



AUTORITE DES NORMES COMPTABLES

5, PLACE DES VINS DE FRANCE

75573 PARIS CÉDEX 12

Phone (+ 33 1) 53.44.28 53

Internet <http://www.anc.gouv.fr/>

Mel [patrick.de-cambourg@anc.gouv.fr](mailto:patrick.de-cambourg@anc.gouv.fr)

Chairman

Paris, May 19<sup>th</sup>, 2017

PDC N°58

EFRAG  
M. Jean-Paul Gauzes  
35, Square de Meeûs  
B1-000 Bruxelles  
BELGIUM

**Re: ED/2017/3 Proposed amendments to IFRS 9 “Prepayment Features with Negative Compensation”**

Dear Mr Gauzès,

Please find here enclosed the ANC’s comment letter to IASB on the above-mentioned exposure draft (ED) 2017/3 *Prepayment Features with Negative Compensation*, issued by the IASB April 23<sup>rd</sup> 2017.

ANC is very supportive of the current EFRAG’s draft comment letter on that ED, especially on the response proposed to Question 2. In that regard, ANC agrees with EFRAG suggesting to remove the second criterion of the exception introduced by § B4.1.12A. ANC also shares EFRAG’s concerns that “references in the Basis for Conclusions [that] go beyond the scope of the proposed Amendments to IFRS 9, as they seem to interpret existing guidance in IFRS 9”, should be removed. ANC has added comments on statements considered not appropriated in the BC of the amendments and hope it will feed EFRAG’s comments with illustrative examples.

With regards to Questions 3 and 4 on transition, ANC is very concerned by the undue difficulties which may arise during the temporary period between the issuance and the endorsement of the amendments. ANC is very concerned that the late issuance of the amendments will not allow the EU to endorse it before 1/1/18. Acknowledging that, even if applied retrospectively, the exception will not be applicable before Q2 2018, this will lead to a double change in the accounting treatment of the symmetrical prepayment options. During that temporary period related accounting processes such as expected credit loss model and macro-hedging would heavily be impacted. In addition to internal control and IT issues, this will raise undue uncertainty on the First Time Adoption impact calculation as well as complexity in financial communication and calculation of regulatory ratios.

Deferring the application date to 1<sup>st</sup> January 2019 will not solve the issue as it will not avoid the successive application of a double change in the accounting treatment of financial assets with symmetrical prepayment options. ANC urges all parties involved in the endorsement process to study how to reduce its duration for this limited amendment in order for preparers to apply it from 1<sup>st</sup> January 2018 and thus to avoid this so confusing double change in accounting treatments.

Finally, ANC is still convinced that an alternative solution, i.e. clarification, is worth being contemplated in order to provide a simpler and also immediately applicable solution. ANC therefore suggests EFRAG to consider its arguments developed in the letter to IASB and its appendix addressing question 1.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

A handwritten signature in black ink that reads "Patrick de Cambourg," with a small mark at the end.

Patrick de Cambourg



AUTORITE DES NORMES COMPTABLES

5, PLACE DES VINS DE FRANCE

75573 PARIS CÉDEX 12

Phone (+ 33 1) 53.44.28 53

Internet <http://www.anc.gouv.fr/>

Mel [patrick.de-cambourg@anc.gouv.fr](mailto:patrick.de-cambourg@anc.gouv.fr)

Chairman

Paris, May 19<sup>th</sup>, 2017

PDC N° 59

Mr Hans Hoogevorst  
Chairman  
International Accounting Standard Board  
30 Cannon Street  
LONDON EC4M 6XH  
UNITED KINGDOM

**Re: ED/2017/3 Proposed amendments to IFRS 9 “Prepayment Features with Negative Compensation”**

Dear Mr Hoogevorst,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned exposure draft (ED) 2017/3 *Prepayment Features with Negative Compensation*, issued by the IASB April 23<sup>rd</sup> 2017. These views result from ANC’s due process which involves meetings with a dedicated working group, followed by an examination by its IFRS Commission and approval of its Board.

ANC welcomes the Board’s intention to provide a solution to the accounting treatment of symmetrical prepayment options that are considered as not passing the SPPI test. ANC supports the proposal that financial instruments containing prepayment features with negative compensation could be eligible for measurement at amortised cost or at FVOCI. ANC considers that the existence of either a positive or a negative compensation element in the prepayment amount should not prevent the instrument from qualifying to amortised cost measurement or at FVOCI. Moreover, in our view paragraph B4.1.12A(a) is not an exception from, but an application of the underlying principles of IFRS 9, since prepayments represent the time value of money, whatever who pays/receives.

Rather than introducing a dedicated exception for such financial assets, as proposed in the amendments, ANC would encourage IASB to contemplate whether the meaning of “*reasonable additional compensation*” included in the SPPI test described at B4.1.11 can be clarified as being either positive or negative, by issuing a complementary application guidance of IFRS 9. Such a clarification would permit IFRS European issuers that are expected to follow an endorsement process before applying IFRSs, to avoid a double undue change in the accounting treatment during the temporary period between issuance and endorsement of the amendments.

The proposed amendments introduce an exception applicable to financial assets with symmetrical prepayment options that are viewed as failing the SPPI test. Introducing an exception instead of adapting the SPPI test has the merit to prevent from modifying any other current (well understood) provisions of IFRS 9. ANC is therefore concerned that the amendments may only address very limited financial instruments whereas in the same time it may create unexpected spill-over effects on the scope of the SPPI test.

The exception is limited by a criterion which purpose is unclear and would reduce the scope of the exception emptying the amendments. Moreover, ANC considers that it does not help to assess the relevance of amortised cost (or fair value through OCI measurement) for the instruments that are considered in the proposed amendments. ANC therefore recommends removing the criterion (b) and any further restrictions provided in BCs.

In addition, ANC considers that the amendments should not be accompanied by references that interpret existing guidance in IFRS 9 (on SPPI test, definition of amortised cost or Effective interest method, incompatibility between the exceptions of § 12 and § 12A). Any such reference might affect the accounting treatment of other financial instruments, which is beyond the scope of the proposals in the Amendments.

If you have any questions concerning our position, we would be pleased to discuss them.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,



Patrick de Cambourg

## Appendix

### **Q1: Do you agree that the Board should seek to address these concerns?**

- 1 ANC welcomes the Board's intention to provide a solution to the accounting treatment of symmetrical prepayment options that are considered as not passing the SPPI test. Introducing an exception, as proposed in the amendments, could achieve that goal.
- 2 ANC, however, concurs with the Alternative View (AV)4 of the ED, that "compensation" is actually different from "penalty".. The aim of symmetrical prepayment options is to provide a well-balanced mechanism to both the lender and the borrower according to which, none of them will be disadvantaged whatever may be the fluctuation of interest rates between the origination and the prepayment of the debt instrument. Therefore, ANC does not consider the symmetrical prepayment option issue to be treated as an exception from, but an application of, the underlying principles of IFRS 9 on the measurement at cost (or FVOCI). This is because the cash resulting from the exercise of the option simply represents the time value of money, whatever who pays/receives the compensation.
- 3 Accordingly, in ANC's view, issuing a clarification could provide a workable solution. It could be contemplated whether "additional reasonable compensation" can be clarified as being either positive or negative.
- 4 As far as the application of IFRSs in the UE is concerned, addressing the issue through such a clarification would also help preparers, auditors and regulators in case the final amendments are not endorsed by the EU on time for first application on 1/1/18.
- 5 Moreover, introducing a narrow-scope amendment to a specific financial instrument, offers a rules-based fix. As expressed in AV 6 of the ED, a rules-based approach in such a complex and innovating matter may not prove efficient.
- 6 Whatever the solution proposed by the Board, either through amendments or clarifications, ANC is concerned that it properly addresses the point that has been sent to the IFRS IC and does not create spill-over effects.

### **Q2: The proposed exception: do you agree with the two criteria required by the exception?**

- 7 ANC supports the proposal that financial instruments containing prepayment features with negative compensation could be eligible for measurement at amortised cost or at FVOCI. ANC considers that the existence of either a positive or a negative compensation element in the prepayment amount should not prevent the instrument from qualifying to amortised cost measurement. ANC therefore agrees with the first eligibility criterion which appears clear and limited to the circumstances of the narrow scope of the proposed amendments.
- 8 However, ANC disagrees with the second eligibility criterion, which purpose is unclear and which would scope out of the exception many financial assets gutting the amendments. Indeed, if the willing of IASB is to prevent the extension of complex financial instruments at cost measurement, such assets with embedded index or elements not representing the time value of money fail the SPPI for any purpose other than symmetrical prepayment feature. Moreover, that second eligibility criterion does not help to assess the relevance of amortised cost (or fair value through OCI measurement) for the instruments that are considered in the proposed amendments. ANC therefore recommends removing the second criterion.

- 9 In addition, ANC considers that the amendments should not be accompanied by references that interpret existing guidance in IFRS 9. Any such reference might affect the accounting treatment of other financial instruments, which is beyond the scope of the proposals in the Amendments.

### **Risks related to the second eligibility criterion**

- 10 In § B4.1.12A (a), the amendments introduce an exception to the SPPI test defined in § B4.1.10. § B4.1.12A (b) provides an additional criterion which limits the scope of that exception to prepayment features the fair value of which is “insignificant” “initially” for the party recognising an “asset” (i.e. the holder). ANC comments as follows:

- a. ANC does not agree with the criterion (b) restricting the amendment to contracts with negative compensation and whose fair value of the prepayment feature is insignificant.

There is no requirement to value the option in the case of positive compensation, unlike the proposal for negative compensation, and in the case of symmetrical compensation there is the need to fair value both sides. It is also not clear how this right would be valued.

As explained in AV 5 of the ED, the amendments may solely accommodate symmetrical prepayment options that could result in negative compensation only as a result of a contingent event beyond the control of both the lender and the borrower which would be very unlikely to occur (such as a business combination). Prepayment provisions that allow the borrower to early prepay their borrowing by discounting the remaining cash-flows using the new current benchmark rate with the initial credit spread may not pass the criteria described at B4.1.12A(b) because such prepayment option has some value for the borrower since it allows to benefit from better credit spread conditions. ANC believes such prepayment should meet the exception criteria since the amount being paid or received by the borrower represents the time value of money (discount value of the remaining cash-flows) and are thus consistent with the SPPI concept.

If the aim of the board is only to prevent from embedding derivatives that would make the instrument depart from a basic lending arrangement, ANC believes that such an instrument would also have failed the SPPI test in § B4.1.11(a) for another reason than the only one addressed in § B4.1.12A (a). Therefore such a condition would not be necessary.

- b. Moreover, applying § B4.1.12A with the second criterion could be inconsistent with § B4.1.11(b) as illustrated in the following example:
- i. Assuming instrument A contains only cash-flows that meet SPPI criterion, and a prepayment option where only the bank may receive a positive compensation in case the borrower exercises its prepayment option PA. Assuming the fair value at initial recognition of PA is significant. According to § B4.1.10 & 11(b), such instrument meets SPPI criterion and is eligible for amortised cost measurement.
  - ii. Assuming Instrument B contains the same cash-flows than instrument A and the same prepayment option than instrument A and, in addition, a prepayment option where the bank may be obliged to compensate the borrower should the borrower decides to exercise its prepayment option PB. Assuming the fair value at initial recognition of PB is insignificant.
  - iii. Instrument B is in the scope of § B4.1.12A, since it fails the SPPI test in B4.1.11(b) only as a result of a possible negative compensation. Therefore, according to § B4.1.12A(b), the asset holder needs to assess whether the fair value of the prepayment option is significant. The fair value of the prepayment of instrument B is the sum of fair values of PA + PB. Accordingly, the fair value of the prepayment option of instrument B is significant and hence would fail the exception criterion

and hence not be eligible for amortised cost measurement, while ANC believes the objective of the IASB is only to require fair value of PB to be insignificant.

### **The proposed exception should not interpret existing guidance in IFRS 9 beyond the scope of the amendments**

- 11 **BC 18** makes the 3 following general statements that are commented below:
- a. “the effective interest method, and thus amortised cost measurement, are not appropriate when the prepayment amount is inconsistent with paragraph B4.1.11(b) for any reason other than that described in paragraph BC17”.
  - b. “because the amount exposes the holder to changes in the fair value of the instrument, and contractual cash flows resulting from such exposure are not solely payments of principal and interest. The Board concluded that a fair value amount is not reasonable compensation for the early termination of the contract”.
  - c. “The same conclusion would also apply to a financial asset that is prepayable at an amount that includes the fair value cost to terminate an associated hedging instrument if that prepayment amount is inconsistent with paragraph B4.1.11(b) because the amount exposes the holder to factors that could result in contractual cash flows that are not solely payments of principal and interest.”
- 12 **On a.** The scope of BC 17 is clearly restricted to the exception introduced by the amendments. Conversely, BC 18 enlarges the statement to all prepayment options that are not in the scope of BC 17. In doing that, it overrides the scope of the amendments and restricts the scope of amortised cost measurement. Actually, according to that statement, § B4.1.11(b) is not more one of “the examples” (as mentioned in § B4.1.11) of the principle set in § B4.1.10; but rather provides a more restrictive scope of the amortised cost measurement.
- 13 **On b and c.** The exception introduced in § B4.1.12A is precisely applicable where the SPPI test failed. Therefore, any guidance on the SPPI test in the BC of the amendments goes beyond the scope of the amendments, and seems to interpret existing guidance in IFRS 9, especially the meaning of ‘reasonable compensation’. ANC therefore recommends the removal of BC18.
- 14 ANC has further identified in the BC items that provide new guidance not directly related to the introduction of the exception described in § B4.1.12. ANC is concerned that such new item will obscure, rather than clarify, the understanding of the standard just a few months before its first application.
- 15 **BC 9**, despite the caveat “for those assets in those circumstances”, makes a general statement according to which “*amortised cost provides information that reflects the amount, timing and uncertainty of future cash flows*”. According to that definition, plain vanilla debt instruments with variable interest rate, i.e. for which the amount of future cash flows cannot be assessed at inception, would not qualify to the amortised cost. Moreover, ANC is concerned that such a general statement goes beyond the scope of the proposed amendments.
- 16 **BC 10** makes a general statement according to which “*more complex cash flows require a valuation overlay to contractual cash flows (i.e. fair value)*”. A contract may have complex features, but the concept of “complex cash-flows” probably needs to be clarified.
- 17 If criterion (b) is removed, then **BC 20-24** should also be removed. Similarly according to **BC 15** symmetrical prepayment options would make “catch-up adjustments” “more likely” and therefore ruled out from amortised cost measurement.

- 18 Some transactions may pertain to the new exception in § B4.1.12A as well as to the exception in § B4.1.12. Both allow applying amortised cost. The standard itself is silent on the priority to set on any of the two exceptions. **BC 19** states however that both exceptions neutralise each other's, so that if a transaction is eligible for both, it may finally not be measured at amortised cost. Actually, this could have an impact on situations such as:
- Business combination or acquisition of a portfolio;
  - Financial instruments purchased on a secondary market;
  - Banking regulation that requires an entity to regularly sell and repurchase financial instruments for liquidity purposes.

---

©Autorité des normes comptables, Mai 2017