STAFF PAPER

July 2014

IFRS Interpretations Committee Meeting

Project	**Tentative Agenda Decisions to Finalise**		
Paper topic	IAS 39 *Financial Instruments: Recognition and Measurement* Classification of a hybrid financial instrument by the holder		
CONTACT(S)	Irina Makarova	imakarova@ifrs.org	+44 (0)20 7246 6453

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify the classification by the holder of a hybrid financial instrument with a revolving maturity option, an early settlement option and a suspension of interest payments option (all at the option of the issuer). Specifically, the submitter raised the question of whether the host of such a financial instrument should be classified by the holder as an equity, or as a debt instrument under IAS 39 *Financial Instruments: Recognition and Measurement*.

2. The Interpretations Committee discussed this issue in March 2014 and tentatively decided not to add it to its agenda, because it observed that:

   (a) the issue is not widespread;

   (b) the financial instrument described in the submission is specific and it would not be appropriate to provide guidance on this particular issue; and

   (c) IFRS 9 *Financial Instruments* would resolve the question of whether the instrument should be classified before or after identifying the embedded derivatives, because it would not require bifurcation for hybrid contracts with financial asset hosts and a holder would be required to classify the instrument as a whole.

3. The objective of this Agenda Paper is to provide an analysis of the comment letters received on the tentative agenda decision and ask whether the Interpretations Committee agrees with the staff recommendation that it should finalise the agenda decision.

4. This Agenda Paper is structured as follows:

   (a) comment letter analysis;

   (b) staff recommendation;

   (c) questions for the Interpretations Committee;

   (d) Appendix A—Proposed wording for the final agenda decision; and

   (e) Appendix B—Comment letters.

Comment letter analysis

5. We received four comment letters on the tentative agenda decision:

   (a) three respondents (AcSB—Canadian Accounting Standards Board, CPC—Brazilian Accounting Pronouncements Committee and Deloitte—Deloitte Touche Tohmatsu Limited) support the Interpretations Committee's tentative decision not to add this issue to its agenda; and

   (b) one respondent (ASCG—Accounting Standards Committee of Germany) does not agree with the Interpretations Committee's tentative decision and its rationale.

6. We analyse the comment letters in the following paragraphs. For the full text of the comment letters, refer to Appendix B of this Agenda Paper.

Comments raised

7. The AcSB agrees with the Interpretations Committee's tentative decision and stated reasons for its conclusion.

8. The CPC also supports the tentative decision and the reasons set out. However, it thinks that the Interpretations Committee could consider performing a more comprehensive project to provide general guidance of the classification of hybrid financial instruments in general, including providing more examples.

9. Deloitte agrees with the tentative decision and the reasons set out (specifically, that the issue is not widespread and that the financial instrument described in the submission is specific). However, it thinks that the comment in respect of IFRS 9 should be removed from the final agenda decision because:

    (a) it is inconsistent with the preceding paragraph, which states that it would not be appropriate to give guidance on a specific instrument; and

    (b) if any comment is provided, it should cover both IFRS 9 and IAS 39 because IFRS 9 will not become mandatory effective for a number of years.

10. The ASCG does not agree with the Interpretations Committee's tentative decision and its rationale. It proposes that the Interpretations Committee should provide further guidance on the following two key issues:

    (a) whether the instrument should be classified before or after bifurcation; and

    (b) the symmetry of classification of an instrument by the holder and the issuer.

11. This is because the ASCG thinks that:

    (a) instruments with some terms that are similar to those of the described instrument are widespread;

    (b) existing Standards do not provide sufficient guidance in respect of the two issues mentioned above; and

    (c) IFRS 9 would resolve the issue of sequence of classification and bifurcation of financial assets, but not of non-financial assets and financial liabilities, to which bifurcation requirements will continue to apply.

Staff view

12. We think that the comments received show us that the majority of the respondents agree with the tentative agenda decision and the main reasons set out.

13. We do not think that the comment in respect of IFRS 9 requirements (the concern raised by Deloitte) should be removed from the final agenda decision because:

    (a) the tentative agenda decision does not provide guidance on the application of IFRS 9 requirements to the specific financial instrument described in the submission; instead

    (b) the comment indicates the general provisions of IFRS 9 that could be relevant to the case described in the submission or a similar case. For that reason, the comment could be beneficial for stakeholders.

14. However we acknowledge that IFRS 9 will not become mandatory effective for a number of years.[1] Consequently, we propose to delete the sentence "as a result, the Interpretations Committee considered that developing accounting guidance on this issue would not be effective for a reasonable time period" from the final agenda decision.

15. We think that the two issues indicated by ASCG (sequence of applying IAS 39/IFRS 9 and IAS 32, and the symmetry of the holder's and issuer's classification) are too broad for the Interpretation Committee to address. Moreover, as noted in the staff paper for the March Interpretations Committee meeting, IFRIC had already discussed these issues in November 2006 and decided not to add them to its agenda.[2]

---

[1] The IASB tentatively decided at its February 2014 meeting to set 1 January 2018 as the effective date for the mandatory application of IFRS 9.

[2] Staff paper for March 2014 meeting:
http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/March/AP16%20-%20IAS%2039%20Hybrid%20financial%20instrument.pdf

Observes notes for November 2006 meeting:
http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2006/November/3rd/0611-AP12ii-IAS-27-obs.pdf

Staff recommendation

16. On the basis of the analysis above, we recommend to the Interpretations Committee that in the final agenda decision it should:
    (a) finalise the decision not to add this issue to its agenda; and
    (b) remove the last sentence in the penultimate paragraph in respect of the period of time before IFRS 9 requirements are applied.
17. The proposed wording of the final agenda decision is presented in Appendix A to this Agenda Paper.

Questions for the Interpretations Committee

Questions
1. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should finalise its decision not to add the issue to its agenda?
2. If yes, does the Interpretations Committee agree with the wording of the final agenda decision in Appendix A to this Agenda Paper?

Appendix A—Proposed wording for the final agenda decision

A1. The following text presents the proposed wording for the final agenda decision, highlighting differences from the wording of the tentative agenda decision published in March 2014 (new text is underlined and deleted text is struck through).

> **IAS 39 *Financial Instruments: Recognition and Measurement*—classification of a hybrid financial instrument by the holder**
>
> The Interpretations Committee received a request to clarify the classification by the holder of a hybrid financial instrument with a revolving maturity option, an early settlement option and a suspension of interest payments option (all at the option of the issuer). Specifically, the submitter raised the question of whether the host of such a financial instrument should be classified by the holder as an equity, or as a debt instrument under IAS 39 *Financial Instruments: Recognition and Measurement*.
>
> On the basis of the responses to the outreach request, the Interpretations Committee observed that the issue is not widespread. The Interpretations Committee also noted that the financial instrument described in the submission is specific and it would not be appropriate to provide guidance on this particular issue.
>
> The Interpretations Committee noted that IFRS 9 *Financial Instruments* would resolve the question of whether the instrument should be classified before or after identifying the embedded derivatives, because it would not require bifurcation for hybrid contracts with financial asset hosts and a holder would be required to classify the instrument as a whole. ~~As a result, the Interpretations Committee considered that developing accounting guidance on this issue would not be effective for a reasonable time period.~~
>
> The Interpretations Committee considered that its agenda criteria are not met. Consequently, the Interpretations Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

Appendix B—Comment letters

Accounting Standards Board
AcSB
CNC
Conseil des normes comptables

277 Wellington Street West, Toronto, ON Canada M5V 3H2 Tel: (416) 977-3322 Fax: (416) 204-3412 www.frascanada.ca

277 rue Wellington Ouest, Toronto (ON) Canada M5V 3H2 Tél: (416) 977-3322 Téléc : (416) 204-3412 www.nifccanada.ca

June 9, 2014

(By e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decisions arising from the Committee's March meeting

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decisions published in the March 2014 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee's tentative decisions not to add any of the four items to its agenda. In the case of the issues involving IAS 12, IAS 34 and IAS 39, we agree with the Committee's stated reasons for its conclusions.

In the case of the IAS 1 issue, we cannot identify a clear, direct statement of the Committee's reason(s) for not taking that issue onto its agenda. We think it might help constituents if such a statement could be drafted into the final version of the decision. In that connection, we note the Committee's final agenda decision on issue IAS 1-5 in July 2010.

We do not understand the comment in the discussion of the IAS 1 issue that paragraph 122 of that standard would apply to going concern. Paragraph 122 deals with disclosures of judgments made in applying an entity's accounting policies. We do not think that a judgment as to whether an entity is a going concern is a matter of accounting policy. Rather, it is a judgment of fact concerning a more fundamental issue. The discussion of going concern within IAS 1 is separated from paragraph 122 by almost 100 paragraphs of discussion on other topics, which suggests that they are not closely related issues. If the Committee nevertheless continues to think that paragraph 122 does apply to going concern uncertainties, it could propose to the IASB that going concern be added to the list of examples in paragraph 123 through an annual improvement. However, we think that, if any clarification to IAS 1 is desirable, a more logical approach would be to add to the disclosure requirement in the third sentence in paragraph 25 of IAS 1. That sentence could be amended to add a requirement to disclose the judgments made in concluding whether there are material uncertainties related to events or conditions that may cast doubt upon the entity's ability to continue as a going concern. Readers of IAS 1 would be more likely to notice and apply such a requirement while considering the other going concern requirements than if the disclosure requirement were included in paragraphs 122-123.

We would be pleased to provide more detail if you require. If so, please contact me at +1 416 204-3276 (e-mail pmartin@cpacanada.ca), or Rebecca Villmann, Director-designate, Accounting Standards at +1 416 204-3464 (email rvillmann@cpacanada.ca).

Yours truly,

Peter Martin

Peter Martin, CPA, CA
Director, Accounting Standards

Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
IFRS-Fachausschus®

DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Wayne Upton
Chairman of the
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

Berlin, 27 May 2014

Dear Wayne,

IAS 39 – Classification of a hybrid financial instrument by the holder (IFRS IC's tentative agenda decision in its March 2014 meeting)

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the IFRS IC's tentative agenda decision regarding IAS 39 *Financial Instruments: Recognition and Measurement* – Classification of a hybrid financial instrument by the holder, as was published in the March 2014 *IFRIC Update*.

We do not agree with the decision not to take the issue onto the IFRS IC's agenda and, in particular, with the rationale that the issue is not widespread and too specific to warrant further discussion.

Although we acknowledge (as commmunicated vis-à-vis the IASB's staff) during the outreach that this particular type of instrument is not typical in our environment, there are many similar instruments for which the same questions arise. It is in the nature of financial engineering that hybrid instruments with brand new, sometimes unique, structuring elements emerge. Therefore, the difficulty of how to classify any such instrument (as equity or liability) emerges every day and in an increasing manner. We note that the IFRS IC seemed to have received similar submissions over recent months, and we would not be surprised if this trend continued. However, even though any assessment requires consideration of the specific facts and circumstances and is, hence, dependent on individual features, we believe that it would be beneficial for all stakeholders if the IFRS IC developed and published its view. That being said, we prefer this being dealt with in as much a holistic manner as possible and less on a submission-by-submission basis.

We take the view that the most crucial question to be addressed is the sequence of applying IAS 39 (regarding the separation of embedded derivatives) and IAS 32 (as regards classification of the instrument). Neither standard provides an ultimate answer on this. We believe that the outcome might alter depending on the sequence that the two standards are applied.

Another fundamental question is whether classification of an instrument by the holder depends on the issuer's classification of the same instrument. Again, we think that neither standard is abundantly clear on this, resulting in that the issuer's and the holder's classification not necessarily being symmetrical.

Further, we do not agree with the argument that IFRS 9 partially resolves the classification issue. Even if IFRS 9 no longer required, or permitted, bifurcation of financial assets, this question would still be valid. The reason is that both IAS 39 and IFRS 9 refer back to IAS 32. Hence, the question whether classification by the holder follows classification by the issuer still arises. Since the bifurcation requirements continue to apply to non-financial assets as well as to financial liabilities under IFRS 9, a hybrid instrument's classification still depends on the question of whether classification or bifurcation is the first step among these two.

Therefore, to meet the confines of the IFRS IC, we propose that the IFRS IC deals with the two questions mentioned – the sequence of applying IAS 39/IFRS 9 and IAS 32, and under which circumstances or conditions the holder's and the issuer's classification can or shall be symmetrical.

In addition, to achieve a comprehensive solution, we urge the IASB to retain, or accelerate, its efforts to revise the equity/liability through pursuing the research project, subsequently revising IAS 32, and to a certain extent possibly the Conceptual Framework.

If you would like to discuss our views further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

May 30, 2014

ifric@ifrs.org
International Accounting Standards Board
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: IFRIC Paper Topic - IAS 39 Financial Instruments: Recognition and Measurement - Classification of a hybrid financial instrument by the holder

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond to the IFRIC Paper Topic - IAS 39 Financial Instruments: Recognition and Measurement - Classification of a hybrid financial instrument by the holder.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

Background of the issue

The IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify the classification of a hybrid financial instrument with a revolving maturity option, anearly settlement option and a suspension of interest payments option (all at the option of the issuer) by the holder. Specifically, the submitter raises a question if the host of such financial instrument should be classified by the holder as an equity or as a debt instrument under IAS39 Financial Instruments: Recognition and Measurement.

Based on the responses to the outreach request the Interpretations Committee observed that the issue is not widespread.

The Interpretations Committee also noted that the financial instrument under issue is too specific and the issue cannot be addressed by the Interpretations Committee in an efficient manner.

Regarding the question whether the instrument should be classified before or after identifying embedded derivatives, the Interpretations Committee noted that IFRS 9 Financial Instruments would not require bifurcation for hybrid contracts with financial asset hosts and a holder would be required to classify the instrument as a whole. As a result, the Interpretations Committee considered that developing accounting guidance on this issue would not be effective for a reasonable time period.

[1] The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

The Interpretations Committee considered that its agenda criteria are not met. Consequently the Interpretations Committee decided not to add this issue to its agenda.

Our comments

We conclude that the rationale exposed by the Interpretations Committee to decide not to require an interpretation or an amendment to IFRSs is consistent and conceptually reasonable. It is important to note that the pattern presented by the submitter is also not found in Brazil.

Thus, we support the decision made by the Interpretations Committee related to this project, however, we believe, due to the complexity of this matter, the IFRIC should consider performing a more comprehensive project to provide general guidance of the classification of hybrid financial instrument in general, including providing more examples of complex instruments and related classification.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,

Idésio da Silva Coelho Júnior
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)

Deloitte Touche Tohmatsu Limited
2 New Street Square
London
EC4A 3BZ
United Kingdom

Tel: +44 (0) 20 7936 3000
Fax: +44 (0) 20 7583 1198
www.deloitte.com

Direct: +44 20 7007 0884
Direct fax: +44 20 7007 0158
vepoole@deloitte.co.uk

Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Email: ifric@ifrs.org

9 June 2014

Dear Mr Upton

Tentative agenda decision - IAS 39 *Financial Instruments: Recognition and Measurement*: Classification of a hybrid financial instrument by the holder

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the March IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for guidance on the classification by the holder of the host contract of a hybrid financial instrument.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision (specifically, that the issue is not widespread and that the financial instrument described in the submission is specific), noting that this is consistent with the agenda decision reached by the Committee in January 2007 in the context of financial instruments puttable at the option of the holders at an amount other than fair value.

We recommend, however, that the comment on the effect of IFRS 9 *Financial Instruments* on such an instrument be removed from the agenda decision for the following reasons:

- it is inconsistent with the comments in the previous paragraph (in that it refers to hybrid financial instruments in general, thus implying that the guidance implies to the specific instrument in question), whilst in the preceding paragraph it is noted that it would not be appropriate to give guidance on a specific instrument; and
- IFRS 9 will not become mandatorily effective for a number of years, meaning that guidance on IAS 39 will continue to be needed for some time. Thus, if any comment is provided it should deal with both IFRS 9 and IAS 39.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader