

2nd July 2021

Ms. Hillary Salo
 Technical Director
 Financial Accounting Standards Board
 401 Merritt 7
 P.O. Box 5116
 Norwalk, CT 06856-5116

By email: director@fasb.org

Re: File Reference No. 2021-002, Exposure Draft, *Derivatives and Hedging (Topic 815)*

Dear Ms. Salo,

The International Swaps and Derivatives Association’s (“ISDA”)¹ North American Accounting Policy Committee (the “Committee”) appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB”) Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815) Fair Value Hedging—Portfolio Layer Method* (the “Proposed ASU”). Collectively, the Committee members have substantial professional and practical expertise addressing accounting policy issues related to financial instruments. This letter provides our organization’s overall views on the Proposed ASU and our responses to the questions for respondents included within the Proposed ASU.

Overview

ISDA supports the FASB’s efforts to clarify and improve the US generally accepted accounting principles (“GAAP”) applicable to the hedging of a closed portfolio of prepayable financial assets. The Proposed ASU will provide clarification for preparers for certain topics included in Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (“ASU 2017-12”). The Committee broadly believes the proposed guidance will reduce the complexity and clarify the accounting and disclosures when hedging interest rate risk for portfolios of prepayable financial assets. However, the Committee has concerns regarding the operability of the criteria that needs to be

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 950 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: www.isda.org. Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#).

met in order to qualify for the portfolio layer method and the proposed amendments for sequencing upon a breach or anticipated breach.

Consistent with this, please see our answers to the Questions for Respondents below.

Questions for Respondents

Question 1—Operability: *Are the amendments in this proposed Update operable and auditible? If not, which proposed amendment or amendments pose operability or auditability issues and why?*

The Committee believes that the criteria in 815-20-25-12A(d) and (e) are operable as currently written, but would request clarification to avoid diversity in practice or interpretation. Specifically, 815-20-25-12A(e)(1) and (2) require all of the assets in the closed portfolio to be or become prepayable by the maturity date of the hedge (for hedges of a single layer) or the longest dated maturing hedge (for hedges of multiple layers). Further, 815-20-25-12A(d)(1) and (2) require all of the assets in the closed portfolio to mature after the maturity date of the hedge (for hedges of a single layer) or the earliest dated maturing hedge (for hedges of multiple layers). The requirements seem to imply that hedges have been executed before or at the same time the closed pool was created, which we believe is not true in all instances. Rather, we believe entities may first establish the closed pool of fixed rate financial assets, then create (or remove) one or more hedged layers they desire to hedge, and subsequently execute (or remove) hedging instruments (over a period of time) to designate against hedged layers as prepayment expectations change. As a result, we believe additional clarity would be helpful regarding how creating a closed portfolio, creating (or removing) hedged layers, and executing (or removing) hedges need to be considered in relation to each other. One suggestion to resolve this may be to amend the requirement in 815-20-25-12A(e)(1) and (2) to (1) only require the assets in the closed portfolio to be or become prepayable during their contractual life in order to be included in the closed portfolio; and (2) that the outstanding hedge notional each period is supported by assets that mature after the period or layer being hedged. This would allow entities to incorporate their assumption regarding prepayments in their forecasts and simplify the Proposed ASU.

Along the same lines, the Committee believes the Board could provide additional clarity regarding when hedge layers may be created and that an entity may voluntarily add hedging instruments (without de-designating existing layers) and terminate hedging instruments (without de-designating an entire layer). For example, an entity has a \$500 million pool with ten years until maturity and plans to hedge \$200 million during years 1 through 5 and \$200 million during years 6 through 10. After year 2, the entity recognizes their hedge was too conservative and wants to hedge \$300 million (i.e., an additional \$100 million) for years 3 through 5. As such, the entity enters into a new derivative to layer on an additional \$100 million for years 3 through 5. We believe it is the FASB's intent to allow entities to be able to add or remove hedging instruments and hedged layers over time. However, without explicitly stating this in the Codification we believe there is a risk this could be interpreted by our auditors as requiring a dedesignation. As such, the Committee believes this could be addressed by including in the authoritative section of the final Accounting Standards Update wording similar to what is in the Summary of the Proposed ASU but clarified with respect to hedged layers. That is "an entity would be permitted to designate new hedging relationships and dedesignate existing

hedging relationships and add new hedged layers and remove existing hedged layers associated with the closed portfolio any time after the closed portfolio is established in a designated portfolio layer method hedge without de-designating any existing or remaining portfolio hedges.

Question 2–Risk Management: *As proposed, would the multiple-layer model align with entities' risk management objectives? Please explain why or why not.*

Yes, the Committee supports the Board's proposal and believes this aligns with entities' risk management objectives.

Question 3–Scope: *Do you agree with the Board's decision to limit the scope of the types of instruments eligible for portfolio layer method hedging to prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments? Please explain why or why not.*

Yes, the Committee agrees with the Basis for Conclusions paragraph BC28 which states the primary objective of this narrow-scope project is to clarify and improve the amendments in Update 2017-12, rather than broadly reconsidering portfolio hedging. However, the Committee would be supportive of the Board considering expanding the scope of the portfolio layer method to liabilities as part of its broader hedge accounting 2.0 project.

Question 4–Dedesignation Sequencing: *Do you agree with the Board's proposed amendments on hedge dedesignation sequencing under the multiple- layer model? Please explain why or why not.*

The Committee does not disagree with the Board's proposed amendments on hedge dedesignation sequencing under the multiple-layer model, however, the Committee believes additional flexibility could be included in the Proposed ASU. In the event of an actual breach, pursuant to paragraph 815-20-55-14M, an entity would dedesignate the hedge layer with the shortest remaining hedge period that, if dedesignated, would bring the portfolio back into compliance with the requirements of paragraph 815-25-2-35-7A. In the Basis for Conclusions paragraph BC25, the Board decided against an alternative that would allow for the option to document a dedesignation sequence because of the complexity that would have resulted from the need to resequence if hedges associated with the closed portfolio changed over time. The Committee believes this complexity can be handled by entities by updating their sequencing documentation each time there is a change, for example if a new hedge is added (in which case the Committee would ask that it is explicitly stated in the Proposed ASU that this would not require de-designation of existing hedging relationships). This complexity could be further mitigated by stating within the guidance if an entity does not update their sequencing when hedges associated with the closed portfolio are changed, or an entity does not define sequencing at all, they would default to the prescribed sequencing method (i.e., dedesignating the shortest remaining hedge periods first). As such, the Committee would suggest allowing entities the flexibility to define dedesignation sequencing for operational and other reasons.

Question 5–Basis Adjustments: *Do you agree with the Board’s proposed amendments on accounting for basis adjustments and disclosure of those basis adjustments in disclosures required by other areas of GAAP outside hedge accounting? Please explain why or why not.*

Yes, the Committee agrees with the proposed amendments on accounting for basis adjustments and disclosing the adjustment as required by other areas of GAAP. This is consistent with the general fair value hedging method under GAAP today.

Question 6–"Follow the Asset" Method: *In the case of a breach, do the expected costs of identifying which assets in the closed portfolio that caused the breach justify the expected benefits of aligning the derecognition guidance with other Topics in GAAP? Please explain why or why not.*

No, the Committee does not believe the expected costs of identifying which assets caused the breach will justify the expected benefits of aligning the derecognition guidance with other Topics in GAAP. Under the portfolio layer method, entities may seek to create large closed portfolios of assets and hedge multiple layers in order to efficiently hedge a larger portion of the closed portfolio than was possible under existing GAAP. This will further complicate entities’ ability to identify which assets caused the breach given different asset classes generally do not reside on the same system for many entities. Additionally, from the perspective of the users of financial statements, we do not view aligning the derecognition guidance with other Topics as providing beneficial information. For example, some entities’ application of impairment could be mid-month (or quarter) versus end-of-month (or quarter), and entities with different application processes could have different results. As such, we do not believe “following the asset” would provide users of financial statements with decision useful or better information compared to applying a policy consistently. Further, there are currently no business-as-usual processes to analyze these breaches because pools are actively managed, and breaches rarely occur. As a result, because breaches are not expected nor planned for, it would be an operational burden to implement processes to accurately determine the P&L geography with very little benefit to the users given the practices described above. As such, the Committee believes allowing for an accounting policy election to determine the geography of the derecognized basis adjustments in the income statement and disclosing those amounts in the footnotes would be sufficient for users of financial statements.

Question 7–Certain Private Companies and Not-for-Profit Entities: *Would any of the proposed amendments require special consideration for private companies that are not financial institutions and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market)? If so, which proposed amendment or amendments would require special consideration and why?*

No, we are not aware of any proposed amendments that require special consideration for private companies that are not financial institutions and not-for-profit entities.



Question 8–Transition: *Do you agree with the proposed transition guidance? Please explain why or why not.*

Yes, the Committee agrees with the modified retrospective approach by means of a cumulative basis adjustment to the opening balance of retained earnings and the balance sheet line items as appropriate as of the date of adoption.

Question 9–Implementation: *How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.*

The Committee believes the guidance in this Exposure Draft should be effective for all entities for fiscal years beginning after December 15, 2022. Because hedge accounting is optional, we also believe entities should have the option to early adopt this guidance to begin more closely aligning their hedge accounting with their risk management objectives.

Closing

We hope you find ISDA's comments and responses informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter please do not hesitate to contact the undersigned.

Jeannine Hyman

Citigroup Inc.

Chair, North America Accounting Committee

Antonio Corbi

ISDA, Inc.

Director, Risk and Capital