

November 17, 2016

Russell G. Golden  
Chairman  
Financial Accounting Standards Board  
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Via email: [director@fasb.org](mailto:director@fasb.org)

File Reference: 2016-310 *Targeted Improvements to Accounting for Hedging Activities*

Dear Chairman Golden:

The American Bankers Association<sup>1</sup> (ABA) appreciates the opportunity to comment on the Exposure Draft *Targeted Improvements to Accounting for Hedging Activities* (ED). The ED proposes changes to GAAP that are meant to expand the opportunities to apply hedge accounting, simplify reporting of certain hedge results, and alleviate some of the burden of ongoing documentation in assessing hedge effectiveness. This ED is the product of the final phase of FASB's three-pronged project to review accounting for financial instruments. Earlier this year, FASB issued final standards related to the first two phases:

- Recognition and Measurement of Financial Instruments (ASU 2016-01), effective in 2018
- Measurement of Credit Losses on Financial Instruments (ASU 2016-13), effective in 2020

The use of derivative instruments in managing various financial risks is critical to the operations of many banks and other entities. However, current hedge accounting requirements are generally complicated and onerous, and the restatement consequences of compliance errors are unacceptable. As a result, use of hedge accounting by many institutions is often limited. With this in mind, ABA strongly supports FASB's efforts to expand and simplify hedge accounting. Taken as a whole, ABA expects that the proposals in the ED will better reflect the economic performance of banks that engage in such risk management activities.

### **Refinements in Fair Value Hedges of Interest Rate Risk Will Better Reflect Economics**

Most significantly, the proposed expansion of component hedging (such as hedging specifically for the interest rate risk of an instrument, instead of its full contractual cash flows) will likely provide bankers

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<sup>1</sup> The American Bankers Association is the voice of the nation's \$16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$12 trillion in deposits and extend more than \$8 trillion in loans.

with more opportunities to operationalize hedge accounting in a cost effective manner. For most practical purposes, the proposed component hedging stipulations sufficiently address the concerns many have historically had with the requirement that hedges need to be “highly effective” in order to qualify for hedge accounting. We are aware that significant efforts were made by FASB to evaluate, as proposed by many bankers, a “reasonably effective” threshold to qualify for hedge accounting. However, the expansion of component hedging enables bankers to better reflect how their specific derivative activities address such risks.

We also understand that there is to be no requirement to use the same approach across all hedging relationships as it relates to whether all or just the benchmark portion of the contractual coupon is utilized in the long-haul computations. We support this change – particularly upon transition – as it will significantly reduce the cost of implementing the standard.

### **Expansion of Indices Eligible for Hedge Designation Will Improve Risk Management Reporting**

ABA supports the expansion of the indices eligible to be designated in a hedge of interest rate risk. The additions of the SIFMA municipal swap rate for hedging fixed rate financial instruments and any contractually specified rate for hedging variable rate financial instruments are common sense improvements that have been sorely needed for hedges of interest rate risk. These changes will significantly improve how a bank’s risk management activities are reflected in the financial statements.

### **Retention of the Shortcut Method is Appropriate**

ABA supports the retention of the shortcut method of hedge accounting. While misapplication of the shortcut method has resulted in some restatements of financial statements, the shortcut method is still in effect at a significant number of institutions. With this in mind, we also believe that the option to apply the long-haul method (under certain conditions) if the bank determines that the shortcut method is no longer appropriate is beneficial.

### **Reduced Timing and Documentation Requirements are Supported**

ABA welcomes the efforts of FASB to alleviate some of the strict and onerous documentation and assessment requirements for hedging relationships, including allowing more time to perform the initial quantitative assessment and, in certain circumstances, allowing subsequent qualitative assessments to be performed. While we believe that the practical impact of such changes could be insignificant for many banks, they remove a big deterrent from those entities that may want to apply hedge accounting for the first time or consider expanding its use.

### **Clarification is Needed for Transactions that are Assumed to be Hedged**

Paragraph 815-20-25-84 allows an entity to assume that, in a cash flow hedge of a group of *forecasted transactions*, the timing in which the hedged transactions are expected to occur and the maturity of the hedging instrument match if those forecasted transactions occur within the same 31-day period as the maturity of the derivative. With this in mind, it is not uncommon to aggregate forecasted *collections or*

*payments* of interest in cash flow hedging relationships involving multiple variable-rate interest-bearing financial assets or liabilities, respectively. For example, such a relationship may identify the first \$100 million of \$3 billion of LIBOR-based interest cash receipts related to a particular lending portfolio for a particular month as the hedged item. Given there may be a large number of underlying financial assets, the timing of cash receipts may occur on multiple days during the month.

While we believe that FASB intends the 31-day “practical expedient” to apply also to collections and payments, the wording in the ED appears to be limited to transactions involving forecasted purchases and sales. We do not believe there is a conceptual distinction between forecasted purchases/sales and forecasted payments/receipts and note that strategies that involve interest receipts or payments are normally highly effective. Thus, we recommend clarification that the 31-day practical expedient applies beyond forecasted purchases and sales.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss our views.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael L. Gullette". The signature is fluid and cursive, with the first name "Michael" being the most prominent part.

Michael L. Gullette