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

11 April 2011

Dear Sir David

ED/2011/1 Offsetting Financial Assets and Financial Liabilities

Lloyds Banking Group plc (‘LBG’) is pleased to comment on the proposals contained in the above exposure draft (‘ED’).

We broadly support the approach to offsetting set out in the ED however we have concerns regarding offsetting of instruments settled through central clearing houses and the new disclosure requirements. Our comments on these matters are set out within our responses to the questions in the ED below.

**Question 1**

The proposals would require an entity to offset a recognised financial asset and a recognised financial liability when an 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 agree with the proposed requirement in principle

However, we believe that the proposed Application Guidance is unduly onerous and, as currently drafted, could prevent offsetting of instruments settled through central counterparties or clearing houses notwithstanding that settlement risk has been legally and operationally eliminated.
Simultaneous settlement
Under Application Guidance Paragraphs C10-C12, simultaneous realisation of a financial asset and settlement of a financial liability is limited to cases when settlements are executed at the same moment such that there is only exposure to the net amount. An entity’s intention to settle simultaneously must be demonstrated through policies or practice. Incidental simultaneous settlements or settlements that take place over a brief period would not qualify for offsetting.

The drafting of these paragraphs would appear to prevent offsetting of contracts executed with a central clearing house that are denominated in the same currency and mature on the same day unless they are settled at the same moment. In practice, due to processing constraints, central clearing houses clear contracts in batches so physical settlement is delayed even though settlement risk has been eliminated and there is only exposure to the net amount.

We believe that the proposals should be amended to allow offsetting for contracts executed with a central clearing house where settlement risk has been eliminated.

Cash margin
It is not clear whether the ED’s proposal to prohibit offsetting of assets pledged as collateral or the obligation to return collateral would extend to all cash margin arrangements. In connection with transactions carried out through a central clearing house, the counterparty to the clearing house usually posts or receives on a daily basis an amount of cash equal to the net position of that day’s mark-to-market movements in values of all instruments to be settled through the clearing house. This ensures that settlement risk is fully eliminated every day across the clearing house, as all positions are in effect fully cash-collateralised and net settlement can be enforced both legally and operationally at all times.

These daily net settlements of mark-to-market positions are often described as ‘margin’ or ‘variation margin’ in the contractual arrangements between the clearing house and its counterparties. Application Guidance Paragraph C14 of the ED states that: “Margin accounts are assets or liabilities that are accounted for separately.” This could be interpreted as not permitting offsetting of such instruments held with a clearing house where all settlement risk is de facto eliminated on a daily basis.

We would request that the Board provides guidance that where cash postings may be called ‘margin’ in the contractual terms between a clearing house and its counterparties, but are in effect a daily net settlement of mark-to-market positions, offsetting should be permitted where the proposed offset criteria are met.
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?

We agree with this proposed requirement.

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 agree that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements.

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?

The proposed disclosure requirements in paragraphs 11-15 of the ED are extensive, and we question their usefulness. In particular, the requirements of paragraphs 12(c), 12(d) and 13 are likely to be onerous and we believe that they will be of little benefit to users of the financial statements.

Paragraph 15 proposes that the disclosures will need to be made where an entity has any rights to offset financial assets and financial liabilities. We believe that disclosures should be limited to offsetting actually achieved in the financial statements.
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 believe that the timetable for implementation of any new standard on offsetting should be aligned with the timetable for IFRS 9 (please refer to our comment letter on the Request for Views on Effective Dates and Transition Methods).

Yours sincerely

[Signature]

David Joyce