

Fundamental Principles of Group Accounts



- A True and Fair View of the Group
- What make up a Group? Parent and Subsidiaries (Control-based Definition)
- No control means no group relationship and no need for consolidation
 - The “Genuine” sale situation of a Securitization transaction (sale by an originator to a party over which they have no control at all)



A Genuine Sale Situation – Control





Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE at \$1,000,000	<u>Liabilities</u> Assets-backed Securities Not Relevant as they are NOT issued by originator	<u>Assets</u> Securitized Assets Derecognized	<u>Liabilities</u> Asset-backed Securities Not Consolidated	Group A/C
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A Controlled-SPE Situation (**With** guarantee provided by the Parent)

Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE at \$1,000,000	<u>Liabilities</u> Contingent Liability disclosed in the footnote
SPE's A/C	<u>Assets</u> Securitized Assets \$1,000,000	<u>Liabilities</u> Asset-backed Securities \$1,000,000



A Controlled-SPE Situation (**With** guarantee provided by the Parent)

Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE at \$1,000,000	<u>Liabilities</u> Contingent Liability disclosed in the footnote	<u>Assets</u>  Securitized Assets Recognized \$1,000,000	<u>Liabilities</u>  Asset-backed Securities Consolidated \$1,000,000	Group A/C (P+SPE)
SPE's A/C	<u>Assets</u> Securitized Assets \$1,000,000	<u>Liabilities</u> Asset-backed Securities \$1,000,000			

A Controlled-SPE Situation (Without guarantee undertaken by the Parent)

Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE	<u>Liabilities</u> No need to record the Contingent Liability
SPE's A/C	<u>Assets</u> Securitized Assets \$1,000,000	<u>Liabilities</u> Asset-backed Securities \$1,000,000

A Controlled-SPE Situation (Without guarantee undertaken by the Parent)



Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE	<u>Liabilities</u> No need to record the Contingent Liability	<u>Assets</u>  Securitized Assets Recognized \$1,000,000	<u>Liabilities</u>  Asset-backed Securities Consolidated \$1,000,000	Group A/C (P+SPE)
SPE's A/C	<u>Assets</u> Securitized Assets \$1,000,000	<u>Liabilities</u> Asset-backed Securities \$1,000,000			

Off-Balance Sheet Treatment of a Controlled SPE

Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE	<u>Liabilities</u> Contingent Liability or No Liability
SPE's A/C	<u>Assets</u> Securitized Assets \$1,000,000	<u>Liabilities</u> Asset-backed Securities \$1,000,000

Off-Balance Sheet Treatment of a Controlled SPE

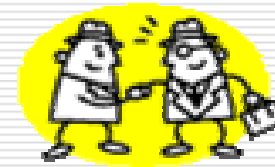
Parent's A/C	<u>Assets</u> Securitized Assets Removed as it is sold to the SPE	<u>Liabilities</u> Contingent Liability or No Liability
SPE's A/C	<u>Assets</u> Securitized Assets \$1,000,000	<u>Liabilities</u> Asset-backed Securities \$1,000,000

<u>Assets</u> 	<u>Liabilities</u> 	Group A/C (P+SPE)
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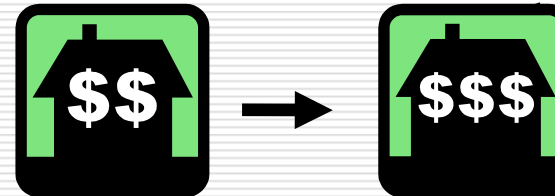
Note: You know what, the parent company has sold assets to a controlled SPE. Had it been consolidated, the securitized assets would amount to \$1,000,000. The asset-backed securities amount to \$1,000,000.

Companies (Amendment) Bill 2004

- Align the “Control”-based Definition of CO more closely with IAS



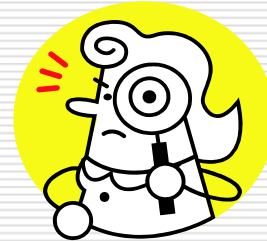
- Introduction of a “Dominant Influence” Test to Catch “Controlled-SPE” belonging to the Group



- Substance Over Form: To plug the loophole of the existing narrower consolidation requirements under CO

Impact on Securitization Market

□ Adverse Impact on Ratios !?



□ To Sophisticated Investors?

- They can see through off-balance-sheet window dressing all the time.

□ To General Ordinary Investors !?

- Consolidation presents a clearer picture



□ Consistency for corporations using either IAS or HKAS

□ Better Financial Reporting means Better Market Quality.

Hong Kong as an International Financial Centre



Importance of Corporate Governance

Transparency of Financial Disclosure



Investor Protection

Market Quality



Quality of Financial Reporting Standards:
Convergence with IFRS