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International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: Prepayment Options with Negative Compensation (ED/2017/3)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Prepayment Features with Negative Compensation (Proposed Amendments to IFRS 9)" issued in April 2017.

Our process

As part of the due process for these proposals, we consulted with stakeholders within financial institutions and credit unions, along with their auditors. We took into account the results of the discussions we had when developing this comment letter.

Our views

We commend the IASB for being responsive to issues that arise during the implementation process of IFRS 9 *Financial Instruments*. We continue to strongly support the IASB in its efforts to identify and address standards implementation issues.

Overall, we agree with the amendments being proposed but we have some concerns over the timing and potential implications beyond prepayment features with negative compensation. We agree that the

effective interest rate method could provide useful information about the contractual cash flows arising from particular prepayment options with negative compensation. We also agree that the amendments need to include some criteria in order to achieve the narrow application in practice intended by the IASB. However, we are concerned that some of the language used in the Basis for Conclusions provides guidance on what is reasonable compensation. Defining reasonable compensation could have implications for other areas of IFRS 9, which is beyond the scope of this project.

We are also very concerned that modifying IFRS 9 within a few months before the effective date can negatively affect the implementation efforts of preparers, auditors and users of the financial statements. This concern is more pronounced with our large financial institutions that are mandated by their regulator to early adopt IFRS 9 as of November 1, 2017. Entities and auditors will need to expend time and effort relating to either applying the amendment or proving that these types of prepayment features do not exist or are immaterial.

Therefore, we think it is appropriate to alleviate some of the implementation efforts for preparers, auditors and users of the financial statements. As such, we recommend an effective date of January 1, 2019, rather than January 1, 2018, with earlier application permitted. Having a later effective date will allow entities to choose a date based on the value of the information the proposals provide and the ability to implement the proposals in a short period of time.

In addition, timing of issuance of the final amendments is a concern because we need time to complete our endorsement process. Therefore, we stress the importance of having the final amendments as soon as possible.

Our responses to your questions

The [Appendix](#) to this letter responds to the questions posed in the Exposure Draft and expands on the points raised above.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Rebecca Villmann, Director, Accounting Standards (+1 416 204-3464 or email rvillmann@cpacanada.ca) or Katharine Christopoulos, Principal, Accounting Standards (+1 416 204-3270 or email kchristopoulos@cpacanada.ca).

Yours truly,



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About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

APPENDIX

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?

1. The AcSB supports the IASB addressing concerns raised about the classification of financial assets with particular prepayment features applying IFRS 9. In Canada, based on our limited outreach, these prepayment features exist in a few industries, most notably within our credit unions. As such, we think addressing these concerns is worthwhile and it will result in better information to the users of the financial statements.

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:

1. 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
2. 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?

2. We agree with the first condition as a financial asset should be eligible to be measured at amortized cost or at fair value through other comprehensive income if the only

reason that the financial asset fails the solely payments of principal and interest treatment is that the prepayment amount might result in negative compensation.

3. We also agree, consistent with the Basis for Conclusions paragraph 9, that in some circumstances, amortized cost provides useful information about particular financial assets in particular situations. Amortized cost provides information that reflects the amount, timing and uncertainty of future cash flows. This treatment is appropriate for instruments with simple cash flows that represent principal and interest, consistent with the financial assets intended to be in scope of this amendment.
4. However, we are concerned with the wording in the Basis for Conclusions, paragraph 18. In two instances, the IASB is providing guidance on what is reasonable compensation. The Basis for Conclusions states that a fair value amount is not reasonable compensation for early termination of a contract. As well, the guidance discusses that amortized cost is not appropriate for a financial asset that is prepayable at an amount that includes the fair value cost to terminate an associated hedging instrument if that prepayment amount is inconsistent with paragraph B4.1.11(b). The reason is that the prepayment amount exposes the holder to factors that could result in contractual cash flows that are not solely payments of principal and interest.
5. We are concerned that providing guidance on reasonable compensation will have a broader impact on other areas of the standard. For example, the treatment of asymmetric prepayment options for which entities have already concluded on their classification and measurement based on the current guidance in IFRS 9 could need to be reassessed.
6. We agree that a second criterion could be appropriate in order to maintain a narrow scope exception. However, it is unclear if an appropriate condition is that the prepayment feature has an insignificant fair value at initial recognition. Some financial assets could have a prepayment feature with a fair value that is close to zero if the prepayment amount is based on changes in the market interest rates.

7. As well, the additional compensation does not depend on which party chooses to terminate the asset early but instead depends only on the movement in the relevant market interest rate. Applying that rationale to the calculation of a prepayment feature with negative compensation, the compensation could be positive or negative which would balance out when calculating the fair value of the feature at initial recognition.
8. Based on the above rationale, we think that the second criterion will not narrow the scope exemption and should be removed.

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?

9. We understand why the IASB has proposed an effective date of January 1, 2018, in order to be consistent with the effective date of IFRS 9. However, we are concerned with the effort required from stakeholders in order to adopt and implement the proposals before this mandatory effective date. Entities and auditors will need to expend time and effort relating to either applying the amendment or proving that these types of prepayment features do not exist or are immaterial. A later effective date will allow entities with these prepayment features a choice, which would be reasonable given the timing. For entities that have completed their IFRS 9 assessment, work will be required to modify conclusions. The entities would have a choice of doing this work on the adoption of IFRS 9 or one year later. For entities that have not

completed their IFRS 9 assessment, they can choose to early adopt to avoid completing the work effort twice.

10. As such, we recommend an effective date of January 1, 2019, with earlier application permitted.
11. Having an effective date later than the date of transition to IFRS 9 can lead to entities with prepayment features with negative compensation classified as fair value through profit and loss in the transition year. In subsequent years, these prepayment features would be classified as amortized cost or fair value through other comprehensive income, depending on their business model. We think this compromise is needed in order to provide the time needed to implement the change. As well, fair value through profit and loss can provide information on the contractual cash flows for financial assets containing prepayment features with negative compensation, which is useful information to the users of the financial statements.
12. The other issue that is of great concern to Canada, as well as many other jurisdictions, is whether there will be sufficient time between the IASB's issue date and the effective date to complete our endorsement process. If the amendment is not published in the Canadian Handbook prior to the effective date, this will cause issues for entities with their security filings. Therefore, we stress the importance of having the final amendments as soon as possible.

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?

13. We agree with retrospective application of the proposed amendments, consistent with the requirements in IFRS 9. We also agree that if it is impracticable for the entity to determine that the fair value of the prepayment feature is insignificant at the date of initial recognition, the entity should assess the contractual cash flow characteristics of the financial asset without taking into account the proposed exception. This approach would be consistent with other contractual features in IFRS 9.
14. We think additional transitional considerations, other than the impracticable notion mentioned above, are not required.