

Straight away

IFRS bulletin from PwC

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IASB publishes amendments to IAS 39 on novation of derivatives

What is the issue?

Widespread legislative changes have been introduced to improve transparency and regulatory oversight of over-the-counter (OTC) derivatives. As a result, entities are novating derivative contracts to central counterparties (CCPs) in an effort to reduce counterparty credit risk.

Under IAS 39, 'Financial instruments: Recognition and measurement', an entity is required to discontinue hedge accounting for a derivative that has been designated as a hedging instrument where the derivative is novated to a CCP; this is because the original derivative no longer exists. The new derivative with the CCP is recognised at the time of the novation.

The IASB, however, was concerned about the financial reporting effects that would arise from novations that are a consequence of laws or regulations. As a result, the IASB has amended IAS 39 to provide relief from discontinuing hedge accounting when novation of a hedging instrument to a CCP meets specified criteria. Similar relief will be included in IFRS 9, 'Financial Instruments'.

Key amendments

The amendments will not result in the expiration or termination of the hedging instrument if:

- as a consequence of laws or regulations, the parties to the hedging instrument agree that a CCP, or an entity (or entities) acting as a counterparty in order to effect clearing by a CCP ('the clearing counterparty'), replaces their original counterparty; and

- other changes, if any, to the hedging instrument are limited to those that are necessary to effect such replacement of the counterparty. These changes include changes in the contractual collateral requirements, rights to offset receivables and payables balances, and charges levied.

The changes are broader than those proposed in the exposure draft published in February 2013, since the amendments refer to novations 'as a consequence of laws or regulations, rather than those 'required by' laws or regulations. The changes also expand the scope to allow the use of clearing brokers.

The amendments will apply for annual periods beginning on or after 1 January 2014. Earlier application is permitted.

Am I affected?

These amendments are beneficial to all entities applying hedge accounting that are subject to novation of OTC derivatives, as described above.

What do I need to do?

Entities should assess whether derivatives that are being novated comply with the criteria described above, to enable hedge accounting to continue.

If you have questions about this issue, please contact your PwC engagement partner. Engagement teams that have questions should contact their Global Accounting Consulting Services contact.



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