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Ms. Leslie Seidman
FASB Chairman
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: File Reference No. 2011-100 - Proposed Accounting Standards Update: Balance Sheet (Topic 210) Offsetting

Dear Ms. Seidman

Goldman Sachs appreciates the opportunity to provide comments on the Financial Accounting Standards Board's ("FASB") exposure draft on the offsetting of financial assets and financial liabilities (the "Exposure Draft" or the "ED"). Goldman Sachs has been following the joint project on offsetting with great interest. Given the material differences between the current FASB and IASB models on offsetting, particularly in respect of derivatives and repurchase agreements, we applaud your decision to seek convergence in this important area. However, we do not believe that the ED will result in an improvement to U.S. GAAP, and do not support the Exposure Draft as a basis for convergence.

We strongly support the current U.S. GAAP offsetting principles as set out in ASC 815-10-45-5 (formerly FIN 39 paragraph 10) and ASC 210-20-45-11 (formerly in FIN 41). We believe these standards, augmented by enhanced disclosures, provide more relevant balance sheet information about the reporting entity's credit and liquidity risks for derivatives and repurchase agreements than the ED for the reasons set forth in the Appendix to our letter.

We do not believe that gross presentation of derivative receivables and payables (as opposed to net presentation) meets the FASB objectives for financial reporting established in the Board's Concepts Statements. In addition, gross presentation does not meet the core objectives set out in the joint Financial Statement Presentation project.

We have previously presented to members of the Boards and staffs the views of our senior risk managers charged with managing credit, liquidity and market risks on whether gross or net presentation of derivative fair values on the balance sheet better informs users about these

risks. We have also shared our views in a letter to the Board dated November 11, 2010 which we attach in the Appendix.

There are a number of features of the ED that we believe lead to information that is not consistent with the ED's objectives. In particular, the ED is form-driven at times; where the substance of the risk of a position is that of net exposure (that is, liquidity and credit risks are substantially removed) balance sheet presentation should also be net. For example, the treatment of collateral as a separate non-offsettable asset in all circumstances may not reflect the substance of settlement arrangements and is likely to amount to a change to both IFRS and U.S. GAAP. In our view, the ED should contain a principle that would consider the substance of margin/collateral arrangements in determining the appropriate balance sheet presentation.

Further, "simultaneous settlement" as proposed in the ED is expected to change not just U.S. GAAP but developed practice under IFRS for presenting certain centrally-cleared repurchase and reverse repurchase agreements. The ED should contain a more principled approach for "simultaneous settlement" that is based around substantial mitigation of credit and liquidity risk (the basis of the principles in ASC 210-20-45-11 through 17). The current definition relies on instantaneous or point in time settlement that is not practical in even the most sophisticated clearing systems. In addition, given these changes significantly impact both IFRS and U.S. GAAP they would not appear to be warranted by convergence.

It was clear from the Boards' outreach activities that there was no consensus on whether gross information or net information was more useful in the statement of financial position. As a result, in our opinion the Board does not have sufficient justification to substantially change the U.S. GAAP model that has proven robust though recent economic crises. Entities reporting under IFRS frequently provide voluntary disclosures for derivatives and repurchase transactions that reverse the effects of gross presentation.

Sophisticated users already make netting adjustments. In our experience when considering collateralized derivatives transacted under a standard-form ISDA Master Netting Agreement ("MNA") users view net presentation on the balance sheet as closer to economic reality while gross presentation is largely meaningless. Uniform convergence of netting adjustments would increase transparency and be a convenience for users from all backgrounds. A clear beneficiary of net presentation would be the less sophisticated financial statement user who may not have the knowledge base to make the necessary netting adjustments.

We understand the need for convergence but it should not come at the cost of less relevant financial reporting. The FASB and IASB should converge on the existing U.S. GAAP model, which results in superior information.

Absent such convergence, we believe that the differences would be better addressed through jointly developed disclosures to ensure consistent information is available under both IFRS and U.S. GAAP to facilitate comparison.

Our detailed comments on the questions in the ED are included in the Appendix to this letter. If you have any questions or would like to discuss any of these comments further, please contact me at 212-357-8437.

Sincerely,

A handwritten signature in black ink that reads "Matthew L. Schroeder". The signature is written in a cursive style with a large, stylized 'M' and 'S'.

Matthew L. Schroeder

Appendix

Question responses

Question 1: *The proposals would require an entity to offset a recognized eligible asset and a recognized eligible liability when the entity has an unconditional and legally enforceable right to setoff the eligible asset and eligible liability and intends either:*

- 1. To settle the eligible asset and eligible liability on a net basis*
- 2. To realize the eligible asset and settle the eligible liability simultaneously.*

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

We have general concerns about the offsetting requirements in the ED and also specific concerns on the appropriateness of these requirements to the offsetting of derivatives, repurchase agreements and regular way security trades where we feel the objective of the ED is not met.

Paragraph 5 establishes the objective of the netting principle in the ED and states that the objective is to present information in the financial statements that provides useful information in assessing:

- the entity's ability to generate cash in the future;
- the nature and amounts of the entity's economic resources and claims against the entity;
- the entity's liquidity and solvency.

We broadly agree with this objective of the offsetting principle in the ED.

However, we strongly believe that Board's proposed requirements do not achieve the objective for certain assets and liabilities. Application of the ED requirements will result in gross presentation of most derivative receivables and payables, most repurchase and reverse repurchase agreements and all receivables and payables from unsettled regular-way trades, which will obscure our true credit risk position and liquidity profile.

Derivative transactions

Derivative balances are not indicative of future cash flow movements whether shown gross or net. They represent the net present value of future cash flows for contracts and do not contain predictive value of cash movements. Further in addition to failing to provide valid information on cash flows, gross presentation would also reduce the information provided in respect of liquidity and credit risk. We strongly believe that the existing requirements of ASC 815-10-45-5 provide information that better meets the objective of the ED.

In particular:

- BC15 and BC21 both make assertions that gross presentation provides superior liquidity information, stating that "offsetting...reduces users' ability to assess the entity's liquidity and solvency". At a fundamental level, the fair value of a single derivative contract generally does not provide relevant information about its liquidity profile, for example, because payments can occur at different amounts, at different times, and in different directions, which are then encapsulated into a single fair value

measurement. When a single contract is then combined with other contracts to create a portfolio of derivative contracts, gross presentation on the balance sheet does not inform about liquidity risk because the issues inherent in a single measurement are multiplied across the portfolio. Net presentation is a more relevant measure of liquidity risk. Dealers manage liquidity risk of derivatives on a net basis. Market movements generate direct and indirect liquidity flows based on net exposure. Ratings contingent provisions with liquidity implications are predominately based on net exposure. Client behavior that could impact a dealer's liquidity is driven by net exposure. A substantial amount of derivative transactions are collateralized. Funding requirements are driven by collateral held and posted and margining is done on a net basis;

- BC34 asserts that netting obscures significant risks, including market risks, and that a net exposure could cover a position that “could still make very large losses”. This argument suggests gross presentation better informs than net presentation on market risk. Presenting derivatives on a gross or net basis bears no relationship to a dealer's market risk exposures. A balance sheet analysis is not relevant, as market risk analysis is first and foremost based on net exposures, that is, positions in offsetting trades, regardless of their composition, for example, cash positions versus derivatives and other off-balance-sheet exposures. Value-at-risk, stress tests, and other disclosed risk metrics inform users about market risk on a net basis;
- BC33 asserts that netting where there is a conditional right of offset reduces users' ability to understand economic leverage. Leverage is a legitimate concern of users, although it is an imprecise and potentially misleading measure of risk if the analysis does not consider the underlying assets funded with leverage and any associated risk mitigants. In the context of derivatives, risk mitigants include enforceable netting provisions and cash collateral margining provisions. When the two are present in a MNA, which is often the case, net presentation on the balance sheet presents a truer picture of economic leverage than gross, which can be misleading.

Our internal risk managers believe that net presentation better informs than gross on credit risk because it is a vastly more relevant measure of current credit risk exposure when supported by a legally enforceable netting framework. Net presentation better informs than gross on liquidity risk because of the significant impact of collateralization agreements, which are based on net fair values and not gross fair values. Further, neither gross nor net presentation informs on market risk, as market risk exposures are forward looking and consider all on and off-balance-sheet exposures, including cash instruments and derivatives.

Effective net settlement

We also believe that gross presentation fails to meet the stated objective when the settlement mechanism is an exchange of assets at the same value, for example a derivative liability which is fully collateralized at all times, as it is misleading to show a forecast inflow and outflow of cash if the settlement is in substance the offset of the two.

An example of such effective net settlement is regular way security trades. The ED would remove industry specific guidance provided by ASC 940-320-45-3 (formerly, the AICPA Accounting and Auditing Guide for Brokers and Dealers in Securities) providing for net presentation of receivables and payables arising from unsettled regular way trades. We disagree with making this change and do not believe this provides any relevant financial information. The majority of these trades settle in the ordinary course of business (with any failed trades presented gross) and are unsettled delivery-versus-payment exchanges so are not

subject to material risk. Given the information not only lacks relevance and usefulness to financial statement users but would also be operationally complex to produce, it is not justified on a cost benefit basis. This change did not receive appropriate discussion in the development of the ED and has not been justified in the Basis for Conclusions.

Further, we do not agree with the Boards decision articulated in C14 to treat collateral margin balances, for example that secure exchange-traded, centrally cleared or bilateral OTC derivatives, as separate collateral assets in all circumstances. We disagree with this approach which does not give regard to the economic substance of the arrangements and the underlying operational settlement mechanics. These settlement processes operate to ensure that all credit and liquidity risk is mitigated and that profit and loss is realized on a daily basis. On maturity of the trade the collateral would be used to settle the liability without being returned to the owner. There are cases where we believe that this variation margin posting constitutes an economic and functional equivalent to settlement and should be recognized as such through net presentation regardless of whether the position is legally viewed as settled on that date. Further, the reporting entity does not have control over the margin and it would be inappropriate for the entity to recognize the margin as its asset. We recommend that the Board remove reference to exchange traded derivatives within C14 and, if considered necessary, create a principle that would consider the substance of the margin/collateral arrangements in determining the appropriate balance sheet presentation.

In our view, where the settlement mechanism is through gross exchange but settled such that the substance is that of net settlement, then the appropriate presentation should be net. For example this is the case for certain centrally cleared repurchase and reverse repurchase agreements. We therefore agree with the inclusion of simultaneous settlement in the ED offsetting model (previously not included in ASC 815-10-45-5 but within ASC 210-20-45) but believe that the principle should encompass settlement mechanics that are the equivalent of net settlement. The ED introduces a rigid ruleset to apply when interpreting this, stating within paragraph 10 that simultaneous conditions are only met if such settlement is “executed at the same moment”. We believe this is unduly restrictive and will cause gross presentation for many assets and liabilities for which the risk is in substance that of net settlement and may lead to diversity in practice due to the operational constraints that apply, for example, at clearing houses. In our opinion the current requirements within ASC 210-20-45-11 through 17 for repurchase agreements generate information appropriate for financial statement users. These criteria provide a balance sheet treatment that appropriately portrays the risks of such transactions; we do not believe that the proposal provides information that would meet users’ needs.

Other comments

The ED permits netting only where an entity has an unconditional legally enforceable right to offset. In our response to question 2 we set out specific concerns we have over the ED definitions of what is unconditional and believe that this should not consider reporting entity bankruptcy.

We find the application of the ED to payment netting under MNAs to be confusing and to lead to information likely to be of little use. The guidance in C2 to C9 of the ED would imply that payment netting under a MNA may meet the netting requirements of the ED. For example C9 states that that activation of payment netting clauses under an MNA could act as a demonstration of intent. However, paragraphs BC 52 and BC 53 suggest that the Boards intend for the criteria to be applied at the unit of account level, and therefore, in order for an

entity to demonstrate its intention to net settle, a derivative asset and liability would be offset only if they have the same maturity date and same payment dates (i.e. close out trades). We are unsure if this was the Boards' intent as this would, for example, prohibit the netting of many centrally-cleared derivatives and represent a significant change to GAAP.

We agree with the requirement to offset when conditions are met and believe that comparability is improved if current optionality is removed.

Question 2: *Under the proposals, eligible assets and eligible liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of setoff. The proposals specify that an unconditional and legally enforceable right of setoff is enforceable in all circumstances (that is, 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?*

For the reasons above, we do not agree with the requirement for an unconditional right when it comes to collateralised derivatives or repurchase arrangements that meet the current requirements of ASC 210-20-45-11. For the reasons above, we believe that the principles of current U.S. GAAP are superior for these transactions as they provide information that better satisfies the objective in paragraph 5 of the ED.

Our understanding of the definition of enforceable in all circumstances is that it survives bankruptcy of both counterparty and/or the reporting entity. We agree that the right of offset should survive the bankruptcy of a counterparty; however, we strongly disagree that it is necessary to consider the bankruptcy of the reporting entity. Such a requirement would be inconsistent with the going concern principle of financial statement presentation.

We do not believe that the narrow description of unconditional will prove to be operational in practice and may lead to less relevant information. We can see many situations where a seemingly unconditional right may in practice prove conditional for example where provisions such as change in law may frustrate an ability to net settle. We believe that the unconditional criterion requires modification for practicality purposes to permit netting where the only conditionality is from highly remote contingencies.

While disagreeing with the principle of the ED regarding when netting should be applied, we do agree with the requirement to apply netting when conditions are met, rather than the retention of the option. The retention of optionality would contradict the conceptual basis of the model and would limit comparability.

Question 3: *The proposals would require offsetting for both bilateral and multilateral setoff arrangements that meet the offsetting criteria. Do you agree that the offsetting criteria should be applied to both bilateral and multilateral setoff arrangements? If not, why? What would you propose instead, and why? What are some of the common situations in which a multilateral right of setoff may be present?*

In order to be consistent with the general principle of the ED, we agree that multilateral set off should be required when the conditions are met. To not do so would contradict the conceptual basis of the ED.

Question 4: *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?*

We are broadly supportive of the principle behind the proposed disclosures. However, we believe that in practice these may prove too wide in scope and potentially overlap with other disclosures elsewhere in GAAP. Certain CVA and DVA disclosures for example seem to lack relevance in a netting context and are duplicative of fair value measurements disclosures. Further, by including all financial assets and financial liabilities it will be necessary to undertake an exercise to identify other potential areas of netting since we would expect that many other instruments may permit netting in certain remote conditions but would be presented gross in virtually all scenarios under the ED. The proposed requirement to identify instruments that have a conditional right to offset will be onerous and costly for preparers.

Question 5: *Do you agree with the proposed transition requirements in Appendix A? If not, why? How would you propose to amend those requirements and why? Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.*

We believe it will be important, when first adopting the ED, for comparative periods to be presented on a consistent basis and as a result retrospective application would be required. We have significant concerns with the system constraints and operational complexity of generating certain elements of the netting requirements, including computation of the trade date adjustment gross up and potentially payment netting adjustments, and these will take time to comply with. Sufficient time will be required to allow for operational changes needed to capture the data needed to meet the ED requirements, some of which would not be readily available at present. Further, it would be appropriate to allow sufficient lead time for any related regulatory or other impacted rules to be identified and adapted as necessary.