



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: commentletters@ifrs.org

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

25 May 2017

**Exposure Draft on Prepayment Features with Negative Compensation
(Proposed Amendments to IFRS 9)**

Dear Mr Hoogervorst

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the International Accounting Standards Board's (the IASB's) Exposure Draft ("ED") Prepayment Features with Negative Compensation (Proposed Amendments to IFRS 9).

The Committee is supportive of the IASB's proposal to finalise this narrow scope exception on an expedited basis. In some jurisdictions, the Committee observes the existence of financial assets that would otherwise have contractual cash flows that are solely payments of principal and interest ("SPPI") but do not meet that condition because the contract contains standard clauses in regard to the extraordinary termination of the contract. These standard clauses allow the borrower or the lender to trigger the prepayment of the instrument. The prepayment amount may be higher or lower than the unpaid amount of principal and interest depending on the current interest rate, such as an amount that reflects the asset's remaining contractual cash flows discounted at the current market interest rate. This could lead to a situation where the borrower exercises the prepayment option when it is "out-of-the money" and, in effect, obliges the bank to compensate the borrower.

A previous IFRS Interpretations Committee discussion concluded that financial assets with such "negative compensation" features do not meet the SPPI test and therefore would be measured at fair value through profit or loss. We are of the opinion that accounting for these financial assets (eg fixed-term loans) at amortised cost provides more useful information if the conditions set out in the ED are met. We therefore support the amendments, which would allow amortised cost measurement for these financial assets under the conditions set out in the ED. This is also consistent with the Committee's *Guiding principles for the replacement of IAS 39*.¹

¹ Available at: www.bis.org/publ/bcbs161.pdf

Regarding the scope of the proposal, we understand that the narrow scope exception excludes fair value prepayment options (eg financial assets for which the prepayment amount is measured at the debt instrument's current fair value), as set out at paragraph BC18. To ensure consistency in the scope of application of the exception, we recommend that the clarification at paragraph BC18 is included in the standard itself, rather than in the Basis for Conclusions, as the latter is non-authoritative.

We further agree that it is important that there is an ability to apply the exception in line with the effective date of IFRS 9; however, to this end, we recommend an effective date of 1 January 2019, with appropriate transitional provisions and early adoption being permitted. This provides flexibility for those that are unable to apply the exception on 1 January 2018.

As a final point, while we appreciate and commend the commitment of the IASB to provide an expedited solution to this issue, we do more broadly caution against a proliferation of rules-based exceptions to International Financial Reporting Standards and strongly support that any exceptions be done only on an extraordinary basis, so as not to compromise the principles-based nature of the framework.

The letter has been prepared by the Committee's Accounting Experts Group, chaired by Mr Fernando Vargas Bahamonde, Associate Director General, Bank of Spain. If you have any questions regarding these comments, please contact Mr Vargas (+34 91 338 8746) or Ms Ruby Garg of the Basel Committee Secretariat (+41 61 280 8463).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Stefan Ingves', is centered on the page.

Stefan Ingves