

19 March 2009

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Submitted via the "Open to Comment" page at www.iasb.org.

Dear Sirs

Exposure Draft ED10 – Consolidated Financial Statements

I am writing on behalf of LIBA (the London Investment Banking Association) to comment on the IASB's 18 December Exposure Draft: *Consolidated Financial Statements* ("the ED"). LIBA is, as you know, the principal UK trade association for firms active in investment banking and securities trading; a list of our members is attached.

We would firstly compliment the IASB on the extensive and constructive informal consultation that has already taken place on this difficult and important topic. The investment banking industry's extensive use of SPEs make this ED particularly significant for our members, and we are therefore very pleased to have had the opportunity to participate in the earlier informal discussions and to provide our more formal comments in this letter.

In general we support the overall principles on which the ED is based, and we fully endorse the Board's stated aims which are set out in Paragraph BC3. We do however have a number of general reservations about the ED as it currently stands, which we feel suggest that substantial further work will be required before the proposed IFRS can be considered a significant improvement over the existing standards, and can therefore be used as a practical replacement. In particular, we find that:

- * the lack of a unified approach for both structured and non-structured entities leads to potentially inconsistent results, both in terms of consolidation analysis and disclosure;
- * the definition of control in Paragraph 4 requires only that a parent have the power to direct activities to generate returns; we believe that an entity does not control another unless it has the power to direct its activities, and obtains significant returns as a result of that power;
- * it is unclear whether the definition of control is intended to refer to de facto control, or whether it is the right to control; we believe it should be the current right to control and that this should be applied consistently;

- * it is not clear whether certain statements in the ED are intended to be taken as basic principles, presumptions to be rebutted, or examples; such ambiguities need to be removed;
- * the disclosure requirements as currently drafted focus on the nature of the entity concerned, rather than on the risk exposure of the reporting entity; we believe the focus should be on the risk to the reporting entity, and that any additional granularity of risk by entity which the IASB might consider desirable should be restricted to entities through which the reporting entity has significant exposure to risk; and
- * the listing of minimum disclosures could create a boilerplate approach of standardised, and potentially meaningless, disclosures; we believe the IASB should encourage disclosures of risk as seen through the eyes of management in order to obtain relevant information.

We have two further general comments:

- * many of the structures used by our industry combine derecognition issues with those of consolidation; we therefore find it difficult to comment on some of the proposals in this ED without knowing the details of the IASB's proposed derecognition model; and
- * we urge the IASB to continue working with the FASB to achieve a consistent global consolidation model over the short to medium term; we also urge both Boards to use common language and terminology wherever possible in order to minimise the risk of unintended divergence or differences.

Our responses to the specific questions on pages 7-13 of the ED are set out below.

Question 1

Do you think that the proposed control definition could be applied to all entities within the scope of IAS 27 as well as those within the scope of SIC-12? If not, what are the application difficulties?

Subject to the practical points below, we welcome the proposed common definition of control for both SPEs and non-SPEs. We note however that control is further explained in the structured entity section (Paragraph 33) as having the power "to direct the activities that cause the returns to vary". We consider this definition to be stronger, and therefore preferable. Using it for all entities would preclude the need to include specific guidance for structured entities, with the consequent risk of creating two approaches to consolidation that may not always lead to the same answer. The definition of structured entities and the guidance in that section would then be more clearly seen as applicable to any entity where the identification of the party possessing control is not clearly established through voting or similar rights.

Within the current definition we think it would be helpful if the proposed IFRS were to emphasise more clearly the linkage between the "power to direct the activities" and the "returns" of an entity. It should also state more clearly that it is the ability to use control to significantly vary the returns from the entity that is important.

We have identified a number of “application difficulties” that are likely to arise from the present wording of the sections that relate to “control”; most of these arise from a lack of clarity, which we believe could lead to inconsistency in interpretation and application:

- * The nature of the “activities” which are to be directed is not defined: we believe it should be those activities that most significantly affect the variability of the returns on assets held by an entity. This would require a reporting entity to appropriately evaluate its involvement with an entity, particularly when different parties have decision-making powers with respect to different activities.
- * We do not think power is clearly or consistently defined. In particular it is not clear whether the Board intends the focus to be on de facto power or on legal power.
- * We agree with the statement (in Paragraph 12) that “a reporting entity need not have exercised its power to direct the activities of an entity to control that entity”. We believe it is the current right to direct that is key, irrespective of whether that right is actually being exercised. We also believe that the reverse applies: where a reporting entity is currently directing the activities of another entity, even though another party has the formal power to do so, then the first entity should not be viewed as having the power to control. These points need to be applied consistently: for example a minority shareholder does not have power as they can be outvoted, while a passive shareholder does have power even if he chooses not to vote.
- * We believe the ED needs to state more clearly that it is power and variability of returns that are key in determining control.
- * We believe the guidance should state that a reporting entity needs to have power over those decisions which significantly affect the performance of the entity (or variability of returns), and to share significantly in that variability.
- * It is not always clear which returns should be ignored for the purposes of determining consolidation; for example does “returns” include those which do not vary? Paragraph 10 states that “returns ... vary with that entity’s activity”, but Paragraph 11 states that “returns ... can include” non-variable items such as upfront fees (and Paragraph 20 contains a similar statement). Alternatively does the inclusion/exclusion depend on whether a return is market based? Paragraph BC54 implies that fees for services can be ignored if they are “commensurate with the service provided”. We believe that only those returns that vary are relevant to whether one entity controls another.

Question 2

Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation?

Yes. This is both consistent with existing IFRS and with the most common definition used in other GAAPs. We would however prefer a requirement that the returns generated for the reporting entity are significant to the entity which generates them.

Question 3

Are the requirements and guidance regarding the assessment of control sufficient to enable the consistent application of the control definition? If not, why not? What additional guidance is needed or what guidance should be removed?

The assessment of control requires assessment of both power and returns. We have a number of concerns with the guidance for both elements.

We find the guidance on returns to be unclear in a number of respects. In general we understand the ED to intend that a parent is exposed to the returns of a subsidiary to some degree (we suggest this should be to a significant degree), and that it controls decisions that affect those returns. We do not agree with this principle as we believe that an entity must direct the activities of, and be exposed to significant variability in the returns from, another entity before its consolidation is required. Without this “significance threshold” in relation to variability in returns we believe that inappropriate consolidation conclusions will be reached in a number of circumstances.

Some of the guidance on returns also seems inconsistent with the principle set out in the ED:

- * We find the Paragraph 13 statement that “power ... is generally correlated with ... exposure to the variability of returns” to be unclear, and not necessarily correct. If the reporting entity has significant exposure to variability of returns, but has at most very limited power, then Paragraph 13 does not hold; does it follow that consolidation is not required? If, by contrast, the reporting entity has considerable power, but limited exposure to the variability in returns, then it should presumably be consolidated. We believe the statement is not intended to be a rebuttable presumption, and recommend that this should be made clear.
- * Paragraphs 19-20 discuss “assessing returns”, but we find it unclear how the results of this assessment are intended to feed into the assessment of control.
- * The example in Paragraph 20 is unclear: even if there were no fixed fee, the credit and liquidity support would presumably comprise “returns”, so why is it necessary to include the fixed element at all? Aggregation is only important if there is a focus on the absolute level of returns to which the party that directs the activities of the entity is exposed. As noted above, we believe this concept should be appropriately developed to focus on variability in returns, and a significance threshold should be included in any final standard.
- * The assertion that power is generally correlated with exposure to the variability of returns is even less clear when dealing with structured entities, where this assumption is restated, but the concepts of significance and relative size of the returns are introduced.

We have also noted some application difficulties in terms of assessing power:

- * Our principal concern, as highlighted in our summary comments above, is that it is unclear whether the ED is focusing on current/de facto control or on legal control. Paragraph 28 suggests that de facto control is key, even in a case where other shareholders may have the technical ability to override a large shareholder. Paragraph 23, on the other hand, states that a shareholder has “power” if they have “the power to

appoint or remove (board members)”, even if that power has not been exercised; this suggests that legal control should be paramount.

- * We do not believe it is right to consider that an entity has power when it could currently be removed, outvoted or generally countermanded by other entities. Hence we do not believe the minority shareholder in the Paragraph 28 example should consolidate on the information given.

Question 4

Do you agree with the Board’s proposals regarding options and convertible instruments when assessing control of an entity? If not, please describe in what situations, if any, you think that options or convertible instruments would give the option holder the power to direct the activities of an entity.

As noted previously, it is unclear whether the IASB considers de facto control, or the ability to exercise control regardless of the actions of other parties, to be the more significant. This distinction is key when looking at options and convertible instruments. More specifically, we find the proposals to be unclear in several respects:

- * An option will not in itself give current (de facto) control. It may however, depending on exercise terms, give the ability to take control either now or in the future.
- * To assess whether an option holder has current control the ED requires the reporting entity to look at other arrangements/terms. Paragraph B14 instructs a reporting entity to consider what power it has from “arrangements other than those that give (present) voting rights”, which suggests that special rules are not required for options or convertibles.
- * We believe it is the current ability to take control that matters, and that the ED should therefore distinguish between currently and non-currently exercisable options, taking into account whether it is economically rational to exercise the options, and any other features that may restrict the holder’s ability to exercise. Where an option-holder is not restricted in its ability to exercise the options, we would consider the options in the same way as shares held by a passive shareholder. We would also add that the existence and terms of any options should not be the sole determining factor, but should be analysed along with all salient facts and circumstances relating to a particular entity.
- * We also consider that the treatment should be symmetrical and that existing shareholders need to take account of the presence of currently exercisable options when evaluating control.
- * We find Paragraph B13 adds further confusion:
 - It is not clear whether the statement in B13(a) (“the governing body determines ... policies in accordance with the wishes of the reporting entity”) is intended to be a rebuttable presumption - e.g. if options give a holder more than 50% of votes, do we assume that they have control, or look for other evidence that demonstrates control? If the latter, what form would this evidence be expected to take? In this case should we not distinguish between the effects of those options that are currently exercisable and those that are not?

- B13(b) appears unnecessary: this is simply an iteration of the agency concept. It is clear that if the person who holds the votes holds them only as agent, then the principal has control. The issue is what factors about an option would mean that the current shareholder is only an agent. It is not clear, furthermore, how to apply this guidance for instruments such as warrants or convertible debt, where the counterparty is the entity itself.
- * We find the guidance regarding options, etc. is not consistent with other parts of the ED. For example, an option exercisable in specific circumstance may create a protective right and would not indicate control, whereas the guidance in Paragraphs 34 and 35 suggests that a right to exercise control over the activities of a structured entity, which can only be exercised at some point in the future and/or which may be contingently exercisable, would create a presumption of control.

Question 5

Do you agree with the Board’s proposals for situations in which a party holds voting rights both directly and on behalf of other parties as an agent? If not, please describe the circumstances in which the proposals would lead to an inappropriate consolidation outcome.

We agree that votes (or control) held in an agency capacity should generally be ignored by the agent and attributed to the principal when determining control - regardless of what other positions are held, but we have a number of questions on related points:

- * Does the same rule apply to control/decision making powers of any kind which are held on behalf of another? We believe it does and that this should be made explicit.
- * Is the rule meant to include only “legal” agents or does it extend to the broader concept of de facto agency? We believe that the type of de facto agent discussed in FIN 46(R) should also be considered and that this should be clarified in the ED. If, for example, a reporting entity’s exposure to another entity is created indirectly via a third party intermediary (e.g. through a derivative contract), in what circumstance should we treat that third party as an agent?
- * Greater clarity is needed regarding which characteristics are necessary to be an agent, which are sufficient in themselves to make a party an agent, and which are merely indicative. Currently there appear to be two criteria, based on removal rights and remuneration. We believe there should be more clarity as to how they will operate. We also think these are not the only criteria that must be considered in determining whether one party is acting as agent on behalf of another.
- * In particular, the standard should address:
 - how removal rights should be treated where they are held by more than one party (i.e. clarification should be provided setting out that removal rights are still indicative of an agency relationship when they are considered substantive); and
 - situations where the agent also holds an interest in the underlying entity.

- * The agency rules are drafted mainly in the context of fund management arrangements and should be applicable to a broader range of agency arrangements, including in particular those where the agency relationship arises from “unwritten” or “implicit” arrangements.

Question 6

Do you agree with the definition of a structured entity in paragraph 30 of the draft IFRS? If not, how would you describe or define such an entity?

We find the proposed definition to be unclear, and we also question whether it is necessary to have a separate set of rules for structured entities. In particular, the definition appears to focus on restricted activities, but it is unclear whether the key test is intended to be restrictions on the activities of the entity or restrictions on the ongoing decisions that are made.

We do not believe that there should be a divide between “non-structured” and “structured” entities. In practice there is a continuum of entities, ranging from those where every key decision is made on an ongoing basis by shareholders/Board of Directors and other parties to those where no significant ongoing decisions are required (whether because there are either no decision points or because all significant decisions have been predetermined). As such, the appropriate consolidation decision for any entity should take account of all of the relevant guidance.

We would also welcome clearer and more explicit discussion of the entity concept and the use of silos, as these concepts are important in many areas of our business.

Question 7

Are the requirements and guidance regarding the assessment of control of a structured entity in paragraphs 30–38 of the draft IFRS sufficient to enable consistent application of the control definition? If not, why not? What additional guidance is needed?

As is evident from our previous comments, we believe the proposed requirements and guidance lack a clear statement of principle and remain unclear in a number of respects, and therefore fall some way short of what is required. In particular:

- * We find the purpose of a number of statements in the ED to be unclear. Is, for example, the Paragraph 32 statement that “a reporting entity is likely to control a structured entity that has been created to undertake activities that are part of the reporting entity’s ongoing activities” intended to be read as a rebuttable presumption? We believe this statement should not be a rebuttable presumption, but should rather be one of the indicators to be considered in determining the control of an entity.
- * There is no guidance on how to weight or evaluate different indicators which may lead to different conclusions: for example, does one clear indicator override any less clear ones, or is it necessary to take an overall view of all such factors? We believe the latter to be the appropriate approach.
- * Where an entity is established so that only trivial decisions (i.e. decisions which do not significantly impact the variability of the entity’s returns) are made, it does not seem appropriate to consolidate on the basis of these decisions alone, which could be one interpretation of Paragraph 35. The IFRS should make it clear that this is not the case:

evaluation of decision-making rights should depend on the specific facts and circumstances, appropriately weighted alongside any other indicators.

- * It is not clear why the conditional ability to make ongoing decisions in the future should be key to the consolidation analysis. From the basis of conclusions it appears this ability may be seen as indicative that the existing structure has been established on behalf of the entity with the conditional decision-making ability, and is therefore run according to that entity's wishes. We do not believe conditional control should lead to consolidation, as it is current power over the key decisions affecting returns that is paramount.
- * Different conclusions could be drawn based on similar circumstances, depending on whether the entity is deemed to be structured or non-structured. This could give rise to confusion and structuring arbitrage; for example:
 - Paragraph 34 states that an entity has power when it has the future ability to act, including situations where access to this ability may be out of its control (e.g. votes which are only conditionally exercisable), rather than when it has actual current power.
 - Paragraph 38 is not limited to participative rights and may lead to the conclusion that holders of rights which are only protective in nature will control a structured entity.
- * Paragraph 31 states that "it is necessary to identify how returns ... are shared", but why this is necessary, and the consequences of the results of this analysis, are both unclear. We believe this could be interpreted as requiring a "risks and rewards fallback" assessment, which we understand is not the Board's intention; we therefore strongly urge that this guidance be removed.
- * Paragraph 33 ("Returns") brings in a new criterion: whether an entity "is exposed to the variability of returns that are potentially significant to the structured entity and the reporting entity's exposure is more than that of any other party", which raises a number of issues:
 - The relative size of returns appears to be significant for a structured entity. References to returns elsewhere in the ED do not factor in size, either in absolute terms or relative to other interest holders.
 - The wording suggests it is the variability of returns that matters rather than the absolute value. Is this correct and, if so, how would variability be assessed where returns cannot be quantified in purely monetary terms (for example the ability, as described in Paragraph 11(b), to make use of the assets of the entity)?
 - It is not clear how variability of returns should be assessed. If the intention is to follow the approach of FIN 46 (R) then more guidance is required; again this should also explain how non-financial returns should be brought into such an evaluation.
 - Testing whether "the reporting entity's exposure is more than that of any other party" may require a detailed knowledge of other shareholdings. If, for example, one shareholder has 10% with ten others holding 9% each, does the 10% shareholder qualify under this criterion? We do not believe that the level of returns held by a

party that directs the activities of the entity relative to those held by others is a relevant factor when considering whether consolidation is required

- The inclusion of non-financial factors in the assessment of returns may make it difficult to assess the relative exposure of different parties, as the returns accruing to an individual party may reflect its particular relationship with the entity and not be transparent to others; we therefore believe non-financial factors should not be included in the determination of returns.
- * Paragraphs 34-36 (“Activities”) also raise a number of issues:
- The statement that a reporting entity “does not have to exercise power in order to have power to direct ...” seems anomalous, and could lead to a situation where there are assets on the balance sheet over which the reporting entity has no current control.
 - It seems inconsistent that this criterion takes account of power which is not yet exercisable in this case, while no account is taken of options and other conditional voting rights which are not yet exercisable.
 - Different entities may have their decision-making powers triggered by different activities or circumstances: this criterion could suggest that all parties that might gain decision-making powers in the future should consolidate, which is contrary to the principle that control is not shared.
- * Does the reference in Paragraph 38 (“Ability to change restrictions ...”) to a “right to dissolve an entity ...” mean that the party with liquidation rights should consolidate even if their control through these liquidation rights is conditional, or only if the rights are currently exercisable? We believe the consequences and costs of exercising the liquidation rights should be taken into account in the consolidation decision, but should not be sufficient in isolation to trigger consolidation.

Question 8

Should the IFRS on consolidated financial statements include a risks and rewards ‘fall back’ test? If so, what level of variability of returns should be the basis for the test and why? Please state how you would calculate the variability of returns and why you believe it is appropriate to have an exception to the principle that consolidation is on the basis of control.

We disagree with the suggestion of a “fall back” test, which we feel goes against the principle of consolidation based on control. We believe that returns should be viewed as just one indicator among many, the weighting of which will depend on the facts and circumstances.

Question 9

Do the proposed disclosure requirements described in paragraph 23 provide decision-useful information? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

While supporting the disclosure principles set out in Paragraph 48, we believe that the application guidance is overly prescriptive and could force a reporting entity to produce

voluminous and potentially irrelevant disclosures that may obscure the key information that users of the financial statements should focus on.

We believe that disclosures should focus on the key risks associated with the results/performance reported, rather than on the nature of the entity in which these risks arise. In general these are already covered by IFRS 7, and any additional risks etc should be subject to disclosures based on the same principles as IFRS 7 (namely through the eyes of management).

In addition to the reasons stated above, we do not support the differentiation of structured and non-structured entities, because it places undue stress on the classification of entities and hence on the definition of structured entities. However, we do not support extending the disclosures proposed in the ED for structured entities to non-structured entities, preferring a risk-based approach along the lines indicated in the previous paragraph.

We also have a number of specific application concerns regarding the disclosures in respect of unconsolidated entities:

- * We believe disclosure should be required only where there is a significant level of ongoing involvement. We agree with the Board's view, as set out in Paragraph BC137, that disclosures should be limited to those involvements which expose the reporting entity to substantial risk. Currently this is not the case, because a reporting entity is required to disclose all structured entities for which it is the sponsor regardless of the level of continuing involvement. Entities with which the reporting entity has little or no involvement are also captured by the requirements, which we find to be inappropriate.
- * The ED requires disclosure of entities that are not consolidated where the reporting entity is exposed to returns that may be significant to the structured entity. We believe this is too wide a disclosure and would not clearly identify the exposures that actually need to be disclosed. We believe that risk-based disclosure and qualitative disclosure will be more valuable and more understandable for users.
- * We think a number of the requirements are unclear, for example:
 - Income: it is unclear whether the ED intends to capture any cash flows with an entity, fee income only, or any income amounts arising from involvement with an entity.
 - Maximum exposure to loss: the Board should clarify what is intended to be disclosed, particularly for derivatives where the theoretical maximum loss may not be calculable, and also how hedging should be taken into account.

A number of the disclosures seem to mirror those in the recently issued US revisions to FIN 46(R) and to FAS 140. However, some of those disclosures focus on vehicles involved in transfers of financial assets and are relevant only in that context. We therefore urge the IASB to include these in its derecognition project, rather than in this project.

Question 10

Do you think that reporting entities will, or should, have available the information to meet the disclosure requirements? Please identify those requirements with which you

believe it will be difficult for reporting entities to comply, or that are likely to impose significant costs on reporting entities.

We see significant problems here: where the consolidating entity has limited (or no) current control and no rights to any information, it is likely to prove difficult, if not impossible, to obtain the required information on a timely basis. There may also be legal obstacles to disclosing information which is not publicly available.

A separate issue is whether two years of comparative data should be required; this is not required by other IFRS and may be particularly difficult to obtain. If two years' comparatives are deemed essential, the transitional arrangements should allow this to be phased in.

Question 11

(a) Do you think that reputational risk is an appropriate basis for consolidation? If so, please describe how it meets the definition of control and how such a basis of consolidation might work in practice.

(b) Do you think that the proposed disclosures in paragraph B47 are sufficient? If not, how should they be enhanced?

We do not believe reputational risk to be an appropriate basis for consolidation: it is too subjective, and generally cannot be clearly identified in advance.

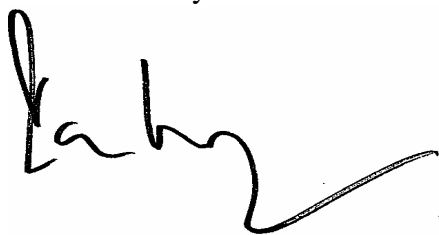
Question 12

Do you think that the Board should consider the definition of significant influence and the use of the equity method with a view to developing proposals as part of a separate project that might address the concerns raised relating to IAS 28?

We think this would be a useful step: the treatment of associates needs to be reviewed in the light of the current proposals and the forthcoming standard on Joint Ventures.

Despite its somewhat critical nature, I hope this letter will be helpful to the Board in deciding how to take this project forward. We would of course be very pleased to expand on any points which you may find unclear, or where you would like further details of our views, either in the context of further detailed dialogue with IASB staff or in any other way that the Board may find helpful.

Yours sincerely



**Ian Harrison
Director**

LONDON INVESTMENT BANKING ASSOCIATION

LIST OF MEMBERS

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Altium Capital Limited	Instinet Europe Ltd
Ambrian Partners Limited	Investec plc
Arbuthnot Banking Group PLC	Jefferies International Limited
Arden Partners plc	JP Morgan Cazenove Ltd
Banc of America Securities Limited	JP Morgan Securities Ltd
Barclays Capital	KBC Peel Hunt Ltd
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