EUROPEAN CENTRAL BANK

EUROSYSTEM

ECB-UNRESTRICTED

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Endorsement of the amendments to IFRS 9 Financial Instruments – Prepayment features with negative compensation

Dear Mr Gauzès,

On 12 October 2017, the IASB issued the final amendments to IFRS 9, titled "Prepayment features with negative compensation". The European Financial Reporting Advisory Group (EFRAG) issued its Draft Endorsement Advice (DEA) on 18 October 2017, requesting comments from its stakeholders no later than 2 November. It has been agreed with the EFRAG Secretariat that written comments from the ECB would be welcome up to 8 November.

The ECB has a keen interest in high quality accounting standards that serve the public interest via a proper reflection of the economic substance of transactions and that do not compromise financial stability. High quality accounting standards are also a major prerequisite for effective prudential supervision.

Thank you for giving us the opportunity to provide comments on the DEA. The ECB would like to express its reservations about the endorsement of the amendments. We are concerned about the potential implications that the amendments may have, in particular given that it is currently unclear which financial assets would be captured and there has not been sufficient time to conduct a thorough impact assessment. In addition, we would see merit in further analysing the economic background of the underlying business cases and whether there is compelling evidence that would justify the amendments to IFRS 9.

The amendments have the potential to substantially alter a widely agreed fundamental concept of IFRS 9, namely the concept of "solely payment of principal and interest" for the classification and measurement of financial assets. More specifically, prepayment features with negative compensation expose the holder of a financial asset (e.g. a lender) to variability of cash flows that is related to changes in market interest rates. As a consequence, measuring these financial assets at amortised cost is less likely to provide relevant and reliable information to users of financial statements. In some circumstances the information provided under the revised IFRS 9 may also reduce comparability as unlike items (prepayment features with positive and negative compensation) are treated as if they were economically similar. The removal of the second eligibility criterion (or another suitable scope restriction) in the final amendments aggravates the problem in our view, as the population of financial assets to which the amendments apply will be increased.

Moreover, the amendments introduce a "rules-based" change to an accounting model that is currently based on a set of principles. However, a principles-based approach is more robust to change and thus more likely to ensure accounts that reflect economic reality in both the short and longer terms.[1]

Finally, it is also important to note that in the absence of a proper impact assessment it is not clear how the amendments could potentially affect important aspects such as banks' profitability, capital requirements and lending behaviour in the short- and longer term. For example, if banks ultimately receive (substantially) less than the amortised cost (less impairment) of the loan, they may suffer unexpected losses, with a corresponding reduction in their Common Equity Tier 1.

If you have any questions regarding our comments, please feel free to contact us.

Yours sincerely,

Vítor Constâncio

Cc:
Mr Olivier Guersent, Director General of the Directorate General for Financial Stability, Financial Services and Capital Markets Union (FISMA)
Mr Alain Deckers, Head of Accounting and Financial Reporting in the Directorate General for Financial Stability, Financial Services and Capital Markets Union (FISMA)
Mr Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA)
Mr Gabriel Bernardino, Chair of the European Insurance and Occupational Pensions Authority (EIOPA)
Mr Andrea Enria, Chair of the European Banking Authority (EBA)
Mr Andrew Watchman, Chair of the EFRAG Technical Expert Group (TEG)

[1] Cf. ESCB (2006): Assessment of accounting standards from a financial stability perspective.