

Banking supervision
And Accounting issues Unit
The Director

Paris, April 18th 2010

# FBF Response to the Exposure Draft: Offsetting Financial Assets and Liabilities.

Dear Sir,

The French Banking Federation (FBF) is pleased to have the opportunity to respond to the Exposure Draft "Offsetting Financial Assets and Financial Liabilities".

We welcome the common approach of the boards of the FASB and the IASB regarding the offsetting criteria for financial assets and financial liabilities as it would help to provide more comparability between entities reporting under IFRS and USGAAP.

We agree with the proposed definition of offsetting based on the current provisions of IAS 32 completed with the unconditional right to offset. We welcome as well requiring offsetting for both multilateral and bilateral arrangements that meet the offsetting criteria.

However we have concerns on the guidance in paragraph C11 which would prevent some repos and reverse repos with clearing houses from being offset due to processing constraints whereas settlement could be regarded as simultaneous when no counterparty or liquidity are undertaken by the entity within the clearing house.

We believe the guidance is paragraph C14 may be confusing as it would not permit offsetting even where criteria of offsetting are met. This would be the case with derivative contracts with clearing houses where payments incorporate margin and cash flows of the derivatives.

We also have concerns regarding the disclosure requirements which are expanded. We would recommend the Board of the IASB to consider the proposals made in relation with the existing IFRS 7 requirements and with the proposals made in other consultation papers.

Our detailed answers to the Exposure draft's questions are set out in the appendix to this letter. We hope you find them useful and would be pleased to provide any further information you might require.

Yours sincerely,

Jean-Paul Caudal

Sir David TWEEDIE Chairman International Accounting Standards Board 30, Cannon Street London EC4M 6XH United Kingdom

## FBF Response to the Exposure Draft: Offsetting Financial Assets and Liabilities.

#### **Appendix**

# 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?

We agree with the proposal that the right to set off the financial asset and the financial liability must be unconditional and legally enforceable in all circumstances.

However we question the meaning of "simultaneously" and the definition given in paragraphs 10.f) and C11.

Where settlement of contract is through a clearing house, an entity would not be able to offset such contracts unless settlement takes place at the same moment. Accordingly, this would prevent repurchase agreements and reverse repurchase agreements with a clearing house to be offset as settlement occur in batches within the day due to processing constraints. Where settlement is through a clearing house, settlement should be regarded as simultaneous as under these circumstances there is no exposure to credit risk or liquidity risk.

We question also the guidance in paragraph C14 which may be confusing and interpretated as no offsetting is allowed even if criteria are met. The proposals might affect the treatment of derivative contracts with clearing houses. Currently entities offset margin and market values of the derivatives when the legally enforceable right to set off is met.

#### 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 (ie 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?

We welcome clarification brought to IAS 32 that the right of set-off must be legally enforceable in all circumstances.

Offsetting of financial assets and financial liabilities would not be appropriate if the outcome of the transaction was contingent on a future event. Therefore we agree that offsetting should be based on an unconditional right of set-off to require a presentation on a net basis on the face of the statement of financial position.

### 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?

We agree the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements as the offsetting conditions should be the sole and main criteria as to whether the offsetting of financial assets and financial liabilities should be required.

We agree with paragraph C13 and arguments developed in BC61 that there is "no basis for explicitly excluding multilateral netting arrangements from the scope of offsetting if all the other criteria, including legal enforceability, are met for the transaction".

#### 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?

Current disclosures need to be enhanced in order to provide users with transparent and complete information about the existence and the effects of rights to offset financial assets and financial liabilities. Sufficient disaggregated information should be provided to clarify the different types of rights of set-off or related arrangements.

However we have concerns about the extensive and disproportionate disclosure requirements proposed in the ED leading to extensive preparation costs with no added value on information for financial statement users.

We believe that disclosures should be set out under general principles. The disclosures proposed by the ED must be reviewed within the framework of the already existing provisions of IFRS 7 or within the framework of the other projects related to the financial instruments.

As an example, the ED has introduced additional disclosure requirements relating to financial assets and financials liabilities that are offset as well as those for which there is no intention of the management to offset even if the criteria are met. We do not see the rationale for requiring on information of rights of set-off without resulting in net presentation.

The paragraph 36 of IFRS 7 already requires information related to the maximal exposure at credit risk including collaterals. Under the ED, information on financial instrument collateral pledged or obtained will need to be disclosed. As a consequence, redundant information will be required.

Entities will be required to disclose the gross amounts of financial assets and financial liabilities before taking into account any offsetting or of any portfolio-level adjustments for credit risk of counterparties.

Portfolio-level adjustments made to incorporate the credit risk of the counterparties in derivative valuation processes have not historically been disclosed separately, as they have been considered a component of valuation as opposed to an offsetting adjustment. Therefore, we do not see the rational for requiring to disclose separately a valuation component next to credit risk mitigation operations. We consider that portfolio-level credit risk adjustments are not relevant in a disclosure about rights of set-off and related arrangements

### 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.

Offsetting of financial assets and financial liabilities is closely related to IFRS 9. It should have the same effective date and transition requirements.

As explained in our response to the request for views "Effective Dates and Transition Methods", the future standards amend the accounting for financial instruments which are the basis of the business of the banking industry, any change for accounting of the financial instruments has huge accounting and operational consequences. Therefore, all the expected standards related to financial instruments should be adopted at the same effective date with the same transition requirements.

As the implementation period is estimated at three years and as new standards are to be completed in 2011 the effective date would not be possible earlier than 1st January 2015.

A full retrospective application would be unrealistic due notably to the scope of financial instruments involved, data to be collected and hypothesis to be formulated in order to restate past transactions. Therefore, we advocate for applying a mechanism similar to the one applied for the transition to IAS 39 for first time adopters in 2005. The opening balance sheet should be restated with a reconciliation schedule between closing and opening balance sheets.