September 14, 2009

To the International Accounting Standards Board

Japanese Bankers Association

Comments on the Exposure Draft of
"Financial Instruments: Classification and Measurement"

The Japanese Bankers Association is an organization for banks and bank holding companies doing business in Japan and represents the Japanese banking industry.

We, as an association, have compiled the following comments on the exposure draft of "Financial Instruments: Classification and Measurement" currently under consideration by the International Accounting Standards Board (IASB).

We hope that these opinions will be of assistance to you as you move this study forward.

○ Accounting treatment for dividends income on equity instruments measured at fair value through other comprehensive income (FVTOCI)

Dividends income on equity instruments measured at FVTOCI should be presented in profit and loss.

1. Mismatch between dividends income and funding costs in profit and loss in view of objectives and decision-making of investment

- The objective of investing in equity instruments measured at FVTOCI is to facilitate business and expand entity’s business profit.
- The objective is not to earn capital gains from increases in the value of equity instruments. This type of investment is intended to be recouped through a combination of 1) an increase in entity’s business profit and 2) dividends income. Decision of investment is made on the basis of income from both 1) and 2).
- In addition, if funding costs to acquire equity instruments are presented in profit and loss while dividends income as a counter value for funding costs are not presented in profit and loss, there will be a mismatch in profit and loss.
- Therefore, usefulness of net income as investment information will be diminished if dividends income is not presented in profit and loss, because the result of

recoupment of investment commensurate with cost of investment will not be adequately presented in profit and loss.

- In this respect, we believe presenting dividend income in a separate line item in profit and loss should enable the financial statements to provide their users with more useful information.

2. Involvement of managements in the timing of recognition of profit

- Unlike profit or loss from sales of equity instruments whose timing can be arbitrarily managed by management decision, dividends are generally paid each period as a result of the investee’s operations for a period. Therefore, net income will not be distorted by management decision.
- Therefore, dividends income should be presented in profit and loss from the perspective of ensuring usefulness of net income as investment information.

3. Nature of dividends

- There is no dispute about the argument that dividends theoretically comprise a portion of future profit on sales of equity instruments, because stock prices decline when dividends are paid.
- However, equity instruments measured at FVTOCI are not held for the purpose of earning capital gains. In order for investment result to be realized in profit and loss, both profit from entity’s own business and dividend income must be presented in profit and loss.
- Therefore, dividends income should be presented in profit and loss from the perspective of ensuring usefulness of investment information, rather than conforming its accounting treatment to gains on sales of equity instruments in light of the theoretical nature of dividends income.

○ <u>Valuation of equity instruments of which fair value cannot be reliably measured</u>

Non-listed stocks should be measured at cost, not fair value.

4. Transparency of financial statements and comparability among companies

- There are a variety of approaches to measuring fair value of equity instruments, such as the net assets method, the DCF method, the comparable sectors method, etc. There are also a number of different instruments that are included in this category besides common stock, such as preferred stock. Since future cash flows are not guaranteed for these instruments, there is no absolute single approach to their valuation.
- We are concerned that financial statements will be less transparent and less

comparable to their users if entities measure fair values calculated according to arbitrary methods.

- This is particularly the case with non-listed equity instruments, which are generally far less easy to sell in the market than listed equity instruments. If unrealized gains or losses on non-listed equity instruments are presented in profit and loss or OCI, the result is the presentation of profits or loss (or OCI) with very little probability of realization, which would rather mislead users of financial statements.
- In addition, we suppose that it will be difficult for auditors to determine the appropriateness of the calculated values.

5. Usefulness as investment information compared to practical burdens imposed

- Valuation of non-listed equity instruments at fair value imposes enormous practical burdens (cost of acquisition of fair value) on entities, such as cost to use external valuation services and/or to make their own internal systems.
- However, in spite of the significant incremental costs, measuring non-listed equity instruments at fair value does not necessarily lead to usefulness of investment information as mentioned above, and would rather impair the interests of users of financial statements (including shareholders of the entities) from the perspective of cost-benefit consideration.

○ Accounting treatment of investment trusts and securitized instruments

We propose that an entity should be permitted to apply measurement categories corresponding to underlying assets for primary securitized products such as investment trusts, collateralized loan obligations (CLO) and other collateralized debt obligations, if a holder of these products can recognize, or "look through" the individual underlying assets.

6. Consistency of accounting treatment

- Investment trusts, securitized products, and other financial instruments that invest in multiple instruments should be given the accounting treatment consistent with single financial instrument.
- In other words, we believe that the standards should provide an entity may look through the components of the underlying investments and apply the amortized cost method to the instruments which satisfy the criteria for the amortized cost method.

○ Retrospective application

We believe that optional waiver provisions for retrospective application of classifications and measurements should be provided.

7. Practical difficulties of retrospective application

- We think that retrospective application of classification and measurement required in the exposure draft is too extensive, especially for financial institutions that would cover an extremely large number of transactions and require significant modifications to systems in order to obtain the enormous volumes of historical data for the retrospective period. The costs, time, and workloads to meet this requirement would be huge and, from a practical standpoint, impossible. Therefore, we do not consider it practical to apply the proposals retrospectively, and recommend that the retrospective application of classifications and measurements should only be optional.
- Countries and entities newly adopting International Financial Reporting Standards (IFRS) would, from a practical standpoint, find it impossible to comply with the requirement of retrospective adjustment, because of the enormous workloads and costs incurred at the time of initial application. We believe that optional waiver provisions should be provided in IFRS 1 for retrospective application of classifications and measurements.