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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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United Kingdom
Email: commentletters@ifrs.org

24 May 2017

Re: Exposure Draft ED/2017/3 – Prepayment Features with Negative Compensation (Proposed amendments to IFRS 9)

Dear Mr Hoogervorst

On behalf of RSM International Limited, a worldwide network of independent audit, tax and consulting firms, we are pleased to comment on the IASB's Exposure Draft ED/2017/3 *Prepayment Features with Negative Compensation (Proposed amendments to IFRS 9)* ('the ED').

We are supportive of the IASB's efforts to fulfil its commitment of being responsive to issues that are identified during the implementation of IFRS 9 *Financial Instruments*.

We are not in favour of introducing exceptions to IFRS 9 - in particular on the eve of its effective date - as it is likely to lead to a precedent and contradicts the principle-based nature of the Standard. However, we believe that the aim of the proposed amendments could be achieved through a simple clarification of the existing requirements.

Our comments and detailed responses to the questions set out in the Invitation to Comment section of the ED are detailed hereafter.

We would be pleased to respond to any questions the Board or its staff may have about any of our comments.

Please do not hesitate to contact me or Joelle Moughanni at +44 207 601 1080.

Sincerely,

Robert Dohrer
Global Leader - Quality and Risk
RSM International

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Question 1—Addressing the concerns raised

Paragraphs BC3–BC6 describe the concerns raised about the classification of financial assets with particular prepayment features applying IFRS 9. The proposals in this Exposure Draft are designed to address these concerns.

Do you agree that the Board should seek to address these concerns? Why or why not?

We welcome the IASB addressing these concerns with a view to clarifying the accounting for financial instruments that incorporate prepayment features with negative compensation.

We agree that the issue proves to be widespread enough that the IASB should amend IFRS 9 so close to its effective date. In fact, such prepayment features appear to be prevalent in particular types of otherwise 'plain vanilla' lending instruments (e.g. corporate loans, retail mortgages, etc.) and that measuring such assets at amortised cost, and including them in key metrics like net interest margin, would provide the most useful information to users of financial statements about the financial assets' performance.

Question 2—The proposed exception

The Exposure Draft proposes a narrow exception to IFRS 9 for particular financial assets that would otherwise have contractual cash flows that are solely payments of principal and interest but do not meet that condition only as a result of a prepayment feature. Specifically, the Exposure Draft proposes that such a financial asset would be eligible to be measured at amortised cost or at fair value through other comprehensive income, subject to the assessment of the business model in which it is held, if the following two conditions are met:

(a) the prepayment amount is inconsistent with paragraph B4.1.11(b) of IFRS 9 only because the party that chooses to terminate the contract early (or otherwise causes the early termination to occur) may receive reasonable additional compensation for doing so; and

(b) when the entity initially recognises the financial asset, the fair value of the prepayment feature is insignificant.

Do you agree with these conditions? Why or why not? If not, what conditions would you propose instead, and why?

We support the proposal that financial instruments containing prepayment features with negative compensation could be eligible for measurement at amortised cost or at fair value through other comprehensive income (FVOCI). We consider that the existence of either a positive or a negative compensation element in the prepayment amount should not in isolation prevent the instrument's cash flows from qualifying as solely payments of principal and interest (SPPI), provided that the compensation element is reasonable.

We consider the main issue to be the selection of the measurement basis that provides the most useful information to users of financial statements. We agree that measurement at amortised cost can provide relevant information for financial instruments that contain prepayment features with negative compensation, if that negative compensation for early termination of the contract does not significantly affect the effective interest rate calculation at inception.

We agree with the first eligibility criterion, but not with the second one as we are of the view that the treatment of prepayment features with negative compensation should be aligned with the treatment of prepayment features with positive compensation. We question why a prepayment feature with negative compensation is to be treated differently from one that provides reasonable additional (positive) compensation as permitted by paragraph B4.1.11(b) of IFRS 9. Thus, the eligibility criteria for prepayment features with negative compensation should be aligned with those for prepayment features with positive compensation, and in accordance with paragraph B4.1.11(b) of IFRS 9, prepayment options for which the prepayment amount includes a compensation element are considered to result in contractual cash flows that are SPPI provided only that the compensation element is reasonable (i.e. first criterion). The second proposed criterion appears currently in paragraph B4.1.12 of IFRS 9 for a specific sub-category of financial assets with prepayment features (acquired or originated at premium or discount). Given the objective of the proposed amendment in this ED, it is more appropriate that eligibility criteria for prepayable financial assets with negative compensation are aligned with the main guidance on prepayable financial assets in paragraph IFRS 9.B4.1.11(b) than with sub-category addressed in paragraph IFRS 9.B4.1.12.

We suggest that the objective of the proposed amendments can be achieved more simply, by clarifying in paragraph B4.1.11(b) that the reasonable compensation for the early termination of the contract can both be positive or negative, in particular by reference to neutral 'cash flows' rather than a 'prepayment amount' . In fact, this is the same contingent event but with opposite effects (paragraph BC4.188(a) of the Basis for Conclusions on IFRS 9 states that all contingent features must be assessed in the same way). Thus, this is simply a clarification of paragraph B4.1.11(b), and not the introduction of an additional exception to the principles of IFRS 9 in a new paragraph.

Our suggested wording for a revised paragraph B4.1.11(b) is as follows (deleted text is struck through and new text is underlined):
"a contractual term that permits the issuer (ie the debtor) to ~~pre~~pay a debt instrument or permits the holder (ie the creditor) to put a debt instrument back to the issuer before maturity and the ~~prepayment amount~~ resulting cash flows for the early termination of the contract substantially represent~~s~~ unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable ~~additional~~ compensation for the early termination of the contract; and"

Moreover, given that IFRS 9 is a principle-based Standard, we tend to share Mr Kabureck's concerns set out in his alternative view on the ED in this respect (paragraph AV6) that if one request for a rule-based exception is granted, it will be seen as an invitation for other requests for exceptions to be submitted.

Furthermore, should the same clarification not be added to paragraph B4.1.11(c) of IFRS 9 for an extension feature with negative compensation?

Question 3—Effective date

For the reasons set out in paragraphs BC25–BC26, the Exposure Draft proposes that the effective date of the exception would be the same as the effective date of IFRS 9; that is, annual periods beginning on or after 1 January 2018 with early application permitted.
Do you agree with this proposal? Why or why not? If you do not agree with the proposed effective date, what date would you propose instead and why? In particular, do you think a later effective date is more appropriate (with early application permitted) and, if so, why?

We agree with the amendment's proposed effective date of 1 January 2018 for the reasons set out in paragraph BC25 of the ED. In our view, staggering the effective dates is at odds with promoting consistency, understandability and comparability of the financial statements.

Question 4(a)—Transition

For the reasons set out in paragraphs BC27–BC28, the Exposure Draft proposes that the exception would be applied retrospectively, subject to a specific transition provision if doing so is impracticable.
Do you agree with this proposal? Why or why not? If not, what would you propose instead and why?

We agree that the amendments should be applied retrospectively using the same transition provisions provided in IFRS 9.

Question 4(b)—Transition

As described in paragraphs BC30–BC31, the Exposure Draft does not propose any specific transition provisions for entities that apply IFRS 9 before they apply the exception.
Do you think there are additional transition considerations that need to be specifically addressed for entities that apply IFRS 9 before they apply the amendments set out in the Exposure Draft? If so, what are those considerations?

We see no need for additional transition requirements.

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