IFRS

STAFF PAPER

June 2017

IFRS® Interpretations Committee Meeting

Project	Centrally Cleared Client Derivatives		
Paper topic	Tentative Agenda Decision to Finalise		
CONTACT(S)	Daisy Yang Ross Turner	dyang@ifrs.org rturner@ifrs.org	+44 (0) 20 7246 0552 +44 (0) 20 7246 6920

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for centrally cleared client derivative contracts from the perspective of the clearing member[1].

2. The Committee concluded that the clearing member first applies the requirements for financial instruments. More specifically, the Committee observed that:

    (a) If the transaction(s) results in contracts that are within the scope of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*), then the clearing member applies the requirements in IFRS 9 (IAS 39) to those contracts. Accordingly, an entity recognises a financial instrument in its statement of financial position, when it becomes a party to the contractual provisions of the instrument. The clearing

[1] Some jurisdictions mandate the clearing of particular derivative products through a central clearing counterparty (CCP). To clear through a CCP, an entity must be a clearing member. Most major international financial institutions offer clearing services for their clients, either by being clearing members at the CCP, or through relationships they have with other clearing members. However, the types of products required to be cleared, and the surrounding legal framework, vary across jurisdictions.

member presents recognised financial assets and financial liabilities separately, unless net presentation in the statement of financial position is required per offsetting requirements in paragraph 42 of IAS 32 *Financial Instruments: Presentation.*

(b) If the transaction(s) results in contracts that are not within the scope of IFRS 9 (IAS 39) and another IFRS Standard does not specifically apply, only then would the clearing member apply the hierarchy in paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to determine an appropriate accounting policy for the transaction(s).

3. The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared client derivative contracts. Consequently, it tentatively decided not to add this matter to its standard-setting agenda.

4. The purpose of this paper is to:

(a) analyse the comments received on the tentative agenda decision; and

(b) ask the Committee if it agrees with the staff recommendation to finalise the agenda decision.

Comment letter summary

5. We received five comment letters, reproduced in Appendix B to this paper.

6. Deloitte, ABN AMRO and the Canadian Accounting Standards Board (AcSB) agreed with the Committee's decision not to add the matter to its agenda. ABN AMRO and the AcSB specifically agreed with the Committee's conclusion that the principle and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally client derivative contracts.

7. KPMG did not disagree with the Committee's decision, but made the following suggestions regarding the wording of the agenda decision:

   (a) to replace '….if the transaction(s) results in contracts that are within the scope of IFRS 9…' with '….if the clearing of a client derivative product results in financial instruments that are within the scope of IFRS 9….', as what may be considered as a single transaction or a single contract in legal sense may result in the recognition of two derivative instruments;

   (b) to emphasise the 'substance over form' principle in paragraph 15 of IAS 32 when classifying financial instruments as financial assets and liabilities, because the legal description of an arrangement is not necessarily the same as its accounting treatment.

8. Mazars suggested that the Committee explain further that:

   (a) a clearing member performs the analysis first to determine whether it 'becomes a party to the contractual provisions of the instrument' acting in its own name, rather than on behalf of a third party; and

   (b) it performs this analysis taking into account legal and contractual rights and obligations.

9. Mazars also said that the clearing member normally accounts for cash collateral in the statement of financial position applying IAS 39 / IAS 32, even when the clearing member acts as an agent, or is not party to the contractual terms of the derivative. They suggested either:

   (a) limiting the scope of the agenda decision to the accounting for the fair value of the cleared derivatives in the clearing member's financial statements (ie excluding aspects relating to collateral); or

   (b) modifying the wording and structure of the agenda decision to accommodate cash collateral that is within the scope of IAS 39/IFRS 9 in most cases.

10. We have analysed the concerns raised by respondents in the following section.

Staff Analysis

11. We note that both of KPMG's suggestions point to the principle of 'substance over form'. We acknowledge that a contract in legal form may contain two financial instruments, and that an entity assesses the substance of a contract when classifying financial instruments as financial assets and liabilities. However, we suggest not including KPMG's second suggestion to emphasise the 'substance over form' principle because it is a pervasive principle throughout IFRS Standards.

12. In relation to KPMG's first suggestion outlined in paragraph 7(a), we note that the wording in the tentative agenda decision refers to 'contracts' rather than 'financial instruments'. This is because IFRS 9 (or IAS 39) includes within its scope both financial instruments (with a number of exceptions) and particular contracts to buy or sell non-financial items. However, we acknowledge that other parts of the tentative agenda decision may give the impression that an entity recognises assets and liabilities only when they meet the definition of a financial instrument. Hence, consistent with the scope of IFRS 9 (or IAS 39), we recommend making the following changes to the wording of tentative agenda decision (as underlined and struck through):

The Committee concluded that the clearing member first applies the requirements for financial instruments. More specifically, the Committee observed that:

a. *if the transaction(s) results in contracts that are within the scope of IFRS 9* Financial Instruments *(or IAS 39* Financial Instruments: Recognition and Measurement*), then the clearing member applies the* recognition *requirements in paragraph 3.1.1 of IFRS 9 (paragraph 14 of IAS 39) to those contracts.* ~~*IFRS 9 (and IAS 39) requires an entity to recognise an financial instrument in its statement of financial position when the entity becomes a party to the contractual provisions of the instrument.*~~ *The clearing member presents* ~~*recognised financial*~~

assets and ~~financial~~ liabilities separately applying IFRS 9 (or IAS 39) in the statement of financial position, unless net presentation ~~in the statement of financial position~~ is required pursuant to the offsetting requirements in paragraph 42 of IAS 32.

13. We acknowledge Mazars' view that a clearing member should first assess whether it becomes a party to a contract. However, as discussed in Agenda Paper 10 for the March 2017 meeting, the clearing member should do so by evaluating its contractual rights and obligations to (a) the clearing house and (b) the client. If its contractual rights and obligations to either (a) or (b) meet the scoping requirements in IAS 32 and IFRS 9 (or IAS 39), then the recognition, measurement and derecognition requirements in IFRS 9 (or IAS 39) apply to those contractual rights and obligations.

14. We also suggest not including in the agenda decision a discussion about the recognition of cash collateral by a clearing member. Paragraph D.1.1 of the implementation guidance accompanying IFRS 9 (or IAS 39) provides specific requirements on the recognition of cash collateral, which is unaffected by the agenda decision.

Staff recommendation

15. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in the IFRIC Update in March 2017 with minor wording changes. Appendix A of this paper sets out the draft wording for the final agenda decision.

Question for the Committee
Does the Committee agree with the staff recommendation to finalise the agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording for final agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through)

> **IAS 32 *Financial Instruments: Presentation*—Centrally cleared client derivatives**
>
> Some jurisdictions mandate the clearing of particular derivative products through a central clearing counterparty (CCP). To clear through a CCP, an entity must be a clearing member[2]. The types of products required to be cleared, and the surrounding legal framework, vary across jurisdictions.
>
> The Committee received a request to clarify the accounting for centrally cleared client derivative contracts from the perspective of the clearing member.
>
> The Committee concluded that the clearing member first applies the requirements for financial instruments. More specifically, the Committee observed that:
>
> a. *if the transaction(s) results in contracts that are within the scope of IFRS 9* Financial Instruments *(or IAS 39* Financial Instruments: Recognition and Measurement*), then the clearing member applies the recognition requirements in paragraph 3.1.1 of IFRS 9 (paragraph 14 of IAS 39) to those contracts.* ~~*IFRS 9 (and IAS 39) requires an entity to recognise an financial instrument in its statement of financial position when the entity becomes a party to the contractual provisions of the instrument.*~~ *The clearing member presents* ~~*recognised financial*~~ *assets and* ~~*financial*~~ *liabilities separately applying IFRS 9 (or IAS 39) in the statement of financial position, unless net presentation* ~~*in the statement of financial position*~~ *is required pursuant to the offsetting requirements in paragraph 42 of IAS 32.*

[2] Clearing Members are sometimes referred to as Clearing Brokers.

b. If the transaction(s) is not within the scope of IFRS 9 (IAS 39) and another IFRS Standard does not specifically apply, only then would the clearing member apply the hierarchy in paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to determine an appropriate accounting policy for the transaction(s).

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared client derivative contracts. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Appendix B—Copies of comment letters

Financial Reporting and Standards Canada
277 Wellington Street West,
Toronto, ON Canada M5V 3H2
T. 416 977.3222 C. 416 204.3412
www.frascanada.ca

May 22, 2017

By e-mail to ifric@ifrs.org

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: IAS 32 *Financial Instruments: Presentation* – Centrally cleared client derivatives

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision regarding the accounting for centrally cleared client derivative contracts from the perspective of the clearing member.

The views expressed in this letter take into account comments from individual members of the AcSB staff.

We agree with the Committee's decision not to add this item to its agenda for the reasons set out in the tentative agenda decision. Specifically, we agree with the Committee's conclusion that the principles and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared client derivative contracts. The tentative agenda decision clarifies that an entity would first apply the requirements of IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*) if a transaction results in contracts that are within the scope of IFRS 9.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me at +1 416 204-3464 (e-mail rvillmann@cpacanada.ca), or, alternatively, Michelle Thomas, Principal, Accounting Standards (+1 416 204-2979 or email mthomas@cpacanada.ca).

Yours truly,

Rebecca Villmann

Rebecca Villmann
Director, Canadian Accounting Standards Board
rvillmann@cpacanada.ca
+1 416 204-3464

KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

Tel +44 (0) 20 7694 8871
mark.vaessen@kpmgifrg.com

Ms Sue Lloyd
Chair, IFRS Interpretations Committee
IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Our ref MV/288
Contact Mark Vaessen

22 May 2017

Dear Ms Lloyd

Tentative agenda decision: *IAS 32 Financial Instruments: Presentation—Centrally cleared client derivatives*

We appreciate the opportunity to comment on the above IFRS Interpretations Committee (the Committee) tentative agenda decision included in the March 2017 IFRIC Update. We have consulted with, and this letter represents the views of, the KPMG network.

We offer the following recommendations to improve the educative value of the agenda decision:

— Where it says that "…if the transaction(s) results in contracts that are within the scope of IFRS 9…", it would be better to say "…if the clearing of a client derivative product results in financial instruments that are within the scope of IFRS 9…" since what may seem to be described as a single transaction or as a single contract in the associated legal documentation may result in two derivative instruments being recognised.

— It would be helpful to emphasise that the identification of financial assets and financial liabilities is based on the substance of the contractual arrangements, reflecting the principle in IAS 32.15. Again, this would indicate that the *prima facie* legal description of the arrangements is not determinative as to the accounting result.

Please contact Mark Vaessen +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited
Cc: Reinhard Dotzlaw, KPMG LLP (Canada)

From:
Stefan van der Bijl
Head of IFRS Policies
ABN AMRO Group N.V.

Tel.: +31 20 6 282 795

To:
IFRS Interpretation Committee

Date: 22 May 2017

Comment on the tentative agenda rejection notice regarding IAS 32 *Financial Instruments: Presentation* – Centrally cleared client derivatives (AP 10)

Dear members of the IFRS Interpretation Committee,

Thank you for providing us with the opportunity to comment on the IFRIC Update – March 2017 edition, regarding IAS 32 *Financial Instruments: Presentation* – Centrally cleared client derivatives (AP 10).

We support the tentative decision of the Committee not to add this matter to its standard-setting agenda. We agree with the Committee that the principles and requirements in IFRS Standards provide an adequate basis for a clearing member to account for centrally cleared client derivative contracts.

We welcome the Staff's recommendation that if the contractual arrangements in place do not meet the definition of a Financial Instrument within IAS 32, the clearing member applies the hierarchy within IAS 8 to determine an appropriate accounting treatment for its contractual arrangements.

Furthermore, we support the conclusion that a clearing member first considers the applicability of the Financial Instrument requirements within IAS 32, IAS 39 and IFRS 9 standards, before the principal versus agent requirements in IAS 18 or IFRS 15 are considered.

Yours sincerely,

Stefan van der Bijl
Head of IFRS Policies
ABN AMRO Group N.V.

Deloitte.

Deloitte Touche Tohmatsu Limited
2 New Street Square
London
EC4A 3BZ

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 1198
www.deloitte.com/about

Direct phone: +44 20 7007 0884
vepoole@deloitte.co.uk

22 May 2017

Sue Lloyd
Chair
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Ms Lloyd

Tentative agenda decision – IAS 32 *Financial Instruments: Presentation*: Centrally cleared client derivatives

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the March IFRIC Update of the tentative agenda decision not to take onto the Committee's agenda the request for clarification on the accounting for centrally cleared client derivative contracts from the perspective of the clearing member.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

MAZARS

Mrs Sue Lloyd

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Paris, May 23, 2017

Tentative Agenda Decisions – IFRIC Update March 2017

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee tentative agenda decisions published in the March 2017 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We would like to draw your attention to Appendix 2 on modified financial liabilities. We strongly believe that this issue, which could lead to a significant change to widespread accounting practices despite the absence of any clear change in IFRS 9 compared to IAS 39, cannot be dealt with through a simple agenda decision.

We consider that such a change deserves to be introduced through an authoritative pronouncement, being an Interpretation or an Amendment to IFRS 9, including appropriate transition relief, and following a sufficient due process that would allow the Board, the Interpretations Committee and all interested stakeholders to question the economic relevance of the outcome.

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin **Edouard Fossat**

Financial Reporting Technical Support

61 rue Henri Regnault - 92075 Paris La Défense Cedex
Tél : +33 (0)1 49 97 60 00 - Fax : +33 (0)1 49 97 60 01 - www.mazars.fr

Mazars
Société anonyme d'expertise comptable et de commissariat aux comptes
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Siège social : 61 rue Henri Régnault - 92400 Courbevoie - TVA intracommunautaire : 07 784 824 153

MAZARS

Appendix 5

IAS 32 *Financial Instruments: Presentation* — Centrally cleared client derivatives (Agenda Paper 10)

In our opinion, the accounting for centrally cleared client derivatives is a complex issue that:

- involves judgement
- and depends on the specific facts and circumstances of the transaction as the underlying legal environment may give rise to very different rights and obligations.

However, we encourage the IFRS IC to take this opportunity to provide a structure / methodology on how the IFRS analysis should be performed.

It is our practical experience that **the key issue and first step of the analysis is to determine whether the clearing member is acting as a principal (and shall as such recognize derivatives on balance sheet) or as an agent**, in which case the clearing member shall limit its accounting entries to those typically arising from a contract that transfers services to a customer.

In our view this critical analysis shall be performed prior to any scope or recognition analysis.

We consider that the standards IAS 32 and IAS 39/ IFRS 9 provide very little guidance to address this topic. Specifically, the notion of "becomes a party to the contractual provisions of the instrument" is not accompanied by guidance or illustrative examples relevant to this kind of situation.

In practice, the analysis performed is closely related to the legal analysis of the contractual rights and obligations. Depending on the legal and contractual environment of the transaction, diversity may occur across jurisdictions.

We therefore encourage the IFRS IC to explain further:

- that a clearing member should perform the analysis first to determine whether it "becomes a party to the contractual provisions of the instrument" acting in its own name and on its own behalf, rather than in the name of and on behalf of a third party; and
- that this analysis shall be performed taking into account legal and contractual rights and obligations as it is generally the key element.

Besides, the proposed tentative agenda decision (part **b** of the IFRS IC observation in particular) does not seem to accommodate the case of **cash collateral** exchanged on client cleared derivatives. Cash collateral is normally accounted for in the balance sheet of the clearer **in accordance with IAS 39 / IAS 32 requirements** even when the clearing member acts as an agent/ is not party to the contractual terms of the derivative, since the cash is in most cases not legally segregated from the clearer's assets (cf. IAS 39 § D.1.1 on this issue).

We therefore suggest that either

1- the scope of the tentative agenda decision be explicitly limited to the accounting for the **fair value** of the cleared derivatives on the clearing member's financial statements (i.e. excluding any aspects relating to collateral exchanged on such transactions in the form of cash or securities), or

2- the wording and structure of the decision be modified to accommodate cash collateral that should fall into the scope of IAS 39/ IFRS 9 in most cases.