STAFF PAPER

June 2017

IASB Meeting

Project	**Prepayment Features with Negative Compensation**
Paper topic	Project direction and plan

CONTACT(S)	Uni Choi	uchoi@ifrs.org	+44 (0)20 7246 6933
	Kumar Dasgupta	kdasgupta@ifrs.org	+44 (0)20 7246 6902

Objective

1. The objective of this paper is to:

   (a) set out the key issues that the staff plans to consider for the International Accounting Standard Board's (the Board's) redeliberations of the Exposure Draft (ED) *Prepayment Features with Negative Compensation* (Proposed amendments to IFRS 9*)*; and

   (b) describe the project plan for those redeliberations and the finalisation of the amendments (if the Board decides to proceed with any amendments to IFRS 9 *Financial Instruments*).

2. The Board noted in the ED that it intends to complete any resulting amendments to IFRS 9 as soon as possible in 2017. Many respondents highlighted the urgency of the issue and asked the Board to finalise the amendments as soon as possible. In order to be in a position to issue the amendments by the end of October 2017, consistent with the project plan discussed during the Board's deliberations leading to the ED, we think the Board would need to substantially complete its redeliberations in July. We are providing this paper to ensure that there is a common understanding and agreement on what issues need to be discussed in order to meet that tight timeline.

Key issues to be discussed

3. Based on the comment letter analysis as summarised in Agenda Paper 3A, the staff intends to analyse the following issues so that they can be discussed at the July board meeting:

   (a) Two eligibility conditions (paragraphs 4—9)

   (b) Effective date (paragraphs 10—11) and

   (c) Transition (paragraphs 12—14)

Two eligibility conditions

4. The ED proposed that a prepayable financial asset that would otherwise have contractual cash flows that are solely payments of principal and interest but does not meet that condition only as a result of the prepayment feature would be eligible to be measured at amortised cost or at fair value through other comprehensive income (FVOCI), subject to the assessment of the business model, 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 (hereafter called the first eligibility condition); and

   (b) when the entity initially recognises the financial asset, the fair value of the prepayment features is insignificant (hereafter called the second eligibility condition).

5. Nearly all respondents agreed with the first eligibility condition. However, many respondents expressed the view that the Basis for Conclusions on the ED seems to interpret or provide additional guidance on some of the existing requirements in IFRS 9; in particular, the meaning of ‘reasonable compensation for the early termination of the contract’. Specifically, these concerns were raised in the context of the discussion in the Basis for Conclusions about the classification of instruments that are prepayable at their current fair value and instruments that are

prepayable at an amount that includes the fair value cost to terminate an associated hedging instrument.

6. Respondents expressed mixed views about the second eligibility condition. Many respondents disagreed with it and, as described in Agenda Paper 3A, they expressed various views and concerns.

7. In addition, many respondents disagreed with the observation in the Basis for Conclusions on the ED about the interaction between the existing exception in paragraph B4.1.12 of IFRS (ie for particular financial assets that are acquired at a premium or a discount but are prepayable at the contractual par amount) and the exception proposed in the ED. Generally, respondents expressed the view that the conditions for those exceptions should *not* be mutually exclusive but rather an entity should be able to apply both exceptions to a single financial asset in order to apply amortised cost measurement.

8. The staff intends to consider whether the Board should proceed with the eligibility conditions as proposed in the ED or whether those eligibility conditions should be amended. That analysis will address the suitability of the second eligibility condition and whether it is necessary to clarify particular aspects of the Board's conclusions and observations on the first eligibility condition that were included in the Basis of Conclusions on the ED.

9. In addition, the staff intends to consider the interaction between the conditions for the proposed exception and the existing exception in paragraph B4.1.12 of IFRS 9, including the implication of any changes recommended as a result of the analysis discussed above in paragraph 8.

Effective date

10. The ED proposed that the effective date of the amendments would be the same as IFRS 9; that is, annual periods beginning on or after 1 January 2018. Respondents had mixed views about the proposed effective date. Some respondents agreed with the proposal, whereas others said they would prefer a later effective date, specifically annual periods beginning on or after 1 January 2019 (with early application permitted).

11. The staff plans to consider whether the Board should proceed with the proposed effective date or whether a later effective date, with early application permitted, is more appropriate in the light of comments received.

Transition

12. The ED proposed that the amendments would be applied retrospectively subject to a specific transition provision, if doing so is impracticable. Nearly all respondents agreed with these proposals.

13. However, as described in paragraphs BC30-BC31 of the Basis for Conclusions on the ED, if the effective date of the amendments is later than the effective date of IFRS 9, then there could be consequences on the transition provisions for the amendments. Some respondents who supported an effective date later than annual periods beginning on or after 1 January 2018 said that any relevant transition provisions in Section 7.2 of IFRS 9 should be available again when the amendments are first applied.

14. We intend to consider those consequences, in the light of the analysis of the effective date, and ask the Board whether particular transition provisions in Section 7.2 of IFRS 9 should be made available again if an entity applies the amendments after it applies IFRS 9. We will also consider whether any additional disclosures are needed in those circumstances.

Conclusion

15. In summary, the staff plan to consider the following issues so that they can be discussed at the July board meeting:

    (a) Two eligibility conditions (paragraphs 4—9)

        (i) whether the Board should proceed with the proposed eligibility conditions or whether those eligibility conditions should be amended;

        (ii) whether particular aspects of the Board's conclusions and observations relating to the meaning of 'reasonable compensation for early termination of the contract' should be clarified

(iii) the interaction between the conditions for the proposed exception and the existing exception in paragraph B4.1.12 of IFRS 9; and

(b) Effective date and transition (paragraphs 10—14)

(i) whether the Board should proceed with the proposed effective date or whether a later effective date, such as annual periods beginning on or after 1 January 2019, with early application permitted, is more appropriate and

(ii) if additional transition provisions and disclosure requirements are needed for entities that apply IFRS 9 before they apply the amendments.

Question for the Board
Does the Board agree that paragraph 15 captures all the key issues that need to be discussed in order to proceed with making amendments to IFRS 9?

Project plan

16. The following table outlines the project plan assuming that the Board agrees with the key issues in paragraph 15. If the Board is able to make decisions in July 2017 on the technical issues listed in paragraph 15 of this paper, the staff think that the Board will be in a position to issue final amendments in October 2017.

Target timeline	**Project plan**
Board meeting in July 2017	a) Re-deliberation: technical discussions and decisions on the key issues b) Consideration of due process steps taken and permission to ballot
August and September	Drafting and balloting the amendments in an expeditious manner
October	Issue final amendments