November 22, 2012

To the International Accounting Standards Board;

Japanese Bankers Association

Comments on the IASB Draft of forthcoming

IFRS on general hedge accounting

The Japanese Bankers Association (the "Association") is an organization that represents the banking industry in Japan; its members comprise banks and bank holding companies operating in Japan.

The Association submits the following comments on the draft of the forthcoming IFRS on general hedge accounting (the "Draft").

We are aware that the Draft has not been released for inviting comments. However, we would like to provide the following comments for areas that may require further clarification from a practical perspective.

<u>Overall comments</u>

We highly appreciate that, as compared to the hedge accounting model under IAS 39, the Draft intends to reflect the effect of an entity's risk management activities in financial statements as much as practicable, and that it incorporates a number of our comments into the Exposure Draft (the "ED") released in December 2010.

However, there are still some areas where clarification is required for practical purposes, and hence it is respectfully requested that the IASB finalise standards, fully considering our concerns discussed below.

As we have commented in the previous comment letter, with regards to the designation of a LIBOR component of a Sub-LIBOR transaction as a hedged item, and the accounting treatment of a currency swap for funding purposes, we still believe that the Draft alone may not, from an accounting perspective, properly reflect the effect of an entity's risk management activities. Of these issues, while our understanding is that the accounting treatment of a currency swap for funding purposes will be subject to on-going deliberations under the macro hedge accounting project, we respectfully request the IASB to sufficiently take into account our concerns in the deliberation process. In addition, we request the IASB to continue to discuss a Sub-LIBOR transaction under cash flow hedge accounting for a portfolio hedge of interest rate risk during the on-going deliberations for the macro hedge accounting project.

In addition to these comments, we hope that the discussion on macro hedge accounting project would not be overly affected by the general hedge accounting principles for which standards will be finalised.

Individual comments

1. Deleting the implementation guidance

The implementation guidance under IAS 39 for hedge accounting model is fully deleted in the Draft. Although it is understood that this guidance was deleted in order to develop principle-based standards, and such deletion does not change current practice, some stakeholders have voiced their concerns that the deletion of the implementation guidance would imply the denial of the current practice. To avoid such confusion and an unintended consequence, such as doubts being raised as to whether current practice may still be retained, it is considered necessary to clarify that the accounting treatment in accordance with the implementation guidance under IAS39 is still permitted under the new hedge accounting model by stipulating implementation guidance under IAS 39 under the new hedge accounting model, or by stating the reason why the implementation guidance is deleted in the Basis for Conclusions. In particular, as discussed below, since IAS 39 IG F.1.4 (Internal hedges) and IG F.6.1-F.6.3 (Cash flow hedge accounting for a portfolio hedge of interest rate risk) are established practices across the banking industry, it is requested that the treatment of such transactions be further clarified. We understand that the staff of the Accounting Standards Board of Japan has raised the same comment to the IASB staff.

(1) IAS 39 IG F.1.4 (Internal hedges)

IAS 39 IG F.1.4 states that an intragroup derivative may be designated as a qualified hedging instrument if the intragroup derivative is an external transaction from the perspective of the group entity. This treatment aligns with the practice of financial institutions.

In Japanese banks, the ALM (Asset-liability management) division executes an intragroup hedging derivative with the trading division, and the trading division transfers the risk externally through an external transaction. Such practice is carried out on reasonable grounds that centralising the function which directly accesses to the market to the trading division facilitates the entity's credit risk management activities. Therefore, under the general hedge accounting model as well as macro fair value hedge accounting, such practice needs to be reflected in the financial statements.

Accordingly, we would like to confirm whether the treatment under IAS 39 IG F.1.4 shall be permitted under the new hedge accounting model.

(2) IAS 39 IG F.6.1-F.6.3 (Cash flow hedge accounting for a portfolio hedge of interest rate risk)

IAS 39 IG F.6.1 through F.6.3 provide the interpretation of how to apply the cash flow hedge accounting for a portfolio hedge of interest rate risk. In particular, the guidance on determining hedge ineffectiveness, the approach on hedge designation, and accounting treatment on related hedge adjustments is meaningful in practice, and is applied by a number of financial institutions.

Given this, we would like to confirm whether the accounting treatment in accordance with IAS 39 IG F.6.1-F.6.3 shall be permitted under the new hedge accounting model.

2. Consideration on a component that the hedged item does not have under the hypothetical derivative method

Draft B6.5.5 states that a hypothetical derivative method cannot be used to include features in the value of the hedged item that only exist in the hedging instrument (but not in the hedged item), and provides debt denominated in a foreign currency as an example (ie. currency basis).

And also IE23 footnote15 and IE33 footnote24 provide currency basis as one of the factor of ineffectiveness.

However, under current practice, the currency basis is also taken into account in constructing a hypothetical derivative, based on an approach to factor in all components included in a normal derivative for constructing the hypothetical derivative. Accordingly, we would like to confirm whether currency basis shall be deleted from the example of B6.5.5. IE23 and IE33.

3. Accounting for amortisation on the forward element of forward contracts

Draft 6.5.16 stipulates that the forward element shall be amortised on a systematic and rational basis over the period to which the forward element relates, and in each reporting period the amortisation amount shall be reclassified from the separate component of equity to profit or loss as a reclassification adjustment. However, the Draft does not specify which account shall be used to recognise amortisation in profit or loss. The Draft BC6.304 states that “The Board considered that this accounting treatment would provide a better representation of the economic substance of the transaction and the performance of the net interest margin”. Therefore, we would like to confirm whether the corresponding account to which the other comprehensive income (OCI) will be reclassified is “interest income or expense” in profit or loss for amortising the forward element under the Draft.

4. Consistency with limited amendments to classification and measurement and the timing for finalising general hedge standards

It is understood that the IASB is deliberating limited modifications to classification and measurement, and tentatively decided to introduce a third measurement category for debt instruments that meet the contractual cash flow requirements – “at fair value through other comprehensive income (FVOCI)” category, if the financial assets are managed within a business model whose objective is both to hold the financial assets to collect contractual cash flows and to sell the financial assets.

Debt instruments classified as FVOCI are likely to be sold; while, for reasonable reasons such as the debt instrument cannot be sold due to the illiquidity of the market the instrument is traded on, there may be cases where changes in OCI of such an instrument which represent changes in fair value arising from market risk, including interest rate and foreign exchange, need to be hedged using derivatives.

The Draft is silent on whether hedge accounting may be applied, or how hedging instruments shall be accounted for in case that debt instruments as FVOCI are designated as a hedged item. Therefore, it is considered necessary to clarify these issues in finalising standards for limited amendments to the classification and measurement. We understand that the staff of the Accounting Standards Board of Japan has raised the same comment to the IASB.

Additionally, IFRS 9 will be effective from annual periods beginning on or after January 1, 2015 in accordance with the IASB’s decision that it is appropriate to simultaneously apply each phase of IFRS 9. However, the limited modifications to the classification and measurement still need to go through the ED and finalisation processes, and during these processes, it is necessary to further discuss the related issues on general hedge accounting as described above. Further, the ED for impairment is expected to be released in the near future. Given such a situation and that entities have only 2 years to prepare for applying IFRS 9, if the decision to simultaneously apply each phase of IFRS 9 is to be adhered to, we respectfully request the IASB to consider further postponing the effective date for IFRS 9.