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By post and email: commentletters@hkicpa.org.hk

Mr Simon Riley
Director, Standard Setting Department
Hong Kong Institute of Certified Public Accountants
37th Floor, Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

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Dear Mr Riley

IASB Exposure Draft of Novation of Derivatives and Continuation of Hedge Accounting (Proposed Amendments to IAS 39 and IFRS 9)

We refer to your letter dated 8 January 2013 inviting our comments on the International Accounting Standards Board's Exposure Draft of Novation of Derivatives and Continuation of Hedge Accounting (Proposed Amendments to IAS 39 and IFRS 9).

Our comments on the specific questions raised in the exposure draft are attached. Should you have any questions, please do not hesitate to contact our Senior Business Manager Ms Caris Wan at 2521 1855.

Yours sincerely

Boey Wong
Secretary

Enc.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Boey Wong

主席 渣打銀行（香港）有限公司
副主席 中國銀行（香港）有限公司
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秘書 黃凱儀

**Response of the Hong Kong Association of Banks (“HKAB”) to the Specific Questions
in the International Accounting Standards Board’s Exposure Draft:
Novation of Derivatives and Continuation of Hedge Accounting,
Proposed amendments 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 generally support the proposed amendment to permit the novation of derivative instruments in certain circumstances without causing a discontinuance of hedge accounting. As the use of a central counterparty to clear derivative transactions becomes required in many jurisdictions, the proposed exception will ensure that reporting entities subject to such rules are not penalized for complying. The discontinuance of hedge accounting in such circumstances would not provide useful information to users of financial statements.

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?

We believe that the scope should be expanded to include those entities that novate derivative contracts to central counterparties 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.

In addition, we suggest that the amendments specifically state that the novation of a hedging instrument is not an expiration or termination if such novation is part of the entity's documented hedging strategy. This is consistent with the existing guidance in IAS 39 and IFRS 9 for replacements and rollovers. If a novation is documented as part of an entity's hedging strategy, then novations in connection with prospective clearing of derivatives with central counterparties would not result in hedge discontinuation, and the proposed amendments in the ED would not be necessary for such novations. As mandatory clearing generally only applies to new derivative instruments, the proposed amendments would effectively only apply to the very narrow circumstance where central counterparty clearing is required, for existing derivatives for which the novation would not have been contemplated in the original hedge documentation.

In addition, it may be necessary to novate a derivative contract to another entity within a group that is authorized to transact with a central counterparty. The proposed amendments should specifically contemplate such a situation.

Should the Board decide not to expand the scope to include voluntary clearing, the scope should still be expanded to include entities that early adopt what are otherwise mandatory clearing requirements under laws or regulations that have either been adopted or substantially adopted. From a practical standpoint, most entities subject to mandatory clearing would likely commence clearing of derivative contracts in advance of the mandatory effective date. However, as written, the proposed amendments would only apply once the mandatory clearing date is in effect.

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 the amendments should be made to both IAS 39 and IFRS 9, as both standards would result in the discontinuance of hedge accounting upon novation of the hedging instrument.

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 disclosures are not necessary for entities meeting the criteria in the proposed amendments. We do not believe that such disclosures would provide useful information to

users of financial statements and would incur unnecessary costs for reporting entities. Any change in the counterparty credit risk due to the change to a central counterparty will be reflected in the amount of ineffectiveness recorded through profit and loss.

Additional Comments

In regards to the transition requirements, we suggest that limited retrospective application be permitted for periods prior to the issuance of the final amendments. This may assist entities that have novated contracts that meet the proposed requirements but such novation occurs prior to the amendments being finalized by the Board. This would be the case where a regulatory requirement becomes effective before the Board completes work on the amendments.

In addition, the Board has concluded in BC5 that the novation of a hedging instrument meets the derecognition criteria under IAS 39. As a consequence of this conclusion, hedge accounting is discontinued upon a novation. While we do not disagree with this conclusion, it is clear from the Board's deliberations that alternative views exist and there may be situations, such as in a business combination, where hedging instruments have previously been novated without discontinuing an associated hedge relationship. The Board should clarify that the proposed amendments only apply to novations occurring after the adoption date and not to existing hedge relationships where there may have been a prior novation.