

STAFF PAPER

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Project	Financial Instruments with Characteristics of Equity (FICE)		
Paper topic	Financial instruments settled in own equity instruments: foundation principle		
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This Agenda Paper was initially prepared for the Board's March 2020 meeting as Agenda Paper 5A. However, it was not discussed at that meeting. This Agenda Paper is identical to Agenda Paper 5A for the March 2020 Board meeting.

1. Introduction

1. At the December 2019 Board meeting (Agenda Paper 5), the Board discussed the staff's preliminary analysis on how the fixed-for-fixed requirement in IAS 32 Financial Instruments: *Presentation* could be clarified. Based on the input provided by Board members at that meeting, the staff have further developed their analysis as set out in this paper and Agenda Paper 5B.
2. At this Board meeting, the staff asks the Board to make tentative decisions that will help set the direction for the clarified principles that are being developed.
3. In this paper and Agenda paper 5B, the staff analyse the classification of derivatives on own equity, whether standalone or embedded in a non-derivative instrument. The staff acknowledge that some derivatives on own equity have features that require consideration of other topics such as contingent settlement provisions when determining their classification. The staff will bring an analysis of these derivatives for discussion at future Board meetings.

4. This paper is structured as follows:
- (a) Clarified principles discussed in December 2019 (paragraph 5);
 - (b) Further considerations (paragraphs 6–11);
 - (c) Foundation principle (paragraphs 12–31);
 - (d) Application of the proposed foundation principle to some illustrative examples (paragraphs 32–38);
 - (e) Share-for-share exchange (paragraphs 39–43);
 - (f) Summary of the staff’s preliminary views (paragraph 44); and
 - (g) Question for the Board (paragraph 45).

2. Clarified principles discussed in December 2019

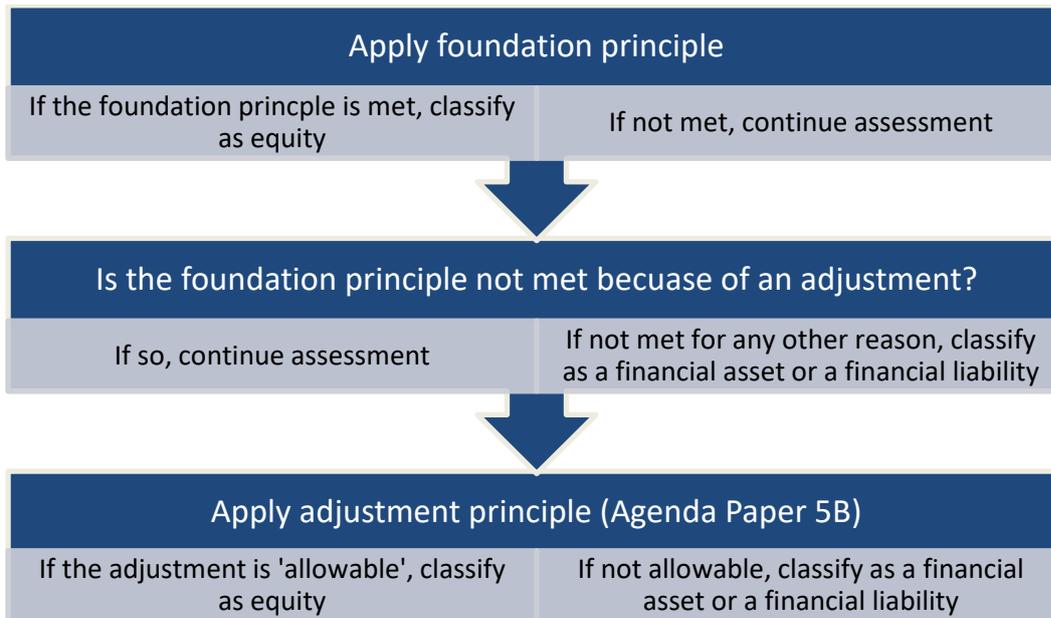
5. In December 2019, the Board considered the following potential clarifications proposed by the staff to explain the rationale for the fixed-for-fixed condition in paragraph 16 of IAS 32 ([Agenda Paper 5](#)):

- (a) **Foundation principle**—a derivative on own equity that meets the fixed-for-fixed condition should have a fair value on the settlement date (settlement value) that is:
 - (i) only affected by fluctuations in the price of the underlying equity instruments (exposed to equity price risk); and
 - (ii) not affected by fluctuations in other variables that the holder of the underlying equity instruments would not be exposed to (not exposed to other risks).
- (b) **Adjustment principle**—if a derivative is subject to any adjustments to the amount of cash or another financial asset, or the number of own equity instruments, the adjustments would not preclude the derivative from meeting the fixed-for-fixed condition if the adjustments:
 - (i) preserve the relative economic interests of the derivative holder and the underlying equity instrument holder (‘preservation adjustments’); or

- (ii) compensate the issuer for the fact that the derivative will be settled at a future date ('passage of time adjustments').

3. Further considerations

6. At its December 2019 meeting, the Board directed the staff to further analyse some aspects of the clarified principles set out in paragraph 5 of this paper. They included the following:
- (a) placing the emphasis on the issuer's perspective;
 - (b) clarifying the meaning of 'underlying equity instruments';
 - (c) clearer articulation of the foundation principle including:
 - (i) whether both the clarification in paragraphs 5(a)(i) and 5(a)(ii) of this paper are required;
 - (ii) what the meaning of 'settlement value' is; and
 - (iii) what the meaning of 'exposure to equity price risk' is.
 - (d) consideration of whether the preservation adjustments should be 'symmetrical'; and
 - (e) specification of the types of passage of time adjustments that would not preclude equity classification.
7. In light of that feedback from Board members, the staff present further analysis of the foundation and adjustment principles as set out in this agenda paper and Agenda Paper 5B respectively. The staff would like to point out that for the purpose of applying the clarified principles, the adjustment principles need to be applied whenever there are adjustments in a contract that could alter the number of underlying equity instruments or the amount of cash that will be exchanged. Said another way, in those cases, both principles apply ie a two-stage process is required. See diagram below.



3. 1 Issuer's perspective

8. At the December 2019 Board meeting, some Board members noted that the perspective of the 'holder' of a call option was considered in some parts of the staff's analysis. Those Board members asked the staff to clarify if and, if so when, this perspective should be considered. The staff would like to clarify that, in all cases, the emphasis for classification is on the perspective of the issuer of the underlying equity instruments, ie the entity that has a derivative on 'own equity', and not necessarily the entity that has issued the derivative. When we refer to the 'issuer' in this paper and in Agenda Paper 5B, we always mean the issuer of the underlying equity instruments. The difference between the issuer of the underlying equity instruments and the entity that issued the derivative could be illustrated as follows:

- (a) for a written option on own equity and for a forward on own equity, the issuer of the underlying equity instruments is also the issuer of the derivative;
- (b) for a purchased option on own equity, the issuer of the underlying equity instruments is the holder of the option.

(c) where an entity within a group issues a derivative over shares of another entity in the same group, it is the group that is the issuer of the derivative on own equity and the issuer of the underlying equity instruments.

9. The classification of a financial instrument as a financial liability or an equity instrument is determined from the perspective of the issuer and directly affects the financial statements of the issuer. Therefore, it is important to analyse the effect of a derivative on own equity from the issuer’s perspective. We have therefore deleted the reference to the holder when articulating the foundation principle in paragraph 5(a)(ii) of this paper (see paragraph 16 of this paper).

3. 2 Underlying equity instruments

10. At the December 2019 Board meeting some Board members asked the staff to clarify what is meant by ‘underlying equity instruments’. For the purpose of assessing classification applying the staff’s analysis, underlying equity instruments are those equity instruments that are used to settle a derivative. For example, an entity may issue a derivative that is indexed to changes in the price of its own Class A shares but that will be settled in its own Class B shares (a derivative to deliver as many Class B shares as are worth 100 Class A shares in two years’ time for CU100). In this example, the underlying equity instruments of the derivative are the Class B shares, ie the shares that the issuer is obligated to deliver. Similarly, if a parent issues a derivative that is indexed to changes in the price of its subsidiary’s shares but that will be settled in the parent’s own shares, the underlying equity instruments of that derivative are the parent’s shares, ie the shares that the parent will be obligated to deliver.

11. As discussed in Agenda Paper 5 for the December 2019 meeting, if one entity within a group (Entity 1) issues a derivative over equity instruments of another entity within the same group (Entity 2), it is the functional currency of the entity whose equity instruments will be used to settle the derivative (ie Entity 2) that is considered when determining whether the group is exposed to foreign currency risk in the group’s consolidated financial statements.

4. Foundation principle

12. The foundation principle discussed in December 2019 focused on the settlement value of a derivative, and the settlement value's exposure to the price of the underlying equity instruments. This relationship was used to compare the risk exposure of the issuer of a derivative on own equity to the risk exposure the issuer would have had by issuing the underlying equity instruments instead. The rationale for this foundation principle was that a derivative on own equity should be classified as equity if and only if the derivative issuer's rights and obligations are similar to those that it would have had if it had issued the underlying equity instruments instead. In particular, at the December 2019 meeting, the focus was on the issuer of a derivative not being exposed to other risks or other variables that it would have not been exposed to if it had issued the underlying equity instruments instead. Otherwise, the derivative would be classified as a financial asset or a financial liability.
13. In this section of the paper, the staff provide further analysis in response to some observations made at the December 2019 Board meeting and present two alternatives to articulate the foundation principle—*Alternative A* is a direct refinement of the foundation principle discussed in December 2019, whereas *Alternative B* is an alternative way to articulate the foundation principle based on the certainty of the amount of cash exchanged per unit of equity instrument.
14. The staff note that these alternatives, when used in conjunction with the adjustment principles discussed in Agenda Paper 5B, are not intended to result in different classification outcomes. Instead, they are intended to be different ways to articulate the proposed rationale for the fixed-for-fixed condition, which is that a derivative on own equity should be classified as equity if and only if the issuer's rights and obligations are similar to those that it would have had if it issued or reacquired underlying equity instruments for cash (or another financial asset) instead. We say 'similar' but not identical because of differences that are inherent in a derivative or in an option derivative. See paragraphs 18–21 for further discussion on this.
15. In addition, the staff wish to highlight that the proposed rationale in paragraph 14 is a refinement of the rationale discussed in paragraph 12 of this paper because

the focus of the refined rationale in this paragraph is on the issuer of the underlying equity instruments instead of the issuer of the derivative.

4.1 Alternative A

16. Taking into account the Board members' comments, in the staff's view, the foundation principle could be articulated as follows:

A derivative on own equity that meets the fixed-for-fixed condition has a fair value on the settlement date (settlement value) that is:

- (a) ~~only~~ affected by fluctuations in the price of the underlying equity instruments; and
- (b) not affected by fluctuations in ~~other~~ variables other than those arising from preservation adjustments and/or passage of time adjustments, if applicable. ~~that the holder of the underlying equity instruments would not be exposed to.~~¹

17. The staff removed the word 'only' at the beginning of the subparagraph 16(a) to make it clear *what must be present* in a derivative that meets the fixed-for-fixed condition, ie the settlement value must vary with the price of the underlying equity instrument. Subparagraph 16(b) specifies *what must be absent* and what *can* be present in such a derivative. The staff think that these changes make it clear that paragraphs 16(a) and 16(b) are both required conditions for equity classification.

4.1.1 Risks that are inherent in derivatives

18. One of the observations made at the December 2019 Board meeting was that the issuer of a derivative on own equity will be exposed to risks that it would not have been exposed to if it had issued the underlying equity instruments instead. That is because some risks are inherent in a derivative because a derivative, by definition, is settled at a future date. For example, the issuer of a derivative to deliver own shares in exchange for an amount of cash will be exposed to time value of money, counterparty credit risk and liquidity risk.

¹ New text is underlined and deleted text is struck through

19. Consequently, the staff think that if any derivatives are to be classified as equity, such a classification approach has to accommodate those risks that are inherent in a derivative even if the issuer would not have been exposed to such risks by issuing the underlying equity instruments instead.
20. The staff considered whether it is necessary to make any modifications to the principle in paragraph 5(a)(ii) of this paper to acknowledge additional risks that are inherent in a derivative. However, the staff are of the view that while the issuer will be exposed to these additional risks, the settlement value will not be exposed to those risks. This is because the settlement value is determined at the settlement date by assuming that the derivative is settled in full (ie each party to the contract fulfils its obligations) based on the rights and obligations specified in the derivative contract. The foundation principle would not require the issuer to estimate, at the issuance of a derivative, what the fair value of the derivative will be on its settlement; rather, it would require the issuer to assess what variables affect the fair value of the equity instruments and fair value of the cash (or another financial asset) to be exchanged on the settlement date(s). Settlement value is the value of what is exchanged when the derivative is settled (ie the value of the issuer's rights and obligations at settlement) and, thus, is not the same as the issuer's risk exposure while the derivative is outstanding. Therefore we do not think any modifications are necessary to acknowledge that additional risks are inherent in derivatives.
21. Derivatives include option contracts and, by definition, the exercise of an option is uncertain. While some option contracts give the issuer the right to exercise, others give the counterparty the right to exercise (counterparty-held options). In addition, option contracts could be exercisable only on the occurrence (or non-occurrence) of an uncertain future event that is beyond the control of both the issuer and the derivative counterparty. The risk/reward profile of option contracts is therefore not the same as for non-option derivatives (ie forwards). An option's risk/reward profile is also not the same as that of the underlying equity instruments. In a counterparty-held call option, in particular, the derivative holder has an unlimited upside from potential increases in the price of underlying equity instruments but has a limited downside (ie only the loss of option premium). However, the opposite applies to the value of the issuer's obligation ie unlimited downside but

limited upside. Hence, the staff think that if any option derivative contracts are to be classified as equity, such a classification approach has to accommodate that the issuer will not be in the same economic position by issuing an option derivative compared to issuing the underlying equity instruments because of the optionality.

22. The staff considered whether there is a need to make any modification to the principle in paragraph 5(a)(ii) of this paper to consider the risk/reward profile of option derivatives. The settlement value would be the value of the issuer's obligation net of the value of the issuer's right on settlement assuming the option is exercised. The settlement value of an option is therefore not affected by the probability of the exercise of the option, and therefore the staff think that no modification to the principle is necessary.

4.1.2 Exposure to equity price risk

23. In order to articulate the foundation principle from the issuer's perspective, the staff considered replacing the reference to the exposure of the holder of the underlying equity instruments in paragraph 16(b) with the exposure of the issuer. However, we note from the observations made at the December 2019 Board meeting that the notion of 'being exposed to equity price risk' is understood differently by different people. For example, consider a derivative to deliver a variable number of shares to equal the value of CU100 in exchange for CU95 in two years' time. One person may conclude that the issuer is not exposed to equity price risk because changes in the share price do not affect the settlement value (the value of the issuer's contractual rights and obligations). The settlement value is a fixed amount of CU5 and changes in the share price will not affect that value. Another person however may say that the issuer is exposed to equity price risk because the number of shares that it needs to deliver to satisfy the obligation will change based on the price per share. An existing shareholder of the issuer may also think that the issuer is exposed to equity price risk because the extent of dilution of the existing shareholder's ownership in the issuer entity will depend on changes in the share price.
24. We noted that the foundation principle is focused on the settlement value ie the issuer's rights and obligations on settlement of the derivative as specified in the contract. However, as explained in paragraphs 20 and 23, the issuer's exposure to

equity price risk is different to the settlement value's exposure to equity price risk. Another example that illustrates this challenge is a derivative that meets the fixed-for-fixed condition in IAS 32. The issuer's contractual rights and obligations are specified in terms of a fixed amount of cash in exchange for a fixed number of equity instruments. Those rights and obligations are not exposed to any variability arising from changes in equity price (ie the amount of cash and the number of shares are fixed) but the value of those rights and obligations (ie the settlement value) is exposed to equity price risk (ie the share price).

25. For this reason, when we removed the reference to the exposure of the holder of the underlying equity instruments from paragraph 16(b), we did not replace it with the exposure of the issuer of the underlying equity instruments. We recognise that the principle does not specify the degree of the required exposure to fluctuations in the price of the underlying equity instruments and the degree of prohibited exposure to other variables. However, by specifying a quantitative threshold, the principle would become a rule. This has led the staff to consider whether there is another way to articulate the foundation principle and the rationale described in paragraph 14 more clearly. Alternative B is such an alternative articulation.

4.2 Alternative B

26. The foundation principle could be articulated as follows:

A derivative on own equity meets the fixed-for-fixed condition if, and only if, the amount of functional currency units² to be exchanged with each underlying equity instrument is fixed and does not vary other than (if applicable) with:

- (a) *preservation adjustments; and*
- (b) *passage of time adjustments.*

27. Alternative B focuses on the certainty of the amount of cash exchanged per unit of equity instrument (eg share), which is a natural extension of the current wording

² The settlement may be in a financial asset other than cash or the extinguishment of a financial liability but in all cases the amount to be exchanged with each share needs to be fixed in terms of the issuer's functional currency units.

for the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 ie a fixed amount of cash (or another financial asset) for a fixed number of its own equity instruments. For a derivative on own shares to meet the fixed-for-fixed condition, the issuer would need to know how much cash it is entitled (or obligated) to exchange per share in the same way it would know how much cash it was receiving per share if it had issued the underlying equity instruments for cash instead (or how much cash it would pay per share if it had reacquired underlying instruments for cash instead).

28. The principle can be expressed as fixed functional currency units per share (for example, exercise price of CU5 per share) or a fixed number of shares for each functional currency unit (for example, 10 shares for each CU1 outstanding in a convertible bond). Essentially, the principle means that the issuer must know the exact exchange or conversion ratio at inception of the derivative. If the issuer knows how much cash it is entitled (or obligated) to exchange with each underlying equity instrument at the inception of a derivative contract, this means that the issuer's rights and obligations are fixed (ie determined) and they do not vary with any variable including the price of the underlying equity instruments. The issuer's rights and obligations are fixed in a similar way that it would have been fixed if it had issued (or reacquired) the underlying equity instruments for cash instead.
29. However, in some cases, instead of cash being exchanged for shares, another financial asset is exchanged or a financial liability of the issuer is extinguished. For this reason, the staff refer to 'the amount of functional currency units' when describing the principle in paragraph 26 of this paper. Regardless of what is exchanged, for a derivative on own equity to meet the foundation principle in paragraph 26, the amount exchanged per equity instrument must be fixed in terms of the functional currency of the issuer. The staff think this is consistent with IAS 32 because, although paragraph 16(b)(ii) of IAS 32 refers to 'a fixed amount of cash or another financial asset', paragraph 22 of IAS 32 specifically refers to 'a fixed stated principal amount of a bond' being exchanged for a fixed number of the entity's shares as an example of an issued share option that is classified as an equity instrument.

30. Applying the principle in paragraph 26 of this paper, if the issuer does not know how many functional currency units it is entitled (or obligated) to exchange per equity instrument, the derivative would not qualify for equity classification unless the uncertainty arises from an ‘allowable’ type of adjustment, which is discussed further in Agenda Paper 5B for this meeting.

4.3 Staff preference

31. The staff’s preference is Alternative B because of the potential limitations of Alternative A discussed in paragraph 25. Also, Alternative B does not use new concepts such as settlement value, which we think will make it easier for stakeholders to understand and implement.

5. Foundation principle—Illustrative examples

32. In this section, the proposed foundation principle (using Alternative B) is applied to a number of illustrative examples. ‘currency unit’ (CU) in the examples is used to denote the issuer’s functional currency.

5.1 Multiple pre-determined fixed-for-fixed exchange

33. Some derivatives on own equity may give the derivative counterparty a choice of how many shares to buy but the strike price per share is fixed. Consider the following example.

Entity X issues a call option that gives the holder a choice between two predetermined ‘fixed-for-fixed’ exchanges, for example, to deliver 100 of its own shares for CU110 or 50 of its own shares for CU55.

Applying the foundation principle in this case, Entity X knows how many currency units it is entitled to receive per share if the option is exercised, being CU1.10 per share. The ratio of own equity instruments delivered in exchange for an amount of cash is fixed. Although there is uncertainty regarding the exercise of the option, that uncertainty is inherent in any option derivative. In the absence of any other feature that precludes equity classification, the derivative on own equity in this example would be classified as an equity instrument.

5.2 Bonds with accrued interest that may be converted

34. Some convertible bonds include a feature that capitalises interest on the bond, for example, if the issuer chooses not to pay accrued interest, that interest amount will be added to the principal amount. At maturity, the bondholder can choose either a cash redemption that would include capitalised interest as well as the principal amount of the bond or a conversion of the outstanding amount of the bond (capitalised interest plus the principal amount) into ordinary shares. Consider the following example.

Entity X issues a convertible bond of CU100 with a coupon rate of 7%. The issuer has the right to capitalise coupons ie unpaid coupons will be added to the principal amount. At maturity after 5 years, the bondholder can choose to receive a cash amount equal to the bond's principal amount plus capitalised interest or to convert that amount into Entity X's ordinary shares. The contract sets out the conversion ratio as one ordinary share per each CU1 outstanding amount of the convertible bond.

Applying the foundation principle, the issuer knows how many currency units it is entitled to receive (in the form of an extinguishment of its financial liability) per share if the conversion option is exercised. Although the total outstanding amount of the financial liability may vary depending on how much interest is capitalised over the life of the bond, the conversion ratio is fixed from inception of the bond.

In the absence of any other feature that precludes equity classification, the conversion option in this example would be classified as an equity instrument

5.3 Foreign currency

35. The foundation principle requires the issuer to know how many functional currency units it is entitled (or obligated) to exchange with each equity instrument. Accordingly, for example, a derivative to deliver own equity instruments in exchange for a cash amount that is denominated in a foreign currency will not meet that proposed foundation principle because the foreign currency cash amount represents a variable amount of cash in the issuer's functional currency and exposes to the issuer to foreign currency risk that it would not have been exposed to had it issued the underlying equity instruments for cash instead.

36. Consider the following example.

Entity X issues a convertible bond of foreign currency amount FCU100. The convertible bondholder has an option to convert the bond into 100 of Entity X's shares at maturity of the bond.

Applying the foundation principle, Entity X does not know how many functional currency units it is entitled to receive (via the extinguishment of the bond) per share it may be obligated to deliver. The conversion option in the convertible bond would be classified as a financial liability.

37. At this time the staff are not recommending the Board reconsider the requirements that were added to IAS 32 in 2009 for 'foreign currency rights issues'. The aim of this project is to clarify particular underlying principles in IAS 32 to address known practice issues.
38. However, as mentioned in the December 2019 meeting, the staff are aware that there are concerns in practice that some financial instruments are classified as financial liabilities as a result of being denominated in a foreign currency; in particular, where the entity is issuing foreign currency denominated convertible bonds. The staff will consider this issue at a later stage of this project when the Board redeliberates the presentation proposals which could apply to foreign currency denominated convertible bonds.

6. Share-for-share exchanges

39. Some contracts are settled by the issuer exchanging one type of its own non-derivative equity instruments for another type of its own non-derivative equity instruments. An example is a derivative issued by a parent that gives a non-controlling interest shareholder the option to exchange a fixed number of its shares held in a subsidiary for a fixed number of ordinary shares of the parent. In the consolidated financial statements, the option involves an exchange of one type of own equity for another type of own equity. Another example is a contract to exchange a fixed number of an entity's own ordinary shares for a fixed number of the entity's own preference shares, assuming both types of shares meet the definition of equity.

40. IAS 32 does not address a fact pattern that involves a share-for-share exchange where both legs of the exchange are a fixed number of own shares. The staff are aware that different views exist in practice with respect to how such a contract should be classified. If the Board agrees with the staff's view in paragraph 41 below, the Board could consider making a clarification to IAS 32 in this regard.
41. In the staff's view, a contract that will or may be settled by exchanging a fixed number of one type of non-derivative own equity instruments for a fixed number of another type of non-derivative own equity instruments should be classified as equity. We believe a contract in which both legs of the exchange are a fixed number of own equity instruments would not itself be a financial asset or a financial liability. By issuing such a contract, the issuer will be or may be extinguishing one type of own equity with another type of own equity. Although the value of shares received in exchange may be different from the value of shares delivered, the issuer's rights and obligations are known in terms of the fixed number of shares to be delivered and reacquired. The issuer has no additional rights or obligations compared to a scenario in which it issues and reacquires the underlying equity instruments directly. Effectively there will be a reclassification within equity to account for the right to receive a fixed number of one type of own equity instruments and the obligation to deliver a fixed number of another type of own equity instruments.
42. The staff then considered the classification of a contract that will be net share-settled by a single transfer of one type of the entity's own equity. In such cases, the issuer does not know the exact number of shares it will receive or deliver and such settlement could impose an additional obligation on or give an additional right to the issuer compared to a scenario in which it issues (or reacquires) the underlying equity instruments directly. Such a contract would not be classified as equity. This classification outcome is consistent with IAS 32. Even though the exchange involves only a transfer of equity instruments, this is different to the type of share-for-share exchange discussed in paragraph 41 of this paper because the issuer does not know whether it will receive or deliver shares. For example, Entity X enters into a forward contract to exchange 100 own shares for CU90 that is net share-settled. The contract essentially requires settlement in shares for the difference between 100 of own shares and a variable number of own shares to the

value of CU90. On settlement, the number of Entity X's shares to be exchanged depends on the value of Entity X's share on that date. Entity X may receive or deliver own shares depending on the value of its own shares.

43. There is another set of contracts that are settled by exchanging two types of equity instruments that we have not discussed in this paper. They are contracts that involve exchanging a variable number of one type of equity instruments on one side of the exchange and a fixed or variable number of another type of equity instruments on the other side of the exchange. The staff are of the view that the classification of such instruments is one of the important issues to consider when accounting for contracts to redeem own equity instruments (such as written put options on non-controlling interests to be settled by a variable number of the parent's shares). The staff plans to bring an analysis on this topic to a future Board meeting for consideration.

7. Summary of the staff's preliminary views

44. The staff's preliminary views are set out below.

- (a) **Foundation principle**—The staff's preference on how to articulate the foundation principle necessary to assess the fixed-for-fixed condition is **Alternative B** because of the potential limitations of Alternative A discussed in paragraph 25 of this paper. Also, Alternative B does not use new concepts such as settlement value, which will make it easier for stakeholders to understand and implement. Foundation principle Alternative B is articulated as follows:

In a derivative on own equity that meets the fixed-for-fixed condition, the amount of functional currency units³ to be exchanged with each underlying equity instrument is fixed and does not vary other than (if applicable) with:

³ The settlement may be in a financial asset other than cash or the extinguishment of a financial liability but in all cases the amount to be exchanged with each share needs to be fixed in terms of the issuer's functional currency unit.

- (i) preservation adjustments; and
 - (ii) passage of time adjustments.
- (b) **Share-for-share exchange**—The staff’s view is that a contract that will or may be settled by exchanging a fixed number of non-derivative own equity instruments with a fixed number of another type of non-derivative own equity instruments should be classified as equity. By issuing such a contract, the issuer will be or may be extinguishing one type of own equity with another type of own equity. The value of shares received in exchange may be different from the value of shares delivered. However, such a contract would not impose any additional obligations on the issuer or give any additional rights to the issuer compared to a scenario in which it issues and reacquires the underlying equity instruments directly.

8. Questions for the Board

45. The staff would like to ask the Board the following questions.

Question for the Board

1. **Foundation principle for classifying derivatives on own equity**—does the Board agree that Alternative B is a better way of articulating the foundation principle?
2. **Share-for-share exchange**—if the Board agrees with Alternative B for articulating the foundation principle, does the Board agree with the staff’s analysis of the share-for-share exchanges where both legs of the exchange are a fixed number of non-derivative equity instruments of the entity?