

Accounting Standards Board of Japan (ASBJ)

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28 April 2011

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir or Madame,

Comments on the Exposure Draft
“Offsetting Financial Assets and Financial Liabilities”

We appreciate the efforts made by the International Accounting Standards Board (IASB) in the Financial Instruments Accounting Project and welcome the opportunity to express our comments on the Exposure Draft “Offsetting Financial Assets and Financial Liabilities” (hereinafter referred to as “the ED”). The following views are those of the Financial Instruments Technical Committee within the Accounting Standards Board of Japan.

1. General Comment

We appreciate the efforts by the IASB and the US Financial Accounting Standards Board (FASB) to develop a common approach to offsetting financial assets and financial liabilities, the difference of which is the cause of the single largest difference in amounts presented in the statements of financial position between those prepared in accordance with IFRSs and US GAAP.

We support the proposal in the ED that an entity shall offset a recognised financial asset and a recognised financial liability and shall present the net amount in the statement of financial position when the offsetting criteria described in paragraph 6 of the ED are met.

We also agree with the proposed disclosure requirement of information about rights of set-off and related arrangements (such as collateral agreements) associated with the entity’s financial assets and financial liabilities.

However, considering the concerns raised by particularly preparers of the financial statements about whether the benefits from the proposed disclosures would sufficiently outweigh the costs to provide them, we suggest that the proposed disclosure requirements be amended where necessary in the light of comments on the ED by users and preparers of the financial statements, if the IASB has not fully considered the costs and benefits of those disclosures.

2. Comments on specific questions

Our comments on questions set out in the ED are as follows:

Question 1

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?

Question 2

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?

Question 3

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?

(Question 1)

1. We agree with the ED's proposal to require offsetting when the proposed criteria are met.
2. We agree with the ED's proposal that offsetting should be required, not permitted, when the offsetting criteria are met, from the viewpoints of ensuring comparability.
3. Concerning simultaneous gross settlement, there may be an argument that it does not have characteristics of 'a single net financial asset or financial liability' when compared with net settlement. However, there is a case for requiring offsetting when an entity intends to settle gross amounts simultaneously, considering that net settlement could be difficult due to capacities in systems. We agree with the ED's proposal providing that an interpretation of 'simultaneous'

should be strictly applied as prescribed in the ED.

4. We agree with the proposal to require the intention to settle net or settle simultaneously. If an entity has an unconditional and legally enforceable right of set-off but does not have intention to do so, offsetting would not faithfully represent an entity's risk exposure and an entity's net cash flows.

(Question 2)

5. We agree with the ED's proposal 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.
6. Net presentation would be desirable when the offsetting criteria proposed in the ED are met (ie an entity has both a right of set-off and intention of net or simultaneous gross settlement) from the viewpoint of providing useful information to help users assess the prospects for future net cash flows, because under such situations the entity has, in effect, a single net financial asset or financial liability at the reporting date, based on rights and obligations on financial assets and financial liabilities.
7. Net settlement of financial assets and financial liabilities under a master netting agreement is enforceable only on the occurrence of some events such as default. Before such an event has occurred, it is difficult to regard a combination of a financial asset and a financial liability to be in effect a single net financial asset or financial liability. Therefore, from the viewpoint of providing useful information to help users assess the prospects for future net cash flows, offsetting merely because of a master netting agreement should not be required.

(Question 3)

8. We basically agree with the ED's proposal to apply both bilateral and multilateral set-off arrangements to the offsetting criteria.
9. Although it is likely that multilateral set-off arrangements are exceptional, we find no reason to exclude multilateral set-off arrangements from scope of offsetting provided that all of the offsetting criteria (including legal enforceability) are met. However, given that both multilateral set-off arrangements and simultaneous gross settlement are exceptional, the proposal to permit offsetting for multilateral simultaneous gross settlement should be reconsidered from the viewpoint of whether there is a need for that.

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?

(Question 4)

10. We agree with the ED's proposed disclosure requirements of 'information about rights of set-off and related arrangements (such as collateral agreements) associated with the entity's financial assets and financial liabilities'.
11. This is because the disclosure of such information would be useful as notes complementing the information about an entity's exposure to net credit risk, because of usefulness in identifying the net credit risk exposure.
12. Users support the proposed requirement to disclose quantitative information in a tabular format. However, they suggest that derivatives and repurchase agreements should be separately disclosed.
13. On the other hand, preparers of the financial statements argue that the proposed disclosures would involve significant costs.
14. The proposed requirements are likely to include not only derivatives and repurchase and reverse repurchase agreements subject to a master netting agreement but also ordinary deposits and loans. We suggest that the proposed disclosure requirements be amended where necessary in the light of comments on the ED by users and preparers of the financial statements, if the IASB has not fully considered the costs and benefits of those disclosures.

Question 5

- (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.

(Question 5)

15. We agree with requiring retrospective application to all comparative periods as proposed in the ED to ensure comparability.

* * * * *

We hope our comments will contribute to the forthcoming deliberations in the project.

Yours sincerely,

A handwritten signature in black ink, consisting of several overlapping, fluid strokes that form a cursive, somewhat abstract shape.

Atsu Kato
Chairman of the Financial Instruments Technical Committee
Vice Chairman of the Accounting Standards Board of Japan