September 1, 2009

To the International Accounting Standards Board

Japanese Bankers Association

Comments on Request for Information ('Expected Loss Model')
Impairment of Financial Assets: Expected Cash Flow Approach

The Japanese Bankers Association (JBA) is an organization whose members consist of banks and bank holding companies that operate in Japan. The JBA acts as the representative of the Japanese banking industry.

We, as an association, have compiled the following comments regarding the Expected Loss Model that is currently being deliberated by the International Accounting Standards Board (IASB), and we ask that you kindly review them.

It is our hope that the following comments will assist in the remaining work of the IASB in the deliberation of this subject.

Question 1

Is the approach defined clearly? If not, what additional guidance is needed, and why?

1. Although the basic concept of the approach is understood clearly, we do not believe the details of the calculation methods, including the estimation methods of expected cash flows, are defined clearly. For example, in the IASB's proposals, examples are given based on the assumption that the actual amount of all cash flows can be forecasted, and given that assumption, default rate per annum is used to estimate the future cash flows. However, it is not stated clearly how to define and calculate the default rate per annum in practical viewpoint.

In order to ensure objectivity and comparability of financial statements, sufficient guidelines on the estimation method of expected cash flows should be provided, including the following items.

(1) In the IASB's proposals, while calculations of the default rate per annum are required, the default rate per annum comprises probability of default (PD) and loss given default (LGD). In calculating PD, we need to determine the definition of default. We think that it would be acceptable as long as PD is defined in a way consistent with LGD.

(2) Since collaterals are provided for loans in many cases, collection from collaterals should be considered in determining LGD.

Furthermore, as we stated in an answer for the Question 2, the burden to apply this approach in practice will be extremely heavy. We strongly request that the guidelines including detailed numerical examples be provided to simplify procedures on the basis of sufficient cost-benefit analysis. As for numerical examples, it is desirable that a lot of alternative methods are provided to the extent available.

Moreover, in view of consistency and costs, it should be allowed that banks adopting Basel II can use the same data as used for the purpose of Basel Ⅱ.

Question 2
Is the approach operational (i.e. capable of being applied without undue cost)? Why or why not? If not, how would you make it operational?

2. The approach is not operational, because it requires a great burden both in terms of systems and administrative procedures. In order to apply the expected loss model, future projections would be required, and they should be based on historical data that have been accumulated over a certain period of time. However, it is unlikely that all companies which should adopt this approach have currently accumulated the necessary data. The banks adopting Basel Ⅱ do not necessarily have sufficient data for expected loss model. (They only have PD and LGD for the purpose of Basel Ⅱ.)

3. Japanese banks generally manage loans on a borrower-by-borrower basis, rather than loan-by-loan basis. In order to apply the proposed approach to each borrower, a completely new system needs to be developed solely for purpose of adopting this approach separately from the contract management system for customer transactions. The system for expected loss model can not be used for other purposes, because expected loss model does not mean that the right to make claims to customers will legally expire. In addition, development of an interface between the system for expected loss model and the contract management system will also be required.

Question 3
What magnitude of costs would you incur to apply this approach, both for initial

implementation and on an ongoing basis? What is the likely extent of system and other procedural changes that would be required to implement the approach as specified? If proposals are made, what is the required lead time to implement such an approach?

4. At present, it is impossible to estimate the actual costs for initial implementation and maintenance, as well as the lead time. However, we do forecast that we will incur significant costs and need a considerably long time.

5. Considering the following aspects, we believe that it is highly possible that the burden for its implementation will greatly exceed the burden for implementing Basel II.

(1) In general, Japanese banks manage book value of loans based on the outstanding balance of contractual principals. Currently, we are not using the amortized cost method set forth by the International Financial Reporting Standards (IFRS). Thus, it is likely that the burden for implementation will be considerably greater for us, compared with European banks that have already implemented the amortized cost method based on the current IFRS.

(2) We would need to develop a system for estimating expected cash flows, in addition to the system for recognizing interest revenue based on effective interest rate. It means that we would have to develop both the accounting system and the management information system on a large scale, which would make our burden inordinately large. We forecast that we would need at least 5 years to develop these systems.

(3) In order to estimate expected cash flows, we would be required to develop our own expected loss model based upon our internal estimations. Even the banks adopting Basel II will not be able to rely only on PD and LGD parameters for Basel II. Therefore, development of new calculation methods is required, based on data accumulation of parameters and available data.

(4) Since the fundamental logic for the balance sheets and the income statements will be changed, the effects will spread widely, including change of workflow at operating offices, review of management accounting and change of risk management methods, etc.

Question 4

How would you apply the approach to variable rate instruments, and why?

6. There are multiple methods indicated for calculating variable rates. However,

deciding which one to use should be left to the discretion of the preparer of financial statements.

Question 5

How would you apply the approach if a portfolio of financial assets was previously assessed for impairment on a collective basis and subsequently a loss is identified on specific assets within that portfolio? In particular, do you believe:

(a) changing from a collective to an individual assessment should be required? If so, why and how would you effect that change?

(b) a collective approach should continue to be used for those assets (for which losses have been identified)? Why or why not?

7. Whether to individually manage loans whose credit standings have worsened should be decided based on the perspective of risk management and the regulatory requirements of the financial administrations of each country.

8. If the credit standing of a borrower whose loans were being collectively assessed becomes worse, we suppose that these loans would be managed individually. In that case, we think that these loans should be individually estimated when reviewing the expected cash flows at each period. Therefore, even if the collective approach is continued, expected cash flows of these loans would probably need to be calculated separately and then totaled again.

Question 6

What simplifications to the approach should be considered to address implementation issues? What issues would your suggested simplifications address, and how would they be consistent with, or approximate to, the expected cash flow model as described?

9. In terms of accounting for impairment loss, discussions need to be made not only regarding the simplification of expected cash flow approach, but also regarding improving the Incurred Loss Model under current IAS 39. For example, we might be able to find an alternative approach to addressing the failings of current incurred loss model by modifying the current model to reflect not only the past statistical data but also future data into the estimated allowances and thus incorporate forward looking viewpoint into the provision for loan losses.