

Comment Letters
IASB
30 Cannon Street
London EC4M 6XH
United Kingdom

Paris, April 28, 2011

Exposure Draft 2011/1: Offsetting Financial Assets and Financial Liabilities

Dear Sir or Madam.

MAZARS welcomes the opportunity to comment on the IASB Exposure Draft, *Offsetting Financial Assets and Financial Liabilities*. Our answers to the Exposure Draft questions are shown in the appendix to this letter which summarizes our concerns and opinion.

We support the Boards' efforts to develop a common approach to offsetting financial assets and financial liabilities. Different offsetting requirements under IFRS and US-GAAP have led to significant differences in gross assets reported by European and US financial institutions. This impairs the comparability of financial statements between IFRS and US-GAAP preparers and creates "level playing field" issues.

We welcome the Exposure Draft proposal to retain offsetting criteria that are based on the current IAS 32 approach. We consider that existing IAS 32 criteria have proved to be resilient, notably since they have not raised much concern during the recent financial turmoil.

While we support the overall approach underlying the proposed offsetting criteria, we have the following concerns:

• We believe that the requirement in paragraph C14 of the Exposure Draft to report margin accounts gross in the statement of financial position does not give sufficient consideration to the different types of margin accounts. We consider that some margin accounts represent an advance payment for settlement of financial instruments (e.g. derivatives). This is particularly the case for many markets organized with transactions being settled through a clearing house. As such, we believe that the margin account and the derivative may be part of a unique transaction depending on the contractual terms and conditions. Therefore provided offsetting criteria are met, we believe that in such situations a net presentation gives a better depiction of an entity's rights and obligations, and future cash flows.



■ The Board should consider relaxing the "simultaneously" criteria when financial instruments are settled in clearing houses so as to take account of their processing constraints.

Do not hesitate to contact us should you want to discuss any aspect of our comments.

Best regards,

Michel Barbet-Massin

Head of Financial Reporting Technical Support



Appendix

Offsetting criteria: unconditional right and intention to settle net or simultaneously

Question 1

The proposals would require an entity to offset a recognized financial asset and a recognized financial liability when the entity has an unconditional and legally enforceable right to set off the financial asset and financial liability and intends either:

- to settle the financial asset and financial liability on a net basis or
- to realize 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 welcome the Exposure Draft proposal to retain offsetting criteria that are based on the current IAS 32 approach. We consider that existing IAS 32 criteria have proved to be resilient, notably since they have not raised much concern during the recent financial turmoil.

We agree that an entity shall be required to offset a recognized financial asset and a recognized financial liability when the entity has both an unconditional and legally enforceable right to set off, and has the ability and intent to do so. Unless these criteria are met, we believe that a gross presentation of financial assets and liabilities on the statement of financial position ensures a better depiction of the entity's rights and obligations, and future cash flows. It provides more relevant information for users so as to assess the liquidity and the solvency of an entity.

Even though we acknowledge that a net presentation of financial instruments (e.g. derivatives) may represent a better depiction of an entity's credit exposure to counterparties, we do not believe that the primary objective of the statement of financial position should be to provide information on an entity's credit risk exposure. We consider that this information can be more adequately disclosed in notes to financial statements.

While we support the overall approach underlying the proposed offsetting criteria, we have the following concerns:

Margin accounts

Paragraph C14 of the Exposure Draft specifically requires that margin accounts shall be presented gross in the statement of financial position, separately from the financial instruments.

"Many financial instruments, such as interest rate swap contracts, futures contracts and exchange traded written options, require margin accounts. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets (typically liquid assets). Margin accounts are assets or liabilities that are accounted for separately."



We believe that this requirement does not give sufficient consideration to the different types of margin accounts. We agree that some margin accounts should be presented separately on the statement of financial position since the cash collateral and the financial instruments constitute two separate transactions. However, some margin accounts represent an advance payment for settlement of financial instruments (e.g. derivatives). This is particularly the case for many markets organized with transactions being settled through a clearing house. As such, we believe that the margin account and the derivative mat be part of a unique transaction depending on the contractual terms and conditions. Therefore provided offsetting criteria are met, we consider that in these specific situations a net presentation gives a better depiction of an entity's rights and obligations, and future cash flows.

In addition, we raise to the Board's attention that offsetting daily margin calls against the fair value of derivatives is a common practice under current IAS 32 standard.

• Clearing houses: the "simultaneously" issue

A common interpretation of IAS 32 is to consider that the settlement of financial instruments in a clearing house is deemed simultaneous. This interpretation is notably based on IAS 32 § 48:

"Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial market or a face-to-face exchange. 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. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment."

The distinction between financial instruments settled in a clearing house and those settled outside a clearing house is not retained in the Exposure Draft. Therefore, the requirement to realize the financial asset and settle the financial liability simultaneously would apply in all circumstances. This may raise issues for entities executing repurchase agreements with a clearing house since those contracts may be cleared in batches, and not necessarily at the same moment. In such cases, offsetting will not be allowed under the criteria proposed in the Exposure Draft.

A solution would be to relax the "simultaneously" criteria when financial instruments are settled in clearing houses so as to take account of their processing constraints.

Intent and ability (and not solely intent)

We believe that the offsetting criteria shall require an entity's intent and ability (and not solely its intent) to settle the financial asset and financial liability on a net basis or to realize the financial asset and settle the financial liability simultaneously. We do not believe that an entity should be allowed to offset when it has the intent but not the ability to settle net or simultaneously because, for example, of some IT system shortfalls.



Unconditional right of set-off must be enforceable in all circumstances

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?

We agree with the Board that financial assets and financial liabilities shall be offset only when they are subject to an unconditional and legally enforceable right of set-off. We believe that offsetting should not be allowed in cases where:

- The right of set-off is not enforceable in all circumstances (e.g. the right of set-off disappears if one counterparty defaults); or
- The right of set-off is contingent on a future event (e.g. a counterparty defaulting in a master netting agreement).

Multilateral set-off arrangements

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 offsetting criteria and requirements should also apply to multilateral set-off arrangements.

Disclosures

Ouestion 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 agree with the Board that the new disclosure requirements should enable users to understand the effect of set-off rights and arrangements on an entity's financial position.

The proposed disclosure requirements raise however the following concerns:

■ The Board should analyze further how the proposed disclosure requirements interact with disclosures currently required in IFRS 7. For instance, IFRS 7 § 36 requires the disclosures of credit risk before taking account of any collateral and a description of collateral held. Paragraph 13 of the Exposure Draft requires additional disclosures on



collateral ("description of each type of conditional right of set off [...], including the nature of those rights and how management determines each type") that may overlap those currently required in IFRS 7 § 36.

• The level of disclosures required on offsetting may result in a disproportionate level of detail in this area when compared to disclosure requirements on other issues. In particular, one may wonder to what extent it is relevant to provide information on a gross basis when the very strict offsetting criteria of the Exposure Draft are met.

Effective date and transition

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?

We agree with the transition requirements proposed in Appendix A: retrospective application for all comparative periods presented.

Question 5

(b) Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements?

Since the proposal is based on the existing IAS 32 approach, we believe it is not necessary to align its application with the revised standard on financial instruments (IFRS 9). We consider that earlier application would be feasible.