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LE DÉLÉGUÉ GÉNÉRAL

Paris, February 23th 2011

Dear Sir David,

Exposure Draft "ED/2010/13 Hedge Accounting"

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the IASB's invitation for comments on the Exposure Draft "Hedge Accounting". The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

Relevance of the hedge accounting ED cannot be properly assessed before proposals that faithfully represent the insurance business are stabilised on insurance contracts and financial instruments

The Board adopted a phased approach to replace IAS 39.

As discussed in our comment letters on the first two phases of IFRS 9 as well as on the ED "Insurance Contracts", we urge the Board to give due consideration to the interactions between the hedge accounting model and proposals in various Exposure Drafts recently published.

We have very limited insight into the relevance of the hedge accounting proposals and how these proposals interact in the financial reporting of insurance companies. For instance, the FFSA and many constituents expressed their deep concerns on several aspects on the proposals in the ED "Insurance Contracts", as this ED does not achieve a faithful representation of the insurance business. We suggested alternative proposals and reckon that the Boards have initiated thorough redeliberations on several issues. The Board also intends to address shortly the specificities of debt securities with regards to the proposals on amortized cost and impairment.

As a result of these major uncertainties on the future treatment of insurance contracts and financial assets underlying future hedge relationships insurance companies are not yet in a position to assess how their hedging activities and underlying exposures (including liabilities resulting from insurance contracts) will interact in their financial reporting and whether their business model will be properly depicted in their financial statements.

Further, we note that the Board decided not to address accounting for hedges of open portfolios at this stage. We believe the final standard on hedge accounting should not be issued before the ED on hedges of open portfolios is published, to ensure our risk management activities and asset-liability matching strategies are appropriately reflected in future standards.

Sir David Tweedie
Chairman
International Accounting Standards Board
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The proposed objective based on risk management activities brings significant improvements to current requirements but lacks consistent application throughout the standard

We support the objective stated in the ED that hedge accounting should reflect the extent and effects of an entity's risk management activities. This objective meets our requests for reporting standards that reflects the entity's business model, as already expressed in our comment letters on IFRS 9 and IFRS 4 Phase II.

We note that this principle would result in significant improvements compared to current requirements under IAS 39, notably with regards to allowing non financial components, derivatives and layers as eligible hedged items.

However, some proposals in the ED fail to meet this overarching principle and need, in our view, to be changed. In particular, the following issues should be changed to allow for a proper representation of actual risk management activities:

- restriction of eligible hedged items to risks that could affect profit or loss should be removed. For instance, equity securities classified at fair value through other comprehensive income should not be excluded from the scope of items eligible to hedge accounting as the risk management activities may require hedging an entity's net assets;
- restrictions to the eligibility of specific components - such as inflation and credit risk, should be removed, so that hedges of these components can be accounted for, when separately identifiable and reliably measurable;
- designating interest rate risk on a layer component of a contract that includes a prepayment option as a hedged item should not be prohibited when layers that are economically not subject to this prepayment risk can be identified at portfolio level.

The link between rebalancing and discontinuation require clarification to be made operational

We think the proposals relating to rebalancing and discontinuation and on the time value of options are overly complex. We ask the Board to clarify this significant issue and to alleviate the operational and documentation burden for issuers of financial statements.

Furthermore, we refer to our comment letter on the Request for Views "Effective Dates and Transition Methods" and reiterate our request for a single effective date, applicable to all phases of IFRS 9 and to IFRS 4 Phase II. The usual two-year timeframe given for transition to new standards will not be sufficient to face the operational challenges of the implementation of such changes (notably IT systems) and to educate both internally and externally on these complex requirements.

The above comments are detailed within our answers to the Board's questions in the Appendix to this letter.

We hope you find these comments useful and would be pleased to provide any further information you might require. Please contact Bertrand Labilloy at + 33 1 42 47 93 58 if you wish to discuss any of the issues raised.

Yours sincerely,

Jean-François Lequoy

Appendix 1

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?

The FFSA supports the objective stated in the ED that hedge accounting should reflect the extent and effects of an entity's risk management activities, and believes that this principle should be pervasive throughout the proposed standard and the coming proposals on hedges of open portfolios. This objective is a crucial step in ensuring that financial reporting depicts adequately the insurance business model.

This objective remediates the most obvious drawbacks of current requirements in IAS 39. The rule-based approach under IAS 39 prevents from appropriately reflecting most risk management activities undertaken by insurance companies. Indeed, most financial instruments used for risk management purposes are currently recorded at fair value through net income because of stringent current rules, whereas they allow for an effective economic hedge of specific risk exposures.

However, we note that the proposed principle is not consistently applied throughout the proposed standard. We consider that the following items should be modified to achieve consistency with the principle:

- the ED restricts hedge accounting to financial instruments hedging risks that could affect profit or loss, thus prohibiting hedge accounting for equity securities classified at fair value through other comprehensive income.

  An entity willing to hedge its economic exposure to these securities, for instance to reduce volatility in reported equity, would face an accounting mismatch between equity securities measured at fair value through OCI and derivatives measured at fair value through net income.

  We are convinced that the final standard should not discourage an entity from hedging risks that will not affect profit or loss because of inappropriate accounting requirements, regardless of its risk management activities. .

  Furthermore, we remind the Board of our long-standing opposition to the current IFRS 9 requirements on equity securities measured at fair value through OCI. We have consistently requested for recycling of realized gains and losses as well as impairments through net income.

- paragraph B18 asserts that inflation is not an eligible risk component unless contractually specified, as the Board considers it cannot be identified separately and measured reliably.

  We believe that this undocumented assertion should be eliminated, so that the standard remains principle-based and meets the above objective.

  For instance, inflation risk is embedded into the assessment of insurance liabilities. Inflation impacts expenses, policyholder's expectations, and may impact minimum guaranteed rates. Therefore, hedging this risk is essential in a proper risk management strategy for an insurance company. This goal can be achieved by investing in inflation-linked assets such as equity securities, investment properties or inflation-linked bonds. For asset-liability management purposes, derivatives as inflation swaps or caps can be a more practical and efficient mean of hedging inflation risk. We consider that hedge accounting should not be precluded on this risk management activity.

  We refer to our answer to question 4 below.

- paragraphs BC219 to BC 246 assert that credit risk is not an eligible risk component, as the Board considers it cannot be identified separately and measured reliably.

We believe that this assertion contradicts with requirements in other standards, such as reporting for own credit risk on financial liabilities under IFRS 9 and assessing future credit losses in the ED "Financial Instruments – Amortized Cost and Impairment". This assertion should be eliminated, so that the standard meets the above objective.

We refer to our answer to question 15 below.

- paragraph 36 e) precludes eligibility of a layer component of an overall group of items if items in the group contain prepayment options.

  We note that the Board decided not to address hedges of open portfolios at this stage. However, we ask the Board not to pre-empt future decisions on hedges of portfolios.

  It is insurance companies' common practice to manage risks through 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), as future cash flows can be reliably assessed on a portfolio basis.

  We recommend this paragraph be deleted so that the overall objective of hedge accounting can be consistently applied, without pre-empting on the upcoming ED on hedges of open portfolios.

  Further, we believe the final standard on hedge accounting should not be issued before the ED on hedges of open portfolios is published, to ensure that our risk management activities and asset-liability matching strategies are appropriately reflected in future standards.

  We refer to our answer to question 5 below.

Last, we agree that hedge accounting should be based on voluntary designation of hedge relationships rather than being compulsory, as mandating hedge accounting would not be relevant or operational.

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?

The FFSA agrees that eligible hedging instruments should not be limited to derivatives as non-derivative financial assets or liabilities may be used within an entity's risk management activities.

Consistently with the objective discussed in question 1, eligibility of a hedging instrument should be based on the capacity of the instrument to achieve the intended hedge rather than on the nature of the instrument.

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?

The FFSA agrees with the proposal to permit a combination of an exposure and of a derivative to be designated as a hedged item.

The ED removes an arbitrary rule under current IAS 39 requirements. It allows for better consistency with the objective to align financial reporting on risk management activities.

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 (ie 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?

We strongly support allowing risk component of financial or non-financial instruments to be eligible hedged items, provided that the risk component is separately identifiable and reliably measurable.

Particularly, this proposal provides appropriate accounting treatment to entities that manage risk components separately. Insurance entities, for instance, commonly hedge the interest rate risk component embedded in their insurance liabilities, which could not be reported adequately under current IAS 39 requirements.

However, we note the assertion in paragraph B18 that inflation cannot be an eligible risk component unless contractually specified, as the Board considers it cannot be identified separately and measured reliably. We believe that this undocumented assertion should be eliminated, so that the standard remains principle-based and meets the above objective. We consider that generally accepted measures of inflation can be found on the market in most countries. We also note that inflation is not excluded from the proposals in the FASB's ED "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities".

Further, inflation risk is embedded into the assessment of insurance liabilities. Inflation impacts expenses, policyholder's expectations, and may impact minimum guaranteed rates. Therefore, hedging this risk is essential in a proper risk management strategy for an insurance company. This goal can be achieved by investing in inflation-linked assets such as equity securities, investment properties or inflation-linked bonds. For asset-liability management purposes, derivatives as inflation swaps or caps can be a more practical and efficient mean of hedging inflation risk. We consider that hedge accounting should not be precluded on this risk management activity.

We also refer to our answer to question 15, as a similar rule in the ED prohibits the use of hedge accounting for credit risk components.

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?

(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?

<u>Question 5 a:</u>

We agree that layers of the nominal amount of an item can be designated as hedged items as it meets the objective of reflecting an entity's actual risk management activities in its financial reporting.

Hedges of layers are common practice for insurance companies (refer to question 5 b below).

<u>Question 5 b:</u>

We strongly object to prohibiting hedge accounting for layer components of a contract that includes a prepayment option.

The proposal in the ED should not preclude subsequent developments of a specific accounting treatment for hedges of open portfolios. Indeed, at portfolio level, the interest rate risk on certain layers can be isolated from the prepayment risk based on policyholder behavior modeling.

It is insurance companies' common practice to manage risks through 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 risk can be identified at portfolio level.

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?

The FFSA welcomes the simplification efforts undertaken by the Board and supports the proposed hedge effectiveness requirements, in line with the stated objective for hedge accounting and the characteristics of principle-based standard.

We agree with the removal of the effectiveness test based on bright-lines (80% / 125%) under current IAS 39 requirements. Many entities refrained from applying hedge accounting because of such unnecessary complexities and of cliff effects of dedesignations occurring in subsequent periods when the tests results in a 79% or 126% effectiveness. The proposal of a mix of prospective qualitative and/or quantitative tests based on the specific facts and circumstances of the hedging relationship meets the objective of a principle based standard.

We also support the proposal not to bring forward to IFRS 9 the retrospective effectiveness assessment. This test entailed inappropriate consequences, such as de-designation because of minor retrospective ineffectiveness in cases where the risk management strategy remained unchanged and the hedge relationship was deemed prospectively effective.

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?

We support the concept of rebalancing as it avoids irrelevant dedesignation and redesignation of hedging relationships. Particularly, under current IAS 39 requirements, the effectiveness test could entail discontinuing hedge accounting whereas the risk management objective remained unchanged.

However, we find the proposals relating to rebalancing overly complex and burdensome, in particular:

- mandatory rebalancing may require revising the hedge ratio at each reporting date;
- subsequent rebalancing may generate undue complexity in the effectiveness tests.

Furthermore, the proposed principles create confusion and consequently the distinction between cases for rebalancing and for discontinuation may be difficult in practice. Clearer definition criteria should be provided.

We ask the Board to clarify this significant issue and to alleviate the operational and documentation burden for issuers of financial statements.

We believe that an entity should be allowed to discontinue hedge accounting and resume accounting for the hedging instrument in isolation, even though the risk management objective for the hedging relationship is unchanged.

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?

Question 8 a:

The FFSA concurs with the Board's proposal that hedge accounting be discontinued prospectively only when the hedging relationship does not meet the qualifying criteria any more.We refer to our answer to question 7 b, asking for clarifications on the respective applications of rebalancing and discontinuation.

Question 8 b:

We agree that hedge accounting should not be discontinued if the hedging relationship still meets the risk management objective and strategy as defined at inception of this relationship and this objective and strategy have not changed

However, we would welcome clarifications on the appropriate level to be considered in the assessment of changes in the risk management objective (transaction level, entity / group risk management).

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?

(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?

(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?

Question 9 a:

We agree with the proposal of a two-step approach for the recognition of hedge ineffectiveness, in OCI first then in net income.

Question 9 b:

We acknowledge that current IAS 39 requirements result in providing meaningless information on hedged items because the reported items end-up being measured at a hybrid value that is neither amortized cost or fair value. The Board's proposal to present separately the gain or loss on the hedged item attributable to the hedged risk eliminates this current inconsistent measurement.

However, paragraph 26 b requires that these separate line items be presented "next to the line item that includes the hedged asset or liability". We are concerned that this requirement might lead to confusion and numerous new line items on the face of the financial statements if separate presentation is required by category of hedged item and by hedged risk. Only aggregates for each category of hedged item should be considered for presentation on the face of the statement of financial position, the detail of which, split by hedged risk, could be disclosed in the notes.

Question 9 c:

We believe that linked presentation results in undue complexity on the face of the statement of financial position, and that description of the risk management strategy should be disclosed in the notes and not on the face of financial statements.

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 (eg like a basis adjustment if capitalised 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 (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?

The FFSA welcomes the Board's decision to solve the issue of ineffectiveness in a hedging relationship that results from the time value of options.

However, the proposals in the ED seem overly complex, in particular with regards to differentiating transaction based and period based transactions. We recommend that a single treatment be retained, aligned on the proposed transaction based model as we consider that the time value of options represents the cost of hedging.

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?

We note that the Board decided not to address hedges of open portfolios at this stage. However, we ask the Board not to pre-empt future decisions on hedges of portfolios. We believe the final standard on hedge accounting should not be issued before the ED on hedges of open portfolios is published, to ensure that our risk management activities and asset-liability matching strategies are appropriately reflected in future standards.

We agree with the criteria in paragraphs 34 a and 34 b for the eligibility of groups of items as a hedged item, provided paragraph 36 e is deleted in order to avoid the exclusion of groups of items that include prepayment options as future cash flows may be reliably assessed on a portfolio basis.We recommend paragraph 36 e) be deleted so that the overall objective of hedge accounting can be consistently applied without arbitrarily excluding individual items from eligible hedged items.

Insurers often hedge net positions resulting from groups of items. For instance, insurers commonly hedge their interest rate exposure resulting from financial assets (mostly long term bonds) and long term insurance liabilities. If no bonds are available on the market to match the duration of long term liabilities (e.g. 15-year bonds to match a closed portfolio of retirement contracts with a duration of 30 years providing a guaranteed rate of return), an insurer may enter into swaptions to secure the rate at which the proceeds will be reinvested in year 15 and ensure that the company is able to pay the guaranteed rate and cover handling costs. The nominal of the swaption equals the estimated cash flows, including lapses. We consider that this hedging activity should not be excluded from hedge accounting.

With regards to the criteria in paragraph 34 c, we do not agree with the restriction on cash flows in the group of hedged items occurring in the same reporting period.

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 (eg in a net position hedge), any hedging instrument gains or losses recognised 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?

The FFSA agrees with the proposal.

However, we are unable at this stage to assess the relevance of these proposals in the hedge accounting project and how they interact with the future presentation requirements in the standard on insurance contracts. We ask the Board to ensure that the final standards result in an appropriate picture of the insurance business model and of the risk management activities. .

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?

Question 13 a:

The FFSA agrees with the objective of disclosure defined in paragraph 40, including a description of the risk management activities and strategies.

However, the FFSA is concerned with the ever increasing volume of disclosure requirements and would prefer that the final standard retains the overall objective discussed above, with a list of disclosure in the BC that was considered useful by the Board as long as they meet the information needs for the types of hedging activities carried out by the reporting entity.

Question 13 b:

We did not identify other disclosures that would provide useful information.

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?

We have no comments on this issue.

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?

(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?

As described in our answer to question 1 above, we disagree with the Board's decision to preclude hedge accounting for hedges of credit risk using credit derivatives.

Paragraphs BC219 to BC 246 assert that credit risk is not an eligible risk component, as the Board considers it cannot be identified separately and measured reliably. We have identified contradictions between this assertion and the requirements in other standards or projects, such as reporting for changes in own credit risk for financial liabilities under IFRS 9 and assessing future credit losses in the ED "Financial Instruments – Amortized Cost and Impairment", whereby credit risk is required to be assessed in isolation.

Insurance companies currently use credit derivatives to hedge credit risk, as these instruments provide one of the most efficient coverage available on the market. This common risk management practice is acknowledged by insurance supervisors in the prudential framework as an effective way of managing and reducing credit risk exposure. The assessment of credit risk and of the impact of such risk mitigating techniques will be performed on a recurring basis to evaluate the capital required for solvency purposes.

As a result, we recommend the Board remove this restriction, so that the standard meets the overall alignment objective of financial reporting on actual risk management activities.

Question 16

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

The FFSA agrees with the proposed prospective application of the standard.

As discussed in our previous comment letters (on IFRS 9, IFRS 4 Phase II, Request for Views "Effective Dates and Transition"), the FFSA asks for a single effective date for mandatory application of all phases IFRS 9 and IFRS 4 Phase II, with early adoption permitted. Insurers must have the ability to change the classification of financial assets upon transition to IFRS 4 Phase II as well as hedge relationships if early adoption of IFRS 9 was elected, without restriction to classification at fair value through net income.

Moreover, we believe that the usual two year timeframe left for transition to new standards will not be sufficient to face the operational challenges of the implementation of such changes (notably IT systems) and to educate both internally and externally on these complex requirements.