

March 8, 2011

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Ref: Hedge accounting: Exposure Draft

Dear Sir or Madam,

Crédit Agricole SA Group welcomes the Board's intent to propose significant changes to the general hedge accounting requirements in IAS 39. However, it is crucial that the new standard addresses all issues that have been leading to the European IAS 39 "carve-out" compromise.

To that extent, Crédit Agricole SA Group urges the IASB to supplement the Hedge accounting Exposure Draft referred to with additional provisions concerning **macro-hedge accounting requirements**. Indeed, as a major actor in the European banking industry, Crédit Agricole SA Group is strongly involved in macro-hedging activities as part of the entity's risk management activities.

Consequently, it should be noted that Crédit Agricole SA Group can only contribute with partial and temporary comments before getting a clear view of the global set of hedge accounting requirements, including macro-hedging activities.

Great improvements have been performed as far as general principles are concerned

Crédit Agricole SA Group welcomes the proposed objective of hedge accounting to **reflect the entity's risk management activities**. It is consistent with the business model approach that Crédit Agricole SA Group has always supported for the purpose of classification and measurement of financial instruments. The hedge accounting alignment with risk management is really a key concept to provide useful information to users and facilitate further understanding of business.

Besides, Crédit Agricole SA Group acknowledges the positive **principle-based approach** that should prevail over all types of arbitrary rules that could prevent hedge accounting from being aligned with risk management practices.

In the same way, Crédit Agricole SA Group also supports fully the IASB's efforts toward more **simplification**.

However, important issues still need to be handled

It appears actually that the Board has not drawn all the consequences of its approach since major risk management activities in the banking industry would not qualify so far for hedge accounting according to the Exposure Draft. This is unfortunately the case for the following hedged items:

- Interest-rate risk component embedded in **demand deposits**;
- Interest-rate risk component embedded in a loans' portfolio with **contractual or legal prepayment options**;

- Interest-rate risk component embedded in a **sub-index financial instrument (ie: the so-called sub-Libor issue)**;
- Credit risk component embedded in a financial instrument;
- **Inflation component** embedded in the price of a financial or a non-financial instrument;
- **Equity investments** that would be fair-valued through other comprehensive income according to the IFRS 9 classification and measurement option;

Please find enclosed in the appendix our detailed responses to the questions raised in the Exposure draft.

Yours faithfully,



Bertrand BADRÉ
Chief Financial Officer
Crédit Agricole SA

Appendix

Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group welcomes the proposed objective of hedge accounting to **reflect the entity's risk management activities**. It is consistent with the business model approach that Crédit Agricole SA Group has always supported for the purpose of classification and measurement of financial instruments. The hedge accounting alignment with risk management is really a key concept to provide useful information to users and facilitate further understanding of business.

On the other hand, it appears that the Board has not made much of this principle since major risk management activities in the banking industry would not qualify so far for hedge accounting according to the Exposure Draft. This is unfortunately the case for the following hedged items:

- Interest-rate risk component embedded in **demand deposits**; such financial liabilities should qualify for eligible hedged items for the purpose of fair value hedge accounting, provided that it can be demonstrated that the effective refundable profile mimics the critical terms of a market-based hypothetical bond. Such a demonstration could be performed at a portfolio level through a bottom layer approach, and should be based on internal historical data. This is part of sound practices for managing the business of maturity transformation in most of the retail banking industry.
- Interest-rate risk component embedded in a loans' portfolio with **contractual or legal prepayment options**; such financial assets should qualify for eligible hedged items for the purpose of fair value hedge accounting, provided that it can be demonstrated that the effective amortization schedule meets a cash flows recovery profile without any prepayment feature. Such a demonstration could be performed at a portfolio level through a bottom layer approach, and should be based on internal historical data.
- Interest-rate risk component embedded in a **sub-index financial instrument (ie: the so-called sub-Libor issue)**; such a financial instrument includes a negative spread on the client side which consists of an effective revenue on the issuer side. This might be the case for bonds issued by sovereign counterparties for instance; this is more commonly the case for commercial funding sources of savings banks. For such instruments, the index component should be analysed as an interest-rate component to be included in the scope of eligible hedged items for the purpose of fair value hedge accounting. At the bank level indeed, the negative spread would never result in an effective negative margin that would overstep the entity's risk management limits or hedge effectiveness ratio. This activity fairly illustrates *"the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place"* that should be assessed *"when identifying what risk components are eligible for designation as a hedged item"*, according to paragraph B14.
- **Credit risk component** embedded in a financial instrument; as credit portfolio management is part of the entity's risk hedging activities, it should also be handled in the hedge accounting model. The proposed fair value option alternatives would not be aligned with the entity's risk management activities and would maintain undue volatility in the financial statements.

Besides, Crédit Agricole SA Group acknowledges the positive **principle-based approach** that should prevail over all types of arbitrary rules that could prevent hedge accounting from being aligned with risk management practices.

For example, Crédit Agricole SA Group welcomes the withdraw of the 80-125 per cent 'bright line' for the purpose of hedge effectiveness assessment, and fully advocates for a hedge ratio linked to the risk management strategy.

However, some requirements in the Exposure Draft are **still excessively rule-based** and would result in arbitrary outcomes:

- **Inflation component** embedded in the price of a financial or a non-financial instrument; such a component may be separately identifiable and reliably measurable even if it is not contractually

specified. It should be permitted for an inflation component to be designated as a hedged item, whatever the contractual features, provided that such a component meets the qualifying criteria, ie separate identification and reliable measurement.

- **Equity investments** that would be fair-valued through other comprehensive income according to the IFRS 9 classification and measurement option; it should be permitted for such an equity risk exposure to be designated as a hedged item whether the gain or loss upon sale would affect other comprehensive income or Equity. Additionally, Crédit Agricole SA Group urges the Board to reconsider the prohibition of recycling in profit or loss gains and losses upon sales of such equity investments.

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees that non-derivative financial instruments could be eligible hedging instruments, but it should not be limited to financial instruments at fair value through profit or loss.

Furthermore, Crédit Agricole SA Group would support that a highly probable loan commitment could be designated as a hedged item for the purpose of fair value hedge as well as cash flow hedge.

Question 3

Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees.

Question 4

Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group fully agrees with the two conditions for a component to be qualified as a hedged item: separate identification and reliable measurement. Indeed, Crédit Agricole SA Group would like to pinpoint that the meaning of a "separate identification" should not be limited to a "contractual specification" whatever the risk exposure, including an inflation component; such a view would be excessively rule-based and would fail to meet the new hedge accounting objective (see Q1).

Furthermore, it should be noted that a component is a hedged item that should not always be less than the entire item; otherwise, hedge accounting could not encompass the whole economics behind a bank's interest rate hedging strategy, such as the sub-Libor hedge.

Question 5

(a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group fully supports the layer approach that consists of the designation of a layer of a nominal amount of an item as a hedged item. This is fairly a great improvement of the Exposure Draft.

(b) Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group disagrees that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item.

It should be clarified that, according to the '**bottom layer**' approach, a contract that includes a prepayment option should be eligible as a hedged item for the purpose of fair value hedge, since the option's fair value is deemed not to be affected by changes in the hedged risk.

Through a 'bottom layer' approach it can be demonstrated that the effective amortization schedule meets a cash flows recovery profile without any prepayment feature. Such a demonstration could be performed at a portfolio level and should be based on internal historical data (see Q1).

Question 6

Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

It is surely a great convenience that hedge effectiveness can be assessed prospectively only, whether on a qualitative or a quantitative basis depending on the hedge relationship critical terms. Crédit Agricole SA Group supports this simplification that will affect the documentation process for most of 'vanilla' hedge relationships.

Crédit Agricole SA Group welcomes the withdraw of the 80-125 per cent 'bright line' for the purpose of hedge effectiveness assessment, and fully advocates for a hedge ratio linked to the risk management strategy.

However, Crédit Agricole SA Group is concerned with the requirement that hedging relationship should minimise expected hedge effectiveness; 'minimization' is a concept that includes a wide range of interpretations and that might be very complex, if not impossible, to demonstrate in practice. The objective of "reducing" significantly the expected hedge ineffectiveness would be more appropriate to reflect the entity's risk management activities.

Question 7

(a) Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees. However, illustrative examples and implementation guidance would be useful.

(b) Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees. However, illustrative examples and implementation guidance would be useful.

Question 8

(a) Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees. However, illustrative examples and implementation guidance would be useful.

(b) Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group does not agree to the extent that it could arbitrarily prevent hedge accounting from being aligned with the entity's risk management activities in some cases such as forex risk hedging relationship. Indeed illustrative examples and implementation guidance would be useful.

Question 9

(a) Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees that the ineffective portion of a hedge relationship shall be recognised in profit or loss; Crédit Agricole SA Group also fully supports the offsetting mechanism for the presentation of the effective portion of a fair value hedge relationship.

However, the current accounting treatments under IAS 39 are already consistent with these approaches; as a preparer, Crédit Agricole SA Group thinks that it would generate undue processing costs (ie costly IT system adaptation) to change the effective portion recognition in other comprehensive income compared to the financial information reporting benefits. Crédit Agricole SA Group is in favour of maintaining the current reporting treatment in profit or loss for the purpose of fair value hedge accounting.

(b) Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees.

(c) Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?

Crédit Agricole SA Group thinks that a linked presentation is not appropriate in the face of the statement of financial position where a single line, respectively on the asset side and the liability side, would be useful enough to report the hedged risks reevaluation impacts. A linked presentation could be performed in the disclosures.

Question 10

(a) Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (eg like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees. However, illustrative examples and implementation guidance would be useful.

(b) Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees. However, illustrative examples and implementation guidance would be useful.

(c) Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (ie the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees. However, illustrative examples would be useful for clarification.

Question 11

Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group globally agrees.

Question 12

Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (eg in a net position hedge), any hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees.

Question 13

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees.

(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

No more comment.

Question 14

Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

Crédit Agricole SA Group agrees; fair valuation is appropriate to reflect the entity's fair value-based risk management strategy.

Question 15

(a) Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?

Crédit Agricole SA Group does not agree with the three alternatives and considers that the most appropriate alternative would consist in considering the accounting of CDS hedging instruments in the same way as accounting for financial guarantee contracts. This alternative would have the benefit of answering all the Board's considerations within this project i.e. meeting risk management's strategy as well as reducing volatility in P&L. Another alternative would be to consider that credit risk hedging is eligible within the proposed new hedging accounting model, through a CDS valuation approach being the most appropriate.

The economic reasons for not agreeing with the three alternatives are numerous:

- a. This accounting methodology is not in line with risk management related to these assets. Indeed, these loans are the consequence of pure banking activity whereby banks contribute to the refinancing of worldwide economy and hence, intend to keep them on balance sheet over time. Therefore, to account for these loans on a fair value basis would not reflect the economy of the transaction nor management's intention. This would also be counter-intuitive when compared with loans for which there is a specific trading activity and an active market, like in London or New-York and for which accounting on a trading basis makes sense and is justified.
- b. It is argued that this fair value methodology would enable banks to mitigate their credit risk volatility. This would indeed be the case if the three alternatives allowed to fair value loans only for the credit risk fair value and not for the other risks value (e.g prepayment, liquidity etc...), which in this case, alternative 3 being the best alternative. In any other cases, it is important to underline the fact that other volatility would be induced when fair valuing a loan based on all its inherent components, at least liquidity volatility. Indeed, fair value would have to be determined on these assets for which there are no real active markets because of their nature and management policy. Prepayment options volatility could also be induced.

- c. Fair value accounting principle also leads to difficult issues such as how to determine the most appropriate fair value on these type of assets: market value or model based value can be considered. Questions arise when markets have few activity and few "reference" transactions that could sometimes be entered into on stressed conditions, creating an inadequate fair value market price. When using in-house models, other questions also arise on parameters that should be used: a reference to CDS curves would not solve the fact that these curves take into account specific CDS valuation components and do not take into account specific characteristics loan itself such as prepayment options etc...If another methodology is used, P&L consistency between the loan fair value and the CDS fair value would not necessarily be more consistent.
- d. Pricing at fair value would also imply that these loans can be sold at that price which has neither economic justification nor any justification from a management's policy standpoint.
- e. Last but not the least, the 3 alternatives enable any entity to value one same loan on two different basis hence to give them two different prices which has no economic substance: the portion of the loan that is eligible for credit risk hedg accounting would be valued on a fair value basis whereas the remaining portion of the loan not eligible would be valued on an accrued basis.

(b) If not, which of the three alternatives considered by the Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?

Crédit Agricole SA Group urges the Board to reconsider the credit risk issue and permit a credit risk component to be designated as a hedged item.

Another alternative would consist in considering the hedging credit risk instruments such as credit default swaps in the same way as financial guarantee contracts, with the same accounting model.

Question 16

Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

As already mentioned in the Request for Views in last January, Crédit Agricole SA Group advocates for a single effective date for the whole set of future IFRSs, without possible earlier application.

Provided that the global set of new standards will be completed by June 2011, and considering that a 3 years implementation time will be necessary at the minimum, this expected effective date shall **not be earlier than the 1st of January 2015.**

For reduction complexity purpose and in order to enhance the transition implementation with high quality inputs, a limited **retrospective application without restatement** of comparative amounts should be required.