FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES
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LE PRÉSIDENT

November 12, 2003

Dear Sir David,

On behalf of the Fédération Française des Sociétés d'Assurances (FFSA), I am writing to comment on the Exposure draft *Fair value hedge accounting for a portfolio hedge of interest rate risk* publicly issued on 21 august 2003. The FFSA is the principal trade association of life and non-life insurance and reinsurance companies in France and its members represent more than 90% of the insurance and reinsurance premiums written on the French market. The FFSA is strongly committed to the goal of developing high quality international and harmonised accounting.

The FFSA welcomes the Board's decision to investigate how IAS 39 may be amended to take into account the fair value hedge of the interest rate risk on a macro-basis (portfolio basis). Insurance companies define and adjust their investment policy in order to match their liabilities towards policyholders and they aim at perpetuating this matching and securing the expected pattern of financial revenues that will enable them to honour their commitments to policyholders throughout the lifespan of these existing and expected liabilities. Insurance companies tend notably to cover their portfolio exposed to the interest rate risk. This hedging is globally appreciated i.e. on a macro basis for insurance companies mutualise and manage risks on a portfolio basis and also because it would not be financially efficient nor possible to do so an individual basis i.e. on a policy basis.

However, the FFSA regrets that some limitations have been brought to such an implementation of macro hedging and express serious concerns about some of the principles stated in the exposure draft:

- It is unfortunate that the exposure draft and the ongoing improvements of IAS 39 do not address the macro hedging of other financial risks that insurance companies face. Indeed, insurance companies tend to hedge on a macro basis the fair value of their stock portfolio, notably through the combination of options on stock indexes. So far, it is our feeling that neither fair value hedge accounting (existing IAS) nor fair value hedge accounting for a portfolio hedge of interest rate risk (current exposure draft) permit to properly account for such hedging strategies.

Sir David Tweedie
Chairman
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30 Cannon Street
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- Until phase II is finalised, insurance companies will tend to account for most of their liabilities under local GAAPs under the current proposition exposed in ED-5 since insurance liabilities and financial liabilities with a discretionary participating feature represent the majority of their liabilities. This majority of liabilities will be therefore accounted for on a basis relatively similar to amortised cost. Since fair value of these liabilities is not yet addressed by the IASB, no common guideline exists on how to compute it. Therefore the proposed macro hedging in the exposure draft, despite being in principle of some interest to reflect the ALM management of the insurers[1], would really not be of some help during Phase I (ED-5) since the latter does not cope with the fair value of most of the liabilities.

- The above last point outlines the absence of a standard to fair value most of the liabilities issued by an insurance entity. Because of this missing item, the French insurance industry has asked, when answering to ED-5, to keep during Phase I accounting for assets held to cover these liabilities under local GAAPs. This would imply notably to account for the bond portfolio on an amortised basis which eliminates the possibility to partially make good use of the proposed macro-hedging accounting. However, hedging accounting is addressed by French GAAP. Indeed the FFSA would like to stress that French local GAAPs have been recently amended to take into account all the macro-hedging strategies (not only for bond portfolio and interest rate risk) put in place by insurance companies; all derivatives linked to these strategies are therefore accounted for and inefficiency of the strategies is accounted for. Hence the conclusion we draw (i.e. inapplicability of the proposed macro-hedging accounting) is not reflecting any purpose of the FFSA to elude the accounting of the macro hedges but the pragmatic view of French insurers in their effort to find consistent ways of accounting under IASs and IFRSs during Phase I.

- The FFSA regrets that proceeding to hedging a net global position is not allowed. The entity must select a portion of either the assets or the liabilities corresponding to the amount of the hedged net position. The FFSA outlines that this treatment is not consistent with the practices of insurance companies when managing assets and liabilities.

- Finally the FFSA wonders whether the rule exposed in question 2 (a) relating to the fair value of a financial liability with a demand feature is also applicable to the financial contracts underwritten by insurers. The FFSA would like to stress that in its comments on ED-5, it has strongly invited the Board to examine its assessment of how the fair value of a financial instrument with a surrender option issued by an insurance entity should be accounted for. Indeed such contract, even if accounted for as a financial instrument, is of a different nature than a simple deposit account due to its specific features (participating features etc…). Therefore, its surrender value should not be considered as the floor for any measurement of the liability consequent to such a contract. Should the tentative decision reached for core deposits (i.e. the fair value of these financial liability with a demand feature could not be less than their redemption value) be extended to contracts issued by insurers, then insurance companies could not properly account for macro-hedging because the underlying measurement of the hedged item would not reflect its true and economic fair value.

I would like to have the opportunity to discuss all these points with you.

Sincerely yours,

Gérard de La Martinière

[1] Bonds portfolios (and associated derivatives) are hedging contract liabilities