ED230 sub 5

ANZ

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.