MINUTES

FINANCIAL ACCOUNTING STANDARDS BOARD

MEMORANDUM

To:	Board Members		
From:	Hedging Team		
Subject:	Minutes of December 2, 2016 Roundtable (AM & PM Sessions)	**Date:**	February 22, 2017
cc:	Stacey Sutay		

The roundtable meeting minutes are provided for the information and convenience of constituents who want to follow the standard-setting process; these minutes do not represent official positions of the FASB. Official positions of the FASB are reached only after extensive due process and deliberations.

Topic: Proposed Accounting Standards Update: *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

Basis for Discussion: Proposed Accounting Standards Update: *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* feedback received from roundtable participant comment letters

Length of Discussion: 9:00 a.m. to 12:00 p.m. & 1:00 p.m. to 4:00 p.m.

Attendance:

External Participants

Jeff Bryan	Dixon Hughes Goodman
Steve Castleton	Chatham Financial
Chandu Chilakapati	Alvarez and Marsal
Chip Currie	PricewaterhouseCoopers LLP
Gautum Goswami	BDO USA LLP
Jon Howard	Deloitte & Touche LLP
Rahim Ismail	U.S. Securities and Exchange Comission
Jeannette Paul	Federal Home Loan Banks
Mark Scoles	Grant Thornton LLP
Lou Fanzini	TD Bank
Helen Kane	Hedge Trackers

Thomas Karafin	American Council of Life Insurers
Kevin Kispert	Ernst & Young LLP
Mark Northan	KPMG LLC
Daniel Palomaki	International Swaps and Derivatives Association
Laurin Smith	JP Morgan Chase
Cindy Steward	National Oilseed Processors Association
David Wendt	Archer Daniels Midland Company

FASB Participants

Russ Golden	Board Chair
Jim Kroeker	Board Vice Chair
Christine Botosan	Board Member
Daryl Buck	Board Member
Hal Schroeder	Board Member
Marc Siegel	Board Member
Larry Smith	Board Member
Sue Cosper	Technical Director
Matt Esposito	Assistant Director
Chandy Smith	Senior Investor Liaison
Jeff Gabello	Supervising Project Manager
Julie Um	Assistant Project Manager
Adam Kamhi	Practice Fellow
Rosemarie Sangiuolo	Project Consultant
Caro Baumann	Postgraduate Technical Assistant
Josh Seward	Postgraduate Technical Assistant

<u>Topic 1: Component Hedging for Nonfinancial Items</u>

1. Participants were generally supportive of component hedging, and thought the proposed amendments were a large improvement over current GAAP.

   AM session

2. A majority of participants advocated “going further” than the contractually specified component (CSC) concept, by proposing a market convention or more principles based approach.
3. Reasons for moving away from the CSC concept include (a) the one-time costs to add specified components into existing contracts are significant (due to entities having long term contracts with many suppliers or having to give concessions to suppliers as a result of opening up contracts), (b) many transactions are done “at spot” and don’t specify specific components, meaning these purchases could not be hedged under the proposed amendments and (c) limiting the amount of hedging relationships that are eligible to be hedged would be moving away from

the Board's objective of accurately reflecting an entity's risk management strategies.

4. Two consultants and two auditors that advocated going further than the CSC concept recommended the separately identifiable and reliably measureable concept, which is included in IFRS 9.
5. One auditor was hesitant about moving to a market convention approach. Instead, he advocated for the CSC concept.
6. One auditor expressed concern over whether the CSC would have to be explicitly stated in the final contract (rather than pre-negotiating documents, for example) to qualify.
7. A FASB Board member expressed concern that if people were having trouble understanding and potentially implementing a CSC concept, then there would be even greater difficulty in trying to understand and potentially implementing a principles based approach.
8. One consultant recommended going forward with the proposed amendments and waiting for IFRS 9 implementation before trying to change contractually specified to a more principles based approach, like separately identifiable and reliably measurable.
9. One consultant mentioned that multiple clients have already implemented the IFRS 9 separately identifiable and reliably measurable concept, and that the evidence produced by those clients relating to how the separately identifiable and reliably measurable component relates to the end product is sufficient for auditors.

PM session

10. A nonfinancial preparer, two industry groups, and auditor supported the CSC concept, but also would support moving to a market convention such as separately identifiable and reliably measurable after IFRS 9 is implemented. One of the industry groups futher clarified that while they support a market convention, they support moving forward with the CSC concept as they would not want the project delayed.
11. A nonfinancial preparer and industry group asked questions about what documents containing the CSC would be acceptable to comply with the standard. They specifically asked about whether invoices, purchase receipts, and any legal obligation to pay – that specifies the price component – would be acceptable.
12. A financial preparer asked whether specifying that a rate plus basis in a contract would be contractually specified if the rate was not explicitly referenced in the contrat, but instead a "rate code" was stated in the contract – which could be traced to a specific rate – would be sufficient.
13. A consultant expressed concern with potential manipulation of the CSC concept.

Topic 2: Determining Benchmark Rates

14. Participants were generally supportive of retaining the current concept of benchmark rates and incorporating into the concept an expectation that a rate will become widely used.

AM session

15. An auditor opposed incorporating whether a rate will become widely used into the benchmark rate concept because there can be both positive and negative expectations, which are judgmental and hard to implement.
16. An auditor, industry group and consultant wanted a more timely process to add more benchmark rates when they arise.
17. A financial preparer supported moving towards a principles based approach instead of the current list of benchmark rates and also supported incorporating whether a rate will become widely used into the concept.
18. A consultant shared that clients would like to add prime to the list of acceptable benchmark rates, but the current list gives clients the ability to use hedge accounting for about 90% of the total hedges into which they enter. The consultant also supported incorporating whether a rate will become widely used, but emphasized that adding that into the standard is not of extreme importance. This consultant also stated the “widely used” concept should not be the only concept considered so that the rate to be introduced by the Alternative Reference Rate Committee (ARRC) can be added as a benchmark rate.

PM session

19. An industry group favored a principles based approach based on any interest rate rather than a principles based approach based on a risk free rate. The group also shared that the current concept of benchmark rates works well because most companies use LIBOR, but the current concept would be more difficult if an entity wanted to use a rate other than LIBOR.
20. Another industry group was supportive of retaining the current concept due to the familiarity with the concept. Additionally, retaining the current concept avoids introducing the “uncertainty” that could come with a principles based approach. They did acknowledge that switching to a princples based approach would better lend itself to whether a rate would become widely used, such as the new benchmark rate to be chosen by the ARRC.
21. A financial preparer expressed concern with switching to a principles based approach other than the IFRS concept of separately identifiable and reliably measurable, since it is the only principles based approach that has been proven to work. They also expressed support in the Board’s process of of adding rates as they become relevant, such as the EITF process for adding OIS to the list of benchmark rates. Therefore, the new rate chosen by the ARRC should be addressed in the same matter.
22. Another financial preparer also emphasized that the current list of benchmark rates is working and that switching to a more principles based approach would be more appropriate in the future.

<u>Topic 3: Sub-Benchmark/Market Yield Test</u>

23. Participants generally opposed the market yield test.

AM session

24. An auditor and a consultant supported the market yield test because they did not feel a company should be able to hedge more than their risk exposure (that is, the total coupon cash flow).
25. An auditor and a financial preparer opposed the market yield test and thought there should always be a choice between the benchmark cash flows and the total coupon cash flows. The auditor pointed out that in late-term hedges, the market yield test allows the benchmark to be designated even though the benchmark is greater than the contractual coupon. Therefore, the market yield test is flawed if it is meant to prevent an entity from hedging more than the total coupon cash flows.
26. A financial preparer opposed the the market yield test because it often issues sub-LIBOR fixed rate loans. Due to not being able to use the benchmark rate to measure the change in fair value of the hedged item, they would be penalized under hedge accounting for issuing high credit quality loans.
27. An auditor requested clarification on whether cash flow hedge accounting would be allowed for a forecasted issuance of fixed rate sub-LIBOR debt because fair value hedge accounting would not be allowed under the market yield test once the sub-LIBOR debt is issued.

PM session

28. A financial preparer stated that quantitative experts at the company disagree with the market yield test because there should be no difference in treatment for a positive or negative spread to the benchmark.
29. An auditor who supported the market yield test stated that without the test, a company would be able to hedge cash flows that do not exist. He also stated that the differences in cash flow and fair value hedging are warranted.
30. An industry group that opposed the market yield test stated that a positive or negative spread is still based on LIBOR and therefore, there should always be the option to choose to designate the benchmark or total coupon.
31. An auditor pointed out that the market yield test does allow for the benchmark rate to be used in late hedges when the benchmark rate is greater than the total coupon.
32. Another industry group mentioned there would not be many circumstances when the market yield test would kick in.

<u>Topic 4: Presentation</u>

33. Participants were generally supportive of presentation of hedging effects in the same income statement line item as the hedged item. Participants were generally not supportive of the presentation of missed forecasts 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.

AM session

34. A financial preparer stated that GAAP should not be prescriptive for presentation of hedge accounting results. A change in fair value should not be forced into Net Interest Margin (NIM), and the proposed amendments would not do enough to reduce the volatility to zero. The disclosures and investor education about the changes from the proposed amendments are not preferable to company discretion over where to present the effects of hedging in the financial statements. The company expressed concern over the volatility from changes in fair value because the majority of financial instruments are held to maturity and therefore the period changes in fair value are not an important indicator of the hedging program. The financial preparer would also prefer entities to have the ability to present the effects of economic hedges in NIM.
35. A consultant expressed concern over the sensitivity of key metrics such as NIM as well as combining what a company can control (the accruals) with what a company cannot control (the changes in fair value).
36. An auditor disagreed with the cost of hedging concept as explained by the Board. This auditor thought the cost of hedging is the extra basis points added onto one of the legs of a swap by a bank that increases the amount a company must pay each period, not the difference between the mark-to-market of the hedged item and the swap.
37. an auditor agreed with the cost of hedging concept as explained by the Board. The consultant stated that this would benefit his corporate clients. The auditor questioned why the clean value would ever not go to the same line item that the proposed amendments prescribe because all aspects of the hedge should be presented together.
38. An auditor stated that there would be some consequences of the presentation changes in the proposed amendments, but that disclosures would help minimize the consequences.
39. Two auditors and a consultant were not supportive of the missed forecast and excluded component presentation in the same income statement line item as the earnings effect of the hedged item. They stated that there is a lack of consistency for missed forecasts because the event did not actually happen, so therefore the hedging effects should not be presented in the same line item as a hedged item that never runs through the income statement.
40. A consultant stated there should not be a requirement to present missed forecasts in the same income statement line item in which the hedged item would have been presented had it occurred.
41. Another consultant stated there should be a princples based approach for where to present the effects of missed forecasts.

PM session

42. An industry group expressed disagreement with presenting excluded components in the same income statement line item as the earnings effect of the hedged item because the proposed change would be distortive and introduce volatility. This industry group also stated that if the presentation

issue would jeapordize the issuance of a final standard, then they have no appetite to hold up the final standard. The industry group commended the Board on the tabular disclosure in conjunction with the proposed amendments on presentation, but suggested breaking it down further by adding a line in the table called “earnings mismatch.”

43. The industry group stated that there would not be a lot of volatility under the proposed amendments in the Exposure Draft, so therefore putting the full effects of the hedging instrument in NIM would be acceptable. The industry group accepts with the presentation changes, especially if cross currency basis spread volatility stays in an “other” income statement line item with the earnings effects of foreign exchange risk. Therefore, the industry group stated the Exposure Draft is beneficial and will help reduce non-GAAP measures. This industry group also added that companies are concerned with the effect of discounting OIS when the derivative is fully collateralized and LIBOR is designated as the hedged risk because the basis spread between OIS and LIBOR has increased since the financial crisis.
44. A financial preparer stated that the biggest issues were presentation of excluded components and missed forecasts, but would also like to have the mark-to-market adjustment of the hedged item in a different line item outside of NIM. The financial preparer also suggested amortization of the excluded component on a straight-line basis over time rather than the mark-to-market adjustment under current GAAP.
45. Another industry group also expressed concern over the presentation changes for excluded components and missed forecasts.
46. An auditor was less concerned with where excluded components were presented, but emphasized concern with the timing of releasing excluded components from OCI. The auditor suggested either releasing from OCI on a straight-line basis or deferring release until the end of the hedging relationship to ease user understanding.
47. A financial preparer commended the Board and staff for their efforts in outreach with companies during the hedging project so far.
48. An industry group supported the presentation changes and stated that the companies within the industry group already present the entire effects of the hedging relationship in the same income statement line item as the earnings effect of the hedged item. The industry group also stated that missed forecasts are part of the cost of hedging and are also presented in the same line item as the hedged item by members of the industry group.
49. A consultant stated that the issue with the proposed changes for excluded components is less about where in the income statement they would be presented, but the timing of when they would be recorded because a company might be recording the excluded components in revenue today when the actual transaction will not flow through revenue for ten more years. They also expressed concern of where to put the hedging effects of an intercompany transaction that affects two different line items.

<u>Topic 5: Disclosures</u>

50. Most participants supported the cumulative basis and income statement tabular disclosures and thought they will provide useful information to users. Most participants opposed the qualitative disclosure of quantitative goals.

AM session

51. An auditor stated that hedge accounting goals are not necessarily the same as risk management goals, and that it is difficult to assess success or failure of hedge accounting goals. Additionally, there are other risk management strategies outside of financial instruments, so users would not get a clear view of an entity's entire hedging strategy.
52. A consultant expressed concern that companies would be requied to disclose operational expertise under the quantitative goals disclosure.
53. A financial preparer stated that the company does not have specified hedging goals and that there is enough information in the MD&A section of the financial statements to render the quantitative goals disclosure unnecessary.
54. An auditor stated that in theory the quantitative goals disclosure would be straightforward, but disclosing these for complex risk management strategies would be difficult.

PM session

55. A nonfinancial preparer asked whether the quantitative goals disclosure focused on all hedging goals or just hedge accounting goals. The staff responded that the focus of the disclosure was on hedge accounting goals. The nonfinancial preparer also stated that companies disclose what was hedged volumetrically, but do not necessarily have a goal.
56. An industry group stated that quantitative hedge accounting goals do not exist and companies economically hedge as much as possible.
57. A financial preparer stated that the company does not have quantitative goals for interest rate risk management using hedge accounting.
58. A consultant stated that for many companies, hedging is a risk management tool and not a core business process. Therefore, it is innapropriate to have a goal.
59. An industry group stated that the company is not aware of goals for hedge accounting and that it is only one part of their risk management strategy.
60. An auditor stated that goals are not part of the financial reporting process otherwise, so therefore the disclosure should be limited to any goals disclosed to governance formally.

<u>Topic 6: Qualitative Testing</u>

61. Most participants supported returning to qualitative testing after a change in facts and circumstances requires a quantitative test that proves the hedge relationship is still highly effective.

AM session

62. An auditor stated that as long as the quantitative test performed after facts and circumstances change proves that the hedging relationship is still highly effective, that an entity should be allowed to return to qualitative testing.
63. A financial preparer stated that an entity should not be precluded from returning to qualitative testing, but asked how an entity should implement qualitative testing.
64. Another auditor stated that an entity should be allowed to return to qualitative testing after apparent one-time events or short-term market disruptions. They acknowledged that there would be difficulty in determining if the degree of correlation has decreased over time.
65. A consultant stated that changes in facts and circumstances will happen often with commodity hedges, due to market indicies constantly changing.

PM session

66. An industry group stated that many companies have already established a system of quantitative tests and therefore may not utilize qualitative testing.
67. A nonfinancial preparer stated that a company should be able to return to qualitative testing after a unique weather event.
68. An auditor stated that if facts and circumstances change to an extent that a company is required to perform a quantitative test, but then the facts and circumstances change back to where they were originally, a company should be able to return to qualitative testing. This is especially supported by the auditor if the company performed stress testing in their Day 1 hedge documentation.
69. An auditor stated that when facts and circumstances change and companies are required to perform a quantitative test that turns out to still be highly effective, they should be able to return to qualitative testing. This auditor would prefer for any change in a critical term to require quantitative testing unless the company performed stress testing at inception of the hedge.
70. A financial preparer disagreed with the auditor in the paragraph above because the company has a good sense of hedge accounting so therefore there is room for judgment in qualitatively determining when changes in facts and circumstances are severe enough to no longer be able to rely on qualitative testing.

Topic 7: Private Company Hedge Documentation

71. Most participants were not supportive of content or timing differences for private companies.

AM session

72. A representative from the Private Company Council stated that private companies struggle with hedge documentation – it is either non-existent or does not meet the requirements. He stated that practitioners have to help private companies with hedge documentation because the private companies have a difficult time understanding the hedge accounting guidance. The representative also stated that private companies are not performing retrospective quantitative effectiveness testing.
73. An auditor stated that timing is the issue more than content of documentation, but that private companies do not provide any hedge documentation beyond the hedged item, the hedging instrument, and the risk the company is exposed to.
74. Another auditor stated that he saw no reason why private companies cannot make assertions for hedge documentation at the end of the year.

PM session

75. A consultant stated that clients realize that they did not have adequate hedge documentation at the end of the year so they discontinue hedge accounting. The constultant also stated that beyond documenting the hedged item, the hedging instrument, and the intent to apply hedge accounting, there is no robustness in documentation from private companies.
76. A nonfinancial preparer stated that there should be no differences in content or timing of hedge documentation for public and private companies because the hedge documentation serves the same purpose for both types of entities.
77. An auditor stated that without documentation, the ability to look back and decide whether an entity does or does not apply hedge accounting is not acceptable.

<u>Other Topics Discussed</u>

78. An auditor stated that there is diversity in practice for how to reclassify amounts from Other Comprehensive Income (OCI) for missed forecasts.
79. A consultant stated that there is flexibility in practice today in how to determine whether there has been a missed forecast. If a client anticipates receiving wheat from Kansas but instead receives it from Minneapolis, there should not be a penalty and therefore there should not be a need to reclassify from OCI immediately.
80. A financial preparer asked whether a transaction that still occurs but not the way you thought it would occur would still be considered a failed forecast. The financial preparer brought up the example in paragraphs 815-30-55-52 to 55-62 in the Exposure Draft.
81. An auditor stated that when entering into a hedge of a forecasted transaction, if an entity designates multiple “grades” of the hedged item (i.e. corn purchased from Iowa or corn purchased from South Dakota) then initial testing can be performed on both “grades”, allowing an entity to successfully hedge despite not knowing which of the two “grades” will actually be delivered.