5 July 2013

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

Dear Mr Hoogervorst,

Re: ED/2013/3 'Financial Instruments: Expected Credit Losses'

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 acknowledge the significant progress the International Accounting Standards Board (IASB) has made in relation to the ongoing development of a final standard in relation to credit losses, specifically we welcome the Board's positive action in simplifying the proposed standard since the initial exposure draft (ED) and the subsequent supplementary document (SD). We further acknowledge the progress the Board made with the Financial Accounting Standards Board (FASB) in producing a converged standard up to the point the FASB decided to pursue their own option.

However, ANZ does not support the ED on expected credit losses in its current form due to the significant complexity created by the requirement to track credit quality of individual exposures (even across one obligor) throughout the life of a financial instrument. We have estimated the cost associated with the development and implementation of a system to track such information to be approximately USD50 million with a lead-time of 24-30 months to complete. Furthermore, the sole purpose of such a system would be to ensure compliance with the financial reporting requirements under IFRS and would not be used for credit risk management purposes.

We believe this and our other concerns raised in this letter can be addressed without fundamental changes to the proposed standard. Our recommendations not only significantly reduce the cost and timeframe of implementation but, in our view, will lead to better alignment of the standard with current credit risk management practices.

Tracking credit quality over loan life

The changes in credit quality of an individual financial instrument from inception and over its life is currently not recorded within credit systems, and the performance relative to origination quality is not seen as an important tool in the management of credit risk. Credit risk management is more focussed on the current credit risk rating of the obligor, rather than the current state compared to its origination credit rating.

To overcome these significant operational issues, we believe that the proposed standard should be amended to align the migration point between bucket 1 and buckets 2 and 3 to an entity's existing portfolio risk appetites and credit writing policies approved by the entity's Key Management Personnel. Under this proposal, the threshold for migration to lifetime expected losses (i.e. the tipping point from measurement of expected losses from a 12 month to lifetime basis) would be where an obligor's current rating fell below the poorest rating that an entity would originate a new instrument to an entity with a similar credit characteristics based on internal standard risk tolerances.

Therefore, once an obligor's credit rating decreases below the origination cut-off point, the deterioration is considered 'significant' even though the relative level of decline to this point since inception will be different for different obligors. We believe entities internal credit origination thresholds represent an appropriate point at which to base the change in measurement period for expected credit losses. Sufficient rigour is applied to the determination of the levels and they form an important pillar of internal credit risk management policy. In addition, they are set at a granular level so as to enable application across loan classes (for example, limits are set for each relevant Basel asset class).

Such an approach would significantly reduce the operational complexity and judgemental interpretation of 'significant deterioration'.

Minimum 12 month expected loss

We agree with the IASB that the 12-month time horizon for the calculation of expected losses[1] lacks conceptual merit. To develop a conceptual basis for a time period, we believe the notion of an emergence period could be introduced. That is, the average time between the date when a loss event occurs (e.g. the obligor is retrenched) and the significant deterioration takes places. We believe the notion of an emergence period introduces a conceptual basis for the time period used to determine the measurement period used to determine the level of credit losses on instruments that have not experienced significant deterioration in credit quality.

Emergence periods vary across portfolios and can be determined with a degree of confidence by analysis of the defaults experienced on the underlying portfolio. Ranges of 12 to 24 months are common, and in extreme circumstances may extend to 30 months. For a practical expedient, we believe the IASB could propose that the emergence period is 12 months be a rebuttable presumption - rebuttable where an entity has sufficient data to support an alternative *longer* duration.

We believe the above would provide a conceptual basis for the duration used to calculate expected loss prior to a significant deterioration in credit rating without placing a significant burden on preparers in through the rebuttable presumption.

Application to debt instruments held at fair value through other comprehensive income

We strongly disagree with the proposed requirement to apply the general impairment model to debt instruments held at fair value through other comprehensive income (FVOCI). A debt instrument purchased at fair value already incorporates the markets view of credit risk inherent in that instrument. Therefore, the requirement for an entity to make a further adjustment for credit risk is counter intuitive and contrary to the fair value requirements of IFRS 13 Fair Value Measurement.

We believe the IASB could look to the practical expedients contained within the FASB model on expected credit losses to overcome these conceptual issues.

Convergence

[1] IASB Exposure Draft paragraph BC 61 "…The IASB acknowledges that this is an operational simplification, and that there is no conceptual justification for the 12-month time horizon."

Finally, we would ask the IASB to continue to work with the FASB in attempting to reach common ground in relation to the credit impairment model as divergence on this issue would create a significant impediment to the goal of developing a single set of high quality global financial reporting standards.

We stress that it would be counterproductive to require reconciliation between the IFRS and FASB models within IFRS financial statements if convergence were not achieved. Currently we perform reconciliations between IFRS and regulatory credit loss provision balances, and the introduction of a third reconciliation would only confuse users and place undue burden on preparers to calculate credit losses under different models.

We are supportive of the other proposals contained with the proposed standard and encourage the Board to consider our proposed simplifications which we believe will result in a high quality standard that achieves the Boards stated objectives in relation to this topic, and can be implemented at a reasonable cost and timeframe.

Should you have any queries on our comments, please do not hesitate to contact me at shane.buggle@anz.com.

Yours sincerely

Shane Buggle
Deputy Chief Financial Officer

Copy: Chairman, Australian Accounting Standards Board (AASB)

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APPENDIX 1

Question 1
(a) Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect: (i) the economic link between the pricing of financial instruments and the credit quality at initial recognition; and (ii) the effects of changes in the credit quality subsequent to initial recognition? If not, why not and how do you believe the proposed model should be revised? (b) Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not?

a) We believe the proposed approach outlined in the ED does not reflect the economic link between the pricing of financial instruments and their credit quality at initial recognition. The pricing of financial instruments includes a risk premium that reflects the expectation of lifetime credit losses on that instrument. Economically, credit risk premiums incorporated in the yield compensate banks for the credit losses they expect to suffer over the life of financial assets. As such, the proposed approach does not reflect this economic relationship between pricing and credit quality and leads to a mismatch between the recognition of income and credit losses on the instrument. However, we acknowledge that this mismatch is necessary in order to simplify the credit-provisioning model to enable it to be practically implemented.

The ED explains how credit losses are calculated prior to and on significant increase in credit risk of financial assets. We acknowledge that the IASB recognises there is no conceptual basis why a loss allowance equal to 12-month expected losses is an appropriate duration for recording initial credit impairment for all financial assets that have not suffered a significant increase in credit risk. In our response to Question 4, we outline how a principal based approach could be adopted when establishing the time period adopted for the measurement of credit losses on financial assets that have not experienced a significant deterioration in credit quality.

In respect of the effects of changes in credit quality, we believe that the migration of a financial instrument from a 12 month expected loss to a lifetime expected loss following a significant deterioration in credit quality does adequately reflect the underlying performance of that instrument.

Although we do note there are theoretical shortcomings of the proposed standard, we do feel the current proposal (subject to our recommendations) does achieve a reasonable balance between the costs to implement versus the quality of information provided compared to alternative methods.

b) We agree that recognising a lifetime expected loss on initial recognition discounted using the original effective useful life does not faithfully represent the underlying economics of financial instruments. As outlined above, the compensation for credit risk is realised over the life of a financial instrument via the credit-adjusted yield and this proposal would require all the expected losses arising on that instrument to be realised upfront.

While we see such a model as simplistic in both its design and execution, it lacks any theoretical justification and is likely to have unintended consequences on the growth of new business and the issuance of long dated financial instruments.

Question 2
(a) Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why? (b) Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)? (c) Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft?

a) As noted in our response to Question 1 above, we agree the proposed approach (subject to our recommendation on tracking credit quality and the period over which expected losses are determined) achieves an appropriate balance between the faithful representation of the underlying economics and the cost of implementation.

b) We agree that the proposed approach achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD. However, we note that some of the proposals in the SD could result in a better alignment of accounting for credit losses and risk management practices of reporting entities than the proposals in the ED. Specifically we feel that the proposals from the SD to align the migration from the 'good' to the 'bad' book to internal credit management practices is superior to the current proposals. We have further elaborated on this in our response to question 5.

c) No. As highlighted in our response to Question 1 above, although such approach may be operationally simplistic it will result in a significantly less faithful representation of the underlying economics of financial assets compared to the approach proposed in the ED.

Question 3
(a) Do you agree with the proposed scope of this Exposure Draft? If not, why not? (b) Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the Classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft? Why or why not?

a) We agree with the proposed scope of the ED.

b) We strongly disagree with the proposed requirement to apply the general impairment model to debt instruments held at fair value through other comprehensive income (FVOCI). A debt instrument purchased at fair value already incorporates the markets pricing of credit risk inherent in that instrument. Therefore, the requirement for an entity to make a further adjustment for credit risk is counter intuitive and contrary to the fair value principles established in IFRS 13 Fair Value Measurement.

We encourage the IASB to consider alternative impairment requirements for this category of financial assets that will be capable of addressing the issues discussed above.

We note that FASB's expected loss model partially addresses the issues raised above by allowing a practical expedient for financial assets at FVOCI when expected credit losses are insignificant. We believe the following approach would be operationally viable and would result in meaningful information about financial assets at FVOCI:

- no credit losses should be recognised on financial assets with fair values above the amortised cost; and
- when the fair values fall below the amortised cost and the expected credit losses are significant, an amount equal to expected credit losses should be reclassified from OCI and recognised as an impairment loss in profit or loss.

Question 4
Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?

Subject to our recommendations, we agree that the measurement of a provision equal to 12 month expected credit loss is operational. However, we do not believe the 12-month time horizon for the calculation of expected losses has conceptual merit. To develop a conceptual basis for a time period for the purposes of an initial expected loss calculation, we believe the notion of an emergence period could be introduced. The emergence period should reflect the time between the date when a loss event occurs (e.g. obligor is retrenched) and the significant deterioration takes places. We believe this introduces a conceptual basis for the period of time expected losses are calculated on for instruments that are not subject to significant deterioration since origination.

Emergence periods vary across portfolios and can be determined with a degree of confidence by analysis of the defaults experienced on the underlying portfolio. Ranges of 12 to 24 months are common, and in extreme circumstances may extend to 30 months. For a practical expedient, we believe the IASB could propose that the emergence period is 12 months be a rebuttable presumption - rebuttable where an entity has sufficient data to support an alternative *longer* duration.

We believe the above would provide a conceptual basis for the calculation without placing a significant burden on preparers in relation to data requirements.

Question 5
(a) Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer? (b) Do the proposals provide sufficient guidance on when to recognise lifetime expected credit losses? If not, what additional guidance would you suggest? (c) Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer? (d) Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?

(e) Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not, and what would you prefer?

a) No, we do not agree that the proposed requirements to recognise a loss allowance at an amount equal to the lifetime expected credit losses on the basis of a significant increase in credit risk **since initial recognition**. We have two primary areas of concern:

- The current proposal is not operationally implementable without a significant system cost and prolonged lead-time. We have estimated a cost of approximately USD50 million, and a lead time of 24-30 months to develop, build and implement a system for the primary purpose of compliance with the *current* version of the accounting standard; and

- Financial institutions do not manage credit risk based on migration of credit quality, but rather on the absolute level of credit quality at a point in time. Our current credit risk systems do not retain origination credit quality, as it is not considered critical to the management of credit risk as origination credit quality is just one set of point in time data (albeit an important one). Following origination, important information (updated financial and behavioural information) is available to assess the credit standing / rating of an obligor.

We believe the IASB could resolve the two most significant issues with the proposed standard by aligning the requirements in the ED with existing credit risk management practices. We believe that the proposed standard should be amended to align the migration point between bucket 1 and buckets 2 and 3 to an entity's existing portfolio risk appetites and credit writing policies approved by the entity's Key Management Personnel. Under this proposal the threshold for migration to lifetime expected losses would be the where an obligor current rating fall below the poorest rating an entity would originate with a similar borrowing based on internal standard risk tolerances (i.e. falling below the level at which we would continue to originate new instruments would be the tipping point from the measurement of expected losses from a 12 month to lifetime timeframe).

This eliminates the requirement to track the credit quality of an individual facility from origination and establishes an absolute level of credit quality that aligns with existing credit management practices thus reducing the requirement to make costly and complex system changes.

b) Please refer to our comment under a) above.

c) Yes, we agree that changes in probability of default (PD) should be considered when assessing when lifetime expected losses are recognised.

d) The operational improvements we have recommended at in response to part a) above would result in lifetime expected losses being recognised when the credit quality declines to a point below the regular origination credit quality for that asset type. In some instances, this approach may lead to assets rated above investment grade being subject to lifetime expected loss.

For consistent application of our recommended operational improvement, we do not believe the investment grade operational simplification is necessary, as it does not align with actual credit risk management practices.

e) We support the re-establishment of 12 month expected losses if the criteria for the recognition of lifetime expected credit losses are no longer met. However to remain consistent with our recommended operational improvement we would expect the re-establishment of a 12 month expected loss when the credit standing / rating of that obligor improves to the internal credit rating at which that asset would be originated.

Question 6
(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not, and what would you prefer? (b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change? (c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (ie that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?

a) We do not believe that interest revenue calculated on either a gross or a net carrying amount of impaired loans provides useful information to users. Financial instruments subject to individual indicators of impairment are managed in a completely different manner to 'unimpaired assets' with actual cash collections being the key measurement criteria. Currently under IAS 39, the exercise of assigning interest income to impaired instruments is performed as a separate exercise from our core systems and is done purely for the purpose of compliance.

As a consequence, we believe the non-accrual approach as suggested by the FASB for credit-impaired assets is consistent with the management of credit impaired assets and improves the balance between a faithful representation of the underlying economics and the cost of implementation / ongoing costs.

b) Refer to comments under (a) above.

c) We agree that interest revenue approach should be symmetrical however we encourage IASB to take into account our specific comments under (a) above.

Question 7
(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why? (b) Do you foresee any specific operational challenges when implementing the proposed disclosure requirements? If so, please explain (c) What other disclosures do you believe would provide useful information (whether in addition to, or instead of, the proposed disclosures) and why?

a) We are supportive of many of the proposed disclosure and we welcome the proposal in the ED to allow incorporating impairment disclosures by cross-reference from the financial statements to other information available to users (noting potential scope implications for entities' auditors). We believe this will help to avoid duplication of information, improve the quality of financial statements and other information available to users and reduce costs associated with their preparation.

However, we believe some of the disclosure requirements in the ED are generally not consistent with how financial institutions manage credit risk and hence will not provide useful information to the users of financial statements. In addition, some disclosure requirements are operationally difficult to implement and will contribute to a longer lead-time requirement to implement.

Following are our concerns in relation to specific disclosure requirements in the ED:
Reconciliation of the gross carrying amounts of financial assets (ED paragraphs 35-36)

- A cash flow based reconciliation including disclosure of reclassifications of financial assets from 12-month to lifetime expected losses measurement on the basis of their gross carrying amounts do not reflect how financial institutions manage performance of amortised cost financial assets. Specifically, performance of these assets is managed on the basis of net interest income, loan impairment expense, coverage and arrears data. Hence, we believe the proposed disclosures will not provide value and will be confusing to the users of financial statements.

- We believe, the IASB should revise the ED to require a disclosure of gross carrying amounts for each of the types of financial assets mentioned in paragraph 35 (a) – (d) at each reporting date but not a reconciliation between opening and closing balances of their gross carrying amounts.

Nominal amount of financial assets written off that are still subject to enforcement (ED paragraph 37)

- We do not agree with this disclosure as enforcement activities may continue after a write off and disclosure of nominal amounts and anticipated losses on identifiable facilities may mislead users as to potential recoveries and be prejudicial in the recovery process.

- We also note that this disclosure requirement contradicts IAS 37 guidance for contingent assets, which are not disclosed if the inflow of economic benefits is less than probable.

b) We expect the following specific operational challenges in relation to proposed disclosure requirement:

- Reconciliation of the gross carrying amounts of financial assets (ED paragraphs 35-36. Illustrative Example 12)

- Disclosures of reconciliation of the gross carrying amounts of financial assets will require financial institutions to keep track of all changes in gross carrying amounts. As mentioned above financial institutions manage performance of amortised cost financial assets on net interest income and loan impairment expense basis and do not normally keep track of all changes in gross carrying amounts for either financial reporting or management accounting purposes. We see little value in disclosing such information and believe the costs of preparation including the costs of implementation of changes to existing systems will outweigh the benefits of disclosing this information.

c) We do not believe there are any additional disclosures required. In addition, we believe that if convergence were not achieved by IASB and FASB, it would be counterproductive to require reconciliation between the IFRS and US GAAP models within IFRS financial statements. Currently we perform reconciliations between IFRS and regulatory credit loss provision balances, and the introduction of a third reconciliation would only confuse users and place undue burden on preparers to calculate credit losses under different models.

Question 8
Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?

We support the proposed treatment for modified financial assets and request that it is linked to guidance on derecognition of financial assets. However, we believe any difference between the gross carrying amount of modified financial assets and the present value of modified cash flows discounted at the original effective interest rate should be recognised within impairment losses in the income statement. Modifications follow a change in credit risk and therefore such presentation will result in useful information for users of financial statements.

Question 9
(a) Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer? (b) Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.

a) Except as discussed below we agree with the proposal on the application of the general model to loan commitments and financial guarantee contracts.

   Financial institutions manage loan commitments as part of credit exposures together with outstanding loan balances on a total commitment basis. We believe impairment on all loan exposures including commitments should be measured on the same basis. Specifically, expected losses on undrawn portions of credit commitments should be reported as part of loan loss allowances and not presented in a separate line item in the statement of financial position as a liability. This will ensure alignment of information reported in the financial statements with credit risk management purposes.

   The ED (BC 129) proposes that loan commitments (or financial guarantee contracts) that can be withdrawn before credit is extended are excluded from impairment measurement on the basis that no present contractual obligations to extend credit exist for such loan commitments. Contractually many credit commitments can be withdrawn before credit is extended but financial institutions do not manage credit commitments on a contractual basis but on a behavioural experience basis. For example, lending commitments under credit card products can be contractually cancelled on a very short notice and so may not be provided for at all under the existing ED. However, such credit commitments are normally included as part of total commitments for credit risk and liquidity management as well as regulatory capital purposes. Hence, the impairment requirements should be modified to allow such credit commitments to be included in calculation of credit loss allowances.

b) As noted above financial institutions consider loan commitments and financial guarantees to be a part of overall credit exposures with PD and LGD factors applied to total exposures at default to calculate credit risk charges for regulatory reporting purposes. In addition, undrawn portions of loan commitments are normally not separated from the drawn portions for credit risk or management reporting purposes. Hence, the separation of amounts relating to the loan commitments portion of total credit exposures is operationally challenging and of limited value to users.

Question 10
(a) Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why? (b) Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?

a) We support the proposed simplification approach.

b) Refer to comments under (a) above.

Question 11
Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?

We agree with the proposals in the ED for financial assets that are credit-impaired on initial recognition.

Question 12
(a) What lead-time would you require to implement the proposed requirements? Please explain the assumptions that you have used in making this assessment. Therefore, what do you believe is an appropriate mandatory effective date for IFRS 9? Please explain. (b) Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why? (c) Do you agree with the proposed relief from restating comparative information on transition? If not, why?

a) We are unable to implement the proposed ED in its current form without significant system build / modifications. As outlined above, to plan, develop, test and implement a new system to capture the information required by the proposed ED would take approximately 24-30 months to complete (based on system builds of similar complexity) at a cost of approximately USD50 million.

   Because of the above costs and timeframe involved, we would require a lead-time of 4 or 5 years to implement the proposed requirements. However, should the IASB chose to adopt the operational improvements as outlined in our letter, including removing the requirement to track credit quality of a loan over its life, we feel the implementation costs would reduce to approximately USD5million and the timeframe for implementation would reduce to 12-18 months.

b) We agree with the proposed retrospective application of the proposals in the ED.

c) We agree with the proposed relief from restating comparative information on transition.

Question 13
Do you agree with the IASB's assessment of the effects of the proposals? Why or why not?

We agree with IASB's assessment that BC 201 that implementation of the expected credit loss approach will require substantial system changes, time and resources even for financial institutions that are already calculating expected credit losses for regulatory purposes.

We broadly agree with IASB's assessment of the effects of the proposals, except in respect of Financial assets at FVOCI. As discussed under Question 3 (b) above the proposals in the ED in relation to impairment of financial assets at FVOCI will not result in useful information for user of financial statements. We disagree with IASB's assessment that the proposed approach will faithfully reflect the economic reality of expected credit losses that are associated with these financial assets.