IEAF International Energy Accounting Forum

IASB
30 Cannon Street
London EC4M 6XH
UK
Brussels, March 27, 2013

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

Dear Sirs,

The International Energy Accounting Forum (IEAF) consists of the major European companies in the energy business (see the list of our members in appendix 2).

The goal of the IEAF is to discuss and formulate best practices, to reduce areas of difference in accounting in the sector, to advocate the energy industry's point of view, and to make specialist energy industry knowledge available to the International Accounting Standards Board and other standard setters.

We are writing to you with respect to the Exposure Draft Novation of Derivatives and Continuation of Hedge Accounting, issued by the IASB on 28 February 2013 (the 'ED').

Our detailed comments are set out in the appendix 1.

To summarise, the IEAF agrees with the proposal but believes that the scope is too limited and can cause significant adverse impacts in other situations where we have frequent novations and while the risk management objective from the entity's perspective remains the same before and after the novation.

In the past, most of the members of the IEAF have continued hedge accounting. Not having been able to do so would have caused hedge inefficiencies that do not reflect the underlying reality: we continue to be economically soundly hedged.

If you require any further information or explanation, please do not hesitate to contact us.
Yours faithfully

On behalf of the International Energy Accounting Forum,

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Appendix 1: proposed amendment to IAS 39 and IFRS 9

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?

We agree that such situation should not trigger discontinuation of hedge accounting.

This being said, new paragraph 101(a) of IAS 39 states that "*the hedging instrument expires or is sold, terminated or exercised. In this case, the cumulative gain or loss on the hedging instrument that has been recognised in other comprehensive income from the period when the hedge was effective (see paragraph 95(a)) shall remain separately in equity until the forecast transaction occurs. When the transaction occurs, paragraph 97, 98 or 100 applies. <u>For the purpose of this sub-paragraph, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy</u>. Additionally, the novation of a hedging instrument is not an expiration or termination if and only if (…)*"

This would mean that a novation – that is not subject to the exclusion provided in the ED – would not result in the discontinuation of a hedge relationship, as long as the novation had been anticipated at the time the hedge was first designated.

IEAF believes that such proposal – in case it is so restricted – can cause significant adverse impacts in situations where we have frequent novations of swaps, stemming from:

- The swap providers novating the hedging instrument to other swap providers, because of e.g.:
    - liquidity considerations of the swap providers;

  - swap providers exceeding their internal credit limits as to exposure to respective the project companies (cf. drop in market interest rates in prior years).
- Widespread practice of novations of 'pre-hedges' at moment of financial close: in emerging economies, power plants often are subject to long-term capacity arrangements, so called PPA's (power purchase agreements). The capacity fee generates a fixed return on the investment in the power plant. The tariff of the PPA is fixed at the moment of bid award, and in some cases it is not adjusted for interest rate adjustments between the moment of bid award and financial close. At the moment of financial close, the variable rate debt, as well as other Project Documents are executed. In those cases, at moment of bid award, the project company may enter into so called 'pre-hedges'. Pre-hedges generally are guaranteed by the project's equity investors. At financial close, the pre-hedges are novated to other swap providers, often lenders underwriting the debt, and no longer have a guarantee from the project's equity investors.

In the past, most of the members of IEAF have continued hedge accounting. Not having been able to do so would have caused hedge inefficiencies that would not have reflected the underlying reality: we continue to be economically soundly hedged.

Therefore, we are of the opinion that other novation/replacement events as illustrated above by nature could not be anticipated in the original hedge documentation or are not under the entity's full control. Nevertheless, it is clear that the entity's risk objective from the entity's perspective remains the same <u>before</u> and <u>after</u> the novation and therefore such situations cannot result in hedge discontinuation.

At last, we are also concerned that the proposal results in a specific rule added to other existing ones rather than into a principle enabling entities to appropriately reflect their transactions.

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 it has been explained in Q1, we are of the opinion that the scope should not be limited to those novations that are 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[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.

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.

Appendix 2: Members of the International Energy Accounting Forum

Alpiq	www.Alpiq.de
Axpo	www.axpo.ch
BG Group	www.bg-group.com
EDF	www.edf.com
EnBW	www.enbw.com
EWE	www.ewe.de
Fortum	www.fortum.com
Gas Natural	www.gasnatural.com
Gazprom Marketing & Trading	www.gazprom-mt.com
GDF SUEZ	www.gdfsuez.com
Iberdrola	www.iberdrola.es
OMV	www.omv.com
RWE	www.rwe.com
Scottish Power	www.scottishpower.com
Unesa	www.unesa.es
Vattenfall	www.vattenfall.com
Verbund	www.verbund.com
Veolia	www.veolia.com