

MEMO

To: Due Process Oversight Committee

From: Michael Stewart, Director of Implementation Activities

Date: 1 February 2013

Subject: Request for short comment period for exposure draft

Proposed Exposure Draft for amendment to IAS 39 *Financial Instruments: Classification and Measurement*

Introduction

At the January 2013 IASB meeting the IASB discussed an urgent issue related to IAS 39. Specifically the matter relates to imminent changes in regulations in the EU and elsewhere on the use of Over The Counter (OTC) derivatives. These changes will require the novation of OTC derivative contracts to a central counterparty (CCP).. This regulatory change is part of the European Market Infrastructure Regulation (EMIR) and reflects commitments made by the G20 in response to the financial crisis. Because this change arises from a G20 commitment, it is not limited to the EU. In the US an equivalent change is included in the Dodd-Frank Wall Street and Consumer Protection Act, and other countries have or will be making similar regulatory changes.

A request for confirmation of the accounting treatment was raised with us in November 2012 and discussed at the January 2013 Interpretations Committee meeting. The Interpretations Committee asked that the Board consider making a limited amendment to IAS 39 as set out below.

Accounting consequences

The requirements of IAS 39 when applied to such a novation would require an entity holding an OTC derivative for hedge accounting purposes to cease hedge accounting on novation. Although the entity could elect to immediately restart hedge accounting using the novated derivative, the detailed requirements of IAS 39 would lead to increased volatility in the income statement because of the way that IAS 39 would require the effectiveness of the (new) hedge to be measured. In some circumstances the (new) hedge might even fail to qualify for hedge accounting under IAS 39.

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IASB proposal

The IASB was concerned about the effects on an entity's hedge accounting that these regulatory changes would introduce, and questioned the usefulness of the information that would result for users of financial statements if IAS 39 is not amended. The IASB therefore decided to propose an amendment to IAS 39 to allow the continuation of hedge accounting in this narrow circumstance. The IASB also decided that an equivalent change should be made to the forthcoming hedge accounting guidance in IFRS 9 *Financial Instruments*.

The IASB propose that the amendment should be limited in scope to circumstances in which:

- a) a novation is required as a result of legislation, regulation or similar statutory requirements;
- b) all parties to the original OTC derivative contract are affected in the same way by the novation; and
- c) there are no changes to the terms of the original OTC derivative contract other than the change of counterparty to a CCP

Short comment period

The IASB proposes a 30 day comment period. The reason for this is the matter is exceptionally urgent, the proposed amendment is short, and the IASB thinks that there will be broad consensus on the topic.

The EMIR regulatory changes are expected to come into effect within the first half of 2013, to be followed by the novation of the contracts as described above. At present the EU Parliament and Council have until 19 February to either approve or reject the technical standards that have been adopted by the European Commission. If approved, these technical standards will come into force 20 days after publication in the Official Journal of the European Union. Novation would occur after this date, but it is important that any changes to IAS 39 are made before this happens. In addition, similar changes are being required in the US with novations occurring in the near term.

The IASB plans to publish the ED in mid-February.

Request for approval

The IASB requests that the DPOC approve the short comment period of 30 days because of the exceptional circumstances described above.