we included in Appendix 2

(b) an explanation of why they consider other involvements to be 'insignificant', including when SPEs are structured by third parties and SPEs to which the company's transfer of assets is accounted for as secured borrowings

(c) information relating to asset values for unconsolidated VIEs, together with the measurement basis

(d) cash flow information relating to their credit card, mortgage and other securitisation vehicles

(e) information relating to maximum exposure to loss, distinguishing between funded and unfunded:

i funded representing the balance sheet carrying amount of the Company's investment in a VIE.

ii unfunded representing the remaining undrawn committed amount, including liquidity and credit facilities provided by the Company, or the notional amount of a derivative adjusted for declines in fair value recognised in earnings.

HSBC Holdings (2007)

2 For the SIVs and conduits that HSBC sponsors it provides the following information:

(a) credit ratings of underlying assets

(b) composition of assets, including a split between, for example, residential mortgage-backed securities, commercial mortgage-backed securities, collateralised debt obligations etc

(c) analysis of balance sheet classification, including, for example, the split between loans and financial investments

(d) weighted average maturity of assets in buckets of 0-6 mths, 6-12 mths, greater than 12 mths

(e) funding structure, providing a split between capital notes, commercial paper, and medium term notes. This may also include information relating to, for example, the weighted-average maturity for commercial paper.

<u>Observations made by other organisations</u>

PwC

3 In its report *Accounting for change: transparency in the midst of turmoil. A survey of banks' 2007 annual reports* (August 2008), PwC surveyed 22 banks[1] relating to disclosures around the type, extent and complexity of structured finance activities.

4 They noted that some banks provided detailed, tailored quantitative information, including an analysis of both on and off-balance sheet arrangements, as well as funded and committed lines. Other banks provided only brief qualitative information.

5 Banks generally provided some qualitative and quantitative information related to their off-balance sheet risk exposures. However disclosures appeared randomly distributed throughout the MD&A and financial statements. Most banks did not elaborate on how risk exposures were quantified.

6 18 of the surveyed banks disclosed quantitative exposures to commercial paper conduits, SIVs, CDOs or similar entities. Disclosures varied in format.

7 The most robust disclosures provided information on entities that were and were not consolidated. Such disclosures included information relating to size of the activities of SPEs, the nature of the bank's involvement, information around the composition of assets underlying the SPEs and the bank's maximum exposure to loss.

8 20 of the 22 banks surveyed disclosed the use of SPEs in their structured finance-related activities. Disclosures focused on the nature of SPE activities and the bank's involvement in SPEs. They provided both qualitative information including their role in the transaction and quantitative information including maximum losses.

---

[1] Banks surveyed –Bank of America, Bank of China, Barclays, BBVA, BNP Paribas, Citigroup, Commonwealth Bank of Australia, Credit Suisse, Danske bank, DBS, Deutsche Bank, Dresdner Bank, HSBC, ING, JP Morgan Chase & Co, Lloyds TSB, Nordea, Rabobank, Royal Bank of Scotland, Societe Generale, Standard Bank, UBS.

9 PwC noted that information around the decision to consolidate (or not) was largely inadequate. For many of the banks surveyed they found that the significant accounting policy disclosures surrounding SPEs failed to provide a tailored discussion of the specific policies. Quite often, disclosures took the form of a repetition of the wording in the consolidation standards.

10 Some banks provided additional information on the potential impact of consolidating off-balance sheet entities and the effect this would have on the capital ratios, debt covenants, credit ratings, collateral requirements and dividends of the bank.

11 Of the banks surveyed, 20 disclosed securitisation activity as well as their accounting policies surrounding derecognition. However most of the banks provided only a brief repetition of the derecognition standard as opposed to providing a tailored discussion of the judgements made in applying accounting policies.

12 Only 9 of the 12 banks that disclosed assets not qualifying for derecognition provided information on the nature of the risks and rewards of ownership to which the entity was exposed.

13 9 of the 22 banks surveyed disclosed reconsideration events during the year. Most of the surveyed banks did not, however, provide detailed disclosures on policies, procedures and monitoring controls around the review of reconsideration events. This information may be of use to users in that it enables them to understand what sort of events might lead the bank to recognising future losses/gains or consolidating or deconsolidating entities in the future.

14 Some banks provided quantitative tabular disclosures on the credit rating and weighted life of the off-balance sheet entities' assets and liabilities. This provides information relating to the quality of the assets held in structures and the difference between the tenor of assets and tenor of liabilities used to fund the off-balance sheet entity.

15 9 of the 22 banks surveyed provided disclosures of the weighted-life of assets and related liabilities held in off-balance sheet entities as well as their credit ratings. PwC believed that additional information on the type, geographic distribution, average maturity and credit rating of the collateral provided would have enhanced

transparency. 6 of the 22 banks provided weighted-average life of the funding provided to the off-balance sheet entities.

16 13 banks disclosed their exposure with the mono line insurer sector, where banks have purchased credit protection to hedge exposures to structured products issued by off-balance sheet entities.

KPMG

17 In its report entitled *Focus on transparency. Trends in the presentation of financial statements and disclosure of information by European banks* (June 2008) KPMG noted that 14 of the 17 European banks surveyed[2] provided a description of the nature of the assets held by off-balance sheet vehicles.

18 9 banks provided a detailed description of their accounting policy in relation to the consolidation of SPEs. Only 6 banks provided detailed descriptions of the reasons for not consolidating some vehicles, or the nature of changes that led them to consolidation.

19 The most frequently provided quantitative disclosure regarding off-balance sheet vehicles related to the volume of assets held by the vehicles. 3 banks also provided quantitative information regarding the impact of consolidating SPEs for the first time.

20 7 of the 17 banks surveyed disclosed amounts provided for liquidity support.

21 6 banks disclosed detailed amounts of other exposures to off-balance sheet vehicles, including amounts of investments in shares or notes issued by such vehicles.

Committee of European Banking Supervisors (CEBS)

22 In the *CEBS report on banks' transparency on activities and products affected by the recent market turmoil* (June 2008), the CEBS assesses the adequacy of banks' public disclosures on securitisation operations, and structured products affected by the recent market turmoil.

[2] Banks surveyed: Barclays, HBOS, HSBC, Lloyds TSB, Royal Bank of Scotland, ING, UBS, Intesa Sanpaolo, Unicredito, BNP Paribas, Societe Generale, BBVA, Santander, Fortis, Commerzbank, Deutsche Bank, Dresdner Bank.

23 The sample it used was comprised of the IFRS 7 compliant annual reports for 2007 of 22 large banks[3] (19 from the EU).

24 In its report the CEBS makes the observation that although the best practises identified are in the context of the sub-prime crisis, they could easily be used as the basis of disclosure to apply in normal times.

25 The CEBS's main finding was that the majority of institutions only provided limited disclosure. In the majority of cases information on types of activities and roles assumed in the context of their involvements in securitised entities was very general in nature.

26 Few institutions, in practise, disclosed information on specific strategies with regard to securitisation / structured products. Very few, they noted, disclosed explicitly whether they operate an 'originate-to-distribute', 'buy-to-hold', or mixed models.

27 Few institutions made explicit, detailed disclosure on the importance of securitisation activities for their business. In most cases this information had to be implicitly derived from the size of the exposure relative to other business activities or from the significance of write-downs or losses.

28 The CEBS recommends that institutions adopt a 'holistic' approach to disclosure and promotes the concept that disclosures should 'tell a coherent story' in order to assist the reader in understanding the background to an activity, its impact and importance.

29 The CEBS believes that more information is required on the extent and nature of the involvement in off-balance sheet entities and how it fits in with the institution's overall business model. How, for example, does the involvement contribute financially to an institution's business and share holder value and how compatible is it with the institution's strategy and objectives.

30 Few banks provided information on the consolidation decision and information around any trigger points, which may have resulted in for example sponsoring banks stepping in and providing additional support.

---

[3] Banks surveyed: ABN Amro, Banco Santander, Barclays, Citi, Commerzbank, Credit Agricole, Credit Suisse, Deutsche Bank, Dexia, Dresdner Bank, Erste Bank, Fortis, ING, Intesa San Paolo, Nordea, Rabobank International, Raiffeisen Zentralbank, RBS, SEB, Societe Generale, UBS, Unicredit Group.

31 Only a few banks were observed as disclosing the provision of any credit enhancements or liquidity support.

32 Though not commonly observed, good disclosure practises, according to the CEBS, included:

(a) discussion of types of involvement originated / invested in

(b) description of role/extent of involvement

(c) risks incurred and how there are managed

(d) disclosure of maximum risk of loss and commentary on how the institution's situation could be impacted by a further downturn or market recovery

(e) the impact of further downturns on exposures through the calculation of maximum exposure to loss.

33 As far as presentation is concerned, the following was observed, according to the CEBS, as good practise:

(a) relevant disclosures for understanding of institution's involvement are found in one place

(b) use illustrative tables

(c) quantitative information supplemented by narrative disclosures

(d) use of cross-referencing.

Regulatory disclosure requirements

Summary of Basel II Pillar 3 disclosures in relation to securitisations

34 The Pillar 3 disclosure requirements, designed to provide increased visibility to an entity's risk profile and adequacy of risk management practises require the following types of information for securitisations:

(a) accounting policies

(b) total outstanding exposure by type

(c) impaired and past due amounts

(d) amounts retained and amounts purchased by type and risk weight bands

(e) revolving exposures

(f) activity in period

Disclosure requests made by the U.S. Securities and Exchange Commission (SEC)

35 In the letter sent to public companies in December 2007 the following disclosure requirements relating to off-balance sheet entities (conduits, SIVs or Collateralised Debt Obligations (CDOs)) were recommended by the SEC for inclusion in Management Discussion & Analysis (MD&A):

(a) categories and rating of assets the off-balance sheet entity holds

(b) weighted-average life of assets the off-balance sheet entity holds

(c) forms of funding (commercial paper, medium-term notes, etc) and weighted-average life of the funding the off-balance sheet entity holds

(d) any material difficulties the off-balance sheet entity has experienced in issuing its commercial paper or other financing during the period

(e) any material write-downs or downgrades of assets the off-balance sheet entity holds

(f) maximum limit of the losses to be borne by any first loss note holders

(g) types of variable interests held in the off-balance sheet entity

(h) detailed disclosures regarding obligations under the liquidity facilities. For example:-

i whether there are triggers associated with obligations to fund

ii whether there are any terms that would limit the obligation to perform

iii any obligations under the facilities (eg to purchase assets from or commercial paper the off-balance sheet entity issued), and their material terms

iv whether there are any other liquidity providers, and if so, how the obligation ranks with other liquidity providers

(i) whether any commercial paper or other securities issued by the off-balance sheet entities were purchased, and whether any agreement required the reporting entity to make these purchases. If not, why these purchases were made

(j) 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

(k) the potential impact on debt covenants, capital ratios, credit ratings, or dividends should the reporting entity be required to consolidate or incur significant losses associated with the entity.

Other observations

Counterparty Risk Management Policy Group (CRMPG)

36 The CRMPG called for enhanced disclosures in its report *Containing systemic risk: The Road to reform* (August 2008).The policy group recommends that standard setters and industry participants consider a holistic and principles-based approach to the disclosure of off-balance sheet activities.

37 CRMPG recommend that the disclosure framework should be fully integrated with 'enterprise-wide' disclosures across the full spectrum of risks-market, credit, liquidity, capital, operational and reputational.

38 Enterprise-wide disclosure should be supplemented with detailed information, which changes in response to changing risks and uncertainties. For example, in the current environment there would be, in their opinion, more disclosures relating to residential and commercial real estate and leveraged loan exposures.

39 The policy group believe that there are opportunities to enhance and strengthen documentation and disclosures provided to prospective investors in high-risk and complex financial instruments, while being mindful that disclosure practises will (and should) vary somewhat, from instrument to instrument, and also over time.

40 The report bemoans the fact that in US GAAP there is currently no single framework for the disclosure of off-balance sheet entities. Disclosure rules are promulgated on a standard by standard basis, usually in response to a perceived weakness highlighted by an event in the marketplace. As a result of this approach, disclosures may overlap in certain areas and result in gaps in other areas.

41 This, the report states, leads to unnecessary complexity and is not conducive to providing clear and transparent disclosures.

APPENDIX 2

ILLUSTRATIVE TABLES [Omitted from the Observer Notes.]

APPENDIX 3

Existing requirements in IFRS for off-balance sheet entities

IFRS 7

42 The majority of the existing disclosure requirements for off-balance sheet activities are found in IFRS 7. The objective of IFRS 7 is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period an at the end of the reporting period and how the entity manages those risks.

43 These requirements are irrespective of whether the financial instruments are on or off-balance sheet.

44 IFRS 7 requires qualitative and quantitative disclosures covering all types of risk, including credit risk, liquidity risk and market risk. The entity is required to disclose the nature of its exposures to risk and how they arise, as well as information relating to management's objectives, policies and processes for measuring, monitoring and controlling risk.

45 The quantitative disclosures provide information about the extent to which the entity is exposed to risk. For each type of risk arising from financial instruments, an entity is required to disclose summary quantitative information, as well as information relating to concentrations of risk.

46 The disclosure requirements in IFRS 7 request information about:

(a) financial assets that are past due or impaired

(b) credit risk disclosures, including the amount that best represents an entity's maximum exposure to credit risk

(c) collateral and other credit enhancements obtained

(d) the credit quality of financial assets that are neither past due nor impaired

(e) maturity analysis of financial liabilities and how liquidity risk is managed

(f) additional sensitivity analysis for each type of market risk.

IAS 39 Financial Instruments: Recognition and Measurement.

47 If an entity has issued a financial guarantee to a third party, the entity will need to consider whether that instrument meets the definition of a financial guarantee contract as defined in IAS 39.

48 In paragraph 9 of IAS 39 a financial guarantee is defined as:

a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument

49 A financial guarantee would therefore provide protection against credit risk, ie protecting against the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

50 Liquidity support would be covered by IAS 39 under loan commitments, which it defines in paragraph BC 15 as

Firm commitments to provide credit under pre-specified terms and conditions

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

51 The disclosure requirements in this IFRS would apply to contingent obligations or liabilities, which do not meet the recognition criteria.