International Accounting Standards Board
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January 27, 2022

Japanese Bankers Association

Comments on the International Accounting Standard Board's Request for Information
Post-implementation Review of IFRS 9 - Classification and Measurement

The Japanese Bankers Association (the "JBA")[1] is pleased to provide comments on the Request for Information *Post-implementation Review of IFRS 9 – Classification and Measurement* published by the International Accounting Standards Board (the "IASB").

We hope that our comments will contribute to your further discussions.

Responses to specific questions

Question 1–Classification and measurement
Do the classification and measurement requirements in IFRS 9: (a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not? (b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?

(Comment)

(a) We do not consider that these requirements enable such an alignment.

(b) We do not consider that these requirements result in an entity providing useful information to investors.

(Rationale)

One of the core activities of financial institutions is asset and liability management (ALM) which is not intended to make short-term profits. As interest rates and stock prices are inversely correlated, the

[1] The Japanese Bankers Association is an organization that represents the banking industry in Japan. Its members are banks and bank holding companies operating in Japan.

ALM portfolios of Japanese financial institutions may include interest rate products (e.g. fixed income) and equity products (e.g. equity index funds).

Under IAS 39, both of these instruments were classified as available-for-sale securities, and unrealised gains or losses at period-end could be recognised in other comprehensive income (OCI). Under IFRS 9, interest rate products (e.g. fixed income) are designated at fair value through other comprehensive income (FVOCI) and unrealised gains or losses at period-end can be recognised in OCI consistent with IAS 39. However, under IFRS 9, most stock investment trusts are designated at fair value through profit or loss (FVPL) and unrealised gains or losses at period-end are recognised in profit or loss, because they are classified as debt instruments[2] and do not meet the solely payments of principal and interest (SPPI) test. As a result, changes in the fair value of financial instruments held for ALM purposes occurring during the period are divided into OCI and profit or loss. Therefore, the performance of ALM activity will not be appropriately reflected in the financial statements.

Since stock investment trusts held in the ALM portfolio would increase the volatility in profit or loss because they are designated at FVPL and unrealised gains or losses will be recognised in profit or loss, it would be difficult for financial institutions to continue holding such investment trusts for risk management and other purposes. This may, in turn, trigger a decline in stock prices across the stock markets. Therefore, this treatment is one of the issues Japanese financial institutions take into account when considering whether to apply IFRS.

Essentially, so long as a financial instrument is not held for trading (i.e. not held to make short-term profits), recognising unrealised gains or losses at period-end in profit or loss does not result in an appropriate presentation of operating results and thus is unlikely to provide useful information to investors.

We request the IASB to consider allowing all financial instruments held in the ALM portfolio that is not intended to make short-term profits to be designated at FVOCI.

Question 3–Contractual cash flow characteristics
(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not? Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows. If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value

2 Refer to the JBA's "Comments on the Discussion Paper *Financial Instruments with Characteristics of Equity* issued by the International Accounting Standards Board ("IASB")" of December 28, 2018. https://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion301238.pdf

through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

(i) why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).

(ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.)

(Comment)

(a) We believe that the assessment is not working as the IASB intended.

(Rationale)

Since, as a result of the cash flow characteristics assessment, investments that are not intended to make short-term profits are designated at FVPL, it does not appropriately represent operating results.

(1) Stock investment trusts held for the ALM purpose

As commented in our response to Question 1, stock investment trusts are classified as debt instruments but do not meet the SPPI test (contractual cash flows that are solely payments of principal and interest on the principal amount outstanding) as they are composed of equities, and therefore are designated at FVPL. Recognising in profit or loss period-end unrealised gains or losses on financial instruments that are not held for making short-term profits does not appropriately represent an entity’s operating results. To address this issue, the IASB should allow such stock investment trusts to be designated at FVOCI by reviewing the SPPI criterion or by focusing on the requirement to classify and measure financial assets based on the business model test.

(2) Investments in private equity funds, etc.

Similarly to the case referred to in (1) above, investments in private equity funds, etc. are designated at FVPL because, while their legal form is stock, they are classified as debt instruments but do not meet the SPPI test as they are composed of stock.

Financial institutions invest in private equity funds with the intention of making a long-term investment to support the growth of investees. If such investments are designated at FVPL and are required to make short-term profits, it will undermine the benefits of long-term investments and will make it difficult for investors to, for example, firmly provide hands-on support for the long-term growth of investees. To address this issue, the OCI option should at least be applied to investments in private equity funds, etc. However, such a solution is impractical given the definition of debt instruments. The IASB therefore should consider revising IFRS 9 to include some of such financial instruments in the scope of application of the OCI option.

(Supplementary comment) Theoretical analysis for expanding the scope of application of the OCI option

- ✓ Due to the existence of structured products (e.g. compound financial instruments), it would be difficult to allow the application of the OCI option to all debt instruments that do not meet the SPPI test and thus are designated as FVPL. Nevertheless, those debt instruments that are evidently similar to equity products should qualify for the application of the OCI option.
- ✓ Specifically, allowing reporting entities to elect the OCI option for those "financial instruments that meet the definition of a financial liability but are deemed as equity" (puttable instrument)[3] would ensure relevance (paragraphs 2.6 to 2.10 of the *Conceptual Framework for Financial Reporting* ("Conceptual Framework")) and faithful representation (para. 2.12-2.19 of the Conceptual Framework).
- ✓ As stated in paragraphs BC7 and BC70 of IAS 32, mutual funds and investments in co-operatives are deemed to be largely equivalent to ordinary shares for accounting purposes. By applying the accounting treatment similar to ordinary shares (equity instruments) to such investments, entities will be able to separately identify investment trusts for making short-term profits and those held for ALM purposes. This would ensure "relevance" ("relevant financial information is capable of making a difference in the decisions made by users.") and "faithful representation" ("includes all information necessary for a user to understand the phenomenon being depicted").
- ✓ When developing the Conceptual Framework, the IASB introduced the concepts of "long-term investment" (paragraphs BC0.34-0.36) and "long-term investment as a business activity" (paragraphs BC0.37-0.39), indicating its direction to incorporate the concept of long-term investment in developing the standards. From this viewpoint, recognising in profit or loss short-term fair value changes on investments, etc. that are intended to provide a long-term support for the growth of investees would not achieve "faithful representation." However, applying the OCI option would help entities to provide "relevant" information.

Question 4–Equity instruments and other comprehensive income
(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?

[3] IFRS 9 specifies in paragraph BC5.21 that puttable instruments do not meet the definition of an equity instrument.

Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

(b) For what equity instruments do entities elect to present fair value changes in OCI?

Please explain the characteristics of these equity instruments, an entity's reason for choosing to use the option for those instruments, and what proportion of the entity's equity investment portfolio comprises those instruments.

(c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?

Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about recycling of gains and losses (see Spotlight 4).

(Comment)

(a) We support the OCI presentation option in that applying the option enables the same accounting treatment as the one applied to available-for-sale securities under IAS 39. We however do not support the prohibition of recycling when the option has been applied.

(Rationale)

We consider that applying recycling to those equity instruments that are not held for trading but are held for the long term will enhance the relevance of profit or loss that represents an entity's performance.

Requiring recycling of all OCI items without exception is a consensus view of all Japanese entities as detailed in the comment letter of the Accounting Standards Board of Japan ("ASBJ") submitted to the European Financial Reporting Advisory Group ("EFRAG") regarding the Discussion Paper *Equity*

Instruments - Impairment and Recycling.[4]

(Comment)

(b) Japanese financial institutions apply the OCI presentation option to all equity instruments except for those equities held for trading. They hold such equities for cross-shareholding purposes, such as to strengthen the relationship with customers.

(c) Compared to IAS 39, there are no unexpected effects. However, investment trusts and other investments in funds for which unrealised gains or losses at period-end were recognised in OCI under IAS 39 are now designated at FVPL under IFRS 9, giving rise to unintended profit or loss and thereby increasing the volatility in changes in profit or loss.

(End)

[4] https://www.asb.or.jp/en/wp-content/uploads/20180523-01_e.pdf