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BPCE’s response to the FASB’s exposure draft “Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities”.

BPCE is pleased to take the opportunity to comment on the exposure draft “accounting for financial instruments and revisions to accounting for derivative instruments and hedging activities”.

BPCE is the second largest retail banking group in France.

Though we do not report under USGAAP, we are concerned by the evolution of US accounting standards on two accounts:

First, as preparers, we support global convergence of accounting standards on a worldwide basis, a key step to achieve a true global financial market.

Second, as users, the financial statements issued by our US counterparts are a major tool to assess their performances and creditworthiness.

Although the Boards have reaffirmed their commitment to converge and to consider jointly the comments received from their constituencies, the FASB is clearly and surprisingly adopting a direction which diverges from the IASB.

We are concerned about the approach adopted by the FASB in its proposed standard for financial instruments. While the IASB decided to keep the mixed measurement model for accounting for financial instruments, the FASB proposal which requires measurement of almost all financial

instruments at fair value through profit or loss, clearly ignores the previous comments of its constituents.

The critical orientation of the ED for generalizing the use of fair values in most circumstances for financial instruments is not in our view a right step to achieve these objectives. It will generalize “level 3” instruments measurement to a high percentage of the banks balance sheets, leading to controversial assessments and endless disputes on the reasonableness of the assumptions used to value these illiquid instruments. The odds are high that the uncertainty on such valuations will be greater than the P& L of the period, leading to withdraw credibility to financial statements.

Instead of a full fair value model, we are rather in favour of a mixed-measurement model consistent with the business model of the entity and holding time horizon. For instance, amortised cost is the best measurement attribute for instruments held to collect or pay cash-flows. Fair value through OCI (with recycling) is appropriate for financial instruments (equity or debt instruments) that are held for medium term (i.e. not for trading purposes).

We also disagree with the proposal to measure credit impairment on an incurred losses basis, based on static economic assumptions. This evolution of the impairment model does not address the key issue of the mismatch between the period of credit risk accumulation during phases of economic expansion and the period where provisions are set up, when the cycle reverse.

We thank you for considering our comments and remain at your disposal if you have any question on them.

BPCE

Appendix I

Detailed comments

1. Classification and measurement

Scope

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments do you believe should be excluded or which financial instruments should be included that are proposed to be excluded? Why?

We note that the scope of the FASB's exposure draft is different from the current scope of IFRS 9/IAS 39. We acknowledge that "the scope of IAS 39 should be considered during a later phase of the project to replace IAS 39" (IFRS 9 BC7). Therefore, our answer to the questions below could be modified by the clarification that could arise during that later phase.

Initial measurement

Question 8: Do you agree with the initial measurement principles for financial instruments? If not, why?

We agree that when an entity initially recognizes a financial instrument, it has to determine whether there is reliable evidence to indicate whether there may be a significant difference between the transaction price and the fair value of the instrument. Such departure is indicative of other elements or subsidies in the deal which must be recorded as such. Nevertheless, the critical term in this statement here is "significant": many financial instruments are not actively traded and only a range of plausible, therefore acceptable fair values can be determined for them. Furthermore, many factors affect the pricing of a financial instrument, and it is not obvious to assess that two instruments share all of the same characteristics taken into consideration to price them. Only significant departure of the transaction price from other prices of "similar transactions" can be identified.

Question 9: For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?

Yes, we agree.

Question 10: Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?

We agree that a single measurement principle should govern the first recordings of transactions. In most cases, the transaction price will be representative of instruments' fair values. Please, see our answer to question N° 8.

Subsequent measurement

Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

Measurement attribute :

We are opposed to the FASB proposal to measure at fair value almost all financial instruments (including loan commitments).

The G20 at the London meeting on 2 April 2009 required that the valuation of financial instruments should be based on their liquidity and investors' holding horizons, taking into account valuation uncertainty, and that the complexity of related accounting standards be reduced. However, the FASB proposals neither reduce complexity nor deal with the other requirements made by the G20, notably regarding liquidity and investors' holding horizon.

We consider, as it was highlighted by the alternative views, that the generalisation of fair value accounting would not portray accurately in the financial statements not actively traded financial instruments or financial instruments held for collecting payments or contractual cash flows. We are opposed to the principle of measuring all financial instruments at fair value because the fair value measurement attribute is not suitable for all activities.

We are rather in favour of a mixed-measurement model consistent with the business model of the entity and holding time horizon. For instance, amortised cost is the best measurement attribute for instruments held to collect or pay cash-flows. Fair value through OCI (with recycling) is appropriate for financial instruments (equity or debt instruments) that are held for medium term (i.e. neither for collection of cash-flows nor for trading purposes).

Presentation :

We disagree with the FASB proposal to present two measurement attribute (amortised cost and fair value) on the face of the statement of financial position for certain debt instruments. We believe that this presentation will provide confusing information.

In addition, the presentation of change in fair value either in net income or in OCI, coupled with the Boards' proposal for a unique statement of comprehensive income, will lead to marginalize the net income as indicator of performance. This is a direction to which we are opposed.

Reclassification

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications

should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

We disagree with the FASB's proposal to prohibit any reclassification.

We believe that a reclassification should be required when an instrument no longer meets the conditions related to its category, including when external circumstances force entities to change their business model

Core deposit

Question 17: The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is appropriate? If not, why? Do you believe that the remeasurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements? Why or why not?

We disagree with the FASB proposed complex re-measurement model for core deposits. This remeasurement approach leads to something similar to the recognition of internally generated goodwill/intangible asset, which is prohibited for other internal intangible assets.

We consider that deposits should follow the same measurement principles than other financial liabilities, which should be consistent with the business model of the entity.

Therefore, since deposits are usually managed on a cash flow basis (like other funding resources), the amortised cost is generally the most relevant measurement basis for deposits.

Embedded derivatives

Question 25: For hybrid financial instruments that currently would require bifurcation and separate accounting under Subtopic 815-15, do you agree that recognizing the entire change in fair value in net income results in more decision-useful information than requiring the embedded derivative to be bifurcated and accounted for separately from the host contract? If yes, how will the information provided be used in the analysis of an entity? If not, for which types of hybrid financial instruments do you believe that it is more decision useful to account for the embedded derivative separately from the host contract? Why?

Question 26: IFRS 9 requires hybrid financial assets to be classified in their entirety on the basis of the overall classification approach for financial assets with specific guidance for applying the classification approach to investments in contractually linked instruments that create concentrations of credit risk. Also, for hybrid financial liabilities, the IASB, in order to address the effects of changes in the credit risk of a liability, tentatively has decided to retain existing guidance that requires embedded derivatives to be bifurcated and accounted for separately from a host liability contract if particular conditions are met. Do you believe that the proposed guidance for hybrid financial instruments or the IASB's model for accounting for financial hybrid contracts will provide more decision-useful information? Why?

We disagree with the FASB proposed approach for hybrid instruments that requires measurement at fair value through net income for financial instruments that would require bifurcation under current US GAAP. We also disagree with the IFRS 9 approach for financial assets (which is not consistent with the approach proposed for financial liabilities).

We consider the principle of identifying and valuing embedded derivatives for hybrid financial instruments is justified in order to properly represent the nature and cash flows of each component of a hybrid instrument (i.e. enhance the understanding of the effect of the embedded derivative on one hand and of the host contract, usually held on a cash flow basis, on the other hand).

Hence, we are in favour of maintaining the current requirements of IAS 39 to separate embedded derivatives when they are not economically closely related to the host contract. Moreover, the existing guidance must be improved for all financial assets and liabilities.

Presentation

Own credit risk

Question 32: For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which could be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?

We disagree with the FASB proposal regarding changes in an entity's credit standing which is counter-intuitive and does not result in decision-useful information as underlined by the IASB..

We are in favor of excluding the effect of changes in the price of own credit risk from profit or loss, We therefore welcome the IASB's proposal that changes in own credit risk would not impact profit or loss for all liabilities designated under the fair value option but we prefer a "frozen spread" approach.

We are opposed to the approach retained by the IASB to recognize in OCI the portion of fair value change attributable to credit risk for the following reasons :

- the counter-intuitive effect underlined by the IASB is only transferred from net income to OCI but remains in the financial statements, whereas users confirmed that they remove the effect of own credit risk from the fair value measurement. Moreover, regulators will still have to maintain a prudential filter to neutralize the own credit risk effect in OCI for capital requirements. These adjustments made by users and regulators demonstrate that the own credit risk effect is not useful in the financial statements and should be only provided in disclosures;
- this will generate undue volatility in OCI;
- the IASB adds a new component in OCI which becomes more and more heterogeneous and confusing;
- the decision to prohibit recycling in profit or loss because "*gains or losses on those liabilities should be recognized only once [and] therefore, recognising a gain or loss in OCI and subsequently reclassifying it to P&L is inappropriate*" (BC37) clearly leads to the promotion of a unique statement of comprehensive income and to marginalizing net income as indicator of performance. This is a direction to which we are opposed and it would result in maintaining in a so-called "income statement" changes in own credit risk contrary to the Board's decision to avoid this counter-intuitive effect;
- if some users consider changes in own credit risk to be useful, then providing such information in the notes is relevant and would meet their needs.

Question 37: Do you believe that the objective of the credit impairment model in this proposed Update is clear? If not, what objective would you propose and why?

The proposal modifies the existing incurred loss model and bases its proposals on entity's expectations on collectability. From that point of view, we may consider it moves in the right direction by proposing an early identification and recognition of losses approach.

However, as it would consider only available information about past events and existing conditions and would exclude future economic events beyond the reporting date, the approach is focusing on "point in time" expected loss parameters. The parameters would be sensitive to the economic cycle and would not permit to assess expected credit losses on an ongoing basis.

Therefore, the proposed approach would not allow reflecting the risk assumed by the firm and would not address the pro-cyclical effects of the current impairment model.

It would not be consistent with the G20 and the Financial Stability Board objectives to promote a more forward looking provisioning and early identification of credit losses leading to a less procyclical model than the current incurred loss provisioning model.

Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).

The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.

Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

We do not believe that the FASB takes the right direction when proposing an immediate recognition of credit impairment when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s). As we answered in question 37, this would not meet objectives defined by G20 and financial authorities to permit less procyclicality in assessing credit impairment.

Concerning the IASB proposals, we support the objective to develop an expected loss model. However, we believe that this model does not give a fully adequate answer to the primary objectives described. We have concern regarding the significant operational challenges related to the use of an EIR mechanism. The implementation of the proposed model is too complex and implies operational difficulties and significant costs which could not be justified in our view by any significant improvement in financial reporting.

Therefore, we consider that the alternative model based on an expected loss approach should meet the following features:

- The new impairment model should not change the current definition of amortised cost or the EIR calculation.
- Expected losses should be determined on open portfolio level aligned with the credit risk management practices and experience, the information already available and the systems developed in order to meet the Basle II requirements.
- The expected loss provision is calculated over the life of the portfolio, i.e. the average maturity of the loans in the portfolio weighted by the outstanding balance.
- Expected loss provision at initial recognition and subsequent revisions of estimates are spread over the life of the portfolio.
- To estimate expected losses, a through-the-cycle approach should be adopted.
- Impairment allowances are built up to be used when incurred loss occurs.

Question 40: For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates. Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?

We do not believe a detailed prescription would be helpful.

Moreover, we do not favour the prescription of a detailed methodology as we believe a standard should be kept rule based.

Question 41: Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?

Yes, we agree

Question 42: If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset. Do you agree with this requirement? If not, why?

determination of expected loss allowance should be made at an open portfolio level. Another principle is that incurred loss principle should be retained for identified losses. Therefore the current incurred model of IAS 39 should be maintained.

Under the alternative approach we advocate, open portfolios should be used.

As the size and the nature of the portfolios may vary within and between different entities, the definition of portfolios should be consistent with the entities' risk management practice. It should also be based on the existing systems and information already available and built for regulatory capital purposes to meet Basle II requirements. Therefore, entities should be able to classify their loans into portfolios used for their credit risk management. At a high level of aggregation, it should follow the categorisation of assets as under Basle II provisions: corporate, bank, sovereign and retail portfolios.

Moreover, in order to accurately assess the exposure to credit risk, sample of loans included in portfolios should be significant and not be limited by a narrow definition of portfolios.

Therefore, we see no reason to evaluate expected loss impairment on an individual basis. Instead of applying historical loss rate of a group of similar assets to the individual asset, this individual asset should be incorporated into a portfolio of similar assets.

Question 46: The proposed guidance would require that in determining whether a credit impairment exists, an entity consider all available information relating to past events and existing conditions and their implications for the collectibility of the cash flows attributable to the financial asset(s) at the date of the financial statements. An entity would assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and would not forecast future events or economic conditions that did not exist at the reporting date. In contrast, the IASB Exposure Draft on Impairment proposes an expected loss approach and would require an entity to estimate credit losses on basis of probability-weighted possible outcomes.

Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate? Are both methods operational? If not, why?

The FASB proposes to assume that economic conditions remain unchanged for the remaining life of the financial asset.

The IASB proposes to estimate credit losses on basis of probability-weighted possible outcomes.

The FASB proposals raise the issue of recognition of changes in losses estimates.

Regarding the way to account for changes in estimates, we are of view that changes are not conceptually different from initial estimations. the bank will collect the premium included in the pricing of the loan to cover the credit risk related to its exposure over the maturity of the concourse. In pricing a loan, banks take into account the expected losses, but also the unexpected losses, i.e. the variation of average losses over time. This is why we price a margin over the risk free rate and the credit premium, to cover changes in estimates of expected losses. This margin will be also collected over the loan's life and therefore, the changes in estimates must be recorded symmetrically.

The IASB model is based on the fundamental assumption that it is possible to estimate accurately the timing and amounts of the expected cash flows resulting from loan portfolios, including expected credit losses.

Expected losses on such portfolios depend from two sets of factors:

- the characteristics of the loans in relation with the idiosyncratic financial situation of the financial borrowers
- the external conditions changes through the economic cycle

This second factor is decisive as economic conditions impact the credit risk components such as default rates and recovery rates. In order to estimate the expected value of cash flows, it is compulsory to have views on the development of the economic cycle for the run-off time horizon of the whole portfolios. It is obvious that it is impossible to predict accurately the amounts and the timing of future losses over several years.

The key point here is the timing of the losses:

- Unlike equity returns or foreign currency rates which are relatively distributed symmetrically and can be well approximated by normal distributions, loss distributions are skewed and fat tailed. The average is therefore often the best estimate of the expected values, as assigning a loss distribution pattern is subject to considerable model risk
- Consequently it is impossible to determine accurately the timing of future losses, though it is possible to approximate their amounts, based on average statistical data calculated over long periods.
- If the timing of losses is unpredictable as macro economic dependent, it does not make sense to incorporate the losses rate in the assets effective interest rate calculation. This methodology does not lead to any superior form of information and does not justify its additional operational complexity.

Therefore, we do not favour any of these proposals. We are in the view of the expected losses provisions to be spread linearly over the portfolios lives as the principles are described in question 38.

Question 47: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets. Historical loss rates would reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool. Would such an approach result in a significant change in practice (that is, do historical loss rates typically reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool or some shorter period)?

In our view, the question raises two points: data available and estimation of expected loss.

The starting point to measure the expectation of collecting cash flows for a pool of similar financial assets should be the entity loss experience.

It should be aligned with management risks and it should be based on data already available and the systems developed in order to meet prudential Basle II requirements.

Please refer to our answer to question 40.

The ED proposals favour a point in time approach which assesses losses considering the economic phase when related loans are granted and an immediate recognition in P&L of the revisions of the EL. This would magnify the cliff effects observed under an incurred losses model. In a recession period, all the customers do not default at the same time but within a period of two or three years so the incurred provisions are built over such a period. Conversely, changes in hypothesis about future losses made at the balance sheet date will be all the more frequent since the losses parameters are determined on a point in time basis, related to the existing economic conditions.

Effectiveness test

Question 56: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

We support the removal of the current highly effective quantitative threshold which is arbitrary and leads to exclude effective hedge from hedge accounting.

For instance, a financial instrument that effectively offsets 75% of the changes in fair value of a designated hedged item is disqualified from hedge accounting and 100% of the hedging instrument creates volatility in P&L whereas only 25% represents ineffectiveness. This requirement discourages entities to manage certain risks for which there are few highly effective hedging instruments available but only proxy (for instance, crude oil derivatives are used to hedge jet fuel prices).

We would like to take the advantage of this comment letter to highlight that hedge accounting should reflect an entity's business model in terms of reducing risk exposure and sensitivity and thus should reduce volatility of profit or loss.

Therefore, hedge accounting should not be an option but should rather reflect in the financial statements the steps taken by the entity to manage risk and their effectiveness. It should be principle based in order to be more robust and more responsive to possible future developments in markets, products and hedging strategies. Hedge accounting should be consistent with sound risk management principles as regards managing risks in the banking book (usually via ALM), as recommended by banking supervisors (Basel Committee of banking Supervisors).

The key elements in the approach should be:

- economic cash flows should take precedence over contractual cash flows, notably for deposits where economic cash flows persist beyond the contractual maturity and assets subject to early redemption where the embedded early payment options mean that expected cash flows end before their contractual maturity;
- the effectiveness of a hedge should be aligned with its objective: when the objective is deliberately to under-hedge a risk exposure, the hedging relationship should be considered effective if there is a real under-hedge in place. The under-hedge must apply to both balances and maturities (i.e.: part-hedging is a form of under-hedge). This corresponds to a "bottom layer" approach: the hedged portion is defined as the bottom layer of a portfolio. For this topic, the term portion refers to a part of the instrument (the hedge covers part of the life of instrument) as to a part of a population of similar items (for example, as some loans can be prepaid before their maturities, a practical way to take this feature into consideration is under hedge the whole loans' portfolio.);
- the hedged item should be permitted to include a net exposure comprised of financial assets, financial liabilities and derivatives.

Question 57: Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?

We are supportive of the FASB's proposed prospective approach to assessing hedge effectiveness at the inception of a hedging relationship. In most circumstances, there should be no requirement for the entity to perform a retrospective effectiveness test. If there is a change in the economics on which the hedge was initially built (e.g. changes in the correlation of two associated rates) and this change results in the initial hedge relationship being no longer effective, then the entity will normally de-designate the hedged items of the initial hedge, enter into additional hedging relationships and re-designate the hedged items of the new hedging relationship. A reassessment of ongoing hedge effectiveness should only be required in the rare case where changes in economic circumstances have happened that suggest that the initial hedging relationship may no longer be reasonably effective and the entity has not terminated the initial hedge.

Question 58: Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?

Today, systematic and quantitative assessment of effectiveness within a strict threshold leads to potential discontinuance of hedge accounting. It follows a burdensome dedesignation/redesignation process.

We believe that the qualitative assessment would ensure effective hedge relationships over the designated period. However, we draw the attention that under this new model, any ineffectiveness must be measured and recognised immediately in profit or loss.

Question 59: Do you believe that a hedge accounting model that recognizes in net income changes in the fair value and changes in the cash flows of the risk being hedged along with changes in fair value of the hedging instrument provides decision-useful information? If yes, how would that information be used? If not, why?

Regarding measurement and recognition of ineffectiveness in cash flow hedge relationships, we:

- disagree with the removal of the “lower of” principle. We consider that no ineffectiveness should be recorded as long as we underhedge.
- agrees with the FASB’s decision regarding purchased options used as hedging instrument in a CFH to provide only one-sided protection against the hedged risk. We consider that, as opposed to current IAS 39 rules, the time value should be deferred and amortised over the hedging relationship for the following reasons :
 - options, by nature, perfectly offset asymmetrical risk, and as a consequence should not create volatility in profit or loss;
 - time value of options represents the cost of hedging (which is known at inception) and should be recognised symmetrically with the hedged cash-flows;
 - the hedged risk is the possibility that the price of the underlying goes beyond or below a defined threshold (strike of the option); this exposure, as described, includes time value, symmetrically to the hedging instrument.