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EFRAG

Françoise Flores

Chairman EFRAG TEG

35 Square Meeûs

Berlin, 22 March 2013

B-1000 Brussels

Dear Françoise,

**EFRAG's Draft Comment Letter on the IASB's Exposure Draft *Novation of Derivatives and Continuation of Hedge Accounting (Proposed amendments to IAS 39 and IFRS 9)***

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on EFRAG's Draft Comment Letter on the IASB's ED *Novation of Derivatives and Continuation of Hedge Accounting*.

The ASCG welcomes the intended relief from having to discontinue hedge accounting when the novation of a hedging instrument meets certain criteria, and therefore appreciates the opportunity to comment on EFRAG's Draft Comment Letter. Nonetheless, we deem the proposed amendments to be too restrictive and therefore do not think that they achieve the intended outcome. We believe that the current demand for relief could reasonably be accommodated by discarding condition (i), because immediate relief is achieved by setting conditions (ii) and (iii) while appropriately limiting the scope of application.

For further details, please see our comment letter to the IASB as attached to this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

*Liesel Knorr*

President



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Berlin, 22 March 2013

Dear Hans,

**IASB Exposure Draft ED/2013/2 *Novation of Derivatives and Continuation of Hedge Accounting (Proposed amendments to IAS 39 and IFRS 9)***

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the IASB Exposure Draft ED/2013/2 *Novation of Derivatives and Continuation of Hedge Accounting* (herein referred to as 'ED').

The ASCG welcomes the intended relief from having to discontinue hedge accounting when the novation of a hedging instrument meets certain criteria, and therefore appreciates the opportunity to comment on the ED. Nonetheless, we deem the proposed amendments to be too restrictive and therefore do not think that they achieve the intended outcome. We believe that the current demand for relief could reasonably be accommodated by discarding condition (i), because immediate relief is achieved by setting conditions (ii) and (iii) while appropriately limiting the scope of application.

Please find our detailed comments on the questions raised in the invitation to comment in the appendix to this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

*Liesel Knorr*

President



## Appendix – Answers to the questions of 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?

Whilst we agree with the intention of the proposal, we do not agree with the way how it is drafted. It is our understanding that the amendments were intended to offer relief for novations that are contingent on current or imminent laws or regulations (i.e. the European Markets Infrastructure Regulation (EMIR) and the Dodd-Frank Wall Street Reform and Consumer Protection Act). We also understand that the exception proposed was meant to be limited in scope. However, we do not believe that the proposed amendments achieve their intended outcome because of the conditions proposed. Specifically, condition (i) requires the novation to be required by laws or regulations: Neither EMIR nor the Dodd-Frank Act do *require* existing OTC derivative contracts to be novated to a CCP. Rather, novation is but one measure an entity can choose in order to meet the requirements of these acts.

We are aware of the fact that many entities have already (started to) voluntarily novate(d) their derivatives in light of the new legislation and would, hence, be outside the scope of the proposed amendments so that the scope might potentially be a null set.



Further, we want to indicate that the term 'novation' is understood differently across various jurisdictions, which could lead to differing accounting implications concerning the derecognition of the derivative and therefore the starting point of the proposed amendments. We would find it helpful if the IASB could define the term 'novation' or explain that the amendment refers to transfers of derivatives to a CCP.

We would like to point out, that the main reason for issuing the proposed amendments, as set out in BC7 of the ED, is that accounting for the hedging relationship that existed before the novation as a continuing hedging relationship would provide more useful information to users of financial statements. We believe that this reasoning is also applicable to voluntary novations, if conditions (ii) and (iii) are met. Therefore, we think that the current demand for relief could reasonably be accommodated without condition (i). We believe that conditions (ii) and (iii) offer a set of requirements that help to achieve immediate relief while appropriately limiting the scope.

Additionally, discarding condition (i) would help:

- avoiding interpretational issues with the term 'required', such as the question if there can be a factual requirement (economic compulsion);
- covering novations by entities that voluntarily apply laws or regulations as 'best practice' (like a non-EU or an EMIR-exempt company voluntarily clearing derivatives contracted with an EMIR-obligated financial institution); and
- improving hedge accounting, since in most cases the hedged risk is the interest rate risk and the expected better credit rating of a CCP would reduce the distorting effect of the credit risk in the (full) fair value of the hedging instrument.

We acknowledge that deleting condition (i) as a short-term solution would broaden the scope of the proposed amendments. Therefore, we would recommend that the IASB deliberate mid- or long-term solutions to the comprehensive issue of 'novations' in the context of hedge accounting, which may also encompass novations to other counterparties (not to a CCP, e.g. within a group) and the distinction from collateral promises and assumption agreements.



**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 refer to our answer on Question 1.

**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?

The ASCG agrees that equivalent amendments should be incorporated into 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?

The ASCG agrees with the IASB's rationale.