National Australia Bank

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Comment Letters
International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Sir

Re: ED/2010/4 Fair Value Option for Financial Liabilities

Thank you for the opportunity to comment on Exposure Draft 2010/4 Fair Value Option for Financial Liabilities (the ED). Our comments on the specific questions included in the ED are addressed in the Appendix.

National Australia Bank Limited (NAB) is one of the four major Australian banks. Our operations are predominantly based in Australia, New Zealand, the United Kingdom and Asia. In our most recent annual results we reported net profit of A$ 2.6 billion and total assets of A$ 654 billion.

We have the following general comments on the Exposure Draft:

- NAB agrees that the portion of the fair value change that is attributable to changes in the credit risk of a liability should not be presented directly in profit or loss, subject to certain exceptions outlined below at question 2 and 7.
- We do not support the two-step approach. We believe that the introduction of such a new presentational method in IFRS is not justified as the disclosure you are seeking is already presented in our Statement of Comprehensive Income.

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

Please contact Marc Smit, Head of Group Accounting Policy, at marc.smit@nab.com.au if you require any further clarification.

Yours sincerely

Peter Beharis
General Manager, Group Finance

Appendix

Detailed Answers to Questions

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?

NAB agrees that changes in credit risk of all financial liabilities designated under the fair value option should not affect profit or loss. Our view is that changes in the credit risk of a financial liability, which is not held for trading purposes and not actively traded, should not be recognised in profit or loss.

The NAB does consider credit risk to be a component of fair value. Where a liability is initially recognised at fair value we believe that credit risk should be one of the factors included in the measurement at inception. Likewise, when a financial liability is subsequently measured at fair value, then the impact of changes in credit risk on fair value should be included in the subsequent measurement of the liability.

The NAB does not, however, believe the effects of changes in credit risk on the fair value of the liability should always be reflected in the income statement. Apart from the circumstances outlined in questions 2 and 7, we consider the fair value changes arising from changes in credit risk should be reflected in Other Comprehensive Income (OCI).

The NAB agrees with the proposal for the following reason:

- In those situations where the entity has no intent nor practical ability to crystallise fair value movements arising from decreases in its own credit standing, or where the business model is such that the liability is held for funding purposes until contractual maturity, we believe the reflection of changes in fair value arising from movements in credit risk through the income statement is not reflective of the underlying profitability of a company and does not provide users with useful information.

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?

In circumstances where the change in fair value of a liability attributable to credit risk does not reflect the credit standing of the entity but the risk of assets held by the entity we believe that such changes in credit risk should be recorded in profit or loss.

Examples are consolidated securitisation vehicles and asset repacking special purpose entities. Such entities may issue liabilities to third parties which are contractually linked to the assets held. If the assets in such consolidated entities are fair valued, the banking group that consolidates the entities may elect to apply the fair value option to the third party held liabilities to eliminate the accounting mismatch that would arise if the assets are fair valued but the liabilities are accounted for at amortised cost.

The liabilities issued by the special purpose entity are generally not sensitive to the credit risk of the consolidating banking group as the assets in the special purpose entity are generally legally isolated. We view the value changes of such liabilities attributable to market risk factors rather than 'own credit risk'. Accordingly, we do not believe it is appropriate to consider the changes in fair value of such liabilities attributable to changes in value of referenced assets 'own credit risk' that must be recorded in OCI. Instead, fair value changes of such liabilities should be recorded in profit or loss where they will offset the fair value changes on the referenced assets.

We recommend that the IFRS 7 guidance on how to determine the amount of change in fair value of a liability that is attributable to changes in the liability's credit risk is amended to clarify that the requirement to present in OCI only relates to own credit risk of the group rather contractual features of the liability referencing assets held by the entity.

The NAB believes that an entity that recognises in profit or loss the effects of changes in its own credit risk on financial liabilities should be required to disclose the impact.

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?

The NAB agrees with the proposal that changes in fair value arising from credit risk be presented in other comprehensive income, subject to the exceptions noted in questions 2 and 7.

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?

NAB does not support the two-step approach and argues that the introduction of this presentation method in IFRS 9 is not justified and unnecessary. This information would already be presented in our Statement of Comprehensive Income.

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

NAB believes that the one-step approach is preferable due to the reasons mentioned in response to Question 4.

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?

NAB believes that the portion of the fair value change that is attributable to changes in the credit risk of the financial liability should not be recorded in equity.

NAB agrees with the IASB's observation in the Basis for Conclusions in paragraph BC34(b) that remeasurements 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.

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?

NAB believes that gains or losses resulting from changes in a financial liability's credit risk included in other comprehensive income should be reclassified to profit or loss if the liability is extinguished prior to its maturity date. This is because extinguishment of a financial liability prior to its maturity date effectively represents a realisation of the issuer's credit risk.

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, except as noted in our response to Question 2.

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?

Yes, agreed.

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

Yes, agreed.