

28 April 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Sir David,

AOSSG Islamic Finance Working Group
Comments on *Offsetting Financial Assets and Financial Liabilities*

The Asian-Oceanian Standard-Setters Group (“AOSSG”) is pleased to provide comments from its Islamic Finance Working Group to IASB ED/2011/1 *Offsetting Financial Assets and Financial Liabilities*.

The AOSSG’s Islamic Finance Working Group (“AOSSG IF WG”) was set up to provide input and feedback on the adequacy and appropriateness of proposed and existing IFRS to Islamic financial transactions and events. The AOSSG IF WG comprises staff from the standard-setters of Australia, China, Dubai, Korea, Malaysia, Pakistan, and Saudi Arabia.

These comments are additional to those in the letter developed by the AOSSG Financial Instruments Working Group dated 28 April 2011, and focus only on issues that are specific to Islamic finance. The AOSSG Islamic Finance Working Group had sought comment and feedback from AOSSG members prior to finalising this letter, and none of those members have expressed significant disagreements.

Offsetting criteria: unconditional right, and intention to settle net or simultaneously

We agree with the proposed requirements. Additionally, we would like to point out that to our knowledge there is no ‘Islamic master netting agreement’. In some jurisdictions, this may be ameliorated by offsetting regulations which put the contracting parties on par with a conventional equivalent arrangement. However, such regulations may not be available in other jurisdictions. Thus, offsetting may be less available to Islamic than conventional entities, because they cannot benefit from the automatic trigger explained in paragraph C9, and their ability to benefit from other triggers will depend on their Sharia or legal advice. Accordingly, an entity may not be able to offset certain Islamic transactions, while their otherwise economically similar conventional equivalents would be offset. Nevertheless, Working Group members view this as a matter to be dealt with by one of the trade bodies, and not one that would necessitate a redrafting of the proposed requirements.

Unconditional right of set-off must be enforceable in all circumstances

The Working Group has no particular concerns with the proposed requirements from an Islamic perspective.

Multilateral set-off arrangements

We agree with the proposed requirements. Additionally, in response to the question “What are some of the common situations in which a multilateral right of set-off may be present?” we would like to highlight that Islamic derivatives are often structured such that in addition to the two main contracting parties, there are suppliers and brokers to provide an underlying commodity to the transaction so that the derivative takes the form of a series of sales and purchases of the underlying commodity in order to comply with Islamic precepts. Depending on the jurisdiction and the commodity exchange, it may be possible to incorporate a multilateral set-off arrangement into the structure. However, the Working Group has not established whether such a set-off is common, and whether it has achieved general Sharia acceptance. The Working Group notes that some Sharia scholars may insist on separating the various sale and re-purchase legs of an Islamic derivative transaction, as well as the amounts payable / receivable therefrom.

Disclosures

For Islamic arrangements where there may be only conditional rights to offset, the requirements of paragraphs 12 and 13 on conditional rights may be unnecessarily onerous and superfluous – especially if an offset is improbable or even remote. Therefore, some Working Group members suggest amending paragraph 15 by requiring these disclosures only if it is probable that a conditional right to offset may be exercised. Other Working Group members believe that the disclosures required by paragraphs 12(c)-12(g) and 13 are not useful even if the conditional right is highly probable to be exercised because, regardless, the financial asset and financial liability would not be permitted to be netted off on the statement of financial position, and the cost in providing the information would outweigh the benefit to users.

Transition

The Working Group does not have any objections to the requirement for retrospective application.

Conclusion

We thank you for this opportunity to share our views. If you have any queries regarding this submission, or require further information on any aspect of Islamic finance, the Working Group would be pleased to offer its assistance.

Yours sincerely,



Mohammad Faiz Azmi
Leader of the AOSSG Islamic Finance Working Group