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Comment letter on IASB ED of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts: Financial Guarantee Contracts and Credit Insurance

FAR, the institute for the accountancy profession in Sweden, is responding to your invitation to comment on the IASB ED of *Proposed Amendments to IAS 39 and IFRS 4 Financial Guarantee Contracts and Credit Insurance.*

In general, we agree that similar financial products with different legal form should be accounted for in the same way. It is our opinion that credit insurance is an insurance product, no different from other insurance products and should be accounted for in the same way as other insurance products under IFRS 4. Financial guarantee contracts, however, are essentially pure credit contracts of a different nature and should be accounted for under IAS 39.

Overall, we support the proposals outlined in the Exposure Draft. However, we have some other comments, see our answer to Question number 5.

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.

We agree that the legal form of a financial guarantee should not affect its accounting treatment. The substance of the arrangement rather than its legal form should drive the accounting treatment. We consider the definition of a financial guarantee as proposed (i.e where the holder of the guarantee is reimbursed if a specified debtor fails to make payment when due) sufficient to draw the line between an insurance product and a pure credit product.

We note that a Letter of Credit, commonly used in export transactions, is mentioned above as one of the examples. A Letter of Credit is commonly considered as a substitute for cash. The proposed definition in the scope paragraphs in IAS 39 would however force it into IFRS 4 as it lacks the requisite of the failure of the due date and for the accounting under IFRS 4, it lacks the adverse effect. We suggest that IASB address this issue on the completion of the proposed amendments.

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?

We agree.

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 Assets; 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?

We believe that the proposal is appropriate for financial guarantee contracts.

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 agree.

Question 5- Other comments

Do you have any other comments on the proposal?

Yes, we have the following other comments;

1. In accordance with the paragraph IN 11, the Exposure Draft does not address the accounting by the *holder* of a financial guarantee contract. This is consistent with IFRS 4. However, we propose that IASB should consider to provide guidelines regarding accounting by the *holder* of a financial guarantee contract as well.

2. The Exposure Draft is based on the assumption that the issuer of a financial guarantee receives a single premium to cover the risk during the period of the underlying risk exposure. In practice, the premium for the total period could be split into annual (or other periodic) payments. We propose that the Exposure Draft provides guidelines for these situations as well.

3. We suggest that the Board consider “on-demand guarantees”. A demand guarantee is a written undertaking by a guarantor (usually a bank) to pay the beneficiary (for instance an importer) up to the maximum sum quoted on the demand guarantee upon presentation of a demand together with any other documents specified under the terms of the guarantee. The party on whose behalf the guarantee has been issued (for instance an exporter) undertakes to repay the guarantor (the bank). Demand guarantees are like substitutes for cash and must be honoured on presentation of a written demand that complies with the provisions of the guarantee. Demand guarantees are payable on first demand without any additional documents, which reflects their origin in replacing cash deposits, although guarantees may require at least a statement indicating that the exporter is in breach.

   As this kind of contract does not require an adverse effect on the beneficiary (policyholder) as a precondition for payment, it would not classify as an insurance contract. Neither does it fall within the scope of a financial guarantee as now proposed. We suggest that IASB address this issue on the completion of the proposed amendments.

Yours faithfully,

Jan Buisman
Chairman FAR’s Accounting Practice Committee

Dan Brännström

Secretary General