



Project **Offsetting Financial Assets and Liabilities**

Topic **Disclosures - Scope**

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### Introduction/Purpose of the paper

1. IASB Agenda Paper 5/FASB memo 13A (May 2011) provided a summary of the comment letters and feedback received on the exposure draft *Offsetting Financial Assets and Financial Liabilities* (the Exposure Draft or ED).
2. As noted in the feedback summary, users almost unanimously supported the proposed disclosures.
3. However, many preparers were concerned about various operational and cost benefit aspects of the disclosures.
4. Most preparers suggested that the boards further analyse if all the disclosure information proposed in the Exposure Draft is really necessary and useful. Many also questioned the scope of the disclosures and wondered if it was necessary to require such detailed information for loans, receivables and other types of financial instruments or if the disclosures should be limited to items such as derivatives and repurchase/reverse repurchase agreements and whether information about non-financial collateral should also be required.
5. Some asked whether just having collateral in place should bring them into the scope of the disclosures or whether it should be restricted to just when set-off is in place.
6. Appendices A and B set out current US GAAP and IFRS disclosure requirements on collateral.

## Scope of disclosure requirements

7. The proposed disclosure requirements in the ED were intended to be applied to all entities and for all financial assets and financial liabilities. Paragraph 11 of the Exposure Draft states the following:

An entity shall disclose information about rights of set-off and related arrangements (such as collateral arrangements) associated with the entity's financial assets and financial liabilities to enable users of its financial statements to understand the effect of those rights and arrangements on the entity's financial position.

8. Paragraph 15 exempts an entity from providing the proposed disclosures if the entity "has no financial assets and no financial liabilities at the reporting date that are subject to a right of set-off **and** the entity has neither obtained nor pledged cash or other financial instruments as collateral in respect of recognised financial assets and recognised financial liabilities."

### ***Feedback received***

9. Many commentators noted that while many contractual agreements commonly meet the definition of a financial instrument (ie cash, customer deposits, trade receivables and payables, an entity's own debt, debt and equity instruments, financial and physical derivatives), many of these items are not subject to offsetting arrangements and do not meet the offsetting requirements. However, entities may have obtained or pledged various forms of collateral in respect of such financial instruments and would therefore be subject to the proposed disclosure criteria as per paragraph 15 in the ED.
10. Some respondents requested that the scope of the proposed disclosures be amended to exclude deposits at financial institutions and traditional loans for which the lender has the right to set off the related non-cash collateral in the event of default. Typically, those institutions manage the credit risk associated with these positions primarily by mechanisms other than rights of set-off.
11. Some respondents questioned the usefulness of providing the proposed disclosures for financial assets and financial liabilities that are not subject to a right of set-off. They believe that existing disclosure guidance requires disclosure of information about the credit risk of those assets and liabilities.

12. These respondents are concerned that the proposed disclosure requirements would require an entity to re-examine all of its contractual arrangements for all of its financial assets and financial liabilities to be able to provide the information required under the proposal.
13. They argue that the costs and operational burdens of such a search are not justified as these instruments are already presented gross in the statement of financial position, and users can find credit information related to collateral obtained for these items in other disclosures (see Appendices A and B).
14. Some therefore requested clarification of paragraph 15 of the ED. They suggested that the proposed disclosures should not apply to an entity with financial assets and financial liabilities not subject to a right of set-off but in respect of which the entity has obtained or pledged collateral.
15. A few respondents were also concerned that the ED will impose requirements on non-financial institutions which seem to be designed for financial institutions. They question the benefit such disclosures will provide to investors in non-financial entities.

**Staff analysis**

16. The disclosure objective in paragraph 11 of the Exposure Draft focuses on providing information to enable users to understand the effect of rights of set-off and related arrangements on an entity's financial position.
17. Paragraph C20 of the Exposure Draft's Basis for Conclusions states that:

An entity shall present the disclosures in a manner that clearly and fully explains to users of the financial statements the nature of rights of set-off and related arrangements and their effect on the entity's financial assets and financial liabilities.
18. Given the recent decisions by the boards and feedback received from users, the staff believes that the disclosures should focus on providing information:
  - (a) that enables users to understand the effect of rights of set-off on entity's financial position and
  - (b) about both the gross and net amounts of an entity's financial instruments that enhances comparability between financial statements

prepared in accordance with US GAAP and those prepared in accordance with IFRSs.

19. The staff agrees with respondents' comments that if an entity has no assets or liabilities that are subject to a right of set-off (other than collateral agreements), there would be no incremental information value in providing the proposed offsetting disclosure information.
20. Where an entity has no assets or liabilities that are subject to a right of set-off (other than collateral), the disclosures in the ED would result in the entity only providing information on collateral obtained or pledged in respect of those assets and liabilities. However, information on collateral is already required by other guidance in US GAAP Topic 815 on Derivatives and Topic 860 on Transfers and Servicing in the *FASB Accounting Standards Codification*<sup>®</sup> and IFRS 7 *Financial Instruments: Disclosures*<sup>1</sup> today. Hence, the staff believes that in such a case there will not be any incremental informational benefit in requiring the proposed disclosures for these types of positions.
21. The staff disagrees with the comments that the proposed disclosure requirements were geared for and are only relevant for financial institutions. The staff believes there are many industries that utilise the set-off mechanism to mitigate exposure to credit risks, and the use of such techniques is prevalent in modern commercial arrangements. The staff believes the required disclosures are useful irrespective of the nature of an entity's business to the extent that such set-off rights have an effect on the entity's financial position.
22. However, the staff notes that the offsetting guidance has the most material impact in relation to the treatment of derivatives, repurchase agreements/reverse repurchase agreements and similar agreements (eg securities lending arrangements). These classes of products tend to be the largest group of items (by value) that are documented under a master netting agreement and are subject to a conditional right of set-off.
23. Thus the staff is persuaded that if the scope of the disclosures were to be limited to instruments under an enforceable master netting agreement or

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<sup>1</sup> See excerpt in Appendix A to this paper.

similar arrangement, and only those for which the parties have the right to settle net in bankruptcy, insolvency or default of the counterparty, the objectives set out in paragraph 18 of this paper will substantially be achieved.

24. Restricting the disclosure requirements to such instruments will reduce compliance cost, will ensure that the guidance is operational (the master netting agreement is one of the primary means of managing the credit exposure on those instruments) and will be consistent with the disclosure objectives set out in paragraph 8 of this paper.

*Staff recommendation*

25. The staff recommends that the boards:
- (a) retain the disclosure objective as originally proposed in the ED – 'An entity shall disclose information about rights of set-off and related arrangements (such as collateral arrangements) associated with the entity's financial assets and financial liabilities to enable users of its financial statements to understand the effect of those rights and arrangements on the entity's financial position';
  - (b) modify the scope of the disclosure requirements such that they apply only to instruments under an enforceable master netting agreement or similar arrangement (eg derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities lending arrangements) and
  - (c) clarify that an entity need not provide the required disclosures if the entity 'has no qualifying assets or liabilities that are subject to a right of set-off (other than collateral agreements) at the reporting date'.

**Question for the boards**

Do the boards agree with the staff recommendation in paragraph 25?

If not, why not and what would the boards propose instead?

## Appendix A: Collateral disclosure excerpts from US GAAP

### Derivatives- Collateral

**815-10-50-8** A reporting entity shall disclose the amounts recognized at the end of each reporting period for the right to reclaim cash collateral or the obligation to return cash collateral as follows:

- a. A reporting entity that has made an accounting policy decision to offset fair value amounts shall separately disclose amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral that have been offset against net derivative positions in accordance with paragraph 815-10-45-5.
- b. A reporting entity shall separately disclose amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral under master netting arrangements that have not been offset against net derivative instrument positions.
- c. A reporting entity that has made an accounting policy decision to not offset fair value amounts shall separately disclose the amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral under master netting arrangements.

### Transfers and Servicing

**860-30-50-1A** An entity shall disclose all of the following for collateral:

- a. If the entity has entered into repurchase agreements or securities lending transactions, it shall disclose its policy for requiring collateral or other security.
- b. As of the date of the latest statement of financial position presented, both of the following:
  1. The carrying amount and classifications of both of the following:
    - i. Any assets pledged as collateral that are not reclassified and separately reported in the statement of financial position in accordance with paragraph 860-30-25-5(a)
    - ii. Associated liabilities.
  2. Qualitative information about the relationship(s) between those assets and associated liabilities; for example, if assets are restricted solely to satisfy a specific obligation, a description of the nature of restrictions placed on those assets.
- c. If the entity has accepted collateral that it is permitted by contract or custom to sell or repledge, it shall disclose all the following:
  1. The fair value as of the date of each statement of financial position presented of that collateral
  2. The fair value as of the date of each statement of financial position presented of the portion of that collateral that it has sold or repledged
  3. Information about the sources and uses of that collateral.

For overall guidance on Topic 860's disclosures, see Section 860-10-50.

## Credit Risk

**825-10-50-21** Except as indicated in the following paragraph, all of the following shall be disclosed about each significant concentration:

- a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration
- b. The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
- c. With respect to collateral, all of the following:
  1. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk
  2. Information about the entity's access to that collateral or other security
  3. The nature and a brief description of the collateral or other security supporting those financial instruments.
- d. With respect to master netting arrangements, all of the following:
  1. The entity's policy of entering into master netting arrangements to mitigate the credit risk of financial instruments
  2. Information about the arrangements for which the entity is a party
  3. A brief description of the terms of those arrangements, including the extent to which they would reduce the entity's maximum amount of loss due to credit risk.

**825-10-50-22** The requirements of the preceding paragraph do not apply to the following financial instruments, whether written or held:

- a. The financial instruments described in paragraph 825-10-50-8(a); (c); (e); and (f), except for reinsurance receivables and prepaid reinsurance premiums
- b. Financial instruments of a pension plan, including plan assets, if subject to the accounting and reporting requirements of Topic 715.

Financial instruments of a pension plan, other than the obligations for pension benefits, if subject to the accounting and reporting requirements of Topic 960, are subject to the requirements of paragraphs 825-10-50-20 through 50-21.

## Appendix B: Collateral disclosure excerpts from IFRS 7

### Collateral

- 14 An entity shall disclose:
- (a) the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 37(a) of IAS 39 [3.2.23(a) of IFRS 9]; and
  - (b) the terms and conditions relating to its pledge.
- 15 When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
- (a) the fair value of the collateral held;
  - (b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
  - (c) the terms and conditions associated with its use of the collateral.

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### Quantitative disclosures

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#### Credit risk

- 36 An entity shall disclose by class of financial instrument:
- (a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (eg netting agreements that do not qualify for offset in accordance with IAS 32); this disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.
  - (b) a description of collateral held as security and other credit enhancements, and their financial effect (eg a quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with (a) or represented by the carrying amount of a financial instrument).
  - (c) information about the credit quality of financial assets that are neither past due nor impaired

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#### Collateral and other credit enhancements obtained

- 38 When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (eg guarantees), and such assets meet the recognition criteria in other IFRSs, an entity shall disclose for such assets held at the reporting date:
- (a) the nature and carrying amount of the assets; and
  - (b) when the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.