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Ladies and Gentlemen,

Allianz appreciates the IASB's initiative to hold public hearings on the Exposure Draft of proposed amendments to IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement. Following your invitation, we would be very grateful to participate in one of the scheduled hearing sessions. Further to the comments we have submitted to the German Accounting Standards Board in October 2002, we aim in the following to constructively provide our detailed comments to you.

Overall, we support the IASB's initiative to reassess the effectiveness of the current requirements in IAS 32 and IAS 39 and believe that it will improve the quality of financial reporting. However, we also see practical difficulties in implementing the exposure draft which in our view should be considered prior to proceeding to a final standard. Before addressing the specific issues, we would like to highlight that we strongly recommend that the amendments be closely coordinated with the IFRS / US GAAP convergence project. Successful convergence of IFRS and US GAAP is of primary importance to the preparers and users of financial statements. The objective of convergence should always be kept at the forefront of any discussions concerning amendments to existing standards or the promulgation of new standards.

In particular, we would like to discuss the following specific issues with you:

Presentation of issued financial instruments as equity or liability (ED IAS 32.18-22D)
The guidance provided by ED IAS 32 for the classification of an issued financial instrument as equity or liability is insufficient. In particular, more guidance and clarification is needed regarding the presentation of an issued "puttable instrument" as a financial liability. Would the provision ED IAS 32.22B require a simple reclassification from equity to liability, or are there further implications such as step acquisitions?

Scope of IAS 39

- **Loan commitments (ED IAS 39.1 (i))**

We agree with the rule in principle. ED IAS 39.1(i) is problematic in several respects, however. The definitions in the second sentence of "past practice" and of "selling assets shortly after origination" are not clear. We assume that:

1. the syndication of loans does not constitute a "practice of selling the assets shortly after origination" and
2. the intention to sell shortly after origination covers a period of a few days only.

Furthermore, we object to an application of ED IAS 39.1(i), second sentence, to all loan commitments which meet the above conditions. We recommend the following adjustment: " ... apply this standard to all loan commitments *in the same portfolio*".

- **Definition**

The IASB has agreed that the definition of the term insurance contract, which will be adopted in the future International Financial Reporting Standard (IFRS) on insurance contracts will be used throughout all relevant IFRS. The Definition in IAS 32 and IAS 39 has to be adjusted accordingly. In our view, it is crucial that the term insurance contract is defined adequately in order to separate the application of either IAS 39 or IAS 32 to financial instruments, or, the future IFRS on Insurance Contracts to relevant insurance contracts. The definition of „insurance contracts that principally involves the transfer of financial risk," which is provided in IAS 32.1 (c) and 39.1(d) does not give sufficient guidance in order to determine which insurance contracts may be excluded from the scope of IAS 32 and IAS 39.

- **Credit insurance (ED IAS 32.1 and ED IAS 39.1)**

In our view, credit insurance contracts should be explicitly excluded from the scope of both, IAS 32 and IAS 39. Instead, the issue should be dealt with comprehensively in the future IFRS on Insurance Contracts. Credit insurance is, in substance, an insurance product and should therefore be accounted for as such. The credit insurer does not normally offer a single risk coverage, but covers the total receivables portfolio of its clients. As such the contract bears a statistical insurance risk. At the inception of the contract it is uncertain whether the specified future event will occur, when the event will occur, or how much the insurer will have to pay if the event occurs. The credit insurer does not know his exact exposure until a claim is made (statistical risk). Whereas banks can provide unconditional on demand guarantees, credit insurance is always conditional. It is important to note that US GAAP recognise the conditionality of insurance contracts. With a view to the convergence between IFRS and US GAAP a deviation from this approach should be avoided under IAS (IFRS).

- **Guarantee contracts (ED IAS 39.1(f))**

The treatment of the initial and subsequent valuations of guarantee contracts is currently covered in IAS 37. The proposed amendment in ED IAS 39.1(f), in contrast, suggests that financial guarantee contracts (including letters of credit and credit derivative default products) should be initially recognised and measured in accordance with IAS 39 and subsequently measured in accordance with IAS 37. Since it would be unsystematic to apply different standards to the initial and subsequent valuations of the same transaction, we suggest eliminating this change.

Based on the initial accounting according to IAS 39, a fair value is capitalised in the current period. It is not clear if an elimination of this liability has to be proceeded in the following period according to IAS 37 due to the fact that the use of the guarantee is improbable. We seek further clarification on the intended accounting treatment. As summary of our concerns we recommend to exclude guarantee contracts from the scope of IAS 39.

- **Credit default swaps (ED IAS 39.1 (f))**

Furthermore, we interpret ED IAS 39.1(f) to mean that credit default swaps and products with economically similar results, which are concluded by the holder to secure assets against the risk of default like guarantees, do not fall within the scope of ED IAS 39 (substance over form). Should this interpretation not be correct, we would appreciate clarification.

A credit default swap has to be classified as a guarantee if reference is made to a failure to pay and the holder of the guarantee is economically exposed to such a risk (see IGC QA 1-

5). From our perspective a more market practice based approach would be to define the credit event allowing guarantee accounting according to the following criteria:

- Bankruptcy
- Failure to pay
- Obligation default
- Repudiation/Moratorium
- Restructuring.

Derecognition (ED IAS 39.35-57)

We do not support the implementation of the proposed continuing involvement approach for derecognition of financial assets. In our view, the inconsistencies arising from the current model of the “control-concept with risk-and-rewards-elements” would be just replaced by another inconsistent and even more complex model.

The complexity and inconsistency is mirrored by the example of a sale of a financial asset with a retained call option given in Appendix B 18-22. The accounting results in a derecognition of the sold asset, a simultaneous recognition of a pledged security measured at the exercise price of the option and a borrowing liability measured at the option exercise less the time value of the call option. In addition to the prolongation of the balance sheet the company does not show the derivative.

Furthermore, the approach contains a number of assumptions which result in a significant distortion of the economic facts and make it much more difficult to assess a company’s financial situation. The following weaknesses are inherent in the envisaged presentation as fictitious collateralised borrowing:

- An actual complete sale of a financial asset is presented partly as the extension of a loan.
- A necessary reserve for a guarantee commitment is presented as a fictitious impairment of a loan.
- The payment of an obligation resulting from a guarantee is presented as the repayment of a liability.
- There is a danger with the continuing involvement approach that the same liability will be reported twice. This is confusing and, moreover, results in considerable distortions to the statistics which are based on bank balance sheets.

We do not see the practicability of this approach. It will be practically impossible to break down the residual amount according to maturity, geographical market etc. because securitised assets comprise a large number of receivables of different type and quality.

In addition, to our knowledge no accounting information system has the functionality to support these comprehensive requirements, especially the recording of virtual assets and liabilities.

Finally, we see problems with regard to the convergence project with US GAAP. The change of the derecognition approach does not fit into the current accounting developments and discussions. Especially for us as a company reporting under both IAS and US GAAP, and dealing in the banking and insurance businesses, the introduction of the continuing involvement approach would imply significant practical difficulties.

We suggest to stay with the original approach until an improved consistent model is created that is easier for the users of financial statements to apply. This approach offers a more realistic presentation of the economic situation.

Reversal of Impairment (ED IAS 39.117-119)
Allianz is completely in agreement with the amendments of IAS 39 which prohibits the reversal of impairment losses recognised on debt and equity instruments classified as available for sale investments. This amendment eliminates the subjectivity in determining when impairment losses have been recovered. Additionally, the amended provision is in line with SFAS 115.16 and makes therefore a significant contribution to the convergence process of IAS (IFRS) and US GAAP.

Hedge Accounting

- **Prohibition of applying hedge accounting to an overall net position (ED IAS 39.133)**
  One critical weakness of the existing standards on accounting for financial instruments is the restrictive and inappropriate rules on hedge accounting. The existing rules widely contradict the companies' risk management objectives, which intend to hedge net risk exposures. The proposed changes do not solve these weaknesses. Accounting should follow prudent business practices – not vice versa.

- **Short-cut method (ED IAS 39.147)**
  We regret the fact that no substantive changes have been made to ED IAS 39.147 so that the short-cut method (assumption of zero ineffectiveness) is still not permitted.

  In the interest of improved working efficiency, we strongly recommend permitting the short-cut method if compliance with certain conditions suggests that the hedge involved is a perfect hedge. We suggest basing these preconditions on SFAS 133.68, which explicitly permits application of the short-cut method in certain circumstances.

- **Amortization of Carrying Amount Adjustments (ED IAS 39.157)**
  The amendment introduces the theoretically correct procedure for amortising adjustments to the carrying amount of a hedged interest-bearing financial instrument under the effective interest rate method. From a practical point of view, however, the existing freedom of choice to apply the alternative linear amortisation method should be retained because the potential improved accuracy of the effective interest method does not outweigh the burden or computing and tracking the amortisation of carrying amount adjustments over the life of the instrument.

- **Hedging of firm commitments (ED IAS 39.140)**
  We endorse the proposed change to account for a hedge of a firm commitment as a fair value hedge instead of a cash flow hedge. This will contribute to the convergence of IAS (IFRS) and US GAAP, while reflecting the economic reality of the transaction.

Disclosure Requirements (ED IAS 32.42-94)
Furthermore, in our view, the level of detail required in the disclosure requirements in ED IAS 32 will no longer provide the investor with valuable information to make investments decisions. Disclosure requirements are essential to well-functioning corporate governance. This condition applies as long as the information disclosed allows investors an accurate insight into a company's risk exposure.

Effective Date and Transition (ED IAS 32.96 and ED IAS 39.171)
The effective date stated in ED IAS 32.96 as well as in ED IAS 39.171 should be determined taking into account the fact that the amendments of IAS 32 and 39 will result in substantial accounting changes.

Allianz does not agree with the retrospective application of the new regulations of ED IAS 39 (ED IAS 39.171 B-C). For reasons of practicability, it is essential to permit grandfathering of all transactions that have already been concluded. Allianz especially disagrees with ED IAS

39.171B which requires the re-recognition of financial assets derecognised under the current IAS 39 version in cases where the transaction no longer meets the derecognition criteria under the amended IAS 39. The retrospective application would result in inconsistent accounting rather than provide useful information for investor decision-making and, therefore, contradicts the objectives of IAS 32. As envisaged in the original standard, there should be no retrospective change in the accounting methods applied to financial instruments and no adjustment of previous financial statements.

We welcome the rule in ED IAS 39.171A. Due to the magnitude of the changes proposed in the amended IAS 32 and 39, it must be possible to designate instruments as held for trading or available for sale upon initial application of ED IAS 39, irrespective of any previous classification.

We would be pleased to discuss our comments with you during the round table hearings in March 2003.

Sincerely,

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Head of Group Accounting
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