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Project	**Financial Instruments with Characteristics of Equity**		
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Introduction

1. The objective of this paper is to discuss:

   (a) the challenges with accounting for derivatives on 'own equity'; and

   (b) how IAS 32 *Financial Instruments: Presentation* deals with those challenges.

2. We are not asking the IASB to make any decisions at this point. However, we welcome comments on the analysis provided and the potential ways forward.

3. This paper is structured as follows:

   (a) Why are we looking into this? (paragraphs 4–9)

   (b) What are derivatives on 'own equity'? (paragraphs 10–16)

   (c) What are the different types of derivatives on 'own equity'? (paragraphs 17–41)

   (d) What are the relevant requirements of IAS 32? (paragraphs 42–45)

   (e) Analysis of the fixed-for-fixed condition (paragraphs 46–69)

   (f) Analysis of the redemption obligation requirements (paragraphs 70–103)

   (g) Potential ways forward (paragraphs 104–116)

   (h) Appendix A—Types of derivatives

   (i) Appendix B—Relevant extracts from IAS 32

Why are we looking into this?

4. Of all the topics in this project, the accounting for derivatives on 'own equity' presents the most challenges. Derivatives on 'own equity' add an additional layer of complexity to our analysis. This is because, not only do we have to consider the issues we discussed in previous meetings for non-derivatives, we have to also consider how those issues interact with other characteristics of derivative contracts as we will illustrate in this paper.

5. The following challenges that we discussed in May 2015 (Agenda Paper 5A) are particularly acute in the case of derivatives:

   (a) the wide variety of contracts;

   (b) the ease with which similar economic outcomes can be reproduced using different combinations of contracts; and

   (c) the complexity and in some cases ambiguity of the terms of these contracts.

6. The challenges above make the consistency, completeness and clarity of the requirements for the accounting for derivatives on 'own equity' paramount but difficult to achieve.

7. Another aspect that we will begin to discuss as part of this topic is **conditionality**. As noted in our discussion of relevant features in June 2015 (Agenda Paper 5A), conditionality attaches to, and modifies, a given feature. Conditionality can be considered as 'trigger' that turns a particular feature on or off. For derivatives this is relevant because many of the derivatives that we will consider are conditional on future events.

8. Considering the accounting for such contracts is critical to addressing many perceived deficiencies with IAS 32. For example, many of the issues we will discuss will be relevant for:

   (a) Put options written on non-controlling interests (NCI puts)

   (b) Contingent convertible bonds (CoCos)

   (c) Foreign currency convertible bonds (FXCBs)

9. Given its complexity and its breadth, the topic and its aspects will be presented over a number of meetings.

What are derivatives on 'own equity'?

10. Paragraphs AG15–AG19 of the Application Guidance of IAS 32 describe the rights and obligations that arise from derivatives on underlying financial assets and financial liabilities. These paragraphs are reproduced in Appendix B.

11. In particular paragraph AG16 of IAS 32 states that derivative financial instruments contain contractual rights or obligations to exchange the underlying financial assets or financial liabilities with another party. As such, you can think of them as exchange contracts with two 'legs', with each 'leg' representing one side of the exchange.

12. The characteristic of derivatives on 'own equity' that distinguishes them from other derivatives is that, by definition, one of the underlying financial instruments of the exchange meets the definition of equity (the equity 'leg'). The other underlying financial instrument of the exchange could be either a financial asset (the asset 'leg') or a financial liability (the liability 'leg').

13. In the case of derivative financial assets and financial liabilities (ie non-'own equity'), we tend to think of them in terms of their 'net position' (the difference in value between the two 'legs' of the exchange). This is because, regardless of whether they result in a transfer, or exchange, of the underlying primary financial instruments (gross settlement), or the receipt or transfer of a net amount (net settlement), the financial reporting consequences are typically similar[1]. In addition, because we are talking about *financial* assets and *financial* liabilities, the exchange typically results in a net cash outflow.

14. However, for derivatives on 'own equity', it is important to be aware of the two 'legs' of the exchange, because the financial reporting consequences of the equity 'leg' are different to those of the asset or liability 'leg'. For example, changes in the non-equity 'leg' meet the definition of income and expense, while changes in the equity 'leg' do not.

[1] For example, changes in both underlying financial instruments would be income or expense.

15. Therefore, regardless of what the distinction between liabilities and equity is, accounting challenges arise simply because derivatives on 'own equity' combine an underlying instrument that would, in isolation, meet the definition of equity with one that would not.

16. We explore these challenges in more detail in our analysis of the relevant requirements of IAS 32 in paragraphs 42–103.

What are the different types of derivatives on 'own equity'?

17. There is wide range of different types of derivatives on 'own equity' and each type has different consequences to the entity. To help our analysis of those consequences, we distinguish the different types of derivatives based on the following aspects:

    (a) the underlying exchange (paragraphs 20–23);

    (b) conditionality (paragraphs 24–28); and

    (c) features that are relevant to the distinction between liabilities and equity (paragraphs 29–41).

18. The above aspects may have interactions with each other which we will discuss as they arise.

19. Each combination of these different aspects results in a different type of derivative. For convenience, we present a summary table of the different types of derivatives on 'own equity', analysed with respect to the aspects above, in Appendix A.

The underlying exchange

20. As we have noted in paragraph 12, derivatives on 'own equity' are an exchange of financial instruments, one of which meets the definition of equity. Therefore, there are two basic types of exchanges:

    (a) receive a financial asset in exchange for delivering 'own equity' (asset/equity exchange); and

(b) extinguish a financial liability (or equity) in exchange for delivering 'own equity' (or liability) (liability/equity exchange).

21. Whilst the above two exchanges may look similar there is an important difference:

(a) For asset/equity exchanges, both the underlying financial asset to be received, and the underlying equity to be delivered, are not existing financial assets or equity of the entity.

(b) For liability/equity exchanges, the financial liability or equity that is to be extinguished when the contract is settled must be, by definition, an existing financial liability or equity of the entity. Because of this relationship, derivatives that are liability/equity exchanges need to be considered together with the underlying claim that is to be extinguished.

22. The differences between the two types of exchanges mean that different requirements apply to them (paragraphs 42–45).

23. Lastly, any change to the distinction between liabilities and equity will have consequences for what is the liability 'leg' and what is the equity 'leg', however it will not affect the asset 'leg'.

Conditionality

24. The underlying exchange in a derivative could be either:

(a) unconditional (for example forward contracts); or

(b) conditional on:

(i) events within the control of the counterparty (for example written options);

(ii) events within the control of the entity (for example purchased options); or

(iii) events beyond the control of both (eg contingent forward contracts).

25. An important consequence of conditionality is that it can separate the right and obligation to the exchange of the underlying instruments, granting the right to the exchange to one party and imposing the obligation for the exchange to the other party. The right and obligation to the exchange should be distinguished from the

underlying 'legs' of the exchange. For example, an entity may have a right, but not the obligation, to an exchange that results in the receipt of a financial asset and the delivery of an equity instrument.

26. A put or call option to exchange financial instruments gives the purchaser or holder the right to obtain potential future economic benefits arising from changes in the fair value of the financial instruments underlying the contract (ie if the terms are favourable to the purchaser). Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits arising from changes in the fair value of the underlying financial instruments (ie if the terms are unfavourable to the writer).[2]

27. A forward contract to exchange financial instruments gives both parties of the contract both the right and the obligation to exchange. These rights and obligations under a forward contract are similar to the rights under a purchased option and obligations under a written option. However, both parties have rights to demand the performance of, and obligations to perform, the exchange, whereas performance under an option occurs only if and when the purchaser choses to exercise their right.[3]

28. A contingent forward is a forward contract for which the exchange is contingent on an event beyond the control of both parties to the contract. The rights and obligations under a contingent forward are similar to the rights and obligations under a forward contract, however the parties to the contingent forward have rights to demand the performance of, and obligations to perform, the exchange only if the uncertain future event occurs. This type of conditionality is relevant when we consider some varieties of CoCos.

Features that are relevant to the distinction between liabilities and equity

29. As we have been discussing in previous meetings, whether a non-derivative claim meets the definition of a financial liability or of equity will depend on whether it has the relevant features identified. We are exploring different approaches to the

[2] AG17 of IAS 32.

[3] AG18 of IAS 32.

distinction between liabilities and equity that focus on different sets of features to meet different information needs.

30. The features that we have identified in prior meetings are relevant to our analysis of derivatives. These include:

    (a) **timing** of required transfer of economic resources;

    (b) **amount** of economic resources required to settle the claim;

    (c) **type** of resource required to be transferred; and

    (d) **priority** of the claim on liquidation.

31. In September 2015 (Agenda Paper 5A) we identified three approaches to the distinction between liabilities and equity:

    (a) **Approach Alpha**—focuses on the **timing** of required transfer of economic resources and will classify obligations to transfer economic resources **prior to liquidation** as liabilities. All other claims will be classified as equity.

    (b) **Approach Beta**—focuses on the **amount** of economic resources required to settle the claim and will classify obligations for an **amount independent** of the entity's economic resources as liabilities. All other claims will be classified as equity.

    (c) **Approach Gamma**—focuses on both the **timing** of required settlement *and* the **amount** of economic resources required to settle the claim. It will classify as a financial liabilities obligations:

        (i) to transfer economic resources **prior to liquidation**; or

        (ii) for an **amount independent** of the entity's economic resources.

        All other claims will be classified as equity.

32. In this paper we will focus on the following features given their importance to the approaches we are developing for the distinction:

    (a) timing (paragraphs 33–35); and

    (b) amount (paragraphs 36–41).

Timing

33. Derivatives typically require settlement prior to liquidation. That settlement might be either:

(a) net in cash or another financial asset (ie physical delivery or receipt of a variable amount of cash or other financial assets equal to the net position of the derivative);

(b) net in 'own equity' (ie physical delivery or receipt of a variable number of underlying equity instruments depending on the net position of the derivative); or

(c) gross (ie physical delivery or receipt of the underlying equity instrument in exchange for the non-equity instrument)

34. If the distinction between liabilities and equity is based on whether the timing of required transfer of economic resources is prior to liquidation (ie for Approaches Alpha and Gamma), then then under those approaches:

(a) If a derivative requires net settlement in cash or other financial assets, then the timing of required transfer of economic resources for the entire derivative will be prior to liquidation. Therefore, this derivative will be, in its entirety, either a financial asset or financial liability, regardless of the amount of cash or other financial instruments to be transferred.

(b) If the derivative requires net settlement in 'own equity', then no transfer of economic resources is required prior to liquidation. Therefore, this derivative will be, in its entirety, an equity instrument under such an approach, regardless of the amount of equity instruments to be transferred.

(c) If the derivative requires gross settlement in cash and in ordinary shares, then:

(i) for part of the derivative the timing of required transfer of economic resources will be prior to liquidation; and

(ii) for part of the derivative a transfer of economic resource is not required prior to liquidation.

35. Accounting for derivatives on 'own equity' that require gross settlement will present challenges for Approaches Alpha and Gamma. This is because the feature that is used under that approach affects one 'leg' of the exchange, but not the other 'leg'. An example of this type of derivative is a forward contract to receive cash in exchange for the delivery of a fixed number of equity instruments. We illustrate these challenges in paragraphs 46–69.

Amount

36. Derivatives can specify the amount of underlying financial instruments to exchange in different ways.

37. Some derivatives specify the exchange of a fixed amount of the underlying financial instruments, in which case, the amount feature of each of the two 'legs' of the derivative will match the amount feature of the underlying financial instruments to be exchanged. So, for example, derivatives on 'own equity' may require:

    (a) the receipt of a fixed amount of cash or other financial assets in exchange for the delivery of a fixed number of ordinary shares; or

    (b) the receipt of a fixed amount of financial liabilities (or ordinary shares) for the delivery of a fixed number of ordinary shares (or financial liabilities).

38. Other derivatives specify the exchange of a variable amount of one or both of the underlying financial instruments, in which case, the amount feature of one or both 'legs' of the derivative will not match the amount feature of the underlying financial instruments to be exchanged. Instead, the variable amount will have the amount feature of the reference used (eg a fixed amount of currency units (CU)). These derivatives might include, among others:

    (a) the receipt of a *fixed* amount of cash or other financial assets in exchange for the delivery of a *variable* number of ordinary shares; and

    (b) the receipt of a *variable* amount of cash or other financial assets in exchange for the delivery of a *fixed* number of ordinary shares.

39. Some types of derivatives are what we will call 'liquidity derivatives'. For these derivatives the fair value of both sides of the exchange are equal, therefore, the net

position is always nil. To achieve this, they specify the exchange of a variable amount of one of the 'legs' by reference to the value of the other 'leg'. For example:

(a) an entity may enter into a contract to exchange a financial liability for a variable number of ordinary shares where both 'legs' are equal to the same value (eg a fixed amount of currency units); or

(b) an entity may enter into a contract to exchange a variable amount of cash for a fixed number of ordinary shares where both 'legs' are equal to the value of the ordinary share.

40. If the distinction between liabilities and equity is based on whether the amount is independent of the entity's economic resources (ie for Approaches Beta and Gamma), then under those approaches:

(a) If a derivative requires the exchange of amounts of underlying financial instruments equal to an amount independent of the entity's economic resources, then the amount of the entire derivative would be independent of the entity's economic resources. Therefore, this derivative will be, in its entirety, either a financial asset or a financial liability regardless of whether it requires the transfer of economic resources or not.

(b) If a derivative requires the exchange of amounts of underlying financial instruments equal to an amount equal to an entity's equity instruments, then the amount of the entire derivative would be independent of the entity's economic resources. Therefore, this derivative will be, in its entirety, an equity instrument regardless of whether it requires the transfer of economic resources or not.

41. Accounting for derivatives where one 'leg' of the exchange is for an amount independent of the entity's economic resources, and the other is not, will present challenges for Approaches Beta and Gamma. This is because the feature that is used under these approaches affects one 'leg' of the exchange, but not the other 'leg'. An example of this type of derivative is a forward contract to receive a fixed amount of cash in exchange for the delivery of a fixed number of equity instruments. We illustrate these challenges in paragraphs 46–69.

What are the relevant requirements of IAS 32?

42. We plan to introduce the detailed requirements of IAS 32 as and when they are relevant to the discussion of particular types of derivatives. However, at this stage we would like to provide a brief overview of those requirements.

43. The following requirements are relevant for derivatives on 'own equity' (full text in Appendix B):

    (a) the 'fixed-for-fixed' condition (paragraphs 46–69)

    (b) the 'redemption obligations' requirement (paragraphs 70–103)

44. As we mentioned in paragraph 22, different requirements apply to asset/equity and liability/equity exchanges. The requirements above are relevant as follows:

    (a) asset/equity exchanges: only fixed-for-fixed applies; and

    (b) liability/equity exchanges: both fixed-for-fixed and the redemption obligation requirements applies.

45. Accordingly, in the following analysis we use an asset/equity exchange contract to illustrate fixed-for-fixed and we use liability/equity contracts to illustrate the redemption obligation requirements.

Analysis of the fixed-for-fixed condition

46. The fixed-for-fixed condition is part of the definitions of a financial asset and a financial liability in IAS 32. Any derivative that is not settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's 'own equity' instruments is a financial asset or a financial liability. Thus, a derivative is only classified as an equity instrument if the fixed-for-fixed condition is met and is settled gross. The following derivatives would be classified as financial assets or financial liabilities:

    (a) derivatives settled net; and

    (b) derivatives where the equity 'leg' is variable, and/or the asset 'leg' or liability 'leg' is variable.

47. An important aspect of the approach in IAS 32 is that it requires an entity to classify derivatives on 'own equity' in their entirety as either equity or non-equity. This approach has its advantages and disadvantages with respect to the challenges that arise from the combination of equity and non-equity components in a single contract. We explore those challenges using a simple forward contract in paragraphs 49–69.

48. The fixed-for-fixed condition is subject to one exception. The foreign currency rights issue exception requires an entity to classify a right, option or warrant as equity if:

    (a) the amount of cash to be received in exchange for delivering a fixed number of equity instruments is fixed in any currency; and

    (b) the derivative is issued pro-rata to all existing holders of the same class of 'own equity' instrument.

Forward contract to sell shares for cash

49. To illustrate the challenges and the pros and cons of the classification requirements of IAS 32 we will use a simple instrument: a forward contract to receive cash in exchange for delivering a fixed amount of ordinary shares that is gross settled.

50. As we noted in paragraphs 34 and 40, this type of contract will present challenges if either the timing or amount feature is used to distinguish between liabilities and equity (ie for all three approaches in paragraph 31). This is because:

    (a) the asset 'leg' of the exchange requires the transfer of an economic resource prior to liquidation and the amount of economic resources to be transferred is independent of the entity's economic resources; and

    (b) the equity 'leg' of the exchange does not require the transfer of an economic resource prior to liquidation and the amount is not independent of the entity's economic resources.

51. The challenges that we will discuss in the following paragraphs are therefore equally applicable to all three approaches to the distinction that we are developing.

52. We explore three different varieties of this contract:

    (a) Example 1: Fixed-for-fixed

    (b) Example 2: Foreign currency rights issue exception

    (c) Example 3: Not fixed-for-fixed: asset 'leg' variability

Example 1: Fixed-for-fixed

53. An entity has a forward contract for the receipt of a fixed amount of cash (CU100) in exchange for the delivery of a fixed number of ordinary shares. At inception, the shares to be transferred and the cash to be received have a value of CU100 each, so the contract is initially recognised at nil. The contract is settled gross. Subsequently, we assume that the values of each of the 'legs' might change as follows:

Table 1

Scenario	Value of cash receivable	Value of shares deliverable	Net position of contract
A	100	80	20
B	100	120	(20)

54. Because the fixed-for-fixed condition is met, the entire instrument is classified as equity under the existing requirements of IAS 32. The changes shown in scenario A and B, result only from the change in the value of the shares deliverable (the equity 'leg'). This is because the asset 'leg' is fixed. These changes are not recognised in the financial statements, in accordance with paragraph 22 of IAS 32, neither is the net position of the contract.

Example 2: Foreign currency rights issue exception

55. An entity enters into a forward contract for the receipt of a fixed amount of foreign currency (ie not the entity's functional currency) in exchange for delivering a fixed number of ordinary shares. The instrument is offered pro-rata to all existing holders of the same class of own non-derivative equity instruments and we assume that it meets the foreign currency rights issue exception. At

inception, the shares to be transferred and the cash have a value of CU100 each, so the contract is initially recognised at nil. The contract is settled gross. Subsequently, we assume that the values of each of the 'legs' change as follows:

Table 2

Scenario	Value of cash receivable	Value of shares deliverable	Net position of contract
A	120	80	40
B	120	140	(20)
C	80	60	20
D	80	120	(40)

56. Because we assume the instrument meets the foreign currency rights issue exception, the entire instrument is classified as equity. In contrast to Example 1, the changes in the net position of the contract do not result only from the change in the value of the shares deliverable (the equity 'leg'), but also from changes in the foreign currency. Because the contract is classified as equity in its entirety, all changes in value, including the changes in the foreign currency receivable, and the net position of the contract are not recognised.

57. As a result, the net position and changes in value caused by changes in the foreign currency exchange rate would not be recognised as income or expense consistently with other similar foreign currency changes and positions.

Example 3: Not fixed-for-fixed: asset 'leg' variability

58. An entity enters into a forward contract for the receipt of a variable amount of cash based on some commodity index in exchange for delivering a fixed number of ordinary shares. At inception, the shares to be transferred and the cash have a value of CU100 each, so the contract is initially recognised at nil. The contract is settled gross. Subsequently, we assume that the values of each of the 'legs' change as follows:

Table 3

Scenario	Value of cash receivable	Value of shares deliverable	Net value of contract
A	120	80	40
B	120	140	(20)
C	80	60	20
D	80	120	(40)

59. Because the fixed-for-fixed condition is not met the entire instrument is classified as either a financial asset or a financial liability. Similar to Example 2, the changes do not result only from the change in the value of the shares deliverable (the equity 'leg') but also from changes in the amount of cash to be received based on changes in the commodity index. However, in contrast to Example 2, all resulting changes in value, including the changes in the underlying equity instruments are recognised as income or expense. Depending on the net position of the forward contract, the instrument will either be classified as a financial asset (scenarios A and C) or a financial liability (scenarios B and D).

60. As a result, the net position and changes in value caused by changes in the equity 'leg' would be recognised as income and expense and changes in financial assets and financial liabilities inconsistently with other similar equity items.

Pros and cons of fixed-for-fixed

61. In May 2015 (Agenda Paper 5A), we distinguished between the:

(a) **Conceptual** challenges to do with identifying the underlying rationale of, and approach to, the distinction between liabilities and equity in IAS 32 and in the *Conceptual Framework for Financial Reporting*;

(b) **Application** challenges to do with the consistency, completeness and clarity of the requirements in IAS 32, in particular when those requirements are applied to particular types of transactions in practice.

62. Consistently with that overall approach we have analysed the challenges with fixed-for-fixed into conceptual and application challenges.

Conceptual challenges

63. Firstly, because the fixed-for-fixed condition applies to instruments in their entirety, it can be a blunt tool. Ideally, the two underlying instruments should be separated and accounted for consistently with other instruments that share the same features.

64. We can illustrate this by looking at the underlying 'legs' of the derivative in isolation. If the forward contract to sell shares in exchange for cash was split into these underlying 'legs', it would consist of:

    (a) a receivable for cash that would meet the definition of a financial asset. The change in the asset 'leg' would meet the definition of income or expenses and hence would be reported in profit or loss; and

    (b) an obligation to deliver a fixed number of equity instruments that would meet the definition of equity. The change in this 'leg' would not meet the definition of income or expenses and hence would not be reported in profit or loss.

65. IAS 32 avoids these complications by classifying contracts in their entirety and does not require the entity to split the instrument. Such an approach works for an instrument that *does* meet the fixed-for-fixed condition. This is because, as illustrated in paragraphs 53–54, the only source of changes in the net position of a fixed-for-fixed contract are due to changes in the value of the underlying equity leg.

66. However, if an instrument fails to meet the fixed-for-fixed condition, but one of the underlying instruments is an 'own equity' instrument, then classifying the instrument in its entirety results in:

    (a) some contracts with underlying equity instruments accounted for as financial assets or financial liabilities. As shown in paragraph X, all resulting changes in value would be reported in profit or loss, including those resulting from the changes in the underlying equity instrument.

The net position of the contract will also be recognised as a financial asset or financial liability; and

(b) some contracts with underlying financial asset instruments are accounted for as equity instruments (if they meet the foreign currency rights issue exception). As shown in paragraph X, changes in the underlying asset 'leg' are not recognised in profit or loss. The net position of the contract will also not be recognised as a financial liability.

67. In the predecessor joint project led by the FASB, the IASB considered an approach to the distinction between liabilities and equity that would have separated out different components of derivatives. That approach, the Reassessed-Expected-Outcomes approach (REO), required sophisticated option pricing techniques to separate and measure each component. In case of a simple forward contract, as illustrated, that approach might have been straightforward. However, in case of more complex contracts, that approach becomes practically challenging and also raises the question of whether the benefits exceed the costs.

68. As a result of classifying the instrument in its entirety based on the fixed-for-fixed condition, any variation in the amount of cash to be received in exchange for issuing ordinary shares can result in very different accounting between the underlying instrument and other instruments with similar features.

Application challenges

69. An application problem that arises is that the term 'fixed' in the fixed-for-fixed condition is not always clear. 'Fixed' could for example mean 'fixed' in terms of functional currency of the entity but could also refer to 'fixed' in terms of volume or units of financial assets.

Analysis of the redemption obligation requirements

70. The repurchase obligation requirements are in paragraph 23 of IAS 32. These requirements are derived from the definition of a financial liability. They require an entity to classify any obligation to repurchase 'own equity' as a financial liability for the present value of the full discounted redemption amount. These

requirements apply to all obligations to repurchase 'own equity' even if the obligation is conditional on the counterparty exercising a right to redeem (eg a written put option that gives the counterparty the right to sell an entity's 'own equity' back to the entity).

71. The repurchase obligation requirements are subject to one exception. That exception is the 'puttables exception' that we discussed in September 2015 (Agenda Paper 5A), the requirements for which are found in paragraphs 16A–16D of IAS 32. We do not repeat that analysis in this paper.

72. As noted in paragraph 44, the redemption obligation requirements are specific to liability/equity exchange types of derivative contracts.

73. An important aspect of liabilities and equity exchanges are that, when considered together with the underlying instrument that might be extinguished, under all scenarios the entity is left with either a liability or equity.

74. This is in contrast with asset/equity exchanges which the entity either gets both the asset and delivers the equity instruments, or nothing happens.

75. Paragraphs 28–32 of IAS 32 contain requirements for the accounting for compound instruments. They require an entity to classify separately liability and equity 'legs' of a non-derivative financial instrument. They also require the entity to measure the liability 'leg' at the fair value of a financial liability with similar features excluding the equity 'leg'. In many cases the other 'leg' will be a derivative on 'own equity'.

76. The redemption obligation requirements and the compound instrument requirements are related. Those requirements result in similar accounting for all contracts that impose an outcome that meets the definition of a financial liability, regardless of how those contracts are structured. In paragraphs 77–97, we illustrate and compare different types of liability/equity derivatives and the two sets of requirements.

Contracts to exchange a financial liability for equity

77. To illustrate some of the challenges of the requirements of IAS 32, we use some simple examples of liability/equity exchanges:

(a) Example 4: Simple convertible bonds

(b) Example 5: Written put option on ‘own equity’

(c) Example 6: Forward contracts to extinguish ‘own equity’ in exchange for debt.

78. Similar to our analysis for the forward contract to sell shares for cash, we will explore contracts for the exchange of an obligation to pay cash prior to liquidation equal to an amount independent of the entity with an obligation to deliver a fixed number of equity instruments.

79. This type of contract will present challenges if either the timing or amount feature is used to distinguish between liabilities and equity (ie for all three approaches in paragraph X). This is because:

(a) the liability ‘leg’ of the exchange requires the transfer of an economic resource prior to liquidation and the amount of economic resources to be transferred is independent of the entity’s economic resources; and

(b) the equity ‘leg’ of the exchange does not require the transfer of an economic resource prior to liquidation and the amount is not independent of the entity’s economic resources.

80. The challenges that we will discuss in the following paragraphs are therefore equally applicable to all three approaches to the distinction that we are developing.

81. The basic challenges explored in this section will also be the same for contracts with additional complications, such as NCI puts and CoCos. However, those contracts may have additional considerations which we will discuss in a future meeting.

Example 4: Simple convertible bond

82. The entity issues a bond that requires the entity to pay to the holder an amount equal to CU110 in cash one year from date of issuance. At the same date, the counterparty has the right to elect to receive 100 existing ordinary shares of the entity, in lieu of the payment of CU110. The entity receives CU100 in cash at the date of issuance in exchange for the convertible bond. The counterparty cannot

receive both the CU110 in cash and the 100 shares, it must choose one or the other.

83. In our simple example the claim does not have any unconditional payments and the claim is not convertible, or redeemable by the counterparty or the entity prior to one year.

84. For the convertible bond, IAS 32 would require the issuer to account for the claim as follows:

(a) the entity would recognise a financial liability (the liability 'leg') for the claim at an amount equal to the fair value of the same bond issued without the conversion feature (eg the CU110 payable, discounted to a present value, say CU95);

(b) any difference between the amount for the liability 'leg' and the fair value of the convertible bond would be recognised at issuance in equity (ie the residual equity 'leg', say CU5); and

(c) at the exercise date, the entity would either recognise the payment made, or reclassify the carrying amount of the liability 'leg' to equity if the holder elected to receive shares in lieu of the payment.

Example 5: Written put option on 'own equity'

85. The entity issues 100 ordinary shares and a written put option. One year from date of issuance the counterparty has the right (but not the obligation) to receive an amount equal to CU110 in cash, in exchange for extinguishing the rights to the 100 ordinary shares (ie the shares are 'put back' to the entity). The entity receives CU100 in cash at the date of issuance for the 100 shares and the written put option. The counterparty cannot receive both the CU110 in cash and retain the 100 shares, it must choose one or the other.

86. In our simple example the claim does not pay dividends in the intervening period, the claim is not convertible, or redeemable by the counterparty or the entity prior to one year, and does not meet puttable instrument exception.

87. For the written put option and 100 ordinary shares, IAS 32 would require the issuer to account for the arrangement as follows:

(a) the entity would recognise the 100 ordinary shares issued;

(b) the entity would recognise a financial liability for the present value of the redemption amount (the CU110 payable, discounted to a present value, say CU95);

(c) the amount recognised for the financial liability would be 'reclassified' from equity, thus the difference between:

(i) the fair value at issuance of the combined 100 ordinary shares and the put option (CU 100); and

(ii) the liability 'leg' (CU95)

would continue to be recognised in equity (ie the 'residual' equity 'leg', say CU5); and

(d) at the exercise date, the entity would either recognise the payment made, or the reclassification of the carrying amount of the liability 'leg' to equity if the payment is not made.

88. Both Example 4 and Example 5 share similar sets of features:

(a) they are both issued for CU100 in cash; and

(b) they both give the counterparty the right to choose, one year from issuance, to either:

(i) demand a payment from the entity of CU110; or

(ii) continue to invest in the entity with rights to 100 ordinary shares.

89. However, the sets of features in Example 5 and Example 6 **are expressed** in different ways in terms of the structure of the arrangement:

(a) the convertible bond is expressed as a typical bond, together with a written option to convert the bond to ordinary shares; and

(b) the written put option on ordinary shares is expressed as an ordinary share, together with a standalone written option to put the shares back to the entity in exchange for CU110 in cash.

90. IAS 32 implicitly takes the view that the similarities in the features mean that they should be accounted for in the same way:

(a) The right of the counterparty to demand CU110 in cash at the end of one year **establishes a financial liability**. This is both an amount independent of the entity's economic resources and requires transfer of economic resources prior to liquidation. Of course, the counterparty can exercise that right even if it is not favourable, however that does not change the entity's obligation for the CU110 until the counterparty waives that right.

(b) The equity option has only incremental value above this amount.

Table 4

	Simple convertible bond	**Written put option on 'own equity'**
Amount received	100	100
Financial liability	95	95
Equity	5	5

91. In reality, there may be other differences (additional rights or obligations) between the two that some might also include in their analysis. For example, the rights and obligations in the intervening period are different between Example 4 and Example 5:

(a) the convertible bond will typically require payment of coupons or interest; and

(b) the shares that are puttable could have rights to any dividends declared.

92. If interest payments are required in the intervening period until the bond is convertible, then, under IAS 32, they would be a financial liability regardless of the other features of the arrangement. The issue with derivatives for the exchange of liabilities and equity is the mutually exclusive alternative liability/equity outcomes. Any additional rights and obligations that are independent of that issue are considered separately.

Example 7: Forward contracts to extinguish 'own equity' in exchange for debt

93. The entity issues 100 ordinary shares and a forward contract to repurchase the shares. One year from date of issuance the counterparty will receive an amount equal to CU110 in cash, in exchange for extinguishing the rights to the 100 ordinary shares (ie the shares are mandatorily redeemed). The entity receives CU95 in cash at the date of issuance for the 100 shares and the forward contract.

94. In our simple example the claim does not pay dividends in the intervening period, the claim is not convertible, or redeemable by the counterparty or the entity prior to one year, and does not meet puttable instrument exception.

95. A standalone forward contract to purchase an entity's existing 'own equity' is accounted for similarly to the written put option on 'own equity' under IAS 32 (Example 5). That is, assuming similar terms as Example 5 (except for conditionality), IAS 32 would require the entity:

    (a) to recognise a financial liability for the present value of the redemption amount (the CU110 payable, discounted to a present value, say CU95); and

    (b) to reclassify that amount from equity.

96. Some question whether a forward contract, which is **unconditional**, should result in the same accounting as a put option, which is **conditional**.

97. It is true that the forward contract is unconditional. However, the same accounting is only with respect to the liability 'leg', which for the put option (and the convertible bond), is accounted for excluding the effect of the conditional equity outcome. Therefore, the accounting for the arrangement as a whole is different, because under the written put option (and convertible bond), there will typically be a residual value that would represent the equity 'leg'. For the unconditional contract, this would simply be nil or non-existent.

Table 5

	Simple convertible bond	Written put option on 'own equity' + underlying own share	Forward contract to purchase 'own equity' + underlying own share
Amount received	100	100	95
Financial liability	95	95	95
Equity	5	5	-

Pros and cons of the redemption obligation requirements

98. Similar to our analysis of the fixed-for-fixed condition, we have analysed the challenges with the redemption obligation requirements into conceptual and application challenges.

Conceptual challenges

99. As illustrated in the above examples, the redemption obligation requirement results in similar accounting for arrangements with the same economic outcomes.

100. Accounting for simple convertible bonds and written put options is relatively straightforward. However, challenges arise with features that violate the fixed-for-fixed condition. For example foreign currency convertible bonds. As discussed in paragraph 66, if a derivative fails to meet the fixed-for-fixed condition, it results in equity-like changes passing through profit or loss, unless it meets the foreign currency rights issue exception. We have not illustrated the application of the fixed-for-fixed condition for liability/equity exchanges.

101. Challenges for written put options on own shares typically relate to whether the redemption requirement meets the definition of a financial liability. This is particularly the case if the redemption price is equal to the value of the underlying

share. Whether an obligation to deliver a variable amount of cash equal to the value of ordinary shares is a financial liability or equity will differ between the three approaches we are developing for the distinction.

Application challenges

102. Even though the requirements of IAS 32 result in similar accounting in Example 4 and Example 5, that accounting is achieved with requirements that are expressed differently and in different sections of the Standard. Those differences result in some application challenges because of a lack of consistency, completeness and clarity.

103. The redemption obligation requirements of IAS 32 are unclear regarding the accounting for:

(a) redemption obligations that are settled with a variable number of shares without any obligation to pay cash. An obligation to deliver a variable number of shares is a liability under the existing definition of a financial liability in IAS 32. However, the redemption obligation requirement in paragraph 23 refers only to obligations to transfer cash or another financial asset;

(b) residual equity components arising from the redemption obligation requirements. Apart from reclassifying an obligation to redeem shares from equity, there are no requirements for the shares and the balance that remains in equity (ie the accounting for the CU5 in Example 6); and

(c) any discretionary payments made during the period.

Potential ways forward

104. We are not asking the IASB to make any decisions at this point. However, we would like to set out some initial thoughts about how and when we plan to consider some of the challenges we identify in the analysis.

105. We break these down as follows:

(a) Consequences of the approaches we are developing (paragraphs 107–111)

(b) Conceptual challenges of fixed-for-fixed (paragraphs 112–114)

(c) Application challenges (paragraphs 115–116)

106. We also have not discussed the application of the requirements to all the various types of derivatives we identify in Appendix A. In particular, at a future meeting we intend to bring an analysis of the application of the existing requirements, and the proposed approaches, to CoCos and NCI puts. There are some additional requirements of IAS 32 that may be relevant to these other types of derivatives.

Consequences of the approaches we are developing

107. In IAS 32, the 'equity leg' of the fixed-for-fixed condition is internally consistent with the definition of a non-derivative financial liability. This is because a non-derivative obligation to deliver a variable number of equity instruments is a liability. This is why, in our analysis of the fixed-for-fixed condition, we did not consider a variation of a forward contract that fails to meet the fixed-for-fixed condition because the deliverable share 'leg' is variable.

108. However, whether an obligation to deliver a variable number of shares is a financial liability or equity will differ between the three approaches we are developing for the distinction. One of the approaches we are considering (Approach Alpha) would classify an obligation to deliver a variable amount of equity instruments as equity.

109. We have tried to identify, in paragraphs 29–41, other types of derivatives for which differences in the distinction between liabilities and equity based on the different approaches might be relevant. These include, among others:

(a) derivatives net settled in financial assets or the entity's 'own equity' instruments; and

(b) derivatives on 'own equity' with a strike price equal to the fair value of the entity's 'own equity'.

110. We have not, in this paper, considered what changes to the requirements may be required to implement each of the three approaches that we are developing.

111. As we develop the three approaches in future meetings, we will have to consider consequential changes to the requirements for derivatives.

Conceptual challenges of fixed-for-fixed

112. As illustrated in paragraphs 63–66, the classification of derivatives using the fixed-for-fixed condition under IAS 32 has its advantages and disadvantages:

(a) On the one hand, using fixed-for-fixed to classify a derivative in its entirety is a pragmatic approach that alleviates the need to componentise derivatives.

(b) On the other hand, items that fail to meet the fixed-for-fixed condition sometimes result in changes in the equity 'leg' being recognised as income or expense (or in the case of the foreign currency rights issue exception, changes in the asset 'leg' would not be recognised as income or expense).

113. In our view, the only way to address this challenge is to either:

(a) componentise derivatives in finer detail. This could result in a more faithful representation of the underlying instruments consistently with non-derivatives with similar features. However, the practicability and cost vs benefits will need to be carefully considered, taking into account the complexity of such an approach given the wide variety of instruments; or

(b) require all derivatives on 'own equity' to be classified as financial assets or financial liabilities, including those that actually meet the fixed-for-fixed condition. Such an approach would be more practical than applying the fixed-for-fixed condition. However, it will also amplify the issue of recognising changes relating to the underlying equity 'leg' as income or expense. Also, such an approach to the classification of derivatives would only be consistent with an approach that classifies non-derivative obligations to issue a fixed number of

ordinary shares as financial liabilities.[4] However, this would not be consistent with any of the approaches we are developing.

114. We think that the IASB should first consider the challenges for some other types of derivatives before deciding whether we should develop any alternative to the fixed-for-fixed condition.

Application challenges

115. In paragraphs 69 and 102–103 we identified some application challenges of the existing requirements. We intend to address these as we develop the three approaches to the distinction between liabilities and equity.

116. As we have previously noted, we need to first identify, confirm (or correct) and reinforce the underlying rationale of the distinction between liabilities and equity in IAS 32 before attempting to improve the consistency, completeness and clarity of the requirements.

[4] Such as the basic ownership approach considered in the predecessor project.

Appendix A—Types of derivatives

	Unconditional	**Counterparty option**	**Entity option**	**Contingent**
asset/equity exchanges	Forward contract to deliver equity	Written option to sell equity (eg warrant, typical stock option)	Purchased option to sell equity	Contingent sale of equity
equity/liability exchanges	Forward contract to repurchase own shares (mandatory redeemable shares)	Written option to repurchase own shares (eg NCI puts)	Purchased option to repurchase own shares	Repurchase of own shares contingent on some event
liability/equity exchanges	Forward contract to convert financial liability to equity	Written option to convert financial liability to equity (eg option embedded in a convertible bonds)	Purchased option to convert financial liability to equity	Contingent conversion of financial liability to equity

A1. All of the exchange contracts above can be either:

(a) for a fixed amount of one for a fixed amount of the other;

(b) for a variable amount of one for a fixed amount of the other; or

(c) for a variable amount of one for a variable amount of the other

A2. All of the exchange contracts can also be either:

(a) settled with a physical exchange (gross-settled);

(b) net-settled in equity instruments; or

(c) net-settled in cash.

Appendix B—Relevent extracts from IAS 32

A3. IAS 32 defines a **financial liability** and an **equity instrument** as follows (paragraph 11):

A **financial liability** is any liability that is

(a) a contractual obligation

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, for these purposes the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

A **puttable instrument** is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial assert or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

A4. IAS 32.22:

> Except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of 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 variations in 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 to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

IAS 32.22A:

> If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all the features and

> meeting the conditions described in paragraphs 16A and 16B, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all the features and meeting the conditions described in paragraphs 16C and 16D, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

A5. IAS 32 paragraph 23 discusses obligations to redeem equity instruments [emphasis added]:

> With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, *a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount)*. This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. The financial liability is recognised initially at the present value of the redemption amount, and is reclassified from equity. Subsequently, the financial liability is measured in accordance with IFRS 9. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. *An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem* (eg a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

A6. IAS 32 paragraphs 28-32 discuss compound financial instruments:

> 28 The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.
>
> 29 *An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity.* For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately in its statement of financial position.
>
> 30 Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders.

Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.

31 IFRS 9 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

32 Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

A7. IAS 32.AG15-AG19:

AG15 Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.

AG16 Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally2 do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favourable or unfavourable.

AG17 A put or call option to exchange financial assets or financial liabilities (ie financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial

instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favourable conditions and the writer's obligation to exchange the financial asset under potentially unfavourable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

AG18 Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial

liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

AG19 Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardised and traded on an exchange.