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Position of the Association of German Public Sector Banks on the Exposure Draft "Amendments to IAS 39 and IFRS 4 – Financial Guarantee Contracts and Credit Insurance"

Dear Sir David,

We should like to thank you for giving us the opportunity to comment on the proposed amendments to IAS 39 and IFRS 4 regarding "Financial Guarantee Contracts and Credit Insurance", published on 8 July 2004 by the International Accounting Standards Board (IASB).

A. General remarks

In our view, the accounting treatment of financial guarantee contracts has so far not been resolved satisfactorily. Both the definition of the scope of IAS 39 and IFRS 4 and the measurement of financial guarantees are in need of clarification.

The present draft deals with the question of the definition, on which we have observations to make. On account of considerable improvements introduced by the draft, we consider the proposals on this subject to be only partially appropriate.

The question of the measurement of financial guarantee contracts is also taken up. We have significant observations to make on this subject, as our approval of the proposals in the draft is marginal.

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In particular, we should like to point out that a financial guarantee contract in principle contains not only a commitment to possible payment but also generally the right to corresponding consideration in the form of premium payments.
When measuring the guarantee, it is consequently necessary to take account of both components. A financial guarantee contract is not necessarily to be recognised as liability at the amount of the prospective payment commitment. On the contrary, the fundamental claim to consideration is to be taken into account in the measurement.

If – as in the case of transactions at market conditions – the premium payments offset the prospective payment commitment precisely, the financial guarantee has a fair value of zero and could not be recognised initially.

In addition, the fair value does not depend on the time at which a payment is made, i.e. a premium paid up front does not represent the fair value of a guarantee, but a deferred and accrued item, since a service was provided but the consideration is still outstanding.
Consequently, in our opinion, a regulation as presented in BC 23 (a) and (b) of this draft is more appropriate.

We therefore recommend a subsequent improvement to the draft in respect of the aspects mentioned.

Our detailed comments are set out under the respective questions.

B. Reply to the questions

Question 1 – Form of contract:
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 support the basic principle that economically equivalent contracts should receive the same accounting treatment despite differences in legal form.

However, we do not agree with the provision on initial measurement of financial guarantees (AG4A (a) and IN3 (a) of this Exposure Draft).

Although the requirement for a financial guarantee to be initially recognised at fair value is unproblematic (IN3 (a) at the beginning and AG4A (a), 2nd sentence of this draft), the **presumption that the fair value equals the premium received – where there is conformity with market conditions – (IN3 (a) at the end and AG4A (a), 3rd sentence of this draft), is in our view incorrect.**

According to this provision, two financial guarantees with the same conditions, but with differing premium payment dates, could be measured differently at inception depending on this time of payment.

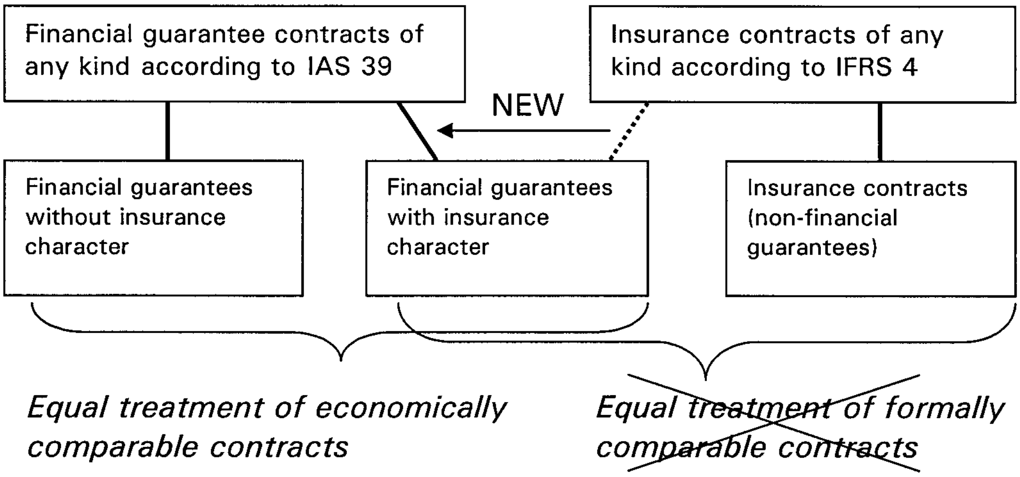
It would be correct for both to be measured equally at inception. The different premium payment dates are rather a question of the accrual provisions (cf. BC 23 (a) and (b) of this draft) and must be reflected in allocation of premium payments made and future premium payments to different periods, but not in the measurement of the financial guarantee contract itself.

At inception, the value of the entire financial guarantee contract results from the balance of the theoretical values for the liability of the prospective payment commitment and the total premium claim. Since – where there is conformity with market conditions – the two values cancel one another out precisely, the fair value at inception is zero. The financial guarantee could not be recognised.

We therefore recommend amending the corresponding passages of the draft.

Question 2 – Scope:
Is the proposed scope appropriate? If not, what changes do you propose, and why?

We consider the amended definition of the scope of IAS 39 and IFRS 4 concerning financial guarantee contracts (see figure) to be appropriate.



In particular, we consider it appropriate that "financial guarantee contracts" with the character of credit insurance are therefore equated with all other forms of financial guarantee contracts, even though as "credit insurance" they would in principle also come under the definition of "insurance contracts".

Through this, the equal treatment of formally comparable (insurance) contracts is abandoned in favour of equal treatment of economically comparable (financial guarantee) contracts.

We also agree to moving the measurement provisions from the "scope" section to the "measurement" section.

Question 3 – Subsequent measurement:
Is this proposal appropriate? If not, what changes do you propose, and why?

In our opinion, the subsequent measurement is appropriate.

The prescribed subsequent measurement (par. 47(c), AG4A (a) and IN3 (b) of this draft) at the higher of the amount determined in accordance with IAS 37 and the amount initially recognised – less where appropriate amortisation in accordance with IAS 18 – results in the liability deriving from the payment commitment under the financial guarantee always being measured on the basis of the original estimate or on the basis of a later corrected higher estimate.

This corresponds to the measurement described above, which in our view is correct.

Question 4 – Effective date:
Are the proposed effective date and transition appropriate? If not, what do you propose, and why?

We agree to the proposed effective date.

Question 5 – Other comments:
Have you any other comments on the proposals?

No.

Please do not hesitate to contact us with regard to further questions or discussions.

Yours sincerely,
Association of German Public Sector Banks

(Dr. Hans-Joachim Beyer) (Jan-Velten Große)