March 27, 2013

To the International Accounting Standards Board;

Japanese Bankers Association

Comments on the Exposure Draft “Classification and Measurement: Limited Amendments to IFRS 9”

We, the Japanese Bankers Association, are an organization that represents the banking industry in Japan; and our members comprise banks and bank holding companies operating in Japan.

We would like to express our gratitude for this opportunity to comment on the Exposure Draft “Classification and Measurement: Limited Amendments to IFRS 9” published by the International Accounting Standards Board (“IASB”).

It is understood that the IASB seeks to minimize the extent of the proposed changes to the existing requirements taking into consideration that some entities have already invested the time and effort in implementing IFRS 9. Nevertheless, it is also important to achieve the objective of developing “a single set of high quality global accounting standards” to provide users of financial statements with useful financial information for their decision-making. Therefore, we would like to express our views on areas which are considered important but are not covered by the questions in the Exposure Draft (such as bifurcation of embedded features).

We respectfully expect that the following comments will contribute to your project to further develop the accounting standards.

Question 1 Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

(Our comment)

1. We agree that even if the economic relationship between principal and consideration for the time value of money and the credit risk is modified due to an interest rate mismatch feature or leverage, a financial asset with such a modified economic relationship could be considered to contain cash flows that are solely payments of principal and interest, and thereby still satisfy the contractual cash flow characteristics assessment.
2. The rationale for our agreement is that there should be allowance to mitigate concerns over those cases where the existing IFRS 9 guidance is strictly interpreted and whereby a financial asset may be assessed as not

satisfying the contractual cash flow characteristics assessment for any modification to the above economic relationship even when that modification is not significant.

3. However, we also believe that the contractual cash flow characteristics assessment still needs to be improved in some aspects, which will be discussed in our comments on Questions 2 and 3.

Question 2
Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

(Our comment)

4. We do not consider the proposed application guidance to be sufficient nor operationally practicable.

(Comparison with the benchmark cash flows)

5. We acknowledge that paragraph B4.1.9E of the Exposure Draft stipulates that "If it is clear, with little or no analysis, whether the cash flows on the financial asset under the assessment could or could not be more than insignificantly different from the benchmark cash flows, an entity need not perform a detailed assessment". However, comparing contractual cash flows with the benchmark cash flows on an asset-by-asset basis in all cases of assessing a modified economic relationship, would in practice entail significant workload, and we thus consider it operationally impractical. We therefore request that the proposed guidance specify that a quantitative comparison with the benchmark cash flows is not a mandatory procedure.

(Clarification of the comparison method with the benchmark cash flows)

6. The proposed guidance does not provide specific guidance on how to compare contractual cash flows with the benchmark cash flows (e.g. whether an entity should compare aggregated cash flows over the contractual term or cash flows over each interest payment period, to assess if the modification results in not significant difference from the benchmark cash flows).

7. The contractual cash flow characteristics assessment relates only to those business models in which assets are managed "in order to collect contractual cash flows" or "both in order to collect contractual cash flows and for sale". It should be noted that under these business models, financial assets are held over a long-term period (contractual term) to collect contractual cash flows. Accordingly, we consider that comparing aggregated cash flows over the entire contractual term is more consistent with such business models and results in providing more relevant information, than comparing cash flows over each interest payment period.

Question 3
Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

(Our comment)

8. As IFRS 9 (issued in 2010) and the Exposure Draft do not provide a proper definition of interest, it is our concern that financial assets with contractual cash flows that should be considered solely payments of principal and interest may not be appropriately identified.

(Definition of interest)

9. Contractual interest on a financial instrument in general encompasses various elements including consideration for the time value of money and the credit risk, consideration for liquidity risk (paragraph BC4.22, IFRS 9 (issued in 2010)), funding cost reflecting own credit risk and administrative expenses.
10. IFRS 9 (issued in 2010) stipulates in paragraph 4.1.3 that “interest is consideration for the time value of money and for the credit risk” and the Exposure Draft stipulates in paragraph B4.1.8A that “If the contractual cash flows include payments that are unrelated to principal, the time value of money and the credit risk, the contractual cash flows do not represent solely payments of principal and interest”. We are concerned over an excessively strict interpretation of these requirements.
11. In particular, we are concerned that (i) many ordinary financial assets without leverage will need to be assessed as to whether they include payments that are unrelated to principal, the time value of money and the credit risk, resulting in increased workload in practice, and that (ii) such general financial instruments encompassing a variety of elements as set out in paragraph 9 of this document may be classified as FVPL.
12. As discussed above, it is technically difficult to consider interest on a general financial instrument based only on the time value of money and the credit risk. Therefore, paragraphs 4.1.3 and B4.1.8A need to be reconsidered.
13. Paragraph B4.1.9B of the Exposure Draft defines the appropriate benchmark cash flows as cash flows of a contract of the same credit quality and with the same contractual terms except for modification in interest feature, as a financial asset with a modified economic relationship. According to this definition, the benchmark cash flows can be interpreted as also encompassing a variety of elements set out in paragraph 9 of this document. In this respect, paragraph B4.1.9B is consistent with our view expressed in the above paragraphs.

Question 4 Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that: (a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and (b) all other gains and losses are recognised in OCI? If not, why? What do you propose instead and why?

(Our comment)

14. We basically agree with the Exposure Draft in this respect.
15. Japanese banks hold debt instruments (securities) for various purposes, ranging from collecting principal and interest payments through holding such instruments, meeting liquidity needs and managing interest rate risk. The introduction of the FVOCI measurement category will provide fair value information on the statement of financial position, and profit/loss information on the income statement in the same manner as for financial assets measured at amortised cost. This would make for a more appropriate reflection of actual economic conditions in the financial statements and provide more relevant information, as compared to the two category approach: the amortised cost category and the FVPL category.

(Scope of debt instruments classified as FVOCI)

16. The scope of financial assets to be measured at FVOCI should not be limited to those debt instruments with the eligible contractual cash flow characteristics (i.e. qualifying debt instruments), held within a business model in which assets are managed both in order to collect contractual cash flows and for sale. Rather, the scope should also include those debt instruments that do not satisfy the contractual cash flow characteristics assessment (i.e. non-qualifying debt instruments), held within a business model in which assets are managed in order to collect contractual cash flows .
17. We support the idea of presenting fair value on the statement of financial position for non-qualifying debt instruments held within a business model in which assets are managed in order to collect contractual cash flows. However, we consider the recognition of changes in fair value in profit or loss which represents the results of operations of the entity may not be consistent with the business model.
18. Under a business model in which assets are managed in order to collect contractual cash flows, it is assumed that assets are managed and their performance is evaluated based on amortised cost rather than based on changes in fair value. If such changes in fair value, which are not managed by an entity, are included in profit or loss, we do not consider that the financial statements exactly reflect the entity's economic conditions and provide highly relevant information to the users of the financial statements.
19. In view of the above, we respectfully recommend that those financial instruments held within a business model in which assets are managed in order to collect contractual cash flows and that do not satisfy the contractual cash flow characteristics assessment, should be measured at FVOCI, thereby providing fair value information on the statement of financial position, while providing profit/loss information through the income statement in the same manner as for financial assets measured at amortised cost.

		Contractual cash flow characteristics assessment	
		Qualified	Not qualified
Business model	To manage assets in order to collect contractual cash flows	Amortised Cost	~~FVPL(Residual)~~ **FVOCI**
	To manage assets both in order to collect contractual cash flows and for sale	FVOCI	FVPL (Residual)
	Others (held for sale)	FVPL (Residual)	FVPL (Residual)

Question 5

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

The Exposure Draft proposes that the existing fair value option in IFRS 9 should be available for financial assets that would otherwise be mandatorily measured at fair value through OCI. That is, the Exposure Draft proposes that an entity would be permitted to designate such a financial asset as measured at fair value through profit or loss if, and only if, such a designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch'). In accordance with the existing fair value option in IFRS 9 such designation would be performed at initial recognition and would be irrevocable.

(Our comment)

20. We do not agree with the proposed guidance, and we expect further improvements to address the following issues.

(Financial assets managed and their performance evaluated based on a fair value basis)

21. Paragraph B4.1.6 of the Exposure Draft stipulates that "A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis […] is neither held to collect contractual cash flows nor managed both to collect contractual cash flows and to sell assets". With regard to financial assets measured at FVOCI, changes to net assets through OCI would be managed, requiring the management of assets and evaluation of their performance on a fair value basis to some extent.

22. Therefore, the paragraph B4.1.6 should be amended not to prohibit entities from classifying financial assets into the FVOCI category just because they are managed and their performance is evaluated on a fair value basis.

(Business model in which assets are managed both in order to collect contractual cash flows and for sale)

23. The Exposure Draft provides a list of examples of when the entity's business model may be to manage assets both in order to collect contractual cash flows and for sale, only focusing on liquidity needs. We request that an example relating to the management of interest rate risk be added in the list because some Japanese banks' business model is to manage assets both in order to collect contractual cash flows and for sale in accordance with a documented investment policy for the purpose of managing interest rate risk or maintaining a certain yield profile. Under such a business model, the frequency of selling assets varies depending on interest rates, liquidity or economic conditions. We therefore request an additional example so as to clarify that such a business model also qualifies as the business model in which assets are managed both in order to collect contractual cash flows and for sale. Please refer to paragraphs 55-36 of Accounting Standards Update ("ASU") "Financial instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" issued by the Financial Accounting Standards Board ("FASB") on 14 February 2013, as it sets forth an example that is similar to our comment.

(Sales of assets that do not contradict the objective of collecting contractual cash flows)

24. Paragraph B4.1.3 of the Exposure Draft gives some examples of sales that would not contradict the objective of an entity's business model to hold financial assets in order to collect contractual cash flows, one of which is "if the credit quality of the financial asset has deteriorated such that it no longer meets the entity's documented investment policy". It is our concern that this "deterioration in credit quality" may be strictly interpreted.
25. Specifically, if this "deterioration in credit quality" is interpreted as relevant to the "deterioration in credit quality" discussed in phase 2 of the IFRS 9 project (i.e. impairment), sales may be restricted until it is confirmed that such deterioration has actually occurred, thereby resulting in an increased loss on sale of assets.
26. Further, in some cases, financial institutions may sell part of their financial assets in order to reduce credit concentration on a portfolio basis as a part of their credit risk management. Such a sale is also construed to be an activity to secure the collection of as much contractual cash flows from the entire portfolio as possible.
27. Given the above, we would expect the IASB to consider adding the following examples: (i) a case where an entity has identified a risk of credit deterioration but where there is no objective evidence that the credit quality of an asset has actually deteriorated; and (ii) a case where credit concentration is reduced on a portfolio basis for the purpose of credit risk management.

Question 9 Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

(Our comment)

28. Given that financial institutions deal with a considerable amount of financial instruments subject to IFRS 9, and that the application of IFRS 9 will have a significant impact not only on financial reporting but also on other areas such as management accounting and risk management, we respectfully expect that the IASB would take the following points into consideration in discussing first-time adoption.

(Restatement of comparative information – Previous GAAP)

29. According to paragraph 7.2.14 of the Exposure Draft, entities other than first-time adopters need not restate prior periods. On the other hand, entities that adopt IFRSs for annual periods beginning before 1 January 2012 are allowed under paragraphs E1 and E2 of IFRS 1 to choose to apply the requirements of its previous GAAP in place of the requirements of IFRS 9 to comparative information about items within the scope of IFRS 9. Despite the extension of the effective date of IFRS 9, the above-mentioned annual period under IFRS 1 is not amended. Therefore, we would like to request that IFRS 1 be amended to include an exception exempting first-time adopters from the restatement of comparative information.
30. If the IASB considers that it is not reasonable to apply the exception to all first-time adopters, an alternative is to limit the scope of the exception to those entities whose date of transition to IFRS (i.e. the beginning of the comparative period) is prior to the issuance date of the completed version of IFRS 9.

(Application of previous versions of IFRS 9)

31. The Exposure Draft proposes that the prohibition on newly applying previous versions of IFRS 9 will become effective six months after the completed version of IFRS 9 is issued. However, it is highly likely that first-time adopters who are also undertaking initiatives for applying other accounting standards in addition to IFRS 9 would find it impracticable to comply with such a proposal. In this view, we respectfully request that if first-time adopters set their date of transition to IFRS on a date before the issuance date of the completed version of IFRS 9, such entities should be allowed to newly apply previous versions of IFRS 9 that are effective as of the date of transition.

(Modified economic relationship)

32. Paragraph 7.2.4A of the Exposure Draft sets forth a transition provision for those cases where it is impracticable for an entity to retrospectively assess a modified economic relationship as required by paragraphs B4.1.9A- B4.1.9E. We request, in addition to this provision, providing an option to "assess a modified economic relationship for cash flows arising after the date of the transition".

33. Although the Exposure Draft does not seek specific comments on the following issues, we respectfully request the IASB to consider our comments stated below as such areas are deemed to be important. Our comments include those submitted in relation to other previous exposure drafts or papers.

- Introduction of a provision to allow bifurcation of embedded features

34. The Exposure Draft proposes "no-bifurcation approach for financial assets" and to retain "closely-related bifurcation approach for financial liabilities," which cannot be supported.
35. It is considered that the IASB should add a provision to allow both financial assets and financial liabilities to be bifurcated when embedded features are separated for management purposes.

36. Under current practice, Japanese banks manage hybrid instruments by separating embedded derivatives from the host contract, with the host contract being held for the purpose of collecting contractual cash flows and with risks inherent in the embedded derivatives being hedged in the markets as necessary.

37. If an embedded feature is separately managed as a derivative, bifurcation of such an embedded feature for accounting purposes should provide more relevant information to users of financial statements.

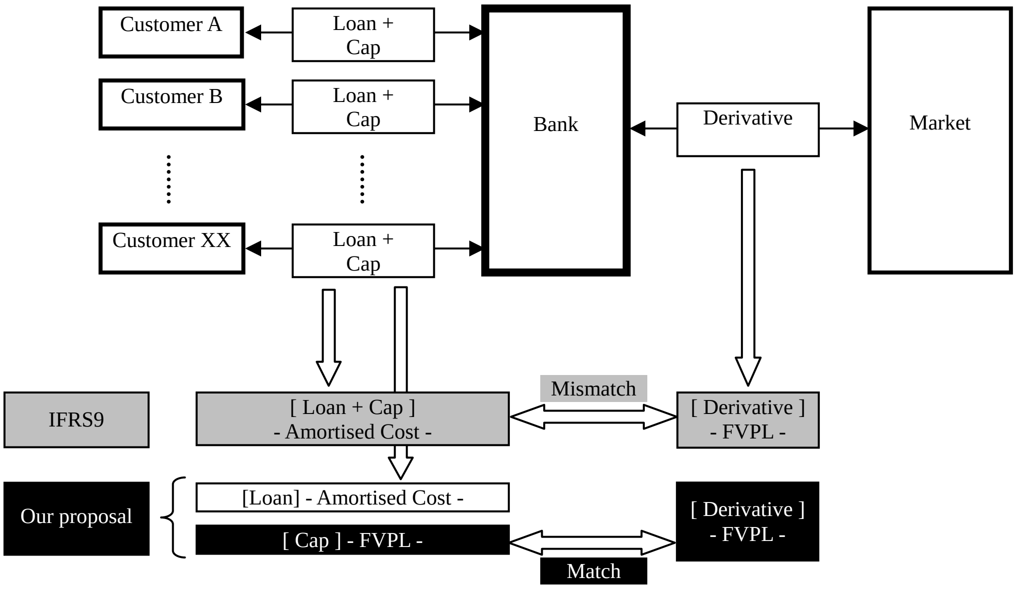
(Issue associated with an instrument measured at amortised cost in its entirety)

38. For example, if a loan with an embedded derivative is classified in its entirety to be measured at amortised cost, any changes in the fair value of the embedded derivative would not be presented in the financial statements; on the other hand those derivatives used as hedging instruments give rise to changes in fair value. As a result, matching of profit and loss is not achieved, thus actual economic conditions are not appropriately reflected in the financial statements. Further, hedge accounting may be applied in this case but is likely to be

impracticable because the amount of derivatives embedded in hybrid instruments offered to customers is generally de minimis, with only slight differences in the terms and conditions of a transaction.

39. It is therefore our view that the IASB should add a provision to allow both financial assets and financial liabilities to be bifurcated when embedded features are separated for management purposes. (See the diagram below.)

(Example)



- Exemption of unlisted equity from measurement at fair value

40. Unlisted equity instruments should be exempted from fair value measurement and be allowed to be measured at cost on the statement of financial position.

(Transparency and comparability of financial statements)

41. There are various valuation methods for equity instruments such as the net asset value method, DCF method and comparable company analysis. Further, as there are a variety of structures of equity instruments including common stock and preferred stock, its future cash flows are not fixed. Therefore, there is no "one-for-all approach" for the valuation of this instrument.
42. Specifically, given that the fair value of equity instruments is independently calculated for each entity presenting, a fair value measurement in the financial statements may result in undermining the transparency and comparability of financial statements.
43. Generally, unlisted equity cannot be easily sold in the markets especially compared to listed equity. Therefore, recognising unrealised gains on such unlisted equity instruments through profit or loss or OCI would mean presenting profits (OCI) which are unlikely to be realised, which may mislead investors.
44. Further, it is presumed that gaining audit comfort on the appropriateness of the amount calculated may also be difficult.

(Usefulness of investment information versus burden of practical implementation)

45. Requiring entities to measure unlisted equity instruments at fair value would cause a significant burden in practice (i.e. cost to obtain fair value) such as using external appraisers and establishing in-house processes to comply with such requirements.
46. Despite such a significant burden, the presentation of the fair value of unlisted equity instruments will not necessarily even contribute to useful investment information as discussed above. From a cost-benefit perspective, it is our concern that recognising unlisted equity instruments at fair value may rather adversely impact shareholders and investors.

- Option to present subsequent changes in the fair value of a investment in on an equity instrument in OCI (OCI option)

47. It is expected that the IFRS conceptual framework project will consider not only the OCI recycling for equity instruments, but also the application of the OCI option to investment trust beneficiary certificates and equity funds

(Recycling of an investment in an equity instrument to which the OCI option is elected)

48. OCI for debt instruments measured at fair value through OCI is subject to recycling, while OCI for equity

instruments for which the OCI option is elected is not recycled. We expect OCI recycling to be discussed in the conceptual framework project.

(Expansion of the scope of OCI option)

49. IFRS 9 (issued in 2010) allows an entity to make an election to present in OCI subsequent changes in the fair value of investments in equity instruments that are not held for trading. Japanese banks indirectly own stocks in the form of investment trust beneficiary certificates, equity funds and others, and do not intend to sell such investments in the short term. If the fair value changes of these instruments in each reporting period affect profit or loss, which is one of the indicators of the entity’s results of operations, the entity’s economic conditions may not be appropriately reflected in the financial statements. In this respect, we expect extending the scope of OCI option to investment trust beneficiary certificates and equity funds, to be discussed in the conceptual framework project.

- Request for the deferral of the effective date

50. In finalising the accounting standards on impairment, we respectfully request the IASB to review the appropriateness of the proposed mandatory effective date and discuss the possibility of the deferral of the effective date.

51. As described in our comment (of 31 January 2011) on “Effective Dates and Transition Methods (issued in October 2010),” the implementation of IFRS 9 which sets out guidance on financial instruments will have a significant impact on financial institutions in terms not only of financial reporting but also of other areas such as management accounting and risk management. Therefore, it is considered that 1 to 2 years of proposed lead time is not sufficient for financial institutions to prepare for compliance with IFRS 9 after the completion of accounting standards of other components of IFRS 9, such as impairment.

- Clarification of the application of hedge accounting to debt instruments classified in the FVOCI measurement category

52. It should be specified that debt instruments classified as the FVOCI measurement category are qualified as a hedged item.

53. In the case of debt instruments classified in the FVOCI measurement category, changes in OCI which represent fair value changes attributable to market risks such as interest rate risk and foreign exchange risk may be hedged by using derivatives. In such cases, the application of hedge accounting will result in a more appropriate reflection of economic conditions in the entity’s financial statements.

- Additional guidance on non-recourse loans

54. It is requested to provide additional examples to clarify how to apply the contractual cash flow characteristics assessment to non-recourse loans.

55. Paragraphs B4.1.16 and B4.1.17 of IFRS 9 (issued in 2010) state that the contractual cash flows of a non-recourse financial asset “may include payment for factors other than consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time” and that “the creditor is required to assess (‘look through to’) the particular underlying assets or cash flows to determine” the contractual cash flows characteristics. However, specific methods of applying these requirements are unclear.
56. We therefore request that examples be added to explain instances of satisfying and not satisfying the contractual cash flow characteristics assessment for non-recourse loans. In doing so, we recommend that the project finance example provided in the Agenda paper 5C for the IASB board meeting held in September 2010 be used.

- Introduction of simplified methods in applying the contractual cash flow characteristics assessment to securitised instruments

57. In applying the contractual cash flow characteristics assessment to securitised instruments, the proposed guidance will cause significant workload. Therefore, the introduction of a simplified method is recommended.

58. Paragraphs B4.1.20 to B4.1.26 of IFRS 9 (issued in 2010) provide guidance on the application of the contractual cash flow characteristics assessment to securitised instruments, requiring entities to look through in detail to the underlying pool of instruments. However, assessing individual securitised instruments in accordance with the proposed guidance would in practice require significant workload and is thus operationally impracticable.
59. Taking this into account, we would like to recommend the introduction of the following simplified methods.
    (a) In light of the intention of paragraph BC4.26 of IFRS 9 (issued in 2010), regarding the most senior tranche, an entity is exempted from applying the contractual cash flow characteristics assessment set forth under the above guidance provided that the entity itself confirms by reference to Loan-to-Value (LTV) or other thresholds, upon structuring that the underlying asset would generate sufficient cash flows.
    (b) Tranches that have a lower yield than the average yield of the underlying assets should be deemed as satisfying the contractual cash flow characteristics assessment.