

INTEREST RATE HEDGING

Current Accounting Practice

Derivative instruments designated as interest rate hedges are not recognized in the balance sheet, but are disclosed as off-balance sheet items in the notes. Only accrued interest on the hedging instruments is recognized in the income statement, along with accrued interest on the hedged items.

IFRS

Under IAS 39 – Financial Instruments: Recognition and Measurement, all derivative instruments are recognized in the balance sheet, at fair value. Except as explained below, changes in the fair value of derivative instruments are recognized in the income statement.

Derivative instruments may be designated as fair value or cash flow hedges. Fair value hedges protect against a change in the fair value of assets and liabilities, while cash flow hedges protect against a change in the value of future cash flows generated by existing or future assets or liabilities.

Hedge accounting can be applied if the following conditions are met:

- The hedging relationship is clearly defined and documented at the inception of the hedge;
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured.

The effects of hedge accounting are as follows:

- For fair value hedges of existing assets and liabilities, the hedged portion is remeasured at fair value. Changes in fair value are recognized in the income statement, neutralizing the earnings impact of symmetrical changes in the fair value of the hedging instrument, to the extent that the hedge is effective;
- For cash flow hedges, the effective portion of the change in the fair value of the hedging instrument is recognized directly in equity. Cumulative gains and losses recognized in equity are included in the income statement in the period in which the hedged asset or liability affects net income.

The ineffective portion of the change in fair value of hedging instruments is recognized directly in the income statement.

Impact On The Group Accounts

Group interest rate hedging policy

The cash surpluses and short-term financing needs of the manufacturing and sales companies in the euro and sterling zones, except for automotive equipment companies, are managed by GIE PSA Trésorerie, which invests net surpluses on the financial markets. The funds are generally invested short-term at floating rates of interest. The manufacturing and sales companies' debt, except for automotive equipment companies, consists primarily of long-term financing originally at fixed and adjustable rates. All of these facilities have been converted to floating rate, using derivative instruments, to match the interest streams on short-term investments.

The finance companies' business consists of supplying wholesale and retail financing, generally at fixed rates. The corresponding refinancing is generally at floating or adjustable rates, across all maturities. Banque PSA Finance – which manages the cash surpluses and financing needs of the euro zone finance companies – and the UK finance companies – for their own businesses – use swaps and purchased options to match interest rates on assets and liabilities.

Faurecia uses caps, swaps and other options, in euros and dollars, to hedge interest rate risks on debts repayable between January 2003 and December 2007.

For both the manufacturing and sales companies and the finance companies, a residual interest rate exposure is retained in order to take advantage of market opportunities. This unhedged exposure, which is measured at daily intervals using VaR (Value at Risk) techniques, is not material.

Accounting impact

The impact on the income statement of remeasuring derivative instruments at fair value is not material, since Group policy consists of designating hedging instruments as either fair value or cash flow hedges. In the balance sheet, the remeasurement at fair value of hedged items and the related hedging instruments increases assets and liabilities. Equity is either increased or reduced by the effect of the effective portion of the remeasurement at fair value of derivative instruments designated as cash flow hedges.