

STAFF PAPER

September 2014

REG IASB Meeting

Project	Matters Arising from the IFRS Interpretations Committee		
Paper topic	Classification of a hybrid financial instrument by the holder		
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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify whether the host contract of a hybrid financial instrument described in the submission should be classified by the holder as an equity or as a debt instrument under IAS 39 *Financial Instruments: Recognition and Measurement*.
2. At its meeting in July 2014 the Interpretations Committee decided not to take the issue onto its agenda. However, it acknowledged the concerns raised by stakeholders and specifically asked for the IASB to be made aware of the issue.
3. The purpose of this paper is to inform the IASB about the concerns expressed on this issue.

Summary of the submission

4. The instrument in question has the following terms:
 - (a) a fixed maturity of 30 years extendable at the option of the issuer;
 - (b) an early settlement option exercisable after 10 years;
 - (c) a fixed interest rate that is stepped up after 10 years; and
 - (d) an option that the issuer can skip interest if no dividends are paid on the entity's common stock.

5. 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.

Interpretations Committee's agenda decision

6. The Interpretations Committee discussed this issue in March and July 2014 and decided not to add it to its agenda.¹ This is because it observed that:
- (a) the issue is not widespread; and
 - (b) the financial instrument described in the submission is specific and it would not be appropriate to provide guidance on this particular issue.

Summary of the concerns raised

7. Respondents that commented on the Interpretations Committee's tentative agenda decision raised a number of concerns on the issue. They noted that:
- (a) similar instruments for which the same question arises are in fact widespread; and
 - (b) taking into account the complexity of the issue, *general guidance on classification of hybrid financial instruments* would be beneficial for stakeholders.
8. We have not performed further outreach to identify particular issues in respect of classification of hybrid financial instruments.
9. We also note the following:
- (a) A similar issue was raised in 2006 and discussed by the IFRIC in November 2006 and January 2007.² The IFRIC decided not to add the

¹ See final agenda decision in [IFRIC Update for July 2014](#) (Agenda Papers [8](#) and [8A](#)) and tentative agenda decision in the [IFRIC Update for March 2014](#) (Agenda Paper [16](#)).

² See final agenda decision in IFRIC Update for January 2007 (agenda decision on page 5: <http://www.ifrs.org/Updates/IFRIC-Updates/2007/Documents/IFRIC07013.pdf>) and tentative agenda decision in IFRIC Update for November 2006 (tentative agenda decision on page 11: <http://www.ifrs.org/Updates/IFRIC-Updates/2006/Documents/IFRIC0611.pdf>).

issue onto its agenda on the grounds that the existing guidance in IAS 39 is sufficient.

- (b) Implementation guidance on a similar issue is currently being developed by the FASB’s Emerging Issues Task Force (the EITF).³ The issue addressed by the EITF is whether the host contract in a hybrid financial instrument issued in the form of a share is more akin to debt or to equity. The summary of the EITF discussions of this issue is presented in Appendix A to this paper. The EITF’s redeliberations of the draft implementation guidance have not yet been completed as at the date when this Agenda Paper was posted.

Question to the IASB

10. The Interpretations Committee asked that we bring this matter, and the concerns raised on these issues, to the IASB’s attention.

Question to the IASB

Does the IASB have any comments or questions in respect of the issue and the concerns raised?

³ See [FASB site](#) for details (EITF Issue No. 13-G, “Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity”).

Appendix A—Overview of the EITF's discussions

- A1. In September 2013, the FASB's Emerging Issues Task Force (EITF) reached a consensus-for-exposure that the determination of the nature of the host contract would be based on a consideration of the economic characteristics and risks of the entire hybrid financial instrument, including the embedded derivative feature that is being evaluated for separate accounting from the host contract (the whole-instrument approach).
- A2. In March 2014, the EITF reaffirmed its consensus-for-exposure. It also asked the FASB staff to explore the possibility of introducing additional guidance to assist entities in evaluating the specific terms and features of a hybrid financial instrument that was issued in the form of a share under the whole-instrument approach. A Staff Draft of this guidance will be discussed on 18 September 2014.