NOVATION OF DERIVATIVES AND CONTINUATION OF HEDGE ACCOUNTING
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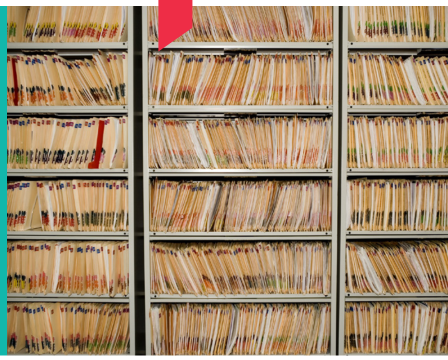

Background

As part of actions taken following the global financial crisis, the G20 made a commitment to improve transparency and regulatory oversight of OTC derivatives. It was agreed that all standard over-the-counter (OTC) derivative contracts should be cleared through a central counter party. A regulation was implemented in Europe which requires certain OTC derivatives to be cleared centrally through an independent counterparty.

As a result, a question was put to the IFRS Interpretations Committee (IFRS IC) as to whether the novation of these OTC derivatives to a central counterparty would result in a requirement to discontinue hedge accounting. This was on the basis that there is a change in the counterparty of the original hedge relationship, meaning that the novation results in a termination of the original derivative contract and the creation of a new derivative contract.

The IFRS IC agreed that the change in counterparty gives rise to a termination of the old, and the creation of a new, derivative contract. The IFRS IC recommended that the International Accounting Standards Board (IASB) should undertake a short term project for a limited scope amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*, providing relief that would allow hedge accounting to continue in this specific circumstance. This was on the basis that a continuation of the hedging relationship would provide more useful information to users of financial statements than the accounting that would result from a discontinuation of the old hedging relationship and (a possible) designation of a new hedging relationship.

At its January 2013 meeting, the IASB agreed that an amendment would be needed to continue the original hedging relationship in these circumstances, and that an amendment would be appropriate. The IASB noted that this issue is not limited to Europe because many jurisdictions have introduced or are expected to mandate, laws or regulations that require the novation of OTC derivatives to a central counter party.

STATUS
Exposure Draft

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
Signficant for entities that have designated over-the-counter (OTC) derivatives as hedging instruments where those derivatives are required to be novated to a central clearing counterparty by law.

Summary

On 28 February 2013, the IASB published Exposure Draft *ED/2013/2 Novation of Derivatives and Continuation of Hedge Accounting*. The ED proposes to introduce an exception to the discontinuation of hedge accounting in IAS 39 and IFRS 9, under which the novation of a hedging instrument would not trigger discontinuation of hedge accounting if certain strict criteria are met.

The proposed change would introduce a narrow scope exception to the requirement for the discontinuation of hedge accounting in IAS 39 and IFRS 9. This would have a significant effect on entities that have designated OTC derivatives as hedging instruments where those derivatives are now required to be novated to a central clearing counterparty by law.

The exception would apply if the following criteria are met:

- The novation is required by laws or regulations
- The novation results in a central counterparty becoming the new counterparty to each of the parties to the novated derivative, and
- The related changes to the terms of the novated derivative are limited to those necessary to effect the terms of the novated derivative.

The effective date for the amendments, if finalised, is to be confirmed. The ED did not propose any specific transitional provisions. Therefore, retrospective application would apply as required by paragraph 19(a) of IAS 8 *Accounting Policies and Changes in Accounting Estimates and Errors*.

Because these new laws or regulations could come into effect in some jurisdictions very soon, the IASB has published this Exposure Draft with a short (30-day) consultation period, with comments due by 2 April 2013.

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