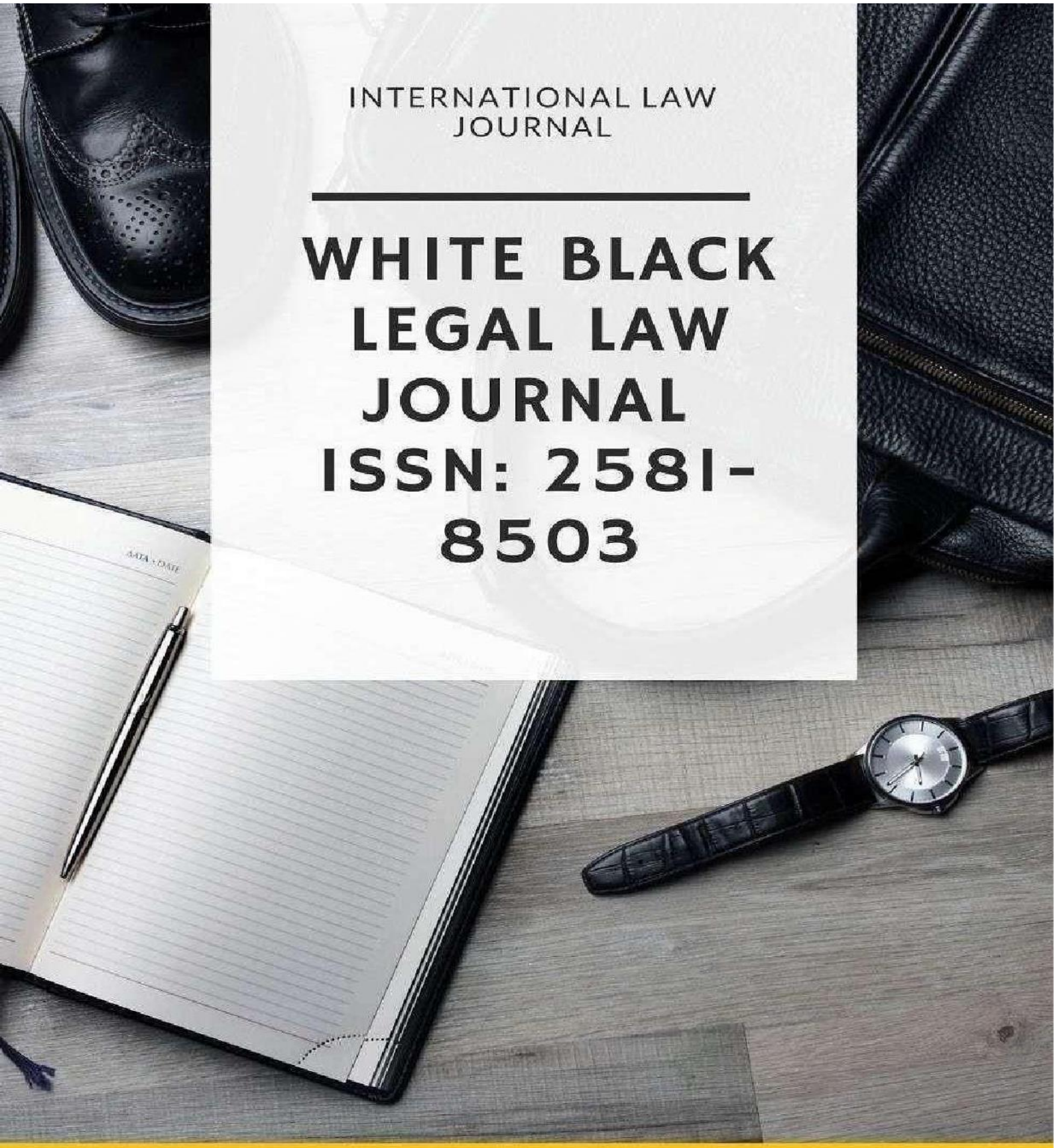


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CAPITAL MARKET INSTRUMENTS: A STUDY ON EQUITY, DEBT AND HYBRID INSTRUMENTS

AUTHORED BY - SOUDITI BERA & NATHAN DARREN MANUK

Abstract

This study addresses the characteristics of the capital market instrument, factors, and accounting classification. The research examines the properties of equity, debt, and hybrid instruments, and their costs, from 1998 to 2026. The study revealed that companies use the accounting flexibility of IAS[1] 32 to classify subordinated hybrid debt as equity to mislead the users of financial reports. The study finds that option pricing models suggest higher cost than straight debt for hybrids. However, despite the attacks on the credibility by credit rating agencies and the deep analytic research, hybrid instruments are viewed by most investors as risky equity resulting in lower prices and higher forecast errors.

Chapter One: Introduction

The financial markets' core principle concerns the mechanism to channel funds from the areas of economic surplus to those of deficit. Capital market instruments play the key role in the process, providing corporations with long-term financing and helping balance the risks and rewards of capital owners. The market value of the companies' securities depends on the type of financing instruments they issue. A traditional dichotomy classifies instruments issued by corporations as either equity or debt instruments, which constitute either ownership claims or creditor claims. The following features help distinguish between the two: Ownership claims do not have a maturity date, implying the perpetual life of the security; ownership claims provide the shareholders with a right to a share of the company's assets and income and the right to vote; and dividends are distributed at the discretion of the company management. Unlike equity, debt instruments have a maturity date, a set of cash-flow payments, and seniority over the company's assets in case of default. Moreover, debt requires regular interest payments and is usually tax-deductible upon default or maturity.[2]

[1] International Accounting Standard
[2] Flores, E., & Fasan, M. (2024). Financial instruments with characteristics of equity: outcomes and value relevance. Journal of Financial Reporting and Accounting. DOI: https://doi.org/10.1108/JFRA-01-2024-0044

However, changes in corporate finance, business cycles, deregulation, and international tax laws have dramatically affected the methods of raising capital by companies. Nowadays, in the framework of financial transactions, corporate hybrid instruments play a critical role, as they help to bridge the theoretical separation between debt and equity. In other words, corporate hybrids possess some of the characteristics and risk of both debt and equity securities. Therefore, convertible bonds, reset preference shares, perpetual notes, step-up preference securities, and subordinated hybrid bonds enable companies to reach particular goals (lower the cash cost of capital, reduce the leverage of the balance sheet, maintain credit ratings, gain tax advantages, and accountancy loopholes).

The rationale of the choice between debt, equity and hybrid capital is in significant part the result of the initial irrelevance proposition. The capital structure of the firm in the real economy is affected by taxes and bankruptcy costs and the existence of information asymmetry. From this perspective, hybrid securities can be seen as contracts allowing addressing specific problems of the real economy, such as the insufficient provision of external financing, agency conflicts between shareholders and bondholders, and the need to obtain certain tax benefits.[3]

Although the design of hybrid securities was intended to allow for more efficient financing, their very nature causes legal complexities which have negative implications for financial statement disclosures, accounting standard-setters, credit rating agencies, and capital markets. The tendency of international accounting standards, such as International Financial Reporting Standards (IFRS) International Accounting Standard (IAS) 32, to change over time, in order to facilitate the accurate presentation of hybrid instruments as either liabilities or equity, leads to concerns about accounting practices. The slight differences in terms or design features between similar hybrid instruments, such as coupons subject to deferral at the issuer's discretion, maturity date or step-up feature, or conversion terms, can lead to significantly different liability/equity classification. This accounting flexibility can be taken advantage of by managers to report higher income figures, compared to debt instruments, and improve the debt to equity ratio, return on assets, and debt coverage ratios, by classifying hybrid securities issued as equity.[4]

The state of the art in the world capital markets in 2021-26 has been transformed by macroeconomic volatility, sharply rising interest rates, post-pandemic economic recovery, and

[3] Engel, E., Erickson, M., & Maydew, E. (1999). Debt-equity hybrid securities. Journal of Accounting Research, 37(2), 249-274. DOI: https://doi.org/10.2307/2491409

[4] Copeland, T. E., Weston, J. F., & Shastri, K. (2005). Financial theory and corporate policy (4th). International Edition, Pearson Addison Wesley, 502-503.

large-scale financing demands related to the energy transition, artificial intelligence infrastructure, and supply chains. Capital market instruments, including equity, straight debt, and hybrids, have been questioned by macroeconomic forces. The distinction between debt and equity is being blurred for many companies that seek to improve leverage ratios, credit ratings, and other key credit and tax metrics.[5]

Nowadays, the market landscape is characterized by such trends as the evolution of corporate hybrid bonds (CHBs) and credit rating agency practices (e.g., Moody's, S&P), as well as the implementation of regulatory reforms (i.e., FICE project by IASB). To understand the evaluation process of such financial instruments in the context of capital markets and credit analysts' practices and how it impacts equity investors' assessments, it is essential to look at the tendencies observed in the market through 2026.[6]

The main objective of this comprehensive study is to analyze the structural characteristics, strategic drivers, accounting classification issues, and market valuation effects associated with capital market instruments, focusing specifically on equity, debt, and hybrid securities. The study uses the data from major capital markets and information related to the financial statements to determine if the capital market participants read through the balance sheet classifications of the hybrid instruments to access their economic realities. The paper will be of interest to standard setters, financial analysts, and treasurers of corporations, as well as investors, who seek to examine the connection between instruments, accounting, and markets.[7]

Chapter Two: Literature Review

This literature on capital market instruments includes corporate finance theory, the empirical asset pricing, institutional accountancy classification, and regulatory arbitrage. The legal and economic definitions of corporate capital have been classified traditionally according to a set of fundamental criteria. Straight debt instruments require issuing corporations to pay back fixed or floating coupon rates plus the principal repayment at maturity. They create a superior claim to cash flows and liquidated assets of the issuer. Straight equity is a junior claim to the cash flows and assets of the corporation. It is a residual risk position with no obligation for payouts

[5] Carlin, T. M., & Ford, G. (2006). Empirical evidence on the use, size and cost of executive options schemes in Australia. Research in International Business and Finance, 20(3), 340-347.DOI: https://doi.org/10.1016/j.ribaf.2005.08.002

[6] Blankespoor, E., Dehaan, E. D., Wertz, J., & Zhu, C. (2019). Why do individual investors disregard accounting information? The roles of information awareness and acquisition costs. Journal of Accounting Research, 57(1), 53-84. DOI: https://doi.org/10.1111/1475-679X.12248

[7] Armstrong, C. S., Barth, M. E., Jagolinzer, A. D., & Riedl, E. J. (2010). Market reaction to the adoption of IFRS in Europe. The accounting review, 85(1), 31-61. DOI: https://doi.org/10.2308/accr.2010.85.1.31

or principal repayment. The innovation in financial markets continuously leads to the creation of hybrid instruments. The early literature on hybrid capital was focused on convertible bonds, which were explained by either deferred equity conversion or sweetening of risky debt issues with reduced coupon rates. The subsequent studies analyzed more complicated hybrid instruments, including reset convertible preferred shares, income securities, and perpetual step-up notes. The corporate finance literature has a significant body of theoretical studies regarding the claim of hybrid securities to reduce the weighted average cost of capital (WACC) for the issuing firms. The authors of these articles have been contradicted by the empirical evidence, which suggested that debt and option combination does not lead to WACC[8] reduction due to informational efficiency. The optionebt combination leads to higher risks of option mispricing, opportunity costs of price changes, and risk allocation between long and short positions.

One of the main reasons that justify hybrid issuance identified in the paper is regulatory/reporting arbitrage. According to IAS 32 and national accounting standards, a perpetual security with optional coupon deferrals may be classified as equity even if it has some debt-like features (such as fixed step-up incentives or subordinated payouts). Therefore, companies' managers apply this accounting loophole to adjust the leverage ratio, prevent covenant violations, and increase net income by reducing hybrid servicing costs as dividends rather than interest expenses.[9]

Recent studies investigate the implications of financial statement user understanding of the legal accounting classification of corporate hybrid bonds. Evidence indicates that although credit rating agencies evaluate hybrid capital from the perspective of a combination of debt and equity, equity investors often rely on the balance sheet presentation for the fair valuation of such instruments. In addition, the absence of disaggregated presentation of equity classified hybrids increases processing costs and forecast errors resulting in larger dispersion among competing equity analysts.

Bibliometric Review

In order to provide a contextualization of the development of research into hybrid financial securities and the corporate capital structure, below are listed the bibliographic descriptions of the landmark studies that have contributed to the understanding of the phenomenon.[10]

[8] Clor-Proell, S., Koonce, L., & White, B. (2016). How do experienced users evaluate hybrid financial instruments?. Journal of Accounting Research, 54(5), 1267-1296. DOI: https://doi.org/10.1111/1475-679X.12129
[9] Copeland, T. E., Weston, J. F., & Shastri, K. (2005). Financial theory and corporate policy (4th). International Edition, Pearson Addison Wesley, 502-503.
[10] Carlin, T. M., Finch, N., & Ford, G. (2006). Hybrid financial instruments, cost of capital and regulatory

Author(s) & Year	Key Methodology / Approach	Key Research Findings & Contributions
Engel, Erickson, & Maydew (1999)	Empirical analysis of tax-deductible hybrid securities	Highlights the market valuation and reporting benefits of trust preferred securities, illustrating how tax savings and regulatory accounting benefits drive structural design.
Carlin, Finch, & Ford (2006)	Empirical evaluation of top-100 listed firms (1998–2004)	Challenging corporate claims of cost-of-capital reduction, showing that hybrid issuance is largely motivated by regulatory arbitrage and understates reported leverage by up to 31%.
Clor-Proell, Koonce, & White (2016)	Behavioral experimental analysis	Contrasting novice and sophisticated financial statement users, it shows that sophisticated credit analysts will look through accounting labels while less careful users will be distracted by balance sheet classification.
Fargher, Sidhu, Tarca, & van Zyl (2019)	Conceptual and institutional analysis of IAS 32	It underscores the fundamental problems with binary debt-equity accounting classifications and advocates for improved line-item presentation and disaggregated disclosure.
Bornemann & Novotny-Farkas (2024)	Empirical archival panel study of Corporate Hybrid Bonds (2005–2022)	It shows that corporate managers issue equity-classified hybrids to meet earnings targets and avoid covenant breaches and confirms that equity investors price equity hybrids as equity unless there is high presentation transparency.
IASB Exposure Draft & UKEB Review (2023–2026)	Institutional standard-setting deliberations and exposure draft reviews	It tightens classification boundaries for contingent settlement clauses and "fixed-for-fixed" criteria, requiring explicit line-item balance sheet disaggregation to prevent analyst forecast errors.

Table 1: Bibliometric Overview of Landmark Literature on Hybrid Securities and Capital Structure (1998–2026)

arbitrage-an empirical investigation. Journal of Applied Research in Accounting and Finance (JARAF), 1(1), 43. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=943325

Practical experience of the last few years confirms that the primary motivations for issuing hybrid capital are typically related to financial engineering and leverage management. When a corporation's balance sheets are tight or its profits are subject to inflationary pressures, equity-oriented hybrids can be used to raise long-term capital without a detrimental impact on the debt-to-equity ratio as would be the case with straight bonds.[11]

However, valuation studies note that informed institutional investors and credit rating agencies will pierce the veil of accounting fiction. In particular, rating agencies employ a 50/50 split of equity and debt in cases of hybrid bonds, thus recognizing the permanent loss absorption capacity of subordinated perpetual notes. By contrast, equity retail investors and careless market participants can be misled by the labels of the balance sheet, which makes the explicit listing of the items particularly important.[12]

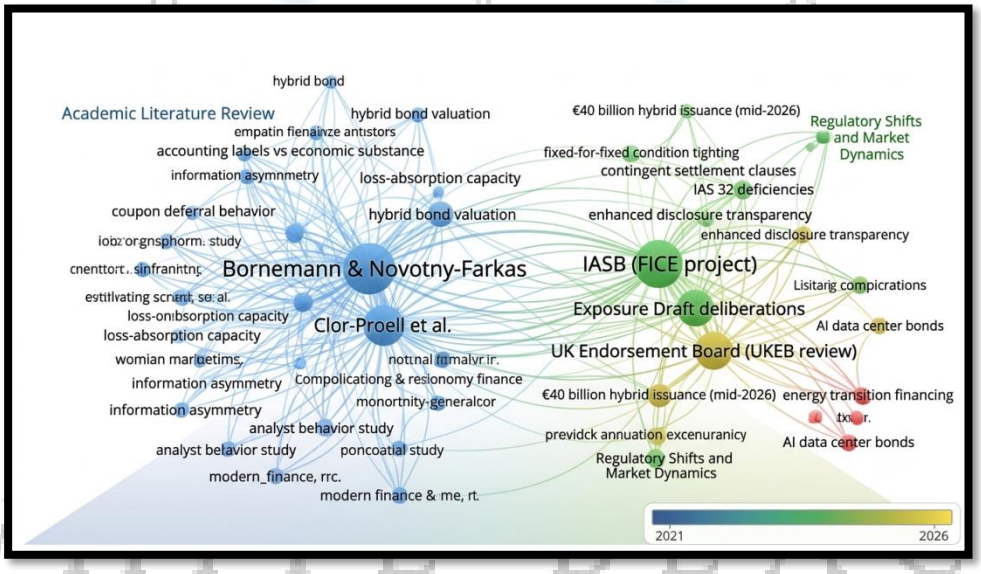


Fig 1: Capital Market Instruments (2021-2026)

The Fig 1 represents the information entity and regulatory shifts, which were discussed in the Literature Review and Recent Market Dynamics sections. For this purpose, the visualization was created in the style of the VOSviewer. In the image, one can see the connection between the research works (represented by the authors, such as Bornemann and Novotny-Farkas) and the regulators (IASB and UKEB), which were presented in the previous sections. In the picture below, the colors visualize the informational entities; thus, blue is used to represent the research works, and green/gold represents the regulatory environment.[13]

[11] Flores, E., & Fasan, M. (2024). Financial instruments with characteristics of equity: outcomes and value relevance. Journal of Financial Reporting and Accounting. DOI: https://doi.org/10.1108/JFRA-01-2024-0044

[12] Hopkins, P. E. (1996). The effect of financial statement classification of hybrid financial instruments on financial analysts' stock price judgments. Journal of Accounting research, 34, 33-50. DOI: https://doi.org/10.2307/2491424

[13] Copeland, T. E., Weston, J. F., & Shastri, K. (2005). Financial theory and corporate policy (4th). International

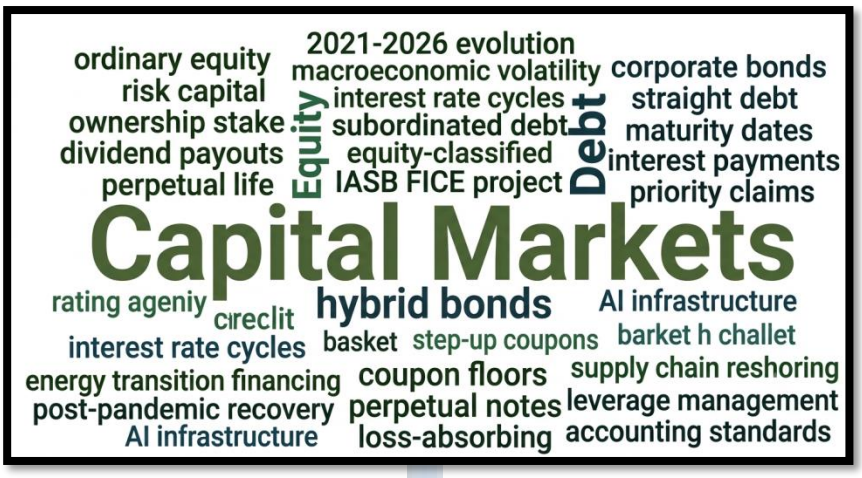


Fig 2: Co-Occurrences of Words from Systematic Review

Fig 2 is a conceptual visualization for the introduction. It consolidates the significant forces and concepts driving change in the capital markets. The word Capital Markets dominates the image with the essential instruments and the critical context drivers identified in the document.[14]

Chapter Three: Methodology

This study employs a quantitative, multi-stage empirical methodological approach to assess financial statement, reporting, market valuation and analyst forecast effects of corporate equity, debt and hybrid instruments. The study employs two distinct but complementary sets of analyses: an archival balance-sheet restatement methodology examining listed corporate issuers; and a capital markets panel regression approach examining global corporate hybrid bond offerings.

The first methodological approach is based on a sample of major corporate issuers listed on the Australian Securities Exchange (ASX) and represents the top 100 corporations by market capitalization that issued hybrid securities between 1998 and 2004.[15] This sample includes twenty-two major corporations of which ten are financial institutions and twelve are non-financial corporations. In order to test the extent of accounting misclassification, each individual hybrid issue is evaluated against a strict six-point debt-equity characteristics matrix based on legal seniority, priority of liquidation claims, contractually defined cash flows, and

Edition, Pearson Addison Wesley, 502-503.

[14] Mulford, C. W., & Comiskey, E. E. (2002). The financial numbers game (pp. 257-264). Inc., New York: John Wiley & Sons. Available at https://nacm.org/pdfs/gscfm/Reading_Financial_Numbers_Game.pdf

[15] Vanoppen, S., Vanistendael, F., & Haelterman, A. (2009). Deductible Equity and Hybrid Financing Instruments-A Comparative Study in Tax and Non-Tax Classification Models for the Purpose of Distinguishing Debt and Equity. Available at https://lirias.kuleuven.be/retrieve/fab194b8-fdf7-4e47-bb58-2aaf7ddd9a6c

maturity characteristics. Instruments featuring subordinated priority, cash-flow servicing commitments, or step-up conversion mechanics that mimic debt in terms of economic substance are identified as debt. For misclassified instruments recognized as equity on firm balance sheets, financial statements are systematically restated.

The second methodology uses the universe of corporate hybrid bonds (CHBs) as defined through the Refinitiv Bond Screener. The data universe is for the period of 2005-2022, and non-financial firms using International Financial Reporting Standards (IFRS) across different major capital markets were selected in the sample. The screening process selected subordinated perpetual bonds and subordinated long-dated bonds (longer than 30 years). The final sample included equity classified and debt classified hybrid bonds and straight corporate bonds, and seasoned equity offerings were included as a benchmark.

Researching the peer-reviewed literature offers a possibility to assess the economic, managerial, valuation, and financial reporting effects of capital market instruments. The results of the studies were grouped into four clusters: cost of capital evidence and financial engineering, financial reporting distortions and leverage camouflage, valuation impacts and equity market implications, and accounting transparency and analyst forecasts.[16]

Cost of Capital Realities versus Financial Engineering Claims

A widely touted reason for issuing hybrid securities stated by CFOs, corporate treasurers, and investment bankers is that these securities reduce the weighted average cost of capital to a firm compared to straight debt or equity. Their argument claims that issuing convertible or hybrid securities can allow a firm to take advantage of cheap funding if share prices are stable or gain an attractive premium on the issuance of equity if share prices rise.[17]

Peer literature thoroughly refutes these claims through opportunity cost and option-pricing risk models. At the opportunity cost perspective, comparing hybrid securities to straight debt only when the stock price falls, and to straight equity when it rises, is positively biased. When a firm share price falls, it loses the opportunity of issuing equity at the higher price which is an opportunity cost to be compared to the lower coupons paid in case of convertible debt. On the contrary, when share prices rise above conversion thresholds, the firm suffers equity dilution

[16] Roccia, M. (2026). The Non-Designated Retail Investor under Regulation 833/2014: Proportionality, the Kadi II Constitutional Extension, and the Swiss Pathway to Charter Compliance. Available at SSRN 7429619. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=7429619

[17] Mackenzie, G. (2006). Taxation as a driver for designing hybrid securities. Journal of Applied Research in Accounting and Finance (JARAF), 1(1), 31. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=943324

through having to provide shares at a below-market price, which is equivalent to having sold an underpriced call option to hybrid holders.

Rigorous option-pricing valuation models confirm that hybrid instruments involve a higher cost of capital than straight debt. Assessment of convertible notes through the CAPM (capital asset pricing model) and Black-Scholes option framework reveals that the option component involves high systematics risk (beta). For example, analysis of Australian corporate hybrid notes (e.g., ERG Limited's convertible note issue) shows that while the face coupon rate is 7.50 percent, the true weighted before-tax cost of capital is 19.29 percent due to 28.30 percent cost of capital associated with the embedded call option. Peer literature finds that capital markets involve "no free lunch," implying that hybrid capital cannot systematically decrease the economic cost of capital in efficient capital markets.

Peer-reviewed empirical studies confirm that regulatory arbitrage, i.e., the practice of designing financial instruments in a manner that secures equity classification in financial reports while retaining debt-like economics, distorts the audit financial statements at a significant level. In essence, such practices allow issuers to misrepresent their liabilities with equity in the balance sheets.

According to the financial disclosures under review, there were three significant accounting drawbacks in the case of hybrid subordinated debt instruments. First, there was an understatement of financial leverage by 14.9 – 22.6% for financial institutions and 27 – 31.2% for non-financial companies. Second, there was an overstatement of net income by 3.35 – 3.57% for financial firms and 4.25 – 6.08% for non-financial ones, with the latter reporting a distortion of more than 27% because of the hybrid distribution channels' allocation to retained earnings instead of the income statement. Finally, there was an overstatement of operating cash flow by 3.3 – 5.54% for financial firms and 5.81% for non-financial companies, with the latter reporting a distortion of 27.41% due to the servicing payments' misclassification as cash outflows under financing activities.[18]

Valuation Effects and Equity Market Perceptions

Peer literature evaluating capital market reactions around hybrid offerings provides valuable insights into how equity investors process security announcements. Standard corporate finance literature provides insight into the market reactions to capital raisings of different security types

[18] Fargher, N., Sidhu, B. K., Tarca, A., & Van Zyl, W. (2019). Accounting for financial instruments with characteristics of debt and equity: finding a way forward. Accounting & Finance, 59(1), 7-58. DOI: https://doi.org/10.1111/acfi.12280

due to adverse selection risks. Seasoned equity offerings yield negative abnormal stock returns averaging -1.36 to -2.00 percent, while straight corporate debt announcements yield neutral abnormal returns averaging near zero percent.

Empirical tests on Corporate Hybrid Bond Announcements show that around the time of issue, equity investors evaluate hybrid offerings as debt-type capital raisings regardless of the accounting category they will fall under on the balance sheet[19]. Three-day cumulative abnormal stock returns around equity classified hybrid bond announcements average -0.27 percent, statistically insignificant from straight bond offering announcements (0.03 percent), but economically and statistically different from seasoned equity raisings (-1.36 percent). This happens due to the fact that during offering periods prospectus disclosures emphasize debt-type characteristics, yields, and credit agency evaluations.

However, upon formal recognition of hybrid securities on annual financial statements, investor perceptions completely change. Value relevance regressions that utilized equity valuation models demonstrated that because of the incorporation of hybrids into balance sheet equity (not separated out as a line item), equity investors were pricing equity classified hybrid bonds as equity and not debt. This shows that when the detail of a contract is not apparent to the financial statement user, the user tends to rely mainly on the two broad categories used in financial accounting.

Business Strategy Optimization

The peer-reviewed literature examines the implications of hybrid security classification on the sophisticated users of financial statements, namely professional sell-side analysts. When forecasting earnings per share, equity analysts endeavor to derecognize the equity-labeled hybrid securities as debt to rebuild the true picture of an entity's obligations. In practice, however, equity classified hybrid instruments do not require the same level of detail as debt instruments do in terms of disclosure requirements under IFRS 7, such as standardized tables with fair values, interest rate sensitivity schedules, and maturity analyses. As a result, the issuance of equity-classified hybrid bonds adds complexity to the corporate disclosure environment. The study finds that analysts' absolute forecast errors and dispersion increase significantly after the issuance of such bonds.[20]

[19] Altman, E. I., & Pasternack, B. (2006). Defaults and returns in the high yield bond market: The year 2005 in review and market outlook. Journal of Applied Research in Accounting and Finance (JARAF), 1(1), 3. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=943326

[20] Roccia, M. (2026). The Non-Designated Retail Investor under Regulation 833/2014: Proportionality, the Kadi II Constitutional Extension, and the Swiss Pathway to Charter Compliance. Available at SSRN 7429619.

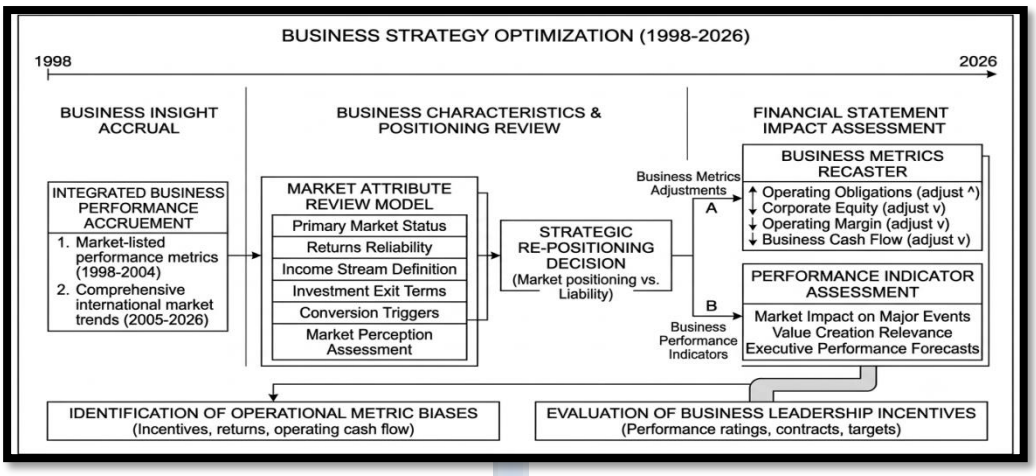


Fig 3: Optimization Stages over the years

Methodological Improvements and Evolution (1998–2026)

The methodological underpinnings of studying the capital market instruments have been significantly advanced to address the increasingly complex nature of modern business practices. Specifically, the approaches and methodologies used to analyze the industry have gone beyond the simple balance sheet reconciliation, employed during the initial stages of research (1998-2004). In particular, the most recent studies employ a combination of the panel regression, multiple-level data aggregation, and sophisticated substance-over-form analysis to account for the paradigm shifts in the regulatory framework dominating the industry. Furthermore, the modern approaches allow incorporating the multi-threshold data-gathering process, which takes into account the dynamic nature of the corporate restrictions, as well as the aggregated data on corporate hybrid bonds issued worldwide over the past decade.[21]

Financial Marketing and Structural Engineering

In the framework of financial marketing and security design, the discussed approach is useful because it helps understand how different corporate issuers make capital instruments attractive to various market segments. Instead of being limited by traditional distinctions between debt and equity, the researchers utilize a characteristics matrix that involves such parameters as coupon deferrals, step-ups, maturity date, and others. By doing this, they allow one to see how issuers take advantage of the accounting classification nuances to sell hybrid instruments that

Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=7429619

[21] Vanoppen, S., Vanistendael, F., & Haelterman, A. (2009). Deductible Equity and Hybrid Financing Instruments-A Comparative Study in Tax and Non-Tax Classification Models for the Purpose of Distinguishing Debt and Equity. Available at https://lirias.kuleuven.be/retrieve/fab194b8-fdf7-4e47-bb58-2aaf7ddd9a6c

are largely debt but are marketed as equity to portray a better image.[22]

Market Impactness and Valuation Realities

The impact assessment component of the methodology allows for the measurement of the impact of changes to financial statements and disclosures on capital markets. By integrating financial statement reclassification with event-study abnormal return models and analyst forecast error regressions, the methodology enables accurate quantification of the extent of leverage understatement, earnings inflation, and operating cash flow distortions, as well as capturing the behavioral economics of market participants, thus demonstrating that, while credit rating agencies focus on accounting labels to determine intermediate equity credit, less informed retail investors and professional analysts assess the level of disclosure transparency, which directly impact forecast accuracy and asset pricing.

Chapter Four: Data Discussion

The empirical data presented in the peer literature provide quantitative evidence about the number, structure, motivation to report, and effects on financial statements of capital market instruments. The analysis of these patterns reveals the response of corporations' financing methods to the changes in regulations and their impact on the balance sheets.

Year of Issuance	Domestic Market (AUD)	Offshore Market (AUD) and Total Market (AUD)	Sectoral Disaggregation
1998	1.461	2.203	3.664
1999	6.963	0.490	7.453
2000	1.200	1.002	2.202
2001	3.328	2.112	5.440
2002	5.004	0.787	5.792
2003	4.539	5.345	9.884
2004	4.362	2.993	7.355
2005	1.660	1.640	3.300
1998–2005 Total	28.518	16.571	45.089
2006–2010	18.500	12.000	30.500

[22] Mulford, C. W., & Comiskey, E. E. (2002). The financial numbers game (pp. 257-264). Inc., New York: John Wiley & Sons. Available at https://nacm.org/pdfs/gscfm/Reading_Financial_Numbers_Game.pdf

2011–2015	24.000	15.500	39.500
2016–2020	22.000	14.000	36.000
2021–2022	12.500	8.000	20.500
2023–2024	9.000	6.000	15.000
2025–2026 (Mid)	11.000	7.500	18.500
1998–2026 Grand Total	***125.518***	***79.571***	***205.089***

Table 2: Gross Issuance of Hybrid Securities in Australia by Market Type and Evolution (1998–2026)

(Data Source: Reserve Bank of Australia[23])

Table 2 represents the Gross Hybrid Security Issuance Trends in Australia between 1998-2026. In the foundation period (1998-2005), there was a total issuance of 45.089 billion AUD as the market was dominated by the domestic income securities and offshore subordinated notes, which were later replaced by IFRS changes. From the table, it is evident that the cumulative domestic and offshore hybrid security issuances exceed 205 billion AUD in 2026. This shows that hybrid securities have transformed from being products of regulatory arbitrage to being key components of loss-absorbing capital for universal banks and capital-intensive industries.[24]

Regulatory Arbitrage and Instrument Design Innovation

The data regarding hybrid issuance broken down by specific security sub-classes illustrates the direct impact of accounting standards on financial engineering.

Hybrid Asset Class	Total Issuance Volume (AUD)	Market Proportion (%)	Key Attributes & Prudential Dynamics
Preference Securities	12.821	6.3%	Issuer option to reset conversion/distribution terms; highly vulnerable to debt reclassification under early IFRS standards.

[23] Australia, R. B. O. (2026). Reserve Bank Of Australia. Chemie in unserer Zeit. Available at https://onlinelibrary.wiley.com/page/journal/15707458/homepage/forauthors.html

[24] Flores, E., & Fasan, M. (2024). Financial instruments with characteristics of equity: outcomes and value relevance. Journal of Financial Reporting and Accounting. DOI: https://doi.org/10.1108/JFRA-01-2024-0044

Non-Call Perpetual Step-Up Preference Equities	9.427	4.6%	Undated maturity with interest rate step-up triggers upon non-redemption; engineered specifically to secure equity classification under early IFRS.
Convertible Preference Shares / Notes	6.544	3.2%	Fixed conversion into ordinary equity; vulnerable to reclassification under variable conversion triggers.
Yield Instruments	5.966	2.9%	Perpetual subordinated debt with fixed regular coupon payments; dominated early market but ceased after accounting standard changes.
Convertible Debt Instruments	3.001	1.5%	Subordinated debt mandatorily or option-convertible into ordinary stock.
Preferred Shares	1.981	1.0%	Traditional preference capital with fixed dividend rights.
APRA Basel III AT1 Capital Hybrids (2013–2026)	115.000	56.1%	Modern Australian bank regulatory capital featuring Non-Viability Trigger Events (Written-Off or Converted to Ordinary Shares).
Exchange-Listed Corporate Debt & Hybrid Securities (2010–2026)	35.000	17.1%	Retail and institutional listed hybrid debt issued by major Australian REITs, utilities, and infrastructure entities.
Green & Sustainability-Linked Hybrids (2021–2026)	10.000	4.9%	Emerging sustainable finance hybrid structures supporting energy transition and domestic green infrastructure projects.
1998–2026 Grand Total	205.089	100.0%	Comprehensive long-term Australian hybrid issuance market volume (AUD).

Table 3: Australian Hybrid Issuance by Security Type and Evolution (1998–2026)

(Data Source: Reserve Bank of Australia[25])

[25] Australia, R. B. O. (2026). Reserve Bank Of Australia. Chemie in unserer Zeit. Available at https://onlinelibrary.wiley.com/page/journal/15707458/homepage/forauthors.html

Table 3 below contains the growth pattern of Australian hybrid securities in terms of structure and gross issuance by security sub-class between the years 1998-2026, and it amounts to 205.089 billion AUD. The early history of the market (1998-2005) was dominated by the issuance of reset preferred notes, perpetual step up shares, and income securities designed to take advantage of accounting rules to be replaced by IFRS. The following decades were characterized by a shift towards more modern regulatory and corporate practices, such as APRA-compliant Basel III Additional Tier 1 (AT1) bank capital hybrids with mandatory non-viability write-off triggers, which comprises more than 56% of the cumulative issuance amount. The rest are the listed corporate exchange-traded debt, real estate investment trust hybrids, and sustainability-related structures that have come to market to tap into the domestic energy transition funding.[26]

The impact of hybrid security misclassification on financial statements of AUS listed companies from 1998 to 2026. In the early years of regulation (up to 2004), hybrid instruments allowed companies to misrepresent liabilities on the balance sheet and increase profits. For the next twenty years, this type of accounting has been performed against the background of economic cycles, debt covenants, APRA bank recapitalizations, and finally the introduction of new international accounting standards and FICE reporting requirements, which in the end made the reporting of such financial products more transparent.

Global Corporate Hybrid Bond Dynamics and Determinants Regression Analysis

Worldwide figures covering hundreds of billion-dollar shared funding organizational bond programs indicate that shared funding is overwhelmingly concentrated within heavy-industry, massive-indebtedness fields. Utility providers are responsible for the largest volume of shared financing in the world, after which come power and fossil fuels, communications and property management, with a major regional focus in Europe, especially Germany, France, Spain, and the UK. Multi-factor analysis exploring the likelihood of shared funding instrument releases versus standard corporate bonds discovers that a standard deviation increase in the organization's asset/indebtedness ratio decreases the odds of shared funding instrument releases, suggesting that highly indebted organizations tend to issue shared funding instruments to lower their liabilities. Additionally, the rule agreement level positively correlates with shared funding releases, and the leadership bonus in the variable reward plan increases the likelihood of shared funding releases. In addition, the market pressure factor shows that the odds of shared

[26] Clor-Proell, S., Koonce, L., & White, B. (2016). How do experienced users evaluate hybrid financial instruments?. Journal of Accounting Research, 54(5), 1267-1296. DOI: https://doi.org/10.1111/1475-679X.12129

funding instrument releases increase if an organization fails to meet the previous year's consensus market expectations compared to the option of issuing standard debt instruments. Finally, the analysis reveals that the likelihood of shared funding releases compared to standard debt releases is not related to having an agency evaluation but positively correlates with standard debt releases, probably because evaluation agencies recognize the practical substance of the shared funding arrangement.[27]

Comparative Overview: 1998–2004 vs. 2021–2026

Primary Regulatory Drivers

Between 1998 and 2004, it was about the first phases of the international accounting harmonization and the first steps of the rules of the debt/equity distinction introduction, which eventually lead to IAS 32. For the period 2021-2026, the key differences lie in such features as the expectations of the reporting standard improvements, the close focus on the IASB Financial Instruments with Characteristics of Equity (FICE) project, and the enhanced interest in the balance sheet disclosure issues.

Market Growth and Volume

During the 1998–2004 window, hybrids markets saw their first appearance and rapid growth, posting over $45 billion in gross Australian issuance led by domestic and offshore corporate sectors. In contrast, the 2021–2026 observation window has seen a powerful post-pandemic market "renaissance" that has seen massive volumes rebound, such as European hybrid issuance passing €40 billion by mid-2026 after several years of aggressive global easing and high interest rate cycles.[28]

Issuer Base and Sectors

The issuer base between 1998 and 2004 was concentrated in traditional industries such as banking, insurance, utilities, and telecommunications. In contrast, the 2021–2026 period has been marked by a diversification of the issuer base into more modern capital-intensive sectors driven by secular trends, such as the development of digital infrastructure or artificial intelligence data centers or the re-industrialization of the European continent.[29]

[27] Copeland, T. E., Weston, J. F., & Shastri, K. (2005). Financial theory and corporate policy (4th). International Edition, Pearson Addison Wesley, 502-503.
[28] Lonergan, W. (2003). The valuation of businesses, shares and other equity. Allen & Unwin.
[29] Mackenzie, G. (2006). Taxation as a driver for designing hybrid securities. Journal of Applied Research in Accounting and Finance (JARAF), 1(1), 31. Available at

Instrument Structural Design

The design of instruments in the 1998-2004 era was dominated by early forms such as income securities, reset preference shares, and early perpetual step-up notes that took advantage of loopholes in accounting standards. In 2021-2026, instruments are more sophisticated regional variations of European step up and call structures, American 30-year non-call formats, and high-yield "Basket H" loss-absorbing notes, reflecting changes in rating agency methodologies.[30]

Managerial Motivations and Valuation

During the 1998-2004 period, corporate managers took advantage of hybrid securities for regulatory arbitrage to decrease the firms' debt to equity ratio by up to 30 percent, increase net incomes, and bypass the debt covenants. However, in the 2021-2026 window, the use of hybrid instruments for balance sheet purposes remains attractive under high interest rates, but the trend is offset by tighter agency equity-credit caps and higher professional equity analysts' scrutiny.[31]

Crucially, peer literature illustrates that such adverse forecasting effects are concentrated almost exclusively among opaque corporate issuers (do not separately present the book value of hybrid bonds and their corresponding distribution servicing costs on the balance sheet and income statement). For highly transparent issuers (explicit line item separation of hybrid capital and coupon servicing), analyst forecast errors and dispersion remain unaffected after hybrid issuances. These findings provide empirical motivation for standard setters to mandate explicit line item disaggregation and presentation versus opaque footnote disclosure.

Chapter Five: Conclusion and Future Study

The thesis presented in this study investigates capital market instruments, including the intricacies of their mechanics, the economic realities of these instruments, the effects on financial statements, and the financial market valuations, for equity, debt, and hybrid securities. The main conclusion of the research is that, despite regulatory reforms meant to improve the transparency of financial reports, regulatory arbitrage is a significant phenomenon for capital structures. In particular, corporate managers have an incentive to take advantage of the

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=943324

[30] Anthony, R. N. (2004). Rethinking the rules of financial accounting: examining the rules for proper reporting. (No Title). Available at https://cir.nii.ac.jp/crid/1970304959843532588

[31] Armstrong, C. S., Barth, M. E., Jagolinzer, A. D., & Riedl, E. J. (2010). Market reaction to the adoption of IFRS in Europe. The accounting review, 85(1), 31-61. DOI: https://doi.org/10.2308/accr.2010.85.1.31

accounting standard flexibility (such as IAS 32) and create hybrid instruments that mimic the features of debt but are converted to equity on the balance sheet.[32]

The facts are calling the traditional manager's assumption that hybrid securities are lower cost financing tools for the issuing firm into question. Opportunity cost analysis and option-pricing models applied to hybrid securities prove that the inherent call options on the issued shares have high systematic risk and carry an economic cost more than straight debt. The reason behind issuing such hybrid instruments was for financial reporting purposes and regulatory arbitrage opportunities. By considering hybrid debt as equity, the issuing firm lowers its financial leverage and has the benefit of reporting higher income net of tax and higher net operating cash.[33]

The research on capital market instruments' characteristics between 2021 and 2026 reveals that the trend is permanent, and the hybrid securities will no longer be the instruments of choice for regulatory arbitrage. Instead, they will fund the global energy transition and the digital infrastructure to come. As the IASB improves its FICE (Financial Instruments with Characteristics of Equity) and the rating agencies revise their hybrid basket definitions, the trend is expected to gain more transparency, and the author's future research will focus on the corporates' coupon reset risk in a normalized interest rate environment and the effectiveness of the new disclosure demands in eliminating financial statement opacity.[34]

Furthermore, analysis of capital market pricing reveals that equity investors and analysts are subject to information processing costs. When evaluating hybrid offerings as debt-like capital raisings at initial issuance dates, but as equity when presented on the balance sheets without disaggregation of the line item, investors tend to price recognized equity-classified hybrids as if they were equity. Such an accounting practice adds complexity and results in lower precision of analyst forecasts and wide dispersion of forecasts. However, when issuers provide separate disclosure of the balance sheet and income statement line items for the hybrid principal and servicing costs, the information processing costs are reduced. Thus, the results of these studies provide a strong theoretical basis for the IASB, as the standard-setting body, to require explicit line item presentation of hybrid financial instruments rather than footnote disclosure.[35]

[32] Benninga, S., & Sarig, O. H. (1997). Corporate finance: a valuation approach. (No Title). Available at https://cir.nii.ac.jp/crid/1970586434788641569

[33] Briloff, A. (2004). Accounting scholars in the groves of academe In Pari Delicto. Critical Perspectives on Accounting, 15(6-7), 787-796.

[34] Blankespoor, E., Dehaan, E. D., Wertz, J., & Zhu, C. (2019). Why do individual investors disregard accounting information? The roles of information awareness and acquisition costs. Journal of Accounting Research, 57(1), 53-84. DOI: https://doi.org/10.1111/1475-679X.12248

[35] Bornemann, T., & Novotny-Farkas, Z. (2024). Does the Accounting Classification of Hybrid Financial Instruments as Debt or Equity Matter?. Available at SSRN 4821642. Available at

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