STAFF PAPER

13-14 March 2012

IFRS Interpretations Committee Meeting

Project	**IAS 39 *Financial Instruments: Recognition and Measurement***
Paper topic	Term-extending options in fixed rate debt instruments

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Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to address an issue related to embedded derivatives, specifically whether they would need to be separated from the host contract under IAS 39 *Financial Instruments: Recognition and Measurement* (or IFRS 9 *Financial Instruments*).

2. Specifically, the submitter requested that the Committee clarify whether the issuer of a fixed-rate debt instrument that contains an embedded term-extending option in the scope of IAS 39 (or in the case of a liability with such features, IFRS 9), should either:

   a) separate the term-extending option from the host debt instrument and account for the term-extending option as a derivative; or

   b) not separate the term-extending option from the host debt instrument. Instead, the issuer would treat the term-extending option as a continuation of the host debt instrument if the term-extending option is exercised.

Explanation of the issue

3. The issue that the submitter raised is where, for example, an entity issues debt with an embedded option that permits the entity to unilaterally extend the maturity date by a set term or series of set terms (eg, one year). If the option ('term-extending option') is exercised, the other terms of the debt, such as the interest rate, remain the same as before the option was exercised. In other words, upon exercise of the term-extending option the interest rate does not reset to a rate equivalent to the then-current market interest rate for debt of similar credit quality. The assumption, in the situations considered by the submitter, is that the debt does not contain any other embedded derivatives which could result in the entity being required to measure the debt at fair value through profit and loss in accordance with IAS 39 paragraph 12 or IFRS 9 paragraph 4.3.5.

> For example, at 31 December 2011 Entity A issues $1 million five per cent per annum debt with an original two-year maturity of 31 December 2013. Interest is due monthly and the $1 million principal amount is due at maturity. At its sole option, Entity A may extend the maturity date by a further two years (the "Term-Extending Option"), with a maximum maturity of 31 December 2015. If Entity A exercises the Term-extending Option, the interest rate on the debt will remain the same five per cent as at issuance; in other words, the interest rate does not reset to the then-current market rate of interest. The interest rate at issuance is a market rate that considers the effect of the Term-Extending Option. Other than the term-extending option, there are no other terms that affect the amount or timing of the contractual cash flows.
>
> Entity A measures the debt at amortised cost.
>
> Should the Term-Extending Option qualify as an embedded derivative that requires separate accounting from the debt host?

4. The submitter thinks that some entities account for these types of embedded term-extending options as derivatives separately from the debt host contracts as they are considered not closely related to the debt host contracts. The submitter thinks that other entities view the term-extending options as embedded loan commitments that are not accounted for separately.

5. The submitter further believes that there is diversity in practice in the accounting as a result of the differing views.

Staff Analysis

6. The requirements of IAS 39 and IFRS 9 are different with respect to embedded derivatives in financial assets but are the same with respect to embedded derivatives in financial liabilities. Because the submitter's request was in the context of the debt issuer (financial liability), we have considered the issue in the context of IFRS 9 as the relevant guidance in IAS 39 has been carried forward unchanged into IFRS 9.

Term-extending options for the issuer of a fixed rate debt instrument

7. In analysing the issue, we are aware of four views:

8. **View 1: Embedded derivative requiring separation**—Under this view, the term-extending option is considered to be an embedded derivative which is not closely related to the host contract and therefore should be separated and accounted for as a derivative. IFRS 9 paragraph B4.3.5(b) states that:

> **An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension**. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised [emphasis added].

9. **View 2: Embedded derivative clearly and closely related**—Under this view, although the term-extending option represents an embedded derivative, it would not be separated from the host instrument. IFRS 9 paragraph B4.3.5(e) states that a prepayment option whose exercise price is approximately equal to the amortised cost of the debt instrument at the exercise date is considered to be closely related to the host debt instrument and therefore the prepayment option is not separated:

> A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless:
>
> (i) the option's exercise price is approximately equal on each exercise date to the amortised cost of the host debt instrument or the carrying amount of the host insurance contract; or…

This view assumes that a debt instrument with a term-extending option (where the other terms of the debt instrument are unchanged) is economically no different from a debt instrument with an early repayment option whose strike price is the amortised cost at the repayment date. Those with this view argue that the accounting treatment should be the same. Because an early repayment option can be considered to be closely related as explained above, the accounting treatment should not change if the form of the debt instrument is a term-extending option:

> For example, assume that entity A is considering issuing one of the two following debt instruments:
>
> Instrument A is a $1,000 debt instrument with fixed monthly interest payments of 5 per cent per annum. The instrument has an initial term of four years with a term-extending option embedded in the contract which, if exercised at the end of year four, would extend the term of the debt instrument for a further two years. Exercising the term-extending option has no other impact on the debt instrument, for example, the interest rate is unchanged at 5 per cent per annum.
>
> Instrument B is a $1,000 debt instrument with fixed monthly interest payments of 5 per cent per annum. The instrument has a term of six years but includes a prepayment option which can be exercised at the end of year four. If the

prepayment option is exercised at the end of year four, entity A would repay the $1,000 principal and any accrued interest at that date (ie, the amortised cost at that time) with no further obligations on either of the parties.

From the perspective of entity A, economically the two instruments are the same.

10. **View 3: Embedded derivative outside the scope of IFRS 9**—Under this view, the term-extending option is acknowledged as having the characteristics of an embedded derivative that is not closely related but that the separated component is not considered to be within the scope of IFRS 9. Under this view the term-extending option is viewed as a loan commitment feature that is held by the issuer of the host debt instrument. Economically the same result could be obtained by issuing a debt instrument with a fixed maturity date and at the same time purchasing a loan commitment which would be available to the issuer of the debt instrument when the repayment of the principal became due:

For example, assume that Entity A is considering issuing one of the two following debt instruments:

Instrument B is a $1,000 debt instrument with fixed annual interest payments of 6.4%. The instrument has an initial term of four years with a term-extending option embedded in the contract which, if exercised at the end of year four, would extend the term of the debt instrument for a further two years. Exercising the term-extending option has no other impact on the debt instrument, for example, the interest rate is unchanged at 6.4%.

Instrument C is a $1,000 debt instrument with fixed annual interest payments of 5%. The instrument has a term of four years. At the same time that Entity A issues Instrument C, Entity A would purchase a $1,000 loan commitment from a third party. The loan commitment would provide Entity A with a two year loan facility of $1,000 that is available at the date that Instrument C is required to be repaid, ie the end of year four. The interest rate on any borrowing taken out on the loan commitment is a fixed rate of 6.4%.

In an efficient market, the interest rate and loan commitment would be priced in such a way that there are no arbitrage opportunities available to Entity A.

Assuming that this is the case, from the perspective of Entity A, economically the two instruments are the same.

Paragraph 2(h) of IAS 39 states that loan commitments are not within the scope of IAS 39 unless they meet the criteria in paragraph 4 of IAS 39:

4 The following loan commitments are within the scope of this Standard:

(a) loan commitments that the entity designates as financial liabilities at fair value through profit or loss (see paragraph 4.2.2 of IFRS 9). An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.

(b) loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments (for example, a mortgage construction loan that is paid out in instalments in line with the progress of construction).

(c) commitments to provide a loan at a below-market interest rate.(see paragraph 4.2.1 of IFRS 9).

Paragraph 4.2.1 of IFRS 9 provides guidance on the accounting for the issuer of a loan commitment, not the holder. Consequently, the *holder* of a loan commitment would only be required to apply IFRS 9 if the holder could net settle the commitment. We confirmed with the submitter that net settlement is not available to parties in the fact pattern provided by the submitter. Consequently, proponents of this view think that the extension feature is a loan commitment outside the scope of IFRS 9.

There are two sub-views that follow from this observation:

a) **View 3A** - that the bifurcation requirements do not apply, ie the extension feature is ignored; or

b) **View 3B** - that the loan commitment should be separated from the loan and then accounted for in accordance with the applicable IFRS (which is not IFRS 9 since this type of loan commitment is outside the scope of IFRS 9).

11. Those who support View 3A note that paragraph 4.3.3 of IFRS 9 provides the requirements that must be met in order for an embedded derivative to be separated from the host contract and accounted for as a separate derivative:

> 4.3.3. If a hybrid contract contains a host that is not an asset within the scope of this IFRS, an embedded derivative shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if:
>
> (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract (see paragraphs B4.3.5 and B4.3.8);
>
> (b) a separate instrument with the same terms as the embedded derivative **would meet the definition of a derivative**; and
>
> (c) the hybrid (combined) contract is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial liability at fair value through profit or loss is not separated). [emphasis added]

The requirement in paragraph 4.3.3(b) of IFRS 9 states that the embedded feature must meet the definition of a derivative in order to be within the scope of IFRS 9. IFRS 9 Appendix A defines a derivative as:

> …a financial instrument or other contract **within the scope of this IFRS** (see paragraph 2.1) with all three of the following characteristics… [emphasis added]

12. As a result, under View 3A it is argued that no bifurcation is required. This would produce an outcome consistent with View 2 and consequently ensure that the outcome for pre-payable and extendible instruments would be consistent.

However, opponents of View 3A note that applying this approach as the general principle to bifurcation would result in *any* derivative outside the scope of IFRS 9 not being bifurcated. Opponents of View 3A question whether that was the Board's intention because the definition of a derivative did not originally refer to the scope of IAS 39 as part of the definition – the introduction of the scope into the definition of a derivative was introduced as part of the 2003 amendments to IAS 39 in order to ensure that certain non-financial sale and purchase contracts were treated like derivatives (Refer IAS 39 paragraph BC24).

13. Those who support View 3B also support the analysis that the embedded feature is a loan commitment outside the scope of IFRS 9. However, proponents of View 3B argue that because paragraph B4.3.5(b) of IFRS 9 only states that extension options that are re-priced to market prices are closely related, this extension feature should be bifurcated. The separate loan commitment would then be accounted for in accordance with the applicable IFRS (as this type of loan commitment is outside the scope of IFRS 9).

Analysis of the alternative views

14. We think that confusion may arise in practice as a result of the guidance contained in IFRS 9 (that was carried forward from IAS 39) being inconsistent for the following:

a) paragraph B4.3.5(b) of IFRS 9 explains that a term-extending option *is not* closely related if the interest rate is not adjusted on the exercise of the option (View 1 above). However, paragraph B4.3.5(e) of IFRS 9 explains that a pre-payment option (which can be economically the same as a term-extending option) *is* closely related (View 2 above); and

b) paragraph B4.3.5 of IFRS 9 explains that in order to separate an embedded derivative and account for it as a derivative under IFRS 9, the *embedded derivative* needs to meet the definition of a *derivative* in IFRS 9. Under View 3, a loan commitment would generally not be within the scope of IFRS 9. However, paragraph B4.3.5(b) implies that a term-extending option, which can economically represent an embedded loan commitment, *is not* closely related to the host debt instrument and requires separation and derivative accounting when the interest rate is not adjusted on the exercise of the option (View 1 above).

The Board were made aware of this internal inconsistency when the inconsistency was raised in the IFRS 9 deliberations as an example of the complexity of the embedded derivative criteria.

Current Board project that might impact the analysis of the alternative views

15. Ideally practice could be improved by removing the internal inconsistency in the embedded derivative guidance. However, at the January 2012 Board meeting[1], the IASB and FASB boards decided to jointly redeliberate selected aspects of their classification and measurement models for financial instruments to seek to reduce key differences.

16. The requirement to bifurcate and the basis for any bifurcation for financial assets is a topic that the boards have agreed to consider jointly along with any knock on implications for financial liabilities (including the need for symmetry).

17. The January 2012 Board discussions occurred after the submission was originally sent to the staff. Consequently, we think that the "current or planned IASB projects" criterion that is required for the Committee to consider a possible annual improvement or interpretation is no longer met.

18. Consequently, we have not provided a recommendation on which view we think is the most appropriate interpretation of the guidance and we do not think that it would be productive for the Committee to debate the views presented in the Staff Analysis at this time, as any conclusions that the Committee reaches might become redundant depending on the outcome of the boards' redeliberations.

[1] http://media.iasb.org/IASBupdateJanuary2012.html#1

Outreach conducted

19. We sent out a request for information to the National Standard Setters Group in order to help assess the Committee's agenda criteria. Specifically, we asked:

    (a) *In your experience, is the issue prevalent in practice? In other words, do entities commonly issue fixed rate debt instruments with embedded term-extending options where there is no adjustment to the terms of the debt instrument if the option to extend is exercised?*

    (b) *If you answered yes to question one, what is the prevalent accounting for fixed rate debt instruments with embedded term-extending options? In other words, are entities accounting for the term-extending option as a separate derivative instrument or are entities accounting for the term-extending option in a manner similar to that of a loan commitment as explained by the submitter?*

    (c) *Based on your response to question two, would your view be that there is diversity in practice for these types of transactions?*

20. The views expressed below are informal feedback from the National Standard Setters Group. They do not reflect the formal views of the Boards of those organisations. The geographic breakdown for the responses is as follows:

Geographic area	**Number of respondents**
Asia/Oceania	5
Africa	1
Europe	3
North America	2
Total respondents	**11**

21. The majority of respondents stated that the issue was either widespread or, if not widespread, that they were aware of these types of transactions in their jurisdictions.

22. Based on the responses, there is diversity in practice, both within jurisdictions and between jurisdictions when agreements include term-extending options. Some entities are separating the term-extending option as an embedded derivative whereas others are not.

Staff Recommendation

23. In summary:

    a) we think that the current wording in IAS 39 (and IFRS 9) is contradictory with respect to the treatment for term-extending options and pre-payable instruments that may be economically equivalent; and

    b) as a consequence, there is diversity in practice in accounting for term-extending options; however

    c) the Board will potentially amend the guidance for embedded derivatives in financial liabilities when it redeliberates the classification and measurement requirements of financial instruments.

24. Consequently, we think that the Committee should not address this issue at this stage. We think that the Committee should recommend that this issue be brought to the Board’s attention again and that the Board consider this issue when it redeliberates the classification and measurement requirements of financial liabilities.

25. Should the Board not address this issue, for example if the Board decides to retain the current guidance in IFRS 9, then we think that the Committee should revisit this issue and provide guidance to clarify the accounting for term-extending options.

Question for the Committee
1. Does the Committee agree with the Staff Recommendation? In other words, does the Committee agree that Committee should not address the issue at this stage but rather recommend to the Board that the Board consider this issue when the Board redeliberates the classification and measurement requirements of financial liabilities?

Appendix A—Extract of submission

Suggested agenda item: Separation of term-extending options in a host debt instrument according to International Accounting Standard 39 *Financial Instruments−Recognition and Measurement* ("IAS 39") or International Financial Reporting Standard 9 *Financial Instruments*.

It has come to our attention that diversity exists in practice in the application of IAS 39 to certain types of term-extending options embedded in fixed-rate debt instruments. Entities commonly issue debt with an embedded option that permits one of the parties to unilaterally extend the maturity date, for instance, by a set term or series of set terms (e.g., one year). In many situations, if the option is exercised, the other terms of the debt, such as the interest rate, remain the same as before the option was exercised. In other words, upon exercise of the term-extending option the interest rate does not reset to a rate equivalent to the then-current market interest rate for debt obligations of similar credit quality. Note that in these situations the debt does not contain any other terms which could result, in a non-default situation, in the investor not recovering substantially all of its recognised investment absent the term extension option. That is, the term extension option is not used to circumvent the guidance regarding situations in which the contractual terms may result in the investor not recovering substantially all of its recognised investment.

Some entities account for these types of embedded term-extending options as derivatives separately from the debt hosts as they are considered not closely related to the debt host contract, while others view the option as an embedded loan commitment that is not accounted for separately. This diversity in the accounting is the result of differing views in practice of whether entities are permitted to analogise to, or are required to apply, the scope exception for loan commitments in IAS 39 or IFRS 9 when they evaluate whether a separate instrument that has the same terms as the embedded term-extending option would meet the definition of a derivative.[2] For further details about the issue, including an analysis of the views encountered in practice, please see Appendix A.

[2] IAS 39:11 (and IFRS 9:4.3.3) lists three criteria that, if all were met, would require an entity to account for an embedded derivative separately from its host contract. One of these criteria is that the embedded derivative, if evaluated as a freestanding item, would be a derivative as defined in the Standard.

Note that while this issue is written in the context of the debt issuer a similar issue may exist for the debt holder applying the guidance within IAS 39[3].

It would be beneficial for preparers, auditors and users of financial statements if the IFRS Interpretations Committee provided guidance on this issue particularly since the practice of writing these types of term-extending options is prevalent and the difference in accounting treatment and resulting impact on entities' financial statements can be significant. We have provided an analysis of the due process criteria for adding an item to the Committee's agenda in Appendix B.

If you have any questions concerning our submission, please contact [Submitter].

Yours sincerely,

[Submitter]

APPENDIX A

Subject

Separation of term-extending options in a host debt instrument in accordance with International Accounting Standard 39 *Financial Instruments−Recognition and Measurement* ("IAS 39") or International Financial Reporting Standard 9 *Financial Instruments* ("IFRS 9")

Example

On 31 December 2011 Entity A issues $100 million of five percent per annum debt with an original two-year maturity of 31 December 2013. Interest is due monthly and the $100 million principal amount is due at maturity. At its sole option, Entity A may extend the maturity date by up to three one-year terms (the "Term-Extending Options"), with a maximum maturity of 31 December 2016. If Entity A exercises a Term Extension Option, the interest rate on the debt

[3] Note that the same issue does not exist for the debt holder applying IFRS 9 as that guidance does not require or permit bifurcation of embedded derivatives from financial assets. Further, the term extension option, if it meets specified criteria within IFRS 9, does not preclude the entire instrument from being measured at amortised cost

will remain the same five percent as at issuance; in other words, the interest rate does not reset to the then-current market rate of interest. The interest rate at issuance is a market rate that considers the effect of the Term-Extending Options. Other than the term extension option, there are no other terms that affect the amount or timing of the contractual cash flows.

Entity A measures the debt at amortised cost in accordance with IAS 39.[4]

Entity A must evaluate IAS 39 to determine whether the Term-Extending Options qualify as embedded derivatives that require separate accounting from the debt host.[5]

Accounting Question

Must all term extension options be considered embedded derivatives requiring bifurcation by the debt issuer (and by the debt holder under IAS 39 if the entire instrument is not accounted for at fair value through profit or loss) or could, or must, specific types of options to extend the maturity of debt be regarded as loan commitments when evaluating whether the scope exceptions for loan commitments (IAS 39:2(h) and 4) apply?

View A – All term extension options are embedded derivatives.

An option to extend the maturity of debt is different from a loan commitment in important aspects. For example, in the case of term-extending options the debt is already outstanding and no more cash will be advanced upon exercise of the option, whereas in the case of loan commitments, the debt has not been issued yet and cash will be advanced upon exercise of the loan commitment. Additionally, the fee for a term-extending option (the option's premium) is typically included in the interest rate of the debt in which the option is embedded, and thus absent a default by the borrower, the lender will collect that fee when the borrower makes the interest payments (alternatively, the fee may be included in the loans proceeds and thus collected by the lender upfront). On the other hand, if a borrower does not go through with a loan commitment, the lender typically will never collect its commitment fee.

Proponents of View A further note that in developing IAS 39, the IASB did not intend for entities to be able to avoid bifurcation of non-closely related term-extending options by applying the scope exceptions for certain loan commitments in IAS 39:2(h) and 4. They believe that, if the IASB had intended for entities to be able to apply the guidance for loan commitments to term-extending options, it would have stated so (e.g., by specifying that the term loan commitment as used in paragraphs 2(h) and 4 of IAS 39 encompasses term-extending options). As support for their argument, proponents of View A further note that IAS 39 and IFRS 9 provide specific

[4]The issue of this submission would equally apply if Entity A measured the debt at amortised cost in accordance with IFRS 9 *Financial Instruments* if Entity A had adopted it early; however, for purpose of this example, Entity A applies IAS 39.

[5]Note that the following accounting questions focus on the Term-Extending Options described in the example. An analysis of other embedded features, including an analysis of other types of options to extend the term of a debt instrument, is not in the scope of this analysis.

guidance about how to apply the closely-related criterion to term-extending options, and this guidance would be less relevant if entities could apply the scope exceptions in IAS 39:2(h) and 4.

View B – Term extension options may be loan commitments and not embedded derivatives requiring bifurcation.

Supporters of View B acknowledge that term-extending options embedded in debt instruments are different in some aspects to loan commitments; however, they believe specific-types of term-extending options are sufficiently similar to loan commitments for purpose of evaluating the scope exceptions for loan commitments in IAS 39:2(h) and 4.

The Term-Extending Options in the example provide Entity A (the borrower) with the unilateral right to exchange the existing debt with new debt that has the same (fixed) interest rate and principal amount as the existing debt. Similarly, a (typical) loan commitment provides a borrower with the right to obtain a (new) loan from a lender at some defined point or range of time in the future. Under the offered terms, while the lender is contractually obligated to issue the loan to the borrower, the borrower is not required to draw down at the interest rate specified in the term extending option, or even borrow from that lender altogether. Proponents of this view note that the two parties could have achieved the same economics by structuring the transaction as a term loan with a separate loan commitment. Proponents of this view believe that the accounting for similar economics should be accounted for consistently irrespective whether the arrangement is one or two contractual arrangements.

Although the question is in the context of specifically applying the criterion in IAS 39:11(b), supporters of View B note that the economics of debt with a two-year maturity and three one-year fixed-rate term extending options (i.e., the debt in the example) is also substantially similar to debt with a five-year maturity and a par call options at years two, three and four, and that these types of call options would likely be considered closely related to the debt host in accordance with IAS 39:AG30(g).

View C

Either View A or View B is acceptable. Entity A must select one of the views as an accounting policy and apply it consistently to all embedded term-extending options that are similar to the Term-Extending Options in the example.

Separate Note

The guidance in U.S. GAAP on evaluating term-extending options in debt instruments for accounting as derivatives separately from the debt host is very similar to the guidance in IAS 39 and IFRS 9 on this topic.[6]

[6] See Accounting Standards Codification (ASC) 815-15-25-1 and 815-15-25-44.

Furthermore, U.S. GAAP has a similar scope exception for loan commitments as IAS 39.[7] We note that View B for Accounting Questions 1 and 2 is consistent with how U.S. GAAP is applied in practice in this area.

APPENDIX B

Assessment of the IFRS Interpretations Committee Agenda Criteria

Paragraph 24 of the *IFRS Interpretations Committee Handbook* identifies the necessary criteria that the IFRIC uses to assess whether it should add an item to its agenda. Such criteria are indicated below in italics, with an assessment of how this topic would, or would not, be met for that individual criterion directly below. The *IFRS Interpretations Committee Handbook* does not require that all criteria be met in order for a proposed topic to be added to the agenda.

(a) The issue is widespread and has practical relevance.

This criterion is met. Fixed-rate debt providing the borrower with an option to extend the maturity is common practice (e.g., in large commercial real estate borrowings).

(b) The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The IFRS Interpretations Committee *will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

This criterion is met. As discussed in Appendix A, different views exist in practice on the relevance of the scope exceptions in IAS 39 (which will continue to apply when IFRS 9 is effective) for the evaluation of embedded derivatives for separate accounting and on the economic similarity between loan commitments and specific types of term-extending options, such as those that are the subject of this submission. As a result, some account for these types of options separately from the debt in which they are embedded, while others do not.

(c) Financial reporting would be improved through elimination of the diverse reporting methods.

This criterion is met. Two entities that have identical contractual rights (i.e., rights to extend the maturity of existing debt at the same fixed rate), and thus are in an identical position economically, could account for those rights differently because they have applied IAS 39:11 (or IFRS 9:4.3.3) differently.

(d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process. The issue should be sufficiently narrow in scope to be capable of interpretation, but not so narrow that it is not cost-effective for the IFRS Interpretations Committee and its constituents to undertake the due process associated with an Interpretation.

This criterion is met. The issues that are the subject of this submission stem from the perceived lack of clarity on whether the scope provisions in IAS 39:2-7 must be considered when applying the embedded derivative guidance in IAS 39:1, and on whether

[7] See ASC 815-10-15-69 to 71.

specific types of options to extend the maturity of debt can, or must, be regarded as loan commitments when assessing whether the scope exceptions for loan commitments (IAS 39:2(h) and 4) apply.

(e) *It is probable that the IFRS Interpretations Committee will be able to reach a consensus on the issue on a timely basis.*

This criterion is met. The issue is narrow and the fact pattern specific; therefore, the IFRS Interpretations Committee should be able to reach a consensus on a timely basis.

(f) *If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance sooner than would be expected from the IASB's activities. The IFRS Interpretations Committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRS Interpretations Committee requires completing its due process.*

This criterion is met. It is unclear whether the IASB will address the scope of IAS 39 as part of the financial instruments project. Further, this issue is relevant both under IAS 39 and IFRS 9. When the IASB incorporated embedded derivative guidance in IFRS 9, it did not address the issue. The IASB appears to have no plans to revisit the topic of embedded derivatives as part of the financial instruments project. Even if the IASB were to decide to address the scope of IAS 39, there is still an issue of whether a term extension option should be considered similar to a loan commitment when applying either IAS 39 or IFRS 9.

Appendix B—US GAAP equivalent guidance

Extract from ASC 815-10-15

Certain Loan Commitments

15-69 For the holder of a commitment to originate a loan (that is, the potential borrower), that commitment is not subject to the requirements of this Subtopic. For issuers of commitments to originate mortgage loans that will be held for investment purposes, as discussed in paragraphs 948-310-25-3 through 25-4, those commitments are not subject to this Subtopic. In addition, for issuers of loan commitments to originate other types of loans (that is, other than mortgage loans), those commitments are not subject to the requirements of this Subtopic.

15-70 The preceding paragraph does not affect the accounting for commitments to purchase or sell mortgage loans or other types of loans at a future date. Those types of loan commitments must be evaluated under the definition of a derivative instrument to determine whether this Subtopic applies.

15-71 Notwithstanding the characteristics discussed in paragraph 815-10-15-83, loan commitments that relate to the origination of mortgage loans that will be held for sale, as discussed in paragraph 948-310-25-3, shall be accounted for as derivative instruments by the issuer of the loan commitment (that is, the potential lender).

Extracts from ASC 815-15-25

25-1 An embedded derivative shall be separated from the host contract and accounted for as a derivative instrument pursuant to Subtopic 815-10 if and only if all of the following criteria are met:

a. The economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract.

b. The hybrid instrument is not remeasured at fair value under otherwise applicable generally accepted accounting principles (GAAP) with changes in fair value reported in earnings as they occur.

c. A separate instrument with the same terms as the embedded derivative would, pursuant to Section 815-10-15, be a derivative instrument subject to the requirements of this Subtopic. (The initial net investment for the hybrid instrument shall not be considered to be the initial net investment for the embedded derivative.)

Term-Extending Options

25-44 An embedded derivative that either (a) unilaterally enables one party to extend significantly the remaining term to maturity or (b) automatically extends significantly the remaining term triggered by specific events or conditions is not clearly and closely related to the interest rate on a debt instrument unless the interest rate is concurrently reset to the approximate current market rate for the extended term and the debt instrument initially involved no significant discount. Thus, if there is no reset of interest rates, the embedded derivative is not clearly and closely related to the host contract. That is, a term-extending option cannot be used to circumvent the restriction in paragraph 815-15-25-26 regarding the investor's not recovering substantially all of its initial recorded investment.

25-45 The preceding paragraph does not provide guidance for determining whether term-extending options in nondebt host contracts are clearly and closely related to the host contract, as discussed in paragraph 815-15-25-1(a). A term-extending option in a nondebt host contract can have a significantly different effect than a term-extending option in a debt host contract. Nondebt contracts (as well as debt contracts) that contain embedded term-extension features shall be evaluated under paragraph 815-15-25-1 to determine whether the term-extension feature is a derivative instrument that shall be accounted for separately.