Barbara Davidson and Christian Kusi-Yeboah
Practice Fellow
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

4th May 2011

Dear Barbara and Christian,

Offsetting Financial Assets and Financial Liabilities

Thank you for the opportunity to respond to the IASB Exposure Draft on Offsetting.

The Chartered Financial Analyst Society of the UK represents more than 9,000 investment professionals working across the financial sector. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

<u>About CFA UK and CFA Institute</u>

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of whom more than 90,000 hold the Chartered Financial Analyst (CFA) designation.

<u>Response to Exposure Draft</u>

Overview

The initial reaction to this ED was concern that a change was being proposed when users of IFRS accounts had not made any noticeable complaints about the presentation of close-to-gross amounts. (This is a different point from the complaints that will inevitably have been made about the lack of comparability between US GAAP and IFRS statements.) Indeed, some users were grateful to have a relatively full picture of the assets and liabilities of ailing financial institutions on the face of the balance sheet during the financial crisis. The issue here is not just the legal enforceability of a netting arrangement but a view of the full range of activity being undertaken so that questions can be asked about the sheer level of it; whether it is profitable – and profitable enough for the amount of risk being taken; and whether it is manageable and can be effectively scrutinised by independent directors and users of accounts.

So, if the existing standards are not broken, why change? This is a rare example of convergence being the only reason for doing so. Hence the suspicion that more netting might be allowed as a compromise, bearing in mind that the impact of imposing IFRS on US financial institutions would be to bring trillions of dollars of netted assets/liabilities on to their statements of financial position (and bearing in mind the inevitable "pushback" from US banks).

Since the quality of standards should be the priority, the FRAC has been reassured to hear that the IASB board went through the existing criteria for offsetting in detail and unanimously endorsed the bulk of them. We note that the proposals may actually tighten up a couple of points eg enforceability, with the change from currently enforceable to "in all circumstances". Indeed, this did prompt an underlying question: is the focus of accounting standards switching in two subtle but important ways?

a) towards what is legally enforceable (which in turn raises questions about different legal systems) rather than what applies on the balance sheet date?

b) towards what happens in bankruptcy rather than presenting the entity as a going concern?

This might well be worth further debate.

Summary: The FRAC's overall position is to prefer all assets and liabilities to be reported gross because offsetting understates the risks being offset especially when non-financial risks may not be reflected in any offsetting contract. This is in line with paragraphs BC15-18 in the Basis for Conclusions. Since we are broadly content with existing IFRS, the reassurances that standards are not being watered down, which we have received from IASB presentations and through meeting staff at our April 4 meeting, have been of particular importance. On this basis, we support the proposals.

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?

Yes, having been reassured that this will not lead to more netting than is currently the case under IFRS. Taken with the enhanced disclosure requirements, users would have more information about the netting that does take place.
We do not regard management intention as a strong criterion.

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…(ie it is enforceable in the normal course of business and on the default, insolvency or bankruptcy of a counterparty)… Do you agree with this proposed requirement? If not, why? What would you propose instead, and why?

Yes. It is the strength of these criteria that allow the answer "yes" to question 1. It is noted that this may be a tighter requirement than the existing currently enforceable legal right.

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?

Yes

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?

Yes. This assumes that the statement of financial position would look similar to the way it looks under current IFRS.

Question 5—Effective date and transition

No comment

We hope that these comments have been useful and would be pleased to provide additional feedback in future.

Yours,

Jane Fuller, Chair, Financial Reporting and Analysis Committee

Will Goodhart, Chief Executive