Date
8 November 2004

Le Président

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Sir David Tweedie
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Dear Sir David,

Re: IASB Exposure Draft of Proposed Amendments to IAS 39 and IFRS 4: Financial Guarantee Contracts and Credit Insurance

1. FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased to submit its comments on the IASB Exposure Draft of Proposed Amendments to IAS 39 and IFRS 4 on Financial Guarantee Contracts and Credit Insurance.

2. FEE as a founding organisation of EFRAG has also contributed to the EFRAG consultation process by submitting our views on their preliminary comments. This response should be read in conjunction with the response submitted by EFRAG. This explains the late submission of our letter. Where we are in agreement with the EFRAG comments we refer to their comments, where we are in disagreement our own views are put forward.

3. We support EFRAG's view that, contrary to what is said in the exposure draft, credit insurance is in substance different from a financial guarantee. We have noted that both IASB and EFRAG have struggled to identify fundamental differences in substance between credit insurance and financial guarantees that would warrant a different accounting treatment. However, in the anticipation of a further debate on the classification and measurement of insurance products during Phase II of the Insurance project, we believe the accounting treatment of each product should remain unchanged, i.e. applying IFRS 4 for credit insurance and IAS 39 for financial guarantee contracts.

4. We do not consider that IFRS 4 contains deficiencies in the accounting treatment of credit insurance. Therefore, in our view, it is premature to prescribe a specific way of accounting for credit insurance at this stage, when Phase II for other lines of insurance still needs to be discussed. We believe that credit insurance should continue to be accounted for in the same way as other insurance products and we do not see the current proposals as an improvement. It would create unnecessary further confusion in differentiating between insurance products.

5. Two different options could be applied if the debate were to conclude at this stage:
   a. classify all credit insurance as a financial instrument as proposed by IASB in the current proposals;
   b. classify financial guarantees as insurance product and bring them under the requirements of IFRS 4; this may have been the intention of the currently existing versions of IAS 39 and IFRS 4 but practice shows that it struggled with the clarity of the standards.

6. In the short run neither of them may be an ideal answer to the question. In either case the parties offering the product will encounter significant system changes to enable them to classify the product differently, with the risk that on completion of Phase II of the Insurance project, further changes will be required. Under the first option, credit insurance contracts will have a different accounting treatment than other types of insurance contracts. Under the second option, issuers of financial guarantees are offered a more permissive regime and there may be regulatory sensitivities about classifying financial guarantees as insurance contracts. It will be more appropriate to revisit the different treatment of both contracts during Phase II.

7. As indicated above, IASB may have intended that all financial guarantees should be covered under IFRS 4. Preparers and users, however, have difficulty in coming to that judgement from reading both standards and therefore clarification that in the short term financial guarantees can remain covered by IAS 39 whilst credit insurance contracts should be treated equally as other insurance product under IFRS 4 might be the most appropriate solution.

8. A further question to address is whether there would be measurement differences between the measurement of credit insurance contracts under IFRS 4 and financial guarantee contracts under IAS 39.

9. Those who read IAS 39 to mean that financial guarantees are covered therein conclude that current IAS 39 requires financial guarantees to be initially measured at fair value with subsequent measurement at the higher of (a) the amount determined in accordance with IAS 37, and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 (IAS 39, paragraph 47). In general, during the life of a contract, we expect IAS 37 to give rise to a higher amount until the liabilities are settled.

10. In the case of (credit) insurance contracts under the scope of IFRS 4, subsequent measurement is, in general, based on local accounting policies, unless these policies do not include a liability adequacy test meeting certain requirements; in such cases, IAS 37 is applicable. Therefore, if a proper liability adequacy test is performed under local accounting policies, measurement under IFRS 4 could result in a different amount than under IAS 39 with subsequent measurement under IAS 37/IAS 18, as described above. However, if there is not an appropriate liability adequacy test under local GAAP, IAS 37 is applied. The Basis for Conclusions argues that – as a result of the liability adequacy test included in IFRS 4, the measurement differences between IFRS 4 measurement of credit insurance and the measurement proposed in the ED, are minimal. However, there may be differences relating to the reflection of the time value of money (BC23(d) and (e)) the risk adjustments (IAS 37.42-43) that are required under IAS 37, but not by some existing models that are allowed under IFRS 4. This difference may cause insurance companies to have to incur substantial costs in the period until Phase II clarifies the accounting for all insurance contracts, if local GAAP includes an appropriate liability adequacy test as defined in IFRS 4.

11. From the above it can be concluded that there may be reporting environments where the measurement of financial guarantees and credit insurance contracts would anyway be similar, i.e. IAS 37, if such environments do not include an appropriate liability adequacy test as defined in IFRS 4. In such cases, IAS 37 will apply to both financial guarantees and credit insurance contracts.

12. In several reporting environments, there will be no proper liability adequacy test applicable to financial guarantees contracts accounted for under IFRS 4, so the result would be the same as measurement under current IAS 37. From this perspective it would be irrelevant under which standard financial guarantees would be accounted for: IAS 39 or IFRS 4.

Conclusion:

Given the fact that:

(a) credit insurance has always been part of insurance accounting;
(b) financial guarantees are still interpreted by many in the sense that they are subject to current IAS 39;
(c) credit insurance companies would suffer substantial cost for system changes to amend their systems, if a proper liability adequacy test is available in local GAAP; and
(d) the 2005 deadline is only months away,

we recommend to withdraw the present proposal and, instead, to clarify that credit insurance contracts are covered by IFRS 4 and financial guarantees can remain covered by IAS 39.

We would prefer no change to be made at the present time for pragmatic reasons. If however, the Board remains convinced that for consistency reason all products should be under one standard, and financial guarantees and credit insurance should be treated similarly, bringing financial guarantees within the scope of IFRS 4 might be the least detrimental solution. This is, of course, on the assumption that the Board revisits the different treatment of both contracts during Phase II.

A further element that we want to bring to the attention of IASB is related to intra group guarantees. Guarantees between the parent and its subsidiaries should not be within the scope of this Exposure Draft as it might be difficult to value them as they would not be on an arm's length basis. At consolidation level they will be eliminated.

We have the following comments on the questions raised in the exposure draft.

Question 1 - Form of contract:

We agree with EFRAG that the legal form of financial guarantee contracts should not affect their accounting treatment. In our view, during Phase I the accounting treatment should depend on whether financial guarantee contracts transfer an insurance risk according to IFRS 4, Appendix A or not. Further work on this may be necessary once the essentials for Phase II are more clear.

A feature that could be used to distinguish the two products could be that in most cases the parties to a contract differ between credit insurance and financial guarantees. The issuer of the financial guarantee and the holder of the guarantee as well as the party whose obligation is being guaranteed are aware of the existence of the guarantee. In case of most common credit insurance contracts, only the issuer and the policyholder are party to the contract. For this reason, we believe that the risks in the two types of contracts are different, which would be a difference in substance that could result in different accounting treatment.

Question 2 - Scope:

We agree with EFRAG that the definition of financial guarantee contracts is not appropriate. In the case where contracts include significant insurance risk, they should be accounted for under IFRS 4, until the treatment of financial guarantee contracts is discussed at the same time as for other insurance contracts in phase II.

Question 3 – Subsequent measurement:

We disagree with the proposal that all contracts, including credit insurance be measured subsequently under IAS 37 or IAS 18. We refer you to our comments above in paragraphs 8 to 12.
There may be reporting environments where the measurement of financial guarantees and credit insurance contracts would anyway be similar, i.e. IAS 37, if such environments do not include an appropriate liability adequacy test as defined in IFRS 4. In such cases, IAS 37 will apply to both financial guarantees and credit insurance contracts.

In several reporting environments, there will be no proper liability adequacy test applicable to financial guarantees contracts accounted for under IFRS 4, so the result would be the same as measurement under current IAS 37. From this perspective it would be irrelevant under which standard financial guarantees would be accounted for: IAS 39 or IFRS 4.

Question 4 – Effective date and transition:

Since we do not support the proposals, we do not comment on the question of the effective date.

We would be pleased to discuss with you any aspect of this letter which you may wish to raise with us.

Yours sincerely,

David Devlin
President