



Accounting Standards Board

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Françoise Flores
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18 April 2011

Dear Françoise

EFRAG Draft Comment Letter on the IASB Exposure Draft 'Offsetting Financial Assets and Financial Liabilities'

Thank you for providing the UK Accounting Standards Board (ASB) with the opportunity to comment on your draft comment letter (DCL) to the International Accounting Standards Board's (IASB's) Exposure Draft (ED) 'Offsetting Financial Assets and Financial Liabilities'.

In common with EFRAG, the ASB considers that it is important for the IASB and FASB to achieve a common solution for offsetting. That said, the ASB disagrees with the EFRAG DCL as it supports the existing requirements in IAS 32 *Financial Instruments: Presentation* as a basis for the converged requirements. As set out in our response to the IASB (attached), we do not believe that the offsetting criteria as proposed by the IASB are appropriate for derivatives under Master Netting Agreements (MNAs) and we would support net presentation for these instruments.

We share EFRAG's view that both gross and net information is important to users. As such, we believe that the benefits of the proposed disclosures outweigh the costs. That said, similar to EFRAG, we also consider that there is a need for the IASB to review the existing disclosures in IFRS 7 *Financial Instruments: Disclosures* in conjunction with the proposed disclosures on offsetting and more widely across the other phases of its financial instruments project.

Should you have any queries regarding this response please contact Deepa Raval, Project Director, on +44 207 492 2424 or by email d.raval@frc-asb.org.uk.

Yours sincerely

A handwritten signature in black ink that reads "Roger Marshall". The signature is written in a cursive, slightly slanted style.

Roger Marshall

Chairman

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Christian Kusi-Yeboah
International Accounting Standards Board
30 Cannon Street
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18 April 2011

Dear Christian

IASB ED Offsetting Financial Assets and Financial Liabilities

This letter sets out the comments of the UK Accounting Standards Board (ASB) on the IASB Exposure Draft (ED) *Offsetting Financial Assets and Financial Liabilities*.

We believe that achieving a converged solution for offsetting is essential. Both gross and net information is important for users but consistent presentation for financial assets and financial liabilities should be the overriding consideration.

We do not support the offsetting criteria as proposed in the ED. As such, we believe that the IASB should take this opportunity to re-visit the presentation of derivatives under Master Netting Agreements (MNAs). In our view, net presentation for these instruments provides better information for a number of reasons:

Generation of future cash flows

- a) Derivatives are required to be reported at fair value which is already a net amount that reflects the present value of the expected net cash inflows and outflows of the contract. Given the conditional and leveraged nature of derivative contracts, the actual cash flows are not discernable from the fair value of that contract. Additional disclosures would be required in order to obtain information about the nature, timing and extent of future cash flows (and other risks) relating to derivatives.

Credit risk

- b) Net presentation better reflects the credit risk exposure for derivatives under MNAs. In the event of default of a counterparty, derivatives under MNAs would be settled net.

Liquidity risk

- c) Collateral is posted daily based on the net fair value open positions with a counterparty. Net presentation is consistent with the way collateral is calculated and therefore provides better information on liquidity.

The ASB has a general concern about the proposed disclosures. In isolation, we agree that the proposed disclosures provide better information on offsetting arrangements. That said, we are concerned that the IASB is adding additional layers of disclosure in its proposals on hedge accounting, impairment and offsetting. This increases the disclosure burden for preparers and increases clutter in financial statements without necessarily improving the usefulness of information to users. Therefore, we recommend that the IASB reviews IFRS 7 and eliminates those disclosures which do not provide useful information. In particular, IFRS 7 contains disclosures that are similar but less targeted than those proposed in the offsetting ED.

If you would like to discuss these comments, please contact Deepa Raval on 020 7492 2424.

Yours sincerely



Roger Marshall
Chairman

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Appendix: responses to questions set out in the ED

Question 1 – Offsetting criteria: unconditional right and intention to settle net or simultaneously

The proposals would require an entity to offset a recognised financial asset and a recognised financial liability when the entity has an unconditional and legally enforceable right to set off the financial asset and financial liability and intends either:

- (a) to settle the financial asset and financial liability on a net basis or
- (b) to realise the financial asset and settle the financial liability simultaneously.

Do you agree with this proposed requirement? If not, why? What criteria would you propose instead, and why?

No. We do not believe that the offsetting criteria as proposed are appropriate for derivatives under Master Netting Agreements (MNAs) for the reasons set out in our covering letter.

Legal right and intention

We agree that the offsetting criteria should include the presence of a legal right of set off and the intention to settle on a net basis or realise simultaneously. That said, we have a concern that the wording used to explain ‘simultaneous’ is too restrictive as noted below.

It has been brought to our attention that some constituents are taking the view that the application of simultaneous settlement (paragraph 10(f)) to transactions that are “executed at the same moment” would prevent transactions on an exchange from meeting the requirement to “realise the financial asset and settle the financial liability simultaneously”. We note that IAS 32 also requires “transactions to occur at the same moment” but this approach does not reflect practice where transactions are offset through an exchange. We would suggest the term ‘at the same moment’ is replaced with a phrase along the lines of the following ‘within a short period of time, where the transactions occur through an exchange and during that period an entity’s exposure to credit risk is minimal’.

Presentation

We believe that consistent presentation between IFRS and US GAAP should be the overriding consideration. To improve comparability, we agree that the offsetting should be required when the criteria are met rather than an option as in US GAAP.

We note that US GAAP also permits net presentation for repos and reverse repo agreements. For the avoidance of doubt, we do not believe that these types of arrangements should be offset.

Question 2—Unconditional right of set-off must be enforceable in all circumstances

It is proposed that financial assets and financial liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of set-off. The proposals specify that an unconditional and legally enforceable right of set-off is enforceable in all circumstances (i.e. it is enforceable in the normal course of business and on the default, insolvency or bankruptcy of a counterparty) and its exercisability is not contingent on a future event. Do you agree with this proposed requirement? If not, why? What would you propose instead, and why?

No. We do not agree with the criterion for an unconditional right of set-off as this would prevent offsetting for derivatives under MNAs. We do not believe that gross presentation reflects the business model or provides useful information (see our response to question 1 above) for such instruments. Consequently, we would like derivatives under MNAs to qualify for offsetting.

Question 3—Multilateral set-off arrangements

The proposals would require offsetting for both bilateral and multilateral set-off arrangements that meet the offsetting criteria. Do you agree that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements?

If not, why? What would you propose instead, and why? What are some of the common situations in which a multilateral right of set-off may be present?

Yes. We agree that the offsetting criteria should apply to both bilateral and multilateral set-off arrangements. We believe that offsetting should not be limited to arrangements between two parties.

Question 4—Disclosures

Do you agree with the proposed disclosure requirements in paragraphs 11–15?

If not, why? How would you propose to amend those requirements, and why?

Yes. We broadly agree with the proposed disclosure requirements as both gross and net information is important for users. In particular, the disclosures on the net amounts, as required in paragraph 12, provide useful information about an entity's credit risk. The IASB may want to consider whether requiring an analysis of credit risk by say top five counterparties may be useful information for investors.

Although we agree with the proposed disclosures in this ED on a standalone basis, we note that IFRS 7 contains disclosures that are similar but less targeted than those proposed in the offsetting ED. We are concerned that this could result in duplication. We also have a general concern that the IASB is adding additional layers of disclosure in its proposals on hedge accounting, impairment and offsetting. This increases the disclosure burden for preparers and increases clutter in financial statements without necessarily improving the usefulness of information to users.

Therefore, we recommend that the IASB reviews IFRS 7 and eliminates those disclosures which do not provide useful information.

Question 5 – Effective date and transition

(a) Do you agree with the proposed transition requirements in Appendix A?

If not, why? How would you propose to amend those requirements, and why?

(b) Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.

(a) Yes. We agree with the proposed transition requirements.

(b) We believe that the effective date should not be before 1 January 2013 so that preparers have some time to gather the data for comparative disclosures.

As the proposals only affect balance sheet presentation it is likely that many entities will already have the information required in some form but may need a short lead time to collate the information required for the additional disclosures.

Ideally, the effective date should be aligned with the effective date for IFRS 9 so that preparers can implement all the new disclosure requirements in IFRS 7 at the same time.