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IASB
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The IASB's Exposure Draft *Offsetting Financial Assets and Financial Liabilities*

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as by enhancing investor protection.

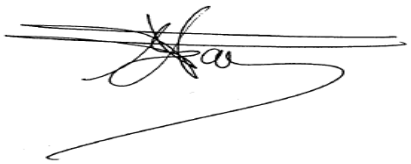
ESMA has considered through its Standing Committee on Corporate Reporting the IASB's Exposure Draft (ED) *Offsetting Financial Assets and Financial Liabilities*. We thank you for this opportunity to contribute to the IASB's due process and to comment on your draft response. We are pleased to provide you with the following comments aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.

ESMA supports and welcomes the proposals in the ED. As noted in the introduction to the ED, differences in offsetting requirements represent the single largest quantitative difference in balance sheet amounts between IFRS and US GAAP. This impairs comparability in financial reporting for users and ESMA highly commends both the IASB and the FASB for coming together to address this issue and reaching a converged, high quality standard.

Our detailed comments on the ED are set out in the Appendix to this letter.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,



Fernando Restoy
Chairman of ESMA's Corporate Reporting Standing Committee

APPENDIX – ESMA's detailed answers to the questions in the IASB Exposure Draft *Offsetting Financial Assets and Financial Liabilities*

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?

1. ESMA agrees with this proposed requirement. The offsetting criteria are appropriate and consistent with the IASB *Framework* and current IFRS requirements. The criteria would mean that offsetting would only be possible where there is, in effect, a single asset or single liability, which ESMA believes is appropriate. Information about credit risk – which ESMA understands is the philosophy underlying the current US GAAP rules on offsetting – is useful information, but this in itself does not justify breaching the principles in the IASB *Framework*. As set out in the response to question 4 below, ESMA supports the ED's proposed disclosure requirements, which would allow users to see this information.

2. The FASB, in its ED on offsetting, proposes to establish a general principle in the FASB Framework to achieve a similar position. This is an example of both Boards working towards convergence to high quality standards, which ESMA welcomes.

3. The requirements to set-off are not included in the main text of the ED. Instead, these requirements are included in the application guidance (paragraph C15). ESMA believes that the role of application guidance is to clarify requirements in the main text and that it would be more appropriate to move the text in paragraph C15 from the application guidance to the main text.

4. ESMA notes that IAS 12 – *Income Taxes* and IAS 19 – *Employee Benefits* both include offsetting criteria and believes that the IASB should consider whether there is a need for any consequential amendments to these standards in light of the ED.

5. ESMA suggests that the IASB may wish to consider whether it is appropriate for the offsetting criteria as set out in the ED to be applicable to all assets and liabilities and therefore whether it would be appropriate to incorporate these criteria into IAS 1, *Presentation of Financial Statements*, and/or

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the IASB *Framework for the Preparation and Presentation of Financial Statements*. This would enhance the consistency of treatment for situations that are similar in economic substance. This said, ESMA is not aware of other situations currently (involving non-financial assets or non-financial liabilities) that would meet the offsetting criteria and thus does not believe that this point is an immediate priority.

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?

6. ESMA agrees that the right of set-off right must be unconditional and enforceable in all circumstances.

7. ESMA also supports the concept of simultaneous settlement as set out in the ED. We agree that simultaneous settlement must mean 'at the same moment' and that a period of time between the settlement of the financial liability and realisation of the financial asset, even if brief, would not normally be consistent with the entity having an exposure to only the net amount represented in an offsetting arrangement. In other words, simultaneous settlement should mean that the entity is not exposed at any time to any type of counterparty or liquidity risk for one leg of the offset. Where settlement is through a clearing house, settlement could be regarded as simultaneous if the clearing house ensures that no counterparty or liquidity risk is undertaken by the entity.

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?

8. ESMA agrees that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements. Although we expect multilateral arrangements to be more infrequent, given the criteria for offsetting have a sound basis in the IASB *Framework*, ESMA does not see any conceptual basis for prohibiting their application just because an arrangement is between more than two parties.

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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?

9. ESMA agrees with the proposed disclosure requirements and welcomes the fact that that they have been developed based on the IASB's user outreach work. In addition ESMA welcomes the illustrative disclosure examples included in the ED, which show how the disclosures required by paragraph 12 of the ED may be presented in a tabular format. These illustrative examples are very helpful in showing how the disclosures, which are comprehensive, can be presented in a clear and understandable form for users.

10. However, ESMA notes that paragraph 12 of the ED states that '*the information required by this paragraph shall be presented in a tabular format unless another format is more appropriate*'. Whilst ESMA would not be supportive of an overly prescriptive requirement for the format of disclosures, it may be helpful nonetheless to strengthen this language so that there is a rebuttable presumption that the disclosures required under paragraph 13 should be in a tabular format.

11. Paragraph 12 (f) of the ED requires disclosure of cash or other financial instrument collateral obtained in respect of the entity's financial assets and financial liabilities. It is not clear to us why there is no requirement to disclosure other forms of collateral. For example, in the case of a mortgage portfolio, there is likely to be collateral in the form of property. Disclosure of this information would be useful to users in assessing the risk exposures of the portfolio.

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.

12. In general, ESMA is supportive of retrospective application, because comparability – across both firms and across time – is a key element of financial reporting and in the use of financial statements by investors. Whilst we acknowledge that in some circumstances there are strong arguments against retrospective application (such as when it would result in preparers applying hindsight to past transactions), in this case we do not see any such impediments and therefore we support retrospective application.

13. ESMA notes that there are a number of IFRSs being developed at the moment and feels that it is important to consider the effective date in the context of those developments. As noted in the ESMA

letter to the IASB on its *Request for Views on Effective Dates and Transition Methods*[1], ESMA believes that complexity, with its consequent impact on lead times, and logical linkages between standards, should be key drivers when considering effective dates.

[1] *ESMA/2011/34*, available at: http://www.esma.europa.eu/index.php?page=document_details&id=7448.