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Date

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Central Division: Accounting
Queries to Ms. Pfaller

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Dear Ms. Pryde,

Exposure Draft 7 Financial Instruments: Disclosures

We are pleased to have the opportunity to comment on the International Accounting Standards Board's exposure draft of its proposed IFRS *Financial Instruments: Disclosures.*

Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance

The draft IFRS incorporates disclosures at present contained in IAS 32 Financial Instruments: Disclosure and Presentation so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements:

(a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).
(b) information about any allowance account (see paragraphs 17 and BC14).
(c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16).
(d) fee income and expense (see paragraphs 21(d) and BC17).

Are these proposals appropriate? If not, why not? What alternative disclosures would you propose?

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Answer:

We consider the required disclosures appropriate.

Question 2 – Disclosure of the fair value of collateral and other credit enhancements

For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28).

Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

Answer:

We consider the proposal adequate.

Question 3 – Disclosure of a sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36-BC39).

Is the proposed disclosure of a sensitivity analysis practicable for all entities?

If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?

Answer:

We agree that disclosure of a sensitivity analysis provides more useful information than the terms and conditions disclosures previously required by IAS 32. With regard to the minimum disclosures required, we are of the opinion that in particular it would involve a great deal of work for companies to determine the difference between impact on profit and loss and impact on equity, since with available-for-sale financial assets, for example, this means looking at each security separately. We consider that the information value of this distinction is not significant, so that the amount of effort involved would appear unjustified.

Moreover, we doubt that the preparation of a quantitative sensitivity analysis is practicable for all entities. If information has to be collected from different sources and is not available on a consolidated basis it might be very time-consuming to prepare valid information. Additionally, the validity of information might depend on the capability of software programs currently in place. We therefore believe that if it is impracticable to prepare a quantitative sensitivity analysis, it should also be possible to disclose qualitative information instead. This would also be consistent with the requirements in IFRS 4, IG 52.

Question 4 – Capital disclosures

The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46-48 and BC45-BC54).
Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

Answer:

Before we comment on the proposal, we would like to make a fundamental remark. We take the view that disclosure requirements on capital do not fit into the framework of this standard, since they do not involve rules connected with financial instruments. The rules should therefore be dealt with in a standard with the appropriate context.

As far as the contents of the above proposal are concerned, we would like to make the following comments: We agree in principle that information about external capital requirements should be disclosed as proposed in the draft IFRS. Concerning information about internal capital targets, we believe that this information is only one of several parameters used to manage and control an entity. Other parameters might be equally or even more important. If only this information is disclosed, users will be given only part of the relevant information and therefore might not obtain a correct picture. Additionally, we believe that many entities consider internal capital targets to be sensitive information that they would not want to disclose.

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Question 5 – Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62-BC67).
Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption (see Appendix B, paragraph B9).
Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

Answer:

Concerning disclosure of comparative information in the first year of adoption, we would like to offer the following comments:

Many entities which apply IFRS 4 for the first time for the period beginning 1 January 2005 will want to apply the risk disclosures for insurance contracts proposed in the draft IFRS also for this period. Otherwise they would first have to implement the disclosure requirements set out in the current IFRS 4 and, in the period beginning 1 January 2007, would have to implement the new disclosures required by the draft IFRS. Those entities also have apply the draft IFRS early concerning disclosures for financial instruments.

Concerning insurance contracts, according to IFRS 4 all companies (no matter whether first-time adopters or not) are exempt from providing comparative information for periods beginning before 1 January 2005. For financial instruments, only companies which apply both IFRSs and the draft IFRS for the first time are exempt from providing comparative information when the draft IFRS is adopted for periods before 1 January 2006.

We believe that in the case of insurance companies that want to apply the draft IFRS early, the timeframe for preparing the comparative information required for financial instruments will be very tight and some information may not be available for the comparative period. In this case, entities may have to decide not to adopt the draft IFRS early with the consequences mentioned above.

If it is decided that IFRS 4 will be amended concerning risk disclosures before phase 2 (which we do not support, see Question 7), we would therefore propose that in the case of early application, comparative information need not be disclosed for financial instruments to make the early adoption of the draft IFRS practicable.

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Question 6 – Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements.
Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

Answer:

To keep information comparable between entities, we believe that it should be ensured that risk information is provided by all entities. Therefore risk disclosures should be part of the financial statements. To avoid redundancies and extra work, we strongly support the approach described in BC 41, that risk disclosures can be part of the information provided by management outside the financial statements and cross-referenced from the financial statements. Since the Basis for Conclusions is not part of the draft IFRS, this should be explicitly included in it.

Question 7 – Consequential amendments to IFRS 4 (paragraph B10 of Appendix B)

Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 Insurance Contracts to make them consistent with the requirements proposed in the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board's reasons for proposing these amendments are set out in paragraphs BC57-BC61.
Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

Answer:

We are fundamentally of the opinion that the disclosure requirements for financial instruments and insurance contracts should be as consistent as possible, but wish to stress that there are differences between financial instruments and insurance contracts that need to be taken into account. These differences can be investigated and determined in detail in phase 2 of the insurance project. Only then can it be established how far a standardisation of disclosure requirements is appropriate.

In addition, we regard altering a standard that was only adopted in March 2004 as problematic. Such changes to standards at short intervals give rise to unreasonably high implementation expenditure for users who have already begun to adjust their systems in order to implement the currently required disclosures. Nor do we consider that it makes sense for users to first implement the currently applicable disclosure requirements in IFRS 4 and then have to make changes again to meet the requirements of the draft IFRS. What is more, there is the possibility that phase 2 of the insurance project may lead to further changes that are not foreseeable at present.

We are therefore of the opinion that in connection with the draft IFRS only the minimum changes necessary should be made to IFRS 4 (such as the adjustment of the references to IAS 32, etc.). An extensive revision of the disclosures, on the other hand, should be put back until phase 2 of the insurance project in order to ensure that the disclosures do not have to be revised a third time.

Question 8 – Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45 (see paragraphs BC19, BC20 and BC42-BC44).
Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

Answer:

We consider the implementation guidance sufficient.

Question 9 – Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards Fair Value Measurements published by the US Financial Accounting Standards Board (FASB)

The FASB's Proposed Statement of Financial Accounting Standards Fair Value Measurements, which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:

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(a) For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities)
   (i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,
   (ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and
   (iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date.

(b) For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of
   (i) the reason for remeasurements,
   (ii) the fair value amounts,
   (iii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and
   (iv) the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.

Disclosures similar to (a)(ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).
Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

Answer:

We agree that the IFRS disclosures are adequate compared with those in FASB's Exposure Draft. No changes proposed.

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Question 10 – Other comments

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

We do not have any other comments.

Yours sincerely,

Münchener Rückversicherungs-Gesellschaft

gez. Pfaller gez. Hörmann

Int. Ref.