

March 26, 2013

Submitted electronically via www.ifrs.org

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

Dear Sirs,

Re: Novation of Derivatives and Continuation of Hedge Accounting (ED/2013/2)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the (IASB) Exposure Draft, *Novation of Derivatives and Continuation of Hedge Accounting*, issued in February 2013.

The AcSB is Canada's national accounting standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises. The AcSB consists of members from a variety of backgrounds, including financial statement users, preparers, auditors, and academics. Additional information about the AcSB can be found at www.frascanada.ca.

The views expressed in this letter take into account comments from individual members of the AcSB and its staff. However, they do not necessarily represent a common view of the AcSB, its committees or staff. Formal positions of the AcSB are developed only through due process.

We agree that IAS 39 *Financial Instruments: Recognition and Measurement* and the forthcoming hedge accounting chapter of IFRS 9 *Financial Instruments* should be amended to permit continuation of hedge accounting with a derivative that has been novated to a central clearing house. However, we do not agree that continuation should be contingent on a legal or regulatory requirement to novate the contract. We understand that regulators may not require novation in all jurisdictions through the issuance of formal laws or regulation. However, novation to a central clearing party will often be strongly encouraged through preferential capital relief or through access to government assistance. We agree that the terms of the new contract must match those of the one it replaces.

We have included responses to the questions set out in the Exposure Draft in the Appendix.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email peter.martin@cica.ca) or Kate Ward, Principal, Accounting Standards (+1 416 204-3437 or email kate.ward@cica.ca).

Yours truly,



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Appendix

Question 1

We agree that IAS 39 *Financial Instruments: Recognition and Measurement* and the forthcoming hedge accounting chapter of IFRS 9 *Financial Instruments* should be amended to ensure novation to a central clearing organization does not result in the discontinuance of hedge accounting. We think the changes will clarify the diverging views we have observed on whether changes to the standards are necessary.

We disagree with proposed paragraph 91/101(a)(i). The most important factor for hedge effectiveness is that the economic terms of the new contract (maturity date, basis, rate reset frequency, etc.) are identical to those of the original contract. Canadian regulators have not required novation but, as in other countries, the use of central clearing parties (CCPs) is becoming best practice, in part due to the effect on meeting capital adequacy requirements. Some jurisdictions encourage use of CCPs through either incentives or penalties. This voluntary use of CCPs equally accomplishes the policy objective of strengthening the financial system.

We have some concerns with proposed paragraph 91/101(a)(ii). We agree that use of a CCP is necessary but understand that, in some jurisdictions, access to CCP's is not direct for all market participants. We encourage the IASB to investigate whether a requirement to transact through a member clearing organization results in the CCP "becoming the new counterparty to each of the parties". We are assuming that this requirement would not affect an entity that transfers derivative contracts to a subsidiary provided the new counterparty is within a consolidated reporting entity. We think it would be helpful to clarify that the proposed guidance is using the term "novation" more broadly than its strict legal definition.

We agree with proposed paragraph 91(a)(iii). This restriction is necessary to maintaining the effectiveness of the instrument as a hedge of the designated risk.

Question 2

We disagree with restricting the scope of the proposed amendment to a novation that is required by legislation or regulation. As discussed above, this requirement would mean that a voluntary novation to a central counterparty would not result in the continuation of hedge accounting without de-designation and re-designation.

Question 3

We agree that equivalent amendments to IAS 39 should also be made to the forthcoming chapter on hedge accounting to be incorporated into IFRS 9. However, we think that careful consideration needs to be made of the proposed revisions to paragraphs 91 and 101 within the context of IFRS 9 prior to finalizing the hedge accounting chapter to ensure that they achieve the intended effect.

We also think that it would be helpful to provide transition guidance, particularly on application of the proposed amendment to novations that were undertaken prior to the change in IAS 39. This would clarify continuance of hedge accounting for those entities that previously applied interpretations similar to the amendments.

Question 4

We agree with not requiring disclosure that an entity has been able to continue hedge accounting by applying the relief provided by the proposed amendments. We think that any relevant information is already captured by the disclosures required by IFRS 7 *Financial Instruments: Disclosures*.