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International Accounting Standards Board

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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: **February 2009, London**

Project: **Derecognition of Financial Assets and Liabilities**

Subject: **Remaining issues relating to derecognition identified when looking at more complex cases (Agenda paper 2 Issues)**

PURPOSE OF THIS PAPER

1. Agenda Paper 2D summarises issues that the staff identified in developing Agenda Paper 2E (Application of Flowcharts to more complex cases).

2. Given the ambitious project timetable it was our intention not to discuss these issues at the Board meeting. However, following feedback from some Board members, we think it is necessary to attempt to address the issues at the February meeting in order to be able to issue an exposure draft on or around 31st March 2009. This paper also addresses some issues relating to Approach 2 that have

been identified by one Board member on review of that Approach in Agenda Paper 2B.

3. The staff plans to discuss this paper before asking the Board the question set out in paper 2B: namely, which approach the Board prefers. This is because decisions that the Board takes on the issues detailed in this paper could affect the two approaches.

4. The issues identified are:

Issue 1: Scope - transfers of financial assets that should be considered for derecognition [Approach 1 and Approach 2]

Issue 2: Derecognition or consolidation analysis first [Approach 1 and Approach 2]

Issue 3: Identical transactions but non identical accounting outcome (transfers of proportionate interests in cash flows) [Approach 2 only]

Issue 4: Transfer of subordinated ('more risky') interests in a financial asset [Approach 2 only]

Issue 5: Practical ability to transfer in the context of securitisations [Approach 2 only]

Issue 6: Remaining interest in the asset that was the subject of the transfer [Approach 2 only]

Issue 7: Transfer of a part of an equity instrument [Approach 2 only]

5. This paper discusses alternative approaches to addressing these issues. This paper contains preliminary staff recommendations based on our analysis to date.

6. We recommend reading this paper in conjunction with Agenda Papers 2D and 2E because this paper makes reference to the examples included in Agenda Paper 2E, and draws on the observations included in Agenda Paper 2D.

7. The issues identified demonstrate possible weaknesses in the two approaches. The temptation is to modify the proposed approaches to obtain a desired accounting outcome. This is true especially for Approach 2. Modifying approach 2 to obtain desired accounting outcomes could make that Approach very similar to IAS 39. If so, that will raise the valid question among

constituents of whether Approach 2 represents a significant improvement to current requirements.

PRELIMINARY STAFF RECOMMENDATIONS

8. The staff recommends the following:

   (a) **For Issue 1**. That the scope of the transactions to be assessed for derecognition be broadened such that irrespective of the form of the transfer transaction, qualifying transactions will be assessed for derecognition. (see paragraphs 17 and 18). [Approach 1 and Approach 2]

   (b) **For Issue 2**. That derecognition is assessed before consolidation for Approach 1 (see paragraph 25) but that consolidation is assessed before derecognition for Approach 2 (see paragraph 35).

   (c) **For Issue 3.** For consolidated financial statements, that the determination of the Asset being transferred and continuing involvement in the Asset is assessed at the group level on the basis of the remaining interest in the asset that was the subject of the transfer (see paragraph 40). [Approach 2 only]

   (d) **For Issue 4.** That the asset definition is amended relating to the transfer of subordinated interests in financial assets as proposed in paragraph 45. [Approach 2 only]

   (e) **For Issue 5.** That wording is added to the practical ability to transfer test as proposed in paragraph 51. [Approach 2 only]

   (f) **For Issue 6.** That any remaining interest in the asset that was the subject of the transfer is treated as part of the previously recognised asset (see paragraph 54). [Approach 2 only]

   (g) **For Issue 7.** That the transfer of a part of an equity instrument qualifies as ‘the Asset’ (see paragraph 63). [Approach 2 only]

STAFF ANALYSIS

Issue 1: Scope of transfers of financial assets considered for derecognition [Approach 1 and Approach 2]

9. The staff proposed in Agenda Paper 2A the following definition of a 'transfer' for Approach 1:

> A transfer occurs when one party passes to or undertakes to pass to another party some or all of the cash flows or other economic benefits underlying its assets. The term 'transfer' is used broadly to include all forms of sale, assignment, and provision of collateral, sacrifice, distribution and other exchange. It does not include origination, issuance or expiry. [paragraph 21 of Agenda Paper 2A]

10. As is noted within the definition, the intention is that the term is used broadly such that the scope of transactions that are considered for derecognition is broad with the underlying objective that the form of a transaction should not matter if economically it is the same as other transactions that would be considered to be transfers of financial assets.

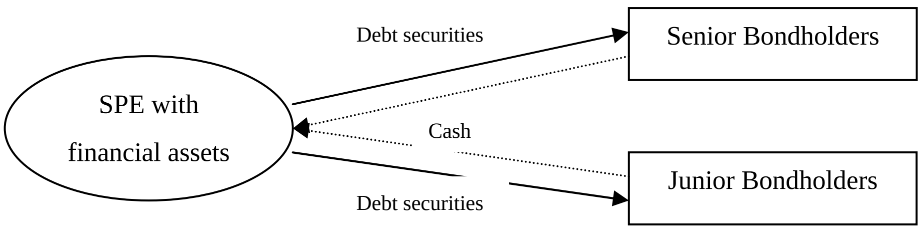
11. However the staff is concerned about the restriction that the last sentence might place on the scope of transactions assessed for derecognition. For example, the last sentence—'it does not include origination, issuance or expiry'—might exclude all nonrecourse loan arrangements and all issuances of beneficial interests, irrespective of whether those transactions are economically similar to other transactions involving (transfers of) financial assets that are considered for derecognition. In addition, we are not aware of any benefit of including such a restrictive sentence.

12. At the December meeting the Board discussed the accounting for nonrecourse loans but the Board did not decide on how to account for some of the nonrecourse loan transactions. The staff recommended that the debtor in a self liquidating nonrecourse loan should recognise a call option and should derecognise the related securing financial asset[1]. Thus a 'liability' would not be recognised by the debtor.

[1] Self liquidating nonrecourse loans are non recourse transactions where the finance (both principal and interest) will be repaid only from proceeds generated by the specific asset it finances (or by transfer of the item itself) and to the extent that sufficient funds are generated by the asset. In addition the entity should not be obliged to support any losses from the financial asset and if the funds generated by the asset are insufficient to pay off the provider of the finance, it does not constitute an event of default for the entity.

Under the recommended treatment, the creditor would recognise an asset, the securing financial asset, net of the effective call option written. The staff's recommendation for self liquidating nonrecourse loans essentially stems from the view that a self liquidating nonrecourse loan is essentially the same as transferring a financial asset (the securing asset in the loan arrangement) with the transferor retaining a call option over the asset. Accordingly, we think that nonrecourse loans should be assessed for derecognition in a similar manner – to avoid arriving at dissimilar accounting outcomes for what are economically very similar outcomes. In other words, the form of the transaction should not matter.

13. Regarding the issuance of beneficial interests, consider the following example:



14. SPE purchases financial assets, and in turn issues debt securities in SPE to senior and junior bondholders. The question is whether the issue of the debt securities should be treated as a transfer of the financial assets of the SPE to the bondholders and therefore assessed for derecognition?

15. In the staff's view, the answer should be 'yes'. The Board has taken a decision that the transfer of 100% of the cash flows of an asset is considered to be the same as transferring the asset itself. The issuance of beneficial interests in the SPE in this example could be viewed as the transfer of all of the cash flows of the financial assets held by SPE. Accordingly, it would be inconsistent to treat the issuance of the beneficial interests in a different manner to the transfer of cash flows from a financial asset. Again, the form of the transaction should not matter.

16. It is important to note that this issue is about the scope of the transactions assessed for derecognition; we are not asking whether transactions such as nonrecourse loan arrangements and the issuance of beneficial interests should achieve derecognition. That would depend on the facts and circumstances and the application of each approach to those facts and circumstances.

17. **The staff recommends that the scope of transactions assessed for derecognition should incorporate all transactions that are economically transfers of financial assets, i.e. the form should not matter. We think that the best way to address this is to amend the definition of a 'transfer' in Approach 1 as follows:**

A transfer occurs when one party passes to or undertakes to pass to another party some or all of the cash flows or other economic benefits underlying its <u>financial</u> assets. The term 'transfer' is used broadly to include all forms of sale, assignment, and provision of collateral, sacrifice, distribution and other exchange. ~~It does not include origination, issuance or expiry.~~ [paragraph 21 of Agenda Paper 2A]

18. **We think that the scope of transfers assessed for derecognition should be the same for Approach 1 and Approach 2. Approach 2 does not currently include a definition of a transfer. Therefore, we recommend using the same definition of a transfer as for Approach 1, detailed in paragraph 17 above.**

19. **Does the Board wish to address this issue for Approach 1 and Approach 2? If so, do you agree with the staff recommendations in paragraphs 17 and 18 of this paper regarding the scope of transactions assessed for derecognition? If not, why?**

Issue 2: Derecognition or consolidation analysis first [Approach 1 and Approach 2][2]

Approach 1

20. This issue applies only to the transferor group's consolidated financial statements—it does not apply to the transferor's separate financial statements. Therefore, all references to the 'transferor' in this section of the paper refers to the transferor group, rather than the transferor as a single entity.

21. Unlike Approach 2, the derecognition outcome is the same according to Approach 1 irrespective of whether derecognition is assessed before or after consolidation. Therefore some might question whether we need to address this issue for Approach 1. However because our view is that the order of assessment is important from a consolidation standpoint, the staff suggested in Agenda Paper 2A (i.e. for Approach 1) that derecognition should precede consolidation. In this

[2] Issue 1 of Agenda Paper 2D.

section of the paper, the staff provides an analysis of the suggested definition for transfers.

22. IAS 39 requires consolidation to be assessed first—an entity sets the boundaries of the reporting entity and then asks whether transfers outside the group structure meet the derecognition criteria. US GAAP requires derecognition to be assessed first (although the exposure draft of the proposed amendment to FASB Statement No. 140 *Transfers of Financial Assets* may change that).

23. The staff are of the view that the logical approach is to assess derecognition first—to assess what assets and liabilities each entity holds and then assess who controls that entity. It does not seem to be logical to assess control of an entity before determining the assets and liabilities of that entity – especially as the control decision for securitisation entities often involves assessing who controls the assets of the securitisation entity.

24. For example, in Example 3 of Agenda Paper 2E (Residential Mortgage Backed Securitisation), if control of Issuer (i.e. consolidation) is assessed first, we would probably assume that the mortgage loans transferred to it are the Issuer's assets and that Issuer has issued debt securities to bondholders. However, that assumption might be incorrect from a derecognition perspective. If derecognition were assessed first, either Seller or the bondholders might recognise the mortgage loans or beneficial interests in those loans. The assessment of who controls Issuer could be different if the assets and liabilities of the entity being assessed are different.

25. Consequently, **we recommend that derecognition is assessed before consolidation for Approach 1**.

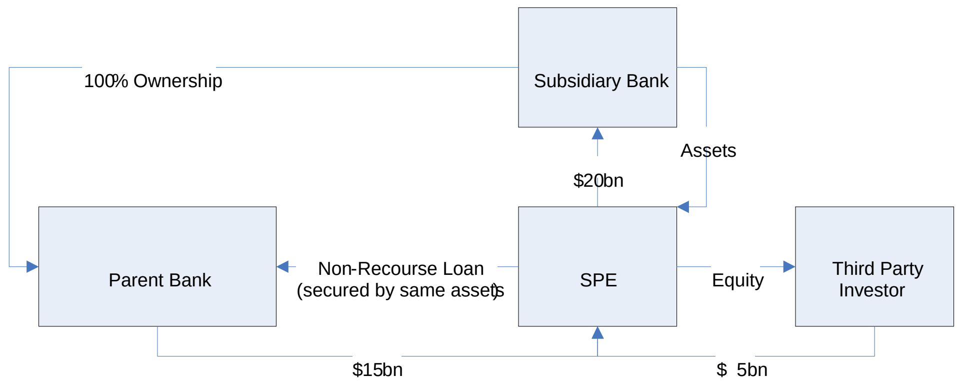
26. **Does the Board wish to address this issue in Approach 1? If so, do you agree with the staff recommendation in paragraph 25 of this paper to assess derecognition before consolidation? If not, why?**

Approach 2

27. As noted above, this issue applies only to the transferor group's consolidated financial statements—it does not apply to the transferor's separate financial statements. Therefore, all references to the 'transferor' in this section of the paper refers to the transferor group, rather than the transferor as a single entity.

28. Example 2 of Agenda Paper 2E (Distressed Debt and Reassessment) highlights that the derecognition outcome can be different under Approach 2, depending on whether derecognition is assessed before or after consolidation.

29. Example 2 is reproduced here. Parent Bank controls and consolidates Subsidiary Bank; third party investor controls and consolidates SPE:



30. If derecognition is assessed first, Subsidiary Bank can achieve derecognition of the financial assets of $20bn because it has no continuing involvement, despite continuing involvement being retained by Parent Bank (this is the case because the transferee (SPE) is not consolidated within the transferor group).[3] If consolidation is assessed first, and the transferee has no practical ability to transfer the financial assets for its own benefit (and assuming that the transferee is not consolidated by the transferor group), the transferor would not achieve derecognition if continuing involvement is retained by another entity within the transferor group.

31. Hence we think that the exposure draft needs to clarify the order in which the derecognition and consolidation guidance ought to be applied for Approach 2.

32. As noted above, IAS 39 requires consolidation to be assessed first; US GAAP requires derecognition to be assessed first (although the exposure draft of the proposed amendment to FASB Statement No. 140 may change that).

[3] The issue does not arise if the transferee is consolidated within the transferor group. If that is the case, the derecognition outcome is the same irrespective of whether derecognition is assessed before or after consolidation, i.e. the transfer would not meet the derecognition criteria.

33. Again for the reasons set out in paragraphs 23-24 above, the staff are of the view that the logical approach is to assess derecognition first—to assess what assets and liabilities each entity holds and then assess who controls that entity. However, we are aware that for Approach 2, some would disagree because the Seller could retain risks and rewards relating to the derecognised assets. Some may also be of the view that it is too easy to structure a transaction such that another entity within the transferor group retains continuing involvement in the transferred assets; in those situations, the transferor might achieve derecognition according to Approach 2 whereas it would not if it held the continuing involvement in the transferred assets directly.

34. The staff notes that Approach 2 already reflects uncertainty about control of an asset when the transferor has continuing involvement in a transferred financial asset. Approach 2 draws a line that determines whether a transaction is a sale or a financing. That line is whether the transferee has the practical ability to transfer the financial asset for its own benefit. In drawing that line, structuring opportunities are inevitably created and the staff believes that one of underlying aims of Approach 2 has to be to minimise the potential for structuring opportunities that arise from drawing such a line.

35. For those reasons, **the staff recommends that consolidation is assessed before derecognition for Approach 2. The proposed wording to address this issue is included in paragraph 39(a) of this paper (the proposed wording provides a solution for both this issue and issue 3).**

36. **Does the Board wish to address this issue in Approach 2? If so, do you agree with the staff recommendation in paragraph 35 of this paper to assess consolidation before derecognition? If not, why?**

Issue 3: Identical transactions but non identical accounting outcome (transfers of proportionate interests in cash flows) [Approach 2 only][4]

37. Example 6 in Agenda paper 2E (Transfers with Acquisition of Proportionate Cash Flows) highlights that two economically equivalent transactions (transfer of a "part" of the assets) could be accounted for differently according to Approach 2.

[4] Issue 3 of Agenda Paper 2D.

38. Example 6A involves the transfer of an asset (100%), with the transferor repurchasing a 20% proportionate interest in the cash flows of the transferred asset. In example 6B, the transferor transfers 80% of the cash flows of an asset. In Example 6B, the asset is considered to be the 80% of the cash flows of the asset. Therefore, absent other facts, the transferor achieves derecognition of 80% of the cash flows of the asset because it has no continuing involvement in the transferred asset. In example 6A, if the transferee does not have the practical ability to transfer the asset, the transferor may not achieve derecognition of 80% of the cash flows of the asset.[5]

39. The Board may wish to address this inconsistency. We think that there are three ways that the issue could be resolved:

    (a) Specify for Approach 2 that the determination of the Asset being transferred and continuing involvement in the Asset is assessed at the group level on the basis of the transferor's remaining interest in the asset that was the subject of the transfer.

    Therefore, in Example 6A of Agenda Paper 2E, the Asset transferred is 80% of the cash flows from the asset transferred (i.e. 100% of the cash flows less the transferor's remaining interest in the asset transferred of 20% of the cash flows).

    (b) Amend 'the Asset' in Approach 2 as follows:

    The 'continuing involvement' step and 'practical ability to transfer' test are applied to a transferred part of a financial asset (or of a group of financial assets) only if that part comprises specifically identified cash flows and/or a proportionate share of the cash flows from that financial asset (or that group or financial assets). <u>If the transferor's only continuing involvement is a proportionate share of the cash flows from the asset transferred, the Asset to be assessed for derecognition is the transferred asset less that continuing involvement (the 'net' asset transferred).</u>

    Therefore, in Example 6A of Agenda Paper 2E, the Asset considered for derecognition would be 80% of the cash flows from the asset transferred.

    (c) Amend 'continuing involvement' by adding an exception as follows:

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[5] The transferee would not have the practical ability to transfer the asset for its own benefit if either the transferee is a structured entity with restrictions on selling its assets, or if the assets are not readily obtainable.

The following items are exceptions to the principle in paragraph X (that is, any one of them would not constitute continuing involvement in the Asset):

…

<u>d.</u> <u>continuing involvement that is a proportionate share of the cash flows from the asset transferred.</u>

Therefore, in Example 6A of Agenda Paper 2E, the continuing involvement of 20% of the cash flows from the asset transferred would not be considered to be continuing involvement in the asset.

40. Should the Board decide to address this inconsistency, **the staff recommend adding the wording in paragraph 39(a) above**.

41. The wording proposed provides a solution for both Issue 2 (consolidation or derecognition assessment first) and this Issue. In addition, it is consistent with the recommendations regarding Issue 6 (remaining interest in the asset that was the subject of the transfer) set out in paragraphs 53-58 of this paper.

42. **Does the Board wish to address this issue in Approach 2? If so, do you agree with the staff recommendation in paragraph 40 of this paper? If not, why? What solution would you propose?**

Issue 4: Transfer of subordinated ('more risky') interests in a financial asset [Approach 2 only]

43. Approach 2 permits the derecognition of a proportionate share of the cash flows from a financial asset even if the transferor continues to hold the remaining proportionate share of the cash flows not transferred. Example 2 of Agenda Paper 2E highlights that if the transferor transfers a financial asset but retains a senior ('less risky') beneficial interest in that asset, Approach 2 would prevent the derecognition of the 'more risky' subordinated beneficial interest transferred because it represents a disproportionate interest in the financial asset transferred.

44. One Board member argues that it is counterintuitive to permit derecognition of a proportionate interest in a financial asset whilst preventing the derecognition of a 'more risky' subordinated interest in a financial asset.[6] This would mean that the

[6] Those who argue that it is counterintuitive not to permit derecognition when a 'more risky' subordinated beneficial interest in a financial asset is transferred are happy that the transfer of a 'less risky' senior

transfer of more risk in some situations would not meet the derecognition criteria. That Board member is thus less concerned with interdependency of cash flows in assessing whether a transferred part of a financial asset qualifies as a component of that asset and more with whether any of the risks of the part transferred are included in the part retained.[7]

45. The Board may wish to address this contradiction in terms of the transfer of risk. If so, **the staff recommends amending 'the Asset' in Approach 2 as follows:**

> **The 'continuing involvement' step and 'practical ability to transfer' test are applied to a transferred part of a financial asset (or of a group of financial assets) only if that part comprises specifically identified cash flows and/or a proportionate <u>or subordinated</u> share of the cash flows from that financial asset (or that group or financial assets).**

Therefore, in Example 2 of Agenda Paper 2E, the Asset considered for derecognition would be the most subordinated $5bn of the financial assets.

46. **Does the Board wish to address this issue in Approach 2? If so, do you agree with the staff recommendation in paragraph 45 of this paper regarding the transfer of subordinated interests in a financial asset? If not, why? What solution would you propose?**

Issue 5: Practical ability to transfer in the context of securitisations (Approach 2 only)[8]

47. As noted at the January Board meeting, in many securitisation structures the transferor would not derecognise the assets according to Approach 2 unless the transferor has no continuing involvement in the assets transferred to a SPE. This is because the transferee (SPE) does not usually pass the "practical ability to transfer

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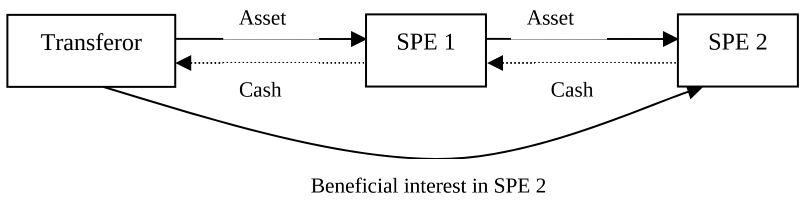
beneficial interest (and thus the retention of a 'more risky' subordinated interest) would not always meet the criteria for derecognition according to Approach 2.

[7] The FASB discussed and rejected a proposal to address this issue as part of its redeliberations of amendments to SFAS No. 140. The FASB decided against changing its definition of participating interest to permit a transferor to retain a senior interest because such a change would be inconsistent with the concept of the participating interest that requires the cash flows received from the asset to be proportionate.

[8] Issue 2 of Agenda Paper 2D.

for its own benefit” test as such SPEs cannot sell assets unilaterally or are prohibited from doing so.

48. The staff, however, notes that the lack of practical ability to transfer in a securitisation scenario could be overcome by a simple structure. For example, the practical ability to transfer test could be circumvented by executing the transaction in two-steps, i.e. one SPE (SPE 1) may transfer the asset to another SPE (SPE 2) simply to demonstrate its ability to sell the asset even though SPE 2 might be restricted from transferring the asset it received from SPE 1. An example of such a structure is as follows:



49. When assessing derecognition in Approach 2, we would first ask whether the transferor has any continuing involvement in the Asset. The answer would be ‘yes’ because the transferor has a beneficial interest in SPE 2 (the continuing involvement guidance to be included in the ED states that continuing involvement may result from contractual provisions incorporated in a separate agreement with a third party entered into in connection with the transfer).

50. We would then ask whether the transferee has the practical ability to transfer the Asset for its own benefit. On the face of it, the transferee is SPE 1 and, therefore, the transferor would achieve derecognition because SPE 1 can and has transferred the asset to SPE 2, thus circumventing the practical ability test.

51. Should the Board wish to address this issue, **the staff thinks that the best way to prevent abuse of the practical ability to transfer test is to add the following wording when describing the practical ability to transfer test:**

The transferee to which the practical ability to transfer test is applied is the entity with which the transferor has agreements that result in the continuing involvement of the transferor with the Asset.

Therefore, in the example in paragraph 48, the transferee would be SPE 2.

52. **Does the Board wish to address this issue in Approach 2? If so, do you agree with the staff recommendation in paragraph 51 of this paper regarding the practical ability to transfer test? If not, why? What solution would you propose?**

Issue 6: Remaining interest in the asset that was the subject of the transfer [Approach 2 only]

53. The Board decided at its January meeting that the sale of a financial asset to a securitisation entity and retention of a beneficial interest in that asset issued by the securitisation entity should be accounted for as a new asset by the transferor (paragraph 24 of Agenda Paper 2B). If the transferor retained an interest in the transferred financial asset directly (rather than through a securitisation entity), it would treat the retained interest as part of the previously recognised asset (paragraph 21 of Agenda Paper 2B). One Board member is now concerned about the inconsistency and structuring opportunities that arise from this approach. Therefore, that Board member would suggest that any remaining interest that the transferor has in the asset that was the subject of the transfer should be accounted for as part of the previously recognised asset, irrespective of whether that retained interest is in the financial assets directly or indirectly via the holding of a beneficial interest in the securitisation entity to which the financial asset is sold.

54. The wording proposed in paragraph 39(a) of this paper highlights the need to consider the transferor's remaining interest in the financial asset transferred when assessing derecognition.[9] If the Board wishes to address this issue about the measurement of that remaining interest, **the staff recommends that the exposure draft would need to clarify that any remaining interest in the asset that was the subject of the transfer should be accounted for as part of the previously recognised asset**. Therefore, the carrying amount of the previously recognised asset would be allocated to the part transferred and the transferor's remaining interest on the basis of the relative fair values of those components on the date of transfer.

[9] Paragraph 39(a) recommends that Approach 2 specifies that the determination of the Asset being transferred and continuing involvement in the Asset is assessed at the group level on the basis of the transferor's remaining interest in the asset that was the subject of the transfer.

55. Any interests obtained by the transferor as part of the transfer that do not constitute a remaining interest in the asset transferred would be treated as new financial assets or liabilities. As a result, the transferor would measure the new assets or liabilities according to the initial measurement requirements of IAS 39.

56. This proposal is relatively straight forward if the transferor's investment in the transferee securitisation entity represents a retained interest in the asset transferred, i.e. if the securitisation entity buys the financial asset from the transferor and issues beneficial interests to investors, including the transferor, without entering into any other transactions. In this situation, the transferor's beneficial interest in the securitisation entity represents a retained interest in the asset transferred. However the proposal is more complicated if the securitisation entity enters into other transactions (which is common practice).

57. For example, if the securitisation entity enters into an interest rate swap or obtains a guarantee relating to its asset from a third party, the transferor's beneficial interest in the securitisation entity represents a retained interest in the asset transferred, a beneficial interest in the swap and a beneficial interest in the guarantee provided by the third party. In this example, the transferor would be required to split the beneficial interest in the securitisation entity into three different components, measuring its retained interest in the asset transferred at the proportionate carrying amount of the previously recognised asset, and measuring its interest in the swap and the guarantee as new assets or liabilities.

58. While the staff agrees that this recommendation is consistent with the recommendations proposed to resolve other issues relating to Approach 2 in this paper (namely, Issues 2 and 3), the staff is concerned about the practicability of the recommendation and how it might be operationalised. If the Board decide to address this issue, the staff recommends including a question in the Invitation to Comment of the ED that specifically addresses this issue.

59. **Does the Board wish to address this issue in Approach 2? If so, do you agree with the staff recommendation in paragraph 54 of this paper regarding the transferor's remaining interest in the asset transferred? If not, why? What solution would you propose?**

Issue 7: Transfer of a part of an equity instrument [Approach 2 only]

60. At its January meeting, the Board decided that a transferred part of a financial asset that involves future economic benefits other than cash flows (e.g. an equity investment) does not qualify as a component and hence does not qualify as the 'Asset' (paragraph 12 of Agenda Paper 2B).

61. The staff recommendation at that meeting relating to the transfer of a part of a financial asset that involves future economic benefits other than cash flows was to permit such transfers to qualify as a component. The staff noted, in support of this recommendation, that it was not aware of a good reason for prohibiting transfers of portions of equity instruments from qualifying as components in Approach 2 (and as a result from qualifying for derecognition) other than for the sake of minimising structuring opportunities. However the Board did not agree with the staff recommendation.

62. One Board member is now concerned that Approach 2 is inconsistent regarding the transfer of a proportionate interest in an equity instrument. He cannot see any reason why the approach would exclude such a transfer from qualifying for derecognition while permitting the transfer of a proportionate interest in other types of financial assets to qualify for derecognition.

63. Therefore, should the Board wish to address this concern, **the staff recommends amending the definition of 'the Asset' in Approach 2 such that a transfer of a part of an equity instrument would qualify as a component and therefore qualify as 'the Asset' assessed for derecognition.**

64. **Does the Board wish to address this issue in Approach 2? If so, do you agree with the staff recommendation in paragraph 63 of this paper regarding transfers of a part of an equity instrument? If not, why? What solution would you propose?**