

24 May 2017

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH  
United Kingdom  
Email: [commentletters@ifrs.org](mailto:commentletters@ifrs.org)

Dear Sir/Madam

**SAICA SUBMISSION ON ED/2017/3 – PREPAYMENT FEATURES WITH NEGATIVE COMPENSATION: PROPOSED AMENDMENTS TO IFRS 9**

In response to your request for comments on ED/2017/3 – *Prepayment Features with Negative Compensation*: Proposed Amendments to IFRS 9, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC), which comprises members from reporting organisations, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this exposure draft.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours faithfully,

**Bongeka Nodada**  
**Project Director:**  
**Financial Reporting Standards**

**Zimkita Mabindla**  
**Senior Executive:**  
**Corporate Reporting**



## GENERAL COMMENTS

We welcome the International Accounting Standards Board's (IASB or Board) effort to clarify the classification of financial assets with particular prepayment features applying IFRS 9 – *Financial Instruments*. We believe that amortised cost would be a more relevant measure for financial assets with symmetrical options where there is reasonable additional compensation. We also consider compensation to be both positive and negative and that such reasonable additional compensation would still be considered basic lending arrangements. Symmetrical prepayment options are not common in the South African environment.

We would like to further draw the Board's attention to some of the inclusions of new guidance in the Basis of Conclusions, specifically BC18 and BC23 and what would be considered reasonable additional compensation. The inclusion of this guidance may impact the one-sided options and we do not agree that all such compensation would not be considered reasonable compensation. Many institutions are in the advanced stages of implementation and this could impact the initial assessments performed. We would ask that the Board in future not include such guidance in the Basis of Conclusions before consultation with constituents and recommend strongly that BC18 and BC23 in particular be removed.

## SPECIFIC COMMENTS

### **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?*

We agree that the Board should address the concerns about the classification of financial assets with particular prepayment features in applying IFRS 9. However, we do not believe an exception is required for this but merely a clarification or additional guidance. Our constituents were of the view that, reasonable additional compensation can be positive and negative, and that such symmetrical prepayment options would still be considered part of a basic lending arrangement.

### **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?*

Symmetrical prepayment options are not common in the South African environment. Notwithstanding this, we believe that IFRS 9 currently addresses the accounting for financial assets with prepayment features and therefore support the inclusion of B4.1.12A (a). However, we do not believe this is an exception but merely additional guidance on how to consider what is reasonable additional compensation.

Furthermore, whilst we agree with the inclusion of the first proposed condition in paragraph B4.1.12A as additional guidance, we do not support the second condition in paragraph B4.1.12.A(b). One of our main concerns relates to B4.1.12A(b), where financial assets with such prepayment options were purchased after origination, it seems from our reading in paragraph BC19, that IFRS 9 would not allow these financial assets to be measured at amortised cost. This would result in inconsistent measurement between originated and acquired portfolios and, we believe that amortised cost for purchased assets should be consistent with originated financial assets. We suggest that the assessment of the prepayment feature should be done at origination of the financial asset and not at the date the reporting entity acquired the financial asset.

For purposes of the South African environment, the most significant concern we have relates to the inclusion of paragraphs BC18 and BC23. In paragraphs BC18 and BC23, the Board appears to have interpreted the meaning of reasonable additional compensation. Specifically, the Board noted that prepayment options settled at fair value should not be eligible for amortised cost measurement. In addition, the Board also noted that a reasonable compensation which includes costs for terminating an associated hedging instrument is inconsistent with the principle of solely payment of principal and interest. We do not agree with this assessment of reasonable additional compensation and specifically the inclusion that reasonable compensation may not include costs for terminating an associated hedging instrument. The inclusion of such costs is common practice in South Africa for one-sided prepayment options. If such costs relate specifically to an interest rate swap, we would consider this to be reasonable compensation. However, if other costs such as terminating a foreign exchange hedging instrument, we would not consider this to be reasonable compensation as this is against the principle of solely payment of principal and interest. We are of the view that reasonable compensation is a matter of judgement and subject to interpretation with due consideration of the solely payment of principal and interest principles. We would not support including additional guidance on reasonable compensation at such a late stage. If such



guidance was to be provided, IFRS 9 should be updated and due process should be followed for such an amendment.

**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 agree with the proposed effective date and are of the view there is sufficient time to process the IFRS 9 amendment. We believe this should be applied concurrently with the requirements of IFRS 9.

**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?*

We agree with the proposed transition requirements and welcome the inclusion of the exception provided.

*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?*

Other than our concerns noted above with respect to BC 18, BC19 and BC23, we do not have any further comments or considerations.