

# ISDA

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28<sup>th</sup> April 2003

## **ISDA – IASB Meeting April 8<sup>th</sup>, 2003**

Dear Sandra:

The International Swaps and Derivatives Association (ISDA) would like to thank you for arranging the meeting on fair value measurement on April 8<sup>th</sup> 2003. We appreciate the time that the IASB staff and Board members have taken in order to listen to our views and consider our concerns.

In anticipation of the Board's April meeting we particularly wanted to highlight the brief discussion we had at the end of the afternoon regarding IAS 32 for "off setting". We understand that many of the issues raised by ISDA at the meeting will have been included in the paper set out for the IASB Board in advance of Wednesday's Board meeting, and also that this will be the first time the IASB will discuss this particular topic.

Given the weight of industry concern surrounding this issue we thought it might be useful to restate some of our concerns in this letter.

The major concerns our members have around the criteria for "off setting" are: -

1. ISDA is concerned that the offset rules set out in IAS 32.33 - 41 [which remain predominantly unchanged from the current IAS 32] only allow offset when the entity 'intends' to settle on a net basis or realise the asset and settle the liability simultaneously (IAS 32.33(b)).
2. ISDA believes that where the entity has the unconditional right and ability to settle net, as demonstrated by the existence of a master netting

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agreement, then this should result in an offset presentation in financial statements. Offset in these circumstances is appropriate because it correctly reflects the credit risk exposure with that counterparty as well the legal positions of the counterparties in bankruptcy. The alternative gross presentation overstates assets and liabilities. It is also inconsistent with both US GAAP and the treatment applied by bank regulators. We have attached for reference excerpts from FIN 39 and the related basis for conclusions, as this is descriptive of the reasons for allowing a net presentation under US GAAP in certain circumstances.

In the OTC derivatives market, master netting arrangements are documented in the form of an ISDA Master Agreement. We would be happy to provide expertise on the legal operation of and concepts underlying these master agreements.

Separately, we look forward to continuing to work with the IASB on fair value measurement issues. The ISDA accounting committee is discussing issues raised at the April 8<sup>th</sup> meeting where further work was agreed. ISDA member firms are currently researching within their organizations a number of details that we hope to bring back to the IASB before the June Board meeting.

We hope that additional information will help the Board in achieving the ir objective of requiring measurement at fair value. We welcome the opportunity to continue working with the IASB in the development of improved standards for financial instruments.

If you have any questions or concerns please don't hesitate to contact me on 020 7330 3574 or at the above address.

Yours sincerely,



Edward A. Duncan  
Asst. Director of European Policy, ISDA

CC:

Sir David Tweedie

James Leisenring

Mary Barth

Tricia O'Malley

Ian Hague

Magnus Orrell

Kristin Hazzis

## **Attachment**

Excerpts from FIN 39 on the issue of offsetting fair value amounts

### Paragraph 10

"Fair value amounts recognized for forward, interest rate swap, currency swap, option, and other conditional or exchange contracts executed with the same counterparty under a master netting arrangement may be offset. The reporting entity's choice to offset or not must be applied consistently. A master netting arrangement exists if the reporting entity has multiple contracts, whether for the same type of conditional or exchange contract or for different types of contracts, with a single counterparty that are subject to a contractual agreement that provides for the net settlement of all contracts through a single payment in a single currency in the event of default on or termination of any one contract. Offsetting the fair values recognized for forward, interest rate swap, currency swap, option, and other conditional or exchange contracts outstanding with a single counterparty results in the net fair value of the position between the two counterparties being reported as an asset or a liability in the statement of financial position."

footnote - "The fair value recognized for some contracts may include an accrual component for the periodic unconditional receivables and payables that result from the contract; the accrual component included therein may also be offset for contracts is executed with the same counterparty under a master netting arrangement."

### Basis for Conclusions:

#### Paragraph 21

"The Board decided to permit offsetting of the fair value recognized for forward, interest rate swap, currency swap, option, and other conditional or exchange contracts if they are executed with the same counterparty under a master netting arrangement. That arrangement effectively consolidates individual contracts into a single agreement between the parties. The failure to make one payment under the master netting arrangement would entitle the other party to terminate the entire arrangement and to demand the net settlement of all contracts. The Board believes that an exception to the requirement of paragraph 5(c) of this Interpretation, which states that "the reporting party intends to set off" is justified when a master netting arrangement exists because the net presentation discloses the amount of credit risk exposure under that arrangement. The Board decided that, given a master netting arrangement, presentation of the aggregate fair values of the individual contracts executed under that arrangement would not provide more information about the uncertainty of future cash flows from those contracts than net amounts would."