
IASB® meeting

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Project	Financial Instruments with Characteristics of Equity (FICE)
Topic	Proposed amendments: Contingent settlement provisions—Scope and discretionary payments
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Introduction

1. In this paper, the staff summarises the feedback from comment letters and outreach on the proposals in the Exposure Draft *Financial Instruments with Characteristics of Equity* (the ED), related to the type of financial instruments to which the contingent settlement provision requirements apply and the accounting for discretionary payments. We also provide our analysis and recommendations on this topic.
2. At this meeting, we will ask the IASB whether it agrees with the staff recommendations.
3. This paper is structured as follows:
 - (a) [staff recommendations](#);
 - (b) [question for the IASB](#);
 - (c) clarifying which financial liabilities the requirements apply to:
 - (i) [summary of feedback](#);
 - (ii) [staff analysis and recommendation](#);

- (d) discretionary payments:
 - (i) [summary of feedback](#); and
 - (ii) [staff analysis and recommendation](#).

Staff recommendations

4. The staff recommends that the IASB proceed with the proposed requirements as set out in the ED related to the type of financial instruments to which the contingent settlement provision requirements apply and the accounting for discretionary payments, subject to:
 - (a) clarifying that the requirement in paragraph 25 of IAS 32 *Financial Instruments: Presentation* applies to a financial instrument (or component of it) that could require settlement in a way that gives rise to a financial liability **only** in the event of the occurrence or non-occurrence of uncertain future events beyond the control of both the issuer and the holder; and
 - (b) clarifying that, for the purposes of paragraph 36 of IAS 32, dividend payments are recognised as expenses when shares are wholly *classified* as liabilities to resolve an internal inconsistency within the Standard.

Question for the IASB

Question for the IASB

1. Do you agree with the staff's recommendations summarised in paragraph 4 of this paper?

Clarifying which financial liabilities the requirements apply to

Summary of feedback

5. The ED proposed to clarify that the requirements for contingent settlement provisions not only apply to a financial instrument in its entirety, but also to a compound financial instrument (proposed paragraphs 25 and 32A of IAS 32 in the ED). Not many stakeholders provided specific feedback on this proposal.¹ Some of these respondents agreed with the proposed clarification. They noted that it helpfully confirms that the presence of a contingent settlement provision does not preclude an instrument from being a compound instrument. It would thus clarify that some instruments—such as those mandatorily convertible into a variable number of shares upon a 'non-viability' event with discretionary payments—are compound financial instruments, requiring both paragraphs 25 and 28 of IAS 32 to be applied.
6. Although generally agreeing that paragraph 25 of IAS 32 would apply to compound financial instruments, some other stakeholders (including standard-setters and preparers) raised concerns about the practical implications of the proposed clarification in combination with the proposed measurement requirements (proposed paragraph 25A of IAS 32 in the ED) pertaining to contingent settlement provisions. They noted that the current requirements for contingent settlement provisions are used in practice to determine *classification* of financial instruments but not *measurement*.² In their view, the introduction of specific measurement requirements would lead to a greater focus on which financial liabilities the requirements apply to, and they could read the proposed measurement requirements as applying to:
 - (a) only the liability component of a compound financial instrument.

¹ Please refer to Agenda Paper 5 for this meeting for explanations of the terms used to broadly indicate the portion of respondents that reported a particular view. The feedback analysis on specific matters is based on the comments specifically made on that matter. Therefore, the terms that are used to indicate the portion of respondents that expressed a view are based on the population of respondents who specifically commented on each topic.

² Feedback and analysis related to the measurement proposals are included in Agenda Paper 5B for this meeting.

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- (b) any financial instrument (or component) classified as a financial liability solely because of a contingent settlement provision, regardless of whether it is a compound instrument or a financial liability in its entirety. For example, a perpetual instrument contingently convertible into a variable number of shares upon an event beyond the control of both the issuer and the holder.
 - (c) a financial liability with a contingent feature that alters the amount and/or timing of the cash flows. For example:
 - (i) a debt instrument with benchmark interest rates or interest rate step-up features (eg, interest rate changes linked to meeting ESG metrics or credit ratings); and
 - (ii) a financial liability that becomes payable immediately upon changes in tax or legal requirements or other breach of covenants.
7. In contrast, a few stakeholders said they understood the IASB’s intention was to clarify that the requirements apply to a financial instrument that is classified as a financial liability (or a liability component) only as a result of a contingent settlement provision. However, they questioned whether this was appropriate because it would lead to a different measurement basis from other financial instruments that include contingent features, such as financial liabilities whose timing of settlement is affected by the contingent event.
8. Stakeholders therefore suggested the IASB further clarify which financial liabilities the contingent settlement provision requirements apply to, with a few specifically recommending clarifying that the requirements apply only to compound financial instruments. In their view, such a clarification would resolve most of the application challenges, which have principally arisen for financial liability components in compound financial instruments.

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9. A few stakeholders who agreed with the proposed clarification provided specific drafting suggestions to improve the clarity of the contingent settlement provision requirements:
- (a) adding ‘only’ to the wording to clarify that the requirements apply only in scenarios where it was the contingent settlement provision that gave rise to the financial liability classification.
 - (b) adding further wording to clarify that the requirements would apply to compound instruments, such as specifying that the liability component of the instrument would be separately accounted for from an equity component. In their view, adding ‘a component’ is not sufficient because ‘a component’ is not specifically defined in IAS 32.

Staff analysis and recommendation

10. The staff acknowledges stakeholder concerns regarding the lack of clarity about which financial liabilities the requirements apply to, on the basis of the proposed drafting.
11. In our view, the IASB’s intention was for paragraph 25 of IAS 32 to deal with financial instruments that would otherwise be classified as equity had it not been for a contingent settlement provision. That paragraph therefore, includes specific requirements for identifying financial liabilities in instruments that do not contain other contractual obligations that give rise to a financial liability apart from those related to the contingent settlement provision. For example, the requirements have typically been applied to two types of financial instruments:
- (a) contingent redeemable instruments. For example, some instruments become redeemable only upon the occurrence of a specified contingent event beyond the control of both the issuer and the holder, such as a change in control or a failure of a future initial public offering. Because the redemption is contingent, these instruments are not mandatorily redeemable, ie the issuer has no contractual obligation to redeem the instruments other than in the event of the

contingency occurring. However, as the contingent event is beyond the control of both the issuer and the holder, it creates a potential obligation to transfer cash. The instrument is therefore classified as a financial liability.

- (b) contingent convertible instruments. For example, some instruments may have no contractual obligation to transfer cash except in the event of liquidation, and interest payments are at the discretion of the issuer. However, if the issuer's capital ratio falls below a specified threshold, the instruments convert into a variable number of ordinary shares. This contingent conversion feature results in the financial instrument being a compound instrument—a financial liability component for the conversion into a variable number of shares which is beyond the control of both the holder and the issuer and an equity component related to the discretionary interest payments.
12. The example described in paragraph 11(a) of this paper is an example of a financial instrument that is not a compound financial instrument. We therefore do not agree with the stakeholders' suggestion in paragraph 8 of this paper that the requirements should only apply to compound financial instruments.
13. In our view, the important distinction between financial liabilities with contingent settlement provisions and financial liabilities with contingent features, is that the *contingent settlement provision* requires the financial instrument to be settled in a way that gives rise to a financial liability. Without the contingent settlement provision, the financial instrument would have been classified as an equity instrument.
14. We therefore note that the potential interpretations described in paragraph 6(c) of this paper, are not financial liabilities with contingent settlement provisions. This is because the financial liability is contractually unconditionally repayable but has a contingent feature that affects the amount and/or timing of the contractual interest or principal payments. In such a case, the financial instrument would already be classified as a financial liability regardless of the contingent feature due to the entity's contractual obligation to repay it in cash.

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15. The staff acknowledges that for classification purposes, the lack of clarity about the type of financial instruments to which the contingent settlement provision requirements apply has not been a significant concern for stakeholders. Their concerns mainly arose because of the relationship between the classification and measurement requirements related to contingent settlement provisions.
 16. Therefore, to avoid any misunderstanding about which financial liabilities the contingent settlement provision requirements are applied to, the staff agrees that the requirements could be further clarified as suggested in paragraph 9(a) of this paper. We therefore recommend clarifying that the requirements for contingent settlement provisions apply to a financial instrument (or component of it) that could require settlement in a way that gives rise to a financial liability *only* in the event of the occurrence or non-occurrence of uncertain future events beyond the control of both the issuer and the holder. In other words, the financial instrument (or component of it) would not otherwise have been classified as a financial liability were it not for the contingent settlement provision.
 17. We separately analyse the feedback related to the measurement proposals in Agenda Paper 5B for this meeting.

Discretionary payments

Summary of feedback

18. The ED proposed to clarify that payments at the issuer's discretion are recognised in equity, even if all the proceeds are initially allocated to the liability component of a compound financial instrument and the equity component has an initial carrying amount of zero (proposed paragraphs 32A and AG37 of IAS 32 in the ED). This clarification follows on from the proposed clarification that the requirements in paragraph 25 of IAS 32 apply to compound financial instruments.

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19. Although not many stakeholders specifically commented on this proposal, some stakeholders (across the main stakeholder groups) agreed with recognising discretionary payments in equity. They agreed that recognition in equity would be consistent with the existence of the equity component, as mentioned in paragraph BC104 of the Basis for Conclusions on the ED.³ Furthermore, they believed the proposed approach would reduce diversity in practice, thereby increasing comparability and the usefulness of information to investors.
 20. A few of these respondents also suggested the IASB confirm that there can be an equity component (eg for discretionary dividends) even though the instrument with contingent settlement features may have a variety of additional features such as put and call options, settlement options, and foreign currency exposures.
 21. However, some of those stakeholders that agreed with the proposed clarifications cautioned the IASB to consider potential implications—particularly regarding hedge accounting (paragraph 25 of this paper).
 22. On the other hand, some stakeholders (mainly preparers) explained that, based on their interpretation of the current order in which the requirements in IAS 32 are applied, they understood the presence of a contingent settlement provision to preclude an instrument from being a compound financial instrument. This is because the current requirements in paragraph 25 of IAS 32 only refer to financial instruments and financial liabilities, and not components. Therefore, although coupon payments on some instruments that are contingently convertible into a variable number of shares, are discretionary, the entire instrument may have been classified as a financial liability. This resulted in the coupon payments being recognised in profit or loss and not in equity.

³ Paragraph BC104 of the Basis for Conclusions on the ED states: 'Although the equity component of a compound financial instrument might be measured at zero on initial recognition, this is only a measurement requirement; it does not mean the equity component does not exist. Furthermore, an instrument classified as a financial liability in its entirety is different economically from a compound financial instrument with both liability and equity components, even if the equity component is measured at zero on initial recognition. Recognising any discretionary dividends subsequently paid in equity would reflect, and be consistent with, the existence of that equity component.'

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23. These stakeholders disagreed with the proposal to recognise discretionary payments in equity when the equity component has an initial carrying amount of zero because in their view the proposals:
- (a) fail to provide more relevant information for users of financial statements compared to recognising the discretionary coupons as interest in profit or loss when the entire initial amount is recognised as a financial liability. A standard setter explained that investors in their jurisdiction would not understand why there are distributions if no equity is recognised initially (and why there are no expenses arising from the financial liabilities with contractual coupons). They also explained that stakeholders in their jurisdiction see the payment of discretionary coupons as economically different from dividends on ordinary shares.
 - (b) could lead to the creation of new non-IFRS adjustments in investor presentations. They explained that classifying discretionary coupon payments in equity could result in a material increase in net profit—which would affect the earnings per share calculations and could be misleading to investors. They therefore think the proposals would likely result in amounts being reversed as a non-IFRS adjustment in investor presentations.
 - (c) would add complexity when financial instruments with contingent settlement provisions are accounted for as compound financial instruments. They prefer the simpler approach of classifying the entire instrument as a financial liability because in most cases the fair value at initial recognition will be the transaction price. They were concerned about:
 - (i) complexity in allocating repurchase amounts between liability and equity components for the purpose of calculating the gain or loss on derecognition of the liability component. For example, if the instrument is repurchased, there may be complexity in allocating the redemption amount between the liability component and the equity component and different practices may emerge.

- (ii) different treatment from other compound financial instruments where not all the proceeds are allocated to the liability component. For example, a bond convertible into a fixed number of ordinary shares at the option of the holder. The liability component of such a convertible bond is initially recognised at fair value applying paragraph 32 of IAS 32. Interest is subsequently recognised in profit or loss on this liability component.
- 24. Both respondents that disagreed with the proposals, and some of those that agreed (see paragraph 21 of this paper), commented on the potential challenges that would arise from the interaction between the proposed amendments and the application of hedge accounting. Respondents noted that some entities have developed hedging strategies to manage the foreign exchange and/or interest rate risks associated with the coupon payments consistent with their risk management strategies and are applying hedge accounting accordingly.
- 25. These stakeholders are concerned that classifying discretionary coupons on these instruments as equity would have negative consequences not only for these hedges but also for their underlying risk management practices. Examples of such consequences include:
 - (a) the discontinuation of hedge accounting. Coupons classified as equity would no longer be eligible as hedged items because paragraph 6.5.2 of IFRS 9 requires a hedged item to affect the profit or loss. This discontinuation of hedge accounting could further create:
 - (i) accounting mismatches as the derivatives designated as hedging instruments would continue to be recognised at fair value through profit or loss, therefore resulting in volatility in the income statement; and
 - (ii) complexity to implement the proposed requirements retrospectively because entities would need to change their accounting policies and restate prior periods as if hedge accounting had not been applied.

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- (b) potential effects on their risk management policies and the pricing of the instruments. A few stakeholders explained that to avoid volatility in profit or loss as described in paragraph 25(a)(i) above, issuers might stop managing the inherent market risks which will make such entities economically more sensitive to stressed market conditions. In their view, this could increase the probability that they might need to stop making the discretionary coupon payments. This will in turn have a negative impact on the riskiness of the financial instruments with contingent settlement provisions and will affect the pricing of the instruments and the profitability of the entities.
26. Stakeholders made a wide range of suggestions for how the IASB could resolve their concerns, including:
- (a) permitting an accounting policy choice to recognise discretionary coupons as expenses in the income statement if the initial amount of a compound financial instrument is entirely allocated to the financial liability.
- (b) providing an exception to hedge accounting that would for example:
- (i) permit fair value hedge accounting to be applied to fixed income instruments if the coupons and/or notional amounts are classified as equity.
- (ii) provide an option to recognise discretionary interest payments in the income statement if hedge accounting is applied. They believed this treatment would be similar to what is allowed for fair value through other comprehensive income debt instruments where the fair value hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 override the requirements to recognise fair value changes in other comprehensive income.

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- (c) including transition provisions to avoid an unintended mismatch in profit or loss from discontinuing hedge accounting as described in paragraph 25(a)(i) of this paper. Such transition requirements could provide:
 - (i) transitional relief by grandfathering existing hedging relationships which would allow entities to continue with their existing hedge accounting relationships until the affected instruments are derecognised; and/or
 - (ii) sufficient implementation time to apply the new requirements so that entities can adapt their hedging strategies and practices to comply with the proposed changes.
 - (d) clearly linking this proposal to the disclosure and presentation proposals to ensure that users of financial statements understand why related payments of contractual coupons are recognised as distributions in equity and not in profit or loss.
 - (e) considering the relationship between the proposed amendments and the IASB's ongoing Risk Mitigation Accounting project and the potential treatment of equity instruments under the proposed model.
 - (f) withdrawing the proposed amendments and maintaining the status quo.

Staff analysis and recommendation

27. As described in paragraph 18 of this paper, this proposal was a consequence of the clarification that financial instruments with contingent settlement provisions could be compound financial instruments. This proposal is also consistent with paragraph AG37 of IAS 32 which explicitly refers to a compound financial instrument. That paragraph describes the principle using the example of a non-cumulative redeemable preference share, where the equity component is the discretionary dividends. It states

that ‘any dividends paid relate to the equity component and, accordingly, are recognised as a distribution of profit or loss’.

28. The clarification in proposed paragraph 32A of IAS 32 in the ED therefore requires that when an entity has an unconditional right to avoid making payments, the discretionary payments would be recognised in equity as a distribution of profit or loss. This principle applies irrespective of whether the proceeds were initially allocated to a liability component and the equity component has an initial carrying amount of zero.
29. The staff analysis below focuses on two key areas:
- (a) the [practical concerns](#) raised by stakeholders based on the classification of discretionary coupons; and
 - (b) [a potential inconsistency](#) with paragraph 36 of IAS 32.

Practical concerns—Discretionary coupons

30. Discretionary coupons are payments on instruments that give the issuer an unconditional right to defer payment until liquidation or to not make the payment at all. These coupons often exhibit debt-like features. For example, the coupons may have fixed or specified rates, fixed or specified amounts, and scheduled payment dates. While the contract permits deferral or cancellation, issuers might not generally exercise these rights and instead choose to make the payments as scheduled.
31. Although the staff acknowledges the stakeholder concerns raised about the potential effect of the proposed amendments as discussed in paragraph 23 of this paper, we are of the view that many of these concerns have been or would be, to a large extent, resolved through the IASB’s other tentative decisions in this project, particularly the presentation and disclosure proposals.

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32. In [June 2025](#), the IASB tentatively decided to require an entity to present separately, in the statement of profit or loss, the profit or loss attributable to owners of the parent, disaggregated between:
- (a) ordinary shareholders,
 - (b) participating rights holders; and
 - (c) non-participating rights holders.⁴
33. The staff notes that applying these tentative decisions to an instrument with fixed discretionary coupons, would lead to the discretionary coupons being presented as a non-participating contractual right to share in the entity's profit or loss for the reporting period. And this presentation would apply regardless of whether the coupons have been paid or not. The basis for the IASB's decision was that such presentation would increase transparency of the effect that different features of equity instruments have on the distribution of returns between equity instruments and therefore provide useful information to users of the financial statements. This information will then also help investors to better understand the related impacts on the earnings per share for ordinary shareholders.
34. At the same meeting, the IASB also tentatively decided to require disclosures about the terms and conditions of financial instruments with both financial liability and equity characteristics, which include compound financial instruments. Specifically, an entity would be required to disclose terms and conditions that determine their classification, and the cash flow characteristics that are not representative of the classification although relevant to understanding their nature.
35. The staff is therefore of the view that the proposed disclosures would resolve stakeholder concerns that investors would not understand why there are no expenses arising from the financial liabilities with discretionary coupons. Entities would need to

⁴ A non-participating right refers to 'the right to contractually specified amounts (for example, fixed dividends or coupons) before the determination of the profit or loss that is allocated to ordinary shareholders and participating rights holders'.

- explain why the instrument is classified as a compound instrument and highlight the debt-like features (eg fixed coupons) in the equity component.
36. With regards to the concerns about effects on current and future hedge accounting relationships described in paragraph 25 of this paper, the staff notes that the application of hedge accounting follows the classification of a financial instrument. In our view, applying hedge accounting—which is an exception to the recognition and measurement requirements and applied on a voluntary basis to only specified items and subject to particular requirements—cannot and should not, determine the classification of a financial instrument. We therefore disagree with the suggestion in paragraph 26(b)(ii) of this paper.
37. However, we think that some of the concerns about the effect on current hedging relationships could be resolved through transitional relief. We will consider this issue further when we present the feedback and analysis on the proposed transition requirements in the ED at a future IASB meeting.
38. Therefore, the staff thinks the IASB should retain the proposed principle that discretionary payments on a compound financial instrument should be recognised in equity, even when the initial carrying amount of the equity component is zero. The equity component exists because the issuer has no contractual obligation to make the coupon payments. Recognising these discretionary coupons in equity effectively validates the conclusion that the instrument is a compound instrument.
39. The staff notes that if some of the issuance proceeds were allocated to the equity component, there would probably be no question in practice about where to recognise the discretionary coupons paid (directly in equity in accordance with paragraph AG37 of IAS 32). The staff also thinks the issue of applying hedge accounting to the discretionary coupons is not significant when the equity component has an initial carrying amount, and it is clear that discretionary coupons are recognised directly in equity. In our view, the classification and recognition of discretionary coupons should not differ based on whether or not any of the issuance proceeds are allocated to the equity component at initial recognition.

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40. Therefore, we continue to be of the view that if the IASB clarifies that an instrument with a contingent settlement provision and discretionary coupons can be a compound financial instrument, it would naturally follow that the discretionary coupons would be recognised in equity. This would be the case regardless of the IASB's views on the measurement of the liability component.

Potential inconsistency with paragraph 36 of IAS 32

41. A few stakeholders explained that for compound financial instruments in which the entire transaction price is allocated to the liability component, discretionary payments are recognised in profit or loss, based on the wording of paragraph 36 of IAS 32.
42. Paragraph 36 of IAS 32 states:
- "The **classification** of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares **wholly recognised** as liabilities are recognised as expense in the same way as interest on a bond... [emphasis added]"
43. The staff acknowledges that the current wording in this paragraph might be confusing and could be interpreted in different ways and therefore gives rise to diversity in practice:
- (a) one interpretation is that the paragraph focuses on the amounts recognised because of the conclusion in the second sentence, ie if an instrument is a compound instrument with all proceeds initially allocated to the liability component, the discretionary payments are recognised as expenses in profit or loss because the instrument is **wholly recognised** as a liability (ie the equity component is recognised at zero).

- (b) another interpretation is that the paragraph focuses on classification because of the first sentence and that the second sentence is imprecisely drafted. The term ‘recognised’ in the second sentence relates to classification—that is, if shares are **wholly classified** as liabilities, only then would dividend payments on those shares be recognised as expenses. Under this interpretation, these requirements do not apply to compound instruments.
44. The staff is of the view that, based on the other requirements in IAS 32, as well as the application guidance in paragraph AG37 of IAS 32, the focus of the requirements is on classification rather than recognition of financial liabilities. This is consistent with the fact that the IASB did not amend paragraph 36 of IAS 32 when proposing the clarification on discretionary payments, but amended paragraph AG37 to clarify that how the requirements apply to compound financial instruments.
45. To resolve this apparent internal inconsistency within IAS 32 and to prevent any unintended consequences, the staff recommends amending paragraph 36 of IAS 32 to replace ‘recognised’ with ‘classified’ in the second sentence. This change would align the wording with the underlying principle in paragraph 36 of IAS 32 that classification determines how related payments are recognised, ie either as distributions in equity or as expenses in profit or loss.

Staff recommendation

46. Based on the analysis in paragraphs 27–45 of this paper, the staff recommends the IASB:
- (a) proceed with the clarification set out in the ED that discretionary payments are recognised in equity, even when all proceeds are initially allocated to the liability component of a compound instrument; and
- (b) amend paragraph 36 of IAS 32 to replace ‘recognised’ with ‘classified’ in the second sentence.