Appendix 1
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IAS 32

Scope - Distinction between insurance contracts and financial instruments

- Paragraph 1 states that rights and obligations arising under insurance contracts are excluded. Paragraph 3 states that, "However, the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks".

- It is not clear to us what is meant by "principally", nor whether this phrase should be interpreted differently than "significant" and "material", which are phrases often used in IAS. We therefore believe there should be more guidance to clarify and define the differentiation between financial instruments and insurance contracts. Is the differentiation primarily conceived to be found in characteristics other than significance and materiality? If so, this must be clarified.

We presume that the position adopted in the ED is in line with the current thinking in the forthcoming Insurance Project.

Q3- Classifications of derivatives that relate to an entity´s own shares (29C-29G)

Do you agree with the guidance proposed about the classification of derivatives that relate to an entity´s own shares?

We do not agree as the guidance seems to overlook the substance of certain transactions:

- The proposal in Paragraph 29C-G is that a derivative contract shall be classified as an equity instrument of the entity if, and only if, the contract will be settled by the exchange of a fixed number of an entity's own equity instruments for a fixed monetary amount of cash or other financial assets. In all other cases the derivatives shall be classified as financial instruments. We understand that the objective of the proposed amendments is to clarify the accounting treatment of derivatives whose value changes in response to changes in the market price of the entity's own equity instruments.

- The proposal achieves a clear distinction between an equity instrument and a financial instrument. However, we are concerned that this advantage may be achieved by neglecting the substance of the underlying transaction. For example, we believe that a “total return swap” will be classified as a financial instrument in accordance with Paragraph 29C-G. Our understanding is that such a transaction occurs when an entity enters into a contract with a financial institution that buys a certain number of shares in the entity. The number of shares is determined with a view to hedging the effects of certain transactions with the entity. The institution agrees to pay to the entity the difference between a notional amount (the current share price of the entity) and the price at a certain date in the future when the shares are sold. The entity agrees to pay the institution interest on the notional amount, adjusted to take into account dividends paid by the entity. The entity also agrees to compensate the institution if the share price of the entity falls below the notional amount.

- It is our interpretation that the substance of such a “swap agreement” is that the entity buys back its own shares and re-sells them at a future date. The institution is not paid to take any risks except for standard credit risks. The return the institution receives is a lender’s return. As for the entity, the transaction does not lead to a transfer of any of the risks associated with the entity’s equity instruments. This means that we do not think that the entity has met the conditions for recognizing revenue. The transaction should, therefore, be accounted for as an equity transaction.

- We believe the proposed distinction in the draft to be too form-oriented and not properly reflecting the substance. The distinction made could be challenged by the Qualitative Characteristic of Substance Over Form in the IASB Framework.

IAS 39

Q 2- Derecognition: continuing involvement approach (35-37)
Do you agree that the proposed continuing involvement approach should be established as the principle for derecognition of financial assets under IAS 39? If not, what approach would you propose?

We do not agree based on the following arguments:

- Our view is that the derecognition requirements in IAS 39 (before amendments) are confusing. IAS 39 is clearly primarily founded on a control model, but it also uses risks and rewards as a basis for derecognition, and the use of both models makes the application of the Standard difficult.

  We are certainly of the opinion that the manner for reliably determining the extent to which risks and benefits have been transferred may not always be obvious. Therefore, it may be difficult to determine when to apply Paragraph38 (before amendments) rather than Paragraph41 (before amendments), both of which include elements of ”control” and ”risk and rewards”.

- The derecognition requirements in IAS 39 should, therefore, be amended. We are, however, unsure of what the proposed amendments would achieve, or whether the proposed amendments would actually eliminate the existing problems regarding derecognition in IAS 39 (before amendments).

We hold this view for the following reasons:

- The definition in Paragraph 37 does not state with sufficient clarity the manner in which to differentiate between "continuing involvement" and the various representations, listed in Paragraph .37, that are deemed not to constitute continuing involvement in a transferred financial asset.
- The proposed amendments would create liabilities that are not financial liabilities and assets that are not financial assets (see proposed Paragraphs 45 and 48).

  From a conceptual point of view, this does not seem to be a satisfactory consequence.
- The proposed approach is a rule-based approach to derecognition. We suspect that such an approach may lead to misuse and that structures will be set up to achieve a particular treatment, as a result of the legal form of the proposed approach.
- It is clear that at least two board members object to the continuing involvement alternative proposed in the ED, as this does not eliminate the problems in combining a control approach with the risks and rewards approach. We believe that the dissidents' views have merit and justify further consideration.
- The Board has listed a number of remaining issues (see C 47) and has made it clear that conceptual issues relating to derecognition are part of a future project. The Board, among other things, has mentioned the consolidation of SPEs' and questioned whether the criteria governing the consolidation of SPEs' to which assets have been transferred, should be reconsidered. It may be necessary to reconsider such criteria before, or at the same time as, IAS 39 is amended.

- A proposed derecognition amendment represents a significant change. A significant change in an important Standard would require field-testing. We do not see any evidence in the ED that the new approach has been field-tested or that its application to a number of financial instruments transactions has been fully considered. If not field-tested, there is a risk that there will be a number of ongoing implementation problems. The importance of considering various implementation aspects is probably one of the lessons from the implementation of IAS 39.

We believe that a components approach for the derecognition of financial instruments is superior to the proposed approach as a result of their legal form. A components approach appears to be more in line with the control criterion of the definition of an asset.

Q6- Collective evaluation of impairment (112 113A-113D)

Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in para 113A-113D?

We do not agree.

- When a loan is found not to be impaired on an individual basis, we agree with the language in C73, that such a loan should not be included in a collective evaluation of impairment.

- Conceptually, we believe that a collective evaluation of impairment is an exercise that will take place for loans, which are not individually assessed, thereby showing the effects of incurred but not yet reported future events. The methods proposed for assessing the recoverable amount by discounting expected cash flows in groups of loans could be theoretically correct but could also, in practice, be quite easily interpreted as reflecting expected losses, instead of incurred losses, which is the aim of the assessment. It is therefore important that methods applied are accurate and properly disclosed. We do not see any evidence of such disclosure requirements.

We believe, furthermore, that the suggested model for collective evaluation of impairment perhaps exceeds existing data sources, even for advanced banks with extensive and sophisticated data retrieval ability and, therefore, could result in evaluations which are neither reliable nor comparable. As this approach represents a significant change, it should be field tested before implementation.