ED230 sub 5

26 March 2013

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

Dear Mr Hoogervorst,

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

Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Securities Exchange. Our operations are predominately based in Australia, New Zealand and the Asia Pacific region. Our most recent annual results reported profits before tax of US$5.9 billion and total assets of US$672 billion.

We welcome the opportunity to comment on this exposure draft (ED) and overall we are supportive of the proposals as outlined. This ED further demonstrates the IASB's willingness to listen and respond to the issues raised by constituents.

We support the Board's decision to permit entities to early adopt the changes to account for the own credit risk part of liabilities using Fair Value Option in Other Comprehensive Income (OCI) without requiring early adoption of the remainder of IFRS 9 as we think that it is a significant improvement to current accounting. However, we think that own credit risk should be recycled to Profit and Loss upon settlement of the liability rather than being transferred within equity. This will ensure consistency with accounting for extinguished liabilities measured at amortised cost as well as recycling requirements for debt instruments measured at fair value through OCI.

We welcome the creation of a third category of measurement (fair value through OCI) but do have concerns in relation to the creation of a third business model to accommodate the application of this category. We feel this adds a further level of complexity that will require significant judgement to apply and is likely to lead to divergence in practice. As an alternative, we believe the IASB could achieve its objective by allowing an entity to utilise the fair value through OCI category as an election subject to certain conditions, much the same as the fair value through profit and loss election that currently exists. This would enable entities to classify instruments in a manner meaningful to their business model without adding the complexity of a third business model.

Finally, we believe the IASB should revisit their approach to assessing economic mismatch in instances where a regulatory body prescribes the interest rate used. In such instances, we propose that the ED is amended to permit the benchmark rate used to assess the modified cash flows to be the rate specified in the regulated market.

Detailed comments on the questions raised in the ED are attached to this letter. Should you have any queries on our comments, please contact me at Shane.Buggle@anz.com

Shane Buggle
Deputy Chief Financial Officer

Copy: Chairman, Australian Accounting Standards Board (AASB)

Appendix: Detailed comments on the questions raised by the IASB on the ED

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 appreciate the IASB has sought to clarify that the existence of a 'modified economic relationship' does not automatically result in the financial instrument being measured at fair value through profit and loss. We agree that is it important to consider the economic characteristics of financial instruments as part of the classification criteria and believe the financial instruments with a modified economic relationship should be assessed at origination/acquisition to determine if they contain cash flows other than payments of principal and interest.

We believe the general rule proposed in the ED should be amended in instances of rate-regulated markets. Retail banks generally originate loans to hold until maturity (i.e. not to sell) and measure and manage those assets at amortised cost. The application of the requirements of the ED could result in a number of loans products in certain jurisdictions to be measured at fair value as they are subject to a rate regulated environment. For example, in certain Asian countries in which we operate, the local regulator mandates the interest rate for certain financial instruments e.g. unsecured personal loans or credit cards. The regulator can mandate a single rate to be charged, or it may establish a maximum rate that can be charged irrespective of credit conditions. Consequently, an instrument that management would consider 'vanilla' could be mandatorily measured at fair value through profit and loss. This would lead undesirable earnings volatility and depending on the regulated interest rate at the time of origination, certain vintages of the a product may (at origination) satisfy the requirements to be held at amortised cost, while the same product originated in another period may need to be held at fair value. In such instances, we propose that the ED is amended to permit the benchmark rate used to assess the modified cash flows to be the rate specified in the regulated market.

We also do not agree with the proposed threshold (more than insignificantly different) used to assess the impact of the modified economic relationship. The requirement of assessment of cash-flow characteristics could be necessary for instruments with any degree of complexity, possibly on an instrument by instrument basis. This assessment would need to identify a reliable (or determine a hypothetical) benchmark which is likely to add complexity and may result in diversity in practice. We believe that the threshold should be changed to be the same test as for determining whether a liability contains an embedded derivative (the so called "double-double test" contained with IAS 39 paragraph AG33 (a)) because this is already understood and implemented in practice.

Notwithstanding the comment above, should the Board consider it more appropriate to retain the 'insignificant impact test', we feel that the term 'insignificant' should be clearly defined to remove potential ambiguity and subjectivity.

Whilst not specifically requested by the Board, we note that the definition of 'interest' in paragraph B4.1.8A of the ED is not aligned with the definition of interest contained in paragraph BC4.22 in IFRS 9. Paragraph BC4.22 specifically recognises premiums for liquidity risk are included within the meaning of interest for the purposes of assessing the contractual cash flows. We believe that the definition of interest in BC4.22 is appropriate and recommend that B4.1.8A be amended accordingly.

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?

Subject to our comments in response to question 1 above, we believe the updated guidance provided in the ED is sufficient to assess a modified economic relationship. We feel that the guidance could be enhanced by including a numerical example that would demonstrate an acceptable method of performing the analysis.

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?

We welcome the proposed amendment and believe that it will assist with the identification of financial assets with the contractual cash flow characteristics assessment (subject to our comments on question 1 above).

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 derecognition 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 support the Board's decision to introduce a third measurement category for financial assets (fair value through OCI) as the existing IFRS 9 classification and measurement framework does not currently accommodate the Australian banking industry 'hold to collect and sell' business model around financial assets held for liquidity purposes. The new category will eliminate the current inconsistency which requires assets managed under a 'hold to collect and sell' business model (e.g. liquidity portfolios) to be accounted for on the same basis as, for example, trading securities held for short-term profit taking.

We would however like to highlight the potential impact of applying the expected loss impairment model to assets measured at fair value through OCI as proposed by paragraph 5.2.2 of the ED. We have interpreted this paragraph to require a provision for credit impairment be established on day 1 for assets measured at FVOCI in line with the proposed requirements for assets carried at amortised cost. This would require a provision for credit losses to be established (equal to 12 months of expected loss) on day 1, even though the assets purchase price would include the market consensus on credit risk specific to that asset. In light of the above, we would ask that the Board clarify the interaction between this ED and the proposed impairment standard. We believe that the reference to the credit impairment should be limited to determining when an entity would be required to recycle the accumulated reserve to Profit and Loss when the asset experiences an impairment event (as defined within the impairment ED).

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?

While we support the addition of a fair value through OCI category for debt instruments, we do not support the mandatory nature of the classification by the creation of the third business model. We believe it more appropriate for this category to be utilised by way of election – with an entity permitted to choose to hold debt instrument at either fair value through Profit and Loss, or at fair value through OCI where the instrument neither meets the requirements to be held at amortised cost nor is held for trading purposes.

The justification for an election in respect of that the mandatory classification is as follows:

- The third business model adds confusion to IFRS 9. While it is easy to articulate and understand the two models at either ends of the spectrum (hold to collect and hold for sale), the introduction of the middle category will only blur the lines when assessing the appropriate classification for debt instruments.

- It will allow an entity to manage any accounting mismatch while still allowing flexibility in relation to how they manage the underlying assets.

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?

As per our response to question 5 above, if an entity has a choice to adopt either fair value through OCI or fair value through profit and loss for basic debt instruments where the business model is not to hold to collect cash flows it will eliminate the need to elect the fair value option for these instruments.

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 proposal that an entity early adopting IFRS 9 after the completed version is issued should be required to apply the completed version of the standard as this would ensure higher level of comparability.

We also agree with the six-month transition period. We believe this will provide an important relief for those entities who are preparing to early adopt IFRS 9 before the completed version is issued while ensuring no large scale divergence in reporting takes place in the industry.

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?

Yes, we fully support the Board's decision to permit entities to early adopt just the changes to account for the own credit risk part of liabilities using Fair Value Option in OCI as we think that it is a significant improvement to current accounting. However, we think that own credit risk should be in Profit and Loss upon settlement of the liability rather than being transferred within equity. This will ensure consistency with accounting for extinguished liabilities measured at amortised cost as well as recycling requirements for debt instruments measured at fair value through OCI.

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 have no comment in relation to this question.

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27 March 2013

Dear Mr Hoogervorst,

Exposure Draft ED/2012/4 - *Classification and Measurement: Limited Amendments to IFRS 9*

We are responding to the IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*. Our responses to the questions included within the consultation document are provided in the attached Appendix.

We agree with the proposal to introduce a third measurement category of fair value through other comprehensive income. However, we consider that it would be more robust to clearly define the boundaries of the three business models using the two models that commonly exist in practice (investments held solely for their yield, and investments held solely for sale), and for the third model be defined as the residual category (investments held for any other purpose or mix of purposes). This approach would be easier to understand and apply in practice.

If you have any questions in relation to this submission, please do not hesitate to contact me at +61 2 8232 5193.

Yours sincerely

Frank Palmer

Frank Palmer
Accounting Policy & Advisory Team Leader
Macquarie Group Limited

About Macquarie Group

Macquarie Group is a global financial services provider. It acts primarily as an investment intermediary for institutional, corporate and retail clients and counterparties around the world.

Macquarie has built a uniquely diversified business. It has established leading market positions as a global specialist in a wide range of sectors, including resources, agriculture and commodities, energy and infrastructure, with a deep knowledge of Asia-Pacific financial markets.

Alignment of interests is a longstanding feature of Macquarie's client-focused business, demonstrated by its willingness to both invest alongside clients and closely align the interests of shareholders and staff.

Macquarie's diverse range of services includes corporate finance and advisory, equities research and broking, funds and asset management, foreign exchange, fixed income and commodities trading, lending and leasing and private wealth management.

Macquarie Group Limited is listed in Australia (ASX:MQG; ADR:MQBKY) and is regulated by APRA, the Australian banking regulator, as the owner of Macquarie Bank Limited, an authorised deposit taker. Macquarie also owns a bank in the UK, Macquarie Bank International Limited, which is regulated by the FSA.

Founded in 1969, Macquarie employs more than 13,400 people in 28 countries. At 30 September 2012, Macquarie had assets under management of $A341 billion.

APPENDIX

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?

Yes, we agree that a financial asset with a modified relationship could be considered to contain cash flows that are solely payments of principal and interest. The benchmark test allows for the application of professional judgment to new product innovation, and we anticipate in many straight forward cases to mean the cash flows are solely payment of principal and interest when that is the substance of the instrument.

We would prefer for the test to be symmetrical to that used under IFRS 9 for determining whether financial liabilities contain embedded derivatives. There is no conceptual basis for having a different test for modifications of financial assets compared to financial liabilities.

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?

We consider the guidance of 'not more than insignificant' is sufficient to understand the assessment. For some instruments the assessment may be difficult and judgmental including using unobservable inputs and estimates.

We recommend including an example of an instrument where the cash flows change during the term of the contract. We also suggest including an example of an asset containing common features, such as caps, floors, extension or prepayment options, and specifically whether the 'comparable' asset should also have this feature or should the entire asset be treated as a modified asset.

As stated in Question 1, we prefer a symmetrical test to be used for financial assets that would be similar to that used for determining whether financial liabilities contain embedded derivatives under IFRS9 para 4.3.5.

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 it will meet the objective where there are interest rate mismatches. We ask for the clarifying examples mentioned in our response to Question 2.

Business model assessment: the 'fair value through other comprehensive income' measurement category for financial assets that contain contractual cash flows that are solely payments of principal and interest

The Exposure Draft proposes that some financial assets should be mandatorily measured at fair value through OCI,[1] specifically, financial assets held within a business model in which assets are managed both in order to collect contractual cash flows and for sale (subject to the contractual cash flow characteristics assessment; i.e. these are debt instruments). Under the proposals, interest revenue, credit impairment and any gain or loss on derecognition would be recognised in profit or loss; all other gains or losses (i.e. the difference between these items and the total change in fair value) would be recognised in OCI.

Interest income and credit impairment would be computed and recognised in the same manner as for financial assets measured at amortised cost.[2] Cumulative gain or loss recognised in OCI would be reclassified to profit or loss when the financial asset is derecognised. That would result in amortised cost information being provided in profit or loss and fair value information being provided in the statement of financial position. The Exposure Draft proposes application guidance on how to determine whether the business model is to manage assets both to collect contractual cash flows and to sell. In addition, the Exposure Draft proposes clarifications to the application guidance in IFRS 9 on what is a 'hold to collect' business model.

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 derecognition 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?

Overall, we agree certain financial assets should be measured at fair value through other comprehensive income (FVTOCI). We comment below in Question 6 that this should not be mandatory, but rather these instruments should be given an unrestricted option to be measured at fair value through profit or loss (FVTPL).

Contrary to the IASB's proposal of defining the business model associated with FVTOCI as being those assets managed both in order to collect contractual cash flows and for sale,

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[1] This is different from the irrevocable option in IFRS 9 to present fair value gains and losses on an equity instrument that is not held for trading in OCI.

[2] For the purpose of recognising foreign exchange gains and losses under IAS 21 *The Effect of Changes in Foreign Exchange Rates*, a financial asset classified at the proposed 'fair value through OCI' category is treated as if it were measured at amortised cost in the foreign currency. Accordingly, exchange differences resulting from changes in amortised cost are recognised in profit or loss.

we consider the model should be described as the residual - neither solely for principal and interest, nor solely for sale. The three business models should be very clear so as to distinguish an instrument's classification because this drives its measurement. Consider an investment that is to be held for principal and interest but may be sold if an appropriate offer were received or the prudential capital requirements were to become unsatisfactory. We consider that it would be more robust to identify the three business models as those investments held: a) solely for their yield; and b) solely for sale purposes; and c) for any other purpose or a mix of purposes to be carried at FVTOCI. This approach to defining the business models would be simpler to apply in practice due to the need to interpret the boundaries of only two definitions and these two definitions capture the most commonly encountered distinct business models used in practice.

If the IASB continues with three definitions, then we believe more guidance is needed because there are many, and sometimes no apparent, reasons for a sale to occur. See our response to Question 5.

We also consider it important to resolve the use of OCI and whether to recycle fair value gains or losses in OCI to profit or loss on disposal. Proposing recycling of OCI for debt investments but disallowing recycling for equity investments measured at FVTOCI (and disallowing recycling for the own credit component of designated FVTPL liabilities) is confusing for users as it is a rule without a logical rationale. We note that the IASB will consider the use of OCI and recycling in its Concepts project. We recommend maintaining the use of recycling for all investments carried at FVTOCI (as is the case today under IAS39 for available-for-sale investments) until the IASB resolves the conceptual issue.

Currently under IAS 39, if an Available-for-Sale investment is impaired then the reserve is recycled to profit or loss. The credit impairment proposals for certain debt instruments carried at FVTOCI will introduce more complexity but we consider give users more useful information than currently under IAS 39. It will satisfy those users in need of fair value information as well as other users in need of amortised cost information.

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?

As discussed above, using three business models can be complex. In particular, the proposed FVTOCI business model is particularly complex and requires more guidance for there to be a clear distinction to be operational. We do not consider the proposed definition of the FVTOCI business model to be operational. The definition raises many judgmental issues, such as how many sales will be acceptable and identifying the reasons for the sales when no apparent reason may in fact exist.

We consider the application guidance is clear for the situations described, but it is not sufficient to be operational, because it does not establish a principle for determining acceptable reasons (or volumes) of sales. More examples are needed to address situations when an investment (e.g. with a 5 year term) is to be held for collecting principal and interest, but may be sold for these reasons - an unsolicited offer is received at an attractive price, an opportunity arises to reinvest in an alternative asset providing either increased income requiring less prudential capital, or for asset and liability management purposes (e.g. to manage interest rate risk).

The Exposure Draft proposes that the existing fair value option in IFRS 9 should be available for financial assets that would otherwise be mandatorily measured at fair value through OCI. That is, the Exposure Draft proposes that an entity would be permitted to designate such a financial asset as measured at fair value through profit or loss if, and only if, such a designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch'). In accordance with the existing fair value option in IFRS 9 such designation would be performed at initial recognition and would be irrevocable.

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?

Yes, we agree this option should be available because it would assist in addressing accounting mismatches. We recommend the IASB work with the US FASB to align the requirements for using FVTPL. To this end, we prefer the US FASB approach of mandatorily classifying investments held solely for sale to be FVTPL and having an unrestricted option to classify an investment in certain debt instruments managed on a fair value basis to be FVTPL.

We encourage the IASB to consider amending paragraph 6.5.3 of the IASB Staff Draft for general hedge accounting to allow hedge ineffectiveness be recognised in OCI where the hedged item is a debt instrument measured at FVTOCI. This would give symmetry to the treatment for an equity investment carried at FVTOCI that is designated as a hedged item.

Early application

At present, more than one version of IFRS 9 can be applied early: that is, an entity is permitted to apply either the classification and measurement requirements for financial assets only (i.e. IFRS 9 issued in 2009) or to apply the classification and measurement requirements for both financial liabilities and financial assets (i.e. IFRS 9 issued in 2010). The Exposure Draft proposes that only the completed version of IFRS 9 (i.e. including Classification and Measurement, Impairment and General Hedge Accounting chapters) can be newly applied prior to the mandatory effective date (except as described in question 8 below).[3] This proposed amendment would become effective six months after the completed version of IFRS 9 is issued.

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

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[3] Entities that have already applied an earlier version of IFRS 9 by the time these proposed transition provisions become effective will be permitted to continue to apply that version until the mandatory effective date of IFRS 9 or until the entity chooses to early apply the completed version of IFRS 9.

> 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?

Yes, we agree. Due to delays being experienced in issuing a final IFRS9, we recommend an extension to when the final IFRS9 is to be first applied. Extending the mandatory application date to periods beginning on or after 1 January 2016 will allow preparers sufficient time for implementing the standard, assuming all elements (including impairment) and related standards such as Insurance are finalised in 2012. Considering the IASB's time between finalising the Revenue standard and its plan for mandatory application, our suggestion for IFRS9 is considered reasonable.

> **Presentation of 'own credit' gains or losses on financial liabilities**
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> Notwithstanding the proposed transition requirement above, once IFRS 9 is completed, an entity will be permitted to early apply only the 'own credit' provisions in IFRS 9, which require an entity to present in other comprehensive income fair value gains or losses attributable to changes in the credit risk of financial liabilities designated as measured at fair value through profit or loss, without otherwise changing the classification and measurement of financial instruments.
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> **Question 8**
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> 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?

Yes, we agree. 'Own credit' is an area of much interest and therefore we recommend the proposals be made available sooner through a limited amendment to IAS 39.

> **First-time adoption**
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> This Exposure Draft does not propose any specific changes to IFRS 1 *First-time Adoption of International Financial Reporting Standards* for first-time adopters of IFRS. However, to make sure that first-time adopters are given sufficient lead time to apply IFRS 9 and are not at a disadvantage in comparison to existing preparers, the IASB intends to consider the transition to IFRS 9 for first-time adopters when these proposals are redeliberated.
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> **Question 9**
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> 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?

No