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**EFRAG draft comment letter on the IASB's Exposure Draft  
"Prepayment Features with Negative Compensations, Proposed  
amendments to IFRS 9" (ED/2017/3)**

Dear Madam or Sir

On behalf of the German Insurance Association (GDV) we welcome the opportunity to comment on EFRAG's draft comment letter regarding the proposals included in the IASB's Exposure Draft ED/2017/3 "Prepayment with Negative Compensations, proposed amendments to IFRS 9" as issued by the IASB on 21 April 2017.

While we do not provide detailed comments on the specific questions included in EFRAG's draft comment letter, we generally agree with the drafted response. We also welcome that the IASB decided to address the particular IFRS 9 issue recommended by the IFRS Interpretations Committee on a timely basis (**Question 1**). Similarly, we are supportive of the IASB's intention to clarify that the particular instruments with negative compensations should be eligible for accounting at amortized cost or at fair value through other comprehensive income (FVOCI). Nevertheless we are concerned about the possible unintended consequences of the proposed amendments. Specifically, we urge further work on the second eligibility criterion as it would significantly limit the scope of the financial instruments concerned and cause implications for existing IFRS 9's common interpretations (**Question 2**). Our more detailed comments regarding the IASB's proposals are provided in the annex to this letter.

Finally, we would like to encourage EFRAG to take the opportunity and to remind the IASB of the need for recycling in case of equities accounted for at FVOCI in IFRS 9. This still outstanding issue should be addressed by the IASB before the effective date of the new standard IFRS 17 Insurance Contracts. It is the firm view of the German insurance industry that recycling should be allowed, at latest at derecognition date.

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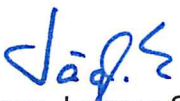
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If you would like to discuss our comments in further detail, please do not hesitate to contact us.

With best regards



Hans-Juergen Saeglitz  
Head of Accounting  
German Insurance Association



Dr. Adam Gieralka  
Manager Accounting  
German Insurance Association

Annex

## **GDV comments on IASB's "Prepayment Features with Negative Compensations, proposed amendments to IFRS 9" (ED/2017/3)**

### **I. General comments**

We appreciate that the IASB decided to address the particular IFRS 9 issue recommended by the IFRS Interpretations Committee on a timely basis. Nevertheless, we are concerned about the possible unintended consequences of the proposed amendments as provided in our comments below. Overall, we are supportive of the Board's intention to clarify that the particular instruments with negative compensations should be eligible for accounting at amortized cost or at FVOCI.

### **II. Detailed comments and suggestions for further fine-tuning**

Irrespective of our general support for the direction of the Board's proposals in the ED/2017/3 we believe that there are some areas of concerns. Hence, we recommend that the proposals should be improved as follows:

- In general, we agree with the proposal to create an exception for the financial assets with negative compensation features. However, the Exposure Draft provides also some clarifications, potentially unintended restrictions, regarding the existing provisions of IFRS 9. We believe that the suggested proposals should not go beyond what is necessary to achieve the intended objective. Hence, the new proposals should not be commingled with clarifications to existing provisions.

For example, regarding the right to terminate the contract at fair value: we understand that the Exposure Draft intends to clarify in BC18 that the prepayment amount equal to current fair value does not allow the underlying instrument to be consistent with paragraph B4.1.11(b) or to meet the SPPI test. We have observed that big accounting firms have had a different view so far (e.g. KPMG Insights into IFRS, 13th Edition 2016/2017, Volume 2, p. 2282. Example 15, 7A.4.210.70 f.).

Hence, the current practice assumed that a prepayment option at fair value is not problematic as long as no negative compensation arises (e.g. prepayment option at current fair value with the additional condition that the repayment of principal is guaranteed). In our view, if the particular financial instruments fulfill the SPPI-condition, when ignoring the fair value prepayment option, than the fair value of such instruments is determined mostly by the interest and principal payments. Consequently, the suggested "clarifications" should not be implement-

ed in IFRS 9. We recommend to delete them (e.g. contained in paragraphs BC18, BC23, BC24).

- The descriptions in paragraphs BC4 und BC5 in conjunction with the example in BC14 (asset A) causes us to ask a more general question. Which additional compensation for the early termination of the contracts is necessary to avoid the case of a negative compensation?

Is it necessary for the compensation to cover the outstanding principle payment including the whole outstanding interest payments (i.e. accrued interest plus the lost future interest payments)? Or is it sufficient for the compensation to include only the outstanding principle payment including the outstanding interest payment until to the point of termination (i.e. outstanding principle plus accrued interest only)? We understand that the latter case is not a case of a negative compensation under IFRS 9.

Our rationale: IFRS 9.B4.1.11 refers only to the case in which a prepayment amount “*may include reasonable additional compensation for the early termination of the contract*”. Consequently, we interpret the case demonstrated in BC14 as an example of specific contractual conditions only, without general implications for other cases. We recommend to explicitly clarify that this is the case to avoid any unintended and unnecessary misinterpretations/discussions.

- In our assessment the suggested approach in IFRS 9.B4.1.12A will cover only narrow cases with eligible negative compensations, while in the case described above a positive additional compensation is allowed. In consequence, negative and positive compensations will not be treated similarly. We believe that positive and negative compensation clauses should be treated symmetrically.
- Regarding the transition the Exposure Draft generally suggests an assessment on the basis of the facts and circumstances that existed at the initial recognition of the financial asset, i.e. a retrospective approach (IFRS 9.7.2.5A, BC27, BC28). However, in the case, in which the necessary information is not available, entities would not be allowed to use the suggested amendment.

While we agree with the transition approach in principle, we also note that IFRS 9 additionally allows assessing the financial instruments on the basis of information available at the transition to IFRS 9 (subject to undue cost and effort clause). We recommend including a similar relief for the proposed amendment as well. In particular, information might not be easily available for financial instruments with long durations (e.g. multiple changes in IT landscape).