The following are comments from the General Insurance Association of Japan with respect to the Exposure Draft of Proposed Amendments to IAS39 Financial Guarantee Instruments: Recognition and Measurement and IFRS4 Insurance Contract on Financial Guarantee Contracts and Credit Insurance published by the International Accounting Standards Board (IASB) on July 8, 2004.

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.

As a general matter, we do not disagree with Board's proposal that transactions should be accounted for in accordance with their economic substance and not their legal form.

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?

(1) We disagree with Board's proposal with regard to the scope. We believe that financial guarantee contracts which meet the definition of 'insurance contract' in IFRS4 should be within the scope of IFRS4, not IAS39. Reasons for that are as follows:

(a) This Exposure Draft describes that IAS39 applies to financial guarantee contracts although they meet the definition of 'insurance contract' in IFRS4. It requires different accounting treatment on two contracts with the same characteristics of insurance contracts (one that meets the definition of 'financial guarantee contract' and one that does not), which would impair the consistency of accounting.

For example, a liability adequacy test (existing accounting standard in each country) would be carried out on insurance contracts under IFRS4, whereas IAS37 would be used on insurance contracts that correspond to a financial guarantee contract under this Exposure Draft. There might exist some differences between the liability adequacy test and IAS37, which would result in differences among the measurement of contracts that are defined as 'insurance contract'.

(b) We understand that most contracts which meet the definition of 'financial guarantee contract' in this Exposure Draft also fall within the definition of 'insurance contract' in IFRS4. Therefore, we believe it reasonable that they are subject to IFRS4, unless accounting treatment under this Exposure Draft is obviously better than that under IFRS4. We could not find any reasonable ground which shows that this Exposure Draft is superior to IFRS4 in any viewpoints.

(c) It is far from clear whether ceded reinsurance contracts corresponding to direct insurance contracts defined as 'financial guarantee contract' would be treated under IFRS4 or IAS39 (and/or IAS37), as to their detailed measurement (including the relationship with the measurements of underlying direct insurance contracts). Furthermore, there would be a problem in both (i) and (ii) cases stated below in that considerable inconformity arises and the function of reinsurance is not reflected in the financial statements of insurers;

(i) If ceded reinsurance contracts were treated under IFRS4:

On one hand, direct insurance contracts would be subject to IAS39 (and IAS37); on the other hand, ceded reinsurance contracts would be subject to IFRS4. Therefore,, accounting treatment would be different, which might give rise to inconsistency between the valuation of direct insurance contracts and that of corresponding ceded reinsurance contracts.

(ii) If ceded reinsurance contracts were treated under IAS39 (and/or IAS37) :

IAS39 does not refer to anything about the subsequent measurement of financial guarantee contracts an entity holds.

Even if ceded insurance contracts were measured using amortised cost method and IAS37 (similar to direct insurance contract measurement), inconsistency might arise between the amount of direct insurance contracts and that of corresponding ceded reinsurance contracts, because accounting treatment concerning the recognition and measurement is different between contingent assets and contingent liabilities.

(2) We believe that explanation of the scope is insufficient, and it should be clarified by the expansion of the Guidance on Implementing IAS39.

For instance, IFRS4 clearly specifies that reinsurance contracts are within the scope of IFRS4. However, this Exposure Draft does not mention how to treat assumed reguarantee contracts (typically, guarantee contracts in the form of reinsurance contracts).

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 Asset*s; and

(b) the amount initially recognised (ie 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?

Financial guarantee contracts which meet the definition of ‘insurance contract’ should be measured subsequently under IFRS4.

The reasons for that are as stated in the comments on Question2.

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?

We disagree with Board's proposal. Effective date should be deferred.
The discussion regarding accounting treatment of financial guarantee contracts is, we believe, closely related to that on insurance contracts or other financial instruments. Therefore, effective date should be in accordance with insurance contract project phase2 and financial instrument project in order to reflect the outcome of discussions in those projects.

Question 5 – Other comments

Do you have any other comments on the proposals?

We believe that the explanation with regard to the measurement in IAS37 and IAS18 when applied to financial guarantee contracts is not sufficient, and it should be clarified by the expansion of Guidance on Implementing of IAS39.