March 9, 2011

To the International Accounting Standards Board;

The Japanese Bankers Association

Comments on the IASB Exposure Draft

"Hedge Accounting"

The Japanese Bankers 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 Exposure Draft, "Hedge Accounting"

We hope that the comments below will assist the Board in its further deliberation.

General comments

We appreciate the effort that has been made to incorporate the realities of enterprise risk management behavior in the hedge accounting model presented in the exposure draft.

We also appreciate the efforts of the IASB to respond to criticism that the hedge accounting in IAS 39 failed to reflect enterprise risk management activities or the degree to which these activities are successful in achieving the enterprise's risk management objectives. The model presented attempts to better reflect the realities of enterprise risk management behavior.

However, we urge the Board to reconsider some aspects so that financial statements better reflect the realities of enterprise risk management behavior, for example the ineligibility of FVTOCI as hedged items and the application of simplified hedge accounting to currency swaps used for the purpose of raising foreign currency.

We are also aware that the IASB has decided to continue the discussion on the hedge accounting (macro hedge accounting) applied to open portfolios. We believe this raises the need to reconsider the timing with which the exposure draft is applied because banks will need to conduct comparative investigations of the proposed hedge accounting model in light of the discussion on macro hedge accounting. There is also the potential for the content of the exposure draft to be inconsistent with the discussion on macro hedge accounting, which we believe will necessitate a reconsideration of the exposure draft in light of that discussion.

Comments on individual "Questions" in the exposure draft

Below are our comments on the questions presented in the exposure draft.

Question 1 Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

(Response)

We would like the objective of hedge accounting to be "risks that could affect OCI" rather than limiting it to "particular risks that could affect profit or loss."

(Reasons)

1. Japanese banks have medium and long-term holdings of equity instruments not for trading purposes but for the purpose of stabilizing the business of their clients and strengthening and expanding banking transactions. Presumably, these equity investments will be designated as FVTOCI when IFRS 9 is applied to them

2. In such situations, changes in the fair value of equity instruments designated as FVTOCI will result in changes to net assets through OCI, and these changes in net assets will result in changes in "Basel" regulatory capital, in other words, changes in BIS capital ratios. BIS capital ratios are an extremely important management metric, and controlling them is crucial to a bank's operations.

   As a result, there are banks in Japan that hedge at either the individual or portfolio level the price fluctuation risks of equity instruments categorized as "other securities" (equivalent of available-for-sale assets or AFS under IAS 39) under the current categories and measurement approaches. Hedges at the portfolio level is imperative when an entity controls changes in fair value of equity instruments on a large scale because instruments to hedge individual equity instruments are less available in Japan.

3. Without applying hedge accounting to these kinds of hedge transactions, changes in fair value of equity instruments subject to FVTOCI will be recognized in OCI while changes in fair value of derivatives for hedging purposes will be recognized in profit or loss. This will achieve hedging effects for the net assets section of the statement of financial position as a whole, but OCI and PL are recognized on a gross basis, which will result in a failure to accurately reflect the economic effects of hedge on the financial statements. This is inconsistent with the purpose of financial statements to provide information on an enterprise's the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

4. Conceivably, the choice could be made not to apply FVTOCI because application of FVTOCI for equity instruments is elective, but inasmuch as the purpose of holding is to stabilize the businesses of clients and strengthen and expand banking transactions, not trading, recognition of changes in share prices in OCI rather than profit or loss is more consistent with the purposes of financial statements, so it is desirable that FVTOCI be applied to equity instruments.

5. We are aware that the current exposure draft provides three reasons why equity instruments designated as FVTOCI are disqualified as hedged items.

   The first is that the objective of hedge accounting is only the hedging of risks that impact net profit/loss.

   The second is that qualifying equity instruments designated as FVTOCI as hedged items amplifies complexity.

With respect to these reasons, we have already discussed the importance of economic activities that hedge changes in OCI, and we believe that the application of hedge accounting should be allowed in light of the purpose of financial statements to provide information on the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

The third reason we understand is that the application of hedge accounting would impact profit or loss in the treatment of ineffectiveness, which is contrary to the principle of prohibition of recycling. Hedge accounting requires that ineffectiveness be recognized in profit or loss, and behind this is the idea of distinguishing between profit or loss and OCI. Conversely, the reason for prohibiting recycling is based on the idea of "not distinguishing between net profit/loss and OCI." The root of the problem is therefore the inconsistency in the two approaches with respect to the relationship between profit or loss and OCI.

We propose the following to address the inconsistency.

(1) This inconsistency needs to be resolved in order to apply hedge accounting to equity instruments designated as FVTOCI. In other words, recycling must be allowed. We therefore propose to allow recycling of equity instruments designated as FVTOCI and we think that the introduction of hedge accounting provides the perfect opportunity to do so, since its objective is to reflect the realities of enterprise risk management as accurately as possible in financial reporting. We deem it possible to allow the hedge ineffectiveness be recycled only for equity instruments designated as FVTOCI when hedge accounting is applied.

If the Board is reluctant to agree to Proposal (1) above, we would ask that it consider the following alternative to hedge accounting treatments.

(2) If the change in fair value of the hedging instrument is larger than the change in fair value of the hedged item, a portion of the change in fair value of the hedging derivatives instrument is simply recognized in profit or loss as ineffectiveness, which would not appear to be particularly problematic. On the other hand, if the change in fair value of the hedging instrument is smaller than the change in fair value of the hedged item, the ineffectiveness is generated by the hedged item, which goes to OCI, but under the principle of prohibition of recycling, it cannot be transferred from OCI to profit or loss. This runs contrary to the principle of recognizing ineffectiveness in profit or loss.

Our proposal is that when the change in fair value of the hedging instrument is larger than the change in fair value of the hedged item, the principles of hedge accounting be followed and the ineffectiveness be recognized in profit or loss, but when the change in fair value of the hedging instrument is smaller than the change in fair value of the hedged item, the ineffectiveness not be recognized in profit or loss but recognized in OCI.

If the Board is reluctant to agree to Proposal (1) or (2) above, we propose the following although it is problematic in that it can be applied on an individual instrument basis rather than portfolio basis.

(3) When an individual equity instrument is hedged using a derivative instrument whose underlying is such an individual equity instrument, the change in fair value of the hedging instrument generally includes changes in other risk components (for example, interest-rate risk) in addition to changes in the fair value of the equity that is the hedged item. If material conditions (for example, outstanding balance) match, the change in fair value of the hedging instrument can be broken down into risk components, and the risk components related to changes in fair value of the equity that is the same as the hedged item can be viewed in isolation, which results in effectiveness of 100%. The change is therefore netted out in OCI, and changes for other risk components are posted to net profit/loss.

6. If the effective portion of the gain or loss of a hedging instrument is recognized in OCI, it is necessary to tie the gain or loss of the hedging instrument recognized in OCI to the hedged item. For example, when the sale of the hedged item will result in transfer of the cumulative gain or loss of the hedged item within equity, the gain or loss of the hedging instrument recognized in OCI must be transferred likewise.

   If the hedging relationship is designated for an individual equity instrument, it would be conceivable to manage each hedging relationship by tying the gain or loss of the hedging instrument recognized in OCI to the hedged item, but it would also be conceivable to adjust the acquisition cost of the equity instrument for the gain or loss of the hedging instrument.

   If the hedging relationship is designated for a portfolio, it would similarly be conceivable to treat the hedging relationship the same as an individual equity instrument by allocating the gain or loss of the hedging instrument according to the fair value or the change in the fair value of the individual equity instruments in the portfolio as at the end of the term or the termination of the hedging relationship.

Question 4 Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

(Response)

We agree.

We agree that the separation of a risk component of a hedged item is consistent with the purpose of financial statements to provide information on the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

However, we also think it should be permissible to separate out a risk component and designate it as an hedged item in cash flow hedges in which the hedged item is a sub-Libor transaction (for example, a time deposit).

(Reasons)

1. The exposure draft allows the separation of a risk component on the basis of risk management if the financial asset's spread against Libor is positive, even if this is not explicitly stipulated in the contract. Similarly, time deposits are treated as negative spreads against the Tibor or Libor margin, etc. for risk management purposes, and based on this practice, there is a need to separate out the Tibor or Libor risk components and apply hedge accounting.

2. BC Paragraph 73 disallows the separation of a risk component for sub-Libor transactions because of the potential for the absolute value of the spread to exceed Libor, resulting in "negative" interest overall for Libor and the spread. The primary sub-Libor transactions to which Japanese banks wish to apply hedge accounting are time deposits, and business practices dictate that the interest for instruments such as time deposits will never be "negative." We therefore disagree with the disallowance of the separation of risk components for sub-Libor transactions which we think is based on imaginary circumstances that will never actually occur.

   We would also note that there are generally no derivatives available to hedge the interest on time deposits, in other words sub-Libor in its entirety, and there is no practice of maintaining hedging relationships by adjusting hedge ratios.

3. We would further note that the IASB continues to elaborate on the application of hedge accounting to open portfolios (macro hedge accounting), and presumably this elaboration will also include discussion of sub-Libor transactions. Finalizing standards in the exposure draft and then reviewing them again when macro hedge is introduced has the potential to disrupt operations; we think that this issue should be discussed in the context of macro hedge so as to maintain overall consistency.

Question 5

(a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree that a layer component of a contract that includes a repayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

(Response to Question 5 (a))

We agree.

We agree that the separation of a risk component of a hedged item is consistent with the purpose of financial statements to provide information on the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

(Response to Question 5 (b))

We do not agree.

(Reasons)

1. There is a need among Japanese banks to designate a layer component of fixed-interest home mortgages as hedged items because of the prepayment risk, and this is in fact allowed under Japanese standards.

   According to Paragraph BC69, the prepayment risk exists separately for both the layer component designated as a hedged item and the layer component not designated as a hedged item, which would be counter to the rule of identifying risk components that can be independently identified. It is therefore disqualified as a hedged item. Particularly for a fair value hedge of fixed-interest home mortgages, the hedged fixed interest can be viewed as risk, with the hedged fixed interest changed to floating interest. This is then the same as a cash flow hedge for the purpose of changing floating interest to fixed interest, and because of this, we think there is economic rationality to allowing the layer component of a portfolio with prepayment risk to be eligible as a hedged item.

2. In addition, the IASB is still in the process of elaborating on the hedge accounting applied to open portfolios (macro hedge accounting), and we anticipate that there will be a discussion of the designation of the layer components of loans that include prepayment options. Finalizing standards in the Exposure Draft and then reviewing them again when macro hedge is introduced has the potential to disrupt operations; from the perspective of maintaining overall consistency we believe that this matter should be discussed in the context of macro hedge.

Question 6

Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

(Response)

We agree with eliminating the bright-line of 80-125% for hedge effectiveness because it undermines the consistency of hedge accounting and risk management.

However, we would like to see the wording "minimize the expected ineffectiveness" currently included in the exposure draft as an eligibility requirement for hedge accounting to be amended because it could be interpreted as requiring 100% effectiveness for the hedging relationship at all times throughout the hedge period.

(Reasons)

1. We have the following issues with the wording "minimize the expected ineffectiveness" included in the exposure draft.

   (1) If there are multiple forms of derivative instruments available on the market as hedging instruments, there will be a need to select the derivative instrument that satisfies the requirement of minimizing expected ineffectiveness, which will require verifying that there are no other derivatives available for minimizing effectiveness.

   However, an institution might also decide to use a particular derivatives instrument as a hedging instrument because of transaction costs or liquidity. It is also difficult from a practical standpoint to provide after-the-fact verification that there were no other derivatives for minimizing the ineffectiveness.

   (2) In addition, there are cases in which there is a temporary change in the coefficient of correlation of a hedging relationship but it is subsequently restored, and it is therefore practical to do nothing about this, including not rebalancing. It would be impossible to interpret such situations as failing to satisfy the eligibility requirements for hedge accounting. The decision to eliminate the 80-125% bright line cannot be understood as requiring 100% to meet hedge eligibility requirements.

2. Our understanding is that the desire to set a standard for hedge accounting eligibility is, as noted in Paragraphs BC81 and BC82, because of the potential for an enterprise to designate an inappropriate hedging relationship, and it is not desirable to allow hedge accounting for hedging relationships that would give rise to avoidable systematic hedge ineffectiveness. We therefore think wording that could be interpreted as requiring the maintenance of 100% at all times should be avoided and would request that the Board consider other wording, for example, using the wording already found in BC81 as the requirement.

Question 15

(a) Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?

(b) If not, which of the three alternatives considered by the Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?

(Response to Question 15 (a))

We do not agree.

(Reasons)

1. We do not agree that this would "add unnecessary complexity to the accounting for financial instruments" based on the purpose of financial statements to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

   For financial institutions, the use of credit derivatives to hedge credit risks is an important part of credit risk management. We would urge investigation and formulation of accounting treatment that reflects in financial statements the realities of bank risk management, including alternative proposals other than hedge accounting, in line with the purpose of financial statements to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

2. There are already financial institutions in Europe that apply hedge accounting to credit risk, so we would urge that the provisions in IN46 and BC220, 225 not be used to impede the application of hedge accounting. Rather, we think further study should be given to how hedge accounting can be applied in line with the realities of credit risk management.

(Response to Question 15 (b))

We think Alternative 3 should be developed further.

(Reasons)

1. As BC241 notes, this would alleviate the accounting mismatch and produce more consistent and relevant information, which would facilitate the understanding of bank risk management strategies by the users of financial statements. This, combined with its less susceptibility to the manipulation of the earnings management, recommends Alternative 3 to our minds.

2. There are three factors that cause Alternative 3 to be considered complex.

   1) The problem of presentation of measurement change adjustments (BC242, BC243)

   2) The potential for entities measuring fair value as a onetime exception to subsequently ceased to do so, and to repeatedly move back and forth (BC237)

   3) The separation of the portion measured at fair value and the portion measured at amortized cost from a single loan or loan commitment (BC232)

With respect to No. 1, we believe it is possible to modify the way in which information is presented so as to clearly segregate the measurement change adjustment portion in a manner that does not lead to confusion. We would therefore urge continued investigation of disclosure approaches. No. 2 and No. 3 can be resolved using the approaches proposed in BC234 and BC232 (b) respectively. We do not, therefore, agree with the conclusion in BC246 "not to allow elective fair value accounting for part of the nominal amount of hedged credit exposures."

3. We believe that Alternatives 1 and 2 are inadequate for the reflection in accounting of the financial activity of hedging. Our reasoning is outlined below.

(1) Alternative 1

With respect to the form of bank lending to counterparties that could serve as reference obligors in credit derivative transactions in Japan, as noted in BC232 (a) (ii) and (iii), it is extremely rare to originate a loan with the intention to hedge its credit risk immediately after or prior to the origination because of concerns about the reputation risk to the client or the desire to maintain the relationship between the bank and the client. Therefore, the hedging strategy for the purpose of bank risk management, particularly credit risk management, is primarily to perform hedging upon or subsequent to the origination of the loan. Therefore, Alternative 1 has significant drawbacks, as noted in BC233.

(2) Alternative 2

While this alternative is close to the realities of bank risk management strategy, we would note, in addition to the points raised in BC241, that Alternative 3 better expresses those realities on the financial statements. Our reasons are outlined below.

Prior to loans, etc. becoming eligible as hedged items, bank risk management in most cases was not performed on the basis of fair value. The approach in Alternative 2 of immediately recognizing in profit or loss the difference between the book value and fair value at the time hedging commences is not in line with actual practice.

Question 16 Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

(Response)

1. We basically agree with the proposed transition measures in the exposure draft in which there would be no retrospective application because of the practical difficulties in retrospectively designating hedge accounting.

2. However, we would note that the IASB continues to elaborate on the hedge accounting applied to open portfolios (macro hedge accounting). Banks need to investigate macro hedge accounting, including the application of the hedge accounting model in this proposal, in light of the discussion of macro hedge accounting, and must then begin the process of documentation and systems development.

   We therefore cannot agree with the stipulation in the exposure draft that application begin with the reporting year beginning during or after January 2013 and would urge the Board to reconsider the timing of application of the exposure draft in light of the timing of finalizing a standard for macro hedge accounting.

   There is also the potential for the content of the exposure draft to be inconsistent with the elaboration on macro hedge accounting, which we believe will necessitate a reconsideration of the exposure draft in light of that elaboration.

3. Additional points

(Point 1) Internal derivatives

1. In BC 41 through 45, the exposure draft stipulates that internal transactions cannot be hedging instruments, but IAS 39 F1.4 says that internal derivatives are eligible for hedge accounting on the consolidated financial statements if they offset derivatives with parties outside the consolidated group. We would like this provision to remain in place.

2. In Japanese banks, there are cases in which the ALM section applying hedge accounting designates the trading section as the counterparty to a derivative transaction for hedging

purposes. As prima facie evidence that a hedging relationship is held by the enterprise overall, the trading section moves the risk from the ALM section outside through external transactions, and this is verified.

This is a reasonable practice because it centralizes external transactions (i.e, access to the market) with the trading unit, which facilitates credit risk management.

3. We understand the reason for deeming internal derivatives ineligible as hedging instruments is that risk is not externally released on a consolidated basis and therefore hedge accounting cannot be applied. The provision in IAS 39 F1.4 saying that internal derivatives are eligible for hedge accounting on the consolidated financial statements if they offset derivatives trading with parties outside the consolidated group allows the application of hedge accounting only when risk is externally released without elimination of the internal derivative upon consolidation.

(Point 2)

Proposal for the introduction of a new hedge accounting framework for foreign currency fund-raising and investment in the banking industry

(Cross Currency Funding)

1. Currency swap transactions, etc.

The functional currency for Japanese banks is yen, in which they have more customer liabilities in the form of deposits, etc. than they do customer assets in the form of loans, etc. On the other hand, they hold large amounts of foreign currency-denominated investment assets, particularly in dollars and euros.

Banks raise foreign currency funding by converting their surplus yen to other currencies via currency swaps and foreign-exchange swaps synthesized from spots and forwards (referred to collectively as "currency swaps, etc." below). These transactions are more rational from the perspective of credit risk than raising funds through simple foreign currency-denominated funds transactions, and they are both necessary and important for bank operations.

These "currency swaps, etc." entail the exchange of principal in two currencies and have real interest cash flow. Fundamentally, they can be seen as a combination of "loans" in one currency and equivalent "borrowings" in another. They can also be considered similar in nature to repo transactions in that obligations in one currency are secured by assets in the other, and are therefore similar to secured loans. In other words, currency swaps, etc. are derivatives, but they are distinguished from derivatives in that they lacks the leverage effect usually associated with derivatives which is presumably the rationale for requiring fair value accounting.

2. Hedge accounting model

We urge the Board to allow a new hedge accounting framework for "currency swaps, etc." used for the purposes described above in which they would be given the same accounting treatment as fund-raising and investment, as warranted by their purposes and realities.

Banks manage multiple foreign-currency denominated assets and liabilities on a portfolio basis, making it impossible to recognize and apply hedge accounting to individual hedging relationships. If they are unable to apply hedge accounting under the hedge accounting model described below, fair value accounting will be applied to "currency swaps, etc, " which would likely to result in recognition of changes in fair value in profit or loss. We would therefore urge that the matter be taken up in the ongoing discussions of macro hedge accounting so as to accurately reflect the realities of bank risk management in financial statements.

(1) Hedging instruments

The currency swaps that constitute hedging instruments have the same amount payable as "principal equivalent" at the time the contract commences as the amount receivable at the time the contract concludes, and the same amount receivable at the time the contract commences as the amount payable at the time the contract concludes. In addition, the swap rate applied to the principal portion and interest portion is restricted to a flat spread between spots and futures (or forwards), which is a rational rate.

The foreign-exchange swaps that constitute hedging instruments are of equivalent value other than adjustments for the interest rates on foreign exchange spots and foreign exchange futures (or forwards).

(2) Hedged items

The hedged items are currently existing or anticipated transactions for both assets and liabilities. In principle, they are restricted to financial instruments measured at amotized cost.

(3) Hedge application requirements

The following requirements must be satisfied at the inception of hedging and on an ongoing basis thereafter.

1) Confirmation of the existence of foreign currency receivables and payables in excess of the principal equivalent of the hedging instrument throughout the term to maturity of the hedging instrument, or

2) Confirmation of the existence of accrual basis interest from foreign currency receivables and payables, etc. in excess of the accrual basis interest equivalent of the hedging instrument throughout the term to maturity of the hedging instrument.

(4) Hedge accounting approach

The deferred hedge approach is used. The specific accounting treatment for the deferred hedge is described below. Ineffectiveness is not recognized in profit or loss.

1) The amount of the revaluation variance of the principal amount of the hedging instrument resulting from changes in spot foreign-exchange rates up to the measurement date is recognized in profit or loss.

2) Among the profit or loss and the revaluation difference of the hedging instrument, the interest equivalent is recognized on an accrual basis in profit or loss throughout the term to maturity of the hedging instrument.

3) Any amounts in the hedging instrument's revaluation variance other than 1) and 2) above are recognized in OCI.

3. Key points and concepts in the proposed hedge accounting model

One conceivable point of discussion with this hedge is the potential to avoid market –to-market and carry an excessive exposure that is not manifest in the financial statements due to the treatment of currency swaps, etc.

We do not believe that this is a problem. Our reasoning is outlined below.

(a) The currency swaps, etc. covered by this treatment are transactions that involve the exchange of principal in which currencies are borrowed and lent, with one for all purposes securing the other. It is therefore impossible to achieve excessive leverage.

(b) The carrying of excessive exposure is also avoided by verification of rational expectations of the existence of an outstanding balance of foreign

currency-denominated financial assets or liabilities in excess of the principal equivalent or accrual basis interest equivalent across the term to maturity of the currency swaps, etc.

Another conceivable point of discussion is contravention of the hedge accounting principle of treating ineffectiveness on the PL.

On this point, we do not believe it will be problematic if ineffectiveness is not recognized in profit or loss. While currency swaps, etc. are derivatives, they are distinguished by not having the leverage effect normally associated with derivatives that is presumably the rationale for requiring fair value accounting. They are therefore not transactions that require strict fair value accounting. In addition, currency swaps, etc. can be interpreted as essentially a borrowing in one currency that is secured with another. Both are transactions giving rise to cash flows that are solely the payments of principal and interest on principal amount outstanding, as described in IFRS 9's classification and measurement approaches, and therefore can be interpreted as transactions to be categorized as amortized costs.

The hedge accounting approach described in 2. (4) above breaks down the hedging instrument into its component elements, which is the same as the treatment employed when recognizing in OCI changes in the fair values of hedging instruments not designated as hedges. By contrast, the exposure draft proposes a treatment that would recognize in OCI the time value of options and any changes in it when options are used as hedging instruments. We believe our proposal is consistent with the treatment for options.

4. Need for and significance of this treatment

From the perspective of credit risk, currency swaps, etc. are a more rational means of raising funds than simple foreign currency-denominated funds transactions, and they are important and necessary for bank operations. Indeed, when the creditworthiness of Japanese banks declined in the latter half of the 1990s, it was difficult for them to raise US dollars on the dollar funds transaction market. Instead, they used currency swaps, etc. to raise the dollar-denominated funds they needed and transferred those dollar-denominated funds to overseas branch offices to ensure the funding liquidity of their overseas customers.

Foreign-exchange swaps and currency swaps are also used to raise and invest foreign currency funds in other situations, for example, when funds transaction markets are immature, as they are in Asia and other regions, and when it is difficult to raise funds through lending transactions during times of upheaval on the financial markets like the Asian currency crisis or the aftermath of the Lehman Brothers collapse.

The introduction of a hedge accounting model consistent with the risk management of Japanese banks for currency swaps, etc. executed for fund-raising purposes is consistent with the purpose of financial statements to provide information on the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

(Point 3)

Hedge of foreign exchange positions for investments in foreign currency-denominated equities

In our response to Question 1 we requested that hedge accounting be applicable to equities when OCI option is applied. In addition, we request you to allow recognizing in profit or loss just the translation variance of the acquisition cost of foreign currency-denominated equities for which OCI option is elected.

The functional currency for Japanese banks is yen, and consideration must be given to accounting treatment that recognize in profit or loss only the translation variance of the foreign currency acquisition cost when banks hedge foreign exchange positions for investments in foreign currency-denominated equities.

If foreign currency-denominated equities are classified as FVTPL, the translation variance of the foreign currency acquisition cost is recognized in profit or loss, but the yen translation of unrealized valuation profit or loss in foreign currency must also be recognized in profit or loss even if these equities are held not for trading purposes, but to stabilize the businesses of client enterprises or strengthen and expand banking transactions with them. On the other hand, if the OCI option is elected, both the translation variance of the foreign currency acquisition cost and the yen translation of unrealized valuation profit or loss in foreign currency must be recognized in OCI. As a result, the economic activity of hedging foreign exchange positions is not accurately presented on the financial statements, which is inconsistent with the purpose of financial statements to provide information on the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

For such situations we would like to see a hedge accounting framework in which hedge accounting is applied for the foreign-exchange risk hedge after applying the OCI option, and then the translation variance of the acquisition cost of the foreign currency-denominated equities is recognized in profit or loss while the yen translation of unrealized valuation profit or loss in foreign currency is recognized in OCI.