SOCIETE GENERALE

CL 92

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DIRECTION FINANCIÈRE
ET DU DÉVELOPPEMENT

AFFAIRES COMPTABLES

29 OCT 2004

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

Re : ED 7 'Financial Instruments: Disclosures'

Dear Sir,

We are pleased to provide our comments on the above exposure draft.

We support the issuance of a new Standard that contains all disclosure requirements in relation to financial instruments of any entity.

We noted that many risks disclosures required by the ED are similar to the ones required for banks by Pillar III of the Basel Accord.
However, as far as risks are concerned we believe that the ED calls for additional information which is not required in Pillar III (e.g. fair value of collateral received, past due loans...).
Additionally, we note that the Basel Accord is only applicable for year end 2007 financial statements – implementation requires indeed for banks further IT developments - whereas the proposed effective date of the ED is for periods beginning on or after 1st January 2007 with earlier adoption encouraged. We believe that, as far as risks are concerned, because of the ED, banks must provide information required by the Basel Accord before the 2007 year end deadline. Therefore, we would suggest that for risk disclosures the effective date of the ED is identical to the Basel Accord's effective date and that in the mean time IAS 32 applies.

Finally, while we agree that information on risks and capital may be relevant for users, we deem that it is not appropriate for IFRS to require this type of disclosure in the notes to the financial statements. We believe that risk and capital disclosures should be located in the information provided by the management.

In the attached Appendix we have noted our concerns as to some aspects of the proposed approach and our responses to the specific matters on which comment was requested.

We appreciate the opportunity to provide our comments. If you have any questions concerning our comments, please contact Pascale DEVERGIES GILODI in Paris at 33 (0)1 58 98 97 54.

Sincerely,

G. Coutant

Geneviève COUTANT
Head of Group Accounting Department

Appendix
Comments of XX on
ED 7 Financial Instruments: Disclosures

Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance

The draft IFRS incorporates disclosures at present contained in IAS 32 Financial Instruments: Disclosure and Presentation *so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements:*

- *a) financial assets and financial liabilities by classification*
- *b) information about any allowance account*
- *c) income statement amounts by classification*
- *d) fee income and expense.*

Are these proposals appropriate? If not, why not, what alternative disclosure would you propose?

We support the proposal to locate all of the disclosure requirements of IAS 32 in one standard together with additional new disclosure requirements.

We believe it is appropriate to require the disclosures of financial assets and financial liabilities by classification. We understand that this classification and the level of details required in paragraph 10 can be either provided for on the face of the balance sheet or in the notes.

We believe that the requirement to disclose a reconciliation of any allowance accounts is appropriate. However we note that entities that do not use allowance accounts and that reduce directly the carrying amount of the impaired asset are not subject to this requirement: ED7-22 only applies.

We believe it is appropriate to require the income statement amounts to be shown by their classification. However we would encourage the Board to clarify the notion of net gains and losses. We feel that paragraph 21 b) is particularly misleading as it could be concluded that net gains and losses on assets/liabilities measured at amortized cost include interest income/expense on these financial instruments. Additionally, we believe it is unclear whether net gains and losses on these financial instruments designate only gains and losses arising from:

- Derecognition of the instruments and /or;
- Changes in the carrying amount due to impairment or reversal of impairment or forex effects.

It is also unclear where the impact of the hedging derivatives should be shown.

We believe the disclosure of fee income/expense is appropriate.

Question 2 – Disclosure of fair value of collateral and other credit enhancements

For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable. Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

We agree that ED7 should enable the reader of financial statements to obtain an understanding of the credit risk of the business of an entity and of the methods of credit enhancement. However, we do not believe that this proposal helps meeting this objective.

Fair Value of collateral

- We believe that the fair value of collateral is a meaningless figure to the extent it is not compared with the loan it does collateralize. It can also be misleading: an entity could have loans that are over-collateralized. Because of the Fair value disclosures requirements, the fair value of these collaterals would be aggregated with insufficient collaterals held on other loans. Readers of financial statements could inappropriately conclude that the bank is properly guaranteed against credit risk or even has no credit risk. Consequently, we believe that disclosures currently required by paragraph 39 b) would not help in understanding the real credit risk of the entity.

- Additionally, the reader of the financial statements could inappropriately conclude that collateralized loans always represent a lower risk than non-collateralized loans, which is not necessarily the case; it depends on the nature of the lending activity and the credit worthiness of borrowers.
As a consequence we believe that information on Fair Value of collateral should not be required in paragraphs 39 b) and 40 c).

Other issues related to collateral pledged

We note that paragraph BC28 states that the Board agreed not to require the disclosure of fair value of collateral pledged where this is impracticable. While paragraph 39(b) contains an impracticability clause, paragraph 16 does not. We believe this should be clarified and homogenized.

We note that the requirement in paragraph 15 requires disclosure of financial assets pledged as collateral, but then goes on to require the disclosure of *'terms and conditions relating to assets pledged as collateral'*. We believe the standard should say *'terms and conditions relating to financial assets pledged as collateral'*.

Past due notion and ageing balance

According to Pillar III of the Basel Accord:

- Information about past due financial assets are disclosed **only if available; and**
- Disclosure of the ageing of past due loans is encouraged.

Additionally , we note that the past due notion as defined in the ED (one payment failure) does not correspond to the default definition under Basel II and consequently, we believe the past due notion as defined in the ED would not be a useful criterion for banks: for example a loan can be past due because of technical impediments only.

Therefore, we believe that there should be some cost-benefit trade off to requiring the information. We believe that information on past due financial assets as defined in the ED and ageing balances should be disclosed only if available and consequently:

- paragraph 39c) should be drafted as follows: '*information about the credit quality of financial assets with credit risk that are not impaired;* ***information about the credit quality of financial assets with credit risk that are not past due nor impaired, if available.***';
- and paragraph 40a) should be read as follows: '*an analysis of the age of financial assets that are past due at the reporting date but not impaired,* ***if available.***'

Collateral and other credit enhancements obtained

We understand that information required by paragraph 41 is disclosed only if the assets obtained by taking control of collateral pledged as security or calling on other credit enhancements are still on the balance sheet at the closing date.

Location of disclosures on credit risk
See Q6

Question 3 – Disclosure of a sensitivity analysis

For an entity that has exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis. Is the proposed disclosure of a sensitivity analysis practicable for all entities? If not, why not and what, if any, alternative disclosures of market risk would you propose of enabling users to evaluate the nature an extent of market risk?

We agree with the requirement to disclose a sensitivity analysis for market risk in relation to financial instruments. Additionally, we believe that in practice disclosures should be commensurate with the class of asset or the type of business (e.g. trading vs. banking book) and we consider that requirements should not go beyond the Basel Accord's requirements.

Additionally, we disagree with the fact that disclosures of sensitivity analysis should be part of the financial statements. See Q6.

Question 4 – Capital disclosures

The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objective, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance.

Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

We agree that information on capital may be relevant for users. However, we believe that it should be limited to externally capital requirements. Information on capital targets set by management and breaches of capital limits, either set by management or the externally imposed requirements, would in many cases be confidential information. Furthermore, we believe that the proposed requirements go beyond what is currently required by Pillar III of the Basel Accord. On this matter, we consider that IFRSs disclosure requirements should not go beyond information required by prudential regulators.
As far as breaches of capital limits are concerned, we feel regulators would not wish to see them communicated. Also we note that disclosure of a breach during the course of the year (which can occur for technical reasons only) and that has since been corrected would be of limited value.

We believe that this is a matter best addressed on a jurisdictional basis by regulators, who are better able to develop requirements consistent with their own frameworks (those frameworks incorporating the requirements of IFRS) that meet the needs of users.

Additionally, we feel that at this point in time, that it is not appropriate for IFRS to require capital disclosure in the notes to the financial statements (see Q6). We are concerned that there is no widespread established framework for determining capital requirements.

Moreover, as qualitative information about the entity's objectives, policies and processes for managing capital and any quantitative data would depend on assumptions made and used by the management, we feel that it is more relevant to disclose such information as part of the information provided by management outside the financial statements.

Question 5 – Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged. Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption. Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

We believe the effective date is appropriate except for risk disclosure requirements that are common with those provided for by Pillar III of the Basel Accord, which are only applicable for year end financial statements (see our comments on Q2). Basel Accord's implementation will require further significant IT developments for banks. Therefore, we would suggest that disclosures on risks required by ED7 apply for 2007 year end's financial statements only and that in the mean time IAS 32's requirements in respect of financial risks are applied.

Additionally, we would kindly urge the Board to finalize this standard at the very beginning of 2005 in order for constituents to prepare and anticipate the adoption of this standard, except for disclosures on risks (see above). This would allow them to not apply IAS 30 and IAS 32 that are only temporary standards. We also noted that entities that would adopt IFRS and this draft IFRS for the first time before 1/1/2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption.

Question 6 – Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards. Some believe that disclosures about risks should not be part of the financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements. Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

We disagree with the fact that the disclosures about risks and capital (should requirements on disclosure of capital be maintained in ED7) should be part of the financial statements especially paragraphs 19 and 20 and 32 to 48. We are concerned that the information requirements embedded in these paragraphs could not be easily audited because of its nature, we believe that such information should be outside the financial statements.

Question 7 – Consequential Amendments to IFRS 4

Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 Insurance Contracts *to make them consistent with the requirements proposed in the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's insurance project?*

We agree that IFRS 4 should be amended to reflect the new disclosures required in respect of financial instruments.

Question 8 – Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32 – 45. Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

We do not have additional guidance to propose.

Question 9 – Difference from the Exposure Draft of proposed Statement of Financial Accounting Standards *Fair Value Measurements* published by the US Financial Accounting Standards Board.

The FASB's Proposed Statement of Financial Accounting Standards Fair Value Measurements, *which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows*

a) *For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period, (for example, trading securities)*
    i. *The fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,*
    ii. *How those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market input were used), and*
    iii. *The effect of remeasurements on earning for the period (unrealized gains or losses) relating to those assets and liabilities still held at the reporting date.*
b) *For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of*
    i. *The reason for the remeasurements*
    ii. *The fair value amounts*
    iii. *How those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and*
    iv. *The effect of the remeasurements on earning for the period relating to those assets and liabilities still held at the reporting date.*

Disclosures similar to (a)(ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a). Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

We agree that the ED as drafted provides sufficient information.

Question 10 – Other Comments

Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

No further comments.