FASB Emerging Issues Task Force

Issue No. 07-5

Title: Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity's Own Stock

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Previously distributed EITF materials: None

References:

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115)

FASB Statement No. 123 (revised 2004), *Share-Based Payment* (FAS 123(R))

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133)

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (FAS 150)

FASB Statement No. 154, *Accounting Changes and Error Corrections* (FAS 154)

APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14)

Proposed FSP APB 14-a, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" (proposed FSP APB 14-a)

*** The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

International Accounting Standard 32, *Financial Instruments: Disclosure and Presentation* (IAS 32)

EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" (Issue 98-5)

EITF Issue No. 99-1, "Accounting for Debt Convertible into the Stock of a Consolidated Subsidiary" (Issue 99-1)

EITF Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary" (Issue 00-6)

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" (Issue 00-19)

EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments" (Issue 00-27)

EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock'" (Issue 01-6)

EITF Issue 02-D, "The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a) of FASB Statement No. 133" (Issue 02-D)

EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share" (Issue 04-8)

EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in Issue No. 00-19" (Issue 05-2)

EITF Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133" (Issue 06-7)

Statement 133 Implementation Issue No. C8, "Scope Exceptions: Derivatives That Are Indexed to both an Entity's Own Stock and Currency Exchange Rates" (DIG Issue C8)

Proposed Statement 133 Implementation Issue No. C21, "Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity's Own Stock and Currency Exchange Rates" (proposed DIG Issue C21)

Background

1. Paragraph 11(a) of FAS 133 specifies that a contract issued or held by the reporting entity that is **both** (a) indexed to its own stock **and** (b) classified in stockholders' equity in its statement of financial position shall not be considered a derivative financial instrument for purposes of applying that Statement. If a freestanding financial instrument (for example, a stock purchase warrant) meets the scope exception in paragraph 11(a) of FAS 133, it is classified as an equity instrument and is not accounted for as a derivative instrument.

2. Paragraph 12 of FAS 133 requires that an embedded derivative instrument be separated from the host contract and accounted for as a derivative instrument pursuant to that Statement if certain criteria are met. One of those criteria, set forth in paragraph 12(c), is that a separate instrument with the same terms as the embedded derivative instrument would, pursuant to paragraphs 6–11 of that Statement, be a derivative instrument subject to the requirements of FAS 133. Consequently, if an embedded feature (for example, the conversion option embedded in a convertible debt instrument) meets the scope exception in paragraph 11(a) of FAS 133, it would not be separated from the host contract and accounted for as a derivative by the issuer.

3. This Issue addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of FAS 133. If an instrument (or an embedded feature) that has the characteristics of a derivative instrument under paragraphs 6–9 of FAS 133 is indexed to an entity's own stock, it is still necessary to evaluate whether it is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). For example, a net-cash-settled stock purchase warrant may be indexed to an entity's own stock, but it is not classified in stockholders' equity. Other applicable U.S. generally accepted accounting principles (U.S. GAAP), including Issues 00-19 and 05-2, provide guidance for determining whether an instrument (or an embedded feature) is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). This Issue does not address that second part of the scope exception in paragraph 11(a) of FAS 133.

4. In addition, some instruments that are potentially subject to the guidance in Issue 00-19 do not have all the characteristics of a derivative instrument under paragraphs 6–9 of FAS 133. For example, a physically-settled forward contract to issue a fixed number of shares in exchange for cash would not meet the net-settlement characteristic of a derivative instrument, as described in paragraphs 6(c) and 9 of FAS 133, if the entity's underlying equity shares are not readily convertible to cash. Provided that the forward contract is considered to be indexed to the entity's own stock, it would be evaluated under Issue 00-19 to determine whether it should be classified in equity or as an asset or a liability. However, if the terms of the forward contract in that example were such that the contract was not considered to be indexed to the entity's own stock, equity classification would be precluded and the instrument would not be within the scope of Issue 00-19 (that Issue provides accounting guidance for instruments that are **indexed to**, and potentially settled in, the issuer's own stock). Consequently, for certain freestanding instruments that do not have all the characteristics of a derivative instrument under paragraphs 6–9 of FAS 133, this Issue is relevant in deciding whether they are within the scope of Issue 00-19.

5. There is a vast array of instruments and features that potentially would be affected by this Issue. Those include freestanding financial instruments such as written and purchased options on an entity's own shares and forward contracts to issue an entity's own shares (including forward contracts entered into as part of an accelerated share repurchase program), regardless of whether those freestanding instruments have all the characteristics of a derivative instrument in paragraphs 6–9 of FAS 133. Additionally, this Issue potentially would affect (a) convertible debt instruments and (b) convertible preferred stock with a host contract that is more akin to debt than equity, provided that the conversion option embedded in those instruments has all the characteristics of a derivative instrument in paragraphs 6–9 of FAS 133. This Issue would not affect the classification and measurement of freestanding financial instruments under paragraphs 11–12 of FAS 150 (for example, put options on an entity's own shares, warrants to acquire an entity's own shares that are redeemable, and forward contracts to purchase an entity's own shares). Those instruments are classified as liabilities (or assets in some circumstances) under FAS 150 and are not evaluated under paragraph 11(a) of FAS 133 or under Issue 00-19.

6. An overview of accounting literature that provides guidance regarding the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock is included in Exhibit 07-5A. In many cases, the scope of that literature addresses the meaning of "indexed to an entity's own stock" within the context of specific instruments or limited subsets of instruments with specified characteristics. For example, the scope of Issue 01-6 applies to instruments for which exercisability is based on the issuing company's stock price and one or more defined contingencies provided that once the contingencies have occurred, the instrument's settlement amount is based solely on the issuing company's stock. That Issue does not provide guidance for evaluating whether instruments (a) without contingent exercise provisions and/or (b) for which some part of the settlement amount could be based on one or more variables other than the issuer's stock price are indexed to an entity's own stock. Consequently, some believe that the current guidance for determining whether instruments and embedded features are indexed to an entity's own stock is inadequate to address the various types of instruments and embedded features encountered in practice. In response to those concerns, this Issue was added to the EITF's agenda with the objective of developing a broad-based framework for evaluating different types of instruments and features.

Scope

7. This Issue applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative in paragraphs 6–9 of FAS 133, for purposes of determining whether that instrument or embedded feature qualifies for the first part of the scope exception in paragraph 11(a) of FAS 133. This Issue also applies to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative in paragraphs 6–9 of FAS 133, for purposes of determining whether the instrument is within the scope of Issue 00-19.

8. This Issue does not apply to share-based payment awards within the scope of FAS 123(R) for purposes of determining whether instruments are classified as liability awards or equity awards under that Statement.

Accounting Issues and Alternatives

9. To facilitate the Task Force's consideration of the various types of instruments and embedded features that are within the scope of this Issue, three general categories of instruments and embedded features have been identified below. This Issue Summary contains alternative views that have been tailored for each of those categories. The three categories have been segregated based on whether the **settlement amount** will be affected by variables other than the entity's stock price. For Category 1 instruments, exercisability is affected by one or more variables other than the entity's stock price, but such variables do not affect the settlement amount. For Category 2 instruments, the settlement amount is always affected by one or more variables other than the entity's stock price (or the party acquiring the entity's shares can elect to settle using consideration whose value is affected by variables other than the entity's stock price). For Category 3 instruments, the settlement amount may or may not be affected by one or more variables other than the entity's stock price, depending on the outcome of a contingent event or other condition. For purposes of this Issue Summary, the term "settlement amount" refers to the net amount paid to or received from the counterparty at settlement (including interim settlements), exclusive of transaction costs and any initial premium paid or received.

<u>Category 1</u>

Instruments and embedded features for which exercisability is based on changes in the issuing company's stock price and one or more defined contingencies provided that once a contingency has occurred, the instrument's settlement amount is based solely on the difference between the fair value of the entity's stock and a fixed strike price. Category 1 encompasses instruments that contain contingent exercise features that affect the fair value of the instrument prior to the contingency being met, but that do not have any affect on the settlement amount if the instrument is exercised.

A warrant that permits the holder to buy 100 shares of the issuer's stock for a fixed amount of cash only if the S&P 500 increases by 500 points before the expiration date of the warrant is a freestanding Category 1 instrument. For purposes of this Issue, a convertible debt instrument denominated in the issuer's functional currency that permits the holder to convert into 100 shares of the issuer's stock only if LIBOR either increases or decreases by 150 basis points before the maturity date of the debt, contains an embedded Category 1 feature. See further discussion of convertible debt instruments under Category 2 below.

Category 2

Instruments and embedded features for which (a) the settlement amount is always based on the entity's stock price and one or more other variables or (b) the party receiving shares at settlement has a noncontingent option to deliver noncash consideration whose fair value is affected by one or more variables other than the entity's stock price.

A warrant to acquire a fixed number of the issuer's equity shares with an exercise price that is denominated in a currency other than the issuer's functional currency is a freestanding Category 2 instrument because the settlement amount is affected by currency exchange rates (that is, the issuer has a foreign currency exposure). In contrast, a warrant to acquire a fixed number of the issuer's equity shares with a fixed exercise price that is denominated in the issuer's functional currency would not be a Category 2 instrument, even if the underlying shares are traded only on an exchange (or other established marketplace) on which trades are not executed in the issuer's functional currency. An equity share is not inherently "denominated" in a particular currency, so the currency in which the shares are traded does not affect the settlement amount for purposes of determining whether the warrant is indexed to an entity's own stock.

A warrant that permits the holder to purchase 100 shares of the issuer's stock for (a) $1,000 cash or (b) a fixed quantity of gold is a freestanding Category 2 instrument. In contrast, a warrant that permits the holder to purchase 100 shares of the issuer's stock for (a) $1,000 cash or (b) a variable quantity of gold whose fair value is always equal to $1,000 at the exercise date is not a Category 2 instrument.

Another example of a freestanding Category 2 instrument is a market-based employee stock option valuation instrument that requires the issuer to make quarterly payments to the holder that are determined based on the stock option exercise behavior of the specific employees that comprise the reference pool of underlying option holders.[1]

Evaluating the Variables Affecting Settlement of an Embedded Conversion Option – FAS 133 Considerations

Upon exercise of a conversion option embedded in a fixed-rate, functional-currency-denominated debt instrument prior to its contractual maturity, the settlement amount is always affected by market interest rates and the issuer's credit standing, in addition to the entity's stock price. That is because the consideration received by the issuer upon exercise is the settlement of a debt obligation, rather than the receipt of a fixed cash payment. However, implicit in the guidance in paragraphs 61(k) and 199 of FAS 133 is a presumption that it is not necessary for an entity to consider the inherent effect of interest rates and credit risk associated with the debt host when evaluating whether an embedded conversion option qualifies for the scope exception in paragraph 11(a) of FAS 133. Accordingly, the conversion option embedded in a functional-currency denominated convertible debt instrument with a fixed conversion ratio is not characterized as a Category 2 feature for purposes of this Issue. However, other variables that would affect the settlement amount upon exercise of an embedded conversion option would cause it to be characterized as a Category 2 feature. For example, a convertible debt instrument that is denominated in a currency other than the issuer's functional currency and permits the holder to convert into 100 shares of the issuer's stock would be considered to contain an embedded Category 2 feature because the settlement amount is affected by currency exchange rates. That is, the issuer has a foreign currency exposure relating to the exercise price of the conversion option because the debt obligation that is settled upon conversion is denominated in a foreign currency.

[1] A market-based employee stock option valuation instrument is a tracking security that makes periodic payments to investors that are a function of the net intrinsic value received by a pool of employees of the issuing entity, based on actual stock option exercises by those employees. Such instruments are auctioned to third-party investors with the objective of providing a market-based measure of the grant-date fair value of employee stock options under FAS 123(R). For further information, see a memorandum from the SEC's Office of Economic Analysis, dated August 31, 2005 (http://www.sec.gov/news/extra/memo083105.htm) and see memoranda from the SEC's Office of the Chief Accountant dated January 25, 2007 (http://www.sec.gov/info/accountants/staffletters/zions012507.pdf) and February 23, 2007 (http://www.sec.gov/info/accountants/staffletters/cii022307.htm).

For purposes of categorizing instruments under this Issue, the implicit exception for market interest rates and credit based on the guidance in paragraphs 61(k) and 199 of FAS 133 is not extended beyond embedded conversion options. For example, a freestanding warrant that, upon exercise, permits the holder to remit (a) a fixed amount of cash or (b) a fixed rate debt instrument with a principal amount equal to the exercise price of the warrant would be a Category 2 instrument. That instrument provides the holder with a noncontingent option to satisfy the exercise price by tendering a debt instrument whose value is affected by interest rates and the issuer's credit standing.

<u>Category 3</u>

Instruments and embedded features for which the settlement amount is based solely on the difference between the fair value of the issuing company's stock and a fixed strike price unless a defined contingency occurs or specified condition is met (including a condition relating to the issuer's share price at settlement). Upon occurrence of the contingent event or other condition, the settlement amount is based on the entity's stock price and one or more other variables. Category 3 encompasses instruments and embedded features for which the settlement amount **may or may not** be affected by a variable other than the company's stock price. A Category 3 instrument may be settled immediately upon the occurrence of a contingency that causes the settlement amount to be affected by one or more variables other than the entity's share price or it may be settled at a later date.

A net-settleable forward contract to issue the entity's equity shares that has a fixed strike price unless a contingent event (for example, a change in control) occurs prior to the contractual settlement date, is a freestanding Category 3 instrument. Upon occurrence of such a contingent event, the counterparty is permitted to elect to early terminate the contract, in which case the settlement amount may be adjusted by a calculation agent (which is often the counterparty to the contract). Adjustments to the settlement terms must be made using commercially reasonable procedures and may include, at the calculation agent's discretion, adjustments (a) to reflect changes in (1) the entity's stock price volatility, (2) expected dividends on the entity's shares, (3) the stock loan rate for the entity's shares, and (4) liquidity relevant to the entity's shares and (b) to reimburse the counterparty for its hedge termination costs.[2]

An example of an embedded Category 3 feature would be a conversion option embedded in a debt instrument that is denominated in the issuer's functional currency and provides for an adjustment to the conversion rate if a change-in-control occurs before a specified date. Such conversion rate adjustment provisions, which the FASB staff understands are standard terms in the majority of convertible debt issuances, are sometimes referred to as "make-whole" features. Under current U.S. GAAP, if an entity concludes that the conversion option embedded in a convertible instrument with a contingently adjustable conversion ratio does not require bifurcation under FAS 133, the instrument must be evaluated under Issues 98-5 and 00-27 to determine whether the instrument contains a contingent beneficial conversion feature.

10. **The category numbers (that is, Categories 1, 2, and 3) are used solely for convenience in referring to instruments with certain characteristics throughout this Issue Summary.** The abstract for this Issue will use the full descriptions of those characteristics to describe the Issues discussed and any conclusions reached by the Task Force; it would not include references to these category numbers.

Issue 1: How an entity should determine whether a Category 1 instrument or embedded feature is indexed to its own stock.

View A: Category 1 instruments or embedded features are considered to be "indexed to an entity's own stock" provided that their contingency provisions are ***not*** *based on (a) an observable market, other than the market for the entity's stock (if applicable), or (b) an observable index, other than those calculated solely by reference to the entity's own operations (for example, sales revenue of the entity, EBITDA [earnings before interest, taxes, depreciation,*

[2] For more information about the contract adjustment terms described in this paragraph, refer to the discussion of this Issue in the July 20, 2007 EITF Agenda Committee Report (proposed Issue 1 in that report).

and amortization] of the entity, net income of the entity, or total equity of the entity). *<u>This view is consistent with the existing consensus in Issue 01-6.</u>*

11. View A proponents believe that, when evaluating whether an instrument is indexed to an entity's own stock, the factors to be considered should not be limited to variables that affect the settlement amount. Those proponents believe it is also necessary to consider variables that affect the fair value of the instrument prior to its settlement. For example, View A proponents believe that an instrument that is only exercisable if (a) LIBOR increases 100 basis points, (b) the Euro exchange rate increases by a certain amount, (c) the price of tea in China decreases by a certain percentage, or (d) the S&P 500 index increases by a certain percentage, should not be considered indexed to a company's own stock before the contingency is met, even though such factors would not affect the settlement amount once the contingent event has occurred and the instrument is exercised. However, View A proponents acknowledge that certain contingencies relating to instruments within the scope of this Issue may be intended to provide protection for either the holder or the issuer (for example, exercise is contingent upon a change in control, the filing of an IPO, a significant asset disposition, or a downgrade in the issuer's credit rating). Those proponents believe that, except for exercise contingencies based on an observable market or an observable index unrelated to the issuer's share price or results of operations, exercise contingencies that do not affect the settlement amount should not preclude a determination that the instrument is indexed to the entity's own stock.

View B: Category 1 instruments or embedded features are ***not*** *considered to be "indexed to an entity's own stock" unless the exercise contingency is based solely on the fair value of the underlying equity shares.*

12. View B proponents believe that any exercise contingency other than a share price contingency should preclude a determination that an instrument is indexed to the entity's own stock. Those proponents observe that substantive exercise contingencies affect the fair value of an instrument before the contingency is resolved because of the possibility that the contingent event will not occur. Those proponents do not believe that the reason for an exercise contingency (for example, to provide protection to the holder) is relevant to the determination of

whether the related instrument is indexed to the entity's own stock. View B proponents refer to the discussion in paragraph B46 of FAS 150, which refers to dual-indexed share-settled instruments as "instruments whose value is tied not only to an issuer's equity shares but also to something else." Those proponents also refer to the discussion in paragraph A53 of FAS 123(R), which indicates that an award that will vest based on the appreciation in the price of a commodity such as gold is an example of an award that is indexed to both the value of that commodity and the entity's own shares. Additionally, proponents of View B refer to paragraph 286 of FAS 133 and to DIG Issue C8, which state that paragraph 11(a)(1) of FAS 133 is applicable to contracts that are indexed **only** to the issuer's own stock. Because contingent exercise provisions affect an instrument's fair value, View B proponents believe that instruments containing those provisions are not indexed only to an entity's own stock before the contingency is met. Many instruments and embedded features within the scope of this Issue contain exercise contingencies other than share price contingencies. For example, contingently convertible debt instruments (Co-Cos) generally contain multiple contingent exercise provisions in addition to the share price contingency (referred to as a "market price trigger" in Issue 04-8). Consequently, View B would significantly reduce the population of instruments that would be considered to be indexed to an entity's own stock, as compared to the existing consensus in Issue 01-6.

View C: All Category 1 instruments or embedded features are considered to be "indexed to an entity's own stock."

13. View C proponents believe that the only relevant factor for assessing whether an instrument is indexed to an entity's own stock should be the variables on which the ultimate settlement of the instrument is based. Accordingly, those proponents believe that exercise contingencies should be disregarded for purposes of evaluating whether an instrument is indexed to an entity's own stock. View C proponents observe that, prior to settlement, the fair value of any option or forward contract is affected by variables other than the entity's stock price (for example, interest rates). Those proponents believe that there are limited financial reporting benefits to be derived from assessing whether or not different types of exercise contingencies preclude an instrument from being considered indexed to an entity's own stock.

14. Additionally, View C proponents observe that there are inconsistencies in practice with respect to the evaluation of contingent exercise provisions under Issue 01-6. For example, some believe that an exercise contingency based on a downgrade to the issuer's credit rating does not affect the evaluation of whether an instrument is indexed solely to an entity's own stock, while others disagree. Proponents of View C believe that complexity would be reduced if the Task Force reached a consensus that the evaluation of whether an instrument is indexed to an entity's own stock is based solely on variables affecting the settlement amount. View C would increase the population of instruments that would be considered to be indexed to an entity's own stock, as compared to the existing consensus in Issue 01-6.

Issue 2: How an entity should determine whether a Category 2 instrument or embedded feature is indexed to its own stock.

View A: Category 2 instruments or embedded features are considered to be "indexed to an entity's own stock" provided that their settlement amounts are ***not*** *affected by one or more variables based on (a) an observable market, other than the market for the entity's stock (if applicable), or (b) an observable index, other than those calculated solely by reference to the entity's own operations (for example, sales revenue of the entity, EBITDA of the entity, net income of the entity, or total equity of the entity).*

15. Proponents of View A on Issue 2 believe that the existing guidance in Issue 01-6, which currently applies to exercise contingencies that do **not** affect the settlement amount once the contingent event has occurred, should be expanded to apply to instruments for which the settlement amount is affected by variables other than the entity's share price. Those proponents observe that FAS 150 provides guidance limiting the extent to which an instrument's settlement amount can be affected by variables other than an entity's share price before equity classification would be precluded. If, at inception, the monetary value of a freestanding share-settleable instrument is predominantly based on variations in something other than the issuer's equity shares, the instrument would be classified as a liability (or an asset in some circumstances) under paragraph 12(b) of FAS 150.

16. View A represents a broad view of the instruments that should be considered indexed to an entity's own stock. Under View A, variables that directly affect the settlement amount do not preclude equity classification unless they are based on an observable market or an observable index, other than the market for the issuer's stock or an index based on the issuer's operations. For example, a market-based employee stock option valuation instrument that requires the issuer to make quarterly payments to the holder based on the stock option exercise behavior of the specific employees who comprise the reference pool of underlying option holders would be considered indexed to the issuer's own stock under View A. However, a warrant that is exercisable for a fixed amount of a currency other than the issuer's functional currency would not be considered indexed to the entity's own stock because the settlement amount is affected by a variable that is based on an observable index (currency exchange rates).

17. Opponents of View A observe that this approach has the potential to significantly increase the population of instruments that qualify for equity classification, even in circumstances in which the counterparty's payoff may not be highly correlated with the return that would be earned over the same period by an equity shareholder. For example, a warrant to purchase an entity's equity shares that provides for adjustments to either the exercise price or the number of shares issuable upon exercise based on changes in the entity's revenues would be considered indexed to the entity's own stock under View A. Given the FASB Board's decision to characterize a narrow view of equity (the "ownership" approach) as its preferred approach in the forthcoming Preliminary Views due process document for the liabilities and equity project, View A opponents believe that it would not be appropriate for the Task Force to support an alternative that could significantly expand the population of instruments qualifying for equity classification.

View B: Category 2 instruments or embedded features are ***not*** *considered to be "indexed to an entity's own stock."*

18. View B proponents believe that an instrument is not indexed to an entity's own stock if the settlement amount is affected by variables other than the entity's share price. Those proponents refer to paragraph 286 of FAS 133 and to DIG Issue C8, which clarify that paragraph 11(a)(1) of FAS 133 should be understood to be applicable to contracts that are indexed **only** to the issuer's

own stock. Therefore, if (a) the settlement amount of an instrument is always based on the entity's stock price and one or more other variables or (b) the party receiving shares at settlement has a noncontingent option to deliver noncash consideration whose fair value is affected by one or more variables other than the entity's stock price, View B proponents would conclude that the instrument is not indexed to the entity's own stock. Those proponents believe that this approach is the least complex of the alternatives for Category 2 instruments and embedded features because it is not necessary to evaluate the nature or significance of variables that affect the settlement amount.

View C: Category 2 instruments or embedded features are not considered to be "indexed to an entity's own stock" unless the only variable (or variables) that affects the settlement amount (other than the issuer's stock price) would be an input (or inputs) to a fair value measurement of any option or forward contract on equity shares (for example, interest rates).

19. View C proponents generally agree with proponents of View B that an instrument is not indexed to an entity's own stock if the settlement amount is affected by variables other than the entity's share price. However, View C proponents believe that an exception should be made when the settlement amount is affected by the same variables that determined the initial pricing of the instrument. For example, View C proponents assert that the forward price in a forward contract to issue an entity's equity shares is determined based on the following formula: [Forward Price = Spot Price of the Shares + Interest – (Expected Dividends + Stock Borrowing Cost)]. Those proponents observe that prior to settlement, the fair value of a forward contract to issue equity shares is impacted by changes in market interest rates, even though the number of shares issuable at settlement and the forward price are fixed. Those proponents believe that a forward contract to issue an entity's equity shares for which the forward price is adjusted based on changes in market interest rates should not be precluded from qualifying for equity classification. View C proponents assert that changes in the fair value of such variable-rate forward contracts prior to settlement are more closely correlated to the unrealized return of an equity shareholder, because the effect of interest rate changes on the fair value of the contract is mitigated through the variable forward price.

20. The FASB staff observes that, if the Task Force supports View C on Issue 2, that approach may require further development for consideration at a subsequent EITF meeting. For example, the Task Force may decide that it is necessary to exclude instruments with settlement amounts that are adjusted for changes in variables that would be inputs to the measurement of any option or forward contract on equity shares if those changes are multiplied by a leverage factor.

Issue 3: How an entity should determine whether a Category 3 instrument or embedded feature is indexed to its own stock.

View A: Assess the probability that the contingency will occur, resulting in a settlement amount that is based on the entity's stock price and one or more other variables. If the contingent event is ***remote****, the instrument or embedded feature is considered to be indexed to the entity's own stock. If the contingent event is* ***more-than-remote****, evaluate the instrument or embedded feature based on the guidance in Issue 2. Each reporting period, the entity must evaluate the probability that the contingent event will occur prior to the expiration of the contract and would reclassify the instrument or embedded feature when the entity changes its assessment of whether the contingency is* ***remote****. If there are multiple contingencies that may result in a settlement amount that is based on the entity's stock price and one or more other variables, the entity would evaluate whether it is* ***more-than-remote*** *that any of those contingent events will occur.*

21. View A proponents believe that the evaluation of whether an instrument is indexed to an entity's own stock should not be affected by remote features. Consequently, if the settlement amount of an instrument within the scope of this Issue is based on a fixed exercise price and a fixed number of the entity's equity shares except in circumstances in which a remote contingency occurs, View A proponents would disregard that contingent feature. However, the entity would be required to reassess the probability of that contingent event occurring each reporting period and the instrument would become subject to the guidance for Category 2 instruments if the contingent event were assessed as more-than-remote. If an instrument is reclassified from an asset or a liability to equity, gains or losses recorded to account for the contract at fair value during the period that the contract was classified as an asset or liability should not be reversed. If an instrument is reclassified from equity to an asset or a liability, the change in the fair value

of the contract during the period it was classified as equity should be accounted for as an adjustment to stockholders' equity. Those reclassification provisions are consistent with the guidance in Issue 00-19 and proposed FSP APB -14-a.

22. For example, a convertible debt instrument may contain a make-whole provision that adjusts the conversion rate if a change in control occurs within five years after the date of issuance. The adjustment to the conversion rate is determined based on a table included in the prospectus that is based on the period of time between issuance and the change-in-control transaction, as well as the issuer's share price at that time (that is, the make-whole consideration transferable through the conversion rate adjustment is reduced as the change-in-control transaction approaches Year 5 and as the entity's share price increases). If, at inception, the convertible debt issuer concludes that the possibility of a change-in-control transaction occurring within the next five years is more-than-remote, the guidance for Category 2 instruments (Issue 2 herein) would be applied. If the guidance in Issue 2 results in a conclusion that the embedded conversion option is not indexed solely to the entity's own stock, then the conversion option would initially be bifurcated under FAS 133. If a change in control does not occur and the entity subsequently concludes that it is remote that such a transaction will occur prior to Year 5, then the conversion option would be considered indexed to the entity's own stock at that time. In that circumstance, it would be evaluated under Issue 00-19 to determine whether the second part of the scope exception in paragraph 11(a) of FAS 133 is met. If the conditions for equity classification in Issue 00-19 are met at that time, the conversion option would be reclassified from a derivative liability to equity pursuant to the guidance in Issue 06-7.

View B: Assess the probability that the contingency will occur, resulting in a settlement amount that is based on the entity's stock price and one or more other variables. If it is ***more-likely-than-not*** *that the contingent event will not occur or that the condition will not be met, the instrument or embedded feature is considered to be indexed to the entity's own stock. If it is* ***more-likely-than-not*** *that the contingent event will occur or that the condition will be met, evaluate the instrument or embedded feature based on the guidance in Issue 2. Each reporting period, the entity must evaluate the probability that the contingent event will occur prior to the expiration of the contract and would reclassify the instrument or embedded feature when the* *entity changes its assessment of whether the contingency is* ***more-likely-than-not****. If there are multiple contingencies that may result in a settlement amount that is based on the entity's stock price and one or more other variables, the entity would evaluate whether it is* ***more-likely-than-not*** *that any of those contingent events will occur.*

23. View B is the same as View A, except the guidance in Issue 2 would be applied to an instrument if the contingency is more-likely-than-not instead of more-than-remote. View B proponents believe that contingency provisions in Category 3 instruments will often be more-than-remote at issuance, particularly when the term of the instrument is several years and there are multiple contingencies that may occur. Consequently, entities may initially account for the related instrument as an asset or a liability even if the contingency is not expected to occur. However, as time passes and the instrument approaches its maturity date, such instruments would then be reclassified to equity when it becomes remote that the contingency will occur (provided that the instrument meets the conditions for equity classification in Issue 00-19). Proponents of View B believe that such reclassifications are unnecessary for circumstances in which the contingency was never expected to occur in the first place. Those proponents believe that a Category 3 instrument, where the settlement amount may or may not be based on one or more variables other than the entity's stock price, should be evaluated based on its expected settlement outcome. View B would result in more instruments being considered indexed to an entity's own stock than View A and View C. However, View B proponents assert that this approach may be more consistent with current practice than View A or View C, because many instruments are currently considered to be indexed to an entity's own stock despite the existence of contingencies that could cause the settlement amount to be affected by other variables.

View C: Category 3 instruments or embedded features should be evaluated as if the contingent event were certain to occur (that is, pursuant to the guidance in Issue 2).

24. View C expands the types of instruments to be included in Category 2 and eliminates Category 3 altogether. View C proponents observe that, in many cases, contingencies that may result in the settlement amount being affected by variables other than the entity's share price may be completely or partially within the control of the entity itself. For example, a make-whole

feature may adjust the conversion rate in a convertible debt instrument if the issuer elects to call the instrument prior to a specified date. Additionally, early termination provisions in certain equity derivative contracts may be triggered, providing for adjustments to the settlement amount, if the entity increases its quarterly dividend payment to common shareholders. Proponents of View C believe that assessing the likelihood that one or more contingent events will occur when one of those contingent events is within the control of the entity making that assessment, amounts to intent-based accounting. Those proponents observe that practice difficulties have frequently arisen in applying accounting guidance that is based on an entity's intent (for example, held-to-maturity classification under FAS 115). Proponents of View C believe that complexity would be reduced if an entity were required to assume that contingencies that may affect the settlement amount will occur, because instruments that contain such contingencies (Category 3 instruments) would be evaluated using the same analysis applicable to instruments for which the settlement amount is always affected by a variable other than the entity's share price (Category 2 instruments).

25. Proponents of View C believe that contingencies that provide for an adjustment to the settlement amount of an instrument are often included in the terms of a contract to protect the counterparty from events that could diminish the value of that holder's position. Consequently, proponents of View C believe that, regardless of whether the likelihood of occurrence is remote, such provisions are substantive contractual terms with a potentially significant magnitude of impact if the related contingent event(s) were to occur. Additionally, those proponents observe that for purposes of applying the guidance in Issue 00-19 (the second part of the scope exception in paragraph 11(a) of FAS 133), **any** provision that could require net-cash settlement precludes equity classification, except in those limited circumstances in which holders of the underlying shares would also receive cash. Issue 00-19 does not allow for an evaluation of the likelihood that an event would trigger net cash settlement. Similarly, View C proponents believe that this Issue should not allow for an evaluation of the likelihood that an event would trigger settlement for an amount that is affected by one or more variables other than the entity's share price.

26. Opponents of View C believe that it is not appropriate to evaluate all contingent events as if they were certain to occur. They believe that there is a significant difference between an

instrument whose settlement amount might be affected by variables other than the entity's share price (Category 3) and an instrument whose settlement amount (a) will always be affected by a variable other than the entity's share price or (b) provides one of the parties with an option to settle by transferring consideration whose value is affected by variables other than the entity's share price (Category 2). Consequently, opponents of View C believe that the likelihood that a contingent event will affect an instrument's settlement amount is an important consideration when evaluating whether that instrument is indexed to an entity's own stock.

International Convergence

27. None of the alternative views in this Issue Summary would converge with IFRS because there is no requirement in IFRS to evaluate whether an instrument is "indexed to the entity's own stock." However, paragraph 22 of IAS 32 contains the following guidance:

> A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument…

28. The alternative views in this Issue Summary that are the most consistent with IAS 32 would be View C on Issue 1, View B on Issue 2, and View C on Issue 3. However, because of other differences between the requirements for equity classification in U.S. GAAP (Issue 00-19) and IFRS, those views would not necessarily achieve convergence for instruments within the scope of this Issue.

Interaction with Other Board Agenda Projects

29. The objective of the liabilities and equity project is to develop a comprehensive standard of accounting and reporting for financial instruments with characteristics of equity, liabilities, or both, and assets. Such a standard would likely replace existing accounting guidance for financial instruments with those characteristics, including instruments within the scope of this Issue.

30. The liabilities and equity project is being conducted under a modified joint approach with the IASB. Under that approach, the FASB's initial due process document will be in the form of a Preliminary Views, which is expected to be issued in October 2007. That document will be concurrently published by the IASB for comment by its constituents. The Boards plan to use the input received on those initial due process documents as the basis for a joint project to develop a common standard of accounting and reporting. In that joint project, the Boards will deliberate and develop a proposed Statement, to be followed by joint redeliberations and development of a common final Statement. A final statement resulting from the liabilities and equity project is not expected to have an effective date earlier than January 1, 2012, for calendar year-end companies.

31. None of the alternative approaches being considered in that project include an explicit requirement to evaluate whether an instrument or an embedded feature is "indexed to an entity's own stock." However, it is expected that a final statement resulting from the liabilities and equity project would apply to (a) basic ownership instruments (whether or not ownership instruments in legal form), (b) other legal ownership instruments, and (c) any other contract that is either **settled with** basic ownership instruments or **whose settlement may be determined by** prices of basic ownership instruments. That is, the determination of whether certain contracts are within the scope of a final statement resulting from the liabilities and equity project would require consideration of how the contract is settled. Additionally, under one of the three approaches being considered under that project (the ownership-settlement approach), equity classification would be precluded for an instrument that contains contingent exercise provisions based on (a) an observable market other than the market for the reporting entity's direct ownership instruments or (b) an observable index other than an index calculated or measured solely by reference to the reporting entity's own operations. That proposed treatment under the ownership-settlement approach is consistent with View A of Issue 1 herein and with the existing guidance in Issue 01-6.

Transition and Effective Date

32. If the Task Force reaches a consensus on View A of Issue 1, no transition guidance is required for that Issue because the existing guidance in Issue 01-6 would continue to apply. If

the Task Force reaches a consensus on View B or View C of Issue 1 or if any consensus is reached on Issues 2 and 3, the FASB staff recommends that the consensus be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application would not be permitted.

33. The Task Force will be asked to consider the following transition alternatives if a consensus is reached on View B or View C of Issue 1 or if any consensus is reached on Issues 2 and 3. The transition disclosures in paragraphs 17 and 18 of FAS 154 would be required under either alternative.

Alternative A – Retrospective Application

The consensus(es) should be applied retrospectively to all prior periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented should be recognized as of the beginning of the first period presented. An offsetting adjustment should be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period, presented separately.

Alternative B – Cumulative-Effect Adjustment to Beginning Retained Earnings

The consensus(es) should be applied to outstanding instruments as of the beginning of the fiscal year in which the consensus(es) is initially applied. The cumulative effect of the change in accounting principle should be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately.

The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before initial application of the consensus(es) and the amounts recognized in the statement of financial position at initial application of the consensus(es). The amounts recognized in the statement of financial position at initial application of the consensus(es) should be determined based on the amounts that would have been recognized if the consensus(es) had been applied from the issuance date of the instrument(s).

34. Proponents of retrospective application observe that the FASB's conceptual framework describes comparability (including consistency) as one of the qualitative characteristics of accounting information. Those proponents refer to paragraph B7 of FAS 154, which specifies that "the Board concluded that retrospective application improves financial reporting because it enhances the consistency of financial information between periods. That improved consistency enhances the usefulness of the financial statements, especially by facilitating analysis and understanding of comparative accounting data."

35. Proponents of a cumulative-effect adjustment to beginning retained earnings believe that the information needed to retrospectively apply a consensus under this Issue (including inputs to potentially complex option pricing models to determine the quarterly fair values of freestanding financial instruments and embedded features) may not be readily available in all circumstances. Additionally, those proponents believe that, even if such information were available, it may be difficult to objectively determine the period-specific fair value changes of certain instruments within the scope of this Issue. Additionally, proponents of a cumulative-effect adjustment to beginning retained earnings believe that retrospective application of a consensus under this issue may not be cost effective based on the additional data that may be required to recreate the information needed to retrospectively apply a consensus to prior periods.

Exhibit 07-5A

OVERVIEW OF RELATED ACCOUNTING LITERATURE

A1. Various accounting literature provides guidance regarding the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock. Some examples of such guidance are provided below.

FAS 123(R)

A2. A share-based payment award may be indexed to a factor in addition to the entity's share price. Paragraph 33 of FAS 123(R) specifies that liability classification is required for such awards unless the additional factor is a market condition, a performance condition, or a service condition. Paragraph A53 of FAS 123(R) contains the following examples of share-based payment awards that are subject to liability classification under that guidance:

> An award may be indexed to a factor in addition to the entity's share price…. An example would be an award of options whose exercise price is indexed to the market price of a commodity, such as gold. Another example would be a share award that will vest based on the appreciation in the price of a commodity such as gold; that award is indexed to both the value of that commodity and the issuing entity's shares…. Such an award would be classified as a liability even if the entity granting the share-based payment instrument is a producer of the commodity whose price changes are part or all of the conditions that affect an award's vesting conditions or fair value.

FAS 133

A3. Paragraph 11 of FAS 133 contains the following guidance:

> Notwithstanding the conditions of paragraphs 6–10, the reporting entity shall *not* consider the following contracts to be derivative instruments for purposes of this Statement:
>
> a. Contracts issued or held by that reporting entity that are both (1) indexed to its own stock and (2) classified in stockholders' equity in its statement of financial position….

> …In addition, a contract that an entity either can or must settle by issuing its own equity instruments but that is indexed in part or in full to something other than its own stock can be a derivative instrument for the issuer under paragraphs 6–10, in which case it would be accounted for as a liability or an asset in accordance with the requirements of this Statement.

A4. The Basis for Conclusions in FAS 133 (paragraph 286) contains the following discussion regarding the determination of whether an instrument is indexed to an entity's own stock for purposes of applying paragraph 11(a)(1) of that Statement:

> The Board considered whether this Statement should exclude instruments that an entity either can or must settle by issuing its own stock but that are indexed to something else. For example, the Board discussed whether an instrument that requires settlement in the issuer's or holder's common stock but that is indexed to changes in the S&P 500 index should be excluded from the scope of this Statement. The Board currently has a project on its agenda that considers whether certain instruments are equity or liabilities. That project will address the issue of whether instruments to be settled in the entity's stock are equity or liabilities. That project will address the issue of whether instruments to be settled in the entity's stock but indexed to something other than its stock are liabilities or equity. The Board will reconsider the application of this Statement to such contracts as necessary when that project is completed. Until that time, contracts that provide for settlement in shares of an entity's stock but that are indexed in part or in full to something other than the entity's stock are to be accounted for as derivative instruments if the contracts satisfy the criteria in paragraphs 6–10 of this Statement. Those contracts are to be classified as assets or liabilities and not as part of stockholders' equity.

FAS 150

A5. Certain share-settled obligations for which, at inception, the monetary value of the obligation is based solely or predominantly on variations in something other than the fair value of the issuer's equity shares are classified as liabilities (or assets in some circumstances) under paragraph 12(b) of FAS 150. The Basis for Conclusions in FAS 150 (paragraphs B46 and B47) contains the following discussion regarding the applicability of the guidance in that Statement to certain dual-indexed instruments.

> The scope of this Statement is limited because the Board has not completed its redeliberations on several major issues raised in the liabilities and equity Exposure Draft, one of which is the separation of instruments with characteristics

> of both liabilities and equity into components. Most issues affecting compound instruments, **including dual-indexed share-settled instruments (instruments whose value is tied not only to an issuer's equity shares but also to something else)**, therefore, are beyond the scope of this Statement. Because of that limitation, the Board initially decided that the requirements of paragraph 12 of this Statement should be limited to instruments that embody obligations, the monetary value of which is based *solely* on (a) a fixed monetary amount known at inception, (b) variations in something other than the fair value of the issuer's equity shares, and (c) variations inversely related to changes in the fair value of the issuer's equity shares. [Emphasis added in **bold**.]
>
> …the Board decided to extend the scope to include share-settled instruments whose monetary value is based solely or *predominantly* on one of the three factors in paragraph 12 of this Statement. The Board acknowledged that judgment will be required to distinguish instruments with monetary values predominantly based on one of those three factors from instruments with monetary values that are indexed both to the issuer's equity shares and to one or more other factors and, thus, are excluded from this Statement's scope.

DIG Issue C8

A6. DIG Issue C8 addresses whether a forward contract that is indexed to an entity's own stock and currency exchange rates qualifies for the exception in paragraph 11(a) of FAS 133. That Statement 133 Implementation Issue contains the following guidance:

> A forward contract that is indexed to both an entity's own stock and currency exchange rates does not qualify for the exception in paragraph 11(a) of Statement 133 with respect to that entity's accounting because the forward contract is indexed in part to something other than that entity's own stock (namely, currency exchange rates)…Paragraph 286 of Statement 133 provides the rationale for why contracts that provide for settlement in shares of an entity's stock but that are indexed in part or in full to something other than the entity's stock are to be accounted for as derivative instruments if the contracts satisfy the criteria in paragraphs 6–9 of Statement 133. Paragraph 286 makes it clear that paragraph 11(a)(1) should be understood as being applicable to contracts that are indexed *only* to the issuer's own stock.
>
> Paragraph 18 of Statement 133 prohibits separating a derivative into components based on different risks. Consequently, it would be inappropriate to bifurcate the forward contract described in the above example according to its differing exposures to changes in Company A's stock price and changes in the US$/EUR exchange rate and then attempt to apply paragraph 11(a) only to the exposure to changes in Company A's stock price. Paragraph 11(a) must be applied to the entire contract.

Proposed DIG Issue C21

A7. Proposed DIG Issue C21, which was issued for a public comment period that ended on May 24, 2007, would provide guidance on determining whether an option (including an embedded conversion option) should be considered indexed to an entity's own stock when (a) the exercise price is denominated in a currency other than the issuer's functional currency or (b) the shares issuable upon exercise are traded only on exchanges for which trades are not executed in the issuer's functional currency. The Board's decision regarding whether to move forward with a final Statement 133 Implementation Issue has been postponed to enable the Board to consider matters identified in connection with the Task Force's discussion of this Issue. That proposed Statement 133 Implementation Issue contains the following proposed guidance:

> For purposes of applying the scope exception in paragraph 11(a), an option to acquire a fixed number of an issuer's equity shares with an exercise price that is denominated in a currency other than the issuer's functional currency (including a conversion option embedded in a foreign-currency-denominated convertible debt instrument) shall be considered indexed to both the reporting entity's own stock and foreign currency exchange rates and, thus, does not meet the requirements for the scope exception in paragraph 11(a).

Issue 99-1

A8. Issue 99-1 specifies that debt issued by a parent company that is convertible into the stock of a consolidated subsidiary should be accounted for in accordance with APB 14. In reaching that consensus, the Task Force implicitly concluded that an **embedded** conversion option indexed to the stock of a consolidated subsidiary should be considered to be indexed to an entity's own stock for purposes of evaluating whether the embedded conversion option qualifies for the scope exception in paragraph 11(a) of FAS 133.

Issue 00-6

A9. Issue 00-6 specifies that freestanding derivatives indexed to, and potentially settled in, the stock of a consolidated subsidiary do not qualify for the scope exception in paragraph 11(a) of FAS 133. In reaching that consensus, the Task Force implicitly concluded that a **freestanding** financial instrument indexed to the stock of a consolidated subsidiary should not be considered to be indexed to the entity's own stock for purposes of evaluating whether the instrument qualifies for the scope exception in paragraph 11(a) of FAS 133. As a consequence of the respective consensuses in Issues 99-1 and 00-6, the evaluation of whether an instrument is indexed to the stock of a consolidated subsidiary meets the exception in paragraph 11(a) of FAS 133 is not consistent for freestanding instruments and embedded features. Currently, the FASB staff expects that the consensus in Issue 00-6 will **not** be nullified by the forthcoming FASB Statement on noncontrolling interests.

Issue 01-6

A10. The instruments addressed in Issue 01-6 are those for which exercisability is based on changes in the issuing company's stock price and one or more defined contingencies provided that once the contingencies have occurred, the instrument's settlement amount is based solely on the issuing company's own stock. For example, the guidance in Issue 01-6 applies to a warrant that entitles the holder to buy a fixed number of the issuer's equity shares in exchange for a fixed amount of cash, but for which exercisability is conditioned on the occurrence of a defined contingency. The Task Force reached a consensus in Issue 01-6 that

> instruments [within its] scope are considered *indexed to a company's own stock* within the meaning of Issue 00-19 and paragraph 11(a) of FAS 133 for the issuer provided that the **contingency provisions** are not based on (a) an observable market, other than the market for the issuer's stock (if applicable), or (b) an observable index, other than those calculated or measured solely by reference to the issuer's own operations (for example, sales revenue of the issuer, EBITDA [earnings before interest, taxes, depreciation, and amortization] of the issuer, net income of the issuer, or total equity of the issuer), and (2) **once the contingent events have occurred, the instrument's settlement amount is based solely on the issuer's stock**. [Emphasis added in **bold**.]

If either of those conditions is not met, an instrument within the scope of Issue 01-6 would not qualify for the scope exception in paragraph 11(a) of FAS 133.

A11. Notwithstanding its title, Issue 01-6 does not broadly define the meaning of "indexed to a company's own stock." Rather, for certain contingently exercisable instruments, it provides guidance for evaluating whether a contingency provision precludes an instrument from qualifying for the scope exception in paragraph 11(a) of FAS 133.

Issue 02-D

A12. Issue 02-D was added to the EITF agenda in March 2002. However, it was not brought to the Task Force for discussion at that time pending further progress in the Board's liabilities and equity project. That Issue was intended to address whether instruments, other than convertible debt, that are indexed to (a) a company's own stock, (b) interest rates, and (c) the company's credit risk meet the condition in paragraph 11(a)(1) of FAS 133. The agenda committee submission for that Issue provided two examples of freestanding financial instruments for which there were circumstances in which the exercise price could be satisfied by the counterparty tendering a debt instrument. In those examples, payment of the exercise price was based on the principal amount of the related debt instrument, rather than its fair value on the date of exercise. Therefore, the settlement amount upon exercise of the freestanding financial instrument could be affected by market interest rates and the issuer's credit risk (inputs affecting the fair value of the debt instrument that could be tendered at exercise). If the Task Force reaches a consensus on this Issue, it would apply to the instruments that were the subject of Issue 02-D.