

Proposed Accounting Standards Update

Issued: February 24, 2015
Comments Due: April 30, 2015

Derivatives and Hedging (Topic 815)

Disclosures about Hybrid Financial Instruments with
Bifurcated Embedded Derivatives

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 815 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing written comments to director@fasb.org, or sending a letter to “Technical Director, File Reference No. 2015-220, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

The *FASB Accounting Standards Codification*[®] is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by April 30, 2015. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing a written letter to director@fasb.org, File Reference No. 2015-220
- Sending written comments to “Technical Director, File Reference No. 2015-220, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

Do not send responses by fax.

All comments received are part of the FASB’s public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB’s website.

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Board is issuing this proposed Update to increase the transparency and usefulness of the information provided in the notes to financial statements about hybrid financial instruments that contain bifurcated embedded derivatives.

Currently, Topic 815, Derivatives and Hedging, does not require that an entity provide information that explicitly links bifurcated embedded derivatives (that are measured at fair value) with their related host contracts (that may be measured at amortized cost, fair value, or another measurement attribute depending on applicable accounting literature). In effect, users of financial statements often see only the bifurcated embedded derivative and related host contract disclosed separately, and they do not have the ability to trace one back to the other. Although bifurcated embedded derivatives are required to be measured separately from their host contracts under current generally accepted accounting principles (GAAP), the embedded derivatives and their related host contracts represent one legal contract. The amendments in this proposed Update would require an entity to disclose information that links each bifurcated embedded derivative to its related host contract, which would provide users of financial statements with decision-useful information that reflects the overall economics and cash flows for the entire hybrid financial instrument.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all reporting entities that are issuers of, or investors in, hybrid financial instruments with embedded derivatives that are separated from their host contracts and accounted for as derivative instruments. GAAP requires an embedded derivative to be separated from its host contract and accounted for as a derivative instrument if all of the following are met:

1. The economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract.
2. The hybrid instrument is not remeasured at fair value under otherwise applicable GAAP with changes in fair value reported in earnings as they occur.

3. A separate instrument with the same terms as the embedded derivative would be a derivative instrument subject to the requirements of Topic 815.

What Are the Main Provisions?

The amendments in this proposed Update would require that an entity disclose (in both interim and annual reporting periods) the carrying amount, measurement attribute, and line item within the balance sheet and the income statement in which each bifurcated embedded derivative and its related host contract are presented.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Current GAAP provides qualitative and quantitative disclosure requirements for derivative instruments and hedging activities that apply to all derivative instruments (including bifurcated embedded derivative instruments), nonderivative instruments that are designated and qualify as hedging instruments, and related hedged items. It requires an entity with derivatives (or nonderivative instruments that are designated and qualify as hedging instruments) to provide information about how and why an entity uses the instruments, how the instruments and related hedged items are accounted for, and how the instruments and related hedged items affect an entity's financial position, financial performance, and cash flows.

Although bifurcated embedded derivatives are included within the scope of the general derivative disclosure requirements, bifurcated embedded derivatives often are not specifically identified within the overall derivative categories in the tabular quantitative disclosures. For example, a bifurcated embedded commodity derivative generally would be grouped together with other freestanding commodity derivatives, and only the total commodity derivative fair value would be disclosed. In addition, there are no requirements in current GAAP to disclose information that links each bifurcated embedded derivative back to its related host contract. The amendments in this proposed Update would require an entity to disclose information that links each bifurcated embedded derivative to its related host contract.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied on a prospective basis to hybrid financial instruments with bifurcated embedded derivatives that

existed as of the beginning of the fiscal year for which the proposed amendments are effective. The effective date, as well as whether early adoption would be permitted, will be determined by the Board after considering stakeholders' feedback on this proposed Update.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

Bifurcated embedded derivatives are within the scope of the general derivatives disclosure requirements under IFRS 7, *Financial Instruments: Disclosures*. IFRS 7 requires disclosure of the carrying amount, the effect of the instruments on an entity's financial position and performance, and the nature and extent of the risks arising from the instruments. There are no existing disclosure requirements under IFRS 7 to provide information that explicitly links bifurcated embedded derivatives with their related host contracts.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Will the amendments in this proposed Update result in more transparent, decision-useful information about hybrid financial instruments with bifurcated embedded derivatives? If not, please explain why.

Question 2: Should the scope of the amendments in this proposed Update be extended to include nonfinancial hybrid instruments with embedded derivatives that require bifurcation under Topic 815? If yes, please explain why and identify any other instruments that should be included in the proposed amendments.

Question 3: Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why?

Question 4: The proposed amendments would apply to all entities. Should the proposed amendments be different for entities that are not public business entities? If so, please describe how and why you think they should be different.

Question 5: How much time would be needed to implement the proposed guidance? Should the amount of time needed to implement the proposed amendments by entities that are not public business entities be different from the amount of time needed by public business entities?

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2 and 3. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 815-10

2. Add paragraphs 815-10-50-4EE and its related heading and 815-10-55-183A, with a link to transition paragraph 815-10-65-7, as follows:

Derivatives and Hedging—Overall

Disclosure

> > Hybrid Financial Instruments with Bifurcated Embedded Derivatives

815-10-50-4EE For those hybrid financial instruments with embedded derivatives that are bifurcated in accordance with paragraph 815-15-25-1, an entity shall disclose all of the following for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented:

- a. For each bifurcated embedded derivative:
 - 1. The location and fair value amounts reported in the statement of financial position
 - 2. The location and amounts of the gains and losses reported in the statement of financial performance.
- b. For each host contract related to each bifurcated embedded derivative above:
 - 1. The location in the statement of financial position, carrying amount, and measurement attribute
 - 2. The location and amounts reported in the statement of financial performance.

These required disclosures can be presented in a tabular or nontabular format and should be presented in a manner that allows each bifurcated embedded

derivative to be linked back to its host contract. See paragraph 815-10-55-183A for implementation guidance on these requirements.

Implementation Guidance and Illustrations

> Illustrations

>> Example 21: Tabular Disclosures of Derivative Instruments

815-10-55-183A The table below is an example of an entity's tabular disclosure of the requirements in paragraph 815-10-50-4EE. Each row in the example table below can be aggregated by derivative type (provided all derivative contracts are reported within the same statement of financial position and statement of financial performance location), along with the related host contracts (provided all host contracts are reported within the same statement of financial position and statement of financial performance location).

Bifurcated Embedded Derivatives					Related Host Contracts					
Derivative Type	Balance Sheet Location	Fair Value	Location of Gain or Loss Reported in Income	Amount of Gain or Loss Reported in Income	Related Host Contract Type	Balance Sheet Location	Measurement Attribute	Carrying Amount	Location of Amount Reported in Statement of Financial Performance	Amount Reported in Statement of Financial Performance
Equity Contracts	Long-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Long-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Equity Contracts	Short-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Short-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Commodity Contracts	Long-Term Borrowings	\$XXXX	Other Income / Expense	\$YYYY	Debt Hosts	Long-Term Borrowings	Amortized Cost	\$XXXX	Interest Expense	\$YYYY
Interest-Rate Contracts	Securities Owned	\$XXXX	Other Income / Expense	\$YYYY	Equity Hosts	Securities Owned	Fair Value through Other Comprehensive Income	\$XXXX	Investment Income	\$YYYY

3. Add paragraph 815-10-65-7 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2015-XX, Derivatives and Hedging (Topic 815): Disclosures about Hybrid Financial Instruments with Bifurcated Embedded Derivatives

815-10-65-7 The following represents the transition and effective date information related to Accounting Standards Update No. 2015-XX, *Derivatives and Hedging (Topic 815): Disclosures about Hybrid Financial Instruments with Bifurcated Embedded Derivatives*:

- a. The pending content that links to this paragraph shall be effective for financial statements issued for fiscal years beginning after [date to be inserted after exposure], and interim periods within those fiscal years.
- b. An entity shall apply the pending content that links to this paragraph prospectively to hybrid financial instruments with bifurcated embedded

derivatives that existed as of the beginning of the fiscal year for which the pending content that links to this paragraph is effective.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. Embedded derivatives that are bifurcated from their host contracts are within the scope of the general derivative disclosure requirements in Subtopic 815-10. However, there are no existing disclosure requirements to provide information that explicitly links bifurcated embedded derivatives (which are measured at fair value) with their related host contracts (which may be measured at amortized cost, fair value, or another measurement attribute depending on applicable accounting literature). Users of financial statements often only see the two components (bifurcated embedded derivative and host contract) disclosed separately, and they have little ability to trace one back to the other. In effect, even though the host contract and the bifurcated embedded derivative encompass one legal contract, they often are disclosed in the footnotes as if they are two separate instruments.

Linking Bifurcated Embedded Derivatives and Their Related Host Contracts

BC3. Following its decision to retain the current requirements under GAAP for bifurcation of certain embedded derivatives in hybrid financial assets and hybrid financial liabilities as part of the project on accounting for financial instruments: classification and measurement, the Board decided that additional disclosures would be helpful to address stakeholders' feedback about increasing the transparency and usefulness of the information provided in the financial statements. The Board believes that this proposed Update will enhance the usefulness of the information in the notes to financial statements by providing a link between each bifurcated embedded derivative and its related host contract. By doing so, users of financial statements will be able to analyze the overall economics and cash flows for the entire hybrid financial instrument. That is, although bifurcated embedded derivatives are required to be measured

separately from their host contracts under current GAAP, the embedded derivatives and their host contracts represent one legal contract. Therefore, the Board believes that the disclosures in this proposed Update that link each bifurcated embedded derivative to its related host contract will provide users of financial statements with decision-useful information that reflects the overall economics and cash flows for the entire hybrid financial instrument.

Scope

BC4. The Board decided that the amendments in this proposed Update would apply to all reporting entities that are issuers of, or investors in, hybrid financial instruments with embedded derivatives that are bifurcated under paragraph 815-15-25-1. In addition, the Board decided that the disclosures would be required for both annual periods and interim periods. The basis for the Board's decisions is to align the scope and timing of the requirements in this proposed Update with the scope and timing of the requirements of Subtopic 815-10, which provides disclosure guidance for all derivative instruments, including bifurcated embedded derivatives.

Transition and Effective Date

BC5. The Board decided that the amendments in this proposed Update would be applied prospectively to hybrid financial instruments with embedded derivatives that are separated from their host contracts and accounted for as derivative instruments under paragraph 815-15-25-1 that exist as of the beginning of the fiscal year for which the proposed amendments are effective. The final effective date, as well as whether early adoption would be permitted, will be determined by the Board after considering stakeholders' feedback on this proposed Update.

Benefits and Costs

BC6. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC7. The Board does not anticipate that the amendments in this proposed Update would introduce significant incremental costs for reporting entities because the information needed to comply with the proposed disclosures is already being produced by reporting entities, and the proposed disclosures are only presenting that information in a more disaggregated and transparent manner. In order to implement this proposed Update, entities may be required to change systems and processes in the first period of adoption. The Board expects that the costs related to those changes should not recur in subsequent reporting periods. The proposed amendments would provide the benefit of improving the usefulness of the information reported about bifurcated embedded derivatives and their related host contracts.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through [ASU Taxonomy Changes](#) provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at www.fasb.org and finalized as part of the annual release process.