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15 July 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
First Floor, 30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Submitted electronically through the IASB Internet site (www.iasb.org)

Dear Sir David

Exposure Draft ED/2010/4: Fair Value Option for Financial Liabilities

Thank you for the opportunity to comment on this Exposure Draft (ED). Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Securities Exchange and remains one of a select group of banks who continue to be AA rated. Our operations are predominantly based in Australia, New Zealand and Asia and our most recent annual results reported profits of USD2.6 billion and total assets of USD418 billion.

Summary

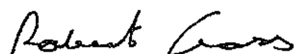
Overall we support the proposed approach and believe that in most circumstances this would enhance the credibility of reported statutory profit or loss. However, there are a number of areas which we would encourage the Board to consider prior to the finalisation of the ED. These are summarised below with more detail included the appendix to this letter:

- Whilst we support unrealised credit related fair value changes on financial liabilities designated into the fair value through profit or loss (FVTPL) being recognised in Other Comprehensive Income (OCI) the same treatment should not be applied to realised gains or losses, which should be recognised in profit or loss.
- We are not supportive of the requirement that entities wishing to early adopt this limited amendment to IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) be required to early adopt IFRS 9 *Financial Instruments* (IFRS 9). In our view, given the discrete impact that this proposed amendment will have on the reported results, the level of comparability between preparers would not be noticeably impacted whether or not the adoption is dependant on the early adoption of IFRS 9.
- In our view, presenting the total change in fair value of the liability in profit or loss and then showing the transfer to OCI would unnecessarily complicate the Income Statement. Transparency regarding the movement in the financial liability is achieved through other disclosure requirements.
- We are supportive of the alternative approach set out in BC20. In our view, the ability to eliminate an accounting mismatch through this irrevocable designation would enhance preparers' ability to more faithfully present their activities. Any loss of comparability between preparers would be mitigated through disclosure. Furthermore, this is consistent with existing options provided in IAS 39 / IFRS 9 to eliminate other accounting mismatches.

- Whilst we are supportive of the decision to retain the guidance around bifurcating embedded derivatives in financial liabilities we believe that the basis for the inconsistency between financial assets and financial liabilities is not justified. We strongly support the retention of the ability to bifurcate embedded derivatives from BOTH financial asset and financial liabilities and ask the Board reconsider the decision to remove this requirement from IFRS 9.

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 Rob.Goss@anz.com.

Yours sincerely



ROB GOSS
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Copy: Chairman, Australian Accounting Standards Board (AASB)

Appendix

Question 1 – Do you agree that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss? If you disagree, why?

We agree that changes in credit risk of all financial liabilities designated under the fair value option should not affect profit or loss, except as noted in our response to Question 2 and Question 7.

Question 2 – Or alternatively, do you believe that changes in the credit risk of the liability should not affect profit or loss unless such treatment would create a mismatch in profit or loss (in which case, the entire fair value change would be required to be presented in profit or loss)? Why?

We are supportive of the alternative approach which permits limited irrevocable designation for all changes in the fair value of the financial liability to be recognised in profit or loss only where this eliminates an accounting mismatch.

For example, a Special Purpose Vehicle (SPV) may be created and issues liabilities to third parties that are contractually linked to the assets held in the SPV. These may be designated at fair value in order to reduce the accounting mismatch where the assets in such consolidated entities are fair valued. The liabilities issued by the SPV are generally not sensitive to the credit risk of the issuer as the assets in the SPV are generally legally isolated. As the ED currently stands, 'the changes in credit risk of the liability' would offset the changes in credit risk of the asset. As the latter is recognised in the profit or loss we believe an entity should be permitted to irrevocably designate that all fair value changes in the liability be recognised in the Income Statement so as to avoid the accounting mismatch.

This would enhance preparers' ability to more faithfully present their activities and any loss of comparability between preparers would be mitigated through disclosure.

Furthermore, this is consistent with existing options provided in IAS 39 / IFRS 9 to eliminate other accounting mismatches.

Question 3 – Do you agree that the portion of the fair value change that is attributable to changes in the credit risk of the liability should be presented in other comprehensive income? If not, why?

We agree with the proposal that changes in fair value arising from credit risk be presented in OCI, subject to the exceptions noted in questions 2 and 7.

Without qualifying our support for the proposal we encourage the Board to continue with its deliberation on a framework which sets out a clear principal on what is recognised in OCI and whether or not it should be recycled out of OCI into earnings or equity.

Question 4 – Do you agree that the two-step approach provides useful information to users of financial statements? If not, what would you propose instead and why?

No, we believe that it unnecessarily complicates the Income Statement. In our view, no information is lost by applying the one-step approach because the information necessary to understand the total change in fair value as well as the components of the change can be obtained from the Income Statement and the Statement of Other Comprehensive Income.

Question 5 – Do you believe that the one-step approach is preferable to the two-step approach? If so, why?

Yes, for the reasons set out above.

Question 6 – Do you believe that the effects of changes in the credit risk of the liability should be presented in equity (rather than in other comprehensive income)? If so, why?

Remeasurement of assets and liabilities should not be presented directly in equity because remeasurements meet the definition of gains or losses and are not transactions with equity holders. We do not believe that the portion of the fair value change that is attributable to changes in the credit risk of the financial liability should be recorded in equity as this contradicts the overriding concept that equity represents the residual interest in the assets after deducting all of the liabilities.

Question 7 – Do you agree that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income (or included in equity if you responded 'yes' to Question 6) should not be reclassified to profit or loss? If not, why and in what circumstances should they be reclassified?

We are not supportive of this approach and believe all gains or losses arising on derecognition of the financial liability (including those relating to credit) should be recognised in the Income Statement. This is because extinguishment of a financial liability prior to its maturity date effectively represents a realisation of the issuer's credit risk. It would be inconsistent and counterintuitive for the gain or loss on derecognition of a financial liability recorded at amortised cost to be recorded in profit or loss but not the same gain or loss just because the liability has been designated at FVTPL.

Question 8 – For the purposes of the proposals in this exposure draft, do you agree that the guidance in IFRS 7 should be used for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk? If not, what would you propose instead and why?

Yes. We believe that this approach is generally understood and would assist in the implementation of this proposed change. This would also assist preparers to apply the ED retrospectively.

We are also supportive of the Board permitting alternative approaches to be used to measure the credit risk of the liability where an entity can demonstrate that it faithfully represents the amount of change in the fair value that is attributable to changes in the financial liability's credit risk.

Question 9 – Do you agree with the proposals related to early adoption? If not, what would you propose instead and why? How would those proposals address concerns about comparability?

We are not supportive of the requirement that entities wishing to early adopt this limited amendment to IAS 39 be required to early adopt IFRS 9.

This proposed amendment is equally applicable to entities that continue to apply IAS 39 as to those entities that have early adopted IFRS 9. As the impact of adopting IFRS 9 has a significant impact on an entities financial position and financial performance, the decision to early adopt is not straight forward. Given the discrete impact that this proposed amendment has on the financial statements, a user could compare the results of an entity that has adopted the proposed amendment to an entity that is yet to adopt the proposed amendment. In our view, the level of comparability between preparers would not be noticeably impacted whether or not the adoption is dependant on the early adoption of IFRS 9.

Question 10 – Do you agree with the proposed transition requirements? If not, what transition approach would you propose instead and why?

Yes. However, should the Board permit an entity to adopt this proposal and not early adopt IFRS 9 (refer to question 9) we would encourage the Board to permit the redesignation of existing financial liabilities into or out of the FVTPL category at the date an entity adopts this amendment.

Other comments

Whilst we are supportive of the decision to retain the guidance around bifurcating embedded derivatives in financial liabilities we believe that the basis for the inconsistency between financial assets and financial liabilities is not justified. We strongly support the retention of the ability to bifurcate embedded derivatives from BOTH financial asset and financial liabilities and ask the Board reconsider the decision to remove this requirement from IFRS 9.