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Hans Hoogervorst
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst:

re: Comments on Exposure Draft
"Classification and Measurement:
Limited Amendments to IFRS 9"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on Exposure Draft "Revenue from Contracts with Customers" put out by the International Accounting Standards Board (IASB). The SAAJ is a not-for-profit organization providing investment education and examination programs for securities analysts. Its certified members number 25,000. The CAC is a standing committee of the SAAJ composed of 14 members, most of whom are users including equity and credit analysts, and portfolio managers, while a few others are academicians and public accountants. The CAC writes comment letters to global standard setters, including the IASB and Accounting Standards Board of Japan (ASBJ), and exchanges opinions with organizations including the ASBJ and Financial Services Agency.

Before drafting this comment letter, the SAAJ sponsored a study session on the discussion paper, inviting two ASBJ staff as lecturers. Some 67 of our certified members participated. A questionnaire was subsequently sent to each and 42 responded, making for a 63% response rate. This comment letter fully takes into account the views expressed in the questionnaire replies as well as discussion among CAC members. The survey results are attached as an Appendix.

General Comments

The CAC considers the exposure draft's primary objective is to establish a new category called FVOCI in order to facilitate the development of insurance standards now under way, while its secondary objective is to improve how IFRS 9 can be practically applied. The CAC supports the idea of establishing a new category, though it thinks the proposals for practical application require further improvement.

Question 2 Guidance for modified economic relationship (Survey question 5)

The exposure draft provides additional guidance to assess financial instruments with a modified economic relationship. The CAC thinks, however, that the guidance is still inadequate for practical application. In our survey (Question 5), we asked whether the proposed guidance was sufficient to assess a modified economic relationship or not. Only 31% replied 'Yes', with 19% 'No' and 50% 'Cannot judge at this moment'.

Question 3 Assessment of contractual cash flow (Survey Question 4)

The exposure draft proposes new processes to assess contractual cash flow characteristics. The CAC considers the proposal is far from sufficient improvement. Our survey question 4 asked whether the proposal made classification easier or not. 'Yes' won a 45% vote, a little shy of getting a majority. 19% of the respondents answered 'No' and 36% 'Cannot judge at this moment'. Comments from those answering 'Yes' revealed that they regarded the change as just a step forward rather than sufficient improvement.

Neither question 2 nor question 3 of the exposure draft obtained majority support, in sharp contrast to question 4 which gathered strong 93% support. The CAC believes that survey respondents felt guidance in regard to questions 2 and 3 was still inadequate.

The adoption of a benchmark cash flow notion is an improvement as a clarification of the assessment process that is more in line with market practices. However, the wording used in the guidance, "more than insignificantly different", is so ambiguous that the same financial instrument could be classified either as FVPL or others according to the judgement of an entity. This might possibly jeopardize the comparability of financial statements. Thus, the IASB needs to provide guidance in clear language. The CAC recognizes the difficulty in providing concrete guidance under principle-based accounting standards which refrain from providing numerical thresholds. Further, there is a tendency in the market to develop innovative financial instruments to evade the clutches of accounting standards no matter how specifically they are written.

Hence, financial instrument accounting functions not only by the wording of the standards but also by the establishment of best practices through the joint efforts of stakeholders including preparers, users, auditors, and regulators. The IASB should provide guidance which will be the framework for such best practices and confirm the practices during the post implementation review which is required two years after standards become effective. If the review identifies any problems, the standards should be immediately revised.

Question 4 Introduction of FVOCI category (Survey Question 1)

The CAC supports the proposal to introduce a third classification category, FVOCI. 93% of the survey participants supported the change.

Increasing the number of categories from two to three ostensibly makes the standards more complex. However, the CAC highly regards the change as it makes asset and liability matching easier and suits investment practices where the dichotomy between 'held for maturity' and 'held for trading purposes' is difficult to apply.

The new category and the insurance project (Survey Question 2)

In our survey, we asked whether the new FVOCI category would have the expected effects on insurance standards to be proposed by the IASB or not (Question 2). 62% answered 'yes'.

The fluctuation in insurance liabilities caused by interest rate movements is to be accounted in OCI under the new insurance standards. Valuing the corresponding financial assets in OCI, as proposed in the exposure draft, would eliminate the mismatch occasioned by valuation methods.

Question 5 Guidance to distinguish three business models (Survey Question 3)

The CAC regards guidance to classify financial instruments into three categories—amortized cost, FVOCI, and FVPL—an improvement. To the question of whether the proposal makes classification of financial instruments easier to understand or not (Question 3), 55% answered 'Yes' and 33% reserved their opinion ('Cannot judge at this moment').

Although slightly more than half thought it easier to understand, still one third were not sure. Behind this divided opinion is a concern that there would be difficulty in practical application. For example, it is difficult to judge whether a portfolio where 70% is held for maturity while the remaining 30% is rather frequently traded should be classified as FVOCI or FVPL. Although the CAC highly regards the introduction of the FVOCI category, it thinks further guidance is required to facilitate practical application.

Some CAC members opined that the application of the amortized cost category should be more rigorously stipulated after the introduction of FVOCI.

Question 7 Early application (Survey Question 6)

The CAC agrees with the exposure draft's proposal that only the completed version of IFRS 9 (ie, including Classification and Measurement, Impairment and General Hedge Accounting chapters) can be newly applied prior to the mandatory effective date and that new application of previous versions will be prohibited six months after issuance of the completed version. In our survey, 91% supported the proposal.

Because of the continuous modification of classification and measurement of financial instruments, allowing plural versions to coexist would not be desirable from the eyes of investors who emphasize comparability. The CAC welcomes single financial instrument accounting standards soon to be realized by the exposure draft.

Question 8 Own credit loss (Survey Question 7)

The CAC agrees with the proposal to only permit early application of the 'own credit' provision of IFRS 9. 62% of survey respondents supported this exception.

As explained in the answer to Question 7 above, coexistence of plural standards should be avoided to the extent possible. Early application of a portion of the standards, in general, would exacerbate comparability. However, the current standards which lead to an increase in the profit of an entity with deteriorating 'own credit' are not only counter-intuitive for investors but also, during the financial crisis, were an inducement to pursue arbitrary accounting to report higher profit. The advantage of early adoption of 'own credit' provisions, which were introduced to rectify the problems mentioned above, far outweighs the temporary decline in comparability.

Other comments

Lastly, the CAC respectfully presents two requests to the IASB.

The first is use of plain and clear English. As referred to in the answer to Question 3, an expression like "more than insignificantly different", which is hard to understand for non-native speakers of English, should be avoided. The language barrier in the introduction and use of IFRS for non-English speaking countries is not low, to say the least. For global acceptance of the IFRS as a single set of international accounting standards, sincere consideration for non-English speaking countries is required and the IFRS should be written in plain, clear and easy to understand English.

The second request is recycling of OCI equities when an accumulated other comprehensive income (AOCI) amount is derecognized. The CAC has repeatedly emphasized the importance of net income and recycling and it still holds the view that the realized AOCI amount should be recycled for all financial instruments.

If you have any questions or need further elaboration, please do not hesitate to contact Sei-Ichi Kaneko, Executive Vice President, SAAJ (s-kaneko@saa.or.jp).

Sincerely yours,

Keiko Kitamura

Keiko Kitamura
Chair
Corporate Accounting Committee

APPENDIX

Results of SAAJ Survey on “Classification and Measurement: Limited Amendments to IFRS 9”

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on IASB’s exposure draft “Classification and Measurement: Limited Amendments to IFRS 9”, inviting lecturers from the Accounting Standards Board of Japan (ASBJ). Some 67 of our certified members participated in the session held on 15 February. A questionnaire was subsequently sent to each participant and 42 responded, making for a 62.7% response rate. The respondents were also invited to make comments. The survey, although small in size, focused on a cohort with the same background (certified members of the SAAJ) and same knowledge level (participation in the study session). This focus and very high response rate gives credibility to the reliability of the survey.

Survey questions and answers

Q1: FVOCI: a third classification category

The exposure draft proposes introducing a new measurement category, FVOCI, for simple debt instruments including bonds and loans, in addition to existing FVPL and amortized cost categories. Do you agree with the introduction of such a third category?

A1

(a) Yes.	92.9%
(b) No.	2.4%
(c) Cannot judge at this moment.	4.8%
Total	100.0%

Q2: The new category and the insurance project

Do you think the new FVOCI category would yield expected effects on insurance standards to be proposed by the IASB?

A2

(a) Yes.	61.9%
(b) No.	4.8%
(c) Cannot judge at this moment.	33.3%
Total	100.0%

Q3: Guidance to distinguish business models

The exposure draft proposes additional guidance to distinguish the three business models, including the models to hold financial assets to collect contractual cash flows. Do you think the proposed guidance would make classification of financial instruments easier to understand?

A3

(a) Yes.	54.8%
(b) No.	11.9 %
(c) Cannot judge at this moment.	33.3%
Total	100.0%

Q4: Modified economic relationship

In response to the criticism that the contractual cash flow characteristics assessment of existing IFRS 9 is too rigorous, the exposure draft proposes a new evaluation process. Do you think this would make the classification of financial instruments with a modified economic relationship (ie, the interest mismatch or leverage) easier?

A4

(a) Yes.	45.2%
(b) No.	19.0%
(c) Cannot judge at this moment.	35.7%
Total	100.0%

Q5: Guidance for modified economic relationship

The exposure draft provides guidance to facilitate the classification of financial instruments with a modified economic relationship. Do you think the proposed guidance is sufficient to assess the modified economic relationship?

A5

(a) Yes.	31.0%
(b) No.	19.0%
(c) Cannot judge at this moment.	50.0%
Total	100.0%

Q6: Early application

The exposure draft proposes that only the completed version of IFRS 9 (ie, including Classification and Measurement, Impairment and General Hedge Accounting chapters) should be newly applied prior to the mandatory effective date and that new application of previous versions would be prohibited six months after issuance of the completed version. Do you agree with this proposal?

A6

(a) Yes.	90.5%
(b) No.	2.4%
(c) Cannot judge at this moment.	7.1%
Total	100.0%

Q7: Own credit loss

Notwithstanding the proposed transition requirement above, the exposure draft proposes permitting early application of only the 'own credit' provision of IFRS 9. Do you agree with the proposal?

A7

(a) Yes.	61.9%
(b) No.	19.0%
(c) Cannot judge at this moment.	19.0%
Total	100.0%