



28th April 2011

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

Re: Exposure Draft ED/2011/1 Offsetting Financial Assets and Financial Liabilities

Dear Sir David,

We are pleased to provide our comments on the above Exposure Draft (the “ED”) issued by the IASB on 28 January 2011.

We welcome the IASB and the FASB efforts to develop joint proposals for converged requirements for offsetting financial assets and liabilities, which would lead to more comparability between entities reporting under IFRS and US GAAP.

Offsetting requirements are indeed very different in IFRS (IAS 32) compared to US GAAP (FIN 9), US accounting standards currently allowing offsetting while IFRS does not. The difference between the two treatments is material and leads to non comparative balance sheets.

Nevertheless, we have some significant concerns regarding the proposals of this ED; we have summarized our main comments in this cover-letter while answers to the detailed questions of the invitation for comment are provided in the appendix.

1) We propose to retain the existing approach in IAS 32

Regarding the proposed offsetting criteria, we support the Boards’ decision to retain the existing approach in IAS 32, which did not raise concern in the past, neither during the recent financial crisis and neither before.

This would enable, from our point of view, the statement of financial position to represent properly the rights and obligations stemming from the entity’s financial transactions and it would also better reflect the entity’s expected cash inflows and outflows.

We also agree with the proposal to require offsetting only when the entity has an unconditional right and intends to settle net a financial asset and a financial liability, which will provide clear and transparent information on the face of the statement of financial position to users. We agree that offsetting cannot result from a conditional event, i.e. from a default that might or might not happen in the future and that the statement of financial position should not represent only the entity’s exposure to counterparty risks.

However, we have a number of concerns about some of the ED’s proposals.

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2) Cash collateral offsetting should be allowed, as currently performed under IAS 32

We have concerns on the guidance in paragraph C14 which may be confusing as it would not permit offsetting even where criteria of offsetting are met. This would be the case with derivatives contracts with clearing houses where payments incorporate margin and cash flows of the derivatives.

Therefore, the IASB should confirm that this prohibition does not prevent from presenting on a net basis financial instruments and some cash collateral when the offsetting conditions are perfectly met.

3) Settlements occurring with a central clearing house should be regarded as “simultaneous”

Paragraph C12 of the ED would prevent some repos and reverse repos with clearing houses from being offset due to processing constraints.

In our opinion, where settlements are performed through a clearing house, settlements could be regarded as simultaneous when no counterparty risk or liquidity risk is undertaken by the entity within the clearing house.

4) The proposed disclosures are too extensive and lead to unnecessary level of details

We have also concerns about the disclosures requirements which are expanded. We would recommend the Board to avoid requiring redundant information and then to previously assess whether the current requirements of IFRS 7 “Financial Instruments: Disclosures” should be revised in the light of this new proposed approach for offsetting financial assets and liabilities.

Should the IASB and the FASB Boards fail to agree on the proposals in the current exposure draft, we would suggest US statements to disclose separately, in tabular format, the gross amounts of financial assets and financial liabilities before taking into account any offsetting and the amounts offset in the balance sheet. Such information would provide users with transparent and complete information about the existence and impact of US GAAP set-off rights and would additionally give them the means to compare US GAAP financial statements with IFRS statements of financial position.

5) Effective date and transition

We consider that the offsetting of financial assets and financial liabilities is linked to the revision of IAS 39. Therefore, we consider that the future standard on offsetting should be applicable at the same time as IFRS 9, that is to say not earlier than **January 1st, 2015**, as we proposed in our answer sent last January to the Request for Views: Effective Dates and Transition Methods. We do not favor a full retrospective application which would be unrealistic due notably to the scope of financial instruments involved, to the volume of data to be collected and to the hypothesis to be formulated in order to restate past transactions. The only opening balance sheet figures would be then restated according to the new standard and a reconciliation schedule would be then provided between closing and opening balance sheet figures with appropriate explanations.

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If you have any queries regarding our comments, please do not hesitate to contact me or Pierre-Henri Damotte, Head of Group Accounting Policies Department of Societe Generale.

Sincerely,

Marie DOUCET
Group Chief Accountant

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Question 1 - Offsetting criteria: unconditional right and intention to settle net or simultaneously

The proposals would require an entity to offset a recognised financial asset and a recognised financial liability when the entity has an unconditional and legally enforceable right to set off the financial asset and financial liability and intends either:

- (a) to settle the financial asset and financial liability on a net basis; or
- (b) to realise the financial asset and settle the financial liability simultaneously.

Do you agree with this proposed requirement? If not, why? What criteria would you propose instead, and why?

In our opinion, the ED should retain existing criteria in IAS 32.

We agree with the Boards' decision to develop common offsetting criteria for financial assets and liabilities based on the current requirements of IAS 32. These existing requirements are globally satisfactory and did not raise concern in the past, neither during the recent financial crisis and neither before.

We agree to require an entity to offset a financial asset and a liability only when the entity has both an unconditional and legally enforceable right to set off and intends to do so. This enables the statement of financial position to represent properly the rights and obligations stemming from the entity's financial transactions. It will also reflect in a more appropriate manner the entity's expected cash inflows and outflows.

We therefore agree with the Boards that the proposed approach will provide information that is useful for assessing the entity's ability to generate cash in the future, the nature and amounts of the entity's economic resources and claims against the entity.

Nevertheless, we have concerns about the treatment of cash collateral. The ED prohibits cash collateral, including margin accounts to be offset with the associated financial assets or financial liabilities. The guidance in C14 is confusing since it could be interpreted as a prohibition of offsetting even where the general principles of offsetting are met. However, many quoted derivatives with clearing houses give rise to daily margin call legally netted against the fair value of those derivatives. It is necessary to make a distinction between collateral given or received as a separate guarantee and some margin calls in cash which are in substance cash flows of the related derivative instruments.

Therefore, the IASB should confirm that this prohibition does not prevent from presenting on a net basis financial instruments and some cash collateral when the offsetting conditions are perfectly met.

We have also a concern regarding the criteria of "*simultaneous settlement at the same moment*" of financial assets and liabilities.

At present, IAS 32 indicates that the operation of a clearing house is deemed to constitute simultaneous settlement and it is only "in other circumstances" that the realization/settlement has to occur at the same moment for the offset requirements to be met. Under the proposals, that distinction is not made and the requirement to simultaneously settle at the exact same moment would apply in all circumstances. As a result, an entity that executes, for example, repurchase agreements (repos) and reverse repurchase agreements (reverse repos) with a clearing house will not be able to offset the financial assets and liabilities arising from such

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contracts denominated in the same currency, and maturing on the same day, unless they are settled *at the same moment*. This does not necessarily happen in practice due to processing constraints, which cause repos and reverse repos to be cleared in batches during the day.

However, in this circumstance, there is no exposure to credit risk or liquidity risk and the flows are in effect equivalent to a single net amount.

That is the reason why in our opinion, simultaneous settlement should mean that the entity is not exposed at any time to any type of counterparty risk or liquidity risk for one leg of the offset. Where settlement is through a clearing house, settlement could be regarded as simultaneous if the clearing house ensures that no counterparty risk or liquidity risk is undertaken by the reporting entity.

Question 2—Unconditional right of set-off must be enforceable in all circumstances

It is proposed that financial assets and financial liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of set-off. The proposals specify that an unconditional and legally enforceable right of set-off is enforceable in all circumstances (ie it is enforceable in the normal course of business and on the default, insolvency or bankruptcy of a counterparty) and its exercisability is not contingent on a future event. Do you agree with this proposed requirement? If not, why? What would you propose instead, and why?

Consistently with our answer to Q1, we consider that the financial assets and financial liabilities presented on the statement of financial position should not be based on the potential occurrence of a future event (such as counterparty default). Therefore, we agree with the Boards that a conditional right of set-off (such as a master netting agreement) is not sufficient to require a presentation on a net basis.

Question 3—Multilateral set-off arrangements

The proposals would require offsetting for both bilateral and multilateral set-off arrangements that meet the offsetting criteria. Do you agree that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements? If not, why? What would you propose instead, and why? What are some of the common situations in which a multilateral right of set-off may be present?

We agree that, by principle, the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements. We do not see, indeed, any conceptual basis for prohibiting their application just because an arrangement is between more than two parties.

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Question 4—Disclosures

Do you agree with the proposed disclosure requirements in paragraphs 11–15? If not, why? How would you propose to amend those requirements, and why?

We do not agree with the proposed disclosure requirements.

We have concerns about the extensive and disproportionate disclosure requirements proposed in the ED leading to extensive preparation costs with no added value on information for users of financial statements.

We would recommend the Boards to avoid requiring redundant information and then to previously assess whether the current requirements of IFRS 7 “Financial Instruments: Disclosures” should be revised in the light of this new proposed approach for offsetting financial assets and financial liabilities. As an example, paragraph 36 of IFRS 7 already requires entities to disclose credit risk exposure without taking into account any collateral or other credit enhancement and a description of collateral and other credit enhancements and their financial effect. The new disclosures proposed by the ED would also convey information on collateral.

The ED has introduced additional disclosure requirements relating to financial assets and financial liabilities that are offset as well as those for which there is no intention of the management to offset even if the criteria are met : we do not understand the rationale for requiring such information related to rights of set-off that do not result in a net presentation in the statement of financial position.

The proposed disclosure in paragraph 12 requires showing separately the gross amount of financial assets or liabilities and the portfolio-level adjustment for credit risk of the counterparties. Portfolio-level adjustments made to incorporate the credit risk of the counterparties are typical in derivative valuation processes and have not historically been disclosed separately, as they have been considered a component of valuation as opposed to an offsetting adjustment. Therefore, we do not see the rational for requiring to disclose separately a valuation component next to credit risk mitigation operations (such as physical collateral arrangement for instance). We consider that portfolio-level credit risk adjustments are not relevant in a disclosure about rights of set-off and related arrangements.

Should the IASB and the FASB Boards fail to agree on the proposals in the current exposure draft,, we would suggest US statements to disclose separately the gross amounts of financial assets and financial liabilities before taking into account any offsetting and the amounts offset in the balance sheet. Such information would provide users with transparent and complete information about the existence and impact of US GAAP set-off rights and would additionally give them the means to compare more easily US GAAP financial statements with IFRS statements of financial position.

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Question 5—Effective date and transition

(a) Do you agree with the proposed transition requirements in Appendix A? If not, why? How would you propose to amend those requirements, and why?

(b) Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.

(a) We consider that the replacement of IAS 39 would potentially imply a significant scale of changes for financial institutions and in our view, specific transitional relief should be provided for accordingly.

The offsetting of financial instruments is related to IFRS 9 and should follow the same transition requirements, including the specific relief mentioned above.

(b) We consider that the offsetting of financial assets and financial liabilities is related to revision of IAS 39. Therefore, we consider that the future standard on offsetting should be applicable at the same time as IFRS 9.

Due to the large scope of application of IFRS 9 and its deep implementation issues, we consider its first application as being a task fully comparable to the 2005 first-time application (FTA) of IAS standards in Europe. Then, as previously mentioned and explained in our past answer to the Request for Views: Effective Dates and Transition Methods (January 2011), and based on our experience taken from the 2005 FTA :

- We estimate that a single date approach for the implementation of the new standard is better than a sequential approach.
- We consider that the implementation period should not be less than three years after the issuance of the full set of new standards to be applied (with all phases of IFRS 9 including macro-hedging). On the basis of the current time schedule of IASB, expecting all standards to be issued before the end of 2011, the effective date for their first application would not be then earlier than January 1st, 2015.
- We do not favor a full retrospective application of the new standards and we rather suggest applying the same transition approach as the one applied by first time adopters for IAS 39 in 2005. The opening balance sheet would be then restated according to the new standards and a reconciliation schedule would be provided between closing and opening balance sheet figures with appropriate explanations.

Furthermore, we anticipate huge implementation costs related to the update of information systems for both:

- Tracking the gross financial assets and financial liabilities that qualify for offsetting under the proposals, and
- Aligning systems with the proposed disclosure requirements of the exposure draft.