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Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Hedge Accounting Exposure Draft – ED/2010/13

Dear Sir David:

Thank you for the opportunity to comment on the Hedge Accounting Exposure Draft – ED/2010/13. The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. Our member companies represent over 90 percent of the assets and premiums of the U.S life insurance and annuity industry.

GENERAL COMMENTS

The following general comments summarize our support for or disagreement with elements of the ED. Appendix A provides our response to the questions enumerated in the ED.

Convergence – As we’ve indicated in our response to previous proposals by the FASB and IASB (collectively the Boards) on Financial Instruments, we strongly recommend a converged standard. While we supported many of the elements of the FASB’s proposed Accounting Standards Update (“ASU”), Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities, the IASB’s ED proposes a significantly different hedge accounting model. Overall, we recommend that the final guidance by each Board be clearly and substantively consistent. We will also be providing a comment letter with similar recommendations to the FASB in response to their recently issued Discussion Paper on hedge accounting.

Consistency with IFRS 9 – Commenting on hedge accounting provisions in the context of other financial instrument guidance that is a) not yet converged, and b) not yet ratified by the EU, as well as insurance contract guidance which is not yet finalized, makes it very difficult for us to offer complete and cohesive comments. We urge the Boards to reconsider their hedge accounting proposals in light of both final, converged financial instrument and insurance accounting guidance for consistency of principle and effect.

Alignment with risk management – We support the underlying objective of aligning the hedge accounting guidance with its purpose as indicated in an entity’s risk management strategies. We understand the concept of risk management strategy to be consistent with its usage in FAS 133, paragraph 20 a. Practically, this means a statement of the type of risk to be mitigated, identification of the hedging instrument, identification of the hedged item, and a description of how the hedging instrument will effectively offset the hedged risk (including a qualitative analysis of the proposed hedging effectiveness

criteria in the ED) as a part of the hedge accounting documentation. Should the Board or other regulators envision either a broader or more specific use of the term, we would need clarification or more specific guidance.

Rules-based vs. principles-based – We fully support the relaxation in the qualification criteria for hedged items, hedging instruments, effectiveness assessment, and hedge accounting treatment as it lends itself to the principle-based approach advocated by both Boards. However, we note that the ED falls back into the rules-based approach in some aspects, creating inconsistencies in the guidance. We note those, specifically, in the comments below.

Hedged risks – We support a definition of hedged risks as any that can be separately identifiable and reliably measured, which would now include layers, and not just portions, of risk. With the proposed criteria, there is no further need to identify specific risks or instrument characteristics (e.g., prepayment options) that are or are not eligible as long as the entity can demonstrate objective identification and consistent measurement of the risk. Again, this is consistent with a principles-based approach and the foundation of identified risk management strategies. Examples may be helpful, but should be clearly excluded from the mandates of the guidance.

We understand the criteria of “unbiased result” and “minimizing ineffectiveness” to be the equivalent of the concept of “reasonably effective” under the current guidance. We do recommend that the final guidance include greater explanation in order to avoid confusion and misinterpretation of these concepts.

Additionally, we concur with other constituents who have noted that the prohibition against the use of credit derivatives in hedge relationships is inconsistent, not only with the principles in this ED, but with the requirement that credit components be separately identified and measured in impairment. We emphasize that the principle of separate identification and consistent measurement should be adequate to support the use of any hedging instrument so qualified.

Portfolio/Macro hedging – Acknowledging the IASB’s intention to address open portfolio hedges, we strongly believe for business and economic reasons that an accounting standard that recognizes and allows for portfolio hedges would be meaningful and align with risk management activities of an entity. Currently, entities can and do effectively manage risk of their portfolios using derivatives; however, due to current hedge accounting requirements, portfolio hedge accounting is extremely difficult and costly to achieve. With increasing regulatory oversight as promulgated by the Dodd-Frank Act, the costs of doing business, including mitigating risk, will increase. Consequently, a strategy for managing risk at a portfolio level will become more essential.

As risk management activities continue to increase in importance, an entity’s ability to execute strategies and respond to risk becomes even more critical and is consistent with the objective of the ED. Further, as the regulatory environment continues to change, we believe that the cost of derivatives will increase significantly. Due to this increased cost, entities should be permitted to execute valid risk management activities at a portfolio level. For these reasons, we fully support portfolio/macro hedging and believe that if it is disclosed in a meaningful and transparent way to the users of the financial statements, it is a useful and meaningful tool of risk mitigation.

We further recommend that guidance for open portfolio hedges be fully addressed before these proposed changes to hedge accounting are finalized in order to assure that the guidance for both are integrated and consistent.

Hedge effectiveness criteria – We agree with a qualitative hedge effectiveness assessment consistent with the identified risk management strategy. We note that the IASB’s criteria of achieving “other than accidental offsetting” is a lower threshold than the FASB’s relaxed criteria of “reasonably effective”, but we believe the concepts of “unbiased result” and “minimizing ineffectiveness” bring the criteria back to

a similar result. Consequently, we believe that the requirement to designate the relationships and the accounting treatment outlined will indicate the appropriateness of the strategy in mitigating risk.

We note with concern that there are some in the accounting and auditing sector that are interpreting the ED to require constant monitoring of whether the hedge effectiveness assessment should be performed outside the normal reporting cycle in order to take timely appropriate action and avoid having hedge accounting precluded. This seems like an extreme position, given the objective of the guidance and the general direction of simplifying the guidance. We recommend that the Boards address and clarify this interpretation.

Voluntary de-designation prohibited – While both Boards have proposed this restriction, we disagree with the apparent reasoning underlying the prohibition. We note that a hedging relationship could be discontinued only when it no longer meets the (relaxed) qualifying criteria of paragraph 19, which would result in significant unlikelihood that once the hedge is achieved, it would ever fail to meet the qualifying criteria.

This prohibition is, first of all, inconsistent with the principle and with the voluntary nature of hedge accounting. In addition, documentation and disclosure, as we've mentioned, should mitigate any risk of earnings manipulation.

This prohibition, together with the rebalancing requirement, like other rules added in the ED, limit an entity's ability to respond to market forces and manage risk in a cost efficient and responsive manner.

The FASB's proposed ASU on financial instruments received significant negative response on this issue and we strongly encourage the Boards to eliminate this restriction, since it adds unnecessary transaction costs and is inconsistent with the principles of hedging. We also believe removal of this prohibition would reverse the notion of 'tainting' that has become an erroneous practice interpretation in forecasted transactions. The accounting should reflect an entity's risk management strategy and changes in response to new information or market conditions.

Rebalancing – We agree that an entity should be allowed to appropriately adjust hedge accounting relationships in accordance with their defined and disclosed risk management strategies, recognizing that the challenges of designation/redesignation would be avoided. Rebalancing also provides for simplification of the management of the hedge. We, therefore, recommend that any rebalancing provisions be voluntary and clarification guidance be added that the rebalancing amounts are only necessary to bring the relationship back into conformity with the hedge accounting requirements of aligning reasonably with management's strategies, not to a perfect hedge relationship. Again, we emphasize that the documentation and disclosure requirements, along with the guidance foundation of aligning hedge accounting with an entity's risk management strategies, provides sufficient protections against untoward intentions of earnings manipulation or financial statement misguidance.

Financial Statement Presentation – In conjunction with our previous statements regarding presentation of financial information on the face of the financial statements and explanatory information in disclosures, we do not agree with separate presentation of hedge accounting adjustment amounts, either next to the hedged item or in OCI. We believe that amounts listed numerically in the balance sheet and income statement would be unclear and possibly misleading and would add complexity and costs with no additional benefits. Presentation on the "core" financial statement should summarize the financial position and results of an entity. Explanatory information with respect to hedge accounting would be more appropriate and clear if it was provided comprehensively in the footnotes to the financial statements.

In the context of financial statement presentation, we note that the ED indicates that its proposals do not affect IFRS 7, the statement for financial instrument disclosures. This is confusing to us since the ED contains disclosure recommendations that cannot and should not be separated from other financial

instrument disclosure guidance. We recognize that the FASB continues to work on a Disclosure Framework project independent of the MoU projects. We again, however, strongly recommend that the Boards move toward a unified and internally consistent approach toward presentation in finalizing the guidance for financial instruments.

Finally, it would be helpful for the Board to indicate the principle behind any specific restrictions to risk management strategies (e.g., fair value hedges of a “bottom layer” of prepayable assets; or the requirement that the hedged component of cash flows must be less than or equal to the total cash flows – “sub-LIBOR issue”; or an unbiased outcome – the expectation that changes in the value of the hedging instrument will not be systematically higher or lower than changes in the value of the hedged item) in order to keep guidance current with market innovation and assist management in making appropriate judgments.

We welcome continued dialogue with the Board on this very important matter.

Sincerely,

A handwritten signature in black ink, appearing to read "M Monahan", with a stylized, cursive script.

Michael Monahan
Director, Accounting Policy

APPENDIX A

RESPONSE TO EXPOSURE DRAFT 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?

We agree to the extent that the ED establishes as an objective to align risk management activities with hedge accounting. At the same time, we believe the scope, i.e., representing the effect of an entity's risk management activities that use all financial instruments, may be misinterpreted too broadly. This guidance should indicate that the objective is to align hedge accounting with an entity's risk management activities. We believe it is appropriate that accounting guidance provide principles that allow the financial statements to reflect an entity's risk management activities, but should not regulate or limit the ability to manage these risks. It should be made clear that this guidance does not scope in economic hedges for which hedge accounting is not sought, and also does not include additional requirements or disclosures for risk management activities for financial instruments not involved in hedge accounting. As such, we believe this objective provides a sufficient foundation for a principles-based approach to guidance that will provide insight into the purpose and effect of an entity's risk management strategies.

Question 2

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

Yes. In order to be consistent with the objective of the ED, hedging instruments should be defined based on the risks being managed and not based on type of instrument or type of business or rules that limit an entity's ability to manage risk. As such, we believe that any risk that is separately identifiable and consistently measured, regardless of the type of instrument that exposes the risk, should qualify for hedge accounting.

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?

We do agree that any combination exposures that meet the definition of a hedged item should be allowed to be so designated. However, attempting to further define the hedged item only promotes complexity in the guidance and in risk management. It is inconsistent with the spirit of the ED's proposals which relax current qualification standards and increase an entity's ability to develop and respond to effective risk management strategies. This example would better serve the guidance in the implementation section, supporting the principles-based guidance.

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?

Yes. As stated in our general comments, we believe that the appropriate criteria for designation is the risk component, consistent with an entity's risk management objective and the ED's objective of linking the two. This wording gives greater clarity and flexibility than US GAAP wording. We believe it is important to make clear in our identification the components that are hedged & those that are not hedged. However, under the separately identifiable and reliably measurable criteria, we do not believe that specific risks (e.g., credit risk and prepayment risk) should be specifically identified in the accounting guidance as ineligible hedge risks; rather the above mentioned principles-based criteria should be applied to all risks.

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?

Yes. In conjunction with questions 2-4, above, any risk that is separately identifiable and consistently measurable should be allowed as a designated hedged item.

(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?

No. US GAAP currently allows an instrument with a prepayment option to be a hedged item in a hedging relationship as long as there is a mirror option on the hedging instrument. We believe this restriction is inconsistent with the principles-based approach and the objective of the ED. It provides no protection or additional benefit. It is also inconsistent with the elements of the proposal that provide for clear delineation and reporting of on-going effectiveness and ineffectiveness. Voluntary rebalancing and clear disclosure of the hedge strategy are sufficient to align a derivative with an entity's risk management strategy.

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?

We agree with an objective-based, forward-looking assessment. We support an "other than accidental offsetting" specification, noting that this low threshold would include more hedges and the "unbiased result" and "minimizing expected hedge ineffectiveness" are similar to the "reasonably effective" current concept. See our general comments for hedge effectiveness criteria.

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?

(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?

The concept of rebalancing furthers the ED objective of linking hedge accounting reporting and disclosure to the focus of an entity's risk management activities. We believe that any effort to respond to new information and market conditions should be allowed. However, a mandate that requires only certain actions militates against the objective of the ED and creates future complexity and costs.

Rebalancing, as well as de-designation or re-designation (as discussed below) should be at the discretion of the Company's management and not a requirement. The ED offers the example of credit deterioration of the counterparty. The implementation of the final guidance should clarify that there may be other legitimate reasons why a hedging relationship might no longer meet the effectiveness assessment, but with or without management action, may continue to meet the risk management needs. Rebalancing should be optional in order to provide maximum flexibility to management to manage risk in most cost efficient way. Mandatory rebalancing would likely increase the cost of the risk management program to the detriment of shareholders.

Question 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?

(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?

No. We do not agree with limitations to risk management through restrictions around de-designation. We believe that the hedge accounting rules and disclosures, including contemporaneous documentation and reporting designed to provide transparency into risk management strategies and transactions, provide adequate restraints to prevent abuse. We strongly disagree with the line of thinking that leads to such rules as mandatory rebalancing and restricted de-designation; we believe it is inconsistent with the principles underlying the remaining hedge accounting guidance which allows hedge accounting to be an option, a tool in management's risk mitigation arsenal. Further, we are under the conviction that these rules (mandatory rebalancing and restricted de-designation) create further complexity and confusion around what can be de-designated and when. We do recommend an expanded, illustrative list of de-designation circumstances with an explanation tied to how these dovetail with a change in risk management strategy. It is currently unclear what circumstances represent an allowable change in risk management strategy as opposed to an unallowable change that would, under the proposal, restrict de-designation.

Question 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 recognised 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?

No. We do not see any benefit gained from this change. It increases operational complexity and communication of this item and results in the same effect on net income. We believe that current treatment of fair value hedges, both sides through the P&L, is simpler and clearer to users of the financial statements. In addition, current treatment highlights the difference in the hedge programs.

(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?

No. We do not see the benefit to breaking out the amount of the hedged risk on the balance sheet, since the carrying value of the hedged item would still not represent the measurement consistent with other items in the same classification, and the amount separately reported would not be a meaningful number. We believe it adds additional complexity to a statement that should be a summary of financial position. In addition, this proposal is inconsistent with other presentations, e.g., PPE (does not reflect

depreciation on the face of the balance sheet, but in the footnotes.) This presentation is best reflected in the disclosures, if needed. The amount is certainly calculable, but provides no decision-useful information. In addition, this requirement seems to create confusion and inconsistency with other aspects of IFRS 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?

Yes. We agree with the linked presentation conclusions in the exposure draft, understanding them to be consistent with recently exposed offsetting guidance by both the IASB and the FASB. We continue to strongly urge convergence between the two boards.

Question 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 (e.g., 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?

(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?

(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 (i.e., 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?

Yes, in principle. We expect these proposals to decrease unnecessary volatility in the financial statements by providing for amortization of the premium into the P&L, and better communicate the performance and effect of the entity's risk management.

We request further clarification of the term 'aligned time value'. Some practitioners are concerned that this terminology implies that only the portion of time value that would match up with the hedged risk would get deferred into OCI. For example, an option used to hedge a financial asset, each having slightly different dates, would you be required to determine how much of the option premium corresponds to the hedge if perfectly aligned? If this is the correct interpretation, we believe that this would increase, rather than decrease complexity. We disagree with the concept that the time value should be further bifurcated and treated differently.

Question 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?

Yes. However, as stated in our general comments above, we remain concerned about the lack of converged guidance around macro/portfolio (open group) hedges and anticipate consistency with the remaining guidance on financial instruments and hedge accounting, including flexibility allowing transparent reporting of nimble risk management methodology.

Question 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 (e.g., 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?

Yes. While we continue to strongly believe that financial statement disclosures are the best and most appropriate place for clearly explaining the components of risk management programs, we do not have any significant opposition to this proposal.

Question 13

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

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

We generally support the proposals in the exposure draft, particularly around relaxed qualification and effectiveness guidelines. However, we find the accounting and reporting details confusing. It is unclear to us whether the ineffectiveness is actually being transparently reported when the P&L presentation separates the hedged item from the hedging instrument. We reiterate our conviction that simplified financial presentation together with robust disclosure, rather than too many line items interspersed in the financial statements, will provide greater clarity and decision-useful information.

In addition, given the consideration of financial statement presentation as a separate project, at this time we recommend retaining the simpler financial statement presentation with expanded disclosure and addressing the line item presentation of derivatives and hedge accounting from the whole perspective of financial statement presentation. We strongly discourage a change in guidance that would cause iterative implementation and possible duplicative operational costs.

While true transparency would best be served by disclosing information based on each separate derivative program, this, of course, is not feasible. Grossing up the P&L also does not make sense as it could adversely affect financial statement analysis and create further confusion in showing disparate pieces of a cohesive strategy.

Beyond these concerns, we reiterate the need for convergence with US GAAP, as we've noted in responses above, regarding disclosures as well as financial statement presentation and accounting guidance.

Question 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 the 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?

No comment.

Question 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?

No. We disagree with the Board's presupposition that it is "operationally difficult (if not impossible) to isolate and measure a credit risk component". It occurs in practice and is required in current accounting guidance, e.g., impairment of financial instruments and adjustment for an entity's own

credit. Identification of components of risk is also assumed in discussions around insurance accounting.

However, we do not believe further guidance proposals or alternatives are needed. As we've indicated in our discussions above, we believe that the principles proposed by the ED and recommended in our comments would allow credit derivatives to qualify for use in hedge accounting when the entity is able to separately identify and reliably measure the risk. We do agree that further alternatives would add unnecessary complexity.

(b) If not, which of the three alternatives considered by the Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?

See response to 15a.

Question 16

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

We agree with the transition provision that allows for the continuation of existing relationships if they meet the new rules. We believe that this should be a qualitative assessment and require only negative assurance that a type of hedge currently in place would not be negatively impacted by the new rules. Companies that wish to update their documentation for the new rules, if necessary, should be allowed to do so without jeopardizing the continuation of the existing hedge relationships.

Paragraph 55 of the ED would imply that a comprehensive review of all hedging relationships would be required to confirm qualification under the ED. We disagree with this requirement, as stated above and, considering the criteria to apply hedge accounting under this ED are more relaxed than those under IAS 39, existing hedge relationships previously qualified under IAS 39 would also meet the criteria of this ED, therefore eliminating the need for a comprehensive review. We believe that the transition guidance should be applied prospectively to hedging relationships entered into on or after the date of adoption and we agree with not applying the disclosure requirements in periods before initial application when preparing comparative information.

We further recommend that continuation of existing hedges be an option available upon adoption, in order to allow companies to de-designate hedging relationships that would not be aligned with risk management going forward.