
Project	Financial Instruments: Replacement of IAS 39
Topic	Amortised Cost and Impairment – Scope: loan commitments and financial guarantee contracts

Purpose of this paper

1. This paper addresses an issue related to the **scope** of the requirements being considered for the upcoming exposure draft on impairment (the upcoming ED). Specifically, this paper asks the Board whether the upcoming ED should include a question as to whether the proposals should also apply to types of off balance sheet items currently **not** within the scope of the impairment model of the financial instrument standard:
 - (a) **loan commitments that are scoped out of the financial instruments standard** and hence subject to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* regarding the impairment test.¹
 - (b) **commitments to provide a loan at a below-market interest rate** that are scoped into the financial instruments standard, but subject to IAS 37 regarding the impairment test.²
 - (c) **financial guarantee contracts** (as defined in paragraph 9 of IAS 39) that an entity elects to account for under IFRS 4 *Insurance Contracts*³.

¹ See paragraph 2(h) of IAS 39 *Financial Instruments: Recognition and Measurement*.

² See paragraphs 4(c) and 47(d) of IAS 39 and paragraph 4.2.1(d) of IFRS 9 *Financial Instruments*.

³ See paragraph 2(e) of IAS 39 *Financial Instruments: Recognition and Measurement*.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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Loan commitments

2. For loan commitments outside the scope of IAS 39, provisions made against these commitments are determined in accordance with IAS 37. Once a drawdown is made on the loan commitment, the financial asset is then accounted for under the IAS 39 impairment model. Some respondents provided suggestions of how to apply the impairment guidance in the exposure draft *Amortised Cost and Impairment* (the original ED) to such loan commitments. The original ED did not formally seek input on this question.
3. Respondents that commented on the issue urged that the accounting treatment (whether within the scope of IAS 37 or IAS 39) should be aligned by using one consistent approach for both on and off balance sheet credit exposures. Some respondents stated that off balance sheet items should be included within the scope of the financial instruments standard because these items are managed under the same business model and use the same systems as loans recognised in the balance sheet. In other words, even when a loan commitment is within the scope of IAS 37, an entity may use the IAS 39 systems to determine the impairment amounts to be recognised under IAS 37. Therefore, respondents felt that applying the same accounting treatment to all items would be appropriate.
4. This issue was also raised during the EAP discussions. The EAP suggested that one way to address this issue would be to amortise the expected loss from the future drawdown of a loan commitment against commitment fee revenue.
5. As a result of the feedback received in the original ED and the fact that this has not yet been exposed for comment, the staff recommend asking a question in the upcoming ED about whether loan commitments that are not measured at fair value should be included within the scope of the finalised impairment requirements.

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Question 1

Does the Board agree with the recommendation in paragraph 5 to ask a question in the exposure draft about whether loan commitments that are not measured at fair value should be included within the scope of the finalised impairment requirements?

If not, what would the Board like to do and why?

Financial guarantee contracts

6. The IASB's exposure draft *Insurance Contracts* (the insurance ED), published in July 2010, proposes that contracts currently defined in IFRSs as 'financial guarantee contracts' should be brought within the scope of the IFRS on insurance contracts (and, thus, be scoped out of IFRS 9). Question 11(c) asked constituents 'Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?' The Board has not yet addressed this issue in redeliberations.
7. Many constituents were concerned that if the Board decides to change the accounting for financial guarantee contracts in the financial instruments project, an entity might have to change its accounting for financial guarantee contracts twice—first, as a result of this project and again as a result of the insurance project.
8. The staff recommend postponing a decision in this project on whether the impairment requirements should apply to financial guarantee contracts until the Board has redeliberated (for the insurance contract project) if financial guarantee contracts will be included in the scope of the finalised insurance requirements.
9. Since many financial guarantee contracts are currently within the scope of IAS 39, constituents have had the opportunity to consider the impact of the impairment proposals on these contracts with the original ED. In addition, constituents have been given the opportunity to comment on whether these contracts should be accounted for as financial instruments or insurance instruments in the insurance ED. Therefore, the staff consider that no re-exposure for financial guarantee contracts would be required irrespective of

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whether the Board decides to include or exclude these contracts from the scope of the impairment requirements for financial instruments when these are finalised.

10. Also, the feedback on whether the impairment model should be applied to loan commitments discussed earlier in this paper would inform the Board whether the impairment test of IAS 37 could or should be replaced by the financial instrument impairment model. This feedback would also be relevant for the decision on financial guarantee contracts because they also use the IAS 37 impairment model (very similar to commitments to provide a loan at a below-market interest rate).

Question 2

Does the Board agree with the recommendation in paragraph 8?

If not, what would the Board like to do and why?