THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: 09-048

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Comments regarding IASB's Exposure Draft of proposed amendments to IFRIC 9 and IAS 39 Embedded Derivatives

Dear Mr. Enevoldsen,

The Committee of European Securities Regulators (CESR), through its standing committee on financial reporting (CESR-Fin), has considered EFRAG's draft comment letter on the IASB Exposure Draft proposing amendments to IFRIC 9 and IAS 39 Embedded Derivatives.

We thank you for this opportunity to comment on your draft letter and are pleased to provide you with the following comments:

1. CESR is generally supportive of the comment letter prepared by EFRAG as CESR believes that this clarification regarding embedded derivatives is very important in ensuring consistent application of the October 2008 amendment to IAS 39 regarding reclassifications.

2. We agree with the proposed clarification that an entity must assess whether an embedded derivative is required to be separated from a host contract at the time the entity reclassifies a hybrid financial asset out of the fair value through profit and loss category. We believe such clarification will help eliminate the diversity that could arise in practice as a result of the current limitations of the recognition criteria in IFRIC 9.

3. EFRAG raises concerns in paragraph 7 (a) in the draft comment letter that the proposed amendment to paragraph 7 in the exposure draft seems to imply that the amendment is an exception to the existing IFRIC 9. In paragraph 7 (b) of its draft comment letter, EFRAG is of the view that paragraph 11 of IAS 39 already makes it clear that an assessment of embedded derivatives is required when the hybrid instrument is not classified as at fair value through profit or loss. CESR believes that this analysis is correct from a technical point of view, but given the concerns raised by many stakeholders on how IAS 39 interacts with IFRIC 9, CESR is of the view that an amendment that clarifies this issue in IFRIC 9 would be useful and help to prevent any emerging practice whereby, following reclassification, embedded derivatives that should be separately accounted for are not.

4. With regard to the question of when the assessment is to be made, EFRAG's draft comment letter suggests amending the proposed guidance in paragraph 7A by stating that this assessment should be made based on the circumstances that existed at the later of the date when the entity first became a party to the contract and the date a reassessment is required by paragraph 7. This would mean the later of the date when a change in the terms of the

contract that significantly modifies the cash flows occurs, and the date the asset is reclassified out of the fair value through profit or loss category. CESR is of the view that in order to eliminate any diversity in practice, the proposed amendment should require that the assessment is made on the basis of the circumstances that exist at the date when the asset is reclassified out of the fair value through profit or loss category. In addition to simplifying how to identify the assessment date, this proposal has the merit of also avoiding unnecessary work relating to past periods when the embedded derivative is no longer present at the reclassification date. The proposed amendment is also justified on the basis that all changes in the fair value of the embedded derivative prior to the reclassification have already been taken into account in the profit or loss of past periods. CESR is of the view that the suggestions made to amend paragraph 7A should be stated more clearly in the covering letter to the comment letter.

5. With regards to the draft comment on question 3, we agree with the amendment suggested by EFRAG that clarifies that the main issue concerns the separate measurement of the embedded derivative. In principle, CESR agrees with the view that when an embedded derivative cannot be separated out from its host contract, as the exposure draft proposes, the whole hybrid financial asset should remain in the fair value through profit or loss category. With regards to the methodology that should be applied in separating the embedded derivative out from the host contract, CESR believes that separation should be required when the embedded derivative can be measured separately both in a direct way and indirect way (i.e. using a residual method instead of a direct method). Paragraph 13 of IAS 39 allows for a residual method to be applied to the embedded derivative. The current wording chosen by EFRAG in paragraph 16 of the draft comment letter might be understood as putting the emphasis on a direct valuation method only. CESR is of the view that this fact should be clarified. As regards the reliability of measurement, EFRAG is proposing to delete the reference to this criterion, and is proposing to replace it with one dealing with the ability to separate out the embedded derivative. CESR is of the opinion that both criteria are important and that the amended paragraph BC8 should refer to both.

6. As regards the proposed effective date and transition requirements, CESR fully supports the proposal made by EFRAG that, for reasons of consistency, the amendments under consideration should be required in the same manner and under the same timing as the October 2008 amendments allowing the reclassification of certain financial instruments out of the fair value through profit or loss category.

I would be happy to discuss any of these issues further with you.

Yours sincerely,

Fernando Restoy
Chair of CESR-Fin