

International Accounting Standards Board

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CL 43

ED Amendments to IAS The Fair Value Option

Dear Sir David

We appreciate the opportunity to comment on the proposed amendments to IAS 39. We are of the conviction the fair value option to be included in IAS 39 (as of December 2003) should be retained and not restricted. After some general, introductory remarks, we will discuss the IASB's individual questions below.

Basic Remarks

German insurers have an active interest in IASB projects, especially as a number of German insurance companies have long prepared their financial statements in accordance with the IAS. However, the ongoing, steady flow of amendments to IAS standards has posed enormous challenges with respect to implementation. For example, the new IAS 39 was only adopted in December of last year, and is now to be modified, with the reintroduction of the fair value option, not six months later. This is incomprehensible for us, since the fair value option was discussed extensively, even controversially, prior to the adoption of the new IAS 39.

To our knowledge, no new technical aspects have emerged since the adoption of the new IAS 39 that would support a modification of the fair value option. While the concerns of the supervisory authorities are generally comprehensible, from their perspective, the fair value option does not, in our view, make it easier for companies to manipulate their financial statements. On the contrary, it represents a practicable solution for limiting earnings volatility and avoiding the "false" earnings resulting due to the valuation system of IAS 39. Apparently, the IASB assumes that companies are either not applying the fair value option responsibly or are unaware of its implications. We do not regard this concern as justified. In our opinion, the requirements in the current IAS 39 are strict enough so that a modification is not necessary.

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Question 1

Do you agree with the proposals of this Exposure Draft? If not, why not? What changes do you propose and why?

Answer:

We do not agree with the proposals of the Exposure Draft.

The fair value option was introduced in order to give users a practicable instrument for limiting the earnings volatility caused by IAS 39's valuation concept (fair value valuation versus at-cost valuation). With the planned amendments to the fair value option, the object of reflecting economically matched positions in a simple manner in accordance with their economic content is no longer met.

The Exposure Draft also calls for a fair value option, in principle, but only if certain requirements are met. Under the proposed amendments, the fair value option may only be used without restriction for structured products or financial instruments which do not constitute "loans and receivables." For all other financial instruments (cf. ED IAS 39.9 b) (ii) and (iii)), an off-setting exposure position must be identified if the fair value option is to be applied. This, in turn, involves further requirements for a reflection of matters in line with the economic risks, in addition to the requirements of hedge accounting. This counteracts the original goal of simplification, thus artificially increasing earnings volatility.

For insurance companies, the restriction on application (in effect, the non-application) of the fair value option to "loans and receivables" based on the requirement for "identification of the offsetting exposure" is to be regarded critically. Firstly, the planned amendment of IAS 39 contradicts the option, existing under the currently applicable IFRS 4, for reclassification of assets into the "at fair value through profit and loss" category (IFRS 4.45 in conjunction with IFRS 4.22). Secondly, the prohibition on accounting for "loans and receivables" at fair value is to be viewed critically in light of IFRS 4 – Phase II, which is expected to prescribe or allow accounting for insurance contracts at fair value.

In our opinion, the introduction of a "quality classification" system (reliable versus verifiable) for the determination of fair value is inexpedient and confusing. It cannot really be intended for fair value changes in trading portfolios which must be recognized in the income statement to impact earnings even if only a "reliable" value exists, while, if the option is selected, those changes only impact earnings if the value is "verifiable." Furthermore, we have always assumed that a "reliable" value is also "verifiable." We would also like to refer to EFRAG's very extensive argumentation on this point.

The remark that banking and insurance supervisory authorities may supervise application of this standard does not belong in an IAS Standard, in our opinion. Accounting matters are separate from the special supervision of those companies. Furthermore, a reference to the supervisory authorities in an IAS Standard could be misunderstood, despite the IASB's clarification in the "Basis for Conclusions." The clear separation between standard setters and supervisory authorities should be absolutely maintained, in our opinion.

Question 2

Is there a financial instrument for which companies would like to apply the fair value option, which would not be possible under the proposed amendments?

Answer:

"Loans and receivables" must be measured at fair value in order to limit the volatility resulting from the measurement of liabilities at fair value (insurance contracts, cf. Question 1 or structured liabilities). However, this is possible only to a limited extent under the planned amendments, which require verification of a "substantially offsetting exposure."

Question 3

Is application of the fair value option adequately limited? If not, what other limitations are necessary?

Answer:

The limitations are too extensive (see Question 1). In general, the "loans and receivables" category should not be excluded from the fair value option. In our view, the requirements described in the current IAS 39 are adequate.

Question 4

Is it appropriate to apply the fair value option for all structured products, including those which do not need to be separated in accordance with IAS 39?

Answer:

As stated in previous responses, we do not deem necessary any restrictions of IAS 39.

Question 5

Question on the implications if the fair value option in the previous version is applied.

Answer:

We support a pragmatic approach, with no modification of previous years' earnings.

Question 6

Do you have any other comments on the proposals?

Answer: no

Please contact us if you have any questions.

With best regards

on behalf of
German Insurance Association

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Dr. Kathrin Schädlich