2011-100
Comment Letter No. 144

The voice of banking
& financial services

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
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28 April 2011

Dear Sir David,

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

This is the British Bankers' Association's response to the above document; we welcome the opportunity to comment.

Whilst we welcome the proposal to establish a principle for offsetting financial assets and financial liabilities and a common IFRS-US GAAP approach to presentation, we believe that the IASB should take the opportunity to seek a more fundamental review of the IAS 32 provisions. Our reasoning is driven by the significant volume of change being made to the prudential regime worldwide and regulatory reforms proposed in Europe and United States to promote greater use of a central clearing mechanism for settling OTC derivatives.

We note from the Basis for Conclusions that the Board considered requests from constituents to align the offsetting guidance with Basel II requirements on netting, however we do not believe that the existence of significant differences between the prudential and financial reporting regimes should be seen as justification in itself for not conducting a thorough review at this time of fundamental change to the global framework for the regulation of financial markets. We would urge the Board to discuss the issues with the Basel Accounting Task Force and the authorities engaged in the development of the new clearing regime for OTC derivatives. We note that drawing the right conclusions on offset and netting may enable the financial statements of financial institutions to be used for regulatory leverage ratios without the need for prudential filters.

If the Board nevertheless decides to press ahead with the proposals in the ED, then we would stress that it must reassess the proposed Application Guidance relating to simultaneous settlement. C11 will prevent transactions settled through a central counterparty or clearing house from qualifying for net presentation as settlement currently takes place on the same day but not necessarily simultaneously. This would have a significant impact on the banking industry. We believe that implementing this provision would work against the grain of the regulatory initiatives underway to promote the central clearing of derivatives and would not provide users with an accurate representation of the entity's position with the clearing house or central exchange. This is especially significant as no there is no exposure to credit or liquidity risk whilst settlement takes place under the standard operational workings of an exchange (even where there is a brief timing disparity between settlement). We would like to emphasise this point as offsetting in such circumstances is considered appropriate and a true and fair depiction of the transaction from the perspective of the users of the financial statements.

We are broadly supportive of the objective of proposed disclosure regime but question the benefits of some of the requirements. We would, however, welcome a more strategic review of the

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consequential amendments being made to IFRS 7 as a result of the reform of IAS 39 to ensure that the standard remains internally consistent. This being said, we strongly support the concept of consistent disclosures between US GAAP and IFRS users as differences in this area would significantly reduce the decision-usefulness of information provided to the markets.

We set out our responses to the individual questions below.

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?

As noted above, whilst we can support the idea of an overarching principle in this area, we believe that the IASB should conduct a fundamental review of the provisions of IAS 32 before determining what that principle should be.

Again as noted above, we are concerned that the definition of simultaneous settlement in C10 -12 would prevent the netting of contracts settled via clearing houses and central counterparties where settlement occurs on the same day (with no credit risk or liability risk to the entity) but not at the exact same moment. We believe the proposals would work against the current direction of regulatory change in this area and would therefore urge the Board to reassess its decision in this area. At the very least, we do not believe a requirement to present such contracts on a gross basis would be a faithful representation of the entity's position.

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 (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?

Subject to our comments above on the need for a fundamental review of the principles in IAS 32, we agree that an entity should have an unconditional and legally enforceable right to set-off in all circumstances and that this right should not be contingent on a future event.

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?

We support in principle the decision to apply the criteria to both bilateral and multilateral set-off agreements, subject to our belief that a fundamental review of IAS 32 is required.

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 recognise the importance of entities providing users with disclosures which enable them to understand rights to offset financial assets and financial liabilities and to understand the impact of those rights on the entity's financial position. That being said, we consider the disclosures set out in paragraphs 11 to 15 to be extensive, with the practical benefits of some of the proposed disclosures uncertain. We would particularly like to draw your attention to the requirements of paragraphs 12(c), 12(d) and 13 where it is unclear in which situations this information would be considered valuable by users of the financial statements.

We support the decision to locate the disclosure requirements in IFRS 7; however, we note that this is just one of a number of proposals flowing from the review of IAS 39 which will lead to consequential changes being made to IFRS 7. We would suggest that the Board conducts a project to assess the overall consistency of the changes being proposed to IFRS 7 – for example the disclosures proposed in this ED will require information to be provided in significantly more detail than is the case in other areas of IFRS 7.

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.**

We support the proposal to require retrospective application.

We anticipate that the disclosure requirements will be the most challenging part of the proposal to implement. The fact that these will be incorporated into IFRS 7, together with a number of other new requirements stemming from the review of IAS 39, only reinforces our view (set in our response to the Effective Dates ED) that it would be helpful to have one effective date for each of the new standards under development.

Yours sincerely

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