

Introduction and Invitation to Comment

In this exposure draft the International Accounting Standards Board proposes to amend the definition of a derivative in IAS 39 *Financial Instruments: Recognition and Measurement*. The definition excludes contracts linked to non-financial variables that are specific to a party to the contract. The proposed amendment would remove the exclusion. As a result, contracts linked to non-financial variables specific to a party to the contract that are within the scope of IAS 39 would be classified as derivatives.

The Board invites comments on the proposed amendments to IAS 39. It would particularly welcome answers to the question set out below. Comments are most helpful if they indicate the specific paragraph, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

The Board is not requesting comments on matters in IAS 39 not addressed in the exposure draft.

Question

Do you agree with the proposal to amend IAS 39 by removing from the definition of a derivative the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract? If not, why?

Proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement*

In the Standard, paragraph 9 is amended and paragraph AG12A of the Application Guidance is deleted (deleted text is struck through)

9 The following terms are used in this Standard with the meanings specified:

Definition of a derivative

A derivative is a ~~financial instrument or other contract~~ within the scope of this Standard (see paragraphs 2–7) with all three of the following characteristics:

- (a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, ~~provided in the case of a non-financial variable that the variable is not specific to a party to the contract~~ (sometimes called the ‘underlying’);**
- (b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and**
- (c) it is settled at a future date.**

~~AG12A The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car’s physical condition, the change in that residual value is specific to the owner of the car.~~

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

Definition of a Derivative

- BC1 The definition of a derivative in IAS 39 *Financial Instruments: Recognition and Measurement* excludes contracts whose value changes in response to a non-financial variable that is specific to a party to the contract. The International Accounting Standards Board introduced this exclusion when it issued IFRS 4 *Insurance Contracts* in order to exclude from the scope of IAS 39 contracts within the scope of IFRS 4. Since then, the International Financial Reporting Interpretations Committee (IFRIC) has informed the Board that it has received representations that the revised wording is creating diversity in practice because in some situations it is unclear whether contracts within the scope of IAS 39 meet the definition of a derivative.
- BC2 In order to determine whether a contract within the scope of IAS 39 is a derivative, an entity needs to assess (among other things) whether the value of the contract changes in response to a non-financial variable that is specific to a party to the contract. If it does, the contract is not a derivative. On reconsidering the matter, however, the Board concluded that this condition is unnecessary in determining whether a contract within the scope of IAS 39 is a derivative. Therefore, in response to a request from the IFRIC the Board proposes to remove the exclusion relating to non-financial variables that are specific to a party to the contract.
- BC3 The Board observes that the proposed amendment would not affect the scope of IAS 39, because contracts within the scope of IFRS 4 are excluded from IAS 39 by paragraph 2(e) of IAS 39.
- BC4 The definition of financial risk in IFRS 4 mirrors the definition of a derivative in IAS 39. The Board does not propose to change the definition of financial risk to remove the reference to non-financial variables. This is because this distinction is relevant in determining whether a contract is an insurance contract.