



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

September 8, 2009

Exposure Draft: Classification of Rights Issues
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft: Classification of Rights Issues

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: Classification of Rights Issues (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 (SC1) 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 SC1 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.

General Observations

While we support a conclusion that the rights issues discussed in the Exposure Draft are equity in nature, we believe better identifying the underlying principle behind that conclusion could have several important implications. Specifically, better identifying the principle could potentially identify other foreign currency indexed equity-settled instruments within its scope and suggest limits to the nature and quantity of the currency indexation that would be permitted. Some SC1

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members believe further work on identifying this underlying principle should be performed prior to finalizing the amendment. Other members believe further deliberation of an underlying principle may not be practical given the need to address this issue now. They would encourage the Board to finalize the amendment as soon as possible, even if the amendment must be structured as a scope exception to general principles. Those members believe the additional issues raised in this letter should be considered in a later project.

Issue

We understand the transaction that is the subject of the proposed amendment to IFRS is how an issuer should account for a nonreciprocal, pro rata distribution by an issuer to its shareholders of a stock purchase right of a particular type. More specifically, the instrument distributed by the issuer gives the right (but not the obligation) for the holder to purchase additional shares of the issuer at a fixed strike price (e.g., 20 CU) in a specified currency (e.g., the Euro). The specified currency is a currency different than the functional currency of the issuer. Further, these instruments may or may not be transferable by the shareholder, but in any event if exercised by the ultimate holder of the instrument may only be physically settled by the issuer (i.e., the terms of the instrument do not provide for the issuer to net settle the instrument for its value at the exercise date).

We understand that the issue is how to account for the commitment to make this distribution and, further, how to account for the rights once they are issued until either they are exercised or expire. If our understanding as noted is different than that contemplated by the Board, then we may have further or different comments. In any event we encourage the Board to make clearer in any final amendment the scope for the resulting changes.

Comments on the Proposal

We understand that the first element of the Board's analysis of this issue is to conclude that the nature of these transactions is that of a distribution to owners in their capacity as owners. We concur with that conclusion.

We understand that the second element of the Board's analysis of this issue is to determine the nature of the right distributed so that it can be accounted for accordingly. Specifically, at issue is whether the substance of the right distributed is distribution of (i) an asset of the issuer (thus giving rise to recognition of a liability); (ii) a derivative or other item accounted for as a financial liability (also giving rise to recognition of a liability); or an equity instrument of the issuer (giving rise to recognition within the equity accounts). We understand that the Board's proposal is based upon a conclusion that the substance of the right distributed is that of an issuer equity instrument. While we appreciate the rationale put forth by the Board for this conclusion, we put forth the following points to be considered:

Identification of an underlying principle

The Board notes in the Exposure Draft's Basis for Conclusions that the rights issues are not liabilities in "substance" because they are issued "only to existing shareholders" and resemble "dividends paid in shares" (BC7). But while pro rata distribution might indicate that the initial distribution of the right should be viewed as a nonreciprocal distribution to owners (i.e., a debit to equity), we note that there are other dividends and share settled contracts that must be

presented as liabilities after declaration. For instance, if a share-settled gold derivative were issued pro rata to all shareholders, we would expect it to be classified as a liability under IAS 39.

Therefore, the Board must believe that the rights issues discussed in the Exposure Draft should be classified in equity for a different reason than either pro rata distribution or share settlement. We believe it is worth seeking out that underlying principle, and we believe it may be related to the evaluation of the impact of foreign currency on equity derivatives. More specifically, does denominating the exercise price of an option in the investor's currency fundamentally establish the nature of that right as a financial liability?

We encourage the Board to consider this question further. IAS 39 notes that contracts denominated in the currency of either party to an arrangement bear a "close economic relationship" to the contract that would not require separating a derivative (IAS 39.BC37). If a similar concept could be used for evaluating fixed for fixed equity contracts, the Board could achieve its proposed result for rights issues while better articulating the basis for and scope of its conclusion.

Nature of the exercise price currency

Some of our members are also concerned that allowing rights issues (and potentially other instruments) to be indexed to *any* currency could provide opportunities for embedding foreign currency speculation activities in capital raising transactions. We note that this potential for introduction of significant foreign currency exposure could be substantially reduced by requiring the currency of the right to represent either the currency of the issuer or the investor counterparty, and by indicating that a single contract cannot contain multiple currency exposures. The determination of appropriate currency could allow for common sense approaches to determining reasonableness. For instance, in a rights issue we believe the currency of the exchange on which the investor's shares trade could be viewed as the investor currency.

Effect on similar instruments

Finally, many of our members believe the current application of IAS 32 to currency issues often overstates the differences between contracts that are economically similar. While the August 2009 IFRIC Update notes that "in the current environment many entities are issuing rights to raise capital, and many of the issues are not denominated in the issuer's functional currency," the same could be said of other means of raising equity-based capital, such as issuances of warrants, convertible debt, and stock options, whether or not issued on a pro rata basis. We wonder whether better identifying the underlying principle for the Board's conclusion on rights issues could potentially identify other instruments that would be subject to the proposed conclusion. Further, pursuant to the Board's convergence objectives there is the matter of a common approach to standards for currency issues so that a new point of divergence is not introduced between IFRS and U.S. GAAP.

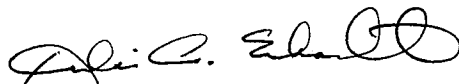
Conclusions

To summarize our views, we do not object to a conclusion that the rights issues in question could be considered equity in nature under a view that considers the investor's currency, rather than just the issuer's currency, in making liability versus equity classification conclusions. However, some SC 1 members are concerned that the conclusion appears to be structured as an exception

for a particular instrument. These members believe the key question here is whether foreign currency denomination means that the rights distributed should be accounted for as liabilities of the issuing entity, which in turn means identifying the underlying principle from which to derive this conclusion given that the subject transactions may not be the only foreign currency indexed equity-settled instruments that a company may issue.

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,

A handwritten signature in black ink, appearing to read "Julie A. Erhardt", with a stylized flourish at the end.

Julie A. Erhardt

Chair

IOSCO Standing Committee No. 1

APPENDIX

Questions for respondents

Question 1

Specifying the characteristics of the rights issue—The proposed amendment applies to instruments (rights) to be offered pro rata to all existing owners of the same class of equity instruments and the exercise price to be a fixed amount of cash in any currency. Do you agree with the proposal to limit the amendment to instruments with these characteristics? If not, why? Are there any other instruments that should be included and why?

See our comments in the sections entitled “Identification of an underlying principle” and “Effect on similar instruments” in the body of the letter.

Question 2

Specifying the currency of the exercise price—The proposed amendment specifies that the fixed amount of cash the entity will receive can be denominated in any currency. If that currency is not the entity’s functional or reporting currency, the proceeds it receives from the issue of its shares will vary depending on foreign exchange rates. Do you agree with the proposal to permit an entity to classify rights with the characteristics set out above as equity instruments even when the exercise price is not fixed in its functional or reporting currency? If not, why?

See our comments in the section entitled “Nature of the exercise price currency” in the body of the letter.

Question 3

Transition—The proposed change would be required to be applied retrospectively with early adoption permitted. Is the requirement to apply the proposed change retrospectively appropriate? If not, what do you propose and why?

We are supportive of the proposed transition method.