Exposure Draft 2013/2: Novation of Derivatives and Continuation of Hedge Accounting

Dear Sir or Madam,

MAZARS welcomes the opportunity to comment on the International Accounting Standards Board’s Exposure Draft, *Novation of Derivatives and Continuation of Hedge Accounting*.

We fully support the Board’s decision to propose an urgent amendment to IAS 39 in order to take into account new regulations related to the clearing through central counterparty.

We agree with the objective of the proposed IAS 39 amendments to enable maintaining hedge accounting for hedging relationships in which hedging derivatives are novated to a central counterparty.

However, we believe that the scope of this amendment should not be limited to novations of derivatives to a central counterparty that arise from law or regulatory requirements. It should be expanded to all novations of derivatives to a central counterparty that meet conditions (ii) and (iii) of proposed paragraphs IAS 39.91(a) and IAS 39.101(a). This would enable to capture situations where an entity decides either to anticipate such requirements or simply to implement a credit risk management decision. This scope expansion could be achieved by removing condition (i) of proposed paragraphs IAS 39.91(a) and IAS 39.101(a), or expanding condition (i) in order to capture such novations made on voluntary basis.
Our answers to the questions raised in the Exposure Draft are shown in the appendix to this letter which summarises our concerns and opinion.

We would be pleased to discuss our comments with you and remain at your disposal should you need further clarification or additional information.

Best regards,

Michel Barbet-Massin
Head of Financial Reporting Technical Support
Question 1

The IASB proposes to amend IAS 39 so that the novation of a hedging instrument does not cause an entity to discontinue hedge accounting if, and only if, the following conditions are met:

(i) the novation is required by laws or regulations;
(ii) the novation results in a central counterparty (sometimes called ‘clearing organisation’ or ‘clearing agency’) becoming the new counterparty to each of the parties to the novated derivative; and
(iii) the changes to the terms of the novated derivative arising from the novation of the contract to a central counterparty are limited to those that are necessary to effect the terms of the novated derivative. Such changes would be limited to those that are consistent with the terms that would have been expected if the contract had originally been entered into with the central counterparty. These changes include changes in the collateral requirements of the novated derivative as a result of the novation; rights to offset receivables and payables balances with the central counterparty; and charges levied by the central counterparty.

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

Question 2

The IASB proposes to address those novations arising from current changes in legislation or regulation requiring the greater use of central counterparties. To do this it has limited the scope of the proposed amendments to a novation that is required by such laws or regulations.

Do you agree that the scope of the proposed amendment will provide relief for all novations arising from such legislation or regulations? If not, why not and how would you propose to define the scope?

We fully support the Board’s decision to propose an urgent amendment to IAS 39 in order to take into account new regulations related to the clearing through central counterparty (CCP).

We agree with the objective of the proposed IAS 39 amendments to enable maintaining hedge accounting for hedging relationships in which hedging derivatives are novated to a central counterparty. Indeed, we concur with the Board’s opinion that, in this specific situation, discontinuing hedge accounting would not provide useful information to users of financial statements.

However, novations of derivatives to a central counterparty that are made on a voluntary basis (e.g. following an internal credit risk management decision, or in order to anticipate future regulatory requirements) also contribute to reduce counterparty risk on OTC derivatives and to increase market transparency. Accordingly, the scope of this amendment should in our opinion be expanded to all novations of derivatives to a central counterparty including those made on a voluntary basis as long as conditions (ii) and (iii) are fulfilled. We therefore recommend removing condition (i) of proposed paragraphs IAS 39.91(a) and IAS 39.101(a)
in order to capture these situations. Alternatively, the IASB could expand condition (i) in order to capture novations made on voluntary basis.

We believe that the novation of a derivative to a counterparty that is not a CCP, or the novation of a derivative to a CCP that does not meet the conditions of IAS 39.91(a)(iii) or IAS 39.101(a)(iii) should not be included in the scope of the proposed amendments. Those situations should lead to the derecognition of the existing derivative with consequential impacts on the related hedging relationship. We therefore support conditions (ii) and (iii) as proposed by the Board.

**Question 3 – Transition provisions**

The IASB also proposes that equivalent amendments to those proposed for IAS 39 be made to the forthcoming chapter on hedge accounting which will be incorporated in IFRS 9 Financial Instruments. The proposed requirements to be included in IFRS 9 are based on the draft requirements of the chapter on hedge accounting, which is published on the IASB’s website(a)

Do you agree? Why or why not?

(a) See the draft of the forthcoming hedge accounting requirements posted on the IASB website on 7 September 2012 (http://go.ifrs.org/Draft-of-forthcoming-IFRS-general-hedge-accounting)

We agree with the IASB’s proposal to incorporate those requirements in IFRS 9 Financial Instruments.

However, since hedging instruments may include derivatives and other financial instruments, we suggest using the word “hedging derivative” when amending paragraph 6.5.6 of IFRS 9 to avoid misleading interpretations: “6.5.6 Additionally, the novation of a hedging instrument derivative is not an expiration or termination if and only if:”

**Question 4 – Other comments**

The IASB considered requiring disclosures when an entity does not discontinue hedge accounting as a result of a novation that meets the criteria of these proposed amendments to IAS 39. However, the IASB decided not to do so in this circumstance for the reason set out in paragraph BC13 of this proposal.

Do you agree? Why or why not? Do you have any other comments on the proposals?

We agree with IASB’s proposal not to require specific disclosures in this particular case. We note that information required by IFRS 7 (in particular credit risk and liquidity risk information) should already lead an entity to mention novations of derivatives to a central counterparty.

Other comment:

We fully agree with the Board’s proposal to permit early application of the amendments in order to capture situations where law or regulation requirements apply before the
amendments’ mandatory effective date. Enabling early application also covers situations where an entity voluntarily chooses to implement the novation of its derivative portfolio towards CCPs.