



March 9, 2011

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Sir David Tweedie  
International Accounting Standards Board  
30 Cannon Street  
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Re: Exposure Draft, *Financial Instruments: Hedge Accounting*

Dear Sir David:

CIGNA Corporation ("CIGNA") appreciates the opportunity to comment on the International Accounting Standards Board's ("IASB" or "Board") Exposure Draft, *Financial Instruments: Hedge Accounting* ("ED" or "proposal"). CIGNA and its subsidiaries constitute one of the largest investor-owned health service organizations in the United States, and have operations in select international markets. As of December 31, 2010, CIGNA held \$38 billion in assets (excluding separate accounts). As investors in approximately \$21 billion of primarily investment grade public and private debt securities and commercial mortgage loans, CIGNA's management team is both a preparer and user of financial information on a daily basis. Our comments that follow represent the joint perspectives of our accountants/preparers and investment professionals/users.

We applaud efforts to simplify hedge accounting requirements and to increase investor confidence in financial reporting by providing financial statement users with more relevant and reliable information about risk management strategies and the results of their application. We believe, however, that while the proposals may further these goals for certain hedging programs (particularly for non-financial items, such as commodities), they do not appear to simplify hedge accounting requirements or improve presentation of the effects of risk management strategies for financial risks such as those used by CIGNA. In summary, we have provided the comments below in an effort to highlight the concerns we have with:

- the lack of convergence with existing and proposed U.S. GAAP and the timing of these proposals in relation to unfinished foundational projects,
- the lack of changes to significant rules-based elements of the current model, and
- the specific changes to certain hedge accounting criteria and their potential impact on forthcoming guidance for macro hedging applications.

### **Convergence and Timing**

First and foremost, we recognize that this proposal is significantly different from the proposals made by the Financial Accounting Standards Board (FASB) in their project for financial instruments. In order to achieve the stated goals of the G20 leaders and international regulatory bodies to improve global investor confidence, we believe it imperative that the IASB and FASB work together to develop a single accounting model for financial instruments that can be applied universally, including hedge accounting. Without convergence, financial reporting will not provide users with comparable financial information for comparable business operations worldwide, placing public companies domiciled in the United States at a disadvantage in raising capital in global markets. Furthermore, dissimilar proposals are distracting and discouraging. Preparers are concerned that the basis for financial statements could change repeatedly in the coming years with adoption of FASB amendments and then IASB standards. We believe it imperative for the IASB and FASB to work together to minimize disruption in financial reporting and the additive costs that would be required of companies domiciled in the United States if convergence is not achieved.

Also, in order to be successful in conveying information as to financial results and condition that is relevant to users of financial statements of insurance entities, we believe that it is important that the IASB and FASB finalize their joint projects on insurance accounting and financial instruments before finalizing principles for hedge accounting. The conclusions reached in these foundational projects establishing financial asset and insurance liability models will help identify the accounting gaps that will then determine the need for hedge accounting by insurance entities. For example, when managing interest rate risk, the need and form of hedge accounting would differ under the following scenarios:

- changes in the values of insurance liabilities are reflected in the income statement while changes in the values of assets are not (e.g. assets held at amortized cost), or
- changes in the values of insurance liabilities are reflected in the income statement as are changes in the values of assets (e.g. assets are fair valued through the income statement).

Therefore, we recommend that the IASB and FASB commit to reviewing the hedge accounting guidance when the guidance related to insurance contracts and financial instruments is complete or to delay the completion of their hedge accounting proposals until that time.

### **Principles-Based Approach (Question 1)**

We support the IASB's objective to adopt a principles-based approach that will align hedge accounting more closely with an entity's risk management objectives. Although the proposal moves toward this goal in a number of areas, we believe that ultimately the proposal falls short because many of the rules that contribute to the complexity of hedge accounting have been retained. Cash flow hedge accounting requires forecasted transactions (e.g. cash flows) to be highly probable of occurring and an entity's ability to achieve hedge accounting is heavily dependent upon predicting both the occurrence and timing of those cash flows. For example, if an entity owns a foreign-denominated bond and employs a simple strategy to hedge foreign currency cash flows with a currency swap, achieving hedge accounting is still unnecessarily complicated by the strict forecasting thresholds. The objective of this hedge is to mitigate variability in cash flows and the entity can manage this risk with great confidence.

However, the current rules-based model requires that the amount and timing of future cash flows be predicted with a level of certainty that is not required to meet the risk management objective.

To further expand on this example, assume an entity has a hedging instrument that closely matches the terms of a prepayable bond. If that bond were prepaid, the hedging instrument could be immediately terminated - thereby fully satisfying the risk management objective. Under neither the current nor proposed model would this hedge qualify for hedge accounting due to the disconnect between the risk management objective (mitigating cash flow volatility due to foreign currency risk during the holding period of the bond) and the rules-based model (requirement to predict cash flows as to timing and magnitude). We recommend that the IASB remove these strict criteria governing the probability of cash flows and allow for a principles-based model that places greater importance on the risk management objective, along with the nature of the risk being hedged and the basis for expectation that the hedge would be effective. We believe increasing the rigor around the substance of the qualitative aspects of the hedge documentation at inception, as well as the related disclosures, will provide for an improved model with transparency for users and appropriate cost/benefit balance for preparers and shareholders.

### **Specific Proposals**

Although limited in scope to general hedges, we are concerned that the proposed changes in the hedge effectiveness requirements will not meet the IASB's stated objectives and will set an unacceptable precedent for the IASB's upcoming decisions regarding macro hedging. In addition, we are not convinced that the proposal to present the results of fair value hedges in a manner similar to that used for cash flow hedges provides additional transparency of hedge results.

*Hedge Effectiveness (Question 6)* - To qualify for hedge accounting, the proposals require that the hedge relationship produce an unbiased result and minimize expected hedge ineffectiveness. The criteria to minimize ineffectiveness replace the current requirement for a "highly effective" hedge relationship. The IASB proposes these new criteria to prevent systematic underhedging that entities have historically accepted to avoid inadvertent failure to meet hedge criteria. We agree with the IASB that a principles-based approach to assessing hedge effectiveness linked to the risk management strategy is appropriate. We note that the FASB has proposed that the current "highly effective" criteria be replaced with "reasonably effective" and that all ineffectiveness be recognized in earnings. We believe that the FASB's proposal will better achieve the objective of simplifying hedge accounting and more clearly convey the results of an entity's chosen risk management strategy.

In addition, we note that certain hedging strategies seek to balance the objective of minimizing risk with the costs of rebalancing hedge instruments. For example, in a dynamic delta portfolio hedge, an entity may set a threshold of mismatch between the sensitivity of the hedged items and that of the hedging instruments that must be reached before hedge instruments are rebalanced. In such a case, it appears that hedge accounting may be prohibited under the current proposal since ineffectiveness will result from market movements that do not cause a mismatch to reach the selected threshold, i.e. acceptable ineffectiveness as defined by the entity. These restrictions will prevent the proposal from achieving its objective to improve users' understanding of the effects of risk management

strategies if hedge accounting is prohibited for such a hedge application. We recommend that the IASB remove this requirement or clarify that balancing limited ineffectiveness and hedge adjustment costs is acceptable under this hedge criteria when the strategy is clearly defined in the hedge documentation.

*Mandatory Rebalancing (Question 7)* – For the reasons noted above in our example of a dynamic delta portfolio hedge, we believe it is not appropriate to mandate rebalancing of hedge relationships. If the hedge is not rebalanced, it will not meet the proposed effectiveness criteria and hedge accounting will be discontinued or hedge ineffectiveness will result and should be recognized in earnings. As noted above, we believe that the FASB's approach to identifying and reporting such a condition better achieves the objectives of simplifying hedge accounting and improving the transparency of hedge results.

*Voluntary De-designation (Question 8b)* - We do not view the present ability to de-designate hedge relationships to be problematic. We disagree with the Board's decision to prohibit voluntary de-designation as we believe it is appropriate for companies to be able to adjust hedging strategies in a cost effective manner as economic conditions and related risks change. We believe any concern that de-designation may be used by an entity to manage earnings is unwarranted because existing guidance requires that de-designation and re-designation be documented contemporaneously and therefore *in advance of* any anticipated market movements. Further, any ineffectiveness prior to the de-designation needs to be measured and reflected in earnings. As such, the impact of de-designating a hedge is only recognized prospectively and could not be used to mask the current period results.

*Fair Value Hedge Presentation (Question 9)* - Recognizing the gain or loss on the hedging instrument and hedged item in other comprehensive income (except for the ineffective portion, which is reported in the income statement) appears to add unnecessary complexity for preparers and result in less transparency for users. The current requirement to recognize fair value changes in income each period is simple and can be presented clearly. And we believe that a presentation of the basis adjustment separate from the hedged item will add unnecessary and distracting detail to the statement of financial condition. Disclosing additional details about the hedged item with and without hedging effects may improve users' understanding of the hedged item and help to resolve the IASB's concern that the basis adjustment confuses users about the measurement basis of the hedged item.

If we can provide further information or clarification of our comments, please call me (215-761-1170) or Nancy Ruffino (860-226-4632).

Sincerely,



Mary T. Hoeltzel