

20 April 2011

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Dear Madam, dear Sir,

**ED/2011/1 Offsetting financial assets and financial liabilities**

The European Banking Authority (EBA), which has come into being as of 1 January 2011, welcomes the opportunity to comment on the IASB's Exposure Draft on Offsetting financial assets and financial liabilities (ED).

The EBA has a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

We are supportive of the proposed requirements in the ED, and welcome the converged approach taken by both the IASB and the FASB.

If you have any questions regarding our comments, please feel free to contact Mr. Elbaum (+33.1.4292.5801) in his capacity as Chairman of the EBA Expert Group in charge of monitoring developments in the accounting area or Mr. Colinet (+ 32.2.220.5247) in his capacity as Chairman of the technical group that coordinated this comment letter.

Yours sincerely,



Andrea Enria  
Chair, European Banking Authority

## Detailed questions

### **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 agree with the proposed requirement, as the criteria are consistent with the IASB Framework and will result in a net position being presented only when there is, in effect, a single asset or liability. These criteria are based on the existing requirements for offsetting financial assets and financial liabilities currently applied under IAS 32, which, in our view, did not raise any concerns in the past. We believe that they result in a faithful representation of the entity's expected cash flows.

The concept of simultaneous settlement in the criteria, according to paragraphs C10-C12 in the ED, means "at the same moment". Although this is not a departure from the existing standard, we note that there might be currently divergence in practice when applying this concept and encourage the IASB to provide more clarity on how this should be interpreted, based on its outreach with preparers and clearing houses.

Additionally, we notice that the ED does not mention the provisions in paragraph 49 of IAS 32 regarding the circumstances in which the offsetting conditions are generally not satisfied<sup>1</sup>. Since the requirements in ED are unchanged, we think it could be useful to point out these situations at least in the Application Guidance.

### **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**

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<sup>1</sup> Par. 49, IAS 32: "The conditions set out in paragraph 42 are generally not satisfied and offsetting is usually inappropriate when:

- (a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');
- (b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
- (c) financial or other assets are pledged as collateral for non-recourse financial liabilities;
- (d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or
- (e) obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.

**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 requirement that the right of set-off must be unconditional and enforceable in all circumstances.

In that respect we agree with the boards that the presentation of the statement of financial position should not exclusively be aimed at conveying only an entity's exposure to credit risk.

**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 offsetting should be permitted for multilateral as well as bilateral arrangements provided that the 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 with the proposed disclosure requirements as they are an important factor ensuring that users of financial statements can make well-informed decisions, and compare across entities.

**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 agree with the proposal to apply the requirements retrospectively which should enhance comparability across time periods and entities.