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Comments on IASB Exposure Draft 7 "Financial Instruments: Disclosures"

Japanese Bankers Association

The Japanese Bankers Association is an industry association with 143 Japanese bank and 38 foreign bank members. We are grateful for this opportunity to comment on Exposure Draft 7 "Financial Instruments: Disclosure."

Below are our comments on questions in the Exposure Draft, which are made with reference to the future application of International Accounting Standards (IAS). We ask that our comments be taken fully into account in the final revisions to the standards.

1. Location of disclosures of "risks arising from financial instruments" (related to Question 6)

- We do not think it should be mandatory for the location of disclosures of "risks arising from financial instruments" to be part of financial statements as notes in all cases. In other words, the disclosure of "risks arising from financial instruments" is a means of providing useful information to investors, and we believe it unnecessary to limit the content of disclosure by making it a part of financial statements. In addition, we are opposed to making risk information a subject of external audits because this information is often unsuitable for financial statements auditing by outside auditors. Moreover, inclusion of it in audits would potentially lead to a surge in auditing costs, which would undermine the balance between costs and benefits.
- There should be some flexibility in the means selected to disclose credit risks, market risks, liquidity risks, etc., for example, allowing the use of figures and graphs or the addition of quantitative analyses.
- Therefore, rather than including this disclosure as part of the financial statements, we believe that firms should be allowed to cover this topic in their financial statements in a location the firms find optimal such as the "Management Discussion and Analysis" (MD&A) section. Therefore, we believe each entity should be given the leeway to determine the means of disclosure.

2. Capital disclosure (related to Question 4)

- We believe the disclosure items for "capital" found in Paragraphs 46-48 of ED 7 should be matters that should be evaluated for the entity as a whole and not just financial instruments. In that sense, we are concerned about the placement of these provisions in ED 7 ("Financial Instruments: Disclosure") beside "risks arising from financial instruments." Taking internationally-active banks as an example, the current "Pillar Three" of Basel II already provides for sufficient disclosure of capital, and disclosure items based on "Pillar Three" would presumably meet IFRS requirements stipulated in "Financial Instruments: Disclosure."

- However, if, for the sake of argument, we assume that "capital" items are to be included in ED 7, we would agree with the arguments in BC52 that the entity-specific capital targets set by authorities for individual banks are confidential and we would therefore oppose the disclosure of those ratios.

- Paragraph 47(d) and (e) ask for the disclosure of whether the entity has complied with any capital targets set by management and the consequences of such non-compliance. It is common among banks to set their management capital targets in their medium and long-term business plans. Under the provisions of Paragraph 47 of the ED, banks would be required to disclose their management targets, and if they failed to meet these targets, investors would ultimately demand to know why. For this reason, and also in view of consistency with "Pillar Three" of Basel II, we consider it sufficient for entities to disclose regulatory capital adequacy ratios (for internationally-active banks, the minimum target is 8%). At the very least, the disclosure of targets set by management should be a voluntary action, not a requirement.

3. Position of implementation guidance (related to Question 8)

- We agree with IG1 and BC42 that the application of the implementation guidance should not be mandatory.
- We also agree with the conclusion in BC42 that this exposure draft does not cover all entities and that such requirements would be excessive and burdensome for entities that do not have large holdings of financial instruments. It is therefore preferable to avoid such unnecessary requirements. Consequently, it is not desirable to form more detailed requirements than are present in the exposure draft; rather, each entity should be given room to follow its own ideas in this matter.
- IG19 (consideration of internal credit ratings), which concerns the concentration risk, asks for "(c) the relationship between internal credit and external ratings." We think that it is sufficient to disclose qualitative information for this and that entities should not be required to describe a specific relationship between external and internal ratings.

4. Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards "Fair Value Measurements" published by the US Financial Accounting Standards Board (FASB) (related to Question 9)

- Given the fact that the standards set by the IASB are principle-based rather than rule-based, we believe that the IASB should not go into the same level of detail as the Exposure Draft of Proposed Statement of Financial Accounting Standards "Fair Value Measurements" published by the FASB.

5. Frequency of disclosure (related to Question 10)

- We understand the disclosure items in the exposure draft are to be disclosed once a year. To clarify this point, there should be an explicit statement that the disclosure requirements in this exposure draft are not mandatory in the "interim financial reporting" regulated by IAS34 ("Interim Financial Reporting").

6. Disclosure of fair value (related to Question 10)

- Paragraph 26 of the IFRS draft requires the disclosure of fair value for each class of financial assets and financial liabilities, but we believe it is inappropriate to require the disclosure of fair value for financial instruments that do not have markets, for example, loans and deposits. At the very least, we believe instruments for which fair value cannot be measured with any reliability should either be included in the list of exceptions in Paragraph 29 or be subject to voluntary application by the entity.
- In Paragraphs 11-12 of the IFRS draft, disclosure of the amount of change in its fair value that is not attributable to changes in a benchmark interest rate is required when designating a financial liability as at fair value through profit or loss. However, the remainder may contain liquidity risk, etc., in addition to credit risk, so the remainder itself does not appear to be meaningful. There is little meaning in imposing the administrative burden that would be generated by having to estimate these figures.

7. Disclosure of liquidity risk

- In the case of liquidity risk, we assume that the disclosure of "a maturity analysis for financial liabilities that shows the remaining contractual maturities" as stated in Paragraph 42 of the IFRS draft envisions the inclusion of all liabilities (time deposits, borrowings and bonds). If this assumption is correct, it would be possible to determine the positions for which there is no balance outstanding and the positions for which there is a concentration of balances outstanding. This would present problems from the point of view of competitiveness, for example, by causing counterparties to demand higher interest rates in the process of raising funds. We therefore believe disclosure of the "results of analysis using the methods used for risk management purposes" should be added to disclosure of bank liquidity risk, so that banks are allowed to disclose the difference between the offer and bid rates in lieu of the maturity analysis.

8. Disclosure of sensitivity analysis (related to Question 3)

- We believe this disclosure would be practical if it is identical to the items required in "Pillar Three" of Base II (Table 9: Market risk: disclosure of capital requirement for interest rate risk, foreign exchange rate risk, etc. for trading portfolios; Table 13: The increase (decline) in earnings or economic value (or relevant measure used by management) for upward and downward rate shocks according to management's method in the banking book). If it is not, consistency should be maintained with Basel II.

9. Disclosures relating to the significance of financial instruments to financial position and performance (related to Question 1)

- We believe it should explicitly state that "each class of financial assets" for the disclosure of "allowance accounts" in Question 1:(b) envisions classifications such as "loans" and "securities" rather than purpose-based classifications like "held-to-maturity assets," "trading assets," "available-for-sale assets" and "assets applied to fair value options."
- Paragraph 21 seeks disclosure of the breakdown of net gains, but there is no need to break down them into held-to-maturity investments, loans and receivables, and financial liabilities measured at amortized cost.

10. Other opinions (related to Question 10)

- Paragraphs 24-25 of the IFRS draft contain the content of disclosures for cash flow hedges, but it is practically difficult to provide this for portfolio hedges. The document should explicitly state that disclosure is not required for portfolio hedges.
- Paragraph 15 of the IFRS draft seeks disclosure of contractual terms and conditions relating to assets pledged as collateral. The requirements for contractual terms and conditions are abstract rather than specific, so it would be sufficient to require "the names of account categories and amounts of liabilities for which assets are pledged as collateral," instead of contractual terms and conditions.