

## **The costs and benefits of implementing the *Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting***

### **Introduction**

- 1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the *Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting* ('the Amendments to IAS 39').
- 2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments to IAS 39, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. The results of the consultations that EFRAG has carried out seem to confirm this. Therefore, as explained more fully in the main sections of this report, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendments to IAS 39 in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

### *EFRAG's endorsement advice*

- 3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

## **A SUMMARY OF THE AMENDMENTS to IAS 39**

### **Background**

- 4 IAS 39 *Financial Instruments: Recognition and Measurement* requires hedge accounting to be discontinued when the hedging instrument expires or is sold, terminated or exercised (unless the replacement or rollover of a hedging instrument into another hedging instrument is part of the entity's documented hedging strategy). As such an entity is required to discontinue the hedge accounting for a derivative that has been designated as a hedging instrument in the existing hedging relationship if the derivative is novated to a central counterparty; the new derivatives, with a counterparty being the central counterparty following the new law or regulation, are to be recognised at the time of the novation.

- 5 The widespread legislative changes across jurisdictions were prompted by a G20 commitment to improve transparency and regulatory oversight of over-the-counter (OTC) derivatives in an internationally consistent and non-discriminatory way.

#### **The issue**

- 6 The IASB was concerned about the financial reporting effects that would arise from the novation as a result of new laws or regulations, i.e. more hedge ineffectiveness especially for cash flow hedges, compared to a continuing hedging relationship. The IASB, taking note of the financial reporting effects, was convinced that accounting for the hedging relationship that existed before the novation as a continuing hedging relationship in this specific situation would provide more useful information to users of financial statements. The *Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting* ('Amendments to IAS 39') provide relief from discontinuing hedge accounting when novation of a hedging instrument to a central counterparty meets certain criteria. Similar relief will be included in IFRS 9 *Financial Instruments*.

#### **What has changed?**

- 7 The Amendments to IAS 39 amend paragraph 91(a) and paragraph 101(a) of IAS 39 and add paragraph AG113A to provide relief from discontinuing hedge accounting when novation of a hedging instrument to a central counterparty meets certain criteria; for this purpose, there is not an expiration or termination of the hedging instrument if:
- (a) as a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty (sometimes called a 'clearing organisation' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effect clearing with the same central counterparty.
  - (b) other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.

#### **When do the Amendments to IAS 39 become effective?**

- 8 An entity shall apply those amendments retrospectively for annual periods beginning on or after 1 January 2014. Earlier application is permitted.

#### **EFRAG's initial analysis of the costs and benefits of the Amendments to IAS 39**

- 9 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing the Amendments to IAS 39, both in

year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows:

- (a) *Costs* – EFRAG's initial assessment is that the Amendments to IAS 39 would not result in increased costs to users, i.e., it is likely to be cost neutral.
  - (b) *Benefits* – EFRAG's initial assessment is that the overall benefits of not derecognising the hedge accounting relationships were likely to outweigh costs associated with providing this information to users.
- 10 EFRAG published its initial assessment and supporting analysis on 4 July 2013. It invited comments on the material by 11 July 2013. In response, EFRAG received nine comment letters. Four respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing the Amendments to IAS 39 in the EU, but supported EFRAG's recommendation that Amendments to IAS 39 be adopted for use in Europe.

### **EFRAG's final analysis of the costs and benefits of the Amendments to IAS 39**

- 11 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of the Amendments to IAS 39 is presented in the paragraphs below.

#### *Benefits and cost for preparers*

- 12 EFRAG has carried out an assessment of the costs and benefits implications for preparers resulting from the Amendments to IAS 39 considering the following costs.
- 13 EFRAG believes that the Amendments to IAS 39 will result in some cost savings as preparers will not have to derecognise existing hedge relationships and document new ones.
- 14 Overall, EFRAG's assessment is that the Amendments to IAS 39 are likely to reduce the one-off and costs for preparers and not result in ongoing costs of tracking and analysing information about novation of derivatives and their effects on the continuation of hedge accounting.

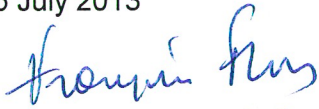
#### *Benefits and costs for users*

- 15 EFRAG has carried out an assessment of the costs and benefits implications for users resulting from the Amendments to IAS 39.
- 16 EFRAG believes that the Amendments to IAS 39 would result in insignificant additional costs of analysis for users, and improve the relevance and understandability of information provided to them.
- 17 Users will also benefit from having a consistent accounting treatment for derivatives novated to a central counterparty following the introduction of a new law or regulation.
- 18 Overall, EFRAG's assessment is that users are likely to benefit from the Amendments to IAS 39.

*Conclusion*

- 19 EFRAG's overall assessment is that the overall benefits of the Amendments to IAS 39 are likely to outweigh costs associated with providing this information to users.

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