QBE Insurance Group

QBE INSURANCE GROUP LIMITED
ABN 28 008 485 014

Head Office
82 Pitt Street
Sydney NSW 2000
AUSTRALIA

Postal Address
GPO Box 82
Sydney NSW 2001
AUSTRALIA

Telephone: +61 (2) 9375 4444
Facsimile: +61 (2) 9235 3166
DX 10171 Sydney Stock Exchange

4 August 2011

Ian Mackintosh
Vice-Chairman, International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM
Email: imackintosh@ifrs.org

Dear Ian,

Re: Exposure Draft ED/2010/13 Hedge Accounting

QBE Insurance Group Limited (QBE) is an Australian-based public company listed on the Australian Securities Exchange. QBE is Australia's largest international insurance and reinsurance company with operations in 49 countries. We are also one of the top 20 global insurers and reinsurers as measured by net earned premium.

We have taken great interest in the rewrite of IAS 39 and have commented on the various exposure drafts where we feel we can contribute to the debate. We also have representation on the AASB Financial Instruments Project Advisory Panel as we feel that these forthcoming changes are a great opportunity to simplify the accounting for financial instruments for both preparers and users of financial statements.

Our particular interest at the moment relates to proposed changes to the hedge accounting components of IAS 39. QBE fully supports the IASB in their aim to clarify, simplify and improve the consistency of the application of hedge accounting. Overall, we support the recommendations set out in the exposure draft which result in hedge accounting better reflecting the economic realities of the hedging process.

Our major concern is that the proposed standard removes the ability to voluntarily revoke a hedge relationship despite the initial designation of hedge accounting being a voluntary process. We consider that the introduction of the concept of rebalancing in the proposed standard will remove many of the situations where a hedge relationship will need to be revoked. We note, however, that there remain situations when it may still be necessary to revoke a hedge relationship, for example where an entity is managing a number of different and potentially competing risks such as solvency, liquidity and profit volatility.

Most of our operational hedging activities involve assets and liabilities that are valued at fair value and therefore derivatives used for hedging are not required to be accounted for as hedges. However, we have substantial foreign currency exposures through holding net investments in foreign operations and through our funding transactions where we may seek to apply hedge accounting. Our concern is reflective of our experience of hedge accounting in these areas.

Consider a practical situation we regularly face. We undertake funding transactions for our international Group, the sources of which are driven by availability and price in the various global capital markets. This can result in entities within the Group holding foreign currency borrowings. The extent of the foreign currency exposure is generally such that we have to deal with the foreign currency exposures by either:

- purchasing foreign exchange derivatives; or
- designating the borrowings as a hedge of the Group's extensive net investment in foreign operations.

The first option reduces foreign exchange risk in line with our risk management strategy but introduces significant liquidity risk and, in the current market environment, is likely to increase interest cost.

Therefore our current preferred strategy is to designate our borrowings as net investment hedges in accordance with the rules of IAS 39/AASB 139.

We do, however, have other areas of foreign exchange risk which we seek to manage, one major component being the impact of foreign exchange rates on profits generated by our overseas entities as they emerge and are translated to our parent entity functional currency of Australian dollars. From time to time and depending on the prevailing foreign exchange rates compared with our budgeted rates we may seek to protect this foreign exchange risk. Our two alternatives are to purchase foreign exchange derivatives selling the profits to Australian dollars or using our borrowings as a proxy. Neither option requires hedge accounting as all gains and losses are valued through the profit and loss account. Again due to the liquidity risk involved we prefer not to use derivatives. However, to utilise borrowings to protect foreign exchange rates on future profits we may need to de-designate borrowings.

In short, within our risk management strategy the ability to designate and de-designate borrowings allows us to reduce foreign exchange risk without the introduction of other risks such as liquidity or solvency risk. Under the proposed changes to hedge accounting, even though these actions are within our risk management strategy, there is a risk that we may be unable to de-designate the borrowings due to the wording which has been adopted in the ED.

We have read and follow the logic in the basis of conclusions and in the subsequent notes from IASB meetings, for the removal of voluntary de-designation but note that this deals only with one choice (i.e. to apply hedge accounting or not). In commercial practice we are constantly managing and balancing a multitude of risks such as liquidity, foreign exchange and solvency in the example above.
In order to avoid any unintended consequences of the ED we suggest the wording of paragraph 24 be amended along the following lines:

"**24** An entity shall discontinue hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable) or when the risk management objective and strategy specifies the conditions for discontinuation. This includes when the hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy). This might affect the entire hedging relationship or a part of it."

In our opinion, the ED is unclear on whether de-designation can occur if it is within the risk management strategy and objective and our experience demonstrates that where something is unclear in the accounting standards, the major accounting firms become the ultimate arbiters. The accounting firms adopt a risk averse approach and will tend to read the ED in the negative and not permit discontinuation of a hedge relationship even if this is specified in the risk management strategy and objective. We are, therefore, concerned that the proposed changes to hedge accounting will have adverse commercial implications and, for companies like QBE, will result in substantial increase in risk and cost.

This is a major issue for QBE and we therefore request the IASB again review this aspect of the proposed ED.

We look forward to engaging in the remaining debate as the changes to IAS 39 progress.

Yours sincerely,

Neil Drabsch
Chief Financial Officer
Direct: +612 9375 4216
Email: neil.drabsch@qbe.com

cc: Kevin Stevenson
Chairman and CEO, AASB
Email: kstevenson@aasb.gov.au

cc: Kim Smith
Partner, PricewaterhouseCoopers
Email: k.smith@au.pwc.com