



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

10 May 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Exposure Draft of Novation of Derivatives and Continuation of Hedge Accounting

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on this Exposure Draft (ED). Our responses to the questions raised in your Invitation to Comment are set out in the Appendix for your consideration.

We welcome the IASB's initiative in addressing this emerging issue and we agree that IAS 39 and IFRS 9 should be amended in order to prevent hedge accounting being discontinued when derivatives that are designated hedging instruments are novated to a central counterparty (CCP) as required by law or regulation. Though the new laws and regulations being enacted as a result of the recommendations made by the G20 mainly concern European Union and U.S. jurisdictions, we believe the issue is potentially of no-less importance to Hong Kong as a leading international financial centre. We agree with the view of the IASB that the discontinuance of hedge accounting in such circumstances would not provide useful information to users of financial statements. However, we consider the proposed scope for the limited amendments to IAS 39 is too narrow. The ED may have little effect if they are limited to novations required by laws and regulations. We understand that many entities are likely to novate existing derivatives in advance of the mandatory date of new laws or regulations to avoid the administrative and legal burden of having to novate all derivatives on a single date. In addition, by placing the focus on "required by laws or regulations", which is somewhat of an arbitrary distinction, would cause preparers and auditors the need to perform a legal analysis to determine whether a novation was "required" at the time of novation. As such, we recommend that the scope of the proposed amendments be broadened to incorporate novations to a CCP that are not required by laws and regulations.

If you have any questions regarding the matters raised in our submission, please contact Winnie Chan, our Manager of Standard Setting at winniechan@hkicpa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

SR/WC
Encl.

Comments on IASB Exposure Draft of Novation of Derivatives and Continuation of Hedge Accounting

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 with the Board's proposal of allowing continuation of hedge accounting when derivatives are novated to a CCP. However, we believe that the proposed amendments should not be limited to mandatory novations. We believe that the scope should be expanded to include those entities that novate derivative contracts to a CCP in connection with voluntarily clearing such contracts. The G20's call for central clearing of derivative contracts was in the context of enhancing global financial stability. Those entities that voluntarily clear derivative contracts are assisting in creating that stability and should not be penalized for doing so. We understand that, as most novations arising from changes in laws and regulations are only for new OTC derivatives entered into after a certain date, there would be little benefit in the amendment for such derivatives. From a practical standpoint, most entities subject to mandatory clearing would likely commence to novate derivatives to a CCP in advance of the mandatory date of new laws or regulations to avoid the administrative and legal burden of having to novate all derivatives on a single date. We recommend that the limitation to novations required by laws or regulations be removed.

In addition, we suggest that a clear definition of what should be considered a "novation" would be helpful as the term may have different legal implications in different jurisdictions.



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 Question 1, we consider that the proposed scope for the limited amendments to IAS 39 is too narrow. We believe that the Board should allow continuation of hedge accounting for novations to a CCP even when not required by laws or regulations.

In addition, we are concerned that the amendment as currently drafted suggests that any other novation of a derivative hedging instrument would result in discontinuance of the hedge relationship. We believe that it would be helpful if the Board could clarify in the finalised standard whether: (a) novation of a derivative from one legal entity to another within the same group; and (b) a novation anticipated and documented in hedge documentation as part of a rollover strategy; would not result in discontinuance of the hedge relationship.

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 that equivalent amendments should also be made to the forthcoming chapter on hedge accounting which will be incorporated into 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 that no additional disclosures need to be introduced as a consequence of the proposed amendments because the existing disclosure requirements in IFRS 7 are adequate.

~ End ~