

IFRS 12 - Example disclosures
for interests in unconsolidated
structured entities

March 2013

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Introduction

IFRS 12 *Disclosure of Interests in Other Entities* is a disclosure standard that was issued by the International Accounting Standards Board (IASB) in May 2011. IFRS 12 includes all of the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities.

IFRS 12 defines a 'structured entity' and requires a reporting entity to make disclosures in respect of its interests in structured entities. Prior to the issuance of IFRS 12, IFRS contained no specific disclosure requirements for structured entities or special purpose entities as described in SIC-12 - *Consolidation: Special Purpose Entities*.

This publication focuses on the disclosure requirements that are contained in paragraphs 24 to 31 of IFRS 12 for interests in unconsolidated structured entities, that is, entities that meet the definition of a structured entity, but which are not consolidated by the reporting entity (as discussed in section 1 of this publication).

Although IFRS 12 is a disclosure standard, it provides no examples to illustrate its disclosure requirements, and so we have included illustrative examples in this publication.

IFRS 12 disclosure requirements for unconsolidated structured entities

IFRS 12 requires an entity to make disclosures about the significant judgements and assumptions in determining whether it controls another entity. In addition, IFRS 12 requires specific disclosure of interests in unconsolidated structured entities.

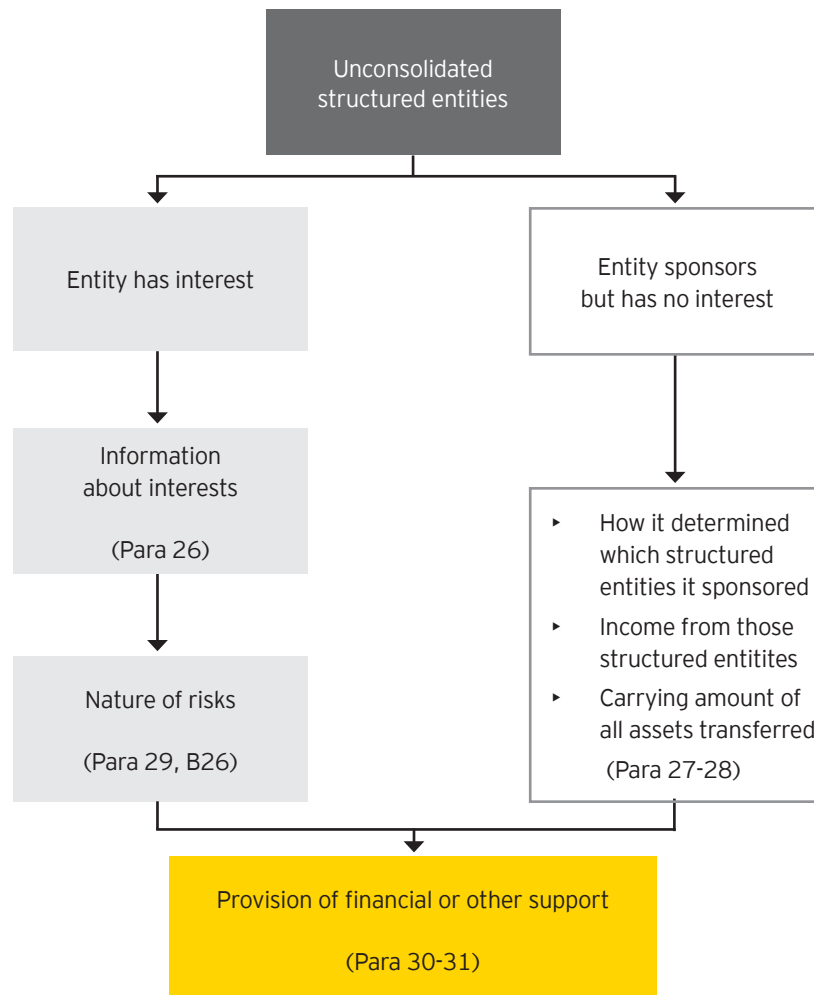
The disclosure requirements for interests in unconsolidated structured entities are split into two areas, namely 'nature of interests' and 'nature of risks'.

Paragraph 24 of IFRS 12 requires an entity to disclose information that enables users of its financial statements:

- (a) To understand the nature and extent of its interests in unconsolidated structured entities (paragraphs 26-28); and
- (b) To evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities (paragraphs 29-31).

Paragraph 25 of IFRS 12 explains that the information required by (b) above includes information about an entity's exposure to risk from involvement it had with unconsolidated entities in previous periods (e.g., sponsoring the structured entity), even if the entity no longer has any contractual involvement with the structured entity at the reporting date.

The disclosures required are summarised in the following chart.



IFRS reporters are likely to be faced with a number of interpretative and disclosure-related issues as they apply IFRS 12 to interests in unconsolidated structured entities, including:

1. What is a 'structured entity'?
2. What is 'an interest' in a structured entity?
3. What disclosure is required to explain the nature, purpose, size and activities of the unconsolidated structured entity and how it is financed?
4. What information would an entity disclose to explain the 'nature of risks' from an unconsolidated structured entity?
5. At what level should the entity aggregate the required information?
6. When would an entity be considered 'the sponsor' of an unconsolidated structured entity?
7. What 'income' related disclosures are required in respect of sponsored structured entities?
8. What constitutes financial or other 'support' provided to an unconsolidated structured entity?
9. What should be disclosed as 'additional information'?

In this publication we discuss each of these issues in turn and provide illustrative examples of disclosures that are relevant to banks and other financial institutions.



1. What is a 'structured entity'?

IFRS 12 defines 'a structured entity' as an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to the administrative tasks only and the relevant activities are directed by means of contractual arrangements.

Paragraphs B22 of Appendix B to IFRS 12 state that a structured entity often has some or all of the following features or attributes:

- (a) Restricted activities;
- (b) A narrow and well-defined objective, such as to effect a tax-efficient lease, to carry out research and development activities, to provide a source of capital or funding to an entity or to provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to them;
- (c) Insufficient equity to allow it to finance its activities without subordinated financial support;
- (d) Financing in the form of multiple contractually linked instruments issued to investors that create concentrations of credit or other risks (tranches).

Paragraph B23 of IFRS 12 provides the following examples of entities that are considered to be structured entities:

- (a) Securitisation vehicles;
- (b) Asset backed financings;
- (c) Some investment funds.

The IASB's rationale for including specific disclosures of investments in structured entities is that users have requested such disclosures because they believed involvement with these entities posed more risk than involvement with traditional operating entities. The increased risk exposure arises because, for example, the structured entity may have been created to pass risks and returns arising from specified assets to investors, or may have insufficient equity to fund losses on its assets, if they arise.

Unconsolidated structured entities

The term 'unconsolidated structured entities' refers to all structured entities that are not controlled by the reporting entity. Therefore, it includes the following entities where they meet the definition of a structured entity:

- ▶ In consolidated financial statements - interests in subsidiaries that are not consolidated, interests in joint ventures, associates or other interests in which the investor does not hold a significant influence
- ▶ In individual financial statements - interests in joint ventures, associates or other interests in which the investor does not hold a significant influence
- ▶ In separate financial statements prepared as an entity's only financial statements - interests in subsidiaries, joint ventures, associates and other interests in which the investor does not hold a significant influence

An entity's separate financial statements are not within the scope of IFRS 12 if that entity also prepares consolidated or individual financial statements.

Where a structured entity is an associate or joint venture, separate disclosure of those interests in their capacity as associates or joint ventures is also required under IFRS 12. Paragraph BC77 of the Basis for Conclusions states that the IASB considered that the requirement to make both sets of disclosures where applicable should not significantly increase the amount of information that a reporting entity would be required to provide.



Comparison with SIC-12

Paragraph BC82 of IFRS 12 states that the type of entity the IASB envisages as being characterised as a structured entity is unlikely to differ significantly from the type of entity that SIC-12 described as a special purpose entity (SPE).

SIC-12 described an SPE as an entity created to accomplish a narrow and well-defined objective. This differs from the definition of a structured entity in IFRS 12, as there is no reference to voting or similar rights being a determinative factor in SIC-12. Therefore, there may be differences between what was an SPE under SIC-12 and what is a structured entity under IFRS 12, although in paragraph BC 84 of IFRS 12 it states, "the Board also decided to include guidance similar to that included in SIC-12 to reflect the Board's intention that the term 'structured entity' should capture a set of entities similar to SPEs in SIC-12." For those entities that are analysing whether they have interests in structured entities for disclosure purposes, a review of entities previously classified as SPEs under SIC-12 is probably a good place to start.

What are 'similar (to voting) rights'?

IFRS 12 does not define 'similar (to voting) rights' or provide any guidance as to what those rights may constitute. It seems likely that this will require the exercise of judgement by reporting entities and that there may be diversity in practice about what constitutes a 'similar' right and, therefore, whether an entity is a structured entity.

One example of what the IASB may have in mind when referring to similar rights is collective investment schemes where investors have a substantive right to vote to remove the manager of the fund without cause, as long as a certain proportion of investors demand such a vote. The assessment of whether this right (to remove the fund manager) could be considered substantive, and therefore whether the collective investment scheme is a structured entity, would depend on the number of investors who would need to collaborate in order to force the vote.

Do the features and attributes in paragraphs B22 to B24 of Appendix B to IFRS 12 take precedence over the definition?

IFRS 12 does not explicitly state whether the 'features or attributes' described above are determinative as to whether or not an entity is a structured entity, or whether the features or attributes should always be subordinate to the definition (i.e., if the entity was controlled by voting or similar rights then the features or attributes would be irrelevant).

Our view is that the features and attributes are subordinate to the definition. However, the implication from the Basis for Conclusions is that the IASB considers that, where some of the features or attributes are present in an entity, then it is unlikely that the entity is controlled by voting or similar rights.



2. What is 'an interest' in a structured entity?

'An interest' in another entity refers to contractual and non-contractual involvement that exposes an entity to variability in returns from the performance of the other entity. An interest can be evidenced by, but is not limited to, the holding of equity or debt instruments, as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. However, an entity does not necessarily have an interest in another entity solely because of a typical customer-supplier relationship.

The application guidance in paragraph B7 of IFRS 12 states that consideration of the purpose and design of the structured entity may help the reporting entity to assess whether it has an interest in that entity and, therefore, whether it is required to provide the disclosures in IFRS 12. That assessment includes consideration of the risks that the structured entity was designed to create and the risks it was designed to pass on to the reporting entity and other parties.

Paragraph B56 of IFRS 10 explains that variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative. An investor assesses whether returns from an interest are variable and how variable these returns are, based on the substance of the arrangement, regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of IFRS 10 because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (i.e., how variable those returns are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the performance risk of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

The above indicates that the definition of 'an interest' in IFRS 12 is much wider than simply holding equity or debt instruments in an entity. Because IFRS 12 requires disclosure of interests that a reporting entity holds in other entities, preparers need to ensure that their reporting systems and processes are sufficient to identify those interests.

IFRS 12 clarifies that a reporting entity is typically exposed to variability of returns from the performance of another entity by holding instruments (such as equity or debt instruments issued by the other entity) or having another involvement that absorbs variability. This is illustrated in the following examples from paragraphs B8 and B9 of IFRS 12:

► Variability of returns arising from issue of credit default swap (1)

A reporting entity issues a credit default swap to a structured entity. The credit default swap protects the structured entity from the default of interest and principal payments on its loan portfolio.

The reporting entity has an involvement in the structured entity that exposes it to variability of returns from the performance of the structured entity because the credit default swap absorbs variability of returns of the structured entity.

Some instruments are designed to transfer risk from the reporting entity to another entity. Such instruments create variability of returns for the other entity but do not typically expose the reporting entity to variability of returns from the performance of the other entity. This is illustrated in the example below.

► Variability of returns arising from issue of credit default swap (2)

A reporting entity enters into a credit default swap with a structured entity. The credit default swap gives the structured entity exposure to Entity Z's credit risk. The purpose of the arrangement is therefore to give the investors in the structured entity exposure to Entity Z's credit risk (Entity Z is unrelated to any party involved in the arrangement).

The reporting entity does not have involvement with the structured entity that exposes it to variable returns from the structured entity because the credit default swap transfers variability to the structured entity rather than the reporting entity itself absorbing variability of returns of the structured entity.



Purchased call options and written put options (in each case unless the exercise price is at fair value) would also be interests in other entities, because these instruments typically absorb variability created by assets held in the entity. In contrast, some derivative instruments such as interest rate swaps, can both create and absorb variability and judgement will need to be exercised in determining whether these derivatives are interests in other entities.

We believe that plain vanilla swaps and other derivatives that both create and absorb variability, based on market rates or indices and which rank senior to the issued notes, do not absorb the risks the entity was designed to pass on, and are not an exposure to variable returns. They are therefore unlikely to be interests in other entities that would require disclosure under IFRS 12.

It is likely that some of the disclosure requirements for unconsolidated structured entities will overlap with those of IFRS 7 *Financial Instruments: Disclosures*, since many interests in unconsolidated structured entities will be within the scope of IFRS 7.

Interests in unconsolidated structured entities would include:

- ▶ Investments in notes issued
- ▶ Written credit default swaps
- ▶ Implicit and explicit loan commitments, liquidity support and guarantees
- ▶ Written put options (unless the exercise price is at fair value)
- ▶ Purchased call options (unless the exercise price is at fair value)
- ▶ Residual interests
- ▶ Credit guarantees
- ▶ Loans provided
- ▶ Asset management fees

Asset management fees

An entity does not necessarily have an interest in another entity because of a typical customer-supplier relationship. However, as explained above, paragraph B56 of IFRS 10 states that fixed performance fees for managing an investee's assets create variable returns for the investor. The fixed performance fees are 'variable' because they expose the investor to the performance risk of the investee. Therefore, it would seem closer to the spirit of IFRS 12 that asset management fees are treated as a variable interest rather than a typical customer-supplier relationship in order to present fully the reporting entity's relationships with structured entities. Fund managers may also earn other incentive fees and may have a direct interest in the investments of the fund itself.

Fund managers need to consider whether the fees, together with any power the fund manager has (e.g., through delegated voting rights or by contractual arrangement), give the fund manager control of the fund, and therefore whether the fund manager is required to consolidate the fund. This issue is discussed in a separate Ernst & Young publication *Applying IFRS 10 - Consolidation for Fund Managers*, issued in January 2013.



3. What disclosure is required to explain the nature, purpose, size and activities of the unconsolidated structured entity and how it is financed?

Paragraph 26 of IFRS 12 states that qualitative and quantitative disclosure of an entity's interests in an unconsolidated structured entity can be met by disclosing information about, including but not limited to, the nature, purpose, size, and activities of the structured entity and how it is financed.

BC96 of IFRS 12 states that, "The Board was persuaded by the views of respondents to [ED 10] who argued that disclosure of assets held by structured entities without information about the funding of assets is of limited use, and could be difficult to interpret. Therefore, the Board decided to require an entity to disclose information about the nature, purpose, size and activities of a structured entity and how the structured entity is financed. The Board concluded that this requirement should provide users with sufficient information about the assets held by structured entities and the funding of those assets without requiring specific disclosures of the assets of unconsolidated structured entities in which the entity has an interest in all circumstances. If relevant to an assessment of its exposure to risk, an entity would be required to provide additional information about the assets and funding of structured entities."

Nature and purpose

Examples of the nature and purpose of an entity include:

- ▶ To manage balance sheet exposure and risk, including securitisation of assets
- ▶ To provide investors with a synthetic exposure to debt and equity instruments such as credit linked notes and equity linked notes
- ▶ To provide investors with a variety of investment opportunities through managed investment strategies
- ▶ To obtain and facilitate funding

Size

The requirement to disclose the size of an unconsolidated structured entity would most likely be met by providing information about the total value of assets of the structured entity. However, paragraph BC120(h) of the Basis for Conclusions to IFRS 12 specifically states that IFRS 12 does not require the disclosure of the reported amount of assets held by a structured entity in which an entity has an interest. This would seem to suggest that measures of size other than asset fair values would be acceptable, including, for example, the notional value of securities issued by structured entities.

Activities

When disclosing the activities of an unconsolidated structured entity, these activities should include the primary activities for which the entity was designed, which are the activities that significantly affect the entity's returns. Although specific guidance is not contained in IFRS 12, we believe the examples previously contained in SIC-12 would also apply. That is, the entity is principally involved in:

- ▶ Providing a source of long-term capital to an entity or funding to support an entity's ongoing major operations through issuing notes
- Or
- ▶ Providing a supply of goods or services that is consistent with an entity's ongoing major operations which, without the structured entity, would have to be provided by the entity itself

Financing

This disclosure requirement is not limited to financing provided by the reporting entity to the unconsolidated structured entity and would include financing received by the structured entity from unrelated third parties. It is also not limited to equity financing and would appear to include all forms of financing which allow the structured entity to conduct its business activities.



Example 1 - Disclosure of the nature and purpose, and activities of a structured entity

XYZ Bank is principally involved with structured entities through securitisation of financial assets, investments in and loans to structured entities and sponsoring structured entities that provide specialised investment opportunities to investors. Structured entities generally finance the purchase of assets by issuing debt and equity securities that are collateralised by and/or indexed to the assets held by the structured entities. The debt and equity securities issued by structured entities may include tranches with varying levels of subordination.

IFRS 12.24(a)
IFRS 12.26

Structured entities have the following business activities:

i. Mortgage-backed and collateralised debt obligations (CDO) and collateralised loan obligations (CLO) structured entities

XYZ Bank sells residential and commercial mortgage loans and mortgage-backed securities to structured entities and sells corporate bonds and loans to CDO and CLO structured entities and may retain interests in the assets sold to the structured entities. XYZ Bank also purchases and sells interests issued by structured entities as part of its trading activities. In addition, the Bank may enter into various derivative transactions with these structured entities.

XYZ Bank is also involved with certain CDOs and CLOs which synthetically create the exposure for the interest holders through the use of credit derivatives. The credit derivatives may reference a single asset, an index, or a basket of assets or indices. These structured entities use the funds acquired through the sale of the interests and the premium received from the credit derivative counterparties to purchase high grade assets, which serve to collateralise the exposure. XYZ Bank does not consolidate these mortgage backed, CDO and CLO structured entities because it acts as an agent on behalf of other investors. The Bank owns only a portion of the senior notes and none of the junior notes of these entities.

ii. Asset-backed commercial paper conduits

XYZ Bank transfers assets, which are generally credit card receivables, into structured entities that issue commercial paper to the market. The commercial paper generally has a maturity of 90 days, whereas the assets have shorter term and typically have a life of 40 days. The Bank is involved with selling, sourcing and servicing the assets. Third parties provide liquidity facilities and credit enhancement. In other cases, the Bank may provide credit enhancement to structured entities. The Bank does not regard itself as controlling these entities.

IFRS 12.B26(g)

During the year, an unconsolidated commercial paper conduit experienced difficulties in financing its activities due to the contraction of the commercial paper market. XYZ Bank provided short-term liquidity support to satisfy the funding shortfall.

IFRS 12.B26(f)

iii. Other asset-backed structured entities

XYZ Bank establishes various structured entities that issue loan notes to clients referenced to assets such as debt and equity securities, and it also purchases and sells interests issued by these structured entities as part of its trading activities. The Bank also establishes a number of multi-issuance vehicles that issue a number of separate debt instruments where the assets, liabilities and equity are ring-fenced within deemed specific entities (silos). The Bank enters into derivative transactions, which are mainly interest rate and foreign currency swaps, with these structured entities.

iv. Property, and other investing structured entities

XYZ Bank structures and purchases equity and debt securities issued by and grants loans to various structured entities that hold property, performing and non performing debt, distressed loans and equity securities.



4. What information would an entity disclose to explain the 'nature of risks' from an unconsolidated structured entity?

Paragraph 29 of IFRS 12 requires disclosure of, in a tabular format, unless another format is more appropriate, a summary of:

- (a) The carrying amount of assets and liabilities recognised in its financial statements relating to its interests in unconsolidated structured entities;
- (b) The line items in the statement of financial position in which those assets and liabilities are recognised;
- (c) The amount that best represents the maximum exposure to loss from those interests, including how it is determined. If the maximum exposure cannot be quantified, this must be disclosed with the reasons;
- (d) A comparison of the carrying amount of assets and liabilities in (a) above, and the maximum exposure to loss from those entities.

IFRS 12 does not define the maximum exposure to loss. The IASB decided not to provide such a definition of maximum loss, but to leave it to the entity to identify what constitutes a loss in the particular context of the reporting entity. The entity should then disclose how it has determined maximum loss exposure. The IASB has acknowledged that an entity might not always be able to calculate maximum exposure to loss from its interest in an unconsolidated structured entity, such as when a financial instrument exposes an entity to theoretically unlimited losses. When this is the case, an entity should disclose the reasons why it is not possible to calculate the maximum possible loss.

We believe that 'maximum exposure to loss' refers to the maximum loss that an entity could be required to record in its statement of comprehensive income as a result of its involvement with the structured entity. Furthermore, this maximum possible loss must be disclosed regardless of the probability of such losses actually being incurred. IFRS 12 is silent on whether the maximum exposure is gross or net of collateral or hedging instruments held by the reporting entity that would mitigate any loss. We believe that the maximum exposure to loss should be disclosed gross of any collateral or hedging instruments and that separate disclosure should be made in respect of instruments held that would mitigate the loss on a net basis.¹

The disclosure of a comparison of carrying amounts of assets and liabilities and the maximum exposure to loss is intended to provide users with a better understanding of the differences between the maximum loss exposure and the amounts recorded in the financial statements. In addition, this disclosure will help a user assess whether it is likely that an entity will bear all or some of those losses.

In addition to the requirements above, IFRS 12 also requires an entity to disclose additional information necessary to assess the risks to which an entity is exposed when it has an interest in an unconsolidated structured entity. These additional disclosures are discussed in section 9 below.

Examples 2 and 3 illustrate the disclosure requirements set out in paragraph 29 to describe an entity's risks in unconsolidated structured entities. The first table illustrates the requirements of paragraphs 29(a) and 29(b) which require disclosure of the line items in the balance sheet in which the interests in unconsolidated structured entities are recognised and the carrying amounts of those interests. The second table illustrates the requirements of paragraphs 29(c), which requires disclosure of the maximum exposure to loss from a reporting entity's interests in unconsolidated structured entities and a comparison of that maximum exposure to loss to the carrying amounts of the unconsolidated structured entities. In addition, the 'size' criterion, referred to earlier in this document is fulfilled by including the total assets of the structured entities.

¹ Disclosure required by paragraph 36 of IFRS 7 *Financial Instruments: Disclosures*



Example 2 - Nature of risks

Risk associated with unconsolidated structured entities

The following table summarises the carrying values recognised in the statement of financial position of XYZ Bank's interests in unconsolidated structured entities, as of 31 December 20XX:

IFRS 12.29(a),(b)

| Balance sheet line item of asset or liability | Loans | Investments | Commitments and guarantees | Derivative instruments | Total | |
|--|--------------|--------------|-------------------------------|---------------------------|--------------|--------------|
| | | | | | Assets | Liabilities |
| Financial investments (fair value through profit and loss) | 1,173 | 3,265 | - | - | 4,438 | - |
| Financial investments (available for sale) | 67 | 820 | - | - | 887 | - |
| Loans and advances (at amortised cost) | 1,276 | - | - | - | 1,276 | - |
| Other liabilities | - | - | 321 | - | - | 321 |
| Provisions | - | - | 164 | - | - | 164 |
| Derivative financial instruments | - | - | - | 511 | 367 | 878 |
| Total | 2,516 | 4,085 | 485 | 511 | 6,968 | 1,363 |



Example 3 - Maximum exposure to loss

Maximum exposure to loss

The maximum exposure to loss presented in the table below is contingent in nature and may arise as a result of the provision of liquidity facilities, and any other funding commitments, such as financial guarantees provided by XYZ Bank to unconsolidated structured entities with which it has an interest as of 31 December 20XX. XYZ Bank's interests in structured entities also create exposure to loss from impairment.

IFRS 12.29(a)
IFRS 12.29(c)
IFRS 12.29(d)

For commitments and guarantees, and written credit default swaps, the maximum exposure to loss is the notional amount of potential future losses.

For retained and purchased interests and loans and investments, the maximum exposure to loss is the current carrying value of these interests.

The maximum exposure to loss does not take into account the effects of any hedging activities of XYZ Bank designed to reduce that exposure to loss.

The following table summarises XYZ Bank's maximum exposure to loss from its involvement at 31 December 20XX with structured entities, by nature.

| In millions | Maximum exposure to loss | | | | | Carrying amount | | |
|--------------------------------------|--------------------------|--------------|----------------------------|---------------------|---------------|--------------------------------|--------------|-----------------------------|
| | Loans | Investments | Commitments and guarantees | Credit default swap | Total | Interests in structured entity | | Assets in structured entity |
| Structured entity type | | | | | | Assets | Liabilities | |
| Mortgage-backed securitisations | 1,273 | 1,938 | - | 2,186 | 5,397 | 3,363 | 211 | 32,035 |
| CDOs and CLOs | - | 502 | 1,765 | 2,876 | 5,143 | 602 | 829 | 18,765 |
| Asset-backed commercial paper | - | 379 | 865 | - | 1,244 | 379 | 124 | 6,803 |
| Other asset-backed | 12 | 335 | - | 1,865 | 2,212 | 416 | 123 | 5,843 |
| Property, and other investing | 1,231 | 931 | 622 | - | 2,784 | 2,208 | 76 | 4,238 |
| Less amounts recorded as liabilities | | | (485) | (878) | (1,363) | | | |
| Total | 2,516 | 4,085 | 2,767 | 6,049 | 15,417 | 6,968 | 1,363 | 67,684 |



5. At what level should the entity aggregate the required information?

IFRS 12 permits an entity to aggregate the disclosures required for interests in similar entities if aggregation is consistent with the disclosure objective and does not obscure the information provided. We believe determining when and how to aggregate information will be a significant challenge for many entities. Getting the right balance between providing too much detailed information and still achieving the disclosure objective of providing information that enables users to evaluate the nature and risks associated with its interests, is likely to require significant management judgement. In determining whether to aggregate information, an entity considers qualitative and quantitative information about the different risk and return characteristics of each entity it is considering for aggregation and the significance of each entity to the reporting entity. The disclosures are presented in a manner that clearly explains to users of the financial statements the nature and extent of its interests in those other entities.

We believe that, when aggregated, interests should share similar risk characteristics. In addition, once interests with similar risks are identified, entities may wish to group those interests in the following manner as contemplated by paragraph B6 of IFRS 12:

- ▶ Nature of activities (e.g., a research and development entity, a revolving credit card securitisation entity)
- ▶ Industry classification
- ▶ Geography (e.g., country or region)

The level of disaggregation will largely depend on the variety of the entity's interests in the structured entity. The more varied the activity, the more detail that will be useful for the users of financial statements. For instance, for a bank it may be appropriate to classify by type of risk, such as sub-prime mortgages, or commercial and residential mortgages.

6. When would an entity be considered 'the sponsor' of an unconsolidated structured entity?

Paragraph 27 of IFRS 12 requires disclosure when a reporting entity has sponsored an unconsolidated structured entity, but does not have to disclose the nature of its risks related to that structured entity because, for example, it does not retain an interest in the entity at the reporting date. Therefore, a reporting entity can be a sponsor and not have an interest in an unconsolidated structured entity and would be captured by paragraph 29 of IFRS 12. IFRS 12 does not define sponsor, although paragraph 1 of SIC-12 described a sponsor as "the entity on whose behalf the SPE was created".

The rationale for this disclosure requirement is that sponsoring a structured entity can create risks for an entity, even though the entity may not retain an interest in the structured entity. Paragraph BC87 of the Basis for Conclusions to IFRS 12 states, "If the structured entity encounters difficulties, it is possible that the sponsor could be challenged on its advice or actions, or might choose to act to protect its reputation."

An entity may have been created to achieve more than one objective, to satisfy both the reporting entity and other investors, for example, a securitisation may provide the bank with funding and give an investor exposure to a specific risk class or an accounting benefit through holding a certain type of debt instrument.



Determining whether the reporting entity is the sponsor of a structured entity requires judgement. If the reporting entity is involved in determining the purpose and design of the structured entity, and any of the following factors apply, this may indicate that the reporting entity has sponsored a structured entity:

- ▶ The reporting entity is the majority user of the structured entity, e.g., the assets are originated by the reporting entity or it buys protection from the structured entity through derivatives
- ▶ The reporting entity's name appears in the name of the structured entity or on the products issued by it
- ▶ The reporting entity provides implicit guarantees of the structured entity's performance

Paragraph 27 of IFRS 12 requires an entity that has sponsored an unconsolidated structured entity, but does not have an interest in it, to disclose:

- (a) How it has determined which structured entities it sponsored
- (b) Income from those structured entities during the reporting period, including a description of the types of income presented
- (c) The carrying amount (at time of transfer) of all assets transferred to those structured entities during the reporting period

The information required by (a) and (b) above must be disclosed whether or not any assets were transferred to the structured entity during the reporting period. There is no time limit set for these disclosures so, in theory, they could continue indefinitely after the cessation of any interest in the structured entity.

IFRS 12 does not specify whether (c) above refers to assets transferred to the structured entity by the reporting entity or to the total assets transferred to the structured entity irrespective of who the transferor may be. However, paragraph BC90 of the Basis for Conclusions states that the Board concluded that the asset information disclosed should refer not only to assets transferred by the sponsor but to all assets transferred to the structured entity during the reporting period.

Income received from structured entities would not be confined to the income derived from the reporting entity's 'interest(s)' as defined in IFRS 12, but would cover all types of income received and reported by the entity. See section 7 for further detail on income.



Example 4 - Sponsored unconsolidated structured entities

Structured entities sponsored where no interest exists at the reporting date

XYZ Bank considers itself the sponsor of a structured entity where it is primarily involved in the design and establishment of the structured entity. XYZ Bank also transfers assets to the sponsored structured entity, it markets products associated with the structured entity in its own name, and/or provides guarantees regarding the structured entity's performance.

IFRS 12.27-28

For some sponsored structured entities, XYZ Bank has no interest at the reporting date. However, it has sold assets to those entities with no continuing involvement during the reporting period and has earned fees for selling those assets and for other transactions carried out for the entities. The table below presents XYZ Bank's income recognised during the reporting period and the fair value of any assets transferred to those structured entities during the reporting period.

IFRS 12.27

| In millions | Total income from interests | | | Assets transferred | |
|--|-----------------------------|-----------------|--|--------------------|--------------|
| | Commissions and fees | Interest income | Total gains and losses on sale of assets | Total | Fair value |
| Mortgage-backed securitisations | 14 | 21 | 7 | 42 | 3,065 |
| CDOs and CLOs | 7 | 8 | 12 | 27 | 2,110 |
| Asset-backed commercial paper | 19 | 2 | 3 | 24 | 426 |
| Other asset-backed | 14 | 11 | 26 | 51 | 1,325 |
| Property, credit related and other investing | 15 | 6 | 18 | 39 | 178 |
| Total | 69 | 48 | 66 | 183 | 7,104 |



7. What 'income' related disclosures are required in respect of sponsored structured entities?

IFRS 12 requires disclosure of income from unconsolidated structured entities when the sponsor does not have an interest at the reporting date (paragraph 27(b)). IFRS 12 defines income from a structured entity in Appendix A.

Income from an unconsolidated structured entity includes, but is not limited to:

- ▶ Recurring and non-recurring fees (structuring fees, management fees, placing agent fees, etc.)
- ▶ Interest
- ▶ Dividends
- ▶ Gains or losses on the re-measurement or derecognition of interests in structured entities
- ▶ Gains or losses from the transfer of assets and liabilities to the structured entity

Paragraph BC90 of the Basis for Conclusions to IFRS 12 states that disclosing income and asset information is not intended to help users assess the actual risk of failure or recourse to an entity, but rather to "give a sense of the scale of the operations an entity had managed with these types of transactions and the extent of the entity's reliance on such entities to facilitate its business."

8. What constitutes financial or other 'support' provided to an unconsolidated structured entity?

Provision of contractual or non-contractual financial or other support to unconsolidated structured entities

IFRS 12 requires disclosure of financial and other support provided to unconsolidated structured entities. The disclosures relating to contractual support are contained in the disclosure requirements about the nature of risks for unconsolidated structured entities, which we discuss in section 4 above. In this section we discuss the disclosure requirements where an entity provides non-contractual support.

Paragraph 30 of IFRS 12 requires entities to disclose non-contractual financial support provided to unconsolidated structured entities. When financial or other support has been provided to an entity in which the reporting entity has, or previously had, an interest and it has no contractual obligation to provide that support it shall disclose:

- (a) The type and amount of support provided, including situations in which the entity assisted the structured entity in obtaining financial support;
- (b) Reasons for providing the support.



Support

'Support' is not defined in IFRS. Paragraph BC105 of the Basis for Conclusions explains that the IASB did not define 'support' because a definition would either be so broad that it would be ineffective, or would invite (re)structuring so as to avoid the disclosure. The IASB believes that support is widely understood as a provision of resources to another entity, either directly or indirectly. Examples of the type of support that may be disclosed for unconsolidated structured entities include purchase of the notes or units issued by the structured entity, purchase of the assets of a structured entity, a long-term loan, or forgiveness of debt.

The IASB does not clarify what is meant by 'other support', but we believe this means support of a non-financial nature, such as the provision of human resources or management services.

Current intentions to provide financial or other support

Paragraph 31 of IFRS 12 requires an entity to disclose any current intentions to provide financial or other support to a consolidated structured entity, including intentions to assist the structured entity in obtaining financial support.

IFRS 12 does not define 'intentions'. Paragraph BC 104 of the Basis for Conclusions indicates that it means 'the entity has decided' to provide financial support (i.e., it has current intentions to do this). This implies that a decision to provide support has been approved by a party with the authority to do so. The wording in the Basis of Conclusions does not require that any 'intention' needs to have been disclosed to the structured entity that will receive the support or that there has been established a constructive obligation as defined in IAS 37 - *Provisions, Contingent Liabilities and Contingent Assets*.



The following example illustrates the requirements relating to non-contractual financial support:

Example 5 - Non-contractual support provided to structured entities

The provision of non-contractual support results in consolidation

On 28 February 20XX, due to a disruption in the supply of commercial paper (CP) funding, XYZ Bank provided £60m of funding to ABC CP Conduit, an unconsolidated structured entity, through purchases of CP. The amount of CP purchased represented 60 per cent of the asset value of ABC CP Conduit. As a consequence, XYZ Bank obtained the power to change the asset investment guidelines, and concluded that it controlled ABC CP Conduit. XYZ Bank has consolidated ABC CP Conduit from 28 February 20XX, resulting in £100m of A-rated mortgage receivables being recognised in the statement of financial position. The CP was acquired as an act of good faith to the clients who had invested in ABC CP Conduit on the basis of XYZ Bank's advice.

IFRS 12.30

The provision of non-contractual support does not result in consolidation

In May 20XX, XYZ Bank was approached by the Management of DEF Fund, which was having difficulties obtaining short-term funding from other sources. XYZ Bank agreed, as an act of good faith, to provide £65m in the form of short-term liquidity support to DEF Fund, which XYZ had originally structured and sold to investors. The full amount was repaid within fourteen days of the funding being advanced and no additional support has been provided since that date. XYZ Bank was not contractually obliged to provide funding, but did so to enable DEF fund to meet its short-term obligations. XYZ did not obtain power over DEF during that period and so did not consolidate it.

IFRS 12.30

Intention to provide financial support

As at 31 December 20XX, the management of XYZ Bank have decided, in good faith, to provide additional collateral to AAA CDO if the existing collateral falls below a credit rating of AA due to adverse market conditions. The amount that could potentially be provided would be between £20m and £30m. The decision was made to prevent potential calls to redeem the notes issued by AAA CDO.

IFRS 12.31



9. What should be disclosed as 'additional information'?

To meet the disclosure requirements in 'nature of risks' the application guidance in paragraph B25 of IFRS 12 states "in addition to the information required by paragraphs 29-31 an entity shall disclose additional information that is necessary to meet the disclosure objective in paragraph 24(b)."

Examples of that additional information that might be relevant, as given in paragraph B26 of IFRS 12 are:

- (a) The terms of an arrangement that could require the entity to provide support to an unconsolidated structured entity (e.g. liquidity arrangements or credit rating triggers associated with obligations to purchase assets of the structured entity or provide financial support) including:
 - (i) A description of the events or circumstances that could expose the reporting entity to a loss;
 - (ii) Whether there are any terms that would limit the obligation;
 - (iii) Whether there are any other parties that provide financial support and, if so, how the reporting entity's obligation ranks with those of other parties.
- (b) Losses incurred by the entity during the reporting period relating to its interests in unconsolidated structured entities.
- (c) The types of income the entity received during the reporting period from its interests in unconsolidated structured entities.
- (d) Whether an entity is required to absorb losses of an unconsolidated structured entity before other parties, the maximum limit of such losses for the entity and (if relevant) the ranking and amounts of potential losses borne by parties whose interests rank lower than the entity's interest in the unconsolidated structured entity.
- (e) Information about any liquidity requirements, guarantees or other commitments with third parties that may affect the fair value or risk of the entity's interests in unconsolidated structured entities.

- (f) Any difficulties an unconsolidated structured entity has experienced in financing its activities during the reporting period.
- (g) In relation to the funding of an unconsolidated structured entity, the forms of funding (e.g. commercial paper or medium term notes) and their weighted-average life. That information might include maturity analyses of the assets and the funding of an unconsolidated structured entity if it has longer-term assets funded by shorter term funding.

IFRS 12 does not prescribe a specific format for this information. Therefore, a reporting entity will need to determine whether a tabular or narrative format is more suitable, based upon its individual circumstances. There is little guidance provided in IFRS 12 relating to this suggested additional information. Given that this information is required in respect of structured entities that the reporting entity does not control, and over which it may not exercise significant influence, some of the disclosures suggested in respect of (d), (f) and (g) above may be difficult to provide since they require current information about the activities of the structured entity, rather than information about the interests held by the reporting entity.

The following section includes both a discussion of the more ambiguous items and illustrative disclosures for the quantitative areas.

Losses incurred

A reporting entity is required to disclose losses incurred in the reporting period from its interests in an unconsolidated structured entity. The standard does not elaborate on 'losses incurred', but we infer that they represent both realised and unrealised losses and losses recognised in both profit and loss and other comprehensive income. It may be informative to explain to users of the financial statements the line items in the primary statements in which the losses have been recognised. It would also be informative to disclose the aggregate losses incurred in respect of investments held at the reporting date, as well as the losses incurred in the reporting period.

In the following illustrative example, we have presented the losses incurred by type of interest held in the structured entity. This type of disclosure would provide users with a sense of scale as to the extent of any losses incurred.



Example 6 - Losses incurred

The following table presents XYZ Bank's losses recognised in profit and loss and other comprehensive income from those interests in the year ended 31 December 20XX:

| Investments and losses In millions | Losses recognised in profit and loss | | | Losses recognised in other comprehensive income |
|--|--------------------------------------|------------|-------------|---|
| | Derivatives | Guarantees | Investments | |
| Structured entity type | | | | |
| Mortgage-backed securitisations | 12 | 17 | 13 | 31 |
| CDOs and CLOs | 4 | - | 10 | 25 |
| Asset-backed commercial paper | - | - | 20 | 5 |
| Other asset-backed structured entities | 8 | - | - | 14 |
| Property, credit-related and other investing | - | 27 | 10 | 47 |
| Total | 24 | 44 | 53 | 122 |

Income received

If a reporting entity receives income during the reporting period from its interests in structured entities, it should disclose the types of income received. If this income is significant, a tabular format may be appropriate, even though not prescribed by IFRS 12.

The following is an example of this disclosure:

Example 7 - Income from interests in unconsolidated structured entities

The following table presents XYZ Bank's total income received from its interests in unconsolidated structured entities:

Total income for the year ended 31 December 20XX

| In millions | Interest income | Commissions and management fees | Liquidity and guarantee fees | Total gains and losses | Total |
|--|-----------------|---------------------------------|------------------------------|------------------------|-------|
| Structured entity type | | | | | |
| Mortgage-backed securitisations | 19 | 18 | 7 | 3 | 47 |
| CDOs and CLOs | 22 | 13 | - | 2 | 37 |
| Asset-backed commercial paper | 14 | 16 | 10 | 11 | 51 |
| Other asset-backed structured entities | 25 | - | - | 3 | 28 |
| Property, credit-related and other investing | 16 | 5 | 12 | 7 | 40 |
| Total | 96 | 52 | 29 | 26 | 174 |

Ranking of losses

Paragraph B26(d) of IFRS 12 suggests, if relevant, an entity should disclose "whether the entity is required to absorb losses of an unconsolidated structured entity before other parties, the maximum limit of such losses for the entity, and (if relevant) the ranking and amounts of potential losses borne by parties whose interests rank lower than the entity's interest in the unconsolidated structured entity."

We expect this disclosure to be relevant for any financial institution which holds notes in securitisation structured entities such as mortgage and other asset backed and CDOs, or where the interests issued are in the form of multiple contractually linked or tranching notes. This would require an analysis of the rights and priorities of other notes holders for each material investment. The following example shows one way of fulfilling this suggested disclosure.



Example 8 - Exposure to losses

The following table presents the maximum exposure to loss for XYZ Bank by type of structured entity and by seniority of interest, where XYZ Bank's interest ranks junior to those of other investors and so the bank absorbs losses before other parties. Also shown are the amounts of losses that in each case would be absorbed first by investors whose interests rank junior to those of the bank, which is represented by the amounts directly below the bank's maximum exposure to loss. In each case, the amounts shown reflect the fair value of those interests as at the reporting date. IFRS 12.B26(d)

| In millions | Seniority of interests | | | | Total |
|---|------------------------|---------------------|------------------|-----------------------|-------|
| | Subordinated interests | Mezzanine interests | Senior interests | Most senior interests | |
| Mortgage-backed securitisations | | | | | |
| i) XYZ's maximum exposure to loss | 150 | 592 | 850 | 346 | 1,938 |
| ii) Potential losses borne by more junior interests | - | 897 | 7,875 | 10,332 | - |
| CDOs and CLOs | | | | | |
| i) XYZ's maximum exposure to loss | 60 | 167 | 243 | 32 | 502 |
| ii) Potential losses borne by more junior interests | 27 | 456 | 4,787 | 5,311 | |
| Asset-backed commercial paper | | | | | |
| i) XYZ's maximum exposure to loss | - | - | - | 379 | 379 |
| ii) Potential losses borne by more junior interests | - | - | - | 25 | - |
| Other asset-backed structured entities | | | | | |
| i) XYZ's maximum exposure to loss | 23 | 59 | 119 | 134 | 335 |
| ii) Potential losses borne by more junior interests | 12 | 442 | 5,652 | 7,311 | - |
| Property, credit related and other investing structured entities | | | | | |
| i) XYZ's maximum exposure to loss | 48 | 112 | 360 | 411 | 931 |
| ii) Potential losses borne by more junior interests | - | 543 | 7,363 | 8,541 | - |



Liquidity arrangements

Paragraph B26 (e) of IFRS 12 states that information about any liquidity arrangements, guarantees or other commitments with third parties that may affect the fair value or risk of the entity's interests in unconsolidated structured entities, may be relevant to the disclosure of the nature of risks from interests in unconsolidated structured entities. It is not clear whether this refers to arrangements provided *by* third parties, or *to* third parties. However, while an arrangement provided to a third party may itself qualify as an interest in an unconsolidated structured entity, it would not normally affect the fair value of an entity's interests in an unconsolidated structured entity. Consequently, we believe this paragraph refers to arrangements provided by third parties.

It is also unclear as to whether the requirement relates to arrangements between third parties and the reporting entity or the structured entity, which affect the fair value or risk of the reporting entity's interest in the structured entity. In the absence of specific guidance, disclosure of arrangements provided by third parties to both the reporting entity and the structured entity may need to be disclosed.

Disclosure of funding difficulties

Paragraph B26 (f) of IFRS 12 requires disclosure of 'any difficulties' that a structured entity has experienced in financing its activities during a reporting period, which could potentially be wide-ranging. In practice, we believe that such disclosure is likely to focus on issues of debt (including short-term commercial paper) and equity securities which have failed either in whole or in part.

Disclosure of the forms of funding of an unconsolidated structured entity

This disclosure appears to refer to the overall funding of the structured entity including forms of funding in which the reporting entity has not participated. A tabular presentation would appear to be the most appropriate way of making this disclosure.

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