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International Accounting Standards Board
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ED/2013/2 Novation of Derivatives and Continuation of Hedge Accounting - Proposed Amendments to IAS 39 and IFRS 9

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft 2013/2 *Novation of Derivatives and Continuation of Hedge Accounting - Proposed Amendments to IAS 39 and IFRS 9* (the ED). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

We support the proposed amendments. We believe that mandatory discontinuation of hedge accounting relationships due to novation of the hedging instrument that is required by a change in law or regulation would be counter-intuitive and fail to reflect the substance of the change. We therefore welcome the proposed relief in the limited circumstances set out in the ED.

Our responses to the questions in the ED's Invitation to Comment section are set out in the Appendix.

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@uk.gt.com or telephone + 44 207 391 9510).

Yours sincerely,

Kenneth C Sharp
Global Leader - Assurance Services
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Responses to Invitation to Comment questions

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?

We agree.

The proposals would create an exception to the current hedge accounting requirements. It is important that this exception is carefully demarcated and limited to the specific problem that it aims to address.

The conditions described above appear to us to be appropriate. That said, the specific laws and regulations in question (such as the European Union’s European market infrastructure regulation (EMIR)), and the associated implementations, are complex. We have not studied these requirements in detail. Preparers directly affected by regulatory changes are best placed to comment on whether the conditions described above are incompatible with any specific aspects of EMIR (or similar laws and regulations).

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 noted in our response to Question 1, we think it is important to ensure that the scope of the proposed exception is carefully demarcated. For that reason we generally agree that the exception should be limited to novations required by laws or regulations rather than voluntary novations.

We do however think that some flexibility in the application of the term ‘required by laws or regulations’ may be appropriate. For example, an entity might novate a class of derivatives to a central clearing counterparty in anticipation of a mandatory requirement to do so. We suggest the proposed relief should encompass this and other situations in which the facts and circumstances indicate that the entity’s actions were a consequence of the change in law or regulation.

However, as noted in our response to Question 1, preparers affected by EMIR and similar regulatory changes are best placed to comment on the detailed implications of the proposed limitation.

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.

Although IAS 39’s hedge accounting requirements are relevant in the context of EMIR and other short-term situations, it seems sensible to include the same relief in IFRS 9’s new hedge accounting requirements. This will avoid calls to amend IFRS 9 should new changes in laws or regulations (either in jurisdictions already affected or in different jurisdictions) give rise to similar novation requirements in future.

We also suggest that mandatory discontinuation of a hedge accounting relationship in the circumstances addressed would be even less appropriate under IFRS 9’s hedge accounting model. This is because the new model is based on the entity’s risk management strategy, which would presumably remain unchanged following novations required by laws or regulations.

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. We believe that an ability to continue the same hedge accounting relationship after a mandatory novation is intuitive and uncontroversial. Accordingly, this should not give rise to additional disclosures.