

National Australia Bank Limited
ABN 12 004 044 937

800 Bourke Street
Melbourne Victoria 3008
AUSTRALIA

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

Dear Sir David

Offsetting Financial Assets and Financial Liabilities

We are pleased to have the opportunity to comment on the *Offsetting Financial Assets and Financial Liabilities* Exposure Draft ED/2011/1 (the ED).

National Australia Bank (NAB) is one of the four major banks in Australia. Our operations are predominately based in Australia, New Zealand, the United Kingdom, the United States and Asia. In our most recent annual results we reported net profit after tax of A\$4.2 billion and total assets of A\$686 billion.

Our comments on the specific questions raised by the IASB are addressed in the Appendix; we have set out below our key comments.

Overall, we agree with the proposed requirements to establish a principle for offsetting financial assets and financial liabilities ensuring that either a financial asset or financial liability is presented when certain criteria have been satisfied. However, we have some reservations about the application of the proposed guidance to instruments that are settled through, for example, central clearing houses and the new disclosure requirements.

Settlement through clearing houses

Application Guidance paragraphs C10 – C12 specify that simultaneous realisation of a financial asset and settlement of a financial liability is limited to situations where settlements take place at the same moment such that there is exposure only to the net amount. The referenced paragraphs conclude that incidental simultaneous settlements or settlements that take place over a brief period would not qualify for offsetting.

We understand the drafting of these paragraphs prevent offsetting of contracts executed through, for example, a central clearing house that mature on the same day, unless they are settled at the same moment. In practice, due to processing constraints, central clearing houses settle contracts in batches so physical settlement could be delayed even though settlement risk has been eliminated and there is only exposure to the net amount.

In our view the application guidance should be amended to allow offsetting for contracts executed with organisations such as a central clearing house where settlement is intended to be undertaken on the same day and the risk has been largely eliminated as in practice organisations manage both processing and this risk on a net basis.

New disclosure requirements

We have some reservations regarding the extent and detail of the proposed disclosures and believe that these should be revised to be aligned with the principle nature of the standard and to remove what we consider less relevant and overly cumbersome documentation. We believe the proposals are over prescriptive and extremely onerous for entities to operationalise.

Specifically, we disagree with the requirements to disclose a reconciliation by class of financial instruments from the net position presented on the balance sheet to the gross amounts sheet. We believe this will cause confusion rather than provide useful information to users. We also believe that it would be operationally difficult to determine amounts of financial assets and liabilities that the entity has conditional rights to set off and to disclose these by conditional right. Further, we are unclear how disclosing a description of each type of conditional right of set off, the nature of those rights and how management determines each type will assist users in their assessment of the entity's performance. Users of financial statements are predominately interested in understanding an entity's performance in the same manner as it is managed. Therefore, an entity which manages risk and settles on a net basis should also disclose information on this basis.

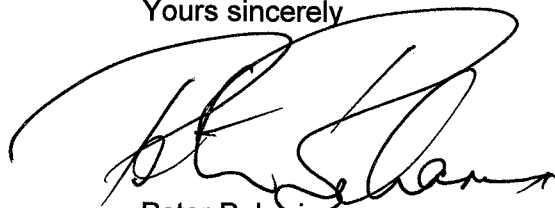
Furthermore, we consider the cross referencing requirement when the required disclosures appear in more than one section of the financial report to be unnecessary. This is not required by any other IFRS literature therefore we are unsure why it would be required in this instance. We believe a user should be able to analyse the information themselves regardless of its positioning in the financial statements.

Overall, we believe that the disclosures required for the offsetting provisions should be aligned with the proposed principles in paragraph 6 permitting offsetting in the statement of financial position. We believe the disclosures should be limited to a description of how the offsetting criteria have been applied to the financial assets and financial liabilities presented on the statement of financial position which should be incorporated in the accounting policy note.

Finally, we also believe a long lead time would be required for an entity to implement the disclosures unless the IASB amends these as there will be significant implications on systems and a full review would need to be performed on underlying contracts, transactions and products. Our detailed comments on the disclosures are included in the Appendix.

Should you have any queries regarding our comments, please do not hesitate to contact Marc Smit, Head of Group Accounting Policy at marc.smit@nab.com.au.

Yours sincerely



Peter Beharis
General Manager, Group Finance



Detailed Answers to Questions

Question 1

The proposals would require an entity to offset a recognised financial asset and a recognised financial liability when the entity has an unconditional and legally enforceable right to set off the financial asset and financial liability and intends either:

- a) to settle the financial asset and financial liability on a net basis or**
- b) to realise the financial asset and settle the financial liability simultaneously.**

Do you agree with this proposed requirement? If not, why? What criteria would you propose instead, and why?

We agree with the proposed requirement to offset a recognised financial asset and a recognised financial liability when the aforementioned conditions are satisfied. However, we request the IASB modify the proposed guidance regarding an entity's intention to realise a financial asset and settle a financial liability simultaneously as the current drafting could prevent the offsetting of instruments settled through clearing houses notwithstanding that settlement risk has been eliminated.

Application Guidance paragraphs C10 – C12 specify that simultaneous realisation of a financial asset and settlement of a financial liability is limited to situations where settlements take place at the same moment such that there is exposure only to the net amount. The referenced paragraphs conclude that incidental simultaneous settlements or settlements that take place over a brief period would not qualify for offsetting.

We understand the drafting of these paragraphs prevent offsetting of contracts executed with, for example, a central clearing house, that mature on the same day unless they are settled at the same moment. In practice, due to processing constraints, central clearing houses settle contracts in batches so physical settlement could be delayed even though settlement risk has been eliminated and there is only exposure to the net amount.

In our view the Application Guidance should be amended to allow offsetting for contracts executed with organisations such as a central clearing house where settlement is intended to be undertaken on the same day and the risk has been largely eliminated as in practice organisations manage both processing and this risk on a net basis.

Question 2

It is proposed that financial assets and financial liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of set-off. The proposals specify that an unconditional and legally enforceable right of set-off is enforceable in all circumstances (i.e. it is enforceable in the normal course of business and on the default, insolvency or bankruptcy of a counterparty) and its exercisability is not contingent on a future event. Do you agree with this proposed requirement? If not, why? What would you propose instead, and why?

We agree that the offsetting principles should be based on the entity's ability to unconditionally offset and should not be subject to any future events which may or may not occur and are conditional (for example bankruptcy or non payment).

We do believe however that paragraph 9 should be revised to permit an entity which has the unconditional and legal right to offset be permitted to offset cash assets pledged as collateral (or the right to reclaim the cash collateral). We believe that considering cash collateral pledged or the obligation to return cash collateral obtained better reflects the true set off position of the entity and should be presented in the statement of financial position if the principles in paragraphs 6(a) and (b) of the proposals are satisfied.

Question 3

The proposals would require offsetting for both bilateral and multilateral set-off arrangements that meet the offsetting criteria. Do you agree that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements? If not, why? What would you propose instead and why? What are some of the common situations in which a multilateral right of set-off may be present?

We agree with the proposals to require offsetting for both bilateral and multilateral set off arrangements which satisfy the offsetting criteria. We note that these are the requirements currently required under IFRS.

Question 4

Do you agree with the proposed disclosure requirements in paragraphs 11–15? If not, why? How would you propose to amend those requirements, and why?

Overall we believe the proposals are overly prescriptive and extremely onerous for entities to operationalise. Further the additional detail would cause confusion rather than provide useful information to users especially when the required information is already presented on the face of the balance sheet.

We are concerned about the extent and detail of the proposed disclosures and believe that these should be revised to be aligned with the principle nature of the standard and to remove what we consider irrelevant and overly cumbersome documentation.

Specifically, we disagree with the requirements to disclose a reconciliation by class of financial instruments from the net position presented on the balance sheet to the gross amounts. We also believe that it would be operationally difficult to determine amounts of financial assets and liabilities that the entity has conditional rights to set off and to disclose these by conditional right. Further, we are unclear how disclosing a description of each type of conditional right of set off, the nature of those rights and how management determines each type will assist users in their assessment of the entity's performance.

We also believe that duplication exists with the requirements of paragraph 12(f) for financial assets and the amendments to IFRS 7.36(b) through the Annual Improvements Project. Specifically, paragraph 12(f) requires the amount of cash collateral and the fair value of other financial instruments obtained as collateral in respect of the entity's financial assets be disclosed. Comparatively, paragraph 36(b) of IFRS 7 will require entities to disclose a description of collateral held as security and of other credit enhancements, and their financial effect (e.g. a quantification of the extent to which collateral and other credit enhancements

mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk. It would appear that these requirements are asking for the same information to be disclosed.

Furthermore, we consider the cross referencing requirement to be unnecessary and not required by any other IFRS literature so unsure why it would be required in this instance. We believe a user should be able to analyse the information themselves regardless of its positioning in the financial statements.

Overall, we believe that the disclosures required for the offsetting provisions should be aligned with the proposed principles in paragraph 6 permitting offsetting in the statement of financial position. We believe the disclosures should be limited to a description of how the offsetting criteria have been applied to the financial assets and financial liabilities presented on the statement of financial position which should be incorporated in the accounting policy note.

Question 5

- (a) Do you agree with the proposed transition requirements in Appendix A? If not, why? How would you propose to amend those requirements, and why?**
- (b) Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.**

Although we generally support retrospective application of accounting standards we are concerned that the proposed disclosures in the ED and the requirement to include these as comparatives would be extremely difficult to operationalise. We do not currently capture the information proposed and it would require significant lead time to amend systems and review contracts and products to enable compliance. As such we urge the IASB and FASB to reconsider the proposed disclosure requirements as they will require significant investment by an entity for what we believe will be little, if any, use to the entity disclosing or a user of financial statements assessing the entity's performance.

It is difficult to provide an accurate estimate of how long it would take us to implement the proposed requirements but we believe at least a 36 month lead time will be required.