

*Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions. The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.*

## Key messages

- **The EBF supports the convergence efforts and elimination of differences on treatment of assets and liabilities offsetting**
- **Offsetting should be based on the principles of credit and liquidity risk elimination**
- **Transactions settled through central counterparties where the entity has no exposure to credit or liquidity risk should be qualified for offsetting.**
- **As the variation margin transferred to the clearing house is a form of settlement of the net derivative position, it should be eligible for offsetting**
- **The proposed disclosure requirements are too extensive and disproportionate compared to other disclosure requirements on financial instruments**

## EBF comment letter on the IASB Exposure Draft: Offsetting Financial Assets and Financial Liabilities

The European Banking Federation welcomes the possibility to comment on the IASB Exposure Draft on Offsetting Financial Assets and Financial Liabilities. The EBF members are supportive of the convergence efforts and welcome the elimination of differences in treatment of offsetting assets and liabilities between IFRS and US GAAPs. The level playing field will increase comparability between financial statements and reduce any competitive disadvantages. While we understood that the intention of the IASB was not to change the current IFRS practices, when compared to current IAS 32, changes in the wording narrow the range of circumstances under which offsetting is allowed.

The proposed changes will impact the contracts executed with a clearing house as the requirement of simultaneous settlements would have to apply in all circumstances. The guidance in paragraph C11 appears to prevent the net presentation where settlement occurs with a central clearing house.

In practice, the settlement takes place on the same day but not necessarily simultaneously. Due to the volume of transactions and processing constraints, the settlement takes place in batches. The requirement of simultaneous settlement will have a significant adverse effect on the banking industry. The implementation of such requirement would be contra-intuitive to the efforts and initiatives to promote the central clearing of derivatives in order to mitigate the

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credit and liquidity risk. The understanding of the requirement of simultaneous settlement would need to be clarified if the aim is to ensure that there is neither liquidity nor credit risk inherent in the process, which is the purpose of the settlement through central counterparties (CCPs) or clearing houses. The EBF strongly believes that the net presentation of transactions settled through CCPs is entirely appropriate.

Also the guidance in C14 is confusing since it could be interpreted to impose a rule that offsetting is not permitted even where the general principles of offsetting are met. Variation margin is an advance payment for settlement of cash flows arising from the derivatives and represent a form of settlement of the net derivative position. The ED however does not allow offsetting of cash collateral paid and the fair value of the derivative settled via a CCP and requires a separate balance sheet presentation of the variation margin transferred to clearing house. Requiring separate presentation fails to recognize that there will be a net payment whereby the fair value under the derivative is netted with cash collateral. The EBF believes that as the variation margin transferred to the clearing house is a form of settlement of the net derivative position, it should be eligible for offsetting. We believe that a balance sheet presentation based on reduction of credit and liquidity risk represents the most useful information for the users of financial statements.

The current market practice under IAS 32 is to net the fair value of the interest rate swap and the variation margin regardless of the maturities of the interest rate swap as long as the interest rate swaps are denominated in the same currency. However paragraph BC 52 and BC53 indicate that for an entity to demonstrate its intention to net settle, a financial asset and a financial liability can only be offset if they have the same maturity and payment dates. This would represent a significant change to the current market practices and prohibit the netting of centrally cleared derivatives. The EBF believes that the overriding principles for netting should be build on the basis of credit and liquidity risk reduction.

Also the requirements for disclosures in the ED are too extensive, leading to unnecessary level of details. As many disclosures relate to risk reporting, these should be aligned and not presented in a fragmented way. The proposals in the ED should be seen in the context with the existing requirements of IFRS7 and other standards on accounting for financial instruments. In this context, the disclosure requirements for offsetting are too detailed compared to other disclosure requirements for financial instruments.

Please find below the EBF answer to the questions raised in the ED.

**Question 1 – Offsetting criteria: unconditional right and intention to settle net or simultaneously**

The EBF does not agree as the requirement of simultaneous settlement would significantly change the current practices and would lead to gross presentation. The requirement should be replaced by a principle build on the basis of credit and liquidity risk reduction.

### **Question 2 – Unconditional right of set-off must be enforceable in all circumstances**

The EBF agrees that assets and liabilities must be offset only if they are subject to an unconditional and legally enforceable right of set-off and this right should not be contingent on a future event. The EBF fails to understand why the enforceability of the right of offset should take into account the reporting entity own default, insolvency or bankruptcy.

### **Question 3 – Multilateral set-off arrangements**

The EBF agrees with the principle that offsetting is required for both bilateral and multilateral set-off agreements, once the counterparties are subject to the same rules.

### **Question 4 – Disclosures**

The proposed disclosure requirements are too extensive and disproportionate compared to other disclosure requirements on financial instruments.

Disclosure requirements related to transactions that have been set off in the statement of financial position will be useful for users and will enable them to see the link between the gross and the net amounts and the relationship between financial assets and financial liabilities.

We fail however to see the additional value in disclosing how reports could be affected by transactions that do not qualify for offsetting.

Presentation of collateral and the net amount after netting, fictitious netting and deduction of collateral in a table format as illustrated would in our opinion not lead to additional value for users.

The overall consistency of disclosure requirements and the changes to IFRS 7 should be assessed to avoid duplication of the disclosure requirements.

### **Question 5 – Effective date and transition**

- a) Offsetting of financial assets and financial liabilities is closely related to IFRS 9. It should have the same effective date and transition requirements. The EBF support full retrospection *without* restatement of comparatives. As the implementation period is estimated at three years, the effective date would not be possible earlier than 1<sup>st</sup> January 2015.