

**Mr. Hans Hoogervorst
International Accounting
Standards Board
30 Cannon Street
London
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United Kingdom**

The IASB's Exposure Draft *Novation of Derivatives and Continuation of Hedge Accounting: Proposed amendments to IAS 39 and IFRS 9*

Dear Mr Hoogervorst,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process. ESMA is pleased to provide you with the following comments aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.

ESMA has considered the IASB's Exposure Draft (ED) *Novation of Derivatives and Continuation of Hedge Accounting: Proposed Amendments to IAS 39 and IFRS 9*. ESMA supports the proposed amendments to IAS 39 and IFRS 9 so that the novation of a hedging instrument does not cause an entity to discontinue hedge accounting if a number of conditions are met. The discontinuation of a hedge relationship following the novation of a derivative contract resulting from it being cleared through a central counterparty without changing other major terms would not reflect the objective of the clearing requirement introduced by the European Market Infrastructure Regulation (EMIR) or similar legislation in other jurisdictions and would not provide useful information to users of financial statements.

Nonetheless, ESMA is concerned that by limiting the continuation of hedge accounting to novation resulting from central clearing that is "*required by laws or regulations*", the amendment would not capture all novations of derivatives resulting from central clearing that are concluded with the aim to reduce counterparty risks and could dis-incentivise central clearing on a voluntary basis.

Therefore, ESMA would support the approach that all novations of derivative contracts resulting from clearing through a central counterparty without changing the other major terms of the contracts benefit from the proposed exception.



Please do not hesitate to contact us should you wish to discuss any of the issues we have raised.

Yours sincerely,

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Steven Maijoor
Chair

European Securities and Markets Authority

A handwritten signature in blue ink, appearing to be 'J. Galbo', written in a cursive style.

Julie Galbo
Chair

Corporate Reporting Standing Committee
European Securities and Markets Authority

APPENDIX – ESMA’s detailed answers to the questions in the IASB’s *Classification and Measurement: Limited Amendments to 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?

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?

1. ESMA agrees that when a derivative contract (hedging instrument) is novated, resulting in being cleared through a central counterparty without changing its other terms, continuation of the hedging relationship would provide more relevant information to the users of the financial statements.
2. Nevertheless, ESMA is concerned that the scope of the proposed amendment could be unnecessarily restrictive by limiting the exception only to those novations that result from legislation explicitly mandating the use of central counterparties for existing derivative contracts. The legislation or implementing regulation would mandate clearing only of certain types of existing OTC derivatives through central counterparties. In other cases, clearing of existing OTC derivative contracts through a

central counterparty is not explicitly mandated or is mandated only subject to certain transitional period that are intended to facilitate its introduction.

3. Given the benefits introduced by the system of clearing of derivatives through central counterparties from a counterparty risk point of view, voluntary clearing of some other existing derivatives through a central counterparty should not be dis-incentivised, even if not mandatory required. That might be the case for certain types of derivatives that would not meet the conditions set in EMIR, as specified by ESMA technical standards. Accordingly, ESMA is of the view that existence of an explicit clearing obligation required by law and regulation should not be a pre-condition for the continuation of the hedging relationship, provided all other proposed conditions are met.

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?

4. ESMA agrees that the same amendment should be made both under IAS 39 – *Financial Instruments: recognition and Measurement* and IFRS 9 – *Financial Instrument* as the relief from the hedging requirements is required under both IAS 39 requirements and IFRS 9 draft requirements.

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?

5. ESMA agrees that requiring specific disclosures when an entity does not discontinue hedge accounting as a result of a novation in these circumstances would not provide useful information. From the perspective of the users of the financial statements, the hedge relationship would continue and current IFRS requirements do not require disclosures of other on-going hedge relationships. Furthermore, the impact of the changes in counterparty risk resulting from the novation would be captured by requirements from of IFRS 7 - *Financial Instruments: Disclosure* and IFRS 13 - *Fair Value Measurement*.