

# Finance and Treasury Association



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2 April 2013

Mr Hans Hoogervorst  
Chairman  
The International Accounting Standards Board (IASB)  
30 Cannon Street  
LONDON EC4M 6XH  
UNITED KINGDOM  
(via email to [hhoogervorst@ifrs.org](mailto:hhoogervorst@ifrs.org))

Cc Mr Kevin Stevenson

Chairman and CEO of the Australian Accounting Standards Board  
(via email to [kstevenson@asb.gov.au](mailto:kstevenson@asb.gov.au))

Dear Mr Hoogervorst,

## **Exposure Draft ED/2013/2 - Novation of Derivatives and Continuation of Hedge Accounting**

The Finance and Treasury Association (FTA) is the peak professional body in Australia for corporate treasurers and senior financial risk managers, with around 900 members primarily from Australasia's largest 300 companies.

We support the IASB in providing a concession to companies to continue applying hedge accounting for derivative hedging instruments which are novated to central counterparties ('CCP's). However, we believe that the wording as drafted will potentially exclude certain novations from the proposed exceptions which may not have been intended. Also, we would like the IASB to clarify whether all novations are considered terminations of the hedging instrument resulting in a discontinuation of hedge accounting even where there is no changes to the actual derivative contract other than the counterparty.

Please find following our responses to the detailed questions set out in the exposure draft.

### **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?*

The FTA's concern with the ED is the tight definition of CCP as a result of the novation. In the case of anyone except the member of a CCP, at some stage or another, the clearing broker will be part of the chain or may indeed be the counterparty. BCBS and APRA rules allow banks to treat the transaction as if it is with the CCP, but fundamentally it may not be. A bank may have a deal with a clearing broker. Also, there are different models in different jurisdictions. For example, with certain CCP's they may be a principal to the novated transaction, however in others they may be an agent. The IASB should consider how the proposed exceptions would apply to the most common proposed CCP structures in the major financial centres.

#### **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?*

The objective for mandating derivative trades to be novated to CCP's was to reduce the credit risk and therefore the systemic risk posed by the large volumes of uncollateralised OTC derivatives transacted between bank counterparties. We support the IASB in providing this concession to financial statement preparers as a way of supporting these global objectives. Extending the concession to counterparties who choose to novate their derivative trades to CCP's further supports this objective of reducing credit risk in the system and we believe is consistent with the IASB's intention of providing this concession in the first place.

#### **Question 3**

*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.*

*Do you agree? Why or why not?*

We agree the amendments should be included in IFRS 9.

#### **Question 4**

*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?*

We agree with the proposal not to include additional disclosures given that hedge accounting would continue unaffected.

### **Other novations of hedging instruments**

The FTA has been made aware by some of its members that in some instances, current corporate accounting practices for novations of hedging instruments between banking counterparties to date have not been accounted for as hedging discontinuations. The view taken has been that where derivatives are novated from one bank to another without changing any of the contractual terms, the derivative contract still exists for the corporate. It is only the counterparty that has changed. Where a derivative is in a liability position for the corporate, the banks enter into a separate transaction to transfer the contract asset between themselves. That is, the contractual obligation for the corporate under the derivative contract has not been extinguished. Similarly, if the derivative is in an asset position, one bank makes a payment to another bank in order to transfer their obligation. From the corporate's perspective the contract asset has not been settled or terminated. The FTA would appreciate if the IASB were to more clearly articulate the principles that support the proposals in the ED so that financial statement preparers know how to apply the standards to novations that occur in the ordinary course of business. Paragraph BC5 states that the IASB concluded that novation to a CCP would result in the derecognition of either assets or liabilities without explaining why.

We trust that the IASB will find our comments useful in finalising the proposals in the exposure draft.

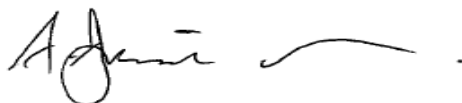
Yours sincerely



Paul Travers FFTP

President

Finance and Treasury Association



David Mitchell CFTP (Snr)

CEO

Finance and Treasury Association

### **About FTA**

The Finance & Treasury Association (FTA) is a professional association for executives working across all aspects of treasury and financial risk management. The FTA provides training and skills development and access to current information, facilitates networking and builds a community in this specialised area of business. It seeks to increase recognition of the skills of members and to convey the views of members on key technical issues facing the profession to government, other associations and the wider community.