



**OICV-IOSCO**

Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaçào Internacional das Comissões de Valore

**January 30, 2009**

Exposure Draft: Embedded Derivatives  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**RE: ED: Embedded Derivatives (Proposed amendments to IFRIC 9 and IAS 39)**

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft on Embedded Derivatives – Proposed amendments to IFRIC 9 and IAS 39 (the ED or the Exposure Draft).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

### **Responses to the Board's Questions**

#### **Question 1**

*The exposure draft clarifies that an entity must assess whether an embedded derivative is required to be separated from a host contract when the entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category.*

*Do you agree with that clarification? If not, why? What would you propose instead, and why?*

We agree with the clarification and believe it will be helpful in eliminating diversity that could arise in practice as a result of the current limitation in the recognition criteria in IFRIC 9.

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## **Question 2**

*The exposure draft requires the assessment to be made on the basis of the circumstances that existed when the entity first became a party to the contract.*

*Do you agree with that proposal? If not, why? What would you propose instead, and why?*

Members of SC1 believe that an argument can be made for performing the assessment either based on the circumstances that existed at the date when the entity first became a party to the contract or on the circumstances that existed at the date of the reclassification of the contract and believe that the Board should clarify the basis for its choice of the former.

On balance, we do not agree with the Board's proposal that the assessment should be based on the circumstances that existed when the entity first became a party to the contract. In determining the frequency for performing re-assessments, the IFRIC indicated in the basis for conclusions in IFRIC 9 that such an analysis should only be required at inception or when a change in the contractual terms significantly modifies the cash flows that otherwise would be required under the contract. Further, the IFRIC noted that performing periodic reassessments as a result of changes in circumstances could be both onerous as well as raise difficult recognition and measurement questions.

Members of Standing Committee No. 1 believe that assessment of embedded derivatives in instruments that are reclassified pursuant to the October 2008 amendments to IAS 39 is a first-time assessment because the instrument no longer qualifies for the exclusion from embedded derivative analysis under paragraph 11(c) of IAS 39. Because it would be an initial recognition event for the embedded derivative and host contract as separate units of account, as opposed to a reassessment of an embedded derivative based on changes in economic circumstances, the analysis should be done using the circumstances existing at the date that the decision to reclassify the instrument is made. In that respect, both a change in terms of the instrument that is a substantial modification and a reclassification of the instrument such that it no longer qualifies for the exclusion under paragraph 11(c) of IAS 39 could both be regarded as initial assessments and hence arguably should receive similar treatment under IFRIC 9, that is, use the facts and circumstances in existence at the date of the modification or reclassification.

The rationale for the requirement in IAS 39, *Financial Instruments: Recognition and Measurement* ('IAS 39') to separate embedded derivatives was to ensure that an entity could not circumvent IAS 39's recognition and measurement requirements for derivatives by embedding a derivative in a non-derivative host instrument or contract. We do not believe that the assessment of embedded derivatives on the later date of the reclassification of the instrument will result in a circumvention of IAS 39 because the accounting change for the security being reclassified is prospective (that is, changes in fair value previously recorded in profit or loss are not reversed) and will also satisfy the principle in IAS 39 that all derivatives, even when embedded in a non-derivative host instrument or contract, should be measured at fair value if the separation criteria are met. The basis for conclusions in IFRIC 9 also indicates that change in external circumstances are not ways to circumvent IAS 39.

## **Question 3**

*The exposure draft proposes that if the fair value of an embedded derivative that would have to be separated cannot be reliably measured, the entire hybrid (combined) financial instrument must remain in the fair value through profit or loss category.*

*Do you agree with that proposal? If not, why? What would you propose instead, and why?*

We agree with the proposal.

**Effective date and transition**

**Questions 4 and 5**

*Do you agree with the proposed effective date? If not, why? What would you propose instead, and why?*

*Are the transition requirements appropriate? If not, why? What would you propose instead, and why?*

While we agree with the proposed transition requirements, we do not agree with the proposed effective date. Specifically, under the October 2008 amendments to IAS 39, instruments could be reclassified as of July 1, 2008. However, as a result of the proposed effective date of the ED, companies with annual periods that ended between July 1, 2008 and December 15, 2008 and that reclassified instruments pursuant to the October 2008 amendments prior to their year-ends could interpret the ED to mean that they do not need to reassess those reclassified instruments for embedded derivatives. For example, a company with a July 31<sup>st</sup> year-end would not need to apply the provisions of the ED to any instruments that were reclassified from July 1, 2008 to July 31, 2008, as the ED would be effective for the annual period ending on July 31, 2009.

We recommend that the effective date of the proposals in the ED be aligned with the effective date (as amended) of the October 2008 amendments to IAS 39 to cover all instruments that have been reclassified.

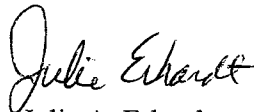
**Other Comments**

In paragraph 12 of the proposed amendments to IAS 39, we recommend that the Board remove the word “separately” in the phrase that reads: “Similarly, if an entity is unable to measure separately....” With the current wording, the proposed amendment could be read to mean that the hybrid contract would only remain in the fair value through profit or loss category if the embedded derivative cannot be measured at fair value in isolation. Paragraph 13 of IAS 39 clearly allows for a residual method to apply to the embedded derivative by valuing the host contract and taking the difference from the fair value of the hybrid (combined) contract as the fair value of the embedded derivative, without the need to measure the embedded derivative “separately.”

\* \* \* \*

We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt

Chairman

IOSCO Standing Committee No. 1