

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of the EFRAG Board. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## ***IASB ED/2017/3 Prepayment Features with Negative Compensation (Proposed Amendments to IFRS 9) - Cover Note***

### **Objective**

- 1 The objectives of the session are to:
  - (a) consider the feedback received in response to EFRAG's draft comment letter on the Exposure Draft ED/2017/3 *Prepayment Features with Negative Compensation (Proposed Amendments to IFRS 9)*, issued by the IASB on 21 April 2017 (the 'ED'); and
  - (b) discuss and recommend to the EFRAG Board a proposed final comment letter on the ED.

### **Comment letters received**

- 2 EFRAG published its draft comment letter on 4 May 2017 with comments requested by 17 May 2017. EFRAG received 12 comment letters, two (2) were from national standard setters, nine (9) from preparers or preparer organisations and one (1) from a regulator. One additional comment letter still to be sent has been announced to the EFRAG Secretariat.

### **Summary of respondents' comments**

#### *Question 1*

- 3 None of the respondents disagreed that the issue of prepayment features with negative compensation is to be addressed. Two respondents noted that the issue could be addressed by a clarification rather than an amendment to IFRS 9, while one respondent explicitly stated that the issue could not be addressed by a clarification. While not disagreeing with the IASB pursuing the amendments, one respondent suggested that the IASB should better articulate the reason it decided to pursue them at this point in time and explain why their proposed scope is appropriate.
- 4 Three respondents provided examples of the sectors and types of loans where such instruments are seen. One respondent noted that they were not aware that such instruments were widespread in their jurisdiction, while another observed that the use of symmetric clauses is widespread enough to justify an amendment to IFRS 9.

#### *Question 2*

- 5 Eight respondents explicitly agreed with the first eligibility criterion.
- 6 Nine respondents explicitly agreed with EFRAG's proposal to remove the second eligibility criterion and three did not agree.
- 7 Reasons provided for rejecting the second eligibility criterion were:

*IASB ED/2017/3 Prepayment Features with Negative Compensation (Proposed Amendments to IFRS 9) – Cover Note*

- (a) prepayment features with negative compensation should be subject to the same eligibility criteria as prepayment features with positive compensation;
  - (b) the second eligibility criterion could seriously limit the scope of the financial instruments subject to the Amendment;
  - (c) the practical difficulties in determining the fair value of a prepayment option at inception; and
  - (d) it could affect situations such as i) business combinations or acquisition of a portfolio; ii) financial instruments purchased on a secondary market; and iii) banking regulation that requires an entity to regularly sell and repurchase financial instruments for liquidity purposes.
- 8 In contrast, one respondent who believed that the second eligibility criterion was appropriate did not agree with the views expressed by others that including this second criterion was too restrictive, could have unintended consequences, create complex operational challenges and disruption.
- 9 Seven respondents also supported EFRAG's view that the final amendments to IFRS 9 should not be accompanied by references that interpret existing IFRS 9, while one stated that the scope exclusion included in paragraph BC 18 of the ED, where the prepayment amount is at fair value, should be part of the authoritative guidance in IFRS 9. Another respondent suggested the ED be finalised in its current form.

*Question 3*

- 10 Six respondents were of the view that the Amendments should be applied at the same time as IFRS 9, i.e. at 1 January 2018, while two respondents agreed with EFRAG's tentative position. Three respondents noted that deferral of the application date to January 2019 does not resolve the double change in the accounting treatment of financial assets with symmetrical prepayment features.
- 11 In addition, four respondents demanded that the endorsement process is done fast enough in order to avoid successive changes in measurement of financial assets with negative compensation.

*Question 4*

- 12 Two respondents asked the IASB to consider additional transitional reliefs.

**EFRAG TEG discussion and advice to the EFRAG Board**

*EFRAG TEG discussion*

- 13 At its conference call on 24 May 2017, EFRAG TEG discussed the feedback received in response to EFRAG's draft comment letter and considered the final comment letter to be recommended to the EFRAG Board.
- 14 Thirteen (13) EFRAG TEG members were present at the conference call. In addition, one (1) EFRAG TEG member shared his vote through email. Of the fourteen (14) in total:
- (a) Eleven (11) voted in favour of recommending to the EFRAG Board the proposed final comment letter;
  - (b) Two (2) voted against of recommending to the EFRAG Board the proposed final comment letter. One of them had fundamental conceptual concerns about the proposal in the ED and shared the alternative view expressed by one IASB member who did not support the ED as well as the points made in the comment letter received from ESMA. The other EFRAG TEG member did not agree with the proposal to remove the second eligibility criterion; and

*IASB ED/2017/3 Prepayment Features with Negative Compensation (Proposed Amendments to IFRS 9) – Cover Note*

- (c) One (1) abstained from voting, due to disagreement to the proposed response in Question 2 of the IASB ED.
- 15 EFRAG TEG members also suggested various drafting changes. These included:
- (a) removing text that indicates that EFRAG has view on how the existing version of IFRS 9 applies to the types of financial asset in concern; and
  - (b) clarifying the argumentation around EFRAG's request to change the effective date to 1 January 2019.

*EFRAG TEG advice to the EFRAG Board*

- 16 EFRAG TEG advises the EFRAG Board to approve the comment letter on the ED.

**Question for the EFRAG Board**

- 17 Does the EFRAG Board agree with the proposed final comment letter?

**Agenda Papers**

- 18 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 05-02 – *Proposed Comment Letter on IASB ED-2017-3* Board 17-05-31; and
  - (b) Agenda paper 05-03 – *CL012 - ESMA - EFRAG DCL on IASB ED-2017-3* – for background only.