

Sir David Tweedie International Accounting Standards Board 30 Cannon Street London EC4M 6XH

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Group Chief Accountant's Level 12 280 Bishopsgate London EC2M 4RB

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Dear Sir David

## ED/2011/1 Offsetting Financial Assets and Financial Liabilities

We welcome this opportunity to set out our views on the Board's exposure draft.

We support the objective of the IASB and the FASB to harmonise their approaches to presentation. However, as set out in our responses in the appendix, we do not support the exposure draft's proposals; in particular, we do not believe that an intention to settle net should be a condition for offset.

In any event, we are concerned that some of the seemingly minor changes from IAS 32 will have a significant effect in practice. Currently contracts settled in clearing houses and central exchanges are considered to meet the simultaneous settlement criterion. We see no reason why such contracts which settle intra-day should not qualify for offset.

Please contact me should you wish to discuss our response.

Yours sincerely

Rajan Kapoor

**Group Chief Accountant** 

### **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?

The proposed criteria for offset are substantially the same as the existing criteria in IAS 32 *Financial Instruments: Presentation*. We have always considered them to be ill-conceived. We remain unconvinced that intentions as to settlement are in any way relevant to determining whether or not a financial liability and a financial asset should be offset. We support criteria along the lines of those previously operating under UK GAAP (FRS 5 before amendment by FRS 25) as being more reflective of the economic substance.

However if the Boards conclude that they should pursue their approach, we have grave concerns over the definition of simultaneous settlement in C10-C12 and its potential effect on the netting of contracts settled through clearing houses and other central counterparties. We believe it vital that the Boards reconsider this guidance as it is a significant change to current practice under IFRS.

# 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 agree that a legally enforceable right of set off should be one of the criteria for offset. However, we have some concerns over the qualification that this right must be enforceable in all circumstances; it is not clear to us what this means in practice. In our view, the ability to insist on net settlement in all situations of default is sufficient.

# 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 that the set-off criteria should apply to bi-lateral and multilateral arrangements. Multilateral arrangements meeting the criteria can arise in groups.

#### 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?

We do not support the disclosure requirements. We see no need to extend them beyond a requirement to disclose the amounts that have been set off. The detailed proposed disclosures are disproportionate, prescriptive and not in accordance with the way management view and control the business. Certain of the disclosure requirements, in particular 12(c) and (d) could be very onerous as the information is not easily available at the level of granularity required.

### 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.

In general we support retrospective application. However, this is subject to operational constraints. If the final standard differs markedly from IAS 32 and the more onerous disclosure requirements remain then there may well be arguments for prospective application.

We would suggest an effective date of 1 January 2013 with early application being allowed.