BNP PARIBAS

April 28, 2011

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

**Comments to the Exposure Draft on *Offsetting Financial Assets and Financial Liabilities***

We are pleased to provide our comments on the exposure draft *Offsetting Financial Assets and Financial Liabilities*.

We welcome the efforts of the IASB and the FASB to propose a common set of requirements to the offsetting of financial assets and liabilities. The current differences between US GAAP and IFRS in the offsetting criteria result in huge differences in the banks' balance sheet size. In order to allow more comparability and therefore achieve a level playing field regarding the balance-sheet presentation, we think that a converged solution is a crucial target to reach.

Regarding the offsetting criteria, we broadly support the Board's proposal to retain the IAS 32 approach.

However, we have disagreements with the following points:

- Many derivatives cleared through central counterparties (clearing houses / CCP) are subject to daily cash variation margin. This cash amount, which covers multiple derivatives which can have different maturities, represents in-substance the settlement of the net position towards the CCP. Consequently, the offsetting between the cash collateral and the associated financial instruments should be allowed.

- Financial transactions operated through CCP should be considered as meeting the simultaneous condition as far as the CCP eliminates credit and liquidity risk for the reporting entity.

  These two previous elements are particularly important because the ED could lead to modifying IFRS practices for financial transactions operated through CCP while at the same time more and more bilateral transactions are cleared through them as a result of the G20's and Financial Stability Board's recommendations.

- Disclosures:

  We think that proposed disclosures are too extensive and can be rationalized, particularly for credit risk exposures, some of which are redundant with the IFRS 7 requirements.


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We disagree with presenting credit valuation adjustments separately from the gross amount of financial instruments. The adjustments made to take into account the credit risk of the counterparties are a component of the fair value of financial instruments. The fact that the fair value of derivatives can be measured based on the net positions of the portfolios rather than the individual values of financial instruments within the portfolio is in line with the way these derivatives are managed. A separate disclosure of the credit valuation adjustment is not relevant regarding the offsetting issue subject to this exposure draft.

Our detailed answers to the questions are included below.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Sincerely,

Gerard Gil
Deputy CFO

**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 support the Board's proposal to retain the IAS 32 approach for the offsetting of financial assets and liabilities.

However, we have disagreements with the following points:

- Cash collateral:

  We understand that the ED prohibits the offsetting of the cash collateral, including margin accounts, with the associated financial assets or liabilities (§9 and C14).

  We disagree with this prohibition because this principle, in certain circumstances, does not consider the substance of the cash collateral, notably when derivatives are cleared through central counterparties (clearing houses / CCP).
  Many derivatives cleared through CCP are subject to daily cash variation margin. This cash amount represents in-substance the settlement of the net position towards the CCP. Not taking into account this cash collateral in the offsetting will lead to an inadequate representation of the effective cash flows.
  We all the more insist on this point as the new legislation, put in place in the wake of the 2008 crisis and following the G20's and the Financial Stability Board's recommendations, creates significant changes to the way that derivative products are regulated. More and more bilateral transactions will now be cleared through a CCP.

  We urge the Board to reconsider this point and confirm that this prohibition will not prevent the offsetting of a financial instrument with margin call when other offsetting conditions are met.

- Simultaneous settlement:

  The ED gives guidance on how the intention to settle net or simultaneously can be demonstrated. According to paragraphs 10.f and C11, in order to be considered simultaneous, the realisation of the financial asset and the settlement of the financial liability must be executed at the same moment. The notion of "same moment" seems to be very restrictive and could question offsetting of repurchase agreements and reverse repurchase agreements cleared in batches during the day through CCP.

  Under the existing IAS 32 requirements, this criteria of "simultaneous settlement" is discussed in paragraph 48. The example of a clearing house is provided, with the following explanation: "*In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk*". The current practice is that repos and reverse repos through clearing houses are eligible for the criteria of “simultaneous settlement”.

Financial transactions operated through CCP should be considered as meeting the simultaneous condition as far as the CCP eliminates credit and liquidity risk for the reporting entity.

We ask the Board to reconsider this point based on the fact that the “simultaneous settlement” condition will build on a principle based on the elimination of credit and liquidity risk and not on a rule based on moments of time.

**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.

**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 offsetting criteria should be applied to multilateral set-off arrangements if all the offsetting criteria are met.

**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 agree that the disclosures about the offsetting of financial assets and financial liabilities should, as explained in paragraph 11, “enable users of its financial statements to understand the effect of those rights and arrangements on the entity’s financial position”.

We think that these disclosures should reflect the rationale of the offsetting and then faithfully represent the rights and obligations associated to the asset and the liability, based on the net inflow or outflow.

Moreover, we think that the proposed disclosures are too extensive and can be rationalized, particularly for credit risk exposures, which are already required under IFRS 7.

We have particular concerns with the following points:

- Credit valuation adjustments:

  We disagree with presenting credit valuation adjustments separately from the gross amount of financial instruments, and by class of financial instruments.
  The adjustments made to take into account the credit risk of the counterparties are a component of the fair value of financial instruments. The fact that the fair value of derivatives can be measured based on the net positions of the portfolios rather than the individual values of financial instruments within the portfolio is in line with the way these derivatives are managed.

  Moreover, added the portfolio-level adjustments made to reflect the effect of the entity's net exposure to the credit risk of counterparties, calculated on a net basis as explain below, to the net amount presented in the statement of financial position does not give a relevant and meaningful gross amount.

  A separate disclosure of the credit valuation adjustment is thus not relevant in the framework of the offsetting subject discussed under this exposure draft.

- Credit risk exposures:

  IFRS 7 paragraph 36 requires that an entity disclose by class of financial instrument:

  *"- the amount that best represents the maximum exposure to credit risk at the end of the reporting period without taking into account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with IAS 32)*
  *- in respect of the amount disclosed, a description of collateral held as security and other credit enhancements."*

  We think that redundant information is not useful for financial statements users.

  We believe that the disclosures should be set out under general principles and we recommend that the Board review the disclosures within the framework of the global replacement project of IAS 39.



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**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.

We think that the offsetting of financial instruments is related to the IAS 39 replacement, IFRS 9. As a consequence, the future standard should be effective at the same date and should follow the same transition requirements.

As explained in our comment letter to *the Request for Views on Effective Dates and Transition Methods,* we think that the single effective date of application of new IFRSs should be fixed at least three years after the completion of the latest standard within the package.

Regarding transition methods and more particularly for IFRS 9, given the major changes financial institutions will have to face, we advocate for a transition relief that does not require comparative financial statements as it was permitted for IAS 39 in 2005.

We believe that the single date approach would allow for better comparability across entities, which is a crucial element to achieve a level playing field regarding the balance-sheet presentation.



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