STAFF PAPER

July 2017

IASB Meeting

Project	Prepayment Features with Negative Compensation
Paper topic	Due Process steps and permission for balloting

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Purpose of this paper

1. Agenda Papers 3A—3D for this meeting ask the International Accounting Standards Board (the Board) to consider the remaining technical issues on the narrow-scope amendments to IFRS 9 *Financial Instruments* for particular prepayment features with negative compensation. Provided that the Board makes the decisions requested in those papers, the staff will have sufficient decisions in order to proceed to draft the amendments.

2. The objective of this paper is to:

   (a) set out the due process steps that the Board has taken in developing the amendments to IFRS 9;

   (b) ask the Board to confirm that it is satisfied that it has complied with the due process requirements; and

   (c) request the Board's permission to begin the balloting process for the amendments to IFRS 9, and ask if there are any planned dissents at this stage.

Structure of the Paper

2. This paper is structured as follows:

(a) background;

(b) re-exposure;

(c) confirmation of due process steps; and

(d) intention to dissent.

Background

3. The IFRS Interpretations Committee (the Interpretations Committee) received a submission asking how to classify particular debt instruments applying IFRS 9. Specifically, the submission asked whether a debt instrument could have contractual cash flows that are solely payments of principal and interest if its contractual terms permit the borrower to prepay the instrument at a variable amount that could be more or less than unpaid amounts of principal and interest, such as at the instrument's current fair value or at an amount that reflects the remaining contractual cash flows discounted at the current market interest rate. As a result of such a contractual prepayment feature, the lender could be forced to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest. Such a prepayment amount would, in effect, include an amount that reflects a payment **to** the borrower from the lender (instead of compensation **from** the borrower to the lender) even though the borrower chose to terminate the contract early, hence the label 'negative compensation'. Applying IFRS 9, those contractual cash flows are not solely payments of principal and interest, and therefore the financial assets would be measured at fair value through profit or loss. However Interpretations Committee members suggested that the Board consider whether using amortised cost measurement could provide useful information about particular financial assets with such prepayment features, and if so, whether the requirements in IFRS 9 should be changed in this respect.

4. In the light of the Interpretations Committee's recommendation and similar concerns raised by banks and their representative bodies in response to the Interpretations Committee's discussion, the Board decided to propose a narrow exception to IFRS 9 for particular financial assets that would otherwise have contractual cash flows that are solely principal and interest but do not meet that

condition only as a result of a prepayment feature. Applying the proposals, some such financial assets would be eligible to be measured at amortised cost or at fair value through other comprehensive income, subject to the business model assessment, if particular conditions are met. Those proposals were published in the Exposure Draft *Prepayment Features with Negative Compensation* (Proposed amendments to IFRS 9) (the ED) in April 2017.

5. The IFRS Foundation *Due Process Handbook* permits a comment period of less than the standard minimum period of 120 days if the matter is narrow in scope and urgent. The proposals in the ED were both narrow in scope (because they would affect only those entities that hold particular prepayable financial assets) and urgent (because there would be significant benefits if any amendments to IFRS 9 resulting from the proposals were finalised before the effective date of IFRS 9). Consequently, with approval from the Due Process Oversight Committee, the Board set a comment period for the Exposure Draft of 30 days. The 30-day comment period ended on 24 May 2017.

6. At the Board's June 2017 meeting, the staff presented a summary of the 60 comment letters received on the ED, as well as a project plan for the redeliberations of the proposals in the ED and the finalisation of the amendments. The agenda papers for this Board meeting analyse the issues described in that project plan and provide the staff's recommendations for finalising the amendments to IFRS 9. The staff has prepared this paper based on the assumption that the Board will make tentative decisions on all of those issues and decide to finalise the amendments to IFRS 9. This includes the recommendation discussed in Agenda Paper 3C to highlight in the Basis for Conclusions on the amendments the relevant accounting required by IFRS 9 for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability.

Re-exposure

7. We recommend that the Board does not re-expose the amendments to IFRS 9. In making this recommendation, we have considered the requirements in paragraphs 6.25-6.29 of the IFRS Foundation *Due Process Handbook*.

8. Most respondents supported the proposed amendments. Respondents expressed mixed views on some aspects of the proposals (eg aspects of the proposed eligibility conditions and the proposed effective date), and the staff think that the recommendations set out in the papers for this meeting for particular changes to those proposals respond to the feedback received on the ED. If the Board agrees with the staff recommendations and decides to proceed with the amendments, we think there are no fundamental changes on which respondents have not had the opportunity to comment.

9. In addition, with respect to the staff's recommendation to highlight the relevant accounting for modifications and exchanges of financial liabilities in the Basis for Conclusions on the amendments, we note that our recommendation is to highlight *existing* requirements. Furthermore, as described in Agenda Paper 3B, that accounting was explained in a tentative agenda decision in the IFRIC Update in March 2017 with a comment period of 60 days. The staff prepared a summary and analysis of the comment letters received, which was presented to the Interpretations Committee at its meeting in June 2017. Those comments are also discussed in Agenda Paper 3B for this meeting and, as described in that paper, the staff think that respondents did not provide any new information beyond that considered by the Interpretations Committee and the Board when reaching their conclusions at previous meetings.

10. Consequently, we think that, on the basis of the re-exposure criteria in paragraphs 6.25–6.29 of the *Due Process Handbook*, the proposed amendments to IFRS 9 should be finalised without re-exposure.

Confirmation of due process steps

11. In Appendix A to this paper, we have summarised the due process steps we have taken in developing the amendments to IFRS 9. We note that the required due process steps applicable to the issuance of narrow-scope amendments have been completed.

12. If the Board is satisfied that it has been provided with sufficient analysis, and has undertaken appropriate consultation and due process, to support the issue of the final

amendments, the staff request permission to start the balloting process. The staff are targeting the issue of the amendments to IFRS 9 in October 2017.

Intention to dissent

13. In accordance with paragraph 6.23 of the *Due Process Handbook*, we are asking whether any Board member intends to dissent from the issuance of the amendments to IFRS 9, which will include highlighting the relevant accounting requirements in IFRS 9 for a modification or exchange of a financial liability measured at amortised cost that does not result in the derecognition of the financial liability.

Questions for the Board

Questions for the Board
1. **Re-exposure**—does the Board agree to finalise the amendments to IFRS 9 without re-exposure?
2. **Dissent**—does any Board member intend to dissent to the issuance of the amendments to IFRS 9?
3. **Permission to ballot**—is the Board satisfied that the due process requirements have been met and that it has undertaken sufficient consultation and analysis to begin the balloting process for the amendments to IFRS 9?

Appendix A

A1. The following table sets out the due process steps taken by the Board.

Step	*Required/optional*	*Actions*
The Board posts all of the comment letters that are received in relation to the ED on the project pages.	Required	All comment letters received by the Board (60 comment letters) have been posted on the project webpage. The link is: http://www.ifrs.org/projects/work-plan/prepayment-features-with-negative-compensation/comment-letters-projects/ed-prepayment-features-with-negative-compensation/#comment-letters
Board and Interpretation Committee meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Required	The Board discussed the comment letter analysis prepared by the staff at its June 2017 meeting (see Agenda Paper 3A, which is a publicly available staff paper). The project webpage has up-to-date information: http://www.ifrs.org/projects/work-plan/prepayment-features-with-negative-compensation/
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or ongoing associated costs.	Required	Because of the narrow scope (these amendments will affect only those entities that hold particular prepayable financial assets) and the expected limited consequences of the amendments (these are not major amendments to IFRS 9) we have not prepared an effect analysis. However, the Board has considered the consequences of these narrow-scope amendments. The effect of the amendments is that some financial assets that contain prepayment features with negative compensation would be eligible to be measured at amortised cost or at fair value through other comprehensive income.
Round-table and outreach meetings to promote debate and hear views on proposals that are published for public comment.	Optional	Not considered necessary because these amendments are narrow in scope. ASAF and GPF members received an update on the amendments at the respective meeting in March 2017 (and in case of ASAF in July 2017 in addition to March).
Finalisation		
Due process steps are reviewed by the Board.	Required	This Agenda Paper provides a summary of all due process steps and will be discussed by the Board at the July 2017 meeting.
Need for re-exposure of a Standard is considered.	Required	Analysis of the need for re-exposure is included in the main body of this Agenda paper. There are no fundamental changes to the proposals in the ED. Consequently it is unlikely that re-exposure would reveal any new concerns, so the staff recommend that the Board should not re-expose the amendments.
The Board sets an effective date for the Standard, considering the need for effective implementation, generally providing at least one year.	Required	Refer to Agenda Paper 3D for the July 2017 Board meeting.

Drafting		
Drafting quality assurance steps are adequate.	Required	To be completed in due course. The Translations team, the Taxonomy team and the Editorial team will review the pre-ballot draft. The staff intend to send a draft of the amendments to external parties for review before finalisation. This process allows external parties to review and report back to the staff on the clarity and understandability of the draft.
Publication		
Press release to announce the final Standard.	Required	To be completed in due course. A press release will be published with the final amendments.
A Feedback Statement is provided, which provides high level executive summaries of the Standard and explains how the Board has responded to the comments received.	Required	Applicable only for new IFRS Standards. Not considered necessary because these amendments are narrow in scope. Basis for Conclusions on the amendments would explain how the Board has responded to the comments received.
Standard is published.	Required	To be completed in due course. Final amendments will be made available on eIFRS on the publication date. The DPOC will be informed of the official release.