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FOR THE ATTENTION OF THE INTERNATIONAL ACCOUNTING STANDARDS BOARD

8 October 2004

COMMENTS ON EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT AND IFRS 4 INSURANCE CONTRACTS: FINANCIAL GUARANTEE CONTRACTS AND CREDIT INSURANCE

BY

CEA (COMITE EUROPEEN DES ASSURANCES)

General Comment

The Comité Européen des Assurances (CEA) representing the European insurance and reinsurance sectors is pleased to comment on Exposure Draft of proposed amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts "Financial Guarantee Contracts and Credit Insurance".

CEA fully supports the principles underpinning the EU-initiated process aiming at a strong, consistent and workable set of accounting standards. Consequently, we are keen to participate actively in the development of the IASB projects.

To prepare our responses to the questions of the Exposure Draft, we considered EFRAG's draft comment on this issue. Though we refer to this document in our comments, our position paper was prepared independently from EFRAG's.

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Key message

Referring to CEA's comments on Exposure Draft 5 – Insurance Contracts dated 31 October 2003, we strongly encourage the Board to concentrate all major changes relating to measurement, recognition and presentation of insurance contracts to one single point in time, being the completion of Phase II of the insurance contracts project.

We support the fact that credit insurance is included in the scope of IFRS 4, whereas financial guarantees are treated in accordance with IAS 39 and IAS 37. We do not support the proposals relating to credit insurance included in this Exposure Draft.

We do not consider that IFRS 4 contains deficiencies in the accounting treatment of credit insurance. Yet CEA strongly believes that it is premature to prescribe a specific way of accounting for credit insurance at this stage, when Phase II of the insurance contract project still needs to be discussed (this is a fact recognised by the Board).

Therefore, CEA considers that credit insurance should continue to be accounted for in the same way as other insurance products under IFRS 4 and we do not consider the current proposals as improvements to the standards.

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Question 1 – Form of contract

The Exposure Draft deals with contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due under the original or modified terms of a debt instrument (financial guarantee contracts). These contracts can have various legal forms, such as that of a financial guarantee, letter of credit, credit default contract or insurance contract. Under the proposals in the Exposure Draft the legal form of such contracts would not affect their accounting treatment (see paragraphs BC2 and BC3).

Do you agree that the legal form of such contracts should not affect their accounting treatment?

If not, what differences in legal form justify differences in accounting treatments? Please be specific about the nature of the differences and explain clearly how they influence the selection of appropriate accounting requirements.

CEA Comments on the form of contract

Concerning this question, CEA agrees with EFRAG's response, namely, that the legal form of such a contract should not be the decisive factor for its respective accounting treatment. Nevertheless, we strongly believe that credit insurance contracts are in substance different from financial guarantees.

In order to support this statement, we would like to highlight three elements:

- ⇨ In our view, the accounting treatment should depend on whether financial guarantee contracts contain a financial risk or an insurance risk according to IFRS 4, Appendix A.

- ⇨ In consequence, a credit insurance contract that covers significant insurance risk is an insurance contract falling under the scope of IFRS 4. The insurance business model is based on a portfolio approach, which means pooling the individual insurance risks within a portfolio and over time and using stochastic processes. Those two elements are the key characteristics of insurance business and are leading to specific features to this business. Adequate reflection of the portfolio approach and those specific features in accounting is currently not addressed in the IAS/IFRS but subject to Phase II of the insurance contracts project.

- ⇨ A third distinguishing element is that the parties to the contracts are different for a credit insurance contract and a financial guarantee.

Indeed, in case of credit insurance there are only two parties to the contract: the insurer and the policyholder. In case of a financial guarantee, the issuer of the guarantee, the holder of the guarantee as well as the party whose obligation is being guaranteed have contractual obligations. We consider that the risks linked to these two types of contracts are different and as a consequence, should result in different accounting treatment

Question 2 – Scope

The Exposure Draft proposes that all financial guarantee contracts should be within the scope of IAS 39 (see paragraph 2 of IAS 39 and paragraph 4 of IFRS 4), and defines a financial guarantee contract as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument" (see paragraph 9 of IAS 39).

Is the proposed scope appropriate?

If not, what changes do you propose, and why?

CEA Comments on the scope

We believe that the scope is right for financial guarantees covering financial risk except if the contract includes significant insurance risk. In such case, they should be accounted for under IFRS 4, until elaboration of Phase II – Insurance contracts (For further explanations please refer to our response to question 1).

Question 3 – Subsequent measurement

The Exposure Draft proposes that financial guarantee contracts, other than those that were entered into or retained on transferring financial assets or financial liabilities within the scope of IAS 39 to another party, should be measured subsequently at the higher of:

(a) the amount recognised in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets; and

(b) the amount initially recognised (i.e. fair value) less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 Revenue (see paragraph 47(c) of IAS 39).

Is this proposal appropriate? If not, what changes do you propose, and why?

CEA Comments on subsequent measurement

We believe that this proposal is appropriate for financial guarantee contracts. The argument has been brought forward that, if financial guarantees are not covered by IAS 39, the guarantor may not recognize a liability when a contract is issued. For credit insurance this argument is not valid since IFRS 4 requires a liability adequacy test, which, if not an integrated part of current accounting policy, has to follow IAS 37 by default. We regard this as sufficient guidance for the recognition and measurement of credit insurance contracts. Our view on this question is in line with the position expressed by EFRAG.

Question 4 – Effective date and transition

The proposals would apply to periods beginning on or after 1 January 2006, with earlier application encouraged (see paragraph BC27). The proposals would be applied retrospectively.

Are the proposed effective date and transition appropriate? If not, what do you propose, and why?

CEA Comments on the effective date and transition

We generally believe that new standards should not have retroactive application. We suggest that any changes to existing requirements to the accounting for insurance contracts should be deferred until a comprehensive solution has been discussed thoroughly in Phase II.

Question 5 – Other comments

Do you have any other comments on the proposals?

CEA comments

No other comment to be made

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