ISDA. Safe, Efficient Markets

IFRS Interpretations Committee
First Floor
30 Cannon Street
London
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Interpretations Committee's tentative agenda decision on IAS 32 *Financial Instruments: Presentation- Offsetting and cash pooling*

Dear Sirs,

The International Swaps and Derivatives Association[1] ("ISDA") would like to take this opportunity to comment on the tentative agenda decision in relation to IAS 32 Financial Instruments: Presentation Offsetting and cash pooling ("IAS 32 Offsetting").

In November 2015, the IFRS Interpretations Committee ('IC') discussed a fact pattern relating to notional cash pooling facility and the extent to which a reporting entity can demonstrate its intent to net settle assets and liabilities within the scope of that pooling facility.

We agree with the Interpretation Committee's tentative decision not to add the issue to its agenda.

However, we do have significant reservations regarding the draft agenda decision put forward.

We believe that in reaching a view as to whether financial assets and liabilities should be offset in accordance with paragraph 42 of IAS 32, it is necessary to undertake appropriate analysis of the facts and circumstances of the situation. Whilst having a legally enforceable right may be relatively straightforward to identify in most cases, establishing whether there is an intention to settle on a net basis (para 42(b)) will require a detailed analysis and judgement.

IAS 32 provides considerable guidance on how a reporting entity should assess its legal right to set-off and on what type of settlement qualifies as being equivalent to net settlement. However IAS 32 only provides limited steers in relation to the "intention" to settle on a net basis – for example:

- Paragraph BC83 confirms an entity's right to set off is not invalidated by the passage of time or uncertainties in the amounts to be paid – absent any words to the

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 67 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

contrary, this implies that BC83 could apply equally to an entity's intention to net settle.

- Paragraph 46: when an entity intends to exercise its right to net settle, the presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed.
- Paragraph 47: when assessing whether there is an intention to net settle, an entity should consider normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

Having regard to these, we would then expect the entity to consider the evidence in support of "intention" – whilst not an exhaustive list, the following are typically areas to consider as indicators of "intent":

- The extent to which an entity risk manages balances on a "net basis";
- The history of net settlements and frequency and the extent to which this can be used as a predictor of future behaviour;
- Communication between the entity and its client(s) to facilitate net settlement.
- The commercial purpose of such arrangements – in this particular fact pattern, cash pooling is typically undertaken to efficiently/effectively manage a client group's liquidity/cash management arrangements.

The basis of conclusion states it expects there to be a degree of certainty of amounts at a reporting date to be offset and if period end balances can subsequently move, then offset cannot be achieved. We do not believe "intention" as required by IAS 32 implies a certainty in period end balances, but instead an expectation in the net exchange of settlement amounts arising from an asset and liability on a specified date. The asset and liability balances that are offset could change over time, but as long as the settlement amounts arising from the asset and liability are net settled on a specified date, the requirements of IAS 32 are met.

We also note that the tentative decision is made for a relatively narrow fact pattern. However, the conclusion is potentially far reaching and could be relevant to other areas where set off have been historically achieved through being able to demonstrate both the "legal right of set off" and the "intention" to net settle. We are confident that this was not the Interpretation Committee's "intention, in which case we invite the Committee to reconsider the wording used in the tentative agenda decision.

In light of the above therefore, we believe that the tentative agenda decision at this stage should be amended so as to highlight only the principles of IAS 32 and not set out an opinion for this specific fact pattern.

Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours faithfully,

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