

Financial Instruments with Characteristics of Equity

Webinar 3: Classification of derivatives on own equity
July 2018

Before we start

- You can download the slides by clicking on the button below the slides window
- This webinar is a recording (it is not live), so we are unable to take any questions
- The views expressed are those of the presenters, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation

Financial Instruments with Characteristics of Equity

– Webinar Schedule

Previous Webinars

Overview of the Discussion Paper

The Board's preferred approach and classification of non-derivative financial instruments

This Webinar

Classification of derivatives on own equity

Future webinars

Classification of compound instruments and redemption obligation arrangements

Presentation of equity instruments applying the Board's preferred approach

Presentation of financial liabilities applying the Board's preferred approach

Classification of derivatives on own equity

What are derivatives on own equity?

- Derivatives settled in an entity's own equity instruments, or derivatives in which the underlying is the entity's own equity instruments.
- Derivatives on own equity:
 - can be gross physically settled, net-cash settled or net-share settled.
 - can be unconditional (eg forwards) or at the option of the holder (eg written options), or the issuer (eg purchased options), or contingent on some other event.

What are derivatives on own equity? (cont.)

- The Discussion Paper examines derivatives on own equity as an exchange comprising “two legs”. For example if physically settled:
 - One leg would be the receipt or delivery of equity instruments.
 - The other leg would be receipt or delivery of cash or another financial asset.
- Applying the Board’s preferred approach, derivatives on own equity would continue to be classified *in their entirety*.

Application challenges when applying IAS 32

What does 'fixed' mean in the 'fixed-for-fixed' condition?

Why is there inconsistency between classification of foreign currency options?

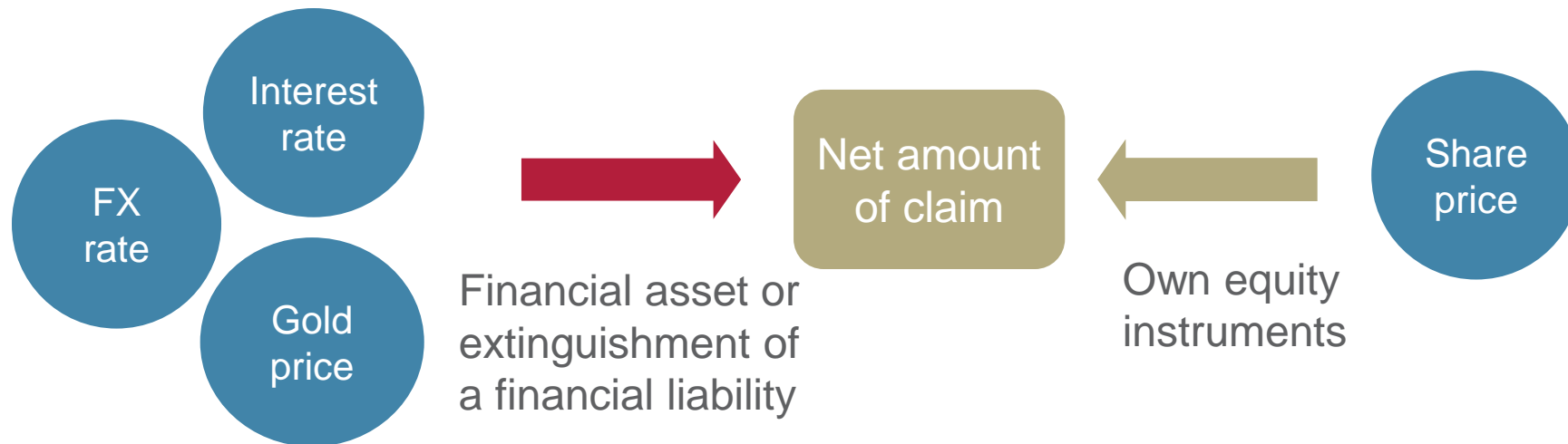
The Board's preferred approach

Classification principle that applies consistently to all derivatives

- Tests whether net amount is affected by any "independent variables" - fixed-for-fixed derivatives will continue to be classified as equity
- Principle would clarify that some variables do not preclude equity classification (eg some anti-dilution provisions)

Classification principles for derivatives

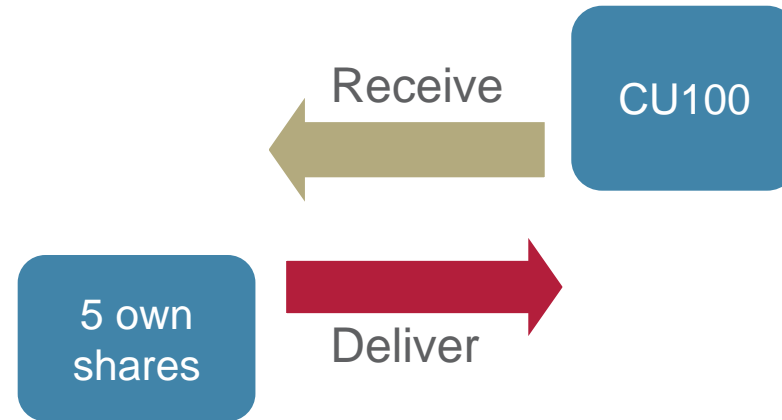
- The Board’s preferred approach would classify a derivative on own equity as a financial asset or a financial liability if:
 - (a) it is net-cash settled (the ‘timing’ feature); and/or
 - (b) the net amount of the derivative is affected by a variable that is independent of the entity’s available economic resources (the ‘amount’ feature).



Example #1

Written call option

Written option to sell 5 own shares for CU100 – gross physically settled (ie receive CU100 and deliver 5 own shares)



Would it be classified as a derivative asset/liability or equity?

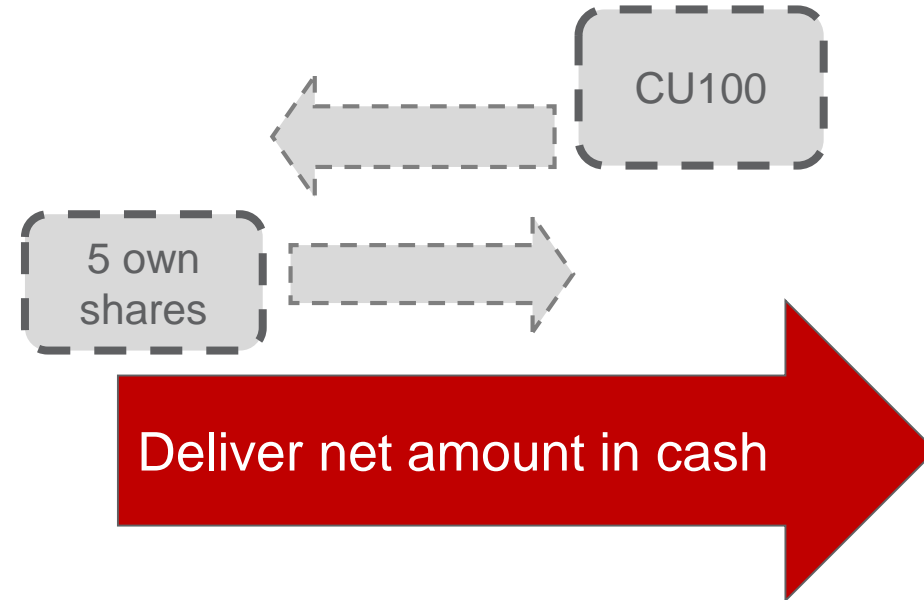
| | | |
|----------------|---|----------|
| Timing Feature | Net amount creates an obligation to transfer cash? | X |
| Amount Feature | Net amount affected by any variable other than own share price? | X |

Classified as equity

Example #2

Written call option

Written option to sell 5 own shares for CU100 – net cash settled.



Would it be classified as a derivative asset/liability or equity?

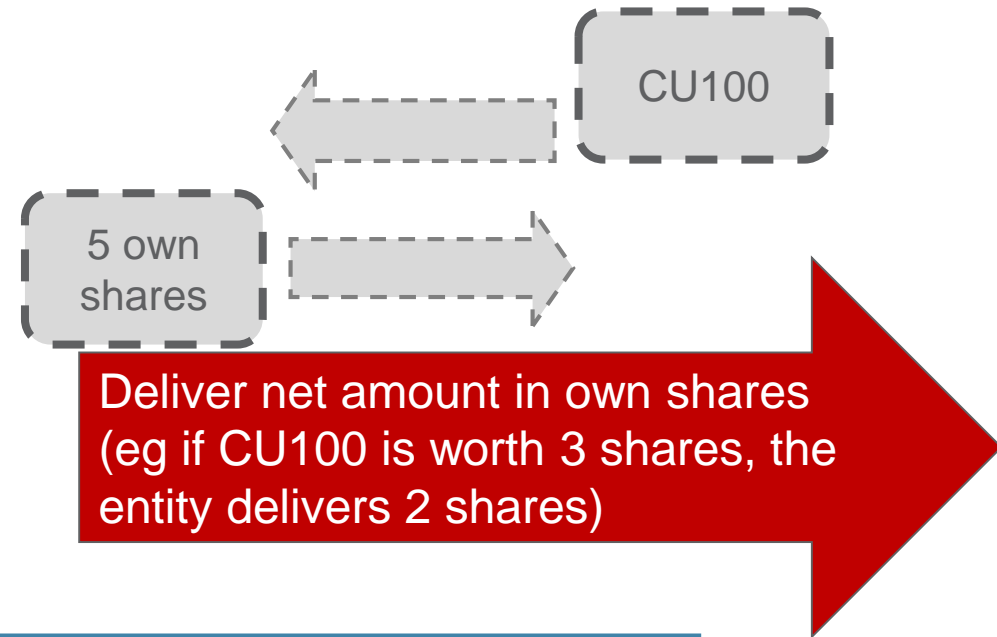
| | | |
|----------------|---|---|
| Timing Feature | Net amount creates an obligation to transfer cash? | ✓ |
| Amount Feature | Net amount affected by any variable other than own share price? | ✗ |

Classified as a financial liability

Example #3

Written call option

Written option to sell 5 own shares for CU100 – net share settled.



Would it be classified as a derivative asset/liability or equity?

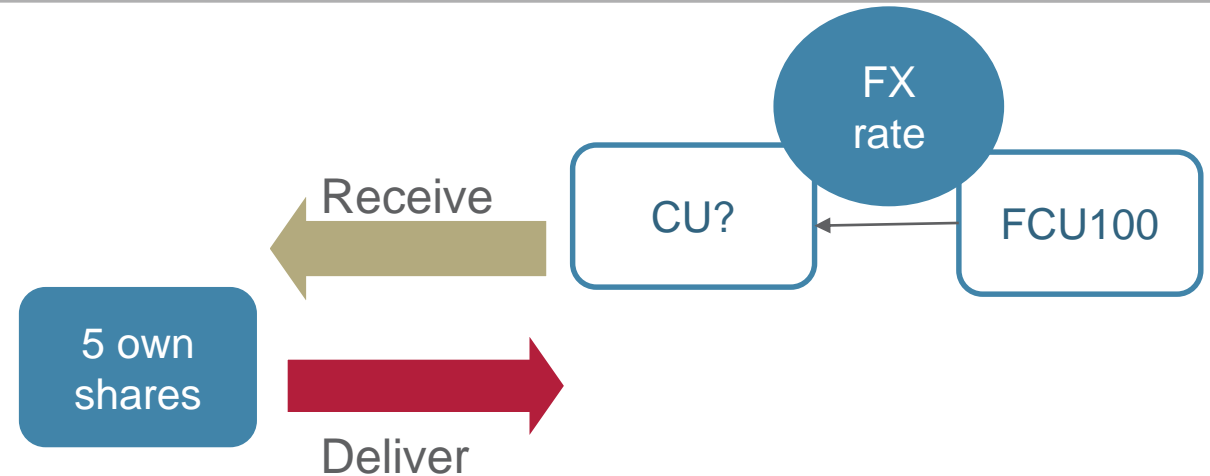
| | | |
|----------------|---|----------|
| Timing Feature | Net amount creates an obligation to transfer cash? | X |
| Amount Feature | Net amount affected by any variable other than own share price? | X |

Classified as equity

Example #4

Written call option

Written option to sell 5 shares for 100 foreign currency units (FCU) – gross physically settled.

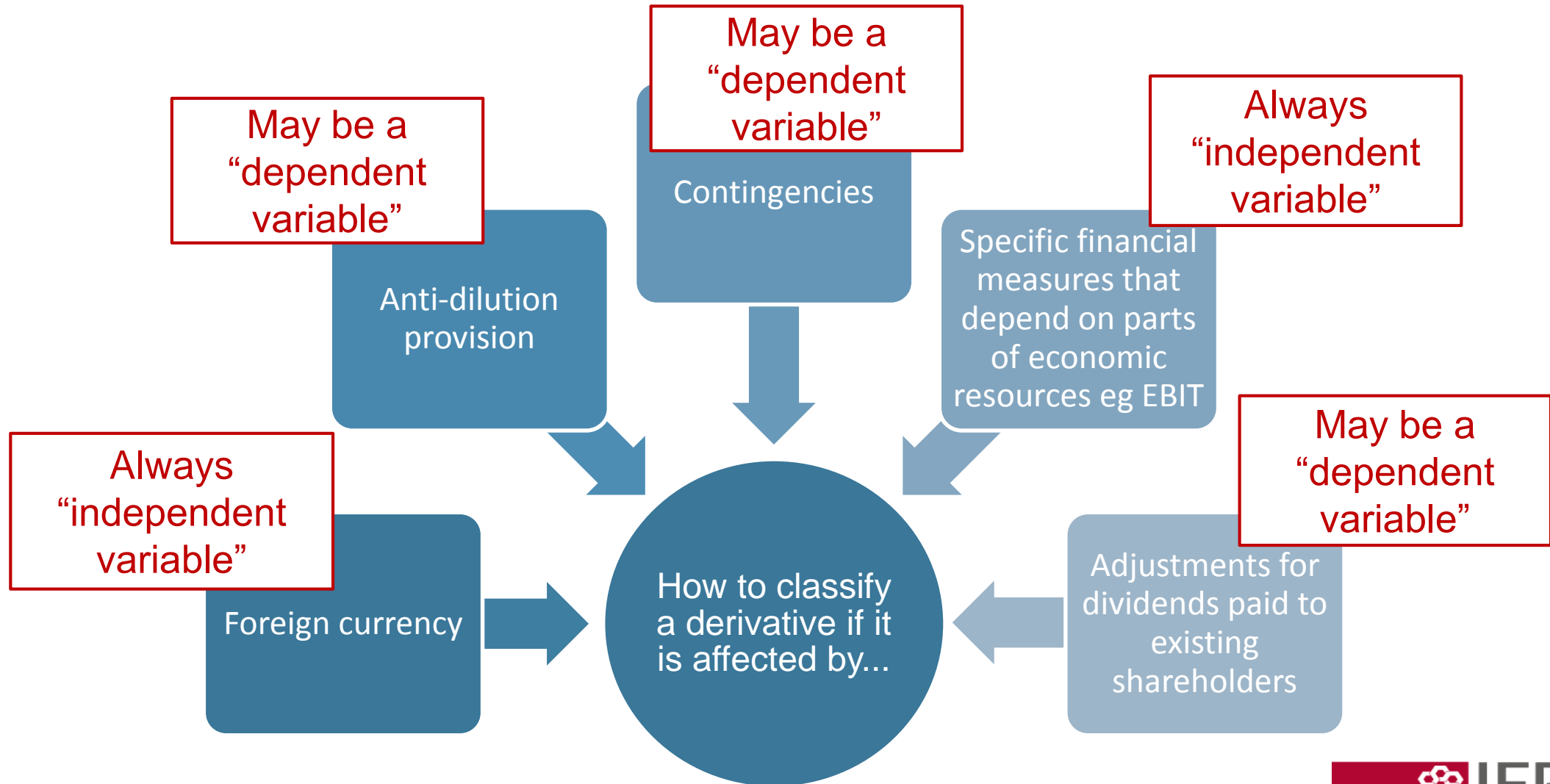


Would it be classified as a derivative asset/liability or equity?

| | | |
|----------------|---|---|
| Timing Feature | Net amount creates an obligation to transfer cash? | ✗ |
| Amount Feature | Net amount affected by any variable other than own share price? | ✓ |

Classified as a financial liability

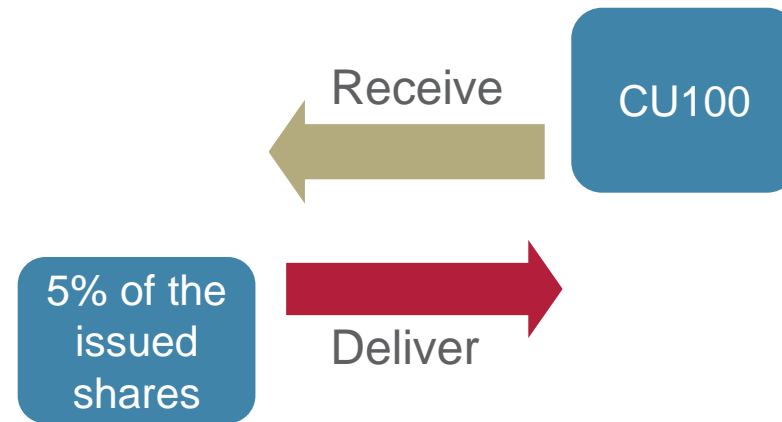
Examples of variables



Example #5 example of variable

Written call option

A derivative that requires an entity to deliver a variable number of own shares that represent 5% of issued shares for CU100 (in functional currency of the entity)—gross physically settled.



Would it be classified as a derivative asset/liability or equity?

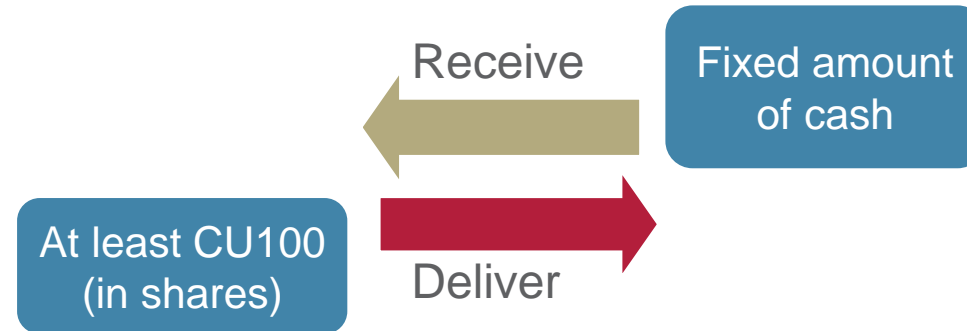
| | | |
|----------------|---|----------|
| Timing Feature | Net amount creates an obligation to transfer cash? | X |
| Amount Feature | Net amount impacted by any variable other than own share price? | X |

Classified as equity

Example #6 example of variable

Written call option

A derivative that requires an entity to deliver 100 own shares for a fixed amount of cash subject to an adjustment that will occur in the event of dilution so that the holder receives shares worth at least CU100 in all circumstances – gross physically settled.



Would it be classified as a derivative asset/liability or equity?

| | | |
|----------------|---|--|
| Timing Feature | Net amount creates an obligation to transfer cash? | |
| Amount Feature | Net amount impacted by any variable other than own share price? | |

Classified as a financial liability

Map of derivatives-IAS 32 vs the Board's preferred approach (no independent variables)

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| Contract types and settlement types | IAS 32 | The Board's preferred approach |
|---|---------------------|--------------------------------|
| Written call option on own equity (receive cash and deliver own equity, if the holder exercises) | | |
| Net-cash settlement | Financial liability | Financial liability |
| Net-share settlement | Financial liability | Equity |
| Gross physical settlement | Equity | Equity |

Map of derivatives-IAS 32 vs the Board's preferred approach (no independent variables)

| Contract types and settlement types | IAS 32 | The Board's preferred approach |
|---|-----------------|--------------------------------|
| Purchased call option on own equity (receive own equity and deliver cash, if the entity exercises) | | |
| Net-cash settlement | Financial asset | Financial asset |
| Net-share settlement | Financial asset | Equity |
| Gross physical settlement | Equity | Equity |
| Purchased put option on own equity (receive cash and deliver equity, if the entity exercises) | | |
| Net-cash settlement | Financial asset | Financial asset |
| Net-share settlement | Financial asset | Equity |
| Gross physical settlement | Equity | Equity |

Map of derivatives-IAS 32 vs the Board's preferred approach (no independent variables)

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| Contract types and settlement types | IAS 32 | The Board's preferred approach |
|---|---------------------------|--------------------------------|
| Forward to sell own equity (receive cash and deliver own equity) | | |
| Net-cash settlement | Financial asset/liability | Financial asset/liability |
| Net-share settlement | Financial asset/liability | Equity |
| Gross physical settlement | Equity | Equity |

Financial Instruments with Characteristics of Equity – Webinar Schedule

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Future webinars

Classification of compound instruments and redemption obligation arrangements

Presentation of equity instruments

Presentation of financial liabilities

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