



**IASB proposes to amend IFRS 9 in relation to  
prepayment features with negative compensation**

Published on: May, 2017

### Why are amendments being proposed?

IFRS 9.B4.1.11(b) states that the prepayment of a debt instrument at an amount that includes 'reasonable additional compensation' for the early termination of the instrument results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding ('SPPI'). A question has arisen in practice as to whether the term 'compensation' includes negative compensation, i.e. where the party exercising the option receives compensation from, as opposed to paying compensation to, the other party for early termination.

Negative compensation can occur, for example, when the instrument is prepayable at an amount that reflects the remaining contractual cash flows discounted at the current market interest rate. Depending on the interest rate movements since initial recognition of the instrument, the option holder may end up paying more (i.e. paying compensation) or less (i.e. receiving compensation) than the outstanding principal and interest at the time of prepayment. The IASB was concerned that in applying IFRS 9 these instruments would fail the SPPI condition and need to be measured at FVTPL. Such prepayment features are prevalent in particular types of otherwise 'plain vanilla' lending instruments, such as corporate loans and retail mortgages. The IASB decided that measuring such assets at amortised cost, and including them in key metrics like net interest margin, would provide more useful and relevant information to users of financial statements about these financial assets' performance than FVTPL.

### What are the proposed amendments?

The IASB proposes a narrow-scope exception to IFRS 9 to allow a prepayable financial asset to be measured at amortised cost if:

- a. the financial asset would otherwise meet the requirements of IFRS 9.B4.1.11(b) but fails it only because the option holder may receive reasonable additional compensation for early termination; and
- b. the fair value of the prepayment feature is insignificant when the entity initially recognises the financial asset.

### Effective date, transition requirements and comment period

The IASB is proposing an effective date of 1 January 2018 for the amendments with retrospective application. Specific transition provisions apply.

The 30-day comment period ends on 24 May 2017.

### Observation

The tight comment deadline was set in view of the narrowness of the scope of the proposed amendment and the urgency to resolve the issue to meet the proposed 1 January 2018 effective date. This date was set to align with the effective date of IFRS 9 to avoid preparers having to apply fair value accounting to financial assets containing such prepayment options and then having to change back to amortised cost once the proposed amendments become effective.



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