The Securities Analysts Association of Japan

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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
"Financial Instruments:
Expected Credit Losses"

The Corporate Accounting Committee (CAC) of the Securities Analysts Association of Japan (SAAJ) is pleased to comment on Exposure Draft "Financial Instruments: Expected Credit Losses" 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 15 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 an ASBJ staff member as a lecturer. Some 81 of our certified members participated. A questionnaire was subsequently sent to each and 38 responded, making for a 47% 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.

Request for a single credit loss model

The CAC is deeply disappointed by the fact that the IASB and the Financial Accounting Standards Board (FASB) are proposing completely different credit loss models albeit the two boards had jointly considered the project since September 2010 until recently. A

predominant majority of survey respondents thought that the two models “should be converged into a single model”. (See Question 7 of the Appendix).

If the two boards adopt different models, against the sincere desire of financial statement users for a converged model, significant differences in recognized credit losses caused by the different models would make comparative analyses of American and European financial institutions extremely difficult. The expected credit loss model per se makes comparative analyses difficult because of possibly wide divergence in the application of loss expectation among financial institutions. The differences in standards between the IASB and FASB models impose an unreasonable burden on financial analysts.

Question 1 (b) and 2 (c): The IASB and the FASB models

No consensus view has been formed among CAC members as to whether the IASB or FASB model should be adopted. The views of our survey respondents were divided too, 42% supporting the IASB model, 32% the FASB model, and the rest (26%) answering “Cannot decide at this moment”. (Survey Question 8).

The FASB’s CECL model requires life time expected credit losses to be recognized at inception. The CAC thinks a reliable estimate of such losses would be very difficult. On the other hand, the IASB model limits the initial loss estimate for a 12-month period, reducing the difficulties in credit loss estimate to a certain extent. On the other hand, the structure of the IASB model is so complex that it would be practically difficult to implement and manage satisfactorily except for a limited number of sophisticated financial institutions, resulting in the reduced reliability of published credit loss data.

Further, under the IASB model, for an entity with a rapidly growing loan portfolio, 12-month credit losses in Stage 1 may end up with insufficient provisions, making it necessary to add provisions later. In that case, excessive profits would be recognized and excessive dividends might be paid out in the initial stage, resulting in insufficient capital accumulation. Under the CECL model, on the other hand, excessive estimated losses might be recognized with unreasonably low profit in the case of the above mentioned entity in Stage 1 of the IASB model.

Question 2(a) Major proposals of the exposure draft

The majority (58%) of survey respondents answered “Yes” to the question “The exposure draft proposes recognizing a loss allowance (or provision) at an amount equal to 12-month expected credit losses (Stage 1) and at an amount equal to life time expected credit losses after significant deterioration in credit quality (Stage 2). Do you think this approach will provide useful information on credit losses of financial instruments?”

(Survey Question 1).

As the CAC thinks it difficult to estimate life time credit losses in all financial instruments, it values the IASB model relatively higher than the CECL model because the IASB model is closer to current business practices and excessive losses would not be recognized at inception. On the other hand, the CAC thinks the model needs further improvement regarding the cliff that exists in the transition from Stage 1 to Stage 2, and also the arbitrary judgment of significant deterioration in credit losses which would trigger such transition.

Question 5(a)(b) Guideline to recognize life time credit loss

Survey respondents had mixed views on the question "Do you think the exposure draft provides sufficient guidance on when to recognize life time credit losses?" (Survey Question 2). "Yes" and "No" were the same at 37%, while 26% responded "Cannot decide at this moment".

The CAC thinks the exposure draft does not provide enough guidance to judge a significant deterioration in credit risk. However, we also recognize providing practically workable and yet not numerically articulated guidance for such deterioration is extremely difficult. Thus, we feel implementation of the model as it is proposed in the exposure draft very difficult.

Question 6(a)(b) Interest revenue

The vast majority (71%) of survey respondents answered "Yes" to the question "The exposure draft proposes that interest from financial assets that have objective evidence of impairment subsequent to initial recognition would be recognized based on amortized cost. Do you think this approach will provide useful information?" (Survey Question 3).

When objective evidence of impairment exists, applying an effective interest method to the gross carrying amount would lead to overstatement of interest revenue because a significant amount of provision has been set against the gross carrying amount. In this regard, the CAC agrees to the proposal.

Question 3(a)(b) Scope

Again, the vast majority (74%) of survey respondents supported the scope of the exposure draft. (Survey Question 4). The CAC agrees with the majority view.

Some CAC members opined that Example 10 does not convince them of the need to apply the exposure draft to FVOCI which is already valued at fair value. They think more

elaboration in Basis for Conclusions and Examples necessary.

Question 7(a)(b) Disclosure

90% of survey respondents supported the proposed disclosure. (Survey Question 6).

The CAC thinks the proposed disclosure would provide sufficiently useful information to financial statement users after taking into consideration that some of the disclosure requirements may be burdensome to preparers.

Specifically, the amount of financial instruments according to classification (Stage 1~3) is useful to evaluate asset quality, and reconciliation of book amount and corresponding provisions is useful to evaluate changes in asset quality.

Question 10(a) Trade receivables and lease receivables

The majority (55%) of survey respondents answered "Yes" to the question "The exposure draft proposes an optional simplified approach for trade receivables and lease receivables in which the loss allowance would be measured at an amount equal to life time expected credit losses at initial recognition and throughout the asset's life. Do you think this approach will provide useful information?" (Survey Question 5). Many respondents commented that trade receivables are typically short term with little need to apply a sophisticated model.

Those who answered "No" to the question claimed that long-term leases may not be accounted properly and that optional application would decrease comparability.

Toward the converged credit loss model

The CAC thinks both the IASB and the FASB models have advantages and disadvantages, making it difficult to choose one as a single model to be used globally. The two boards should aim again to create a new converged model. In this regard, the CAC thinks an alternative model proposed by the Accounting Standards Board of Japan (ASBJ) in its comment letter to the FASB could be a starting point of deliberations.[1]

The attached survey does not include a question regarding the alternative model of the ASBJ as it was issued after the survey date. CAC members studied the model at their meeting and concluded that most of the problems identified in the IASB model could be improved by the alternative model.

The CAC thinks the alternative model is a simple but sufficient expected credit loss

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[1] The comment letter can be obtained from the following. See paragraphs 5, 18-48 of the comment letter. The same proposal will be explained in the ASBJ's comment letter to the IASB.
https://www.asb.or.jp/asb/asb_e/international_activities/comments/20130618_e.pdf

modes that fits between the IASB and FASB models. The CAC respectfully requests the two boards to seriously consider the alternative model in order to develop a single converged expected credit loss model.

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
Chair
Corporate Accounting Committee

APPENDIX

Results of SAAJ Survey on “Financial Instruments: Expected Credit Losses”

Background and methodology

The Securities Analysts Association of Japan (SAAJ) sponsored a study session on IASB’s exposure draft “Financial Instruments: Expected Credit Losses”, inviting a lecturer from the Accounting Standards Board of Japan (ASBJ). Some 81 of our certified members participated in the session held on 14 June. A questionnaire was subsequently sent to each participant and 38 responded, making for a 47% 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: The exposure draft proposes recognizing a loss allowance (or provision) at an amount equal to 12-month expected credit losses (Stage 1) and at an amount equal to life time expected credit losses after significant deterioration in credit quality (Stage 2). Do you think this approach will provide useful information on credit losses of financial instruments?

A1

(a) Yes.	57.9%
(b) No.	21.1%
(c) Cannot judge at this moment.	21.1%
Total	100.0%

Q2: Do you think the exposure draft provides sufficient guidance on when to recognize lifetime credit losses?

A2

(a) Yes.	31.8%
(b) No.	31.8%
(c) Cannot judge at this moment.	26.3%
Total	100.0%

Q3: The exposure draft proposes that interest from financial assets that have objective evidence of impairment subsequent to initial recognition would be recognized based on amortized cost. Do you think this approach will provide useful information?

A3

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

Q4: The proposed scope of the exposure draft includes the following:

(a) financial assets measured at amortized cost;

(b) trade receivables measured at amortized cost;

(c) financial assets that are mandatorily measured at fair value through other comprehensive income (FVOCI);

(d) lease receivables;

(e) certain loan commitments with a present contractual obligation to extend credit;

(f) certain financial guarantee contracts.

Do you think the above scope is appropriate?

A4

(a) Yes.	73.7%
(b) No.	2.6%
(c) Cannot judge at this moment.	23.7%
Total	100.0%

Q5: The exposure draft proposes an optional simplified approach for trade receivables and lease receivables in which the loss allowance would be measured at an amount equal to life time expected credit losses at initial recognition and throughout the asset's life. Do you think this approach will provide useful information?

A5

(a) Yes.	55.3%
(b) No.	15.8%
(c) Cannot judge at this moment.	28.9%
Total	100.0%

Q6: The exposure draft proposes that interest revenue, impairment losses or gains should be presented in the statement of profit or loss and other comprehensive income as separate line items. It also proposes that the amounts arise from expected credit losses and the effect of deterioration and improvement in the credit risk should be disclosed. Do you think the proposed presentation and disclosure are useful?

A6

(a) Yes.	89.5%
(b) No.	0.0%
(c) Cannot judge at this moment.	10.5%
Total	100.0%

Q7: The Financial Accounting Standards Board (FASB) issued an exposure draft "Financial Instruments – Credit Losses" in December 2012 and proposed the Current Expected Credit Loss (CECL) model in which life time credit losses are recognized at inception. What do think about the IASB and the FASB proposing two different models?

A7

(a) Should be converged into a single model.	89.5%
(b) Co-existence of the two models is acceptable.	5.3%
(c) Cannot judge at this moment.	5.3%
Total	100.0%

Q8: Which of the two models will provide more useful information on credit losses of financial instruments taking into consideration implementation costs, the IASB's three-stage model or the FASB's CECL model?

A8

(a) The IASB model.	42.1%
(b) The FASB model.	31.6%
(c) Cannot judge at this moment.	26.3%
Total	100.0%

*In Questions 1, 2, 3,and 7 (a)~(c) do not add up to 100.0 because of rounding.