

Comment Letters  
EFRAG  
35 Square de Meeûs  
1000 Brussels  
Belgium

Paris, 24 May 2017

**Re: ED/2017/3 Proposed amendments to IFRS 9 “Prepayment Features with Negative Compensation”**

Dear Mr Gauzès,

Please find here enclosed Mazars’s comment letter to the IASB on the above-mentioned exposure draft (ED) 2017/3 Prepayment Features with Negative Compensation, issued by the IASB on April 23rd, 2017.

We share the concerns expressed by EFRAG in its answer to question 2. In that regard, we agree with EFRAG suggesting to remove the second criterion of the exception introduced by § B4.1.12A. We also share EFRAG’s concerns that “references in the Basis for Conclusions [that] go beyond the scope of the proposed Amendments to IFRS 9, as they seem to interpret existing guidance in IFRS 9” should be removed.

We disagree however with EFRAG’s proposal to differ the date of initial application to 1/1/2019. This would expose preparers to very significant challenges in terms of financial communication and IT systems together with related costs.

Indeed, what is at stake is much more than a simple classification issue as the asset category directly interacts with two of the most important elements in banking management : impairment of credit risk, and hedging of interest rate risks.

Moreover, IFRS 9 is a very significant change for users as well. Changing IFRS 9 requirements only one year after its initial application would impair the users’ confidence in the information published.

We realize the timing challenge Europe is facing with this amendment, but we encourage the EFRAG to do its outmost effort to facilitate an application of this amendment within Europe from the 1/1/2018.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,



**Michel Barbet-Massin**

*Head of Financial Reporting Technical Support*

Comment Letters  
IASB  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Paris, 24 May 2017

**Exposure Draft ED/2017/03 : Prepayment Features with Negative Compensation – Proposed amendments to IFRS 9**

Dear Hans,

Mazars welcomes the opportunity to comment on the International Accounting Standards Board's Exposure Draft (hereafter ED) *Prepayment Features with Negative Compensation – Proposed amendments to IFRS 9 Financial Instruments*, issued on 21st April 2017.

We welcome the Board's initiative to address the issue of Prepayment Features with Negative Compensation. These contractual features are frequent in some types of financing activities and its impact on the accounting treatment under IFRS 9 is very significant as non SPPI instruments are not classified in accordance with the Business Model in which they are managed.

We agree with the first condition proposed by the Board that ensures the link with the fundamental SPPI principles. We are convinced that an SPPI prepayment feature could come with a negative compensation depending on the current market conditions.

However we disagree with the second condition because we fail to understand its conceptual rationale as it is in contradiction with common prepayment features that IFRS 9 itself gives as an example of an SPPI prepayment feature. We also consider that this condition will limit the scope of this amendment to an extent that could neutralize its benefit without enhancing its conceptual rationale.

We therefore encourage the Board to retain only the first condition.

We draw the attention of the Board to the fact that it should not interpret IFRS 9 within this amendment beyond its limited scope. We welcome the Board's initiative and encourage the Board to address this significant issue in the very short term, but the first application date of IFRS 9 is only seven months away and we recommend that the Board avoid creating uncertainty or any change in the accounting requirements of IFRS 9 that

would go beyond the initial purpose of this limited amendment. We are particularly concerned by the consequences of paragraph BC18 of the amendment. Please refer to our answer to question 2 for more details.

Our detailed comments to the questions raised in the ED are set out in the Appendix.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,



Michel Barbet-Massin  
*Head of Financial Reporting Technical Support*

***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?*

Mazars fully agrees with the concerns that the IASB is seeking to address for the following reasons:

- a) it is our experience that this kind of situations are frequent in some types of financing such as large corporate bonds (Make Whole amount);
- b) we consider that the standard is unclear in this regards as paragraph B4.1.10 does not provide any principles to address the issue and paragraph B4.1.11 b) is introduced as a simple example rather than as a rule or guidance on what kind of early redemption option can be considered as SPPI.
- c) The potential impact of this issue is very significant as failing the SPPI test leads to classify the financial asset at Fair Value Through P&L whatever the Business Model of the portfolio to which it belongs. Inadequate application of this SPPI test could indeed significantly impair the information provided to the users of financial statements on the performance and cash flow generation process of the holder.

We would like to draw the attention of the Board to the important difference between an amendment issued to “clarify” an accounting treatment, and one that would aim at “modifying” an accounting treatment. This difference could be critical for preparers before the date of initial application of this amendment. We encourage the Board to adopt a wording in line with a “clarification”. We consider that this is justified by the lack of clarity of the current standard:

- for the reason expressed in paragraph b) above; and
- because we consider that a “reasonable additional compensation” could be in the form of negative compensation depending on the change in the economic environment.

**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 support the proposal that financial instruments containing prepayment features with negative compensation could be eligible for measurement at amortised cost or at FVOCI. We consider that the existence of either a positive or a negative compensation element in the prepayment amount should not prevent the instrument from being SPPI. We therefore agree with the first eligibility criterion which appears clear and limited to the circumstances of the narrow scope of the proposed amendments. We are convinced that this condition is the key point to be addressed with this amendment.

However we disagree with the second proposed condition for the following reasons:

- We fail to understand the rationale of this condition. Fixed rate loans are commonly originated at par (or close to par) and at market conditions so that their principal amount is substantially the par amount. This kind of early redemption option is clearly SPPI as mentioned in the example provided in B4.1.11b, even if its initial fair value is probably not insignificant.
- It is our understanding that a large range of basic early redemption options may be found not to have an insignificant value at initial recognition. For example the compensation may provide a protection against change in benchmark/risk free interest rate but not against change in credit risk providing a value to any early redemption at par. In practice this second criterion will therefore limit the scope of this amendment to an extent that will minimize its benefit without enhancing its conceptual basis.

We therefore recommend that this second criterion be removed.

We draw the attention of the Board to the fact that the Board should not interpret IFRS 9 beyond the limited scope of this amendment. We welcome the Board's initiative to

address this significant issue, but the first application date of IFRS 9 is only seven months away and we recommend that the Board avoid creating uncertainty or any change in the accounting requirements of IFRS 9 that would go beyond the initial purpose of this limited amendment.

This is especially the case of BC18. Our understanding is that this paragraph is not limited to the scope of the amendment but goes beyond, expressing the view of the Board on other matters such as on early redemption options at fair value or on compensation based on cost of hedging. We encourage the Board to limit its guidance to what is essential to understand its position on “Negative compensation”.

We disagree with the Board’s assumption in BC18 that “*the effective interest method, and thus amortised cost measurement, are not appropriate when the prepayment amount is inconsistent with paragraph B4.1.11(b) for any reason other than that described in paragraph BC17*”. This sentence seems to transform an example of the standard into a rule, overriding the principles of the standard on the Principal and Interest concept. We disagree with this assumption. It is our experience that a large majority of early redemption options are an integral part of basic lending arrangements. We therefore agree with the current IFRS 9 wording that states that paragraph B4.1.11b is an example of an SPPI feature rather than a limitative list, or an exemption to the SPPI principle.

The Board is clearly stating in BC18 that an early redemption option at fair value is not SPPI, not only because of its symmetrical feature but because of a new position expressed by the Board. We fail to understand its rationale. In our opinion, a compensation based on fair value is the most reasonable compensation in any case as it is the price at which the transaction would be unwound upon agreement of both parties in the absence of any specific contractual provisions. Requiring a fair value measurement because a loan embeds a feature that does not trigger any change in fair value is difficult to understand. On the other side, variability of cash flows cannot be a reason to fail the SPPI test without raising a question on any floating rate instrument. We fail to understand why such feature would be in contradiction with the “payment of principle and interest” on a debt instrument. We encourage the Board to rely on the fundamental principles of the “Principle and Interest” criterion without creating any arbitrary rules derived from paragraph B4.1.11b.

**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?*

Yes we agree with an effective date of this amendment being the same as the effective date of IFRS 9, i.e. 1 January 2018.

We think this is the only way to:

- provide useful and clear information to the users of financial statements from 1 January 2018 onwards;
- ensure comparative information among entities; and
- avoid undue massive costs for preparers, especially in the banking industry.

**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?*

Yes we agree with the proposal that is consistent with other IFRS 9 requirements.