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International Accounting Standards Board  
30, Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sir/Madam:

Aflac welcomes the opportunity to share with you our views regarding the Exposure Draft: Hedge Accounting. Below we offer our general comments on the proposal, and have included our responses to the specific questions in an attachment.

Aflac sells supplemental insurance products in the US and Japan and is the world's leading underwriter of individually issued policies marketed at worksites.

### **General Comments**

Aflac is overall in support of the Board's changes to the general hedge accounting requirements in International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*, that are proposed in this exposure draft, which would provide more useful information to users of the financial statements. We believe that the proposed changes will simplify the hedge accounting requirements, establish a more principle-based approach to hedge accounting, and address some inconsistencies and weakness of the existing hedge accounting model.

### **Hedge Accounting Objective**

Aflac is supportive of the Board's proposal of aligning hedge accounting requirements with the risk management objective of an entity. This objective will clearly bring about a more principle-based approach to hedge accounting by reducing the hedge accounting restrictions and rules and providing more useful information to users of the financial statement about the risk management objective of the entity and the effect on the financial statements. Since the hedge

requirements will be focused on the risk management objective of the entity, this will require an entity's risk management objective be clearly defined in its hedge documentation.

### **Hedge Accounting qualification criteria**

We support the simplification of the hedging qualification criteria as it relates to hedged items, hedge effectiveness assessment, hedging instruments, and hedge accounting treatment. The proposed changes in the hedge accounting qualification criteria align hedge accounting with the risk management objective of the entity and are more principle-based than rules-based.

### **Hedged Risks**

We are in agreement with the proposed definition of hedged risks that are any risks that can be separately identifiable and reasonably measured. This new definition eliminates the bright-line restrictions around what constitutes a hedged risk. It is focused on a principle-based approach that says if it can be separately identified and reasonably measured then it can be designated as a hedged risk in a hedging relationship. Once again, this focus is around an entity's risk management strategy, which allows an entity more flexibility to mitigate risks without the limitations of rules that prohibit hedging certain risks. This flexibility in the definition of hedged risk will provide entities with the ability to successfully designate credit risk as a hedged risk if the entity can separately identify and measure the risk. The ability to hedge credit risk is a very essential tool in any risk management strategy.

### **Hedge effectiveness criteria**

Aflac supports the Board's proposed changes to the hedge effectiveness criteria. The changes align with the risk management strategy of an entity by focusing more on a qualitative assessment approach. The assessment criterion of achieving "other than accidental offsetting" is a lower threshold than the FASB's "reasonably effective". This threshold seems to include more hedging relationships irrespective of its effectiveness and will appropriately align the accounting treatment by recording the effective portion in Other Comprehensive Income (OCI) and any ineffectiveness in the income statement. While the proposal eliminates the bright lines it still must be effective to qualify. The hedge documentation stating the hedging strategy, effectiveness assessment, and the risk management objective should clearly define whether hedging relationship should qualify for hedge accounting treatment.

### **Voluntary de-designation prohibited**

We do not agree with both Board regarding changes to de-designation. Since hedge accounting is voluntary the prohibition on voluntary de-designation appears to violate this concept. The ability to de-designate is important to certain hedging strategies employed by Aflac. Specifically, we believe that voluntary de-designation of net investment hedges is imperative to the management of net investment hedges. The hedging of a net investment in a foreign operation is a unique hedging relationship since the net investment is a portfolio of dissimilar

assets. The prohibition against voluntary de-designation will limit management's ability to respond to various market forces and to manage risk in the most cost efficient manner.

### **Rebalancing**

We agree that an entity should be allowed to rebalance its hedging relationship in order to meet its hedging objective which will align with its documented risk management strategy. This will give entities the flexibility to adjust its hedging relationship based on the various market forces and to manage its risk which allows the entity to still meet its risk management objective. Even though rebalancing gives the entity the ability to meet its risk management objective, it still should be voluntary and not mandatory. As stated below, the mandatory rebalancing could be costly to the entity even though its risk management objective has not changed.

### **Hedged instrument**

We also support the changes relating to a permitted hedging instrument in a hedging relationship. Allowing a non-derivative financial asset or financial liability, which is measured at fair through profit and loss, to be eligible as a hedging instrument in a hedging relationship gives an entity flexibility in its hedging strategy in order to mitigate risk which would have an effect on its financial statements. Under IAS 39, a non-derivative financial asset or liability could only be designated as a hedging instrument if it was hedging foreign currency risk. This was restrictive and very limiting to an entity. This requirement was also rule-based not principle-based which this is the objective of hedging accounting exposure draft.

### **Responses to Questions**

**Question 1: Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. We believe that an entity's financial statements should reflect the overall risk and economics of the risk management objective relating to the hedging strategy. This objective lends itself to a more principle-based approach to hedge accounting.

**Question 2: Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit and loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. The prior restriction under IAS 39 limiting the designation of non-derivative financial assets and liabilities as hedging instruments only in relation to foreign currency risk was too restrictive. Allowing non-derivative financial assets and liabilities to be designated as hedging instruments in their entirety for any eligible hedged risk will be consistent with properly reflecting the entity's risk management objective in the financial statements. The determination of eligible hedging instruments should be based on the

economic correlation between a non-derivative financial asset and non-derivative financial liability and whether this correlation is effective at hedging the designated risk.

**Question 3: Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. An entity should be allowed the flexibility to designate any hedged item whether it is a derivative or a non-derivative financial asset or liability as long as it meets the entity's risk objective. However, we feel that designating aggregate exposures as hedged items introduces more complexity which the proposal is attempting to limit.

**Question 4: Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (i.e. a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. An entity should be allowed to designate a specific risk(s) in a hedging relationship related to changes in cash flows or fair value as long as the risk is separately identifiable and reliably measurable. These risks include credit and prepayment risks. The key issue should be whether the hedging strategy is effectively meeting the entity's risk management objective and whether the financial statements accurately reflect the risk of the entity.

**Question 5 (a): Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item. Why or why not? If not, what changes do you recommend and why.**

Response: As previously stated in the question above, any risk that is separately identifiable and reliably measurable should be allowed to be designated as a hedged item.

**Question 5 (b): Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?**

Response: We do not agree. Currently, US GAAP allows an entity to designate an instrument with a prepayment option as a hedged item in a hedging relationship as long as the hedging instrument has a mirror prepayment option. We believe this limitation is inconsistent with the principle-based approach and the proposed objective of the hedging accounting exposure draft.

**Question 6: Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?**

Response: We agree. Hedge effectiveness requirements should be principle-based and not based on a bright-line assessment. An entity's hedge assessment should be based on whether the hedging strategy is meeting the risk management objective. If the objective is to successfully offset the variability of cash

flows for a hedged item due to foreign exchange risk other than accidental offsetting, then the entity's hedge effectiveness assessment should be developed to ensure that the hedging strategy is effectively mitigating the hedged risk. The hedge effectiveness testing could be based on qualitative or quantitative assessment.

**Question 7 (a): Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. An entity should be allowed to rebalance its hedging relationship so that the hedging strategy will continue to meet the risk management objective of the entity. This adjustment could be in the form of adjusting the hedge ratio or entering into another hedging instrument. However, the requirement to rebalance the hedging relationship may increase cost to the company, so rebalancing should be optional or a tool of management to meet their risk management objective. De-designation or re-designation also should be at management's discretion and not a mandatory requirement. For example, if the counterparty or hedged item is experiencing credit deterioration, which is not in the control of management, it may be necessary to de-designate even though the risk management objective of the hedge is still being achieved even though the overall risk to the entity is increased. Management should have the discretion to evaluate and balance risks among various alternatives.

An entity should be allowed to be proactive as it relates its hedge effectiveness and be allowed to rebalance their hedging relationship in order to still meet its risk management objective.

**Question 7 (b): Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?**

Response: see above.

**Questions 8 (a): Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. Hedge accounting should be discontinued when the hedging strategy that is currently being used is no longer meeting the entity's risk management objective. If an entity's risk management strategy changes or the hedging relationship is unable to meet the risk management objective after rebalancing, then hedge accounting should be discontinued prospectively.

**Questions 8(b): Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?**

Response: We do not agree with the changes on de-designation. Since hedge accounting is voluntary, the prohibition of voluntary de-designation appears to violate this concept. The ability to de-designate is important to certain hedging strategies employed by Aflac. Specifically, we believe that voluntary de-designation of net investment hedges is imperative to the management of net investment hedges. The hedging of a net investment in a foreign operation is a unique hedging relationship since the net investment is a portfolio of dissimilar assets. The prohibition against voluntary de-designation will limit management's ability to respond to various market forces and to manage risk in the most cost efficient manner.

**Questions 9 (a): Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognized in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. This change of accounting treatment for fair value hedges will reduce the complexity with fair value hedges and align the accounting more closely to cash flow hedging. This change will properly reflect in the income statement the risks that are not being hedged which will align with the risk management strategy of the entity. By allowing the effective portion of the hedged item and hedging instrument to be reported in OCI, users of the financials are able to see the effectiveness of the hedging relationship.

**Questions 9 (b): Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. We feel that reporting the gain or loss on the hedged item as a separate line item of the statement of financial position will provide prominence and transparency to the users of the financials. Under US GAAP, ineffectiveness is currently reporting in the footnotes. Presenting the gain or loss on the hedged item in this manner allows the readers of the financials to see the magnitude of the adjustment to the hedged item and still report the original carrying value of the hedged item.

**Questions 9(c): Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented.**

Response: We agree with the linked presentation model, preferably for fair value hedges. Additional disclosures may need to be included to discuss the risks that are not being covered by the linked asset and liability (for example foreign currency or credit risk).

**Questions 10 (a): Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (eg. like a basis adjustment if capitalized into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. Allowing the option's time value to be reclassified into earnings from OCI in the period that the hedged item impacts earnings is consistent with the objective of hedge accounting. The

time of the reclassification will properly reflect the effect that the hedging strategy has on the entity's financial statements. This approach will decrease the volatility in the financial statements and will allow users to better understand the effect on the entity's risk management objective.

**Questions 10 (b):** Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?

Response: see above.

**Questions 10 (c):** Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (ie the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?

Response: see above.

**Questions 11:** Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

Response: We agree. Hedged items being managed on a group basis as it relates to its risk should be allowed to be hedged collectively to accurately reflect the effect that managing the risk on a group basis has on the financial statements.

**Questions 12:** Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (eg. in a net position hedge). Any hedging instrument gains or losses recognized in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

Response: We agree. This approach seems reasonable given that the hedged items are being managed as a group; therefore, the gain or loss on the hedging instrument used to hedge the entity's net hedge position should be reported on a separate line item in the income statement.

**Questions 13 (a):** Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

Response: We agree with the proposed disclosure requirements to the extent that they provide information not currently being disclosed. The proposed disclosures will provide more useful information to the user's of the financial statements concerning how an entity manages its risk, what effect that hedged risk has on the financial statements, and the amount, timing, and uncertainty of its future cash flows.

**Questions 13 (b): What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?**

Response: no comment

**Questions 14: Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?**

Response: We agree. If the contracts held by the entity are measured at fair value, which is consistent with its risk management strategy, the entity should be allowed to apply fair value derivative accounting on these types of contracts.

**Questions 15 (a): Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?**

Response: We do not agree. We feel that alternative 1 would be the simplest solution to hedging credit risk; however, alternative 1 does not allow the flexibility that is needed by an entity's risk management department to properly manage the risk of the entity. Alternative 1 only allows the entity to elect the fair value on the hedged item at the time of initial recognition. Most risk management strategies do not contemplate purchasing credit default protection on the initial purchase of the hedged item (bond) unless the hedged item is already a distressed asset. Therefore, alternative 1 does not give the entity the flexibility to purchase credit default protection at a later time in order to alleviate the accounting mismatch that can occur if the hedged item is measured at amortized cost and not fair value.

Alternative 2 allows the entity to elect the fair value option for the hedged item subsequent to initial recognition. This will offer flexibility to the entity to effectively manage credit risk of its portfolio by purchasing credit default protection at a later time and will allow for a better offset in the income statement in the fair value of the hedged item and hedging derivative (credit default swap) related to the credit risk.

Under Alternative 2 or 3, the hedged item will have a difference in its carrying and fair value at the time of election if the hedged item is measured at amortized cost since the election may not take place at the time of initial recognition of the hedged item. Therefore, we feel that the entity should have the option to recognize the difference between the carrying and fair value of the hedge item at the time of election through earnings immediately or amortized into earnings over the hedged period.

Alternatives 2 and 3 are preferable to Alternative 1; however, they will introduce increasing levels of operational complexity that will have to be addressed in implementation guidance.



**Questions 15 (b) If not which of the three alternatives considered by the Board in paragraphs BC 226-BC 246 should the Board develop further and what changes to that alternative would you recommend and why?**

Response: See the answer above.

**Questions 16: Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?**

Response: We agree that the proposed changes to hedge accounting should be prospectively applied to hedging relationships entered into on or after adoption. We feel that prospectively applying the new requirements would be administratively easier.

Sincerely,

A handwritten signature in black ink, appearing to read "June P. Howard". The signature is fluid and cursive, with the first name "June" being the most prominent part.

June P. Howard  
Senior Vice President and  
Chief Accounting Officer