November 25, 2024

Mr. Jackson M. Day
Technical Director
Financial Accounting Standards Board
801 Main Avenue, PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2024-ED200

Dear Mr. Day,

This letter is submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) in response to the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update—Derivatives and Hedging (Topic 815): Hedge Accounting Improvements (Exposure Draft or proposed Update).

FEI is a leading international organization comprised of members who hold positions as Chief Financial Officers, Chief Accounting Officers, Controllers, Treasurers, and Tax Executives at companies in every major industry. CCR is FEI's technical committee of approximately 50 Chief Accounting Officers and Corporate Controllers from Fortune 100 and other large public companies, representing more than $16 trillion in market capitalization. CCR reviews and responds to pronouncements, proposed rules and regulations, pending legislation, and other documents issued by domestic and international regulators and organizations such as the U.S. SEC, PCAOB, FASB, and IASB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary
We commend the Board's efforts to refine the hedge accounting guidance to (1) more closely align hedge accounting with the economics of companies' risk management activities and (2) address complexities driven by reference rate reform. CCR believes the amendments included in the five issues addressed in the proposed Update will better reflect companies' strategies in financial reporting by enabling companies to achieve and maintain hedge accounting for a greater number of highly effective economic hedges. CCR is supportive of the proposed amendments included in all five issues and believes they are clear and operable. We are supportive of the proposed transition method and strongly agree that companies should have the option to elect early adoption. We believe it would be beneficial to provide preparers with 18 months to implement after a final standard is issued.

In our letter, we provide suggestions to further improve the applicability of the proposed amendments for banks related to Issue 1: Similar Risk Assessment for Cash Flow Hedges and Issue 4: Net Written Options and discuss the basis for our suggested implementation period.

Suggestions Related to Issue 1: Similar Risk Assessment for Cash Flow Hedges
CCR is supportive of the proposed amendments to expand the hedged risks permitted to be aggregated in a group of individual forecasted transactions in a cash flow hedge by changing the requirement to designate a group of individual forecasted transactions from having a *shared* risk exposure to having a *similar* risk exposure. We believe the proposed amendments related to the similar risk assessment for

cash flow hedges will enable companies to apply hedge accounting to broader portfolios of forecasted transactions.

However, we believe the proposed Update can be further enhanced to better align the accounting with banks' risk management strategies. Below, we provide specific suggestions from the banking perspective.

Dedesignation when forecasted transactions are no longer similar
First, we believe companies should not be required to dedesignate the entire hedging relationship when (a) an entity has designated a hedge based on multiple interest rate indexes under the first-payments-received method and (b) one or more hedged risks related to individual forecasted transactions are no longer similar, in accordance with paragraph 815-20-55-23D and as illustrated in Example 4 —Variable Interest Payments on a Group of Variable-Rate, Interest-Bearing Loans as Hedged Item (Example 4), Case C.

Complexities related to dedesignation
We understand the Board's objective with the proposed amendments related to Issue 1 was to provide stakeholders with the ability to apply hedge accounting to more economic hedges in a cost-effective and efficient manner by allowing entities to expand pools of loans to reduce potential missed forecasts. Consistent with this objective, we would expect large banks with material first-payments-received programs to aggregate as many loans as possible. A complete dedesignation event for an entire hedge program would create significant complexity, as entities may use hundreds of different derivative instruments to hedge large pools. Furthermore, certain companies' systems are not able to automatically track and account for dedesignated hedges. As a result, dedesignation of an entire hedging program would result in a large-scale manual and recurring effort to track changes in expected cash flows and reclassify amounts from accumulated other comprehensive income (AOCI) to earnings. In addition, the requirement to dedesignate and redesignate raises the risk of not obtaining hedge accounting due to ineffectiveness from the off-market component.

Further complexities and inconsistencies may arise in scenarios when (1) entities change their risk management strategies or (2) an interest rate index is permanently discontinued by the rate administrator (i.e., cessation).

Change in risk management strategies
For example, assume (1) an entity initially designates an instrument as hedging the cash flow variability attributable to the first interest payments received on $100 million in principal of Prime or SOFR OIS variable interest rate loans, (2) discontinues its Prime loan business after one year, (3) and Prime and SOFR OIS become dissimilar ten years later. As proposed, the guidance may be interpreted to mean the entity would need to discontinue hedge accounting when Prime and SOFR become dissimilar, even if there have been no Prime cash flows for nine years but sufficient SOFR cash flows have continued. We believe this outcome is unintuitive and inconsistent with the company's risk management strategy.

Discontinuation of an interest rate index
In addition, the proposed guidance in paragraph 815-20-55-23D may be interpreted to mean that an entity needs to dedesignate the entire hedged pool of loans when an interest rate index is discontinued, even if the index that is expected to be discontinued remains "similar" up until its cessation date. As discussed above, a large-scale dedesignation event already creates significant complexities. When an

entity experiences these dedesignation complexities in conjunction with an interest rate cessation event that is already operationally burdensome in and of itself, it would seem that the outcome of the proposed Update's accounting model is not consistent with the proposed Update's stated objective.

Furthermore, after a similar risk dedesignation event in conjunction with a cessation event, there may still exist practice interpretations related to the inability of an entity to specifically identify the occurrence of the hedged forecasted transaction in a first-payments-received hedging relationship. As a result, entities would potentially be required to reclassify the entire net gain or loss related to the pool from AOCI to earnings upon dedesignation. The conclusion to reclass AOCI upon a cessation event missed forecast is even more clear if the market's identified fallback interest rate index was not included as part of an entity's initial hedge documentation. We do not believe this significant impact to earnings is consistent with the economics of the hedging strategy or the Board's objective.

While a permanent discontinuation of an interest rate index may not be common, we believe the probability is higher in a post-LIBOR environment where entities increasingly use a variety of alternative reference rates. For example, the recent discontinuation of the Bloomberg Short-Term Bank Yield Index ("BSBY") created significant complexity and required large reclassifications from AOCI to earnings for many banks.

Suggestions
First, when (a) an entity has designated a hedge based on multiple interest rate indexes under the first-payments-received method and (b) one or more of the hedged risks related to individual forecasted transactions are no longer similar, we believe (1) the loans related to the dissimilar risks should be removed from the pool and (2) no dedesignation should be required if (after removing the dissimilar loans from the pool) it is **probable** the entity will receive interest payments on a principal amount that is greater than or equal to the notional of the hedges.[1]

If, after removing the dissimilar loans from the pool, it is **not probable** that the entity will receive interest payments on a principal amount that is greater than or equal to the notional of the hedges, we believe the hedging relationship should only be partially dedesignated for future cashflows where the risks are no longer similar. Dedesignation should not be required for the remaining forecasted hedged cash flows that continue to have similar risks and are still probable of occurring.[2] If this partial dedesignation were to be allowed, we believe the similar risk and hedge effectiveness assessments for the remaining active hedges should be updated prospectively. Removing a designated hedged risk would only eliminate irrelevant risks, not add new risks to the pool. In other words, hedge accounting

[1] For example, consider a pool of loans where $40 million in principal is indexed to SOFR OIS, $80 million in principal is indexed to 1-Month Term SOFR, and $20 million in principal is indexed to the Prime rate. The entity designates an instrument as hedging the cash flow variability attributable to the first interest payments received during each month for the next 3 years on $100 million of principal. If the Prime rate becomes dissimilar, we would propose that dedesgination not be required. The loans indexed to the Prime rate would just be removed from the pool.

[2] For example, consider a pool of loans where $40 million in principal is indexed to SOFR OIS, $80 million in principal is indexed to 1-Month Term SOFR, and $20 million in principal is indexed to the Prime rate. The entity designates an instrument as hedging the cash flow variability attributable to the first interest payments received during each month for the next 3 years on $100 million of principal. If the 1-Month Term SOFR rate becomes dissimilar, we propose the entity be able to dedesignate the hedging relationships only for the cash flows that are no longer probable of occurring. The loans indexed to the 1-Month Term SOFR rate would be removed from the pool, and only $40 million would be dedesignated as the entity still has sufficient cash flows to cover $60 million in principal.

would not be obtained if the hedged risk was not one of the designated risks and had not passed the similar risk test. Although an entity would still be required to make operational updates to its remaining active hedges to reflect the removed hedge risk, the effort needed to implement is expected to be significantly less than a full program dedesignation and redesignation as currently proposed. This expectation is driven from the belief that many entities will apply the guidance in paragraph 815-20-55-23A(a), which is consistent with what many in practice apply today for testing effectiveness when a hedged pool is comprised of loans that all share the same interest rate index but have different underlying reset frequencies, etc. As such, the change would only require a documentation change and the removal of one of the hypothetical derivatives[3] from an entity's hedge system of record.

Furthermore, we suggest the Board provide explicit guidance addressing scenarios where banks change their risk management strategies or there is a discontinuation of interest rate indexes. Consistent with our suggestion above, we believe the Board should provide guidance to explicitly allow entities to remove certain hedged risks when they become irrelevant either due to a change in risk management strategies or index rate cessation, without affecting the remaining hedge relationship, provided sufficient cash flows indexed to the other hedged risk remain in a sufficient amount. We understand that the FASB developed the proposed amendments to reduce the frequency of AOCI reclassification due to missed forecasts and to better align hedge accounting with an entity's risk management strategies. To achieve this objective, we believe the Board should explicitly clarify that no missed forecast (i.e., immediate reclassification of AOCI into earnings) would be required due to rate cessation or discontinued cash flows resulting from changes in risk management strategies, as long as sufficient hedged cash flows indexed to any remaining risks continue to occur. When it is not probable that there will be sufficient flows indexed to remaining risks, we believe the Board should provide guidance to explicitly allow partial dedesignation upon a change in risk management strategies or index rate cessation, including addressing the ability to support the occurrence of the underlying forecasted transaction in a cessation scenario.

Lenders' aggregation of choose-your-rate debt instruments

We believe that the proposed Update should be modified to explicitly allow lenders to hedge a group of forecasted interest rate payments on variable choose-your-rate debt instruments with contractual terms that permit the borrower to change the interest rate index and interest rate tenor upon which interest is accrued, as long as the lender can prove that the forecasted interest payments have a similar risk exposure. Consistent with the proposed amendments in Issue 2 of the proposed Update, we believe the contractual terms of the debt agreement should determine the alternative interest rate indexes and interest rate tenors that the borrow may select during the hedging relationship without the lender needing to dedesignate the hedging relationship, as long as the lender can prove that the hedged forecasted interest payments continue to have a similar risk exposure and are probable of occurring. In addition to explicit guidance, we suggest the Board add a scenario to Example 4 to illustrate the application of the guidance when hedging a pool of forecasted interest rate payments on variable choose-your-rate debt instruments using the first-payments-received method (Case D).

Suggestion Related to Issue 4: Net Written Options as Hedging Instruments

CCR is supportive of the proposed amendments to making the net written option test more operable for hedging relationships involving a variable-rate loan with an interest rate floor hedged by an interest rate

[3] Assuming the entity applies the guidance in 815-30-35-25.

swap that contains a mirror-image interest rate floor. However, certain companies, particularly banks, question the need to retain the net written option test as described in paragraph 815-20-25-94 at all when the use of a net written option is still subject to the effectiveness requirements of Topic 815.

In practice the application of the net written option test can be complex as the assessment requires consideration of potential gain and loss symmetry for the hedged position for all possible percentage changes in fair values or cash flows. We believe the original intent of this guidance was to prevent potential abuse by entities in trying to designate a written option which by definition has a capped gain and the potential for unlimited losses. As the prospective effectiveness requirements in paragraph 815-20-25-79(a) require consideration of all reasonably possible changes in fair values or cash flows, the assessment of hedge effectiveness would already limit the use of net written options to narrow fact patterns and those scenarios that may otherwise pass the written option test without the additional complexity.

If the net written option test is retained, we suggest the Board extend the proposed conceptual changes to the qualitative net written option test. For example, we suggest the Board clarify whether the simplifying assumptions for net written options in paragraph 815-20-25-88 also apply to the qualitative net written option test in paragraph 815-20-25-89(b). This notion would apply when strike price and notional amount remain constant and hedges are combined collar hedges. In this instance, we believe the underlying rates should be assumed to be the same if they are within the same derived indexed (e.g. Daily SOFR and SOFR Term).

Effective Date and Transition

We support requiring entities to apply the amendments in the proposed Update prospectively for existing hedging relationships as of the date of adoption. CCR also strongly agrees that companies should have the option to elect early adoption. We believe it would be beneficial to provide preparers with 18 months to implement after a final standard is issued. This will allow companies time to assess the new requirements, identify the portfolio of impacted contracts, adjust hedging strategies, update hedging documentation, and develop new processes and controls. Furthermore, certain companies – primarily banks in response to the proposed amendments in Issue 1 – may need to make system changes, which require funding authorization, planning and testing. Additional time is also needed given the expected concurrent implementation of other standards.

Conclusion

We appreciate this opportunity to provide feedback on the proposed Update related to hedge accounting. We thank the Board for its consideration of our comments and welcome further discussion with the Board or staff at your convenience.

Sincerely,

Alice L. Jolla

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Chair, Committee on Corporate Reporting
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