



Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

via email: standard@asb.gov.au

8 April 2013

Dear Kevin

Re: Submissions on AASB ED 228, ED 230, ED 231, ED 235 and ED 236

I am enclosing a copy of PricewaterhouseCoopers' responses to the following International Accounting Standards Board's Exposure Drafts:

- ED 228 (IASB ED/2012/3) *Equity Method: Share of Other Net Asset Changes (proposed amendments to AASB 128)*
- ED 230 (IASB ED/2012/4) *Classification and Measurement: Limited Amendments to AASB 9 (proposed amendments to AASB 9 (2010))*
- ED 231 (IASB ED/2012/5) *Clarification of Acceptable Methods of Depreciation and Amortisation (proposed amendments to AASB 116 and AASB 138)*
- ED 235 (IASB ED/2013/1) *Recoverable Amount Disclosures for Non-Financial Assets (proposed amendments to AASB 136)*
- ED 236 (IASB ED/2013/2) *Novation of Derivatives and Continuation of Hedge Accounting (proposed amendments to AASB 139 and AASB 9)*

The letters reflect the views of the PricewaterhouseCoopers (PwC) network of firms and as such include our own comments on the matters raised in the requests for comment. PwC refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (02) 8266 7104 if you would like to discuss our comments further.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. Shepherd', is written over a light blue horizontal line.

Paul Shepherd
Partner, PricewaterhouseCoopers

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International Accounting Standards Board
30 Cannon Street
London
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2 April 2013

Dear Sir/Madam

Exposure draft: Novation of Derivatives and Continuation of Hedge Accounting

We are responding to the invitation of the Board to comment on the exposure draft 'Novation of Derivatives and Continuation of Hedge Accounting' (the ED) on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of those member firms who commented on the exposure draft. 'PricewaterhouseCoopers' refers to the network of firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We support the Board's efforts in clarifying whether an entity is required to discontinue hedge accounting when an over-the-counter (OTC) derivative is novated to a central counterparty (CCP) as required by law or regulation. We also appreciate the Board's responsiveness in addressing this urgent issue in a pragmatic way, as requiring entities to treat such novations as a discontinuance of hedge accounting would not provide useful information to investors.

Our responses to the Board's questions are included in the Appendix to this letter. The key comments that we would like to raise with the Board are summarised below.

We believe that the proposed amendments should not be limited to mandatory novations. It is our understanding that the new laws and regulations being enacted as a result of the recommendations made by the G20, for example in the EU, generally propose mandatory novations only for new OTC derivatives entered into after a certain date when exceeding certain thresholds and will not require existing derivatives at that date to be novated to a CCP. Therefore the proposals in the ED may have little effect if they are limited to novations required by laws and regulations. However many entities are likely to novate existing derivatives to a CCP as we understand there may be incentives for financial institutions to novate existing derivatives to improve capital ratios in some jurisdictions. In general, the novation of derivatives by introducing a CCP is beneficial for the overall financial system by improving transparency, regulatory oversight and reducing counterparty credit risk. Restricting the proposed amendments to mandatory novations might discourage entities from novations to a CCP, which in our view, would be detrimental to overall financial stability. As such we suggest that the scope of the proposed amendments be broadened to also incorporate novations to a CCP that are not required by laws or regulations.

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The proposed amendments might also result in unintended changes to the existing treatment for novations of derivatives when, for example, a consolidated group performs an internal reorganisation resulting in the novation of derivatives from one consolidated subsidiary to another fellow consolidated subsidiary. We do not believe that novations in such circumstances should result in discontinuance of hedge accounting.

Recommendations for addressing the above mentioned concerns are included in the response to question 1 in the Appendix to this letter.

If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 207 804 2497) or Gail Tucker (+44 117 923 4230).

Yours sincerely,

A handwritten signature in black ink that reads 'PricewaterhouseCoopers' in a cursive script.

PricewaterhouseCoopers



APPENDIX

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?

In general, we agree with the Board's proposal of allowing continuation of hedge accounting when derivatives are novated to a CCP. However, as described in our cover letter, we have some concerns regarding the scope of the limited amendments and some unintended consequences resulting from the words in the exposure draft.

We believe that the proposed amendments should not be limited to mandatory novations. As noted in our cover letter, it is our understanding that the new laws and regulations being enacted as a result of the recommendations made by the G20, for example in the EU, generally propose mandatory novations only for new OTC derivatives entered into after a certain date when exceeding certain thresholds and will not require existing derivatives at that date to be novated to a CCP. Therefore the proposals in the ED may have little effect if they are limited to novations required by laws and regulations. However many entities are likely to novate existing derivatives to a CCP as we understand there may be incentives for financial institutions to novate existing derivatives to improve capital ratios in some jurisdictions. We suggest that the scope of the proposed amendments be broadened to incorporate novations to a CCP rather than only those required by laws or regulations.



We understand that the use of legal terms varies from territory to territory. In some territories, certain types of novations do not result in new contracts. We suggest the Board clarifies the use of the term 'novation' or explain that the amendment refers to transfers of derivatives to a CCP that achieve derecognition, rather than using the term 'novation'.

In addition, it is our understanding that in certain territories not all counterparties will be able to clear directly with a CCP but will use clearing brokers, mainly because becoming a direct clearing member of the CCP requires a significant commitment of capital. We believe that these transactions should qualify for the same relief as novations with a CCP.

The proposed words for describing what changes to contracts would be permitted for novations seem to imply that entities are required to determine what the terms would have been at the date of the inception of their derivatives, as if those derivatives had been entered into with a CCP at that time. The basis for this is not clear, as in many cases a CCP did not exist at such date, nor was there an established practice for pricing or collateral requirements for similar contracts. We believe it would be sufficient if the requirement was amended to be those changes that are 'a direct result of the novation of the contract to the CCP'.

The proposed amendments might also result in unintended changes to the existing treatment for novations of derivatives when, for example, a consolidated group performs an internal reorganisation resulting in the novation of derivatives from one consolidated subsidiary to another fellow consolidated subsidiary. In some jurisdictions, this may also be performed in response to legislative reforms restricting certain entities from engaging in specific types of derivative transactions. We do not believe that novations in any of these circumstances should result in discontinuance of hedge accounting. We consider that by removing the phrase 'and only if' from the proposed paragraphs 91(a) and 101(a) might alleviate this concern.

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?

As explained in our cover letter, we do not believe the ED results in the relief the Board was seeking to achieve. We consider that the proposed scope for the limited amendments to IAS 39 is too narrow. We believe that, instead, the Board should allow continuation of hedge accounting for novations to a CCP even when not required by laws or regulations.



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 with the Board's proposal to incorporate the limited amendments in the draft chapter on hedge accounting in IFRS 9. We have not identified any reason to have different hedge accounting requirements regarding novation of derivatives in IAS 39 and 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 Board's proposal to not require additional disclosures. Current disclosure requirements provide the necessary information to understand the nature of the derivative (e.g. its significant terms and fair value), type of hedge and nature of financial risks being hedged.

