Grupo Latinoamericano
de Emisores de Normas
de Información Financiera

Group of Latin-american
Accounting Standard Setters

May 24, 2017

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft ED/2017/3 – Prepayment Features with Negative Compensation

Dear Board Members:

The "Group of Latin American Accounting Standard Setters"[1] – GLASS welcomes the opportunity to comment on the Exposure Draft ED/2017/3 – Prepayment Features with Negative Compensation (the "ED").

Due process
The discussions regarding the ED were held within a specified Technical Working Group (TWG) created in April 2017. All country-members had the opportunity to appoint at least one member to participate in this TWG. Each standard setter represented in the TWG has undertaken different tasks in their respective countries (e.g. surveys, internal working groups). All results were summarized, and this summary was the platform for the TWG discussion process.

The TWG discussed the different points of view included in the summary during several conference calls. In those calls the TWG developed a final document on the basis of the agreed-upon responses and the technical points of view of its members. Finally, the TWG document was submitted to and approved by the GLASS Board.

Overall Comments
We would like to congratulate the Board for its efforts to address the concerns of some interested parties about how IFRS 9 classifies particular prepayable financial assets.

IFRS 9 determines the situations when the contractual terms permit the early termination of contracts and still meet the criteria of solely payments of principal and interest (SPPI) on the principal amount outstanding.

One of the SPPI criteria is that the prepayment amount substantially represents unpaid amounts of principal and interest, which may include reasonable additional compensation for the early termination of the contract that lead to a general interpretation that a prepayment penalty must be paid to the other party by the party exercising the option.

However, in some cases, the party choosing to terminate the contract receives an amount (instead of paying an amount), as it could force the lender to accept a prepayment amount that is substantially less than unpaid amounts of principal and interest. Therefore, the prepayment includes an amount that reflects a payment to the borrower (i.e. negative compensation), instead of compensation from the borrower, even though the borrower chose to terminate the contract early, which is inconsistent with paragraph B4.1.11b) of IFRS 9.

Even though the party that decides to terminate the contract early receives an amount, GLASS believes that prepayment features with negative compensation should be subject to the same eligibility conditions as prepayment features with positive compensation considering that the nature of the transactions are similar and the instrument should be held within the appropriate business model.

Following this rationale GLASS considers that financial instruments containing prepayment features with negative compensation could be eligible for measurement at amortized cost or at fair value through other comprehensive income ('FVOCI').

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[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions with respect to all Exposure Drafts issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS is constituted by: Argentina (Board), Bolivia, Brazil (Vice Chairman), Chile, Colombia (Board), Costa Rica (Board), Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico (Chairman), Panama, Paraguay, Peru (Board), Uruguay (Board) y Venezuela (Board).

GLASS observes that paragraphs B4.1.12 and B4.1.12A differ mainly due to subsection (a) of paragraph B4.1.12, which is not included in paragraph B4.1.12A. The Basis for Conclusions on the ED refers to the differences between the two paragraphs, but it does not seem to be clear. Therefore, we believe that a numerical example might be included to make clear the rationale of the differences between the two paragraphs.

GLASS also notes that modifying IFRS 9 *Financial Instruments* a few months before its effective date could cause some problems for entities in obtaining the necessary information to apply the modification retrospectively.

However, GLASS believes that it is reasonable that this exception has the same effective date as IFRS 9 as this instrument should be held within the appropriate business model and should be properly classified and measured from the adoption of IFRS 9. In addition, GLASS believes that it will be inefficient for entities to initially apply IFRS 9 without this exception and subsequently be required to change the classification and measurement of some prepayable financial assets.

Despite the above, one country-member does not agree with some items proposed in the ED as it believes the fair value of the compensation resulting from the prepayment feature of the contract is not a relevant factor to determine whether the instrument should be measured at amortized cost or at fair value through OCI. That country-member believes that the business model should be the driver for classification and, therefore, the treatment should be the same for both positive and negative compensation.

Specific Comments
Attached please find our specific responses to the questions presented in the ED.

Contact
If you have any questions about our comments, please contact glenif@glenif.org.

Sincerely yours,

Felipe Pérez Cervantes
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

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Exhibit

**GLASS Comment Letter on the IASB Exposure Draft on
Prepayment Features with Negative Compensation**

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?

Considering it is a new standard and that this situation can exist in different types of transactions in different jurisdictions, doubts could arise and different views and interpretations could be applied regarding the classification and measurement of financial instruments with particular prepayment features.

Therefore, GLASS agrees that the Board should seek to address these concerns as it clarifies how to classify particular prepayable financial assets pursuant to IFRS 9.

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 amortized 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 recognizes 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?

With respect to the first condition, GLASS understands that a prepayment feature with negative compensation appears to not meet the solely payments of principal and interest (SPPI) criteria due to the fact that the reasonable additional compensation for the early termination is received by the party that decides to terminate the contract early, which is not aligned with the overall interpretation that the prepayment penalty must be paid to the other party by the party exercising the option.

Even though the party that decides to terminate the contract early receives an amount, GLASS believes that a positive or a negative compensation in the prepayment amount should not prevent the instrument from being held within the appropriate business model.

With respect to the second condition, GLASS understands that it is included to limit the scope of the amendment, since when the fair value of the prepayment feature is insignificant it becomes unlikely that the entity will exercise the prepayment option and, therefore, there is a low probability that the negative compensation will be realized.

Taking into account the entity business model approach of IFRS 9, GLASS believes that allowing these kinds of instruments to be measured at either amortized cost or fair value through other comprehensive income fairly presents the entity's portfolio, something that would not result if those were measured at fair value through profit and loss.

Despite the above, one country-member does not agree with some items proposed in the ED as it believes that the option (a) is aligned with the situation in paragraph B4.1.11. That country-member believes that the fair value of the compensation resulting from the prepayment feature of the contract is not a relevant factor to determine whether the instrument should be measured at amortized cost or at fair value through OCI. That country-member believes that the business model should be the driver for classification and, therefore, the treatment should be the same for both positive and negative compensation.

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?

GLASS agrees with the proposed effective date as this instrument should be held within the appropriate business model and should be properly classified and measured from the initial adoption of IFRS 9. We also believe that it would be inefficient for entities to initially apply IFRS 9 without this exception and subsequently be required to change the classification and measurement of some prepayable financial assets.

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?

(a) We agree with the proposal as it appears reasonable to have the same transition requirements as IFRS 9 for this exception, considering that it is related to an amendment of the standard and for most situations it would not appear to be impracticable to apply it retrospectively.

(b) No, we do not think that 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, as we agree that the exception should be applied retrospectively and believe that most entities would be able to do it even when they early apply IFRS 9.

One country-member does not agree with the proposal and stresses that at the transition date it would be impracticable to estimate the fair value of the negative compensation.