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Comments to Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts, Financial Guarantee Contracts and Credit Insurance

Dear Ms Pryde,

Swiss Re, as one of the world's leading reinsurers, supports the IASB on improving International Financial Reporting Standards (IFRSs). Swiss Re Group's financial statements are currently published in accordance with Swiss GAAP (FER). Some of our subsidiaries, as well as a number of our clients, use IFRSs as their reporting base. 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 are concerned about the Board's proposal to scope credit insurance and similar contracts out of IFRS 4 and we have the following comments.

The nature and form of the business

The business model of credit insurance is distinct from the credit products offered by banks. We believe that credit insurance contracts should be exempt from IAS 39 if they meet the definition of an insurance contract in IFRS 4.

Credit insurance contracts are contingent in nature and cover claims only if defined policy terms and conditions are met, and if a default affects defined assets of the policyholder. The fact that a debtor defaults on a debt does not necessarily mean a claim under the insurance policy. Indemnification by the insurer is subject to proof of loss, and the insured is only compensated for the actual loss incurred. If, despite the insolvency of a debtor, the insured party does not suffer a loss under its contract of sales, the insurer is not under a duty to pay. Credit insurance is purchased to protect a company's balance sheet against non-payment of trade receivables.

The basis for conclusions (BC9.(a)) refers to moral hazard for different contractual parties to the issuers of credit insurance contracts and financial guarantees (usually creditors in the case of credit insurance contracts, often debtors in the case of financial guarantees). We believe that the risk of moral hazard inherent in these types of contracts is a matter of degree. Although credit insurance contracts may contain some risk of opportunistic behaviour by the contractual party, the incentives to default in a typical financial guarantee contract lead to a significantly higher level of moral hazard risk compared to credit insurance contracts.

It is often argued that the portfolio approach used by credit insurers to manage credit risk does not justify a different accounting treatment to banks, which manage credit risk in a portfolio of financial guarantees (paragraph BC8.(a)). We think this is also a question of degree. Although we agree that banks would manage credit risk on a portfolio basis, we believe that the portfolio approach is significantly more important in the context of credit insurance con tracts. In particular, the issuers of credit insurance contracts may use stochastic methods to estimate future cash flows because they pool individual risks within a diversified portfolio and because such cash flows are not subject to the same level of moral hazard.

We believe that the business model of credit insurance does differ from credit products offered by banks. The difference often leads to a different outcome in the event of default, for example in the Parmalat case. The guarantee and derivative type credit products suffered immediate and significant loss when Parmalat defaulted. Our trade credit business suffered an insignificant loss (and we are a market leader in European trade credit).

Credit insurance contracts share the same features as other types of insurance contracts such as premiums, fixed and variable commissions, claims, low claim bonus, proportional and non-proportional treaties and excess of loss coverage. They do meet the definition of an insurance contract under IFRS 4.

Measurement and presentation

We understand that the measurement requirements proposed in the exposure draft are similar to current US GAAP practice for credit insurance. Commissions to cedents would qualify for deferral under the IAS 39 definition of transaction costs. Differences exist in setting up provisions where IAS 37 requires discounting, and in recoveries where the threshold for recognition under IAS 37 appears to be different to US GAAP. However, we would generally not expect the differences to be significant for credit insurance contracts.

We are concerned about the proposed change in presentation. We understand that financial guarantee contracts and credit insurance would have to be shown as one net liability in the balance sheet and all related income and expenses would be presented as interest income or interest expense on the face of the income statement. We do not believe that it is appropriate to make a significant change to the presentation given that the basic measurement principles remain similar.

The interpretation of credit insurers' performance will be complicated by the change, and the performance model will have to be revised. It will become more difficult to understand the performance of multiline companies like Swiss Re because one piece of the business will be in a different format.

A change in the reporting framework will require substantial changes in the underlying systems and processes. Multiline (re)insurers will have to change their systems and processes twice within a relatively short period of time due to Phase II. We consider that operational changes in advance of Phase II mainly for presentation are not consistent with the Board's objectives for the insurance project.

Convergence with US GAAP

The proposed guidance in the exposure draft is not consistent with the objectives outlined in the convergence project. FASB Interpretation 45 exempts insurance contracts from guarantee accounting if they are issued by an insurance company and are within the scope of insurance-specific FASB statements. Given the ongoing efforts to reach convergence between IFRS and US GAAP, we recommend that the Board does not create new differences between the two sets of accounting standards.

Scope of individual standards

The Board accepts that credit insurance contracts meet the definition of an insurance contract in IFRS 4 if they transfer significant insurance risk. The proposal however is to account for credit insurance contracts under IAS 39/37 because they are considered similar to certain credit based banking products. We believe that it is not consistent to reference products which fall under one standard to the accounting model in a different standard.

We appreciate the Board's efforts in preparing the exposure draft and the opportunity to comment on the proposals. Please contact me if you would like to discuss any of our comments.

Yours sincerely,

M. Swallow.

Mark Swallow
Chief Accounting Officer
Swiss Reinsurance Company