November 4, 2016

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

File Reference: 2016-310, Exposure Draft of a Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedging Activities

Dear Ms. Cosper:

The 11 Federal Home Loan Banks (the “FHLBanks”) appreciate the opportunity to comment on the Financial Accounting Standards Board’s (the “FASB” or “Board”) Exposure Draft of a Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedging Activities (hereinafter referred to as the “proposed Update”). Derivative instruments are an integral part of each FHLBank’s financial and risk management strategies and as such, the impact of these instruments permeates each FHLBank’s financial statements. At June 30, 2016, the combined notional amount of derivative instruments held by the FHLBanks was $530 billion. Accordingly, the FHLBanks welcome changes to ASC 815 that simplify the application of hedge accounting.

Additionally, the FHLBanks would be supportive of changes that address the main objective of the proposed Update, which is “improving the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements.” However, the proposed Update would require an entity to present the entire change in the fair value of a hedging instrument in the same income statement line item in which the earnings effect of the hedged item is presented. This would require the FHLBanks to recognize within net interest income the transitory effects of market influences that are unrelated to their business strategy of managing interest rate risk. This would render the FHLBanks’ financial statements less useful because they would not faithfully portray the FHLBanks’ ability to manage interest rate risk. Net interest income and net interest margin are key performance indicators used both internally and externally that are currently visible and readily calculated from the amounts presented on the face of a financial institution’s financial statements. The proposed presentation change would distort these key performance metrics.

Background information on the FHLBanks and their extensive use of derivatives is presented below. The FHLBanks’ responses to the questions presented in the proposed Update that are relevant to the FHLBanks are presented in Appendix A. The FHLBanks’ letter to the Board regarding the inclusion of the Fed Funds Effective Swap Rate (“OIS”) as a benchmark interest rate is referenced in Appendix A and included as Appendix B.
Background Information—The FHLBanks and Their Use of Derivatives

The FHLBanks were created by the Federal Home Loan Bank Act of 1932 to enhance the availability of credit for residential mortgages, community lending, and targeted community development. The FHLBanks are cooperatives, which means that only members and (in certain circumstances) former members own the capital stock in each of the FHLBanks. FHLBank members receive dividends on their investment in capital stock from the earnings of their respective FHLBank. Today, there are approximately 7,200 FHLBank members, including commercial banks, thrifts, credit unions and insurance companies. The FHLBanks are U.S. Securities and Exchange Commission (“SEC”) registrants and accordingly, file periodic reports with the SEC.

The FHLBanks play a critical role in the continuous flow of funds to the residential mortgage market by providing loans (known as advances) to their members. The FHLBanks raise funds through the issuance of bonds and discount notes (collectively referred to as consolidated obligations) in the capital markets. These funds are loaned to member financial institutions, which in turn provide mortgage credit to homebuyers. In keeping with their cooperative philosophy, the FHLBanks price their advances at relatively small mark-ups over their cost of funds and return the majority of their net income to their members in the form of dividends. Accordingly, the FHLBanks’ net income, net interest income and balance of retained earnings are small relative to total assets and total liabilities, as presented below for the years ended December 31, 2015, 2014, and 2013.

![FHLBank System Combined Financial Information (in billions)](image)

It is not possible for an FHLBank to consistently issue debt simultaneously with the issuance of an advance in the same amount and with the same terms as the advance, or to predict what types of advances members might need or what types of consolidated obligations investors might be willing to buy. Therefore, to mitigate the mismatches between advances and consolidated obligations, both having a wide range of terms, the FHLBanks frequently convert both assets and liabilities to a variable-rate index such as LIBOR, and manage the interest spread between the pools of variable-rate assets and liabilities. This process of aligning the timing, structure, and amount of an FHLBank member’s credit needs with the investment requirements of an FHLBank’s
creditors is made possible by the extensive use of interest rate exchange agreements. At December 31, 2015, the notional amount of interest rate exchange agreements whereby the FHLBanks were hedging changes in fair value or probable future cash flows due to changes in a benchmark interest rate designated in qualifying ASC 815 hedging relationships with advances and consolidated obligations was approximately $145 billion and $183 billion, respectively. Given the volume of these instruments relative to FHLBank levels of net income, the proposed presentation of the entire change in the fair value of a hedging instrument in the same income statement line item in which the earnings effect of the hedged item is presented (i.e., in the margin) could cause substantial net interest income volatility for even minor movements in fair value due to risks other than interest rate risk. Because the FHLBanks issue advances and consolidated obligations with the intention of holding them until maturity, any such volatility would be transitory and would only distort the results of the FHLBanks’ ability to effectively manage interest rate risk. In addition to hedging interest rate risk associated with advances and consolidated obligations, the FHLBanks hedge interest rate risk associated with investment securities, mortgage loans and mortgage delivery commitments. Additionally, the FHLBanks offer interest rate exchange agreements to their members and may enter into offsetting positions to hedge the interest rate risk of those instruments. The FHLBanks do not use derivatives for speculative purposes. As of June 30, 2016, the combined notional value of interest rate derivatives that were designated in qualifying ASC 815 hedging relationships was approximately $353 billion. As of that same date, the FHLBanks had a combined $177 billion (notional value) of derivatives economically hedging identifiable risks.

The FHLBanks appreciate the Board’s efforts to make targeted improvements to the hedge accounting guidance and encourage the Board and the EITF to continue to address hedge accounting issues. However, in an effort to not delay the issuance of the proposed amendments, other targeted issues have not been included in this letter. We thank the Board for its consideration of our views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (404) 888-8142.

Sincerely,

[Signature]

William Shaw
First Vice President and Controller
Federal Home Loan Bank of Atlanta
(On behalf of the Federal Home Loan Banks as Chair of the Controllers’ Committee)
Appendix A

Question 1: The Board decided it would allow an entity to designate the hedged risk as the variability in cash flows attributable to changes in a contractually specified component stated in the contract in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset. Do you agree with that decision? Please explain why or why not. If not, what specific alternatives should the Board consider? Please explain why those alternatives would be beneficial.

Currently, none of the FHLBanks are hedging risks associated with non-financial assets, nor do they anticipate hedging such risks in the foreseeable future. Accordingly, this question is not applicable to the FHLBanks.

Question 2: The Board decided that it would retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments and forecasted issuances or purchases of fixed-rate financial instruments, maintain the existing list of permissible benchmark rates, and add the SIFMA Municipal Swap Rate to the list.

a. Should the Board retain the current concept of benchmark interest rates for fair value hedges of fixed-rate financial instruments and for cash flow hedges of forecasted issuances or purchases of fixed-rate financial instruments? Please explain why or why not.

b. If the Board continues to maintain the current concept of benchmark interest rates, should the Board consider within the concept expectations that a rate will become widely used?

c. If the Board continues to maintain a list of rates, are there any other rates that should be added to the list? Please explain why a particular rate meets the definition of a benchmark rate.

d. Are there other alternatives to the current concept of benchmark interest rates the Board should consider (for example, a principles-based approach)? Please describe those alternatives.

The FHLBanks agree with the Board’s decision to retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments and forecasted issuances or purchases of fixed-rate financial instruments. We believe that hedging changes in fair value or probable future cash flows attributable solely to changes in a benchmark interest rate for both assets and liabilities is one of the most common, straightforward and effective hedging strategies used by a multitude of entities.

We are not currently aware of other widely used interest rates that should be added to the list of permissible benchmark rates. We expect this list will change and expand over time as markets change and other rates become more widely used. Additionally, at this time, we are not aware of an alternative to the current concept of benchmark interest rates that the Board should consider.

Question 3: The Board decided that it would allow an entity to use either the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in the fair value of the hedged item attributable to interest rate risk, except when the current market yield of the financial instrument is below the
benchmark rate at hedge inception. In that instance, the total contractual coupon cash flows would have to be used. Do you agree with this decision? Please explain why or why not.

The FHLBanks agree with the Board’s decision to allow an entity to use either the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in the fair value of the hedged item attributable to interest rate risk. However, we do not believe that it is necessary to include a rule that prohibits an entity from measuring the change in fair value of the hedged item on the basis of the benchmark rate component of the contractual cash flows when the current market yield of the financial instrument is below the benchmark rate at hedge inception. Rather, if an initial prospective quantitative assessment of hedge effectiveness supports an expectation that a hedging relationship will be highly effective in achieving offsetting changes in fair value attributable to the hedged risk, then an entity should apply the principles of the guidance and select the method that it believes is most appropriate given the specific facts and circumstances of the transaction.

Question 4: In regard to hedging forecasted transactions, paragraph 815-30-40-5, as amended, states that “a pattern of determining that hedged forecasted transactions are probable of not occurring would call into question both an entity’s ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions.” What is your policy on what constitutes a pattern? Are there certain instances or scenarios in which missed forecasts should not be incorporated into the consideration of this pattern?

The FHLBanks believe that entities need to apply judgement in light of their specific facts and circumstances to determine if a pattern exists. We are not aware of any specific instances or scenarios in which missed forecasts should not be considered in the determination of a pattern of missed forecasts. Additionally, the FHLBanks do not believe that this is an area of accounting that needs additional guidance.

Question 5: Are there hedging relationships that would be eligible to meet the requirements in the proposed amendments and IFRS 9, but the hedge results would be recognized and presented differently? If so, please describe the transaction and why it would be recognized and presented differently in accordance with IFRS 9.

This question is not applicable to the FHLBanks.

Question 6: Do you agree with the following Board decisions on presentation? Please explain why or why not. If not, what other alternatives should the Board consider?

a. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would modify current GAAP by requiring the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is presented.

b. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would retain current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded
c. For cash flow hedges in which the hedged forecasted transaction is probable of not occurring, the proposed amendments would retain current GAAP by requiring amounts recorded in accumulated other comprehensive income to be reclassified to earnings immediately. However, the proposed amendments would require presentation of reclassified amounts in the same income statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.

The FHLBanks agree there should be a connection between the presentation of financial information and the activities undertaken to manage exposure to particular risks. Specifically, hedge accounting should reflect the purpose and effectiveness (or ineffectiveness) of an entity’s risk management activities. However, as previously stated, the FHLBanks do not agree that the Board’s decisions on presentation achieve this result, especially for financial institutions, because recording hedge ineffectiveness in the same income statement line as the earnings impact of the hedged item would impair the usefulness of a financial institution’s financial statements and disclosures. Net interest income and net interest margin are key performance indicators used both internally and externally that are currently visible and readily calculated from the amounts presented on the face of a financial institution’s financial statements. Requiring ineffectiveness to be presented within net interest income distorts these key performance metrics by requiring the entity to recognize the effects of market influences that are unrelated to business strategy (i.e., holding the instrument for the collection or payment of contractual cash flows). Distorting net interest margin could render the FHLBanks’ financial statements less useful to users of those statements, which is inconsistent with the FASB’s goal of improving financial reporting for hedging activities. Of particular concern to the FHLBanks, as both creditors and issuers of debt, would be the lack of comparability between peer financial institutions, and the inability of regulators and credit rating agencies to adequately evaluate performance by using the financial statements. The proposed presentation change may result in financial institutions disclosing non-GAAP measures so that users will be able to distinguish between the net interest settlement impact of the hedging instrument and the fair value volatility of the hedging instrument on net interest income. The creation of non-GAAP measures to address this issue will add additional complexity to entities’ periodic reports filed with the SEC, especially given the SEC’s recent heightened focus on the use of non-GAAP financial measures.

The FHLBanks use derivatives to reduce funding costs and manage interest rate risk and prepayment risk. Although we manage the risks mentioned and utilize these transactions for asset-liability tools, we do not manage the fluctuations in the fair value of our derivatives. We are essentially “hold-to-maturity” investors that transact derivatives to hedge interest and prepayment risks. We do not use derivatives for speculative purposes. By including volatility created by ineffectiveness with the income from our fundamental business activities, we are obscuring longer-
term trends in results of operations and profitability. The gains or losses from this volatility are associated with short-term market movements and will not be realized, as the derivatives’ values converge to zero over the lives of the derivatives.

Paragraph BC 62 of the proposed Update indicates that the Board considers the entire change in fair value of the hedging instrument a cost of hedging, hence the proposed recognition and presentation approach. The FHLBanks do not believe that ineffectiveness is a “cost” of hedging, as it is primarily the result of (i) volatility (gain or loss) associated with short-term market movements that will likely not be realized over the life of the hedging instrument (i.e., the fair value of the interest rate swap is zero at issuance and is zero at maturity) and (ii) the spread between the discount rate used to estimate the present value of the cash flows of the hedged item and the discount rate used to estimate the present value of the cash flows of the hedging instrument. The Board noted in paragraph BC 68 that the proposed measurement methodologies for fair value hedges of interest rate risk would “reduce or potentially eliminate the earnings mismatches (that is, ineffectiveness) that exists under current GAAP for these hedging strategies.” As illustrated in Example 9, Case A and Case B (paragraphs 815-25-55-53 through 55-61C, this conclusion is predicated on the assumption that the same discount rate is used to estimate the change in fair value of the hedged item and the hedging instrument. However, in practice, the fair value of a collateralized derivative is estimated using OIS as the discount rate, regardless of whether the derivative is indexed to LIBOR or OIS. Therefore, if an entity has designated the change in fair value of a financial instrument due to the change in LIBOR (as the benchmark interest rate) as the risk being hedged and has designated a collateralized LIBOR swap as the hedging instrument, the probability of achieving perfect offset is remote. Furthermore, the longer the term of the hedging relationship, the greater the risk of divergence between the LIBOR curve and the OIS curve, which can lead to relatively significant ineffectiveness. The FHLBanks do not believe that recording these earnings mismatches in the same line item as the earnings effect of the hedged item would increase the understandability or value of the results of an entity’s intended hedging strategies. Furthermore, depending on the magnitude of the mismatch, a financial institution’s interest income or expense may be completely diminished or even become negative. In our April 22, 2013 letter to the Board regarding the inclusion of OIS as a benchmark interest rate, the FHLBanks proposed a solution to exclude the impact of inconsistent discount rates from the assessment of effectiveness. That letter is included as Appendix B for ease of reference.

It is not necessary to record the effective and ineffective portions of a hedging relationship in separate line items in the income statement. Presumably, the change in fair value of the derivative is offset by the change in fair value of the hedged item and therefore only the difference in the change (i.e., the ineffective portion) is reflected in earnings. Currently, the FHLBanks record any ineffectiveness in other income (loss). The FHLBanks would, however, appreciate the Board addressing the income statement geography of net interest settlements associated with derivatives that are not designated in hedging relationships under ASC 815. The FHLBanks have historically recorded these amounts in other income or expense consistent with the recognition of any gain or loss on the derivative. However, if an entity has entered into an interest rate swap, regardless of whether the swap has been designated in a qualifying hedging relationship or was entered into to effectively hedge interest rate risk associated with a financial instrument for which the fair value option has been elected, net interest settlements should be recorded in interest income or expense consistent with the underlying economics of the transaction. This is of particular concern for
financial institutions. Requiring entities to record net interest settlements on derivative instruments in other income or expense does not faithfully represent a financial institution’s net interest income. Therefore, the FHLBanks request that the Board address the income statement presentation of net interest settlements for derivatives that are not designated in hedging relationships.

Furthermore, the cost of hedging as referred to by the FASB varies by type of entity. For an airline that hedges the cost of fuel with futures contracts, including realized gains on the futures in the income statement with the cost of the fuel reflects the economics of the transaction because the airline is hedging the change in fuel price. For a financial institution that is economically hedging interest rate risk with interest rate swaps, the comparable cost is the net interest rate settlements already included in net interest income with the debt being hedged. If interest rates increase and the financial institution has higher interest expense on their debt, it will be offset by net interest rate payments received on the interest rate swap in interest expense and will represent the true economics of the transaction. There will always be a realized dollar impact (or cost) on the net interest settlements on interest rate swaps unless there is no change in interest rates, which is highly unlikely. This impact is similar to a futures contract on commodities. However, fair values on the interest rate swap and the debt will fluctuate over the life of the interest rate swap and the debt but will net to zero at maturity. The actual economic impact of hedging (net interest settlements paid/received) is already reflected in the margin under current GAAP.

**Question 7:** Do you agree with the proposed disclosure amendments in (a), (b), and (c) below? Please explain why or why not.

a. **Cumulative basis adjustments related to fair value hedges**

b. **Quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals**

c. **Revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items.**

No. The FHLBanks generally believe the disclosure requirements of ASC 815 *Derivatives and Hedging* coupled with the requirements of ASC 825 *Financial Instruments* are sufficient to address the needs of financial statement users. Furthermore, the FHLBanks do not believe that the proposed disclosure regarding quantitative hedge accounting goals should be required in an entity’s financial statements. The FHLBanks believe such information may be difficult to audit and would be better suited in Management’s Discussion and Analysis.

**Question 8:** Unless the hedging relationship meets one of the exceptions that assumes perfect offset at hedge inception, an entity would be required to perform an initial quantitative test of hedge effectiveness and would be allowed to perform subsequent hedge effectiveness assessments qualitatively unless facts and circumstances change. Do you agree with this proposed change? Please explain why or why not.

Yes. The FHLBanks believe this in an improvement to the current guidance and applaud the Board’s efforts in this area.
**Question 9:** The Board decided that an entity may elect at hedge inception to perform subsequent assessments of effectiveness qualitatively. However, certain changes in the facts and circumstances associated with the hedging relationship in subsequent periods may require a quantitative assessment of effectiveness to be performed. Once an entity determines that a quantitative assessment of effectiveness is required, the entity would be prohibited to return to qualitative testing in periods after this determination is made. Can situations arise in which an entity no longer may assert qualitatively that the hedging relationship continues to be highly effective but when tested quantitatively would be highly effective? If so, please describe those circumstances. Should an entity be allowed to return to qualitative testing after such a significant change in facts and circumstances precluded it in a prior period? If so, please discuss the factors that an entity should consider to justify a reasonable expectation that the hedge will once again be highly effective on a qualitative basis.

The FHLBanks agree that subsequent changes in certain facts and circumstances associated with a hedging relationship may cause an entity to revert to a quantitative assessment test of effectiveness, rather than a qualitative test to confirm that the hedging relationship continues to be highly effective. Determining the timing of when a change is potentially material will require judgement.

An entity may choose to perform a quantitative test to confirm that an existing hedging relationship either continues to be highly effective or is no longer effective and therefore needs to be terminated. Once a quantitative hedge effectiveness test confirms that the hedging relationship is expected to be highly effective, then an entity should have the option to revert back to a qualitative hedge effectiveness test for subsequent periods or continue to perform a quantitative test. However, a quantitative test should not be a requirement.

**Question 10:** Do you agree with the proposed amendment that would allow an entity to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date using data applicable as of the date of hedge inception? Please explain why or why not.

Yes. We support the proposed amendment as it may provide us relief in certain scenarios and we believe that it will provide relief for entities with limited hedging activities.

**Question 11:** The proposed amendments related to the timing of the preparation of hedge documentation and subsequent qualitative testing apply to both public entities and private companies. Are there valid reasons why the content of or the timing of the preparation of hedge documentation should be different for public entities and private companies? If so, please describe the specific types of transactions for which different treatment should be considered.

The FHLBanks are not aware of any valid reasons why the content of or the timing of the preparation of hedge documentation should be different for public entities and private companies.
Question 12: Should the effective date be the same for both public business entities and entities other than public business entities?

The FHLBanks do not have an opinion regarding the effective date for other than public business entities.

Question 13: How much time is needed to implement the proposed amendments? Should entities other than public business entities be provided more time? If so, how much more time?

The FHLBanks believe that entities should be provided at least one year to prepare for adoption so that information system, financial reporting and internal control changes can be developed, implemented, and tested prior to adoption. However, because the proposed Update does simplify certain aspects of the hedge accounting model, we agree that early adoption should be permitted.

The FHLBanks do not have an opinion regarding how much time should be provided to other than public business entities.

Question 14: Do you agree with the proposed transition method and disclosures in paragraph 815-20-65-3? Do you agree with the Board’s decision not to allow a retrospective transition approach? Please explain why or why not.

The FHLBanks generally agree with the transition provisions in paragraph 815-20-65-3, with the exception of 65-3(c)(2). As discussed in our response to question 6, the FHLBanks do not believe that the entire change in the fair value of the hedging instrument should be presented in the same income statement line item as the earnings effect of the hedged item.

In addition, as provided in paragraph 815-20-65-3(g), the FHLBanks appreciate the Board providing entities with elections to modify the documentation for existing hedging relationships to specify subsequent hedge effectiveness methodologies. However, we believe the Board should clarify whether modification of each individual hedging relationship’s documentation is necessary. We do not believe it would be efficient to modify the documentation on thousands of hedging relationships. Rather, we believe that the final guidance should clearly state that entities may simply document how they will prospectively apply the guidance for a group of similar hedging relationships (e.g., assets designated in benchmark hedging relationships for which a quarterly quantitative hedge effectiveness assessment using rolling regression will no longer be performed because the entity will perform qualitative assessments in accordance with 815-20-25-117A without redesignating the hedging relationship).

The FHLBanks agree that a modified retrospective method of transition would reduce the cost and complexities of transition.
April 22, 2013

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File Reference: EITF-13A Exposure Draft of a Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815) Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes - a consensus of the FASB Emerging Issues Task Force

Dear Ms. Cosper:

The 12 Federal Home Loan Banks (the “FHLBanks”) appreciate the opportunity to comment on the Financial Accounting Standards Board’s (the “FASB” or “Board”) Exposure Draft of a Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815) Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes - a consensus of the FASB Emerging Issues Task Force (hereinafter referred to as the “proposed Update”). The FHLBanks are government-sponsored enterprises that serve the public by enhancing the availability of credit for residential mortgages and targeted community development. The FHLBanks are financial cooperatives and SEC registrants. Our responses to the questions asked in the proposed Updated are presented below.

**Question 1: Do you agree that the Fed Funds Effective Swap Rate (OIS) should be included as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR? Why or why not?**

Yes. The FHLBanks believe that including OIS as a benchmark interest rate may improve hedge accounting for current risk management strategies, as well as enable entities to incorporate new strategies to address market risks. Generally, the OIS curve is used as the discount curve when performing a present value calculation to estimate the fair value of a collateralized LIBOR-based swap that is designated as a hedge of changes in fair value due to changes in LIBOR (as the designated benchmark interest rate). Because LIBOR is the designated benchmark interest rate, the changes in the fair value of the hedged item due to changes in the designated benchmark interest rate are estimated using LIBOR as the discount curve when assessing hedge effectiveness using the long-haul method. This difference in discount curves results in additional hedge ineffectiveness that would not be present if the fair values of both the hedging instrument and the hedged item attributable to the risk being hedged were determined using the same discount curve. The FASB Emerging Issues Task Force (“EITF”) acknowledged this issue in EITF Issue No. 13-A (“Issue No. 13-A”) and proposed the inclusion of OIS as a benchmark as a means to address the issue. Issue No. 13-A states that proponents of including OIS as a benchmark interest rate believe that entities would utilize OIS products for fair value hedging strategies. However, including OIS as a benchmark interest rate may also decrease the ineffectiveness recognized in a fair value hedging relationship in which a LIBOR-based swap is used to hedge changes in fair value due to changes in OIS (as the designated benchmark interest rate) because the fair values of both the hedging instrument and the hedged item would be determined using the same discount curve (OIS) when assessing hedge effectiveness.
Question 2: Do you agree that no additional disclosures should be required? If not, please explain why.

Yes.

Question 3: Do you agree that the proposed amendments only should be applied on a prospective basis for qualifying new or redesignated hedging relationships? If not, please explain why.

Yes. The FHLBanks agree that the proposed amendments should only be applied on a prospective basis for qualifying new or redesignated hedging relationships. For certain hedging relationships using LIBOR-based swaps, the LIBOR swap curve will continue to be the benchmark interest rate risk being hedged. But for certain new or redesignated hedging relationships using LIBOR-based swaps, OIS may be the designated benchmark interest rate risk being hedged. Paragraph BC11 of the proposed Update clarifies that the inclusion of a new benchmark interest rate would justify an entity’s use of different benchmark interest rates for similar hedges. However, ASC 815-20-25-6 states that the use of different benchmark interest rates for similar hedges should also be rare. Assume an entity designates OIS as the benchmark rate for all new benchmark interest rate hedging relationships. Until the existing LIBOR-based benchmark interest rate hedging relationships have been terminated, or redesignated, the use of different benchmark interest rates for similar hedges will be commonplace. Furthermore, because an entity could use LIBOR-based swaps to hedge changes in both benchmark interest rates (LIBOR and OIS), the use of different benchmark interest rates for similar hedges could continue indefinitely. Accordingly, ASC 815-20-25-6 should be amended to remove the requirement that the use of different benchmark rates for similar hedges be rare.

Question 4: Should the effective date of the amendments in the proposed Update coincide with the issuance date of a final Update? If not, when should the amendments be effective? Please explain why.

Yes. The effective date of the amendments should coincide with the issuance date of the final Update.

Question 5: If the effective date of the amendments in the proposed Update does not coincide with the issuance date of a final Update, should early adoption be permitted? If not, please explain why.

Yes. The FHLBanks believe that entities should be able to adopt the amendments as soon as practicable.

Additionally, the FHLBanks believe the Board should consider further amendments to ASC 815 due to the increasing use of the OIS curve to estimate the fair value of derivatives. If the LIBOR curve and the OIS curve were to diverge significantly, entities that designate LIBOR-based swaps to hedge the risk of changes in fair value attributable to changes in LIBOR (as the designated benchmark interest rate), but use the OIS curve to discount the projected cash flows when estimating the fair value of the swap, would record additional ineffectiveness and potentially have to redesignate hedging relationships even if they are actually effective at hedging changes in the designated benchmark interest rate (LIBOR). This is because the current guidance in ASC 815 (formerly in FAS 133) does not permit an entity to exclude any components of the gain or loss on the hedging instrument, other than time value, from the assessment of hedge effectiveness. FAS 133, which was adopted by entities over a decade ago, has undergone many interpretations and amendments. However, none of those interpretations or amendments considered the shift from the use of the LIBOR curve to the OIS curve to discount projected cash flows when estimating the fair value of certain LIBOR-based swaps. Accordingly, the FHLBanks believe that the guidance needs to evolve so that the accounting is consistent with the general principle underlying ASC 815-20-25-82, which permits the exclusion of a gain or loss component that is unrelated to an entity’s defined risk management strategy for the assessment of hedge effectiveness. Specifically, at a minimum, ASC paragraph 815-20-25-83, “Example 9” in paragraphs 815-25-55-53 through 55-61, “Example 11” in
paragraphs 815-25-55-72 through 55-77, paragraph 815-20-35-16, and paragraph 815-25-35-2 should be amended.

Paragraph 815-20-25-83 states, in part, “Changes in the excluded component shall be included currently in earnings, together with any ineffectiveness that results under the defined method of assessing ineffectiveness. No other components of a gain or loss on the designated hedging instrument shall be excluded from the assessment of hedge effectiveness nor shall an entity exclude any aspect of a change in an option's value from the assessment of hedge effectiveness that is not one of the permissible components of the change in an option's time value.” This paragraph should be amended such that another component of a gain or loss on the designated hedging instrument (i.e., the difference in the values computed using OIS as the discount curve and LIBOR as the discount curve) may be excluded from the assessment of hedge effectiveness in a benchmark fair value hedging relationship. Consistent with the guidance in the first sentence of paragraph 815-20-25-83, this component would be recorded in earnings; however, it should not be viewed as ineffectiveness. It is not related to changes in the benchmark interest rate. The difference in values should be viewed as merely a component of the gain or loss on the hedging instrument as a result of changes in fair value. Consistent with the current disclosure requirements for excluded components (paragraph 815-10-50-4C(d)(2)), this amount could be disclosed separately as illustrated in Example 21, presented in paragraph 815-10-55-182. To isolate the changes in value due to a change in the benchmark interest rate, an entity should be permitted to use LIBOR as the discount curve for hedge effectiveness testing, even if OIS is used as the discount curve for estimating fair value. The accounting principle underlying this approach is consistent with the guidance in paragraph 815-20-25-82(d), which states:

If the effectiveness of a hedge with a forward contract or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the change in the difference between the spot price and the forward or futures price shall be excluded from the assessment of hedge effectiveness.

The FHLBanks believe similar language, such as the language shown below, could be provided:

If the effectiveness of a hedge with an interest rate swap is assessed based on changes in fair value attributable to changes in LIBOR, as the designated benchmark interest rate, the change in fair value of the contract related to changes in values computed using OIS as the discount curve and LIBOR as the discount curve should be excluded from the assessment of hedge effectiveness.

Example 9 may either be amended to incorporate the use of the OIS curve in the determination of the fair value of the swap or to state that the fair value of the swap in the example is estimated using the LIBOR curve as the discount rate due to the collateralization of the swap. If the latter approach is used, then an additional example illustrating the use of the OIS curve to determine the fair value of the hedging instrument and the use of the LIBOR curve to estimate the component of that change in fair value due to changes in the benchmark interest rate could be provided. This additional example could emphasize that the component of the gain or loss on the designated hedging instrument calculated as the difference in the values computed using OIS as the discount curve (for estimating fair value) and computed using LIBOR as the discount curve (for hedge effectiveness testing) should also be included in current earnings. If an additional example is not included, but the use of different discount rates for determining the swap's fair value and the swap's value for testing hedge effectiveness is permitted, then paragraph 815-25-55-61 should be amended to state that both the change in fair value of the hedged item and the change in fair value of the hedging instrument are attributable to the risk being hedged. In other words, any component of the gain or loss on the swap that is not due to changes in the benchmark interest rate (calculated as the difference in the values computed using OIS as the discount curve and LIBOR as the discount curve) is not ineffectiveness. Consistent changes should be made to Example 11.

Additionally, for a benchmark interest rate hedge, credit risk should be excluded from the assessment of hedge effectiveness and should not impact the recorded amount of ineffectiveness. As discussed above, in
a benchmark interest rate hedge, the assessment of hedge effectiveness and the amount of any recorded ineffectiveness should be based on the change in fair value attributable to only the change in the benchmark interest rate in order to be consistent with an entity's defined risk management strategy. Therefore, paragraph 815-20-35-16, which addresses the impact of a change in a derivative's fair value due to a change in the creditworthiness of the derivative counterparty, should be amended to clarify that it applies to full fair value hedges but not benchmark interest rate hedges, except for cases where it is not probable that payments will be made by the derivative counterparty.

Paragraph 815-25-35-2 states, in part, “If the fair value hedge is fully effective, the gain or loss on the hedging instrument, adjusted for the component, if any, of that gain or loss that is excluded from the assessment of effectiveness under the entity’s defined risk management strategy for that particular hedging relationship (as discussed in paragraphs 815-20-25-81 through 25-83)…” This paragraph should be amended to also refer to the paragraphs discussing the permitted exclusion of the component of a gain or loss on the hedging instrument calculated as the difference in the hedging instrument’s values computed using OIS as the discount curve and computed using LIBOR as the discount curve for assessing hedge effectiveness.

While the FHLBanks understand that the FASB’s hedging project has been indefinitely delayed, the FHLBanks suggest that the Board consider these additional amendments at this time so that entities will be able to apply comprehensive accounting guidance that reflects the current market environment. We thank the Board for its consideration of our views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (412) 288-5123.

Sincerely,

Edward V. Weller
Controller
Federal Home Loan Bank of Pittsburgh
(On behalf of the Federal Home Loan Banks as Chair of the Controllers’ Committee)