# Swiss Re

III



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LETTER OF COMMENT NO. 124

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Re: Exposure Draft (ED) - Accounting for Hedging activities - No. 1590-100

Dear Sir or Madam.

As one of the leading global reinsurers Swiss Re supports the FASB in developing high-quality accounting standards. We have considered this Exposure Draft on Accounting for Hedging Activities, which would amend FASB statement No. 133, and welcome the opportunity to share our thoughts with you.

We have the following comments on the Exposure Draft:

#### Introduction

We support efforts to simplify hedge accounting but believe that the current proposals are not in line with the way hedging of risk is performed today. We are concerned that the current proposal may not achieve its original objective to significantly simplify hedge accounting. We are also not convinced that it will provide more useful information to users. Instead, it would create new complexity and hinder convergence with International Financial Reporting Standards (IFRS). We discuss individual points in the paragraphs below.

### Convergence with IFRS

Given the likelihood of a conversion with IFRS in the foreseeable future we consider it unreasonable to expect preparers to incur the cost and effort to adapt their systems and processes to these changes when these principles may be reconsidered when converging to IFRS. We think that this ED will create new differences with IFRS and make convergence more difficult.

### **Hedged Risk**

The proposed changes would require companies – apart from defined exceptions – to incorporate all risks into their hedging strategies. Hedging the overall risk instead of specific risks does not necessarily reflect companies' current approach to risk management, which normally involves hedging a specific exposure e.g. the exposure to variability in cash flows due to interest rate changes.

An important concern of insurance companies is the economic matching of assets and liabilities. Normally the matching is concerned with interest rate risk to ensure that changes in interest rates impact both the assets and liabilities in a similar manner. To achieve this result, interest rate hedges are entered into complementing the fixed income assets to ensure a duration match of assets and liabilities to the extent targeted. In this case the hedge is put in place to manage interest rate risk only, whereas the credit spread and default risk of credit sensitive assets are not necessarily hedged.

If specific risks were no longer allowable for hedge accounting this would increase complexity and cost. Even though Swiss Re manages economic risk exposures on a comprehensive level, current systems and processes are not necessarily configured to consider all risk exposures geared towards the hedge accounting treatment as defined in the Exposure Draft. Despite a lower threshold for effectiveness, the limitations on designated hedged risks also reduces the usefulness of the hedge accounting designation. As a result, companies may refrain from applying the designation even though the economic purpose of a transaction is in fact hedging.

### Assessment of Hedge Effectiveness / Ineffectiveness

Under the changed rules, companies would have to demonstrate that the hedging instrument is expected to "reasonably" offset changes in the hedged item related to the hedged risk. We support the simplification of the effectiveness testing in general as well as the move to more qualitative criteria and reduction in the threshold form 'highly' to 'reasonable' in particular. However we have the following concerns.

The effectiveness thresholds and ongoing efforts to assess effectiveness may seem to have been lowered (from "highly" to "reasonably" effective, and evaluation required only at inception unless changes to hedged item or hedging instrument suggest a reassessment is required), companies would still have to demonstrate the "reasonable" effectiveness at inception. This would in most cases require some sort of quantification to ensure an objective conclusion. While the overall workload may be reduced, companies would not be freed from investing cost and effort into implementing and maintaining tools for the initial hedge effectiveness assessment and they would also have to set up processes to ensure any changes suggesting a reassessment are identified and addressed on time. Such processes, to be reliable, would have to be sufficiently robust and regular, and be supported by dedicated resources and skills. We therefore do not see significant efficiency gains from these changes.

As mentioned earlier, we are also concerned about the operational complexity that would be created by the requirement to hedge the overall risk and demonstrate related effectiveness. Constructing and valuing a perfect hypothetical derivative reflecting the overall risk would be challenging and would entail additional investments in tools and skills to ensure full compliance with the revised guidance.

## De-designation of Hedging Relationship

The ED suggests that companies cannot voluntarily de-designate a hedge unless the hedging instrument is sold or expires or is otherwise extinguished, or it is no longer expected to be reasonably effective. We are concerned that this would create undesired economic impacts as selling a hedge may not always be economically prudent at a given point of time, and entering into an offsetting hedge may create further complexity and related cost and risk.

### Presentation of hedging gains and losses

We do not think that FAS 133 should prescribe the presentation of hedging instruments in the income statement as items being hedged may be presented in different line items. This is best resolved via appropriate disclosure as to where these gains and losses have been presented.

#### Conclusion

As outlined above, we are concerned about the new complexity and cost that the proposed changes will create shortly before a potential conversion with IFRS and without clear benefits for shareholders or analysts. We are in particular concerned that the proposed changes do not reflect some of companies' most common approaches to investment management and neither enhance the insight into, nor the comparability of, companies' financial performance.

Before ad hoc changes are made to FASB Statement No. 133, we recommend to consider hedge accounting as part of the comprehensive solution on the measurement and presentation of financial instruments and also as part of ongoing discussions on insurance accounting.

We appreciate the opportunity to respond to your Invitation To Comment. Please do not hesitate to contact me for any questions regarding our above comments.

Yours sincerely,

Martin Müller

Chief Accounting Officer Swiss Reinsurance Company