

ASC

ACCOUNTING STANDARDS COUNCIL
SINGAPORE

22 May 2017

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Hans

RESPONSE TO EXPOSURE DRAFT ON PREPAYMENT FEATURES WITH NEGATIVE COMPENSATION (PROPOSED AMENDMENTS TO IFRS 9)

The Singapore Accounting Standards Council appreciates the opportunity to comment on the Exposure Draft on *Prepayment Features with Negative Compensation* (Proposed amendments to IFRS 9) (the ED) issued by the International Accounting Standards Board (the IASB or the Board) in April 2017.

We are generally supportive of the ED proposals. In particular, we agree with the IASB that applying the effective interest method to particular financial assets that are within the scope of the ED can provide useful information about those financial assets' performance.

We further appreciate the IASB's commitment to issue the final amendments expeditiously, particularly if the IASB aligns the effective date of the amendments with the effective date of IFRS 9 *Financial Instruments*.

Our comments on the specific questions in the ED are 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?

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 can appreciate the IASB's rationale for proposing a narrow-scope exception to the classification and measurement requirements of IFRS 9, notwithstanding the impending effective date of IFRS 9.

Subject to our comments below, we are generally supportive of the IASB's proposed exception. We agree that the proposed exception would improve the accounting for financial assets with particular prepayment features, without expanding the scope beyond the population of financial assets for which the effective interest method can provide useful information.

Notwithstanding so, some of our stakeholders have expressed concerns about the IASB's narrow interpretation of 'reasonable additional compensation' as articulated in the Basis for Conclusions on the ED.

IFRS 9 does not provide guidance on 'reasonable additional compensation', and naturally, market practice would have developed during the course of IFRS 9 implementation. It is evident from the accounting manuals published by some of the international accounting firms that the market has adopted a broader interpretation of this term. In particular, it appears that 'reasonable additional compensation' would accommodate the cost of unwinding associated hedging transactions, if the amount is intended to compensate the creditor for early termination costs that would have been avoided otherwise.

Notably, banks might enter into derivative instruments in connection with prepayable financial assets that they hold. This would typically occur, for example, when the prepayable financial asset is denominated in a currency to which the bank has limited access, or as part of the bank's strategy to reduce its cost of funding and to pass on some of the benefits to its customer.

In such cases, the bank would have taken into account the effect of those derivative instruments in determining consideration for the time value of money. Consequently, the bank would also include the cost of unwinding those derivative transactions in the prepayment amount to

compensate for early termination costs that would have been avoided otherwise. Moreover, compensation for the unwinding cost could be seen as a form of consideration for basic lending risks associated with holding the financial asset. Besides, the effective interest method should not cease to provide useful information about the financial asset's performance, only because the prepayment amount includes compensation for the unwinding cost.

Importantly, the IASB's narrow interpretation of 'reasonable additional compensation' would have implications for the wider population of prepayable financial assets that may result in positive compensation only. This could be disruptive to ongoing implementation activities, given the impending effective date of IFRS 9.

Hence, we recommend that the IASB should allow practice to develop on 'reasonable additional compensation', as it would for any other terms used in principle-based IFRS Standards. The IASB could support consistent application of IFRS Standards, by identifying practice difficulties or diversity that may require standard-setting activities, either through submissions to the IFRS Interpretations Committee or as part of the post-implementation review of IFRS 9.

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 do not object to the IASB's proposed effective date and rationale.

With only six months left to the proposed effective date of 1 January 2018, we cannot over-emphasise the importance of the IASB completing its re-deliberations and issuing the final amendments expeditiously.

Question 4 – 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.

(a) Do you agree with this proposal? Why or why not? If not, what would you propose instead and why?

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.

(b) 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 agree with retrospective application, subject to specific transition provision(s) if doing so is impracticable.

However, we do not necessarily agree that the existing transition provisions in Section 7.2 of IFRS 9 should not be made available, if an entity has applied IFRS 9 before it applies the exception.

For particular financial assets that are within the scope of the proposed exception, they would have been measured at fair value through profit or loss when the entity first applied IFRS 9. In theory, the entity would be applying the existing transition provisions relating to the effective interest method (including those relating to contractual cash flow characteristics and impairment) to those particular financial assets for the first time, only when it applies the exception.

Arguably, the IASB's rationale for providing the existing transition provisions relating to contractual cash flow characteristics and impairment¹ ought to receive due consideration in determining the transition provisions for the exception. In particular, under the current IFRS 9, this has not been a concern as those transition provisions were only introduced in the complete version of IFRS 9, and hence, no financial assets would fail to be eligible for those transition provisions because of paragraph 7.2.27 of IFRS 9.

Furthermore, those transition provisions would be relevant to a larger population, if the effective date of the exception is later than the effective date of IFRS 9.

Therefore, we recommend that the IASB should consider making available those existing transition provisions relating to contractual cash flow characteristics and impairment to entities that have applied IFRS 9 before they apply the exception.

We hope that our comments will contribute to the IASB's deliberation on the ED. Should you require any further clarification, please contact our project manager Siok Mun Leong at leong_siok_mun@asc.gov.sg.

Yours faithfully

Suat Cheng Goh
Technical Director
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¹ Such as the availability of initial credit risk data to determine whether there has been a significant increase in credit risk since initial recognition.