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Comments on Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement, The Fair Value Option

Dear Sirs:

We, the Japanese Institute of Certificate Public Accountants, are pleased to provide our comments on the proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement, The Fair Value Option (the "ED").

We support the ED and, therefore, agree with certain of the proposed standards. However, we do have specific comments and recommendations with respect to certain other of these proposed standards, which are outlined as follows:

If the ED is adopted by an entity, the following financial instruments would not be eligible for the fair value option:

(i) In cases where an entity holds fixed-rate bonds privately placed with changes in the fair value of the bonds hedged by an interest-rate swap, the bonds are stated at amortized cost because their fair value is not verifiable. On the other hand, the swap is valued at fair value with recognition of changes in its fair value recorded directly in the statement of income since the swap is a derivative. If the entity intends to adopt hedge accounting for the bonds and the swap, testing of hedge effectiveness would be required on a periodical basis, otherwise the derivative would not initially be eligible for hedge accounting.

(ii) In cases where an entity enters into an agreement to borrow funds at a fixed rate and the proceeds are intended to finance investments in fixed-rate bonds, the bonds held should be stated at fair value unless the entity classifies them as securities held to maturity. On the other hand, such borrowings are not deemed eligible for fair value measurement even though their fair value is verifiable. As a result, a mismatch would arise in the statement of income.

Our comments on the ED:

We agree with the proposed amendments as set out in the ED, except for the following items:

(1) Paragraph 9(b) (iii) requires, as one of the conditions in which an entity can elect the fair value option, that the exposure to changes in the fair value of a financial asset or a financial liability be *substantially offset* (italics added) by exposure to changes in the fair value of another financial asset or financial liability. It is unclear what level of correlation "substantial offset" entails. We understand that the word "substantial" represents 90% or more. If so, the scope of the transactions which would meet this condition would be extremely narrow. For example, if an available-for-sale financial instrument such as a national bond is financed by the proceeds from fixed-rate notes issued, changes in the fair value of the financial asset would not be substantially offset by the corresponding changes in the fair value of the financial liability because the credit spread for national bonds is different from that of the note issuer. This condition would remain unchanged, even if the fair value of the notes were verifiable.

    Therefore, we propose that an entity be able to elect the fair value option for a financial asset or financial liability if the exposure to changes in the fair value attributable to a specific risk to the financial asset or financial liability is substantially offset by exposure to changes in the fair value of the matched financial liability or financial asset which are attributable to the corresponding risk. This could be viewed as being similar to the conditions for hedge accounting. In such cases, the portion of the changes in fair value which substantially offset each other relates solely to the exposure attributable to a specific risk inherent in the financial instruments, but not to relevant changes in fair value of the financial asset or financial liability as a whole.

(2) Paragraph 9 of the ED states that, for entities subject to prudential supervision such as banks and insurance companies, the powers of the relevant prudential supervisor may include oversight of the application of these requirements and of relevant risk management systems and policies. As explained in BC11 (b), IAS 39 does not confer any additional powers on the supervisors. Although we agree with this position, we recommend that the above sentence be removed from Paragraph 9 because its inclusion is not appropriate.

(3) In order to clarify that verifiability, as one of the conditions for the election of the fair value option proposed in Paragraph 9, cover only paragraph 9(b), Paragraph 48B should refer to the verifiability conditions outlined in Paragraph 9(b), and not simply refer to Paragraph 9.

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We would be pleased to discuss any aspect of this letter with the IASB or its staff at your convenience.

Very truly yours,

Michiyoshi Sakamoto
Chairman
Technical Committee for IASB