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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels,



Draft

**COMMISSION REGULATION (EC) No .../..**

**amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as regards International Financial Reporting Standard No 1 and International Accounting Standards Nos. 32 and 39**

**(Text with EEA relevance)**

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community.

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards<sup>1</sup>, and in particular Article 3 (1) thereof,

Whereas:

- (1) By Commission Regulation (EC) No 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council<sup>2</sup> all international standards and interpretations that were extant at 14 September 2002 except International Accounting Standards (IAS) 32, IAS 39 and the related interpretations were adopted. In the cases of IAS 32 and IAS 39, the degree of amendment was considered so important that it was considered inappropriate to adopt the extant versions of these standards at that time.

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<sup>1</sup> OJ L 243, 11.9.2002 p. 1

<sup>2</sup> OJ L 261, 13.10.2003, p.1 Regulation as last amended by Regulation (EC) No 211/2005 (OJ L 41, 11.2.2005, p. 1)

- (2) On 17 December 2003 the International Accounting Standard Board (IASB) published revised IAS 39 Financial Instruments: Recognition and Measurement as part of the IASB's initiative to improve fifteen standards in time for them to be used by companies adopting IAS for the first time in 2005. The purpose of the revision was the further improvement of the quality and consistency of the body of existing IASs.
- (3) IAS 39 as revised in December 2003 introduced an option that permitted entities to designate irrevocably on initial recognition any financial asset or financial liability as one to be measured at fair value with gains and losses recognised in profit or loss (the full "Fair Value Option"). However, the European Central Bank (ECB), prudential supervisors represented in the Basel Committee as well as security regulators expressed concerns that an unrestricted fair value option might be used inappropriately, in particular for financial instruments relating to a company's own liabilities.
- (4) The IASB recognised these concerns and therefore published an Exposure Draft on 21 April 2004 proposing an amendment to IAS 39 in order to restrict the scope of the fair value option.
- (5) In order to have substantive accounting guidance on financial instruments in time for application in 2005, the Commission endorsed IAS 39 with the exclusion of certain provisions relating to the full Fair Value Option and hedge accounting, by Commission Regulation (EC) 2086/2004 of 19 November 2004 amending Regulation (EC) No 1725/2003 on the adoption of certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards the insertion of IAS 39<sup>3</sup>. The Commission considered this exclusion as exceptional and of a temporary nature pending resolution of the outstanding issues by further consultation and discussion.
- (6) In the light of the comments received to the Exposure Draft published on 21 April 2004 and further discussions, in particular with the ECB and the Basle Committee, as well as a series of roundtables with interested parties in March 2005, the IASB published on 16 June 2005, Amendments to IAS 39 Financial Instruments, Recognition and measurement: The Fair Value Option.
- (7) The revised IAS 39 Fair Value Option restricts application to situations where this results in more relevant information, because it either eliminates or reduces significantly a measurement or recognition inconsistency ("accounting mismatch"); or a group of financial assets or financial liabilities or both is managed in accordance with a documented risk management or investment strategy. In addition, the revised Fair Value Option permits an entire combined contract containing one or more embedded derivatives to be designated as a financial asset or financial liability at fair value through profit or loss in certain circumstances. Consequently, the application of the revised Fair Value Option is restricted to cases where certain principles or circumstances must be respected. Investments in equity instruments that do not have a quoted market

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<sup>3</sup> OJ L 363, 9.12.2004 p.1,

price in an active market, and whose fair value cannot be reliably measured, shall not be designated as at fair value through profit or loss. Lastly, application should be supported by adequate disclosure.

- (8) Therefore, the provisions relating to the application of the fair value option to financial liabilities, which were excluded under Regulation (EC) No 2086/2004 should be inserted. Furthermore, the full fair value option with regard to financial assets as endorsed by Regulation (EC) No 2086/2004 should also be subject to a principles based approach.
- (9) The IASB acknowledges that for the purposes of prudential supervision, the revised standard does not prevent prudential supervisors from evaluating the rigour of the fair value measurement practices of a regulated financial institution and the robustness of its underlying risk management strategies, policies and practices and from taking appropriate action. Furthermore, the IASB agrees that certain disclosures would assist prudential supervisors in their evaluation of capital requirements. This is particularly the case regarding the recognition of gains arising from deterioration in own credit standing which are to be further studied within the context of broader improvements to IAS 39.
- (10) The adoption of amendments to IAS 39 implies, by way of consequence, amendments to IFRS 1 and IAS 32 in order to ensure consistency between the accounting standards concerned.
- (11) In the light of the new principles based approach to the fair value option and the need for first time adopters to provide more meaningful initial financial statements and comparative information, it is appropriate to provide for the retroactive application of this Regulation as from 1. January 2005.
- (12) The consultation with technical experts in the field confirms that International Accounting Standard (IAS) *Amendments to IAS 39 Financial Instruments: Recognition and Measurement, the fair value option* meets the technical criteria for adoption set out in Article 3 of Regulation (EC) No 1606/2002, and in particular the requirement of being conducive to the European public good.
- (13) Regulation (EC) No 1725/2003 should therefore be amended accordingly.
- (14) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee,

HAS ADOPTED THIS REGULATION:

#### *Article 1*

The Annex to Regulation (EC) No 1725/2003 is amended as follows:

- (1) International Accounting Standard (IAS) 39 is amended as set out in point A of Annex I to this Regulation;

- (2) The text of “International Accounting Standard (IAS) *Amendments to IAS 39 Financial Instruments: Recognition and Measurement, the fair value option*” as set out in point B of Annex I to this Regulation, is added to IAS 39.
- (3) International Financial Reporting Standard (IFRS) 1 and IAS 32 are amended as set out in Annex I B to this Regulation.

## *Article 2*

This Regulation shall enter into force on the third day following that of its publication in the *Official Journal of the European Union*.

It shall apply from 1 January 2005.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, [...]

*For the Commission*  
*Charlie McCREEVY*  
*Member of the Commission*

## ANNEX I

A International Accounting Standard No 39 *Financial Instruments: Recognition and Measurement* is amended as follows:

(a) in paragraph 35 the following text is inserted::

“If the transferred asset is measured at amortised cost, the option in this Standard to designate a financial liability as at fair value through profit or loss is not applicable to the associated liability.”

(b) in Appendix A, Application Guidance, the text of AG 31 is replaced by the following text:

“An example of a hybrid instrument is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a ‘puttable instrument’). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through profit or loss, it is required to separate an embedded derivative (ie the indexed principal payment) under paragraph 11 because the host contract is a debt instrument under paragraph AG27 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG30(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.”

B. The following text is added to IAS 39:

<b>INTERNATIONAL ACCOUNTING STANDARDS</b>	
<b>IAS No</b>	<b>Title</b>
IAS 39	<b><i>Financial Instruments: Recognition and Measurement</i> with the addition of the provisions on the use of the fair value option</b>

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