# EFRAG Hedge accounting questionnaire for insurers

## Objective and background

1. The objective of this questionnaire is to collect information on the current hedging activities and hedge accounting practices of insurers and the future possibilities of applying hedge accounting when applying IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* hedge accounting to insurance liabilities.
2. This hedge accounting questionnaire is part of EFRAG’s preparatory work relating to developing an endorsement advice on IFRS 17 *Insurance Contracts*.
3. Answers to this questionnaire need to be submitted to the EFRAG Secretariat **no later than 16 September 2019**. Submissions can be sent to [IFRS17Secretariat@efrag.org](mailto:IFRS17Secretariat@efrag.org)
4. The EFRAG Secretariat is available during the consultation period to respond to any questions or uncertainties through email or conference call. The EFRAG Secretariat can be contacted through email or by phone:

|  |  |
| --- | --- |
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## Introduction and general description

1. Please provide the following details
   1. The name of the entity you are responding on behalf of:

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* 1. Country where head office is located:

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* 1. Contact details, including email address:

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1. The structure of the questionnaire is as follows:
   1. Step 1: Current economic hedging strategies
   2. Step 2: Accounting for current economic hedging strategies
   3. Step 3: Future economic hedging strategies
   4. Step 4: Application of IFRS 9 (including continued use of IAS 39 hedge accounting)
   5. Step 5: Economic mismatches
   6. Step 6: IFRS 9 and risk mitigation under IFRS 17
2. The Appendix summarises the relevant paragraphs for hedge accounting under both IAS 39 and IFRS 9.

## Step 1: Current economic hedging strategies

1. Please provide an overview of your current hedging strategies used for risk management and asset and liability management purposes, irrespective of whether these qualify for hedge accounting or not.

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| **Hedging strategy A:**  *Hedged risk:*  *Hedged item:*  *Hedging instrument*:  **Hedging strategy B:**  *Hedged risk:*  *Hedged item:*  *Hedging instrument*:  **Hedging strategy C, …**  …  ***Please add strategies as appropriate*** |

## Step 2: Accounting for current economic hedging strategies

1. Do you currently apply IAS 39 hedge accounting (excluding the carve-out)?

Yes  No  n/a (please explain)

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1. Do you currently apply the IAS 39 hedge accounting carve-out ***for insurance activities***?

Yes  No

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1. Do you currently use the overlay approach and the hedge accounting requirements of IFRS 9?

Yes  No  n/a (please explain)

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1. Of the strategies described in question 8, please provide information as to the hedge accounting applied (refer to paragraph 61 for more information).

| **Strategy** | **Type of hedge accounting applied** | **Applicable standard** |
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1. Please describe your accounting for those strategies described in question 8 that do not qualify for hedge accounting.

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| **Strategy** | **Accounting for hedging instrument** | **Accounting for hedged item/hedged risk** |
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## Step 3: Future economic hedging strategies

1. Please describe the hedging strategies for risk management and asset and liability management purposes you expect to follow after the adoption of IFRS 17 and IFRS 9, including those strategies currently used that will be carried forward.

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| **Hedging strategy A:**  *Hedged risk:*  *Hedged item:*  *Hedging instrument*:  **Hedging strategy B:**  *Hedged risk:*  *Hedged item:*  *Hedging instrument*:  **Hedging strategy C, …**  …  ***Please add strategies as appropriate*** |

1. In case your hedging strategies in response to question 8 are different than the ones listed in response to question 14, please explain the reasons why.

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## Step 4: Application of IFRS 9 (including continued use of IAS 39 hedge accounting)

1. Please indicate your hedge accounting policy choices under IFRS 9.
   1. For purposes of hedge accounting per IFRS 9 paragraph 7.2.21 will you apply:

IAS 39  IFRS 9

* 1. If you plan to apply IFRS 9 hedge accounting requirements, do you intend to apply fair value portfolio hedge accounting under IAS 39 as allowed under paragraph 6.1.3 of IFRS 9:

Yes  No

1. Of the strategies described in question 14, please provide information as to the hedge accounting applied (refer to paragraphs 61(a) and 61(b) for more information).

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| **Strategy** | **Type of hedge accounting applied** | **Applicable standard** |
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### Inability to apply hedge accounting

1. In case you are willing to apply IFRS 9 hedge accounting but are unable to do so, further information is required. The following questions aim to guide you through some of the improvements to hedging requirements under IFRS 9 compared to IAS 39.
2. Please list below the strategies for which in your view it is not possible to apply hedge accounting under IFRS 9.

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| **Strategy** | **Reason why it is not possible to apply hedge accounting under IFRS 9** |
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#### Measurement of risk components[[1]](#footnote-2)

1. Hedging of risk components may be specifically relevant in cases where voluntary unbundling under IFRS 4 was done. IFRS 9 has relaxed some of the requirements around hedging of risk components, specifically for non-financial hedged items.
2. Please explain how you identify the hedged risk components:
   1. What level of aggregation (group, portfolio, entity level, consolidated entity level, other, …)?
   2. How do you determine the “volume” of risk that is present (contractual basis, line of business, behavioural estimate, actuarial estimate[[2]](#footnote-3), …)?
   3. What is the “identification boundary” for those risk components (contractual basis, including or excluding renewals[[3]](#footnote-4) or future sales[[4]](#footnote-5) , …)?

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1. Are you able to identify separately and measure reliably any risk component in accordance with IFRS 9 for which you would like to apply hedge accounting?

Yes  No

Please describe the risk component.

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1. In case you are not able to identify separately and measure reliably a particular risk component, please explain whether the reason is related to IFRS 9 (please quote the relevant paragraphs[[5]](#footnote-6)), the relevant IT and accounting systems or other reasons.

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| **Risk component** | **Reason** |
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1. If you are unable to identify separately and measure reliably a particular risk component, please explain how you measure effectiveness of the overall strategy and the specific execution.

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| **Risk component** | **How effectiveness is measured** |
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#### Rebalancing[[6]](#footnote-7) of the hedge relationship

1. During the life of a group of insurance liabilities, the hedged risk component will evolve due to different reasons (lapses, exercise of options by some policyholders, evolution of financial markets, etc.)
2. Please explain the difficulties in applying rebalancing of the hedge relationship for changes in the hedged risk components during the life of the group of insurance liabilities. Please explain whether the reason is related to IFRS 9 (please quote the relevant paragraphs), the relevant IT and accounting systems or other reasons.

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| **Risk component** | **Reason** |
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#### Hedging layers of a group

1. IAS 39 allowed the hedging of layers of a group in limited circumstances (e.g. cash flow hedging). IFRS 9 paragraphs 6.3.7 (b) and (c) and B.6.3.16 to B.6.3.20 allows a layer[[7]](#footnote-8) to be designated as the hedged item.
2. Are you planning to use this option?

Yes  No  n/a (please explain)

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1. Do you hedge or plan to hedge proportions or layers of a particular risk component? Please explain in detail.

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1. Please explain any challenges in application that deters you from applying this option if you currently or plan to hedge layers of a group.

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#### Hedging aggregated exposures

1. IFRS 9 paragraph 6.3.4 allows derivatives to form part of the hedged item unlike IAS 39.
2. Are you planning to use this option?

Yes  No  n/a (please explain)

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1. Please explain any challenges in application that deters you from applying this option if you currently or plan to include derivatives in your hedged items.

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#### Hedging net positions

1. IFRS 9, like IAS 39, allows the hedged item to be a single item or a group of items. However, IFRS 9 provides more flexibility including hedging groups of net position (IFRS 9 paragraph 6.6.1) and hedging of net nil positions (IFRS 9 paragraph 6.6.6).
2. Are you planning to use this option?

Yes  No  n/a (please explain)

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1. Do you hedge a gross amount or net amount of risk, and if so for which risk components? For example, an entity may consider hedging the net margin between interest income and interest expense but may hedge mortality risk on a gross basis. Please explain in detail.

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1. Please explain any challenges in application that deters you from hedge accounting for net positions if you currently hedge or plan to hedge net positions.

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#### Fair value portfolio hedge of interest rate risk (paragraph 89A of IAS 39): Insurance liabilities

1. We understand that some consider insurance contracts not to be financial instruments and so ineligible for fair value portfolio hedging under paragraph 89A of IAS 39 which is carried forward under IFRS 9.
2. Would the availability of this hedging option to insurance liabilities be important for representing your risk mitigation activities?

Yes  No  n/a (please explain)

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1. Please explain any further challenges in application that deters you from applying this option if you currently or plan to hedge interest rate risk of financial assets and liabilities.

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#### Option to designate a credit exposure as measured at fair value through profit or loss

1. IFRS 9 paragraph 6.7 provides the option to designate a financial instrument (all or a proportion of it) at fair value through P&L where for example a credit default swap hedges the credit risk in a financial instrument. This option is available only where: a) there is name matching between the borrower and derivative used to hedge the exposure; and b) the seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative. This option is not irrevocable but, once this option is elected, specified criteria must be met to discontinue its use.
2. Are you planning to use this option?

Yes  No  n/a (please explain)

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1. Please explain any challenges in application that deters you from applying this option if you currently or plan to hedge credit risk.

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1. Apart from the reasons provided above, please explain any other reasons why designation under IFRS 9 is not possible. Please identify the paragraphs of IFRS 9 that prevent you from selecting these items as hedged items, hedged risk or hedging instrument.

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| **Hedging strategy A:**  *Hedged risk:*  *Hedged item:*  *Hedging instrument*:  *References*:  **Hedging strategy B:**  *Hedged risk:*  *Hedged item:*  *Hedging instrument*:  *References*:  **Hedging strategy C, …**  …  ***Please add strategies as appropriate*** |

##### Current monitoring of strategies

1. What is the aim of each of the hedging strategies that do not qualify for hedge accounting under IFRS 9 (i.e. those identified in question 19 above)? Do you aim:
   1. to mitigate solely risk inherent in the balance sheet; or
   2. to optimise[[8]](#footnote-9) returns (in addition to the mitigation strategies)?

Please explain

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1. For each of the hedging strategies not qualifying for hedge accounting above, how do you measure the success of these strategies (i.e. whether you have obtained the goal set out at inception of defining the strategy or not)? Please explain especially where you follow this strategy in an open portfolio environment.

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1. What role does your IFRS equity or equity required for solvency purposes play in these hedging strategies? Please explain in detail.

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1. Do you set thresholds for the quantity of risk that the entity is willing to accept? Please explain in detail.

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##### Possible mismatches

1. Please explain whether the application of IFRS 9 and IFRS 17 to those hedging strategies that fail hedge accounting result in accounting mismatches.

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1. For each of the accounting mismatches identified in question 49, can these be addressed by relying on the fair value option in accordance with IFRS 9 and/or disaggregation of the interest expense under IFRS 17? Please explain.

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1. In your view, how would the performance of these hedging strategies be best reflected in the financial statements? Please explain.

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## Step 5: Economic mismatches

1. Applying IFRS 17 and IFRS 9 together, are there ***economic*** mismatches that you are able to hedge account for under IAS 39/IFRS 4, but not under IFRS 9? Please explain:

#### IFRS 17, general measurement model approach

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| **IAS 39** | **IFRS 4** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration: | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
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| **IFRS 9** | **IFRS 17, general model** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
| **IAS 39** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? |

#### IFRS 17, variable fee approach

| **IAS 39** | **IFRS 4** |
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| **Characteristics:**  Country where assets are held:  Currency:  Duration: | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
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| **IFRS 9** | **IFRS 17, VFA** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
| **IAS 39** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? |

#### IFRS 17, premium allocation approach

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| **IAS 39** | **IFRS 4** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration: | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
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| **IFRS 9** | **IFRS 17, PAA** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
| **IAS 39** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? |

#### IFRS 17, reinsurance contracts held or issued

| **IFRS 4 (reinsurance held)[[9]](#footnote-10)** | **IFRS 4 (direct insurance contracts or reinsurance issued[[10]](#footnote-11))** |
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| **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
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| **IFRS 17 (reinsurance held)** | **IFRS 17 (direct insurance contracts or reinsurance issued)** |
| **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |

1. Are there any economic mismatches between reinsurance contracts and underlying assets in accordance with IAS 39 or IFRS 9? If so please specify.

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#### IFRS 17, proprietary investments (activities relating to surplus assets specifically)

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| **IAS 39** | **IFRS 4** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration: | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
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| **IFRS 9** | **IFRS 17** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? | **Characteristics:**  Country where liabilities have been issued:  Currency:  Duration: |
| **IAS 39** |
| **Characteristics:**  Country where assets are held:  Currency:  Duration:  Why no hedge accounting? |

## Step 6: IFRS 9 and risk mitigation under IFRS 17

1. In accordance with IFRS 17, risk mitigation can be applied to contracts with direct participation features using derivatives or (tentatively) reinsurance contracts held to mitigate financial risk, but not to contracts that fall under the general model.
2. In addition, risk mitigation could be applied prospectively from the IFRS 17 transition date (tentatively).
3. In accordance with IFRS 9, hedge accounting is applied prospectively with few exceptions.

### Prospective application of risk mitigation

1. Some insurers prefer to apply the risk mitigation requirements of IFRS 17 instead of the hedge accounting requirements of IFRS 9. The following questions identify these preferences.
2. Are there any hedged items under IFRS 17 where you want to apply risk mitigation because you cannot apply the IFRS 9 hedge accounting requirements (as demonstrated in your answers to Step 4)?

Yes  No  n/a (please explain)

1. The reasons for this are (please refer to your answers under Step 4):

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### Retrospective application of risk mitigation

1. Some insurers prefer to apply the risk mitigation requirements of IFRS 17 retrospectively. In case you do, please describe the reasons why as well as how you currently address the mismatch that you want to address applying risk mitigation retrospectively.

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### Background information

1. Types of hedges under IFRS 9 and IAS 39 and references
   1. Types of hedge accounting available under IAS 39.
      1. fair value hedge\* (paragraphs 89- 94 of IAS 39);
      2. portfolio fair value hedge of interest rate risk (paragraph 89A of IAS 39);
      3. cash flow hedge\* (paragraphs 95-101 of IAS 39); and
      4. net investment hedge\* (paragraph 102 of IAS 39)

\*For individual items and groups of items per IAS 39 paragraphs 83 – 84.

* 1. Types of hedge accounting available under IFRS 9 including hedging of groups of items as allowed by IFRS 9 paragraph 6.3.1.
     1. fair value hedge (paragraphs 6.5.8- 6.5.10 of IFRS 9);
     2. cash flow hedge (paragraphs 6.5.11 - 6.5.12 of IFRS 9);
     3. net investment hedge (paragraphs 6.5.13 – 6.5.14 of IFRS 9); and
     4. portfolio fair value hedge of interest rate risk (paragraph 89A of IAS 39).

1. This refers to a component in the hedged item that is designated, for example the interest rate risk in a bond rather than its total fair value. This improves the possibility of qualifying for hedge accounting and minimises hedge ineffectiveness as one compares the change in the fair value of the bond due to interest rate risk to the fair value of the derivative, e.g. an interest rate swap. [↑](#footnote-ref-2)
2. Actuarial estimate: please describe what the actuarial estimate represents. [↑](#footnote-ref-3)
3. Renewals: please define the expected renewal boundary used (i.e. how many years). [↑](#footnote-ref-4)
4. Sales: please define the expected new business included in the hedged risk position. [↑](#footnote-ref-5)
5. Where this is based on interpretations from audit firms, please include the relevant information. [↑](#footnote-ref-6)
6. Rebalancing refers to the adjustments made to the designated quantities of the hedged items or the hedging instrument of an existing hedging relationship for the purpose of maintaining a hedge ratio that complies with the hedge effectiveness requirements. [↑](#footnote-ref-7)
7. A layer component can be specified from a defined, but open, population or from a defined nominal amount such as part of a monetary transaction volume (such as the next €5 cash flows from sales denominated in a foreign currency after the first € 55 in June 2020) or part of the nominal amount of the hedged item such as the bottom layer of €5 million of a €50 million fixed rate bond. [↑](#footnote-ref-8)
8. This refers to any technique that results in a financial result that goes beyond the mere mitigation of existing risks such as (but not limited to) taking a position with the aim of earning additional money based upon the risks present in the balance sheet. The word may mean different things to actuaries, risk management practitioners and accounting practitioners. [↑](#footnote-ref-9)
9. It is acknowledged that (re)insurance contracts held can be in an asset or liability position. [↑](#footnote-ref-10)
10. Applicable for reinsurers. [↑](#footnote-ref-11)