



International Association of Insurance Supervisors

31 October 2003

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Ref./File No.: 6-401

Sir David Tweedie

Chairman
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Sir David,

Re: IAIS comments on Exposure Draft ED 5 Insurance Contracts

Thank you for giving us the opportunity to comment on the Exposure Draft distributed in July 2003. On behalf of the International Association of Insurance Supervisors (IAIS) members, we are pleased to provide you with the attached comments.

IAIS is an international organisation composed of insurance supervisors from more than one hundred and twenty jurisdictions. One of the main objectives of the IAIS is to set standards that insurance supervisors around the world may adopt within their jurisdiction. An important part of this objective is to define a common basis for regulatory reporting by insurance enterprises, so that supervisory financial reports are consistent and system efficiency can be enhanced.

As stated in the third paragraph of the following main comments, we would like to emphasise that it is vitally important that the methodologies for calculating the items in public financial statements are also acceptable for calculating items for supervisory or prudential purposes, so that we can all easily reconcile the two different approaches.

If there is any way in which the IAIS Accounting Subcommittee can assist the Board further, please do not hesitate to contact Mr. Luc Cardinal at the IAIS Secretariat (tel.: 41 61 280 8119; fax: 41 61 280 9151, email: luc.cardinal@bis.org).

Yours sincerely,

Manuel Aguilera
Chairman, Executive Committee

Tom Karp
Chairman of Technical Committee

These comments cover the Exposure Draft, the Draft Implementation Guidance and the Basis for Conclusions on the Exposure Draft ED 5 – Insurance Contracts (the draft IFRS¹) issued in July 2003 by the International Accounting Standards Board (the Board).

Our comments are limited to areas where the members of the IAIS Accounting Subcommittee reached a general consensus, as such we have not provided comments on all the questions in the draft IFRS. It is expected that some of the IAIS members jurisdictions will provide separate or additional comments in relation to some or all of the questions, based on the issues, impacts or circumstances relevant to their particular jurisdiction.

Main comments

Interim standard

We believe that the draft IFRS is only acceptable as a short term interim solution and phase II should be introduced as soon as practicable. This statement is not meant to imply that we agree with the current tentative phase II proposals, which will require considerable consultation and development.

We are of the opinion that the draft IFRS may not lead to comparable and consistent accounting policies. Furthermore, the options contained in the draft IFRS may lead to significant application problems in certain jurisdictions, including emerging countries, which may be difficult to solve within the very short time frame envisaged for its application.

It is important that phase II provides a robust and sustainable long term financial reporting model for insurance contracts. In developing it, we urge the Board to consult broadly and field-test all proposals to make sure that the model can be implemented without undue or inappropriate impact, and with lasting benefits to users of financial statements. As stated in our letter of 20 June 2002, we would like to reiterate that the model should be adaptable to supervisory purposes and needs, and should be functionally relevant within the insurance business context in which supervisors operate.

Valuation of financial assets

As already expressed in the IAIS comment letter of 29 April 2003, we recognize that the option to classify any financial instrument into the trading category will allow companies in some jurisdictions to continue their current practice of measuring all financial assets at fair value and recording the resulting unrealized gains or losses in income. However, this amendment only partially deals with the situation in which a company is required to hold assets to support insurance business; where assets are intended to match the liabilities of an insurance contract, IAS 39 only allows use of fair value for matching purposes. Where a historic cost method of valuation for liabilities is used, a matching problem arises, as corresponding assets may be required to be stated at fair value.

Insurance supervisors remain most concerned regarding the possible negative effect of inconsistent asset/liability reporting due to differing measurement bases during phase I. In

¹ International Financial Reporting Standard

particular, they remain concerned that over the near term, insurers' financial statements might be perceived as not being fully reflective of the economic reality, pending the development of phase II. We have noted and carefully considered the Board's Basis for Conclusions (paragraph BC110) in this matter and would like to suggest some changes.

A faithful representation of the financial position of an insurer which has closely matched its assets to its liabilities should not show much volatility as asset and liability values move. In order to mitigate the volatility problem, which the application of the IFRS and IAS39 will produce, while not undermining the fundamental assertions of IAS 39, we recommend that the Board considers a temporary modification to asset measurement bases as part of this draft IFRS for assets with fixed maturities matching insurance liabilities and held at amortized cost. Strict criteria will be needed to prevent abuse and we stand ready to work cooperatively with the Board in developing these appropriate criteria for phase I. We recognise that this solution would result in differing measurement criteria for different industries during phase I, however it will be limited in scope, be subject to rigorous criteria for application and will disappear once phase II is promulgated.

Sufficient guidance

Given the rapid product development within insurance, we would like to emphasise the importance of a frequent review/update of the guidance or clarification of interpretation through the International Financial Reporting Interpretations Committee (IFRIC), to ensure harmonised global implementation and interpretation of the standard.

Answers to the questions

Question 1 – Scope

The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

- i) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs, for example, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.
- ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate? If not, what changes would you suggest, and why?

The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?

We agree that the focus on insurance contracts rather than on insurance entities is appropriate, as it ensures that similar contracts would be accounted for in the same manner, regardless of the legal structure of the entity issuing the contract. However, the standard(s) must be written to ensure consistent application among insurance entities. Furthermore, care needs to be taken to ensure that the entire picture resulting from the application of all relevant IFRSs aligns with the economic reality.

For similar reasons, it would be appropriate to extend the requirements applying to insurance contracts under this draft IFRS to financial instruments with discretionary participation features, so that consistent accounting treatment of otherwise comparable contracts is achieved.

Question 2 – Definition of insurance contract

The draft IFRS defines an insurance contract as a ‘contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary’ (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and IG Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

Level of insurance risk require to qualify as an insurance contract

During phase I, consistency in the measurement principles for two contracts falling marginally on one or on the other side of the dividing line between insurance contracts and financial instruments may not be achieved, which might lead to rule arbitrage and lack of comparability of financial statements. Further guidance in relation to the significance of insurance risk would be helpful in order to reduce the scope for such accounting arbitrage.

Pure endowment contracts

We agree that pure endowment contracts meet the definition of insurance contracts under this draft IFRS (the insured event being survival without sufficient financial resources). Consequently, we do not agree with the suggestion in example 1.4 of paragraph IG2 of the Draft Implementation Guidance that pure endowment contracts should not be considered as insurance contracts.

As life contingent annuities can be seen as merely sums of pure endowments contracts with different terms, it would be inconsistent to consider them as insurance contracts while pure endowment contracts are considered financial instruments.

If the Board decides not to recognise pure endowments contracts as insurance contracts, we would like the Board to provide guidance on how the risks related to these contracts should be disclosed.

Reinsurance contracts

Considering the Draft Implementation Guidance on reinsurance contracts, we would like further explanation. The Draft Implementation Guidance should, in our opinion, clarify whether reinsurance protection acquired by a captive insurance company which insures risks from its parent company should be treated as reinsurance or as direct insurance in the consolidated financial statements.

The IFRS should, in our opinion, also clarify whether the definition of reinsurance contracts only applies to contracts that provide compensation for losses on insurance contracts that are within the draft IFRS, or if it also applies to insurance contracts that have been scoped out from its application. For example, appendix B, paragraph B17 (h) relates to the transfer of risk for product warranties to third parties. It is unclear as to whether the transfer of such a risk to a third party is a reinsurance contract or a direct insurance contract.

Consistency with other financial instruments

The adopted IFRSs should provide a consistent treatment for insurance contracts and financial instruments that have similar features.

As raised in earlier comments from the IAIS, it is important that similar transactions are accounted for using similar principles, regardless of whether they fall under the definition of an insurance contract or a financial instrument. Different measurement principles for similar transactions will invite rule arbitrage and a lack of comparability of financial statements.

Further, we believe that all performance-linked contracts should be accounted for in a consistent way, regardless of whether they transfer a sufficient level of insurance risk. For example, under the current proposed standards, similar contracts could fall under either the draft IFRS, IAS 39 or perhaps other standards (such as IAS 38) and this may lead to different treatments of items such as deferred acquisition costs.

Financial guarantees

We believe that it is important that financial guarantees, credit insurance contracts and other types of insurance contracts are accounted for in a consistent manner. Therefore, we welcome the Board's decision to include in the scope of this draft IFRS, certain financial guarantees that meet the definition of an insurance contract (i.e. financial guarantees, regardless of their legal form, that, as a precondition for payment, require the holder to be exposed to, and have incurred a loss on, the failure of the debtor to make payments on the guaranteed assets when due).

Other issues

We do not agree with the brackets in paragraph B18(b) of the draft IFRS and thus suggest to delete them. More precisely, we agree that contracts that have the legal form of insurance but pass all significant insurance risk back to the policyholder through adjustment mechanisms are not insurance contracts, but we believe that all contracts that do not meet the definition of an insurance contract are not necessarily financial instruments.

While we welcome the Board's emphasis on the fact that any definition used in the draft IFRS is intended solely for accounting purposes (cf. paragraph BC12 of the Basis for Conclusions), we nevertheless suggest that the definition could be amended in one of the

following ways “... if... the insured event adversely affects the insured” or “... if... the insured event adversely affects the policyholder, the insured or other beneficiary” as, at least from a legal point of view, the person that may be affected by the insured event is neither referred to as the policyholder nor the beneficiary, but the insured

Paragraph B13 of the draft IFRS states that “the definition of an insurance contract refers to an adverse effect on the policyholder or other specified beneficiary”. We would suggest that the word “specified” be deleted, as not all insurance contracts have specified beneficiaries.

Question 3 – Embedded derivatives

(a) IAS 39 *Financial Instruments: Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:

- (a) meets the definition of an insurance contract within the scope of the draft IFRS;
or
- (b) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate)?

However, an insurer would still be required to separate, and measure at fair value:

- (i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and
- (ii) an option to surrender a financial instrument that is not an insurance contract. (paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and BC118-BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

- (b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?
- (c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?
- (d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

We agree with the general principle that all embedded derivatives and options contained in insurance contracts must be recognised in the valuation of insurance liabilities and measured as they relate to real economic values. This principle applies even if it is sometimes difficult to identify what is the host contract and what is the embedded derivative in an insurance contract. However, this should not be taken to construe our agreement on whether the separation from the host contract should occur, or on the valuation methods in the draft IFRS for such embedded derivatives.

We also agree with the exemption given regarding the option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate). For options to surrender an insurance contract, where the surrender value varies in response to a change in an equity or commodity price index, we believe that additional clarity is needed regarding the requirement to measure them at fair value. For example, if this is taken to apply to the surrender value of a “bundled” unit linked contract that is partially investment linked, then it is likely to impose a minimum liability of the surrender value on such contracts.

Other issues

According to the draft IFRS, IAS 39 applies to derivatives in an insurance contract, unless the embedded derivative is itself an insurance contract within the scope of the draft IFRS. We agree with this proposal, however, as mentioned before, this should not be taken to construe our agreement on whether the separation from the host contract should occur. A derivative is defined in IAS 39 as a financial instrument or other contract within the scope of IAS 39 with three specific characteristics. If the embedded “derivative” meets the definition of an insurance contract, it is by definition excluded from the definition of a “derivative” in IAS 39. As such, the example and guidance illustrating the embedded derivatives that are or are not insurance contracts is confusing and should be clarified.

Question 4 – Temporary exclusion from criteria in IAS 8

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before 1 January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

- i) insurance contracts (including reinsurance contracts) that it issues; and
- ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

- (i) eliminate catastrophe and equalisation provisions.
- (ii) require a loss recognition test if no such test exists under an insurer's existing accounting policies.
- (iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you propose, and why?

Temporary exclusion from the criteria in paragraphs 5 and 6 of IAS 8 / sunset clause

We agree with the draft IFRS's proposal to grant an exemption from the criteria in paragraphs 5 and 6 of IAS 8 for insurance contracts that an insurer issues and reinsurance contracts that it holds. However, we have serious concerns on the implications (usefulness and/or the practicability) of the sunset clause. We therefore suggest that this exemption should be granted not only for accounting periods beginning before 1 January 2007, but for all periods beginning before phase II is implemented.

Moreover, we believe it would be appropriate to extend the temporary exemption granted to insurance contracts in this draft IFRS to financial instruments with discretionary participation features as well.

Other issues

We support the proposal that insurance liabilities should be kept on the balance sheet until they are discharged or cancelled.

Question 5 - Changes in accounting policies

The draft IFRS:

- (a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).
- (b) proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS).

Are these proposals appropriate? If not, what changes would you propose and why?

A number of comments emerged from that question, but no consensus was reached on the comments to include in this letter.

Question 6 – Unbundling

The draft IFRS proposes that an insurer should unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30-BC37 of the Basis for Conclusions and paragraphs IG5 and IG6 of the proposed Implementation Guidance).

- (a) Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?
- (b) Should unbundling be required in any other cases? If so, when and why?
- (c) Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

A number of comments emerged from that question, but no consensus was reached on the comments to include in this letter.

Question 7 – Reinsurance purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

We agree with the proposal that a cedant should apply an impairment test to its rights under a reinsurance contract.

Question 8 – Insurance contracts acquired in a business combination or portfolio transfer

IAS 22 *Business Combinations* requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 *Business Combinations* proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement. However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- (a) a liability measured in accordance with the insurer’s accounting policies for insurance contracts that it issues; and
- (b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38

Intangible Assets. Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired.

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BC101 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

A number of comments emerged from that question, but no consensus was reached on the comments to include in this letter.

Question 9 – Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of this project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

We support the Board’s intention to address these features in more depth in phase II and the requirement to account for unallocated surplus as either a liability or equity, and the prohibition of an item in between.

We would request clarification regarding paragraphs 24 (c) and 24 (d) of the draft IFRS.

The requirement that the issuer shall recognise a liability measured at no less than the measurement of IAS 39 would apply to the fixed element, may have potential ramifications due to the minimum surrender value requirement.

Other issues

We understand that the “future policyholders benefits” means “future benefits for policyholders”, however, for clarity we would suggest that it be rephrased as “future benefits for policyholders or beneficiaries”.

We would like to suggest that the definition of “discretionary participation features” be amended to make it clear that legal or regulatory discretionary participation features are included in the definition.

We would welcome additional examples of what constitutes discretionary or non-discretionary participation features.

Question 10 – Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG60 and IG61 of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

We do not support establishing the implementation date for fair value disclosure requirements as stated in paragraph 32-34 of the draft IFRS and the Draft Implementation Guidance IG 50 at this stage. It should not be set until phase II is successfully completed, as it is likely that the deadline of the end of 2006 to complete phase II will likely not be met. If this occurs, the Board will either have to revise the phase I to remove the fair value disclosure requirements or expect compliance even though no guidance on how to assess fair value has been provided. If this occurs, there will be inconsistent disclosures among insurance companies.

We recommend as an alternative that the Board should encourage the disclosure of value-based information, including information about the key assumptions and the methodologies used to arrive at those values.

We note that in the absence of quantitative disclosure of fair value, disclosure requirements in the draft IFRS regarding the amount, timing and uncertainty of cash flows will give the users of financial statements some qualitative information on the nature and risks associated with insurance liabilities.

We also believe that it would be inappropriate to require fair value disclosures of liabilities for financial instruments with discretionary participation features, before the Board has determined how those values should be measured.

Question 11 – Other disclosures

- (a) The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26-29 of the draft IFRS, paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG59 of the draft Implementation Guidance).

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.

To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar

disclosures that IFRSs already require for other items.

- (b) The proposed disclosures are framed as high-level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.

Is this approach appropriate? If not, what changes would you suggest, and why?

- (c) As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135).

Should any changes be made to this transitional relief? If so, what changes and why?

Level of disclosure required

We believe that the Board should clarify the level of detail required when disclosing at group level, as opposed to when disclosing at company level (the disclosure should be less detailed at group level than at company level).

Overall, we do not disagree with the proposed disclosures, provided such disclosures are balanced between qualitative and quantitative information.

Disclosure on claims development

With regard to the requirement on claims development, we consider that it is very important to include examples within the Implementation Guidance. Such disclosure requirements are often difficult to state in words alone and the incorporation of examples would be very informative. The example given in the Draft Implementation Guidance (IG example 4) is very useful, but we suggest developing it further in the two following ways:

- the example shows estimates of claims for each underwriting year. In some cases, a presentation of claims development for each accident year would be more relevant. We suggest that this approach be mentioned in the Implementation Guidance; and
- we welcome the fact that the effect of discounting is separately disclosed. We believe it would also be desirable to separately disclose the currency effects on claims development tables, as this is an issue for companies that operate internationally.

We agree that, as a transitional relief, an insurer would not need to disclose information on claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS.

Other issues

Paragraph 29(d) of the draft IFRS requires an insurer to disclose information on interest rate risk. When disclosing this information, we would suggest that insurance entities not deal with individual classes of assets and liabilities separately, as suggested in IAS 32, but establish a parallel between the exposure to interest rate risk of insurance liabilities and the exposure of assets backing these liabilities.

We would like the Board to explain the requirement in IG 39 (e) to disclose the sensitivity of reported profit or loss and equity to changes in key assumptions, and the requirement in IG 40 (g) to disclose the sensitivity of reported profit or loss and equity to changes in variables that have a material effect on them. If these two requirements are overlapping, we would also request clarification.

Question 12 – Financial guarantees by the transferor of a non-financial asset or liability

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 *Financial Instruments: Recognition and Measurement* to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-BC46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

We agree with the draft IFRS's proposal, but we wonder whether this requirement should apply to a guarantee given to the transferee in connection with the transfer of an insurance liability (or a portfolio of insurance liabilities), when this guarantee meets the definition of an insurance contract.

We agree with the Board that it is appropriate to make a distinction between the treatment of real financial guarantees and credit insurance.

Credit insurance contracts are not derivatives. In many jurisdictions, credit insurance is a branch of its own and needs a special permission in order to carry its business. On one hand, such contracts are not eligible as hedging instruments; on the other hand, they can in substance be used as hedging instruments, and hence they should be taken into account when valuing the financial instruments being guaranteed. The Board should confirm that the change in value of the guarantee may be offset against the change in value on the "hedged" exposure, and that the entity does not need to test for effectiveness.

There are some inconsistencies between this requirement and the fact that some financial guarantees may be accounted for as insurance contracts.

Question 13 – Other comments

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

We believe that an entity that has recognised deferred acquisition costs related to investment contracts should be allowed to continue that practice during phase I.

We also believe that IAS 40 should be re-opened to include buildings used by insurers.