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Dear Madam

ED of proposed amendments to IAS 39 Financial Instruments: *Recognition and Measurement* and IFRS 4 *Insurance Contracts: Financial Guarantee Contracts and Credit Insurance*

The Danish Accounting Standards Committee is pleased on behalf of the Institute of State Authorized Public Accountants in Denmark (FSR) to submit its views on the IASB Exposure Draft of proposed amendments to IAS 39 and IFRS 4: Financial Guarantee Contracts and Credit Insurance ("the Exposure Draft").

Our comments are based on a review of the exposure draft performed by members of the insurance working party and bank working party of FSR.

If the risk transfer resulting from a financial guarantee contract is significant, the contract meets the definition of an insurance contract in IFRS 4. Nevertheless, the Exposure Draft proposes that all financial guarantee contracts should be within the scope of IAS 39.

The Exposure Draft proposes that all financial guarantee contracts should be measured initially at fair value. Subsequently financial guarantee contracts would - as a main rule - be measured at the higher of:

(i) the amount determined in accordance with IAS 37; and
(ii) the amount initially recognised less, when appropriate, cumulative amortisation recognized in accordance with IAS 18.

According to paragraph BC 22 of the Exposure Draft the International Accounting Standards Board ("the Board") decided to publish the Exposure Draft to counter the view that IFRS (and specifically IAS 37) do not require an entity to recognise a liability when it issues a financial guarantee contract. However, in paragraph BC 21 of the Exposure Draft the Board argues that the Exposure Draft is unlikely to significantly change the existing practise for measuring financial guarantee contracts.

Therefore, we believe that it is unnecessary to introduce the suggested amendments to IAS 39 and IFRS 4. In our view continuing to treat financial guarantee contracts and credit insurance contracts that meet the definition of an insurance contract according to IFRS 4 is appropriate until a comprehensive solution in phase II of the insurance contracts project has been found.

As it appears from paragraph BC 11 of the Exposure Draft most insurers responding to ED 5 (now issued as IFRS 4) agreed with this while bank respondents typically argued that financial guarantees should remain within the scope of IAS 39 or IAS 37 on the following grounds (relating to accounting issues):

- ED 5 did not indicate precisely what the accounting treatment should be for issued financial guarantee contracts within its scope, except for the proposed loss recognition test (subsequently relabelled in IFRS 4 as the liability adequacy test).
- If viewed as an insurance product, these financial guarantees may be measured at fair value in phase II of the project on insurance contracts, which bank respondents regarded as less appropriate than applying IAS 37.

In our view – and as it appears from the Exposure Draft – these arguments are based on misunderstandings. As it appears from paragraph BC 20 of the Exposure Draft under IFRS 4 an issuer (including a bank) may continue using its existing accounting policies for these contracts, unless they conflict with the requirements of paragraphs 14-20 of IFRS 4. To comply with paragraphs 15-19 of IFRS 4 an issuer (including a bank) would carry out a liability adequacy test. If that test did not meet the minimum requirements in paragraph 16 of IFRS 4, the issuer would use IAS 37 to determine whether an additional liability should be recognized (in other words similar to what is proposed in the Exposure Draft, cf. paragraph BC 21 (c) of the Exposure Draft). Furthermore, an issuer could improve its accounting policies for such contracts if those improvements meet the criteria in paragraphs 21-30 of IFRS 4.

Thus, the accounting treatment for issued financial guarantee contracts within the scope of IFRS 4, including that used by banks, should be relatively clear. In our view, this clarification to the bank respondents, that believed that ED 5/IFRS 4 is not precise, should not require amendments to IAS 39.

Regarding the second bullet point mentioned by some bank respondents (i.e. the outcome of phase II of the project on insurance contracts) the Board has emphasized that IFRS 4 does not prejudge the outcome of Phase II.

We believe that the initial measurement is however not clear as it indicates on the one hand to record such a contract at its fair value at inception being the premium received and on the other hand does not state a difference between the Exposure Draft and FIN 45 which requires to measure the fair value by discounting all premiums received or receivable.

Overall, therefore we suggest that any changes to existing requirements to the accounting for financial guarantee contracts and credit insurance contracts should be deferred until a comprehensive solution in phase II of the insurance contracts project has been found. Until then, inclusion of implementation guidance with respect of clarifying the accounting treatment of financial guidance could be the interim solution.

When developing specific and comprehensive requirements to the accounting for financial guarantee contracts and credit insurance contracts we suggest that the accounting of the holder be covered as well.

If you would like further clarification of the points raised in this letter, we would be happy to discuss these further with you.

Yours sincerely

Eskild Nørregaard Jakobsen	Ole Steen Jørgensen
Chairman of FSR's Accounting Standards Committee	Head of Department

ED of proposed amendments to IAS 39 Financial Instruments: ***Recognition and Measurement*** **and IFRS 4** ***Insurance Contracts: Financial Guarantee Contracts and Credit Insurance***

Answers to questions 1 - 5 set out in the Exposure Draft.

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.

FSR response:

We agree that the legal form of such contracts should not affect their accounting treatment. This is already the case under IFRS 4.

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?

FSR response:

We believe that those contracts that meet the definition of an insurance contract should remain within the scope of IFRS 4. (See main letter).

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 (i.e. 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?

FSR response:

We believe that it is unnecessary to introduce the suggested amendments to IAS 39 and IFRS 4. In our view, continuing to treat financial guarantee contracts and credit insurance contracts that meet the definition of an insurance contract according to IFRS 4 is appropriate until a comprehensive solution in phase II of the insurance contracts project has been found. (See main letter).

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?

FSR response:

Not applicable as we suggest that any changes to existing requirements to the accounting for financial guarantee contracts and credit insurance contracts should be deferred until a comprehensive solution in phase II of the project has been found.

Question 5 – Other comments

Do you have any other comments on the proposal?

FSR response:

No.