

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

**Ref:** ECO-ACC-11-070

**Subject:** CEA and CFO Forum joint response to IASB ED on Hedge Accounting

9 March 2011

Dear Sir David,

This letter has been drafted jointly by the CEA, which is the European Federation of insurers and reinsurers, who represents all types of insurance and reinsurance undertakings, accounting for approximately 95% of total European premium income, and the European Insurance CFO Forum, which is a body representing the views of 21 of Europe's largest insurance companies. Accordingly, it represents the consensus views of the European insurance industry.

Insurance companies are not only preparers but are also one of the largest institutional investors, hence users of financial statements.

### Overview

We believe that the IASB proposal on Hedge Accounting ('ED') represents a significant improvement compared to current IAS 39 requirements, for example the alignment of hedge accounting requirements with risk management or the possibility to hedge net positions. However, the ED also raises major concerns, such as the restriction on the use of hedge accounting for certain risks (e.g. inflation risk) or the ineligibility of financial instruments classified at fair value through OCI as hedged item. We expand on those points below.

### Preliminary comment

At this stage, the IASB has not yet considered hedge accounting for open portfolios. We believe the IASB should develop proposals for open portfolios before finalising the requirements for closed portfolios. In addition, the IASB is progressing on the elaboration of a final standard for insurance contracts. The business model of an insurance company is based on the asset-liability management. In order to be in a position to assess the impact of hedge accounting on insurers' financial statements (including on insurance liabilities), it is of utmost importance that the IASB consider hedge accounting from an insurance perspective when developing proposals for open portfolios.

### Significant areas of improvements introduced by the ED

We fully support the ED proposal that the objective of hedge accounting is to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss (Q1).

As a consequence, we welcome two proposals:

- to allow non-derivative financial assets and non-derivative financial liabilities as hedging instruments as those may be used by management to hedge some exposures (Q2);
- to allow the designation of an exposure that is a combination of another exposure and a derivative as hedged item (Q3) as management may hedge this aggregated exposure in the course of their risk management.

We believe that IAS 39 restrictions were arbitrary in this respect and in conflict with a principle-based standard.

Finally, we support the removal of the effectiveness test based on arbitrary bright lines (80%-125%) (Q6).

### Areas of significant disagreement with the IASB proposals

We believe that in certain areas the IASB has introduced rules which contradict the IASB proposed overarching principle of aligning hedge accounting with risk management. We strongly encourage the IASB to remove those arbitrary rules.

#### Scope of items eligible as hedged items

We do not agree with the exclusion of financial assets (equity securities) classified at fair value through OCI as eligible hedged items (paragraph 4). Indeed, this restriction would create an accounting mismatch for entities which would want to hedge a risk on those instruments. As a consequence, this rule could discourage an entity to take a sound economic decision (to hedge itself). We do not believe that accounting standards should have such impact.

#### Hedging of components of non-financial instruments (Q4)

While we see allowing risk components of both financial and non-financial instruments to be eligible hedged items (under certain conditions) as a significant improvement, we disagree with the IASB's statement that inflation is not separately identifiable and reliably measurable (and therefore cannot be designated as a risk component of a financial instrument) unless it is contractually specified (B18). We disagree with the IASB's conclusion and encourage the board to reconsider it.

In practice, many life and non-life insurance contracts provide cover for inflation risk (sometimes by national law) as an implicit component of the contract rather than as an explicit contractual term. Insurers very often hedge themselves against this risk. Based on the IASB's overarching principle, we believe that this hedging should be reflected in the financial statements.

Accounting for hedges of credit risks using credit derivative (Q15)

We strongly disagree with the IASB to reject hedge accounting for hedges of credit risk using credit derivatives. A lot of companies do hedge themselves against credit risk through credit derivatives and risk management quantifies credit risk. Furthermore, we note that in IFRS 9, changes in own credit risk of financial liabilities must be reported.

We therefore recommend the IASB to permit hedge accounting for credit risk using credit derivatives by investigating the methods identified in the Basis for Conclusions. Again, this would be consistent with the IASB's objective to align hedge accounting with risk management.

Hedge accounting for a layer of a nominal amount (Q5)

We support the possibility to designate a layer of a nominal amount as a hedge item under certain conditions. However, we strongly object prohibiting hedge accounting for layer components of a contract that includes a prepayment option. It is insurances companies' common practice to manage risks trough hedges of layers of an overall group of items containing prepayment options (e.g. caps or floors to hedge interest risks on layers of insurance liabilities with demand features, such as French DPF contracts), as layers that are economically not subject to this prepayment can be identified at portfolio level.

**Other comments**

We fully support the proposed prospective application of the standard. As in our previous joint comment letters on the insurance contracts ED and on the Request for Views "Effective Dates and Transition", we believe that IFRS 9 (full standard) and the future insurance standard should become mandatory simultaneously and not before periods starting 1 January 2015. It is critical that insurers have the ability to revisit the classification of financial assets when applying the future insurance standard for the first time, as well as hedge relationships if early adoption of IFRS 9 was elected.

Do not hesitate to contact us for any further information.

Yours sincerely,



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Dieter Wemmer  
Chair, European Insurance CFO Forum