National Australia Bank

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25 March 2013

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Cc: Mr Kevin Stevenson, Chairman, Australian Accounting Standards Board (AASB)

Dear Sir,

Re: ED/2012/4 Classification and Measurement: Limited Amendments to IFRS 9

Thank you for the opportunity to comment on Exposure Draft 2012/4 Classification and Measurement: Limited Amendments to IFRS 9 (the ED). Our comments on the specific questions included in the ED are addressed in the Appendix.

National Australia Bank Limited (NAB) is one of the four major Australian banks. Our operations are predominantly based in Australia, New Zealand, the United Kingdom, the United States and Asia. In our most recent annual results we reported net profit after tax of A$ 4.1 billion and total assets of A$ 763 billion.

We have the following general comments on the Exposure Draft:

- Overall NAB is supportive of the additional guidance from assessing modified economic relationships, however, we do believe there are some areas for further clarification with respect to this assessment;
- We support the introduction of the FVOCI category, which would be particularly relevant in some of the NAB's liquidity portfolios business models; and
- We are of the view that in adopting the completed versions of IFRS 9, that both Classification and Measurement and Impairment chapters should be adopted together as those models are interrelated, however, we believe that the general Hedge Accounting chapter should be capable of separate transition at a later date.

Our answers to the specific questions in the Exposure Draft should be read in the context of the general points raised above.

Should you have any queries regarding our comments, please do not hesitate to contact Marc Smit, Head of Group Accounting Policy at marc.smit@nab.com.au.

Yours sincerely

Stephen Gallagher

General Manager, Group Finance

Appendix

Detailed Answers to Questions

Question 1 - Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

We agree that the intent behind the contractual cash flow characteristics test should be to not disqualify relatively plain vanilla instruments from amortised cost accounting solely on the basis of insignificant features that could create some limited form of leverage, when the predominate nature of the instrument is that of cash flows that are solely payments of principal and interest.

Overall, the NAB supports the proposed guidance on assessing "modified economic relationship" as part of the contractual cash flows characteristics test.

Question 2 - Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

Overall, we agree that the examples are relatively clear around the assessment of modified economic relationship for interest rate reset features. However, as the guidance will be specific to only interest rate reset features this will still likely result in some insignificant features being disqualified from amortised cost accounting for some instruments.

We suggest some additional guidance to clarify the following points around assessing the modified economic relationship:

- It is our interpretation that the modified economic relationship guidance on interest rate reset features is to be read independently of the existing guidance around interest rate floors, caps, extension and pre-payment options;

- If the instrument under assessment contains both an interest rate reset feature as well as other features (such as a floors, caps, extension and prepayment options) in our view the assessment of benchmark cash flows on a comparable asset would include such "other features" (i.e. the assessment is only to analyse specifically the interest rate reset feature itself); and

- the cash flows in the assessment should be discounted (e.g. when assessing a longer life instrument).

Question 3 - Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features?

Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

Yes, we agree that amendments clarify the application of interest rate mismatch features and will mostly ensure that "plain vanilla" financial instruments with such features are not necessarily disqualified from amortised cost accounting, if considered to be insignificant.

Question 4 – Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:

(a) interest revenue, credit impairment and any gain or loss on de-recognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and

(b) all other gains and losses are recognised in OCI?

If not, why? What do you propose instead and why?

We agree with the IASB's view that a business model may in some circumstances reflect that an entity may manage both to hold to collect contractual cash flows and to sell certain financial assets. We believe that such a business model may have particular relevance to liquidity portfolios for the banking sector.

The proposed additional FVOCI category does enable more flexibility, particularly where the existing requirements may have required a FVTPL outcome due to more than infrequent or insignificant levels of sales.

We agree that under this proposed category that interest revenue, credit impairment and any gain or loss on de-recognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost, and all other gains and losses are recognised in OCI. This would minimise any unintended profit or loss volatility from measuring such assets at fair value.

Question 5 – Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

Broadly speaking we believe that the proposed application guidance examples do provide a sufficient amount of guidance to appropriately distinguish between the three business models.

However we have the following comment with respect to the proposed application examples when assessing a liquidity portfolio under the both hold to collect contractual cash flows and to sell business model.

In context of a Bank's liquidity portfolio business model, some elements of the portfolio may comprise of more than one business model and may be held and sold for many reasons including opportunistic circumstances or increased capital requirements. Therefore it is difficult to apply the proposed liquidity portfolio examples under a "one fits all" approach to a broader liquidity portfolio as that portfolio may comprise of different groups of products and business models.

Our interpretation of the current IFRS 9 requirements is that these respective business models can (and should) be considered separately at a lower level to ensure that the business model faithfully represents the way in which the financial assets are separately managed. Therefore, whilst we don't believe that there will be necessarily any counterintuitive outcomes in terms of the interpretation; we do feel that it is appropriate to highlight that in practice some financial institutions would perform this assessment at a much lower level than might be assumed from the application examples.

Question 6 - Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

We agree that the fair value option should also be extended to the newly proposed FVOCI measurement category.

Question 7 - Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (i.e. including all chapters)? If not, why?
Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

We agree with the prohibition on adopting the previous versions of IFRS 9 after six months from the date that the finalised version of IFRS 9 is completed.

In terms of adopting all of the completed chapters of IFRS 9 (once completed), we believe that Classification and Measurement and Impairment chapters should be adopted together as the accounting models are very much interrelated. However, we believe that the general Hedge Accounting chapter is capable of separate transition at a later date, as it is not as closely related to the other chapters, and will allow entities to adopt earlier the other chapters through a reduced implementation effort.

Also we understand that the IASB staff have been recently considering the need for additional transitional guidance for Insurers on the measurement of financial assets backing policy holder liabilities under IFRS 9 as at the implementation date of the future Insurance Contracts standard.[1] In Australia, the NAB Group applies AASB 1038 *Life Insurance Contracts* which requires any financial assets that are within the scope of IAS 39 (or AASB 139) that are backing life insurance or life investment contract liabilities ("policyholder liabilities") that are permitted to be designated at fair value through profit or loss to be designated as such. This approach ensures a consistent measurement approach to the policy holder liabilities, which are required under AASB 1038 to be measured under the present value measurement approach for life insurance liabilities and the fair value measurement approach for life investment contract liabilities.

We are concerned that the IASB staff's proposed transitional guidance to follow the reclassification guidance in IFRS 9 with some exceptions for insurers (i.e. Alternative 2 in the staff paper) may restrict the ability to properly reconsider the appropriate classification model for financial assets backing policyholder liabilities at the transition date to Insurance Contracts, which may cause the unintended consequence of creating or enlarging an accounting mismatch. We prefer the Alternative 1 suggestion in the staff paper that would permit insurers to classify such financial assets at Amortised Cost, Fair Value through profit

[1] Raised in IASB October 2012 meeting – Agenda paper 10C

or loss, or FVOCI, as if IFRS 9 had been initially applied at the same time that the insurance standard is applied. We encourage the IASB to further consider this transition issue as part of the Insurance Contracts project as we are concerned (particularly if IFRS 9 is early adopted) that there will be a significant time period between IFRS 9 and Insurance Contracts transition. This will make it increasingly difficult to appropriately assess the business model of policyholder backing financial assets at IFRS 9 transition date if the Insurance Contracts project is still not sufficiently progressed.

Question 8 - Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

We agree that these 'own credit' provision amendments should be able to be early adopted. In drawing a parallel with the premise of 'own credit risk' being recognised in OCI, within the IFRS 9 Hedge Accounting phase, we also believe that the IASB's recent expanded interpretation of 'costs of hedging' to incorporate FX basis spreads (i.e. currency basis risk for both cash flow hedges and fair value hedges) to be recognised in OCI should be subject to a similar allowance for early adoption once IFRS 9 is completed. Like 'own credit risk' we believe the currency basis risk volatility is accounting noise that will ultimately reverse over time and hence it is appropriate to measure this within OCI.

We also encourage the IASB to further consider (as a result of the FVOCI category introduction) the treatment of recycling any residual "own credit risk" gains recognised in OCI into profit and loss upon de-recognition of financial liabilities (For example in the scenario where an entity repays an amount other than the contractual amount). This would follow the proposed guidance under the new FVOCI category for financial assets and also the accounting treatment for extinguished liabilities carried at amortised cost.

Question 9 - Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

We do not have any specific comments regarding first-time adoption as it is not relevant to the NAB Group.

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ED 230 sub 4

Ian Laughlin
Member

11 March 2013

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
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London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst

ED/2012/4 Exposure Draft: Classification and Measurement: Limited Amendments to IFRS 9 (*Financial Instruments)*

On behalf of the Australian Prudential Regulation Authority (APRA) I am writing to comment on ED/2012/4 Exposure Draft: *Classification and Measurement: Limited Amendments to IFRS 9*. APRA is the Australian prudential regulator for all financial services entities that operate in Australia.

Insurers and pension funds in Australia have used fair value measurements for assets and liabilities on the balance sheet for over a decade. Banks use fair value measurement for derivatives, and trading book assets and liabilities. Amortised cost is used for most loans and deposits in the banking book.

APRA supports the existing classification and measurement model in IFRS 9 that requires that assets and liabilities be measured at fair value or at amortised cost in accordance with an entity's business model. This model reduces complexity with the reporting of financial instruments by Australian financial institutions.

If a third measurement category, namely fair value through other comprehensive income, is introduced in IFRS 9, APRA would strongly support the IASB proposal in the ED that allows the current fair value option in IFRS 9 (to measure assets and liabilities at fair value through profit and loss) to be extended to financial assets that would otherwise be mandatorily measured at fair value through other comprehensive income. This approach minimises the likelihood of accounting mismatches for those insurers and banks that presently use the fair value option in IAS 39 *Financial Instruments: Recognition and Measurement* for measuring assets and liabilities on the balance sheet.

APRA agrees that once the completed version of IFRS 9 is available, an entity should only be able to early adopt IFRS 9 in its entirety[1].

[1] Excludes the own credit requirements that may be adopted earlier.

APRA would also like to ensure that there be matching of assets and liabilities where possible. Hence, we believe that the effective dates of the proposed insurance contracts standard and IFRS 9 need to be aligned for insurers. At present, our expectation is that insurers will have to implement two major changes in their financial statements within a few years of each other unless the IASB aligns the effective dates. This would create a significant reporting burden on preparers

We trust these comments are helpful to the IASB.

Yours sincerely

cc: Mr Kevin Stevenson – Chair and CEO AASB