Project **Consolidation**

Topic **Disclosure of risks from sponsoring structured entities**

1. Paragraph 27 of the ballot draft of IFRS 12 *Disclosure of Interests in Other Entities* requires the disclosure of income derived from, and asset transferred to, structured entities that the reporting entity has sponsored and for which it does not provide other risk information (typically because it does not have material contractual interests in the structured entity at the reporting date). [Paragraphs 26-28 of the ballot draft are reproduced below after paragraph 13 of this paper.]

2. The purpose of those disclosure requirements is to give a sense of the scale of the operations an entity had managed with structured entities and the extent of the entity's reliance on such entities to facilitate its business. The idea is that we want a reporting entity to disclose some information about entities that it sponsored, and has since 'walked away', but perhaps might need to 'step in' and provide financial support at some point in the future for reputational reasons (perhaps because they provided investment advice that proved to be wrong).

3. The disclosure requirement asks for income and asset information during the reporting period. Together with the comparative disclosure requirements, this means that two years of information will be presented in financial statements.

4. One board member believes that we should ask for this information for five years or, as a minimum, ask for additional information in previous periods for some entities to try to address the issues that arose with structured investment vehicles (SIVs) during the financial crisis. He believes that asking for two years of information will not provide sufficient information to address those reputational risk concerns.

5. We have thought about what additional information we should ask for to try to address that board member's concerns.

6. There are a few possibilities.

7. The easiest option might be to ask for the income and asset information required in paragraph 27(a) and (b) for more than two years so, for example, for five years as requested by the board member.

8. The ED had proposed that this information be provided for three years. However, the vast majority of respondents to ED10 opposed this approach. They questioned why we would ask for this one disclosure for three years when other disclosure requirements in IFRSs ask for information for the current and comparative periods only. When redeliberating this proposal in the ED, the Board agreed with those respondents and decided *not* to ask for three or more years of disclosure of the income and asset information in paragraph 27. In reaching that decision, the Board and staff also noted that asking for this information for more than the comparative period does not provide any additional information to users. If users want to have the information for previous periods, they would simply need to look to previous financial statements. Requiring such disclosures would, in effect, amount to asking for disclosures made in prior period financial statements to be 'stapled' to the financial statements for the current period. Thus, we question the benefit of this approach given the response that we received in the ED.

9. Another option would be to ask for the following in addition to the income and asset disclosures already required by paragraph 27 of the ballot draft of IFRS 12 (ie these words would be added as paragraph 27(c)):

   (c) if the reporting entity originated a substantial proportion of the assets of the structured entity, the reporting entity shall disclose the carrying amount (at the time of transfer) of all assets transferred to the structured entity by the reporting entity since the structured entity was established.

10. On the face of it, this disclosure may seem to work, especially when we think about SIVs or other vehicles that invest in more risky assets. However, the definition of a structured entity would incorporate not only typical vehicles set up by banks, but also most funds. We think that the disclosure could be

extremely burdensome and difficult to apply—some vehicles that have revolving assets could last for many years; some funds could last for many years. We would be asking entities to possibly go back for many years to identify whether entities that they sold assets to (but have no interest in) are structured entities—using a new definition of structured entity that they had never thought about at the time of selling those assets. There would also be questions about what 'substantial' means and how a reporting entity might make that assessment about the assets of the structured entity if it does not control, nor has any ongoing involvement with, that entity. We think this approach does not work.

11. A third option would be to try state the objective in the requirement, by asking for (in addition to paragraph 27(a) and (b)), any other information that enables users to assess the possibility of the entity providing financial support to structured entities in the future. Again, we don't think this would work. We don't know what this requirement is really asking preparers to provide—presumably, before any crisis occurs, preparers have no intention of 'stepping in' and providing financial support without a contractual obligation to do so. And so, for example, if such a disclosure requirement had been in place in 2006, banks may not have disclosed any particular information in this respect about SIVs or other vehicles with exposure to, say, residential mortgage loans (at that time, the financial world assumed that property prices would increase forever). Similarly, before Toyota were aware of any faults in its cars, Toyota probably would not have disclosed any information about that risk, beyond general business risk information that would not have provided anything specific about the possible effects of those unknown faults occurring.

12. What might be useful is information about the extent of a reporting entity's activities with a particular class of entity when a known problem exists. And therefore, in the residential mortgage loan example, as soon as economic conditions change and house prices start to fall, it would be useful to know, for example, about a reporting entity's previous involvement with structured entities that hold residential mortgage loans. Such an approach could be worded something like the following (again this would be added as paragraph 27(c) in addition to the income and asset information already required in paragraph 27):

(c) if the reporting entity becomes aware that a structured entity for which it has previously presented information in accordance with paragraph 27(a) and (b), is holding troubled assets, the reporting entity shall provide information about its involvement with that structured entity and the extent of its previous involvement with that entity. Such information would normally include the information reported in accordance with paragraph 27(a) and (b) for periods earlier than the prior period, supplemented by information about the nature of the troubled assets.

13. We seek Board member views on how to proceed.

Extract from the ballot draft of IFRS 12

Nature of interests

26 An entity shall disclose qualitative and quantitative information about its interests in unconsolidated structured entities, including, but not limited to, the nature, purpose, size and activities of the structured entity and how the structured entity is financed.

27 If an entity has sponsored an unconsolidated structured entity for which it does not provide information required by paragraph 29 (eg because it does not have an interest in the entity at the reporting date), the entity shall disclose:

(a) how it has determined which structured entities it has sponsored; and

(b) a summary of:

(i) income from those structured entities in the reporting period, including a description of the types of income presented in the summary; and

(ii) the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.

28 An entity shall present the information in paragraph 27(b) in tabular format, unless another format is more appropriate, and classify its sponsoring activities into relevant categories (see paragraphs B3-B7).