FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2016-05
March 2016

Derivatives and Hedging (Topic 815)

Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification®*

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The term *novation*, as it relates to derivative instruments, refers to replacing one of the parties to a derivative instrument with a new party. In practice, derivative instrument novations may occur for a variety of reasons, including (but not limited to) financial institution mergers, intercompany transactions, an entity exiting a particular derivatives business or relationship, an entity managing against internal credit limits, or in response to laws or regulatory requirements. The derivative instrument that is the subject of a novation may be the hedging instrument in a hedging relationship that has been designated under Topic 815, Derivatives and Hedging.

The issue is whether a change in the counterparty to a derivative instrument that has been designated as a hedging instrument under Topic 815, in and of itself, results in a requirement to dedesignate that hedging relationship and therefore discontinue the application of hedge accounting.

The guidance in Topic 815 is not explicitly clear about the effect on an existing hedging relationship, if any, of a change in the counterparty to a derivative instrument that has been designated as a hedging instrument. Furthermore, the existing guidance, which is limited, is interpreted and applied inconsistently in practice.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all reporting entities for which there is a change in the counterparty to a derivative instrument that has been designated as a hedging instrument under Topic 815.

What Are the Main Provisions?

The amendments in this Update clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18) continue to be met.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Questions were raised about whether a change in the counterparty to a derivative instrument, in and of itself, is considered to be a “termination” of the original derivative instrument in the context of the hedge accounting guidance in Topic 815. Similarly, questions were raised about whether the counterparty to the derivative instrument represents a “critical term” (as that term is used in Topic 815) of a hedging relationship. The answers to those questions affect the determination of whether the novation of a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship results in a requirement to dedesignate that hedging relationship and therefore discontinue the application of hedge accounting.

The amendments in this Update address those issues and resolve the diversity in practice.

When Will the Amendments Be Effective?

For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years.

For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.

An entity has an option to apply the amendments in this Update on either a prospective basis or a modified retrospective basis.

For entities electing the prospective approach, the amendments in this Update should be applied to all existing hedging relationships in which a change in the counterparty to a derivative instrument occurs after the date an entity adopts the amendments.

For entities electing the modified retrospective approach, the amendments in this Update should be applied to all derivative instruments that meet all of the following conditions:

1. The derivative instrument was outstanding during all or a portion of the periods presented in the financial statements.
2. The derivative instrument was previously designated as a hedging instrument in a hedging relationship.

3. The hedging relationship was dedesignated solely due to a novation of the derivative instrument, and all other hedge accounting criteria would have otherwise continued to be met.

Under the modified retrospective approach, an entity should not revise its financial statements for derivative instruments that were not outstanding as of the beginning of the earliest period presented in the financial statements.

Under the modified retrospective approach, derivative instruments that were dedesignated from hedging relationships during a period presented in the financial statements should have:

1. The effect of the hedge dedesignation removed from the financial statements for each period presented.

Under the modified retrospective approach, derivative instruments that were dedesignated from hedging relationships before the beginning of the earliest period presented that remain outstanding during all or a portion of the periods presented should have:

1. The effect of the hedge dedesignation removed from the financial statements for each period presented
2. Beginning retained earnings reflect a cumulative-effect adjustment for effects to financial statements before the beginning of the earliest period presented.

Under the modified retrospective approach, assessments of effectiveness and measurements of ineffectiveness required by the original hedge documentation should be performed for all periods between the date on which the hedging relationship was dedesignated due solely to a novation and the date on which an entity adopts the amendments in this Update.

Early adoption is permitted, including adoption in an interim period.

Amendments to the
FASB Accounting Standards Codification®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–8. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 815-25

2. Add paragraph 815-25-40-1A, with a link to transition paragraph 815-20-65-2, as follows:

Derivatives and Hedging—Fair Value Hedges

Derecognition

> Discontinuing Hedge Accounting

815-25-40-1 An entity shall discontinue prospectively the accounting specified in paragraphs 815-25-35-1 through 35-6 for an existing hedge if any one of the following occurs:

a. Any criterion in Section 815-20-25 is no longer met.
b. The **derivative instrument** expires or is sold, terminated, or exercised.
c. The entity removes the designation of the **fair value hedge**.

<u>**815-25-40-1A** For the purposes of applying the guidance in paragraph 815-25-40-1, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument.</u>

Amendments to Subtopic 815-30

3. Add paragraph 815-30-40-1A, with a link to transition paragraph 815-20-65-2, as follows:

Derivatives and Hedging—Cash Flow Hedges

Derecognition

> Discontinuing Hedge Accounting

815-30-40-1 An entity shall discontinue prospectively the accounting specified in paragraphs 815-30-35-3 and 815-30-35-38 through 35-41 for an existing hedge if any one of the following occurs:

a. Any criterion in Section 815-30-25 is no longer met.
b. The **derivative instrument** expires or is sold, terminated, or exercised.
c. The entity removes the designation of the **cash flow hedge**.

<u>**815-30-40-1A** For the purposes of applying the guidance in paragraph 815-30-40-1, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument.</u>

Amendments to Subtopic 815-20

4. Amend paragraph 815-20-55-56 and add paragraph 815-20-55-56A, with a link to transition paragraph 815-20-65-2, as follows:

Derivatives and Hedging—Hedging—General

Implementation Guidance and Illustrations

> Implementation Guidance

> > Hedge Effectiveness

815-20-55-56 This Subtopic permits a hedging relationship to be dedesignated (that is, discontinued) at any time. (See paragraphs 815-25-40-1(c) and 815-30-40-1(c).) If an entity wishes to change any of the critical terms of the hedging relationship (including the method designated for use in assessing hedge effectiveness), as documented at inception, the mechanism provided in this Subtopic to accomplish that change is the dedesignation of the original hedging relationship and the designation of a new hedging relationship that incorporates the desired changes. The dedesignation of an original hedging relationship and the designation of a new hedging relationship represents the application of this Subtopic and is not a change in accounting principle under Topic 250, even though the new <u>hedging</u> relationship may differ from the original <u>hedging</u> relationship only with respect to the method designated for use in assessing the hedge effectiveness of that hedging relationship. Although paragraph 815-20-35-19 refers to discontinuing an existing hedging relationship and then designating and documenting a new hedging relationship using an improved method for assessing effectiveness, that reference was not meant to imply that the perceived improved method had to be justified as a preferable method of applying an accounting principle under Topic 250.

815-20-55-56A For the purposes of applying the guidance in paragraph 815-20-55-56, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a change in a critical term of the hedging relationship.

5. Add paragraph 815-20-65-2, and its related heading, as follows:

> Transition Related to Accounting Standards Update No. 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*

815-20-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*:

a. For **public business entities**, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years.
b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
c. An entity shall apply the pending content that links to this paragraph on either a prospective or a modified retrospective basis.
d. For entities electing the prospective approach, the pending content that links to this paragraph shall be applied to all existing hedging relationships in which a change in the counterparty to a derivative instrument occurs after an entity adopts the pending content that links to this paragraph.
e. For entities electing the modified retrospective approach, the pending content that links to this paragraph shall be applied to all derivative instruments that meet all of the following conditions:
    1. The derivative instrument was outstanding during all or a portion of the periods presented in the financial statements.
    2. The derivative instrument was previously designated as a hedging instrument in a hedging relationship.

3. The hedging relationship was dedesignated solely due to a novation of the derivative instrument, and all other hedge accounting criteria would have otherwise continued to be met (including those in paragraphs 815-20-35-14 through 35-18).

f. Under the modified retrospective approach, an entity shall not revise its financial statements for derivative instruments that are no longer outstanding as of the beginning of the earliest period presented in the financial statements.

g. Under the modified retrospective approach, derivative instruments that were dedesignated from hedging relationships during a period presented in the financial statements shall have:
   1. The effect of the hedge dedesignation removed from the financial statements for each period presented.

h. Under the modified retrospective approach, derivative instruments that were dedesignated from hedging relationships before the beginning of the earliest period presented that remain outstanding during all or a portion of the periods presented shall have:
   1. The effect of the hedge dedesignation removed from the financial statements for each period presented
   2. Beginning retained earnings reflect a cumulative-effect adjustment for effects to financial statements before the beginning of the earliest period presented.

i. Under the modified retrospective approach, assessments of effectiveness and measurements of ineffectiveness required by the original hedge documentation should be performed for all periods between the date on which the hedging relationship was dedesignated due solely to a novation and the date on which an entity adopts the pending content that links to this paragraph.

j. Early application of the pending content that links to this paragraph is permitted for all entities, including adoption in an interim period.

k. An entity shall provide the disclosures in paragraphs 250-10-50-1(a) and 250-10-50-2, as applicable, in the period the entity adopts the pending content that links to this paragraph.

l. An entity that elects to apply the pending content that links to this paragraph using the modified retrospective approach also shall provide the disclosures in paragraph 250-10-50-1(b)(1) and (b)(3), as applicable, in the period the entity adopts the pending content that links to this paragraph.

Amendments to Status Sections

6. Amend paragraph 815-20-00-1, by adding the following items to the table, as follows:

815-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-20-55-56	Amended	2016-05	03/10/2016
815-20-55-56A	Added	2016-05	03/10/2016
815-20-65-2	Added	2016-05	03/10/2016

7. Amend paragraph 815-25-00-1, by adding the following item to the table, as follows:

815-25-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-25-40-1A	Added	2016-05	03/10/2016

8. Amend paragraph 815-30-00-1, by adding the following item to the table, as follows:

815-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-30-40-1A	Added	2016-05	03/10/2016

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. As it relates to derivative instruments, the term *novation* refers to replacing one of the parties to a derivative instrument with a new party. In practice, derivative instrument novations may occur for a variety of reasons, including (but not limited to) financial institution mergers, intercompany transactions, an entity exiting a particular derivatives business or relationship, an entity managing against internal credit limits, or in response to laws or regulatory requirements. The derivative instrument that is the subject of a novation may be the hedging instrument in a hedging relationship that has been designated under Topic 815.

BC3. The guidance in Topic 815 is not explicitly clear about the effect on an existing hedging relationship, if any, of a change in the counterparty to a derivative instrument that is designated as the hedging instrument in that hedging relationship. Furthermore, the guidance, which is limited, is interpreted and applied inconsistently in practice. As a result, questions were raised about whether a change in the counterparty to a derivative instrument, in and of itself, is considered to be a "termination" of the original derivative instrument in the context of the hedge accounting guidance in Topic 815. Similarly, questions were raised about whether the counterparty to the derivative instrument represents a "critical term" (as that term is used in Topic 815) of a hedging relationship. The answers to those questions affect the determination of whether the novation of a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship results in a requirement to dedesignate that hedging relationship and therefore discontinue the application of hedge accounting.

BC4. At its June 18, 2015 meeting, the Task Force reached a consensus-for-exposure that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18) continue to be met.

BC5. The Board subsequently ratified the consensus-for-exposure and on August 6, 2015, issued a proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships,* for public comment, with a comment period that ended on October 5, 2015. The Board received 17 comment letters on the proposed Update. Overall, respondents supported the amendments in the proposed Update.

BC6. The Task Force considered the feedback received on the proposed Update at its November 12, 2015 meeting and reached a consensus affirming the amendments in the proposed Update. The Board subsequently ratified the consensus, resulting in issuance of this Update.

Scope

BC7. The Task Force reached a consensus that the amendments in this Update should apply to all reporting entities for which there is a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship under Topic 815.

BC8. The Task Force decided that focusing the scope of the amendments in this Update on the effect, if any, on an existing hedging relationship of a change in the counterparty to a derivative instrument will resolve the practice issue while not affecting the application of Topic 815 as it relates to the effect of other changes on existing hedging relationships.

Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships

BC9. The Task Force reached a consensus that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18) continue to be met.

BC10. Specifically, the amendments in this Update clarify that when applying the guidance in paragraphs 815-25-40-1 (for fair value hedges) and 815-30-40-1 (for cash flow hedges), a change in the counterparty to a derivative instrument, in and of itself, should not be considered a "termination" of the original derivative instrument by the entity. Similarly, the amendments clarify that when applying the guidance in paragraph 815-20-55-56, a change in the counterparty to a derivative instrument should not, in and of itself, be considered a change in a "critical term" of the hedging relationship.

BC11. In reaching its consensus, the Task Force noted that the analysis of whether a derivative instrument has been "terminated" in the context of the hedge accounting guidance in Topic 815 was intended to go beyond a legal determination and instead focus on whether the hedging relationship itself would continue to exist. If the only change to the derivative instrument is the counterparty, the hedging relationship may be largely unaffected. Therefore, "termination" (as that term is used in the hedge accounting guidance in Topic 815) of the derivative instrument will not have occurred.

BC12. The Task Force acknowledged that certain instances of novation may lead to changes in security or cash collateral posting requirements. The Task Force decided that these changes should be incorporated into the assessments of hedge effectiveness and measurements of hedge ineffectiveness performed by an entity after the occurrence of a novation, as necessary.

BC13. The Task Force noted that the hedge accounting guidance refers to critical terms in other contexts (for example, the critical terms match method of hedge accounting) and does not cite the counterparty, in and of itself, as a critical term. In those contexts, critical terms refer to factors that affect the amount and timing of contractual cash flows. Other terms of a hedging relationship that do not affect the contractual cash flows may affect the probability of performance of the contractual terms. The Task Force noted that those terms that affect the probability of performance of the contractual requirements of each instrument are addressed in paragraphs 815-20-35-14 through 35-18 (the counterparty default guidance).

BC14. As a result of the counterparty default guidance, the Task Force noted that a reporting entity always is required to assess the creditworthiness of the derivative instrument counterparty in a hedging relationship (both in the normal course of the hedging relationship and upon a novation). Therefore, if a derivative instrument novation involves a new counterparty with different creditworthiness than the old counterparty, the reporting entity must consider that change in creditworthiness in determining whether the hedging relationship continues to qualify for hedge accounting, as well as the amount of hedge ineffectiveness to be recorded to the extent that it does continue to qualify for hedge accounting.

BC15. The Task Force also noted that it is clear in other Topics that transactions in the market between investors (counterparties) do not affect the accounting for the issuer (reporting entity). For example, paragraph 470-50-40-7 states:

> Transactions among debt holders do not result in a modification of the original debt's terms or an exchange of debt instruments between the debtor and the debt holders and do not impact the accounting by the debtor.

Therefore, the Task Force determined that it is inconsistent to claim that changing the counterparty to the derivative instrument, in and of itself, would cause a dedesignation of the hedging relationship under Topic 815, while changing the counterparty to the hedged item would not.

BC16. The Task Force concluded that the financial reporting result of dedesignating a hedging relationship upon a derivative instrument novation (that is, the existing derivative instrument will likely have a fair value other than zero upon dedesignation and, therefore, may or may not qualify to be redesignated as part of a new hedging relationship) does not provide decision-useful information to users of financial statements when the reporting entity plans to continue the hedging relationship. They noted that as part of the feedback received by the FASB on its previous hedge accounting Exposure Drafts in June 2008 and May 2010, users expressed frustration with trying to understand the financial reporting implications of reporting entities going in and out of hedge accounting. The Task Force concluded that the amendments in this Update will result in financial reporting that best captures the economic substance of derivative instrument novation transactions.

BC17. In addition, the Task Force noted that assessments of hedge effectiveness and measurements of hedge ineffectiveness when off-market derivative instruments are involved can require complex calculations. Therefore, the Task Force concluded that requiring the dedesignation of a hedging relationship upon a derivative instrument novation may increase the cost and complexity of complying with Topic 815. That could be particularly true for those entities that may have applied an abbreviated qualitative assessment of hedge effectiveness (for example, the shortcut method) before a hedge dedesignation and performed complex quantitative hedge effectiveness calculations under the long-haul method after redesignation.

BC18. The Task Force considered but rejected several other alternatives that would have resulted in more dedesignation events upon a change to the derivative instrument counterparty. One of those alternatives would have clarified that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship does not require dedesignation of that hedging relationship provided the creditworthiness of the new counterparty is similar to or better than the creditworthiness of the old counterparty. The Task Force ultimately rejected that alternative because the judgment needed to determine whether the creditworthiness of the new and old counterparties would be considered "similar" may lead to continued diversity in practice. In addition, the Task Force concluded that the incremental safeguard in this rejected alternative was not necessary because novation of a derivative instrument generally requires the consent of the remaining party to the derivative instrument, and the remaining party is unlikely to agree to a novation in which the creditworthiness of the new counterparty is significantly worse than the creditworthiness of the old counterparty without receiving consideration. As a result, in practice under the amendments in this Update, novation of a derivative instrument generally is likely to occur only if the creditworthiness of the new counterparty is similar to or better than that of the old counterparty. Therefore, the Task Force concluded that this rejected alternative would have added an additional requirement to be assessed, which adds cost, complexity, and (potentially) diversity, while not serving a functional purpose in many circumstances. In addition, as noted earlier, a change in creditworthiness of the derivative instrument counterparty must be considered by the reporting entity in determining whether the hedging relationship continues to qualify for hedge accounting, as well as the amount of hedge ineffectiveness to be recorded to the extent that it does qualify for hedge accounting.

Transition

BC19. The Task Force reached a consensus that an entity should apply the amendments in this Update prospectively to all existing hedging relationships in which a change in the counterparty to a derivative instrument occurs after the effective date of this guidance. This is consistent with the transition framework established by the Derivative Implementation Group (DIG) in Statement 133 Implementation Issue K5, "Miscellaneous: Transition Provisions for Applying the Guidance in Statement 133 Implementation Issues."

BC20. The proposed Update requested feedback on allowing retrospective transition for hedging relationships dedesignated due to a derivative instrument novation if hedge effectiveness was originally assessed using an abbreviated method. The Task Force initially thought that the most significant benefit of retrospective transition would be for hedging relationships originally assessed using an abbreviated method because of the increased costs incurred by entities when those hedging relationships were redesignated as hedges under a long-haul method or were not redesignated as hedging relationships. Retrospective transition allows those entities to revert back to the less costly abbreviated method of assessing effectiveness and measuring ineffectiveness.

BC21. Based on feedback received from comment letter respondents, the Task Force decided to permit a modified retrospective application. Under that approach, retrospective application applies to hedging relationships dedesignated as a result of a derivative instrument novation where the derivative instrument was outstanding during the current period or comparative periods presented in the financial statements, regardless of whether the hedging relationship was redesignated or whether assessments of effectiveness, before the dedesignation, were performed using an abbreviated method or a long-haul method.

BC22. The Task Force decided that the intent of the amendments in this Update is to allow preparers to revise prior-period financial statements for dedesignations that occurred as a result of a derivative instrument being novated. The Task Force preferred to provide an opportunity to revise prior-period financial statements for all hedging relationships, not just those for which hedge effectiveness was originally assessed using an abbreviated method. The Task Force did not see the benefit of providing this benefit to a subset of hedging relationships.

BC23. The Task Force decided that a modified retrospective application could be beneficial to both preparers and users of financial statements. For preparers, modified retrospective transition will remove income statement volatility generated by (a) incremental ineffectiveness from redesignated hedging relationships, relative to the ineffectiveness generated from the original hedging relationship, and (b) the periodic change in fair value of derivative instruments not redesignated in hedging relationships, after a dedesignation due solely to a novation of the derivative instrument. For users, modified retrospective transition will facilitate users' analysis of trend information in financial statements for entities that present comparative periods.

BC24. The Task Force concluded that if an entity elects the modified retrospective approach, the entity must apply the amendments to all hedging relationships that meet all of the following criteria:

a. The derivative instrument was outstanding during all or a portion of the periods presented in the financial statements.
b. The derivative instrument was designated as a hedging instrument in a hedging relationship.
c. The hedging relationship was dedesignated solely due to a novation of the derivative instrument, and all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18) would have otherwise continued to be met.

BC25. Under the modified retrospective approach, the modified retrospective accounting provisions apply to all derivative instruments that meet the above criteria because the Task Force was concerned that some entities may apply the modified retrospective approach to only a subset of hedging relationships that would improve specific aspects of the financial statements.

BC26. Permitting retrospective transition is within the transition framework established by Statement 133 Implementation Issue K5. That transition framework allowed the Board to specify retroactive application of any implementation guidance if warranted by the circumstances.

BC27. Under the modified retrospective approach, an entity should not revise its financial statements for derivative instruments that were not outstanding as of the beginning of the earliest period presented in the financial statements.

BC28. The Task Force acknowledges that full retrospective application would be a more precise form of retrospective transition but concluded that the additional time and cost associated with full retrospective application will not provide incremental benefit relative to the modified retrospective application described herein.

BC29. The time and cost needed to apply the modified retrospective application described in this Update was considered by the Task Force when deciding to permit rather than require a modified retrospective application.

Effective Date

BC30. The Task Force reached a consensus that the amendments in this Update should be effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years.

BC31. Based on the Private Company Decision-Making Framework, the Task Force concluded that for entities other than public business entities, the amendments in this Update should be effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.

BC32. Furthermore, the Task Force decided that earlier application should be permitted to allow entities to apply the amendments in this Update at their convenience.

Benefits and Costs

BC33. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC34. The Task Force anticipates that the amendments resulting from this Update will decrease costs and complexity for entities that experience a change in counterparty to a derivative instrument that is part of an existing hedging relationship designated under Topic 815. The amendments in this Update will result in financial reporting that best captures the economic substance of derivative instrument novation transactions, which will provide decision-useful information to users. The amendments in this Update also will provide the benefit of improving consistent application of GAAP by clarifying the application of guidance that already exists within GAAP.

Comparison with International Financial Reporting Standards (IFRS)

BC35. In June 2013, the International Accounting Standards Board (IASB) published Novation of Derivatives and Continuation of Hedge Accounting

(Amendments to IAS 39), which allows hedge accounting to continue when the novation of a derivative instrument is done to effect central clearing with a central counterparty as a consequence of laws or regulations. Similar relief was incorporated into IFRS 9, *Financial Instruments*.

BC36. The amendments in this Update are broader than the amendments to IAS 39 because these amendments allow a hedging relationship to continue after any novation of the hedging instrument, provided that all other hedge accounting criteria (including those in paragraphs 815-20-35-14 through 35-18) continue to be met.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.