

European Financial Reporting Advisory Group (EFRAG)

35 Square de Meeûs
B-1000 Brussels
BELGIUM

Amsterdam, 22 November 2010

Re : EFRAG Draft Comment Letter - IASB Exposure Draft *Insurance Contracts*

Dear Sir / Madam,

This letter is sent on behalf of the members of the International Credit Insurance & Surety Association to comment on the EFRAG Draft Comment Letter on the Exposure Draft *Insurance Contracts* ('the ED') and more specifically on Question 11 - Definition and scope :

- c) Do you agree that the contract currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts ?
Why or why not ?

The International Credit Insurance & Surety Association (ICISA) brings together the world's leading companies that provide trade credit insurance and/or surety bonds. Founded in 1928 as the first trade credit insurance association, the current members account for 95% of the world's trade credit insurance business. ICISA members annually insure over 2 trillion USD in trade receivables.

ICISA welcomes the position taken by EFRAG in the paragraph 134 of its Draft Comment Letter :

“We understand that some financial guarantee contracts are currently out of the scope of IFRS 4 for practical reasons. The ED proposes that financial guarantee contracts are assessed in the same way as other contracts to determine if they are insurance contracts or financial instruments. We agree with this approach as the scope determination will reflect the substance of the underlying contract.”

This position reflects EFRAG previous statement on trade credit insurance as expressed in its Comment Letter on the ED of proposed amendments to IAS 39 Financial Instruments: *Recognition and Measurement* and IFRS 4 *Insurance Contracts: Financial Guarantee Contracts and Credit Insurance* (15/10/2004) :

“In our view credit insurance, as applied in Europe, is usually an insurance product, no different from other insurance products and should be accounted for under IFRS 4 *Insurance Contracts*.”

“Overall, we take the view that credit insurance products, which comply with the definition of insurance contracts should remain in the scope of IFRS 4”

We nevertheless understand that the position taken in paragraph 134 is currently subject to the following questions raised by EFRAG to its constituents :

“The proposals in the ED will bring financial guarantee contracts that meet the definition of an insurance contract within the scope of the new insurance standard.

Do you think there could be a reason to exclude financial guarantees from the scope of the insurance standard?

Financial guarantees are currently in the scope of IAS 39, except for those contracts that are explicitly ‘selected’ and treated as insurance contracts. IAS 39 requires such contracts to be measured at the higher of the amount determined in accordance with IAS 37 and the initially recognised amount less cumulative amortisation.

The proposed amendments to IAS 39 mean that a financial guarantee contract that does not meet the definition of an insurance contract should be measured as a derivative in accordance with IAS 39. Do you agree with these classification and measurement requirements?”

The above concern is not new and was already expressed in EFRAG’s Comment Letter on the ED of proposed amendments to IAS 39 Financial Instruments: *Recognition and Measurement* and IFRS 4 *Insurance Contracts: Financial Guarantee Contracts and Credit Insurance* (15/10/2004) :

“Further, we believe that the definition of financial guarantee contracts as proposed by the new paragraph 9 in IAS 39 needs to be further developed. Any overlap between the definition of (credit) insurance contracts and financial guarantee contracts would lead to the result that certain financial guarantee contracts would fall under IFRS 4 and certain insurance contracts would fall under IAS 39. Therefore, this amendment to IAS 39 should result in a clear distinction between contracts covering pure financial risk and contracts covering significant insurance risk”

Yet, ICISA members consider that the current ED is providing a clear dividing line amongst financial guarantees¹ between “*credit insurance*” (ED B 18 g)) and “*credit-related guarantees*” (ED B 19 f)). This dividing line lies in the existence, or the non existence, of a contractual obligation for the holder to suffer a loss in order to have a claim under his contract.

Coverage against credit defaults	
=	
credit insurance contractual precondition to suffer a loss IFRS 4	credit-related guarantees no contractual precondition to suffer a loss IAS 39

¹ We understand that, as a result of the current ED, financial guarantees would no longer be a defined word in IFRS and would be replaced by the concept “*Coverage against credit defaults*” (BC 193)

Indeed in a “*credit-related guarantee*” the above pre-condition is not met :

- either because the contract does not require it (eg, credit derivatives),
- or, because the “*credit-related guarantee*” covers the obligation of the holder towards a third beneficiary party and the holder cannot suffer a loss on itself (eg payment guarantees).

Whereas, in a “*trade credit insurance*” contract the above precondition is always met because:

- the contract is arranged by the seller of the goods to protect him against the default of his clients ; in this respect, the holder and the debtor are two distinctive entities and the holder can suffer a loss on the debtor,
- the contract always requires the policyholder to suffer a loss in order to have a claim.

Based on the experience gained through the similar exemption provisions of paragraph 10 (c) (insurance contract) and 10 (d) (financial guarantee) of FASB Statement N° 133, *Accounting for Derivative Instruments and Hedging Activities*, ICISA members are inclined to consider that the above precondition for payment is a robust dividing line which should accommodate (as it has done under US GAAP for many years) all respondents (insurers, banks, corporates, ...).

Notwithstanding the conditions in paragraphs 6-9, the following contracts are not subject to the requirements of this Statement:

10 (c) *“That is, a contract is not subject to the requirements of this Statement if it entitles the holder to be compensated **only if**, as a result of an identifiable insurable event (other than a change in price), **the holder incurs a liability** or there is an adverse change in the value of a specific asset or liability for which the holder is at risk.”*

10 (d) *“They provide for payments to be made **solely to reimburse the guaranteed party** for failure of the debtor to satisfy its required payment obligations under a non-derivative contract”*

In responding to the questions raised by EFRAG to its constituents, ICISA Members support the view that :

1. In a principle based referential such as IFRS, there is no valid reason to exclude the financial guarantees that meet the definition of an insurance contract from the scope of the Insurance Contract standard.
2. Given the clear dividing line introduced by the ED, we see no risk to attract financial guarantees into IFRS 4 other than the currently “*selected*” ones that already apply IFRS 4 (“Financial guarantees are currently in the scope of IAS 39, except for those contracts that are explicitly ‘selected’ and treated as insurance contracts”)
3. The question of the classification and the measurement requirements of financial guarantee contracts that do not meet the definition of an insurance contract is to be

dealt with in IFRS 9, not in IFRS 4. It is nevertheless our understanding that some of these are derivatives, some of these are not. It is our further understanding, from reading the current version of IFRS 9, that the non derivatives ones are to be measured at the higher of the amount determined in accordance with IAS 37 and the initially recognised amount less cumulative amortisation.

Finally ICISA members would like to stress their belief that the IASB proposed accounting model for insurance contracts is not only appropriate but also necessary to the accounting of *trade credit insurance* contracts :

- *trade credit insurance* meets the definition of an insurance contract and should be accounted for accordingly,
- the boundary set between *trade credit insurance* and “*credit-related guarantee*” is a clean cut and there is no risk of confusion or overlap (precondition for payment criteria),
- the current ED proposition is consistent with US GAAP where all contracts meeting the above precondition for payment criteria are scoped out of SFAS 133 whether based on 10c) or 10d) exclusion criteria,
- there is no possible alternative accounting option in IFRS as no other Standard than the Insurance Contract Standard will provide guidance among others for : revenue recognition and performance measurement for contracts with significant insurance risk, claim cost recognition model inclusive of “salvage and recoveries”, gains and losses on buying reinsurance, unit of account based on a portfolio of contracts, policyholder participation features, presentation & disclosures on insurance risk.

We thank you for the opportunity to present our views on these matters and are happy to enclose a copy of our Draft comment letter to the IASB for more details.

Yours sincerely,


Robert Nijhout
Executive Director