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Date

19 July 2004

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Dear Mrs. Thompson,

IAS 39 Exposure Draft The Fair Value Option

We are pleased to have the opportunity to comment on the planned change to IAS 39. In the following, we would like to make some general introductory remarks before answering your individual questions.

General remarks

We acknowledge the IASB's work as generally positive. However, the ongoing alterations and changes to standards at short intervals makes enormous demands on users in terms of implementation. Thus, for example, the new IAS 39 was adopted only in December last year and now, not even half a year later, we face a proposal to change it with regard to the newly introduced fair value option.

The fair value option was thoroughly discussed prior to the adoption of the new IAS 39. To our knowledge, no fresh technical aspects have arisen since the new IAS 39 was adopted which support a change to the fair value option. The reservations of the regulatory authorities are understandable in principle, but in our view the fair value option does not give companies additional accounting scope that facilitates balance sheet manipulation. On the contrary, it offers a practicable solution for reducing result volatility and for avoiding economically "false" results that arise as a consequence of the IAS 39 valuation approach. In our opinion, the requirements in the current IAS 39 are strict enough, so that no change is needed.

Question 1

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

Answer:

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

The fair value option was introduced to give users a practicable tool to reduce the result volatility caused by the IAS 39 valuation concept (fair value versus at-cost valuation). The intended changes to the fair value option would mean that the objective of presenting the economic substance of hedging activities or items adequately and in a simple way would no longer be met.

In principle, a fair value option is still provided for in the Exposure Draft, but only if certain preconditions are fulfilled. Without additional restrictions, this fair value option can only be used for structured products or financial instruments that do not constitute loans or receivables. For all other financial instruments (cf. IAS ED 39.9 b) (ii) and (iii)) a corresponding offsetting exposure must be identified if the fair value option is to be applied. This means that for an economically risk-commensurate presentation, requirements have to be met similar to those that already exist for hedge accounting. The original simplification is counteracted and result volatility artificially increased as a result.

For insurance companies, restricting the use of the fair value option, or its de facto non-application to "loans and receivables" owing to the required "identification of the offsetting exposure", is critical. Firstly, the planned changes to IAS 39 contradicts the reclassification of assets to the category "at fair value through profit and loss", which is unrestrictedly possible in the currently valid IFRS 4 (IFRS 4.45 in conjunction with IFRS 4.22). Secondly, excluding loans and receivables from accounting at fair value must also be assessed as critical in view of IFRS 4 – phase II, which is likely to prescribe or admit the accounting of insurance contracts at fair value.

The introduction of a "quality categorisation" (reliable versus verifiable) for determining fair values is not conducive to objectives and is confusing in our view. It surely cannot be the desired intention that changes in the fair value of investments held for trading which have to be recognised in the income statement have an impact on net income as soon as the value is "reliable", whilst the precondition for the option of recognition with impact on net income depends on whether the value is "verifiable". Furthermore, up to now we have assumed that a "reliable" value is also "verifiable".

The reference to the fact that regulatory authorities of banks and insurance companies could appropriately supervise the application of this standard does not belong in an IAS standard in our opinion. The accounting is independent of the specific supervision of these companies. A reference to the regulatory authorities in an IAS standard might possibly be wrongly understood, despite clarification by the



IASB in the Basis for Conclusions. We consider that the clear separation between standard setters on the one hand and regulatory authorities on the other should definitely be preserved.

Question 2

Are you aware of any financial instruments to which entities are applying, or intending to apply, the fair value option that would not be eligible for the option if it were revised as set out in this Exposure Draft?

Answer:

Loans and receivables ought to be measured at fair value in order to appropriately reduce the volatility that arises in the recognition of liabilities at fair value (insurance contracts – cf. first question – or structured liabilities). However, this would only be possible to a limited extent with the planned changes, given that a "substantially offsetting exposure" has to be identified.

Question 3

Do the proposals appropriately limit the use of the fair value option? If not, how would you further limit the use of the option and why?

Answer:

The limits are too extensive (see first question). In our view, the requirements set out in the current IAS 39 are sufficient.

Question 4

Is it appropriate to apply the fair value option to all structured products, even those that IAS 39 requires not to be separated?

Answer:

As already stated in the previous answers, we do not think any restrictions in IAS 39 are necessary.

Question 5

Question on the effects if the fair value option has already been used in the old version.

Answer:

We favour a pragmatic approach, without changes made to previous years' figures.



Question 6

Do you have any other comments on the proposals?

Answer: No

We will be glad to participate in further discussion.

Yours sincerely,

Münchener Rückversicherungs-Gesellschaft

gez. Pfaller

gez. Hörmann

