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Comments to the Exposure Draft of Proposed Amendments to IAS 32 and IAS 39

Dear Sir David

Swiss Re, as one of the world's leading reinsurers, supports the IASB on improving International Accounting Standards. Swiss Re Group's financial statements are published in accordance with Swiss GAAP (FER). Swiss accounting standard setters have expressed an intent to avoid significant departures from IAS and to aim for convergence with IAS, wherever possible. Furthermore, some of our subsidiaries, as well as a number of our clients use IAS as their reporting standards.

Swiss Re, operating through more than 70 offices in over 30 countries, is exposed to accounting regulations issued by many different national standard setters and regulatory authorities. We strongly support the harmonisation of national accounting frameworks and the elimination of options in existing accounting standards. In this regard, the section on elimination of differences from US GAAP, included in the appendix to the exposure draft of the revised IAS 39, offers a valuable summary of the Board's convergence efforts and has assisted us in the review of the proposed amendments.

Definition of insurance contracts

We are concerned with the inconsistencies in the definition of insurance contracts between IAS 32 & 39 and the DSOP on Insurance Contracts (the DSOP). More specifically, under paragraph 1d of IAS 32, a contract that "principally" involves the transfer of financial risks shall be accounted for as a financial instrument. However, no further guidance is provided as to what constitutes a risk being transferred "principally". On the other hand, under the DSOP, a contract creates insurance risk if, and only if, there is a reasonable possibility of a significant change in the present value of the insurer's net cash flows arising from the contract.

We support the definition of insurance contracts in the DSOP as it is broadly consistent with existing US GAAP. In addition, we would like to see the DSOP develop as the authoritative source of guidance on insurance accounting with the power to override the treatment of insurance contracts present in any other standard. To prevent inconsistent application of the provisions set forth in the DSOP and in the future standard on insurance accounting, we believe it is critical that the Board confine, as much as possible, the introduction of accounting guidance on insurance contracts to the insurance project. Alternatively, insurance companies could be entirely exempted from the scope of IAS 32 and IAS 39.

Convergence with US GAAP

We acknowledge the Board's efforts to harmonise the US GAAP and IAS accounting guidance in a number of areas. We also understand that this cannot solely be the responsibility of the Board. However, to achieve the maximum benefit, it is important that the Board and other standard setters converge to an existing solution. We do continue to see changes in the detail that would have significant consequences for preparers (e.g. please see our commentary below on derecognition of financial assets).

Recognition of financial guarantees

We disagree that financial guarantee contracts should be accounted for as financial instruments. Financial guarantee contracts are insurance arrangements and we therefore encourage the Board to stipulate that financial guarantee contracts shall be accounted for as insurance contracts. Recognising a liability prior to the occurrence of a triggering event would be inconsistent with the provisions of IAS 37.

Derecognition of financial assets

The proposed continuing involvement approach for derecognition does not converge with US GAAP and does not offer a fundamental improvement over the sale criteria of paragraph 9 in SFAS 140. Indeed, the credit guarantee contract example provided in paragraph C34 illustrates the difficulty of determining, based on the continuing involvement approach, whether the transferor shall keep all of the receivables on the balance sheet or derecognise the receivables in full and recognise a liability for the 10% guarantee. In our opinion, and contrary to the Board's conclusion, the most appropriate treatment of that transaction would be to derecognise the receivables in full and recognise a liability for the 10% guarantee.

Furthermore, under the continuing involvement approach proposed in IAS 39, transfers where the transferor may reacquire control of its previous contractual rights through a repurchase agreement or call option should be accounted for as a secured borrowing. Under US GAAP, the mere existence of a repurchase agreement or call option held by the transferor would not preclude sale accounting. This also leads to confusing situations where companies that own identical financial instruments (e.g. call options) can arrive at different accounting conclusions depending on prior ownership of the asset underlying the option.

This issue is also illustrated by the difficulties in applying the continuing involvement approach by a transferor that buys a call option on a transferred available-for-sale financial asset and the fair value of the asset decreases below the option exercise price. As the asset does not qualify for derecognition, the transferor is forced to measure it at the option exercise price. Keeping an asset in the transferor's balance sheet when the asset is not expected to revert to the transferor because the purchased call option is out-of-the-money is at least counter-intuitive. Based on the above, we would recommend the adoption, instead of the continuing involvement approach, of the three sale criteria in paragraph 9 of SFAS 140.

Pass-through arrangements

We agree that pass-through arrangements, as defined in paragraph 41 of SFAS 39, should qualify for derecognition. Although existing IAS 39 provisions do not provide explicit guidance about the extent to which derecognition is appropriate when a transferor sells its contractual rights to all or a portion of the cash flows that constitute a financial asset and retains custody of the asset, we consider that more general framework guidance for derecognition may prove to be more useful in practice than adding the proposed set of very specific rules on pass-through arrangements.

Impairment evaluation for financial assets held at amortised cost

We agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment. Such an approach would be consistent with the law of large numbers and, more specifically, the practice of establishing reserves for incurred-but-not-reported claims (IBNR) by the insurance industry.

Reversal of impairment

We welcome the Board's proposal that impairment losses on available-for-sale financial instruments that are recognised in profit and loss shall not be reversed through profit and loss as long as the financial instrument is recognised. This is an extremely helpful step towards convergence with US GAAP that eliminates a significant problem for companies preparing results on both accounting bases.

Discount rate for groups of impaired financial assets

We find the Board's detailed discussion on discount rates to be counter to the spirit of IAS. The IAS standards are frequently described as principles-based and in that respect the provisions of paragraph 113D are too detailed.

We appreciate the Board's efforts in preparing the exposure drafts on IAS 32 and IAS 39 and would like to thank you for giving us the opportunity to comment on the proposals. We would be happy to lend our support to any future discussions. We also would be pleased to discuss with you at your convenience any questions or issues that you may have concerning our letter (please contact Alexandre Hristov on +41 43 285 2547 or John Karvellas on +41 43 285 2234).

Yours sincerely,

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