

Supplementary study – Consolidation of Special Purpose Entities (SPEs) under IFRS 10

This report on findings has been prepared by the EFRAG secretariat for the sole use of the Internal Market and Services Directorate General of the European Commission, for its assessment of how IFRS 10 *Consolidated Financial Statements* is likely to affect consolidation of Special Purpose Entities as described in SIC-12 *Consolidation – Special Purpose Entities*. This supplementary study is intended to serve as input to the impact assessment of IFRS 10 by the European Commission, in addition to, and separately from, EFRAG's endorsement advice on IFRS 10 which was issued on 30 March 2012. The findings of the supplementary study are intended to describe the impact of IFRS 10 on the scope of consolidation in relation to SPEs, compared to IAS 27/SIC-12. This report should not be used for any other purposes.

This report has been prepared based on procedures and tasks agreed with the staff of the European Commission and draws on the experience of the EFRAG secretariat to undertake the supplementary study in accordance with the needs of the impact assessment that the European Commission is performing at present. These procedures were limited to those specified. Had the procedures differed in any way or had the participants been different from those included in Appendix A, other matters may have come to the attention of the EFRAG secretariat, which would have been included in this report on findings. The EFRAG secretariat has carried out its work and issued this report on findings independently of the European Commission in order to assist the European Commission in the endorsement of the new IFRS guidance on consolidation.

The report on findings does not include any form of advice or assessment. Therefore, EFRAG TEG has not been involved in any form in this document, has not provided any direction for the tasks performed by the EFRAG secretariat and has not approved this report on findings before its issuance.

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EXECUTIVE SUMMARY

- 1 The EFRAG secretariat was asked by the European Commission to conduct a supplementary study to assist them in collecting evidence, intended to describe the impact of IFRS 10 on the scope of consolidation of Special Purpose Entities (SPEs).
- 2 The fourteen companies that participated in the supplementary study are listed European groups, of which eight are also listed in the United States. The total balance sheet assets of the fourteen participants are in excess of EUR 13 trillion.
- 3 The findings indicate that the new guidance will result in more informative financial statements in relation to SPEs.
- 4 The findings demonstrate that the overall quantitative impact from adopting IFRS 10 on the scope of consolidation, compared to current requirements for SPEs, is likely to be relatively limited for total assets and total consolidated SPEs as reported by participants. The seven participants that provided quantitative information reported being involved with approximately 10,500 SPEs in total. This included funds, securitisation vehicles, asset-repackaging vehicles, finance and leasing SPEs and other types of SPEs. In aggregate, IFRS 10 results in the consolidation of an additional 50 SPEs with a corresponding net increase in total assets of EUR 4.4 billion, mainly of funds that were previously not consolidated.
- 5 The total SPE assets consolidated under IFRS 10 increased by 1.3% compared to the total SPE assets consolidated under IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. This comprises a net increase of 1.4% related to the consolidation of additional funds that is offset by a net decrease of 0.1% related to deconsolidation of other types of SPEs.
- 6 The direction of these findings was confirmed by the responses from the other seven participants that provided a qualitative assessment based on their IFRS 10 implementation work.
- 7 In addition, some participants reported that although IFRS 10 did not necessarily result in consolidation of considerably more or of less SPEs, the standard should not be considered in isolation, but should be assessed in conjunction with the disclosure requirements of IFRS 12. Some of these participants specifically noted that the new disclosure requirements in IFRS 12 would require them to provide significantly more narrative information about their interests in unconsolidated SPEs.
- 8 Some participants also pointed out that even if certain SPEs were deconsolidated, they would still be required to continue to recognise the assets of those SPEs because of the risks and rewards model underlying IAS 39's *Financial Instruments: Recognition and Measurement* derecognition criteria.

BACKGROUND

- 1 In May 2011, the IASB published IFRS 10 *Consolidated Financial Statements* (IFRS 10) which establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 changes the scope of consolidation, meaning that a reporting entity may:
 - (a) have to consolidate certain Special Purpose Entities (SPEs) that were previously not consolidated under existing IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*; and
 - (b) no longer consolidate certain other SPEs that were previously consolidated.

Whether a reporting entity will have to consolidate more SPEs or fewer SPEs will depend on various factors, and will generally be driven by the nature of its interests in the SPE being evaluated. The application of a uniform consolidation principle based on ability to control (which incorporates risks and rewards but requires power over those risks and rewards to have control) is intended to provide robust guidance in situations where it has proved difficult to assess control in practice and divergence had evolved. As explained below, this report gives an overview of how participants of the supplementary study are expected to be impacted by IFRS 10.

- 2 In an Accounting Regulatory Committee meeting the specific question of the impact that the requirements in IFRS 10 are likely to have on the scope of consolidation in relation to SPEs as described in SIC-12, was raised.
- 3 To respond to this question, the Internal Market and Services Directorate General of the European Commission (European Commission) asked EFRAG to provide assistance with collecting facts that could illustrate the likely impact of IFRS 10 on the scope of consolidation in relation to SPEs. In this respect, it is noted that EFRAG's previous field-test on IFRS 10 and IFRS 12 focused on the relevant aspects of the new requirements as a whole, rather than on the narrower question about the impact of IFRS 10 on the scope of consolidation of SPEs.

PROCEDURES AND TASK SPECIFICATION OF THE SUPPLEMENTARY STUDY

- 4 The EFRAG secretariat was asked by the European Commission to assist in collecting evidence based on facts that could illustrate the likely impact of IFRS 10 on the scope of consolidation in relation to SPEs.
- 5 This supplementary study is separate from EFRAG's final endorsement advice and effects study on IFRS 10, which was issued on 30 March 2012, and has been prepared solely for the use of the European Commission as additional input when developing its final impact analysis on the endorsement of IFRS 10.
- 6 This report has been prepared based on the procedures and tasks that were agreed between the European Commission and the EFRAG secretariat specified in paragraphs 8 to 17 of this document and to report the findings from the supplementary study. Procedures and tasks, which have been discussed with the European Commission as the work progressed, were designed in accordance with the needs of the European Commission mentioned above and draw on the experience of the EFRAG secretariat. In particular, the procedures and tasks included, among other considerations, the scope of the supplementary study, its objective, the industry sector of the participants, the methodology to be used and the size of the sample.
- 7 Had the task specification differed in any way, including the size of the sample of participants, or had the participants been different from those included in the Appendix A, other matters might have come to the attention of the EFRAG secretariat that would have been included in this report on findings, and might have resulted in a different outcome to that reflected in this report. Notwithstanding the above, EFRAG secretariat has carried out its work and issued this report on findings independently from the European Commission.

Scope of the supplementary study

- 8 This supplementary study focuses on how the requirements of IFRS 10 affect the consolidation of SPEs as described in SIC-12. An SPE is an entity created to accomplish a well-defined objective, for example a vehicle into which trade receivables are securitised (also referred to as a securitisation).
- 9 SIC-12 describes an SPE as an entity that:
 - (a) Often is created with legal arrangements that impose strict limits on the decision-making powers of its governing body; in some cases these restrictions are permanent; or
 - (b) Frequently operates in a predetermined way such that virtually all rights, obligations and aspects of activities are controlled through the legal/contractual provisions determined at inception.
- 10 Appendix B includes a list of the names of SPE categories reported by participants.

Objective

- 11 The objective of the supplementary study is to describe the impact of IFRS 10 on the scope of consolidation of SPEs, compared to the requirements under IAS 27/SIC-12 (also

referred to in this report as ‘existing requirements’), and to explain the reasons for that impact.

- 12 The supplementary study aims to provide, to the extent possible and based on each participating company’s internal assessment, evidence on:
 - (a) The aggregate impact of IFRS 10 on the scope of consolidation of SPEs;
 - (b) The primary categories and nature of SPEs that the participating companies were involved with and the description of the features that would trigger a change in the consolidation decision from the application of IAS 27 and SIC-12; and
 - (c) The high level reasons for the change in the scope of consolidation, as compared to the accounting under IAS 27 and SIC-12.

Methodology

- 13 The supplementary study was carried out in four stages:
 - (a) *Identifying participating companies* – EFRAG’s secretariat invited companies to participate in the supplementary study through a series of contacts and by publishing a call for participants in a news item on EFRAG’s website. EFRAG’s secretariat worked in close cooperation with the staff of National Standard Setters in Europe who offered to help in identifying participants. All companies that volunteered and agreed to participate were included in the supplementary study.
 - (b) *Questionnaire* – EFRAG’s secretariat prepared a questionnaire that formed the basis for the supplementary study. Each of the participants completed the questionnaire (see the section about the companies below) on a *confidential basis*. The questionnaire included a reporting template and asked companies to report on the results and conclusions of their internal assessment regarding the consolidation of SPEs under IFRS 10. The content of the questionnaire was approved by the European Commission before being provided to participants.
 - (c) *Analysis of completed questionnaires and follow-up interviews with participants* – EFRAG’s secretariat analysed the completed questionnaires, compared the answers received between questionnaires and analysed the rationale provided in the answers against the requirements of IFRS 10. Where necessary, EFRAG’s secretariat contacted participants by email or phone to obtain further clarifications on the answers and explanations that they had provided and to discuss any issues that they had identified.
 - (d) *Issuance of this report on findings* – This report, reflecting the findings from the supplementary study, has been prepared by EFRAG’s secretariat.

Companies that participated in the supplementary study

- 14 Most of the participants are banks or insurers. The participants in these industries are often involved with a considerable number of SPEs and have started their IFRS 10 implementation projects earlier than companies in other industries.
- 15 The list of participants is included in the Appendix A of this document.

Other considerations

- 16 It should be noted that the supplementary study is based on participants' internal assessments regarding the scope of consolidation of SPEs under IFRS 10 which were ongoing when the supplementary study was conducted. Therefore, participants were asked to share the results of the internal assessments conducted so far. This means that participants responded only to the questions included in the questionnaire for which they had collected all the necessary information. The findings in this report have been reported on that basis. All participants noted that their preliminary conclusions and interpretations had not yet been agreed with their auditors. As a result, their analysis of the impact of IFRS 10 on the consolidation of SPEs could be subject to change.
- 17 In addition to the targeted set of questions, the questionnaire allowed entities to report on any other matters related to the consolidation of SPEs on which they would like to comment (e.g. IFRS 12 *Disclosure of Interests in Other Entities* disclosure requirements or the interaction between IFRS 10 and the derecognition criteria in IAS 39 *Financial Instruments: Recognition and Measurement*). This report also summarises the other matters reported by participants.

FINDINGS

General information about participants

Characteristics of the participants

- 18 Fourteen companies participated in the supplementary study. All participants are listed European groups, of which eight participants are also listed in the United States.
- 19 The table below summarises the number of participants by country and by industry:

Table 1: Total participants by country and by industry

<i>Participants by country:</i>		<i>Participants by industry:</i>	
France	3	Banking	9
Germany	2	Energy and Utilities	1
Italy	2	Insurance	4
Netherlands	1		<u>14</u>
Spain	2		
UK	4		
	<u>14</u>		

Status of participants' internal assessments

- 20 Most participants reported that they had finalised their initial impact assessment of IFRS 10 on the population of SPEs. These preliminary assessments generally involved a detailed 'gap analysis', development of internal interpretative guidance and in some cases discussions with peers and auditors. Three participants reported that their initial impact assessment was still in progress.
- 21 Seven participants (mainly Foreign Private Issuers in the United States) reported that their initial impact assessment of SPEs was relatively well progressed. These participants were able to provide a quantitative analysis of the impact of IFRS 10 on the population of SPEs with detailed information regarding the SPEs (per type of SPE) that would be consolidated under IFRS 10, but were not consolidated under IAS 27/SIC-12 (and vice versa). The detailed information included the total number of newly consolidated (deconsolidated) SPEs by category, and their respective total asset value.
- 22 The remaining seven participants provided a qualitative analysis of the impact of IFRS 10 on their SPEs, and reported that the impact of adopting IFRS 10 was unlikely to be significant.
- 23 All participants noted that their preliminary conclusions and interpretations had not yet been agreed with their auditors. As a result, their analysis of the impact of IFRS 10 on the consolidation of SPEs could be subject to changes.
- 24 Most participants explained that the implementation of IFRS 10 would include several phases of analysis, which would continue throughout 2012, although some reported that they would conclude the implementation of IFRS 10 by the end of 2012. Ongoing assessment work included discussing interpretations with peers, reassessing SPEs on a case-by-case basis with careful analysis for complex SPE structures, obtaining missing

data for some SPEs, developing internal guidance for implementation purposes and agreeing results with their auditors and company directors.

How participants defined SPEs

- 25 Some participants specifically reported that they had not identified any significant differences between the definition of a structured entity in IFRS 12 and the current definition of an SPE in SIC-12.
- 26 Participants generally observed that SPEs were entities created to accomplish a narrow and well-defined objective. For example, an SPE had strict and sometimes permanent limits on the decision-making powers of their governing board, trustee or management over the operations of the SPE or the SPE operated in a predetermined way such that virtually all rights, obligations, and aspects of activities were controlled through legal/contractual provisions determined at inception (i.e. they operated in autopilot mode).
- 27 Participants generally defined structured entities as those entities in which voting rights were not the dominant factor in deciding who controls the entity and the entity has some of the following features (i) restricted activities, (ii) narrow and well defined objective, (iii) insufficient equity and (iv) financing in the form of multiple contractually linked instruments.
- 28 Some participants referred to the following other specific features of SPEs:
 - (a) There is no specific legal form that a SPE has to take but they are often formed as a corporation, trust, partnership or unincorporated entity;
 - (b) Control over SPEs cannot be exercised based on the voting rights and is established through existing legal arrangements, which often impose strict and sometimes permanent limits on the decision-making powers over the operations and ongoing activities of the SPE;
 - (c) SPEs are often set up with provisions specifying that the policy guiding the ongoing activities cannot be modified, other than perhaps by its creator or sponsor (i.e. the SPEs operate in autopilot mode);
 - (d) The sponsor (or entity on whose behalf the SPE was created) frequently transfers assets to the SPE, obtains the right to use assets held by the SPE or performs services for the SPE, while other parties may provide the funding to the SPE by acquiring the notes issued by the SPE; and
 - (e) The creator or sponsor (or the entity on whose behalf the SPE was created) retains a significant beneficial interest in the SPE's activities, even though it may own little or none of the SPE's equity. Beneficial interest can take many forms but are generally split between those giving a fixed or stated rate of return and those giving rights or access to other future economic benefits of the SPE's activities.
- 29 The way participants categorised funds as SPEs varied across participants. Some participants considered all of their investments in funds to be a class of SPEs, whereas others did not, or considered only some of their funds to be SPEs.

- 30 For example, one participant observed that only funds containing guarantee elements (e.g. guarantees on certain levels of the net asset value) were internally considered as SPEs, whereas another participant reported the following factors that they used to assess whether a fund was an SPE:
- (a) Existence of well-defined restrictions on the type of investments and the parameters within which these investments can be made;
 - (b) Significant limitations in the manager's scope to exercise investment decisions;
 - (c) Ability to approve or reject investment, financial and operating policies or decisions only by a unanimous decision of all investors; and
 - (d) Existence of strict legal or regulatory restrictions over the activities of the fund.

Detailed findings on the impact of IFRS 10 on the consolidation of SPEs

Categories identified by participants

- 31 Most participants categorised their SPEs either by (i) type of entity or (ii) by the business purpose for which the SPE was set up, while only some combined both approaches.
- 32 Participants used a wide range of names to identify the categories of SPEs that they were involved with. However, it should be noted that despite differences in the naming of the categories of SPEs, many of the underlying SPEs are in fact similar in nature. Appendix B to this report lists in alphabetical order the names of SPE categories provided by participants.
- 33 For the purposes of the analysis in this report, the different types of SPEs have been categorised as follows by EFRAG's secretariat:
- (a) Funds;
 - (b) Securitisation entities;
 - (c) Asset repackaging SPEs;
 - (d) Leasing and financing SPEs; and
 - (e) Other SPEs.

Nature of the SPEs included in categories

- 34 A summary of the main features and some examples of SPEs reported by participants when describing the nature of the SPEs included in their internal categories is presented below:
- (a) Funds:

Entities that have a collection of investments (e.g. financial instruments, properties or commodities) where investors usually receive a return based on the value of the investments, unless the fund contains a capital and/or performance guarantee.

Funds might be managed by either participants or a third party; however, participants might have a financial interest in funds regardless whether they are the asset manager or not. In addition, those participants that are involved with the insurance business might use funds as backing assets for unit-linked and index-linked products.

This category would include, among others, investment funds with guarantees, tracker funds, private equity funds, real estate funds, hedge funds, commodity funds, exchange traded funds (ETFs) and money market funds.

(b) Securitisation entities:

Entities that issue securities that are secured by a collection of assets. Generally, securitisation entails the transfer of a portfolio of assets (e.g. loans and receivables or other assets originated by the participants or a third party) and its subsequent transfer to securitisation entities which, to finance the purchase, issue securities that are later placed on the market (traditional securitisations) or purchased in full by the transferor (self-securitisations).

The issuance of securities could be done in classes or tranches with a different seniority in the capital structure. Participants might retain the majority of the risks holding the subordinated debt or the lowest quality tranche for those securitisations that they have originated. In addition, in case of default of the loans transferred, participants might manage their recovery. Participants might also have a financial interest in securitisation entities originated by third parties.

Examples of securitisation entities would be commercial mortgage backed securities (CMBS), asset-backed commercial paper programs (ABCP), multi-seller conduits and collateralised debt obligations (CDOs).

(c) Asset repackaging SPEs:

Vehicles tailored to meet specific needs of investors (e.g. investment opportunities, cash flow alignment and risk exposure) who are allowed to invest in synthetic assets (e.g. a vehicle containing a fixed rate corporate bond plus an interest rate swap giving the investor a corporate credit risky bond with a floating rate return). Asset repackaging SPEs usually purchase one type of security from a third party and later issue their own debt or equity securities to investors. The SPE's securities might initially be held by participants prior to sale to investors.

These SPEs might run on autopilot. The benefits of the underlying security are passed to the holders of the repackaged securities. However, a default event on the collateral usually implies the liquidation of the SPE, in which case the investors assume the losses.

Participants might act as an intermediary (establishing the asset repackaging SPEs and financing the acquisition of collateral by investors in certain circumstances) and/or have an interest in such SPEs originated by a third party to meet their specific objectives (e.g. in an asset repackaging SPE that enters into a series of interest rate swaps transactions to match the cash flows of the securities and the collateral with the participant's cash flows).

(d) Leasing and financing SPEs:

Vehicles established to facilitate the leasing of a certain asset (e.g. property, shipping or aircraft lease SPEs) and to finance structured transactions (e.g. infrastructure projects of the public or private sector).

(e) Other SPEs:

This includes entities reported by participants that are not covered by the above categories. Participants might hold financial interests in other entities or be involved with other specific types of SPEs (e.g. SPEs set up to protect participants against extreme catastrophes such as hurricanes and earthquakes). In addition, SPEs might be established for other purposes such as funding and liquidity (e.g. vehicles incorporated abroad to raise funds on specific markets through the issuance of preference shares or subordinated debt where collateral is usually deposits retained with the originating company) and for accounting, tax and/or regulatory reasons.

Changes in the scope of consolidation

35 Participants reported their results based on the information available as at 31 December 2011. The results have not been reviewed by their auditors and might be subject to change once the detailed assessments and conclusions are finalised and agreed.

36 Overall, participants did not identify significant changes to the scope of consolidation for SPEs from adopting IFRS 10, compared to SIC-12. More specifically:

(a) *Quantitative analysis* – Seven participants reported detailed information about the impact that IFRS 10 would have on the scope of consolidation of SPEs or provided a qualitative analysis which indicated the impact on the category of SPEs being assessed by the respective participant. The quantitative information reported by these participants has been aggregated based on the groups of SPEs outlined by EFRAG secretariat and is reported in the section ‘Quantitative analysis’ below. These participants estimated the change in the scope of consolidation of SPEs to be relatively small compared to the total population of SPEs and the total assets of the SPEs that were consolidated under IAS 27/SIC-12.

(b) *Qualitative analysis* – The other seven participants provided aggregated information or a qualitative analysis which outlined, in general terms, the impact that IFRS 10 would have on their scope of consolidation. With one exception, those participants reported that the impact was unlikely to be significant and their observations are reported in the section ‘Qualitative analysis’, below.

Quantitative analysis

37 The table below summarises, for those seven participants that provided quantitative information, the estimated impact of applying IFRS 10 on the scope of consolidation of SPEs including the estimated net impact on total assets of SPEs as at 31 December 2011:

Supplementary study – Consolidation of Special Purpose Entities under IFRS 10

Table 2: Summary of SPEs newly consolidated and SPEs no longer consolidated

	SPEs newly consolidated under IFRS 10 (i)			SPEs no longer consolidated under IFRS 10 (ii)		Net Impact (iii)	
	Number of SPEs in each category	Number of SPEs in each category	Assets (EUR million)	Number of SPEs in each category	Assets (EUR million)	Number of SPEs in each category	Assets (EUR million)
Funds	5,507	161	21,806	76	17,040 (iv)	85	4,766
Securitisation entities	1,437	7	2,795	14	1,953	-7	842
Asset repackaging SPEs	1,010	69	1,983	27	2,436	42	-453
Leasing and financing SPEs	749	5	155	41	185	-36	-30
Other SPEs	1,834	1	15	35	785	-34	-770
Total	10,537	243	26,754	193	22,399	50	4,355

(i) This corresponds to SPEs that would be consolidated under IFRS 10 and were previously not consolidated under IAS 27/SIC-12.

(ii) This corresponds to SPEs that would not be consolidated under IFRS 10 and were previously consolidated under IAS 27/SIC-12.

(iii) The above table only shows the total assets of the SPEs, but does not include the secondary effect of the impact that IAS 39's derecognition criteria might have by prohibiting the derecognition of assets held by the unconsolidated SPEs.

(iv) See paragraph 45.

38 The tables below show, for those seven participants that provided quantitative information, the net impact of applying IFRS 10 on the scope of consolidation of SPEs as a percentage of the total assets that were consolidated under IAS 27/SIC-12 and as a percentage of the total balance sheet assets of those participants:

Table 3: Increase/(decrease) of SPE assets consolidated under IFRS 10 compared to IAS 27/SIC-12

	SPEs consolidated under IAS 27/SIC-12 (i)			Net Impact (ii)		Increase/ (decrease) of SPE assets consolidated under IFRS 10 compared to IAS 27/SIC-12
	Number of SPEs in each category	Number of SPEs in each category	Assets (EUR million)	Number of SPEs in each category	Assets (EUR million)	
Funds	5,507	481	132,200	85	4,766	3.6%
Securitisation entities	1,437	189	173,549	-7	842	0.5%
Asset repackaging SPEs	1,010	78	6,754	42	-453	-6.7%
Leasing and financing SPEs	749	55	751	-36	-30	-4.0%
Other SPEs	1,834	1,360	34,020	-34	-770	-2.3%
Total	10,537	2,163	347,274	50	4,355	1.3%

(i) This corresponds to SPEs that were consolidated under IAS 27/SIC 12

(ii) Net impact as shown in Table 2.

Table 4: Net impact as percentage of the participants' aggregated total assets

Net SPE assets additionally consolidated under IFRS 10 as percentage of the participants' aggregated total balance sheet assets	<u>0.06%</u>
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Explanation of changes in the scope of consolidation of SPEs

39 As illustrated in the above tables, in both total and individually for each category of SPEs, the estimated net change in the scope of consolidation is relatively limited compared to the total population of SPEs (50 SPEs out of 10,537 in total) and compared to the total assets of the SPEs that were consolidated under IAS 27/SIC-12 (1.3%). Also, the net impact of the change in the scope of consolidation is not significant compared to the aggregated total balance sheet assets reported by those seven participants that provided quantitative information (0.06%).

40 The net increase in consolidation of SPEs of approximately EUR 4,355 million (a net increase of 50 SPEs) shown above can be analysed as follows:

Funds

41 In aggregate, participants reported that they would consolidate more funds categorised as SPEs under IFRS 10 than they would under IAS 27 and SIC-12. Specifically, participants estimated that 161 funds would be newly consolidated, whereas 76 funds would be deconsolidated. The total assets of these funds represented an estimated amount of EUR 21,806 million and EUR 17,040 million, respectively.

42 Participants that were involved with funds reported that the control model of IFRS 10 would lead to consolidation of more funds compared to the existing assessment under SIC-12 which focused on which investor, if any, obtained the majority of the rewards or was exposed to a majority of the risks of the SPE. When reassessed under IFRS 10, certain interests in funds of less than 50% would be consolidated, because entities have power over those funds based on the link between power and returns. Such funds might not be consolidated under SIC-12 if the participant did not have an interest in excess of 50% or was not exposed to the majority of the risks and rewards.

43 For example, one participant observed:

'Under IFRS 10 a fund manager will have to consolidate a fund if it manages a dynamic strategy, has significant exposure to variable returns, and the other fund investors do not hold any significant decision rights'.

44 Another participant explained that guaranteed funds might not be consolidated under SIC-12 if the probability of having to pay under the guarantee was considered to be remote.

45 The decrease in the number and total assets of funds is mainly due to the results provided by one participant. This participant reported that SPEs for insurance products would likely be deconsolidated. Such funds were consolidated under SIC-12.

Securitisation entities and asset repackaging SPEs

46 Participants reported that a relatively small number of securitisation entities would be affected by the implementation of IFRS 10. In aggregate, they estimated that 7

securitisation entities would be newly consolidated, whereas 14 securitisation entities would be deconsolidated. However, the total assets of the entities being consolidated exceeded the total assets of the newly deconsolidated by approximately EUR 842 million.

- 47 With regards to asset repackaging SPEs, participants reported in aggregate that they estimated that 69 SPEs would be newly consolidated and 27 SPEs would be deconsolidated. The total assets of these SPEs were EUR 1,983 million and EUR 2,436 million, respectively.
- 48 The decrease in the number of securitisation entities and asset repackaging SPEs being consolidated resulted from situations in which an entity was considered not to have power over the SPE entity, as defined by IFRS 10, and was therefore not permitted to consolidate it. Under SIC-12, some securitisation entities and asset repackaging SPEs were consolidated where an entity was subject to the majority of the risks and rewards, without necessarily having 'power' over the securitisation entity. For example, one participant noted that:

'Entities become deconsolidated where either there are no ongoing decisions to be made in the securitisation entity (the entity is in effect brain dead or on autopilot) or where the decisions are made by a third party in which the entity [participant] cannot influence – for example a special servicer which cannot be removed by the participant'.

- 49 Another participant noted that:

'When an entity has no relevant activities, no party has control over the SPE and therefore under IFRS 10, no party would consolidate the SPE even when they have exposure to the SPE. For example, a credit protection SPE – SPE sells CDS protection to Bank X, issues credit linked notes to investors and holds high quality collateral. Neither the note holder nor Bank X can make any decisions on day 2 that impact the performance of the SPE – hence no party has power and therefore no party would consolidate the SPE under IFRS 10. Under SIC-12 the party absorbing the majority of the risk (i.e. the note holder) may have consolidated the SPE despite having no power. We support this approach and believe it ensures consolidation is only performed when an entity has control.'

- 50 IFRS 10 requires more consolidation of securitisation entities and asset repackaging SPEs than IAS 27/SIC-12 where an entity has power over the securitisation entity and some exposure to variability (not necessarily 50%). Under IFRS 10, participants might consolidate such SPEs when they have the ability to influence the returns and they are exposed to variable returns, even if they do not obtain the majority of the rewards. Under SIC-12, these SPEs might not have been consolidated. For example, under IFRS 10 an entity might have to consolidate an asset repackaging SPE if it has the ability to change the underlying collateral and is exposed to a more than insignificant level of variable returns.

Leasing and financing

- 51 Participants reported an estimated net decrease in total SPE assets of approximately EUR 30 million (a net decrease of 36 SPEs).
- 52 Participants reported that under IFRS 10 such entities might be consolidated when the activities of the SPEs are predetermined at inception and participants did not have any unilateral rights over the SPE (e.g. when the main decision relates to the purchase option

over the underlying asset which can only be executed by the lessee). Under existing requirements, such SPEs might be consolidated when participants financed the acquisition of the underlying asset since they were exposed to the credit risk of the lessee.

Other SPEs

- 53 Participants reported an estimated net decrease in total SPE assets of approximately EUR 770 million (a net decrease of 34 SPEs).
- 54 Although the group of 'Other SPEs' includes a variety of SPEs and structures not considered above, the main reason reported for deconsolidating such entities was that participants were not considered to have power under IFRS 10 as the link between power and returns was not sufficiently strong or as participants were not able to control the most significant decisions of the SPEs.

Qualitative analysis

- 55 Seven participants provided a qualitative analysis. Six of these participants did not expect a significant/material impact as a result of adopting IFRS 10 on the scope of consolidation of SPEs, compared to IAS 27/SIC-12 with one of them noting that only limited changes, if any, should be expected to the overall population of structured entities consolidated in accordance with IFRS 10. The other participant, while not anticipating a material change to the total number of SPEs consolidated, was still assessing whether additional consolidation of CDO securitisation entities would be required (see paragraph 59).
- 56 For example, one of the participants, who did not expect a significant/material impact, observed that:

'The objective of IFRS 10 was to improve the usefulness of consolidated financial statements by developing a single basis for consolidation and guidance for applying that basis to situations where it was difficult to assess control in practice and divergence had evolved. Therefore, compared to IAS 27/SIC-12, only limited changes if any should be expected to the overall population of SPEs (structured entities) consolidated under IFRS 10.'

Several others participants shared similar views.

- 57 Four of the above six participants provided some aggregated quantitative data and reported that they had not identified, so far, any newly consolidated or deconsolidated SPEs. One participant reported that under IFRS 10 approximately 11 funds would become consolidated whereas 49 SPEs would be deconsolidated, but this participant did not quantify the financial impact of the changes in its scope of consolidation. However, the supporting explanations provided by this participant were similar to those included in paragraphs 39 to 54 above for the participants that provided quantitative information.
- 58 One of the above six participants expressed concern about the impact that IFRS 10 might have on specific structured entities that operated in regulated sectors. For example, when regulation imposes restrictions over the operations and ongoing activities of structured entities, difficulty arose in identifying the link between the ability to direct relevant activities and the participant's exposure to risks and rewards.

- 59 One participant did not anticipate a material change to the total number of SPEs consolidated, however this participant had identified a number of entities (CDO securitisation entities) that would potentially be required to be consolidated under IFRS 10. If consolidation was required for these SPEs, this participant observed that a material transition adjustment to opening retained earnings could result. In addition, they observed that they were aware that certain fund type entities which are currently not consolidated may require consolidation under IFRS 10. They added that work on the impact of these SPEs was ongoing; however the impact could result in a material transition adjustment.
- 60 Appendix C to this report provides a detailed overview of the features identified by participants that might lead to consolidation or deconsolidation of SPEs when applying IFRS 10.

Others matters reported by participants

- 61 Participants observed the following additional matters:
- (a) *Interaction with IFRS 12 disclosures* – Some participants noted that IFRS 10 should not be considered in isolation, but should be assessed in conjunction with the disclosure requirements of IFRS 12. Some of these participants specifically noted that they expected IFRS 12 to result in significantly more information in relation to off-balance sheet risk exposures arising from an entity's involvement with unconsolidated structured entities. Such disclosures were found to be useful for their investors; therefore, they believed that in considering IFRS 10 one should also consider the impact of IFRS 12 on the disclosures in the financial statements.
 - (b) *Interaction with IAS 39 derecognition criteria* – Some participants observed that if a transfer of financial assets did not meet the derecognition criteria in IAS 39, the conclusion on whether to consolidate a SPE or not becomes largely irrelevant as the assets (and related liabilities) would remain on their balance sheet. This situation often arises for SPEs that hold assets that were originated by participants themselves and that run on autopilot.

Appendix A – List of participants in the supplementary study

Participant	Industry	Balance sheet total for each participant (EUR billions)
Aegon Nederland NV	Insurance	82
Allianz SE	Insurance	641
Assicurazioni Generali SpA	Insurance	423
AXA SA	Insurance	730
Barclays plc	Banking	1,871
Banco Bilbao Vizcaya Argentaria (BBVA)	Banking	598
Banco Santander SA	Banking	1,251
Deutsche Bank AG	Banking	2,164
GDF Suez	Energy and Utilities	213
HSBC Holdings plc	Banking	1,975
Intesa Sanpaolo SpA	Banking	639
Standard Chartered plc	Banking	462
Société Générale	Banking	1,181
UBS AG	Banking	1,149
		13,379

Appendix B – List of the names of SPE categories

List of the names of SPE categories reported by participants

- Asset backed securities (ABS)
- Asset management vehicles
- Asset realisations
- Asset repackaging entities
- Asset securitisations
- Client intermediation
- Client structuring
- Collateralised debt obligations (CDO)
- Commercial mortgage backed securities (CMBS)
- Conduits
- Consumer banking
- Financial engineering SPEs
- Funding SPEs
- Fund management
- Funds (and Investment funds)
- Hedge funds and off-shore mutual funds
- Insurance securitisation vehicles (CAT bonds)
- Investment funds with guarantees
- Investment funds managed by the participant
- Leasing SPEs
- Off-shore reinsurance vehicles
- Private equity funds
- Real state SPEs
- Securitisation conduits
- Securitisation SPEs
- SPEs for raising liquidity for the Group
- SPEs focused on customers' objectives
- SPEs for insurance products
- Structured finance
- Structured notes
- Vehicles for issuing structured notes ad-hoc for clients

Appendix C – SPE features that affect consolidation

This appendix provides a description of the features of SPEs that might trigger changes in the consolidation decision under IFRS 10 as compared to IAS 27/SIC-12 and provides the high level reasons for the change as described by participants in the supplementary study.

SPEs that were not consolidated under IAS 27/SIC-12 but that would be consolidated under IFRS 10

Funds

- 1 *Investment funds managed by third parties where investors have an effective liquidation right* – In the case of investment funds where the third party manager cannot be removed without a specific cause but all the investors of the fund have rights to put back their units to the fund, IFRS 10 might lead to consolidation when an investor holds the majority of or all the units in the fund, since it could force the liquidation of the fund.

Under existing requirements, the above rights might be considered to be protective in nature and, thus, would not lead to the consolidation of the investment fund.

- 2 *Investment funds managed by participants that contain guarantees* – Some investment funds for which participants provide guarantees (e.g. on certain levels of the net asset value) to retail investors at certain guarantee dates. Usually such type of funds are initially set up by participants that later manage them in exchange for a market management fee. IFRS 10 might lead to consolidation of such guaranteed investment funds if participants identify the set-up and adjustment of the investment mandate as the relevant activity. In addition, participants might be exposed to variable returns, due to the guarantees provided regardless of their probability. The exposure of participants and investors is different in nature and, for participants, this might influence the ongoing decisions related to the selection of the subsequent financial assets of the investment fund.

Under existing requirements these funds might not be consolidated if the probability of having a liability to pay under the guarantee was considered remote (the majority or risks and rewards criteria was not met).

- 3 *Investment funds managed by participants with high performance fees* – In such cases participants might conclude that they act as principals for certain investment funds that they manage after considering a range of factors such as the perception of high performance fees, their units in the investment fund, dispersion of other investors, and the removal rights held by others.

Under existing requirements, participants might not consolidate such investment funds if the removal rights held by others were considered substantive. Under IFRS 10, substantive removal rights would only be determinative if they were held unilaterally.

- 4 *Investment funds where the participants hold less than the majority of the units* – In such cases participants might identify funds for which they have the ability to affect its amount of variable returns (power) although their holding is less than 50%.

Securitisation entities and Asset repackaging SPEs

- 5 *Securitisations vehicles where participants hold junior notes and have the practical ability to influence variable returns* – In this cases securitisations would be consolidated under IFRS 10 if participants had the practical ability to influence variable returns of the SPE.
- 6 *Securitisations vehicles where participants hold the controlling class notes and have the practical ability to influence variable returns only in certain circumstances* – A financial interest greater than 50% of the controlling class could lead to control of the SPEs only if a certain event occurs, for example if the participant had the right to remove the special servicer or to liquidate the vehicle when there is a default event. Participants might consolidate the vehicle under IFRS 10 if the event triggering control has occurred, and they have a significant exposure to variable returns.
- 7 *Securitisations vehicles where participants have power to influence the returns and exposure to variable returns but do not obtain the majority of rewards* – Consolidation might be required under IFRS 10 in some cases where participants have the ability to control an SPE and some exposure to variability of returns (although not necessarily greater than 50%). Under existing requirements, certain securitisations vehicles might not be consolidated due to the fact that they failed the risks and rewards model although the company might have the power over such SPE.
- 8 *Securitisations vehicles where participants have legally transferred mortgage loans (originated asset-backed commercial paper programs)* – Participants often set up vehicles to transfer a portfolio of mortgage loans. The legal arrangement of such SPEs might specify the policy guiding the ongoing activities (autopilot vehicle). Although participants have transferred the portfolio of mortgage loans, they still have to administer and receive all interests and prepayments of the portfolio. Participants might also have the right of first refusal, (i.e. on the first option redemption date, the SPE would have to offer the portfolio of mortgage loans to the participant). Under the risk and rewards model of SIC-12, these vehicles might not consolidated given that the participants did not retain the risks.
- 9 *Asset repackaging SPEs where participants have the right to change the underlying collateral* – In such cases participants might conclude that they have the ability to control the relevant activities of such type of vehicles if they have power to change the underlying collateral. Under IFRS 10, participants would consolidate these vehicles if they are exposed to a more than an insignificant level of variable return (e.g. through a switch option or holding notes of the vehicle).

Under existing requirements, these vehicles might be consolidated when participants held the majority of risks and rewards.

SPEs that were consolidated under IAS 27/SIC-12 but that would not be consolidated under IFRS 10

Funds

- 10 *Investment funds managed by third parties where participants obtain the majority of the rewards and/or absorb the majority of risks* – In some cases investment funds would no longer be consolidated because participants do not have the ability to control them (for example, participants might have a financial interest in excess of 50% but do not have

removal rights or substantive liquidation rights). Under the risk and rewards model in SIC-12, these funds might be consolidated.

Securitisation entities and Asset repackaging SPEs

- 11 *Vehicles and securitisation entities where participants obtain the majority of the rewards and/or absorb the majority of risks* – Participants might not have power over certain vehicles when there are no ongoing decisions over the relevant activities or such ongoing decisions are made by third parties. Thus, participants cannot significantly affect the returns of the SPEs. This would be the case of SPEs that run on autopilot, since all decisions are determined at inception and detailed in the legal agreements, or SPEs where the counterparty can only direct the relevant activities (e.g. if the counterparty could select a special servicer which could not be removed by participants).