

Mr Hans Hoogervorst  
Chairman of the  
International Accounting Standards Board  
30 Cannon Street  
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United Kingdom

23 May 2017

540/636

Dear Mr Hoogervorst

**Re.: IASB Exposure Draft 2017/3 'Prepayment Features with Negative Compensation – Proposed amendments to IFRS 9'**

The IDW appreciates the opportunity to comment on the IASB's Exposure Draft 2017/3 'Prepayment Features with Negative Compensation – Proposed amendments to IFRS 9'. We agree that the Board should urgently address the accounting for contracts that contain prepayment features with negative compensation. While we support the objective of the ED, we also have several concerns.

Firstly, the IDW does not agree with the proposed addition of a second criterion for prepayment features with negative compensation, namely the feature having an 'insignificant fair value' at initial recognition. We do not believe there is a sound basis for treating features with positive compensation differently from those with negative compensation. In our view, it is an inherent feature of amortised cost measurement that changes in cash flow expectations lead to volatility, regardless of whether the change is positive or negative. Therefore, we suggest the criteria for both prepayment features with negative and positive compensation should be the same.

Certainly, both kinds of prepayment features may change the timing and the amount of contractual cash flows on a limited scale (we refer to the requirements in IFRS 9.B4.1.11(b)). However, in our view, this does not mean that such financial instruments are different from a basic lending arrangement and hence, this should not be an obstacle in complying with the SPPI criterion. Both the SPPI criterion and the business model criterion provide a reasonable and

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sufficient basis for measuring financial assets at amortised cost or at fair value through other comprehensive income.

Secondly, we believe that the amendments could be drafted in a simpler and more understandable manner, especially if the Board follows our suggestion to remove the second criterion in paragraph IFRS 9.B4.1.12A of the ED. We note that the Basis for Conclusions does not form part of the mandatory guidance in IFRS. However, adding 32 paragraphs to the Basis for Conclusions creates potential for confusion, given the limited and, in our view, clear objective of the amendments. In particular, we believe that the additional 'guidance' in the Basis for Conclusions may have unintended consequences as it also interprets what 'reasonable additional compensation' is – an area that has not been identified as being contentious so far. Since many preparers are well-advanced in their implementation process, this guidance will create uncertainty in the market.

Lastly and in general, in our opinion, the proposed amendment is more in the nature of a clarification than an amendment to IFRS 9. Treating this as a clarification rather than an amendment would be beneficial, as it would partly eliminate the need for further discussion, especially concerning the effective date. If the Board does not treat this as a clarification, it will need to finalise the amendments as swiftly as possible in order to give those jurisdictions that need to incorporate the final amendments into their legal system the opportunity to do so ahead of the first-time adoption of IFRS 9 (e.g. the European Union, which has to endorse IFRS).

We would like to comment on the specific proposals as follows:

**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 agree with the IASB addressing the concerns raised regarding the classification of prepayment features with negative compensation. Given that both the IFRS Interpretations Committee (IFRS IC) and the IASB have discussed this issue, we believe the proposal is, in general, a sensible approach to its resolution. However, we note that the current wording of IFRS 9 does not necessarily exclude features with negative compensation from meeting the SPPI criterion.

Hence, we believe the Board could treat the amendment as a clarification rather than an actual change in the accounting method. This would also mitigate some of the concerns around effective date and lead time for incorporating the amendments into the legal framework where necessary (see our comments below on question 3).

### **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?*

Whilst we agree with the Board making this a narrow-scope exception, we disagree with the proposed additional second criterion of the prepayment feature having an insignificant fair value on initial recognition. Not only is there no such requirement in regard to prepayment features that include positive compensation (cf. IFRS 9.B4.1.11(b)), the proposed second criterion would also restrict the availability of the exception, despite there being no apparent justification for this. The Board's argument that the second criterion limits the necessary catch-up adjustments (cf. paragraph 21 of the Basis for Conclusions in the ED) is not convincing, as frequency, sign and magnitude do not constitute areas of concern in other circumstances in IFRS 9 when amortised cost is calculated using the effective interest rate method. In fact, catch-up adjustments are inevitable when expected cash flows need to be adjusted with an historical effective interest rate; regardless of direction. Therefore, we suggest the second criterion be deleted so that the requirements for prepayment features with positive compensation and negative compensation are consistent.

Further, we are concerned with the precise drafting of the amendments. We believe that the way the amendment has been drafted makes it difficult to read, let alone comprehend. In addition to our concerns regarding the second criterion, we note that the Basis for Conclusions is very extensive for such a limited amendment. This will most probably create unintended consequences as, in our view, the statements in the Basis for Conclusions go beyond what we believe the Board intended. In particular, the paragraphs in the Basis for Conclusions on what constitutes 'reasonable additional compensation' could create confusion and lead to diversity in practice, as it might impact assessments already being made for positive compensation. Preparers are already well-advanced in their IFRS 9 implementation projects in this area. We do not think it is helpful to provide further guidance as part of the non-mandatory Basis for Conclusions at this point on an area which is not considered in need of further clarification.

### **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 an effective date of 1 January 2018 to ensure alignment with the original effective date of IFRS 9.

While we generally prefer no last minute changes be made to standards near to their first-time application, we appreciate the need for such an amendment. In addition, we do believe that all parties involved are willing to do their best to ensure the amendments can be finalised as soon as possible. The IASB has only provided a 30-day comment period for constituents. We expect the IASB to treat the matter with the same urgency, i.e. the Board will finalise the amendments as quickly as feasible and accelerate the process from its side. This will increase the chances that those jurisdictions that have yet to incorporate the amendments into their legal system – as is the case in the European Union – will be able to do so ahead of the first-time application of IFRS 9.

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We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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