



Michael Monahan
Director, Accounting Policy
(202) 624-2324 t (866) 953-4097 f
mikemonahan@acli.com

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Ms. Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2011-175 – Selected Issues about Hedge Accounting (Topic 815) Invitation to Comment, February 2011

Dear Ms Seidman:

Thank you for the opportunity to comment on the Selected Issues about Hedge Accounting (Topic 815) Invitation to Comment, February 2011. 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 both concerns and recommendations with regard to financial instrument hedge accounting guidance. Appendix A provides our response to the questions enumerated in FASB's Invitation to Comment. We have also attached a copy of our original comment letter to the IASB, including our responses to their ED questions.

We generally support the IASB ED on Hedge Accounting, with some modifications recommended, believing it to represent a move in the right direction toward comprehensive, high-quality, principle-based standards. We support the concept of anchoring hedging accounting guidance in the risk management activities of the entity, recognizing that hedging is one of the strategies most widely used to manage risk in a financial services entity. Relaxation of the qualifying criteria and alignment with risk management activities allows entities greater flexibility in those risk management activities.

We caution the Boards against basing any accounting guidance too strongly or narrowly on either a banking model or on one asset type or from further complicating the guidance and deviating from hedge accounting principles by setting specific item limitations.

We further strongly support a comprehensive, converged standard for financial instruments as soon as is realistically possible. Great progress has been made in through the deliberation process. However, we believe further deliberation and possible field testing is necessary to achieve the high-quality accounting standard needed for all types of companies and all stakeholders.

Thank you for this opportunity to comment, and we welcome continued dialogue on this topic.

Sincerely,

A handwritten signature in black ink, appearing to read "M Monahan". The signature is fluid and cursive, with a long horizontal stroke at the end.

Michael Monahan
Director, Accounting Policy

APPENDIX A

RESPONSE TO QUESTIONS FOR RESPONDENTS:

Risk Management

Question 1

When an entity uses financial instruments to manage risk exposures in economic hedges but those instruments are not designated in relationships for accounting purposes, do you believe that the proposed guidance would provide useful information about all of the effects of an entity's risk management objectives?

No. We believe that the guidance put forth on hedge accounting is for the purpose of describing the accounting for those risk management activities that only qualify for hedge accounting treatment. It is not intended, nor should it be, to describe all of an entity's risk management activities, nor to describe all of the uses of derivatives for which hedge accounting is not sought.

Understanding that deliberations continue on certain aspects of impairment accounting guidance, we recognize that the Boards have not reached final conclusions on converged changes to current guidance on financial instruments. However, we do understand that this exposed guidance on hedging picks up on the concepts established in FAS 133, relaxing the standards for the instruments and risks that qualify for hedge accounting and does not cover all of an entity's risk management activities.

It is unclear to us whether the financial statement disclosure requirements of Topic 815 are intended to be addressed in the exposed guidance or whether this is a part of the guidance under re-deliberation.

Question 2

Do you believe that the proposed guidance and illustrative examples included in the IASB's Exposure Draft are sufficient to understand what is meant by risk management, how to apply that notion to determine accounting at a transaction level, and how to determine the appropriate level of documentation required?

Yes. We support aligning the hedge accounting guidance with an entity's risk management strategies as in Topic 815-20-25, paragraph 3 (formerly FAS 133, paragraph 20 a). Currently, 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 part of the hedge accounting documentation is required and we believe the intent of the ED is to continue this level of documentation.

Question 3

Do you foresee an entity changing how it determines, documents, and oversees its risk management objectives as a result of this proposed guidance? If yes, what changes do you foresee? Do you foresee any significant difficulties that an entity would likely encounter in establishing the controls related to complying with the proposed guidance?

Yes. We believe that the added emphasis of risk management activities to accounting transactions and financial reporting will require new management reporting and processes to assess the efficacy of the risk management strategy and the criteria for determining when the strategy has changed. While we are currently required to state the risk being mitigated, we anticipate an increased level of compliance activity surrounding risk management as it becomes the foundation for proper financial reporting in order to set boundaries and determine changes.

We believe that the determination of the risk management objective should be defined by the reporting entity in order to align with the entity's risk management actions taken.

Question 4

Do you foresee any significant auditing issues arising from the proposed articulation of risk management and its link to hedge accounting? For example, is the information required to be disclosed regarding an entity's risk management strategies measurable and objective? Could the inclusion of an entity's risk management objectives create an expectation gap that the auditor is implicitly opinion on the adequacy of an entity's risk management objectives?

Yes. As we indicated in question 3, the auditing issue we foresee is primarily the interpretation and application of the concept of risk management, including the criteria for determining strategy changes. Previous guidance required a statement of the risk being addressed. The proposed guidance creates a requirement that this risk management be used to qualify and evaluate hedge accounting. Just as entities will work to address and overcome the internal translation and application differences in understanding, the same conversations will be required to come to a consensus of understanding and application between the entity and its auditor. There is not yet a definitive and authoritative source for defining or measuring risk management activities. There are general definitions of risk and some of those have developed practical ways of estimation and reporting, which include a fairly significant subjective element.

We, therefore, reiterate that we believe that the determination of the risk management objective should be defined by the reporting entity in order to assure alignment with the entity's risk management actions taken.

An entity's risk management actions should include the ability to rebalance and/or de-designate as appropriate to the cost effective management of that risk.

Hedging Instruments

Question 5

Should cash instruments be eligible to be designated as hedging instruments? Why or why not? If yes, is there sufficient rigor to prevent an entity from circumventing the classification and measurement guidance in other relevant accounting guidance (for example, IFRS 9, *Financial Instruments*, and IAS 21, *The Effects of Change in Foreign Exchange Rates*)? Are there any operational concerns about designating cash instruments (such as items within a portfolio of receivables) as hedging instruments?

We agree that current IFRS guidance provides enough rigor, including the requirements around hedging documentation, to prevent an entity from circumventing the classification and measurement guidance. We expect that the principles underlying all guidance effecting financial instruments are and will be sufficiently integrated to avoid conflicts and abuse. Hedge accounting based on risk mitigation activities as determined by the entity will also prevent anomalies, such as increased volatility due to the risk management activities that would otherwise create noise in the financial statements. In addition, we believe that the principles-based approach is more in line with the activities of entities using hedges and will allow for greater use of hedge accounting. Together, these effects would indicate that the principles-based approach would allow for hedging activities that entities might have foregone in the past due to the negative effects of income volatility.

We do not foresee any operational concerns, recognizing that there will be operational adjustments and commensurate resources required to update our processes for any changes in guidance.

Hedged Items – Overall

Question 6

Do you believe that the proposed guidance is sufficient to understand what constraints apply when determining whether an item in its entirety or a component thereof is eligible to be designated as a hedged item (for example, equity instruments measured at fair value through profit or loss, standalone derivatives, hybrid instruments, and components of instruments measured at fair value through profit or loss that are not permitted to be bifurcated)? If not, what additional guidance should be provided?

Yes. Based on extensive discussions of the proposed guidance, we believe we understand how to determine and designate an appropriate hedged item. However, if the Boards intend specific exclusions of assets or liabilities that might otherwise qualify under the principle, we anticipate that those would be specifically excluded from the scope.

We recognize that risk management activities, by themselves, may create accounting anomalies in the interim between the inception of the transaction and the ultimate conclusion. Hedge accounting addresses these anomalies by linking the related transactions that accomplish the risk mitigation. Consequently limiting the eligibility of components or items from hedge accounting, when they do, in fact, accomplish the risk mitigation purpose, is not appropriate, nor is it consistent with the direction and purpose of the IASB ED.

For that reason, we strongly disagree with the specific exclusion of credit risk from qualifying as a hedgeable component. We believe this exclusion (based on a focus on bank loans in the IASB staff papers) is arbitrary and not consistent with the proposed guidance principle or other accounting guidance. Further, we believe that the change in value of a debt security for credit risk can be reasonably calculated and that a credit default swap is often a good proxy for credit risk in a bond, and should be allowed for the same reasons that a hypothetical bond is used in forecasted transactions. Perfect effectiveness is not required for risk mitigation and the hedge accounting guidance generates transparency related to the ineffectiveness.

Also, in situations in which debt securities are hedged with credit default swaps, and the risk management strategy is to protect against a credit loss from default, a high level of effectiveness can be achieved.

Hedged Items – Risk Components

Question 7

Do you believe that the proposed criteria are appropriate when designating a component of an item as a hedged item? If not, what criteria do you suggest? Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to determine when the criteria of separately identifiable and reliably measurable have been met? If not, please describe what additional guidance should be provided?

Yes. We believe these appropriate and understandable criteria. The illustrative examples, however, should focus on the application of the principle: what does qualify and how it qualifies rather than examples of what, in some cases, might not. We would expect these examples to include how bifurcation of risk is handled since strategies realistically used by entities are addressed by risk and not necessarily by an instrument as a whole.

Question 8

Do you believe that “separately identifiable” should be limited to risk components that are contractually specified? Why or why not?

No. We see no need to limit the risk components to those that are contractually specified. We believe this restriction could have an unnecessary, limiting impact on an entity’s risk management strategies. A more principles-based approach, as proposed by the IASB, would allow for hedging activities that entities might have foregone in the past due to the negative effects of income volatility.

Question 9
(Excluded from FASB Invitation to Comment)

Hedged Items – Layer Component

Question 10

Do you believe that the proposed guidance is sufficient to understand what constraints apply to determining a layer component from a defined, but open, population? (For example, do you believe that the sale of the last 10,000 widgets sold during a specified period could be designated a layer component in a cash flow hedge?) If not, what additional guidance should be provided?

Yes. We agree that the proposed guidance is sufficient to understand the constraints of separately identifiable and reasonably measured. However, we do not agree with the exclusion of a prepayment option from eligibility as a layer component that is hedgeable. We believe there are circumstances under certain risk management strategies wherein the prepayment option should be an allowable hedged risk, for example when the hedging instrument itself has a mirror prepayment option as the hedged item. We believe that the proposed guidance principle and requirements are sufficient to determine the appropriateness of a hedged risk without that specific exclusion.

Hedged Items – Aggregated Exposures and Groups of Items

Question 11

Do you foresee any operational concerns applying other guidance in IFRS (for example, guidance on impairment, income recognition, or derecognition) to those aggregated positions being hedged? For example, do you foresee any operational concerns arising when an impairment of individual items within a group being hedged occurs? If yes, what concerns do you foresee and how would you alleviate them? The proposed guidance would define an *aggregated exposure* as a combination of another exposure and a derivative. The proposed guidance would permit an entity to recognize changes in the fair values of derivatives that are part of the aggregated exposure to be reflected in other comprehensive income rather than through profit or loss.

No. Systems are currently equipped to track multiple items in hedge relationships. There may be some systems adjustments required for new types of items included in an aggregated position, but we anticipate the Boards will take operational requirements into consideration when deliberating the effective date of the proposed guidance.

We are concerned, however, about the integration of guidance coming out piecemeal and the possibility that a looming deadline will take precedence over well-thought-out, comprehensive guidance. We reiterate our belief that a final, converged and comprehensive financial instruments standard should be re-exposed and field tested to assure the best outcome of this long and costly process.

Question 12

Do you believe that the proposed guidance on aggregated exposures will provide more transparent and consistent information about an entity's use of derivatives? Why or why not?

Yes. We believe that the proposed guidance, including disclosures, contemplating the modifications we've recommended, will provide clearer information about an entity's use of derivatives with respect to its risk mitigation activities using hedging strategies. Other uses of derivatives may not be within the scope of this guidance.

Question 13

Do you believe that an entity should be permitted to apply hedge accounting to a group of cash instruments or portions thereof that offset and qualify as a group under the proposed guidance and satisfy the proposed hedge effectiveness criteria? Why or why not?

Yes. Consistent with our comments above, we believe that the proposed guidance, including disclosures, contemplating the modifications we've recommended, provide sufficient parameters for determining appropriate hedge accounting treatment for those items or groups of items and components. Designation, assessment and documentation requirements, including connection to and entity's risk management, provide sufficient guards against abuse and provide greater clarity into the business and strategy of the entity.

Hedge Effectiveness

Question 14

Do you foresee any significant operational concerns, including auditing issues, in determining how to assess whether a hedge achieves other-than-accidental offset? If yes, what concerns do you foresee and how would you alleviate them?

No. However, we recommend additional explanation regarding the meaning and application of the "unbiased result" and "minimize hedge ineffectiveness" with examples that would show how those criteria are violated. We believe further clarification is needed in order to avoid the practical development of bright lines or rules of thumb in order to determine the parameters of these concepts.

Question 15

Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to analyze hedge effectiveness (for example, how to measure the change in the value of the hedged item attributable to the related hedged risk for nonfinancial items)? If not, what additional guidance is needed?

Yes. We are comfortable with the guidance and examples for analyzing hedge effectiveness for the types of relationships we contemplate. We do not observe any significant changes from current practice or guidance in the analysis of hedge effectiveness.

Changes to a Hedging Relationship

Question 16

Do you foresee any significant operational concerns or constraints in determining whether (a) a change to a hedging relationship represents a rebalancing versus a discontinuation of the hedging relationship or (b) an entity's risk management objective has changed? If yes, what concerns or constraints do you foresee and how would you alleviate them?

We believe that both rebalancing and de-designation should be discretionary and not mandatory in order to provide the maximum transparency to investors regarding an entity's risk management efforts. We foresee no significant operational concerns or constraints to amending documentation and executing transactions in order to accomplish risk management activities. However, we recognize the need for sufficient lead time to digest the final guidance requirements and implement system changes through outside vendors.

Question 17

Do you foresee any significant operational concerns or constraints relating to the potential need to rebalance the hedging relationship to continue to qualify for hedge accounting? If yes, what concerns or constraints do you foresee and how would you alleviate them?

No. See our response to questions 16.

Accounting for the Time Value of Options

Question 18

Do you believe that capitalizing the time value of an option as a basis adjustment of the nonfinancial items (in other words, marking the asset or liability away from market) will improve the information that is provided in an entity's statement of financial position? Why or why not?

Generally, we believe the ability to isolate and amortize the full time value of an option in an effective hedging relationship is an important improvement for both financial and non-financial instruments offered by IFRS 9. Insurers use options to protect against adverse financial results by paying an upfront premium on options; this is usually made up, predominantly, of time value. This option premium including time value is viewed as being significantly different from the insurance an entity purchases on its own properties, which is recognized evenly over the period covered. The current inability to amortize this component over time has led to a preference by insurance entities not to hedge or use non-derivative products to hedge such risk, because the insurers cannot live with the short-term volatility generated by the time value of options. Eliminating this reporting difference allows entities to use the cheapest and best hedge against adverse events as part of their risk management policy, without concern for the short-term income volatility an option's time value currently creates.

However, we believe that adding line items to the face of the financial statements is counterproductive. We are concerned that continuing to adjust the financial statements prior to completing thorough and comprehensive deliberations over financial statement presentation and a disclosure framework will continue to muddy the message.

Hedge Accounting and Presentation

Question 19

Do you believe that the proposed presentation of the gains and losses in other comprehensive income will provide users of financial statements with more useful information? Why or why not?

No. Consistent with our view expressed in question 18, we do not believe that adding additional line items to the statement of comprehensive income would provide significant decision-useful information, but would rather create potential distraction and confusion. We believe the purpose of hedge accounting is to clearly communicate the effects of an entity's activities to mitigate risk. We believe that attempting to itemize the components of a hedging relationship in other comprehensive income merely creates additional, unnecessary detail through which to wade, and may be misinterpreted by financial statement users rather than clearly communicating the results of an entity's hedging strategies.

We support clear disclosures that outline the strategies undertaken and believe that the numbers on the face of the financial statements should reflect the results of an entity's risk management strategies.

Question 20

Do you believe that the proposed presentation of a separate line item in the statement of financial position would increase the transparency and the usefulness of the information about an entity's hedging activities? Why or why not?

No. See our responses to questions 18 and 19.

Question 21

Do you believe that there is sufficient guidance to specifically link the hedging adjustments to the hedged assets and liabilities that compose a hedged net position with respect to presenting a separate line item in the statement of financial position?

As discussed in questions 18 and 19, we do not believe it helpful or necessary to itemize the components of the hedging strategy on the face of the financial statements throughout the hedge relationship.

Disclosures

Question 22

Do you foresee any significant auditing issues arising from the inclusion of risk management disclosures in the notes to the financial statements? If yes, what issues do you foresee and how would you alleviate them? Do you believe it is appropriate to include risk management disclosures in the notes to the financial statements rather than in other information in documents containing financial statements? Why or why not?

As we've stated in response to previous questions, we believe that the increased emphasis on risk management as a basis for qualification for hedge accounting will require increased collaboration in definitional agreement between auditors, regulators and the entity. We believe that the determination of the risk management objective should be defined by the reporting entity in order to assure alignment with the entity's risk management actions taken. We support transparent disclosures around risk management activities, but are concerned about the audit requirements yet to be developed.

Other

Question 23

Do you believe that the changes proposed by the IASB provide a superior starting point for any changes to US GAAP as it related to derivatives and hedging activities? Why or why not? Should the FASB be making targeted changed to US GAAP or moving toward converging its overall standards on derivatives and hedging activities with the IASB's standards?

We generally support the IASB ED regarding hedging as indicated by the attached comment letter previously sent. We believe the IASB's ED is more internally consistent and will allow more risk management strategies to qualify for hedge accounting. We believe that the IASB's principles-based approach is the right foundation and appropriately addresses isolating and measuring what is being hedged. This principles-based approach makes transparent an entity's risk management activities and will allow better engagement with an entity's risk mitigation activities.

The ACLI member companies do strongly support converged standards and recommend that the FASB continue its efforts to assure a complete and converged standard for financial instruments, including derivatives and hedging activities, as soon as is realistically possible. We believe that a converged standard, using IFRS 9 principles as a foundation, should include the following:

- ***Principals based*** – We believe the principles-based approach to hedge accounting is preferable to the current rules-based approach, which has limited the use of hedge accounting for valid economic hedges. We believe a principles-based approach will ultimately increase the transparency of and result in correctly reported results of good economic risk management activities.
- ***Emphasis on risk management*** – The use of risk management as a guiding principal, should limit differences between the true economics of good intended risk management activities and their resulting financial statement impact.
- ***Rebalancing*** – Allows for better alignment of hedge accounting and risk management activities. A good risk management program should be able to evolve with changes in market forces and the entity own risks. The currently proposed de- and re-designation rules create significant inconsistencies with the true economics of such risk management activities. These proposed rules also add significant complexity and can incorrectly penalize good risk management activities.
- ***Bifurcation of risk at a cash flow level*** – The IFRS model better aligns with an entity's risk management objectives, because it allows an entity to include only the hedged items' cash flows they are hedging with each risk management strategy. Examples of this are partial-term hedges or hedges of a benchmark risk component. FASB's model requires the inclusion of all contractual cash flows for fair value hedges, even when some of the hedged items' cash flows or components of cash flows aren't part of the entities risk management hedging strategy. The inclusion of all contractual cash flows incorrectly represents hedge ineffectiveness and, in some cases, causes a good economic hedge to fail hedge accounting.

- ***Avoiding bright-line testing criteria*** – Ultimately the results of hedge ineffectiveness measurement reflect the quality of a hedging relationship. A bright-line criterion only limits the number of relationships that are visible in hedge reporting. The higher the bar is set, the less transparency entities will be able to share about their risk management performance in the heart of the financial statements.