



30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: <http://www.iasb.org>

International
Accounting Standards
Board

This document is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. It does not represent an official position of the IFRIC. IFRIC positions are set out in Interpretations.

Note: These notes are based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: July 2006, London

Project: IAS 39 *Financial Instruments: Recognition and Measurement*
– **Securitisations: Derecognition of groups of financial assets**
(Agenda paper 11)

Background

1. At its March 2006 meeting, the IFRIC preliminarily concluded that one interpretation could be issued relating to the following two questions ('two questions') as summarised in the IFRIC Update:

The first issue was how the derecognition provisions of IAS 39 should be applied to groups of financial assets. The staff noted that, in practice, entities may transfer groups of financial assets which comprise non-derivative financial assets and derivatives. The staff noted that the key issue in this question was whether one derecognition test should be applied to such groups of financial assets, or whether separate derecognition tests should be applied (even though economically such groups of financial assets may be viewed as a single unit and cash flows from the financial instruments are grouped together).

The second issue was whether certain transfers of financial assets, as detailed below, should fall within paragraph 18(a) or paragraph 18(b) of IAS 39. IAS 39 differentiates two types of transfers: transfers of contractual rights to cash flows are set out in paragraph 18(a); and transfers in which the entity retains the contractual rights to cash flows and assumes a contractual obligation to pay cash flows to a recipient are set out in paragraph 18(b). If the transfer falls within paragraph 18(b), all of the 'pass through' conditions set out in paragraph 19

must be met. The transfers at issue include those where an entity can contractually agree to pass on cash flows without notifying the debtor; and those in which an entity may transfer contractual rights to cash flows subject to certain conditions, eg (i) conditions relating to the existence and legal status of the asset at the time of the transfer, (ii) conditions relating to the performance of the asset after the time of transfer, and (iii) offset agreements. The question arose whether, in these cases, the 'pass through' provisions set out in paragraph 19 should be applied.

2. IFRIC discussed the first question at the IFRIC meeting in May 2006. At that meeting the staff presented the IFRIC with the following Interpretation Options:
 - a. Option A: Apply separate derecognition tests to non-similar financial assets which are transferred in the same arrangement.
 - b. Option B: Apply single derecognition tests to entire groups of financial assets which are transferred in the same arrangement.
 - c. Option C: Par 16 of IAS 39 should be applied to determining whether the derecognition provisions are applicable to a portion of the asset, or to a portion of a group of similar assets, transferred in their entirety. The derecognition provisions of IAS 39 should be judgementally applied to the assets identified in Par 16 individually or on a combined basis.
3. May IFRIC Update reflects the following record of that meeting:

The IFRIC discussed the application of the derecognition requirements of IAS 39 Financial Instruments: Recognition and Measurement to transfers of groups of financial assets. In practice, entities transfer groups of financial assets which often comprise non-derivative financial assets and derivatives. The question is how to apply the derecognition provisions to such groups of assets.

The IFRIC discussed the meaning of the word 'similar' in paragraph 16 of IAS 39 in relation to grouping of similar assets in the derecognition test. Paragraph 16 states that 'In paragraphs 17–26, the term 'financial asset' refers to either a part of a financial asset (or a part of a group of similar financial assets) as identified in (a) above or, otherwise, a financial asset (or a group of similar financial assets) in its entirety.' The inclusion of the word 'similar' could imply that separate derecognition tests are required for assets that are not 'similar' even though they were transferred in a group in the same arrangement. If this was the case then the pass-through test in paragraph 19 of IAS 39 and the test of risks and rewards in paragraph 20 would be applied separately to the non-similar financial assets, even though they were transferred as a group.

The IFRIC discussed whether it had been the intention of the Board (evidenced by paragraph BC 53 of IAS 39) that paragraph 16 should define when the derecognition principles of IAS 39 could be applied to part of a financial asset (or part of a group of financial assets), rather than to require separate derecognition tests for non-similar financial assets being transferred in their entirety.

The IFRIC tended to the view that the wording of paragraph 16 of IAS 39 was not consistent with such intention. Accordingly, it directed the staff to consider the implications of an Interpretation which would align the wording in paragraph 16 of IAS 39 with the possible intention of the Board.

Staff analysis

4. At the May IFRIC meeting the staff was asked to *consider the implications of an Interpretation which would align the wording in paragraph 16 of IAS 39 with the possible intention of the Board*. That mandate raises two questions:
 - a. What was the intention of the Board at the time of writing IAS 39, and
 - b. How can that intention be applied to the more recent questions which are on the IFRIC agenda (as well as future issues that may arise)?
5. The staff does not consider that it will be possible to ascertain what the intention of the Board actually was without asking the Board directly.
6. For example, the May IFRIC meeting discussed the possibility that the Board's intended objective of IAS 39 Par 16 was not to define the application of the derecognition provisions to groups of assets, but to define when a part of an asset (or a part of a group of assets) can qualify for derecognition ('Intention'). This Intention is not in itself helpful in identifying the groups of assets to which the other derecognition provisions should be applied, such as the risks and rewards test (IAS 39 Par 20) and the pass through test (IAS 39 Par 19).
7. Due to the nature of the two questions on the IFRIC agenda and because of the limited guidance in IAS 39, the staff considers that it is inevitable that Board involvement is necessary. The staff therefore believes that both questions should be directed to the Board sooner rather than later
8. The staff are further concerned by the extent of possible questions for interpretation which may arise on derecognition in IAS 39, and securitisation transactions in particular. For example, FAS 140: *Accounting for Transfers and Servicing of*

Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125 which was issued in September 2000 continues to see significant interpretation questions. These questions require considerable FASB Board time.

9. Consequently the staff recommends that the broader question relating to interpretation of how IAS 39 is applied to derecognition transactions should be considered by the Board. For example it may be more efficient for the Board to make wording changes to IAS 39 only once a significant number of queries have been received. Alternatively the Board may consider that no changes to IAS 39 should be made in respect of derecognition transactions, that practice should be allowed to develop and that staff resources be devoted to the longer term research project on derecognition. The Board may also decide that the wording in IAS 39 is clear and that the IFRIC should continue to interpret derecognition issues as they arise.
10. If the IFRIC support the staff recommendation to refer these matters to the Board then the staff would seek to include them on the September 2006 Board agenda.

Question for the IFRIC

1. Does the IFRIC agree with the staff that the two questions relating to securitisation transactions be referred to the Board?
2. Does the IFRIC agree that the IFRIC should ask the Board how it should deal with future questions on derecognition?