American Bankers Association
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Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
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Via email: director@fasb.org

RE: File Reference No. 2019-790 Proposed Accounting Standards Update—*Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting*

Dear Chairman Golden:

The American Bankers Association[1] (ABA) welcomes the opportunity to comment on Proposed Accounting Standards Update—*Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting* (the exposure draft). The exposure draft seeks to clarify certain areas of Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (Update 2017-12) so that the standard achieves the objectives articulated in Update 2017-12. Specifically, the key issue addressed by the exposure draft is the clarification and codification of the Board's intention to maintain hedge accounting in certain circumstances when there is a change in hedge risk in a cash flow hedge. The exposure draft also seeks to clarify specified components in cash flow hedges of nonfinancial forecasted transactions, address the dual hedge of a foreign-currency-denominated debt instrument as a hedging instrument and a hedged item, and address conflicting uses of the word "prepayable" by replacing it with the term "early settlement" for the purposes of applying the short cut method of hedge accounting. ABA supports the objective of Update 2017-12, as adjusted by the changes proposed in the exposure draft, to align hedge accounting better with risk management activities, and in that process see that reported results better reflect those activities to users of the financial statements. However, we have further comments and recommendations.

[1] The American Bankers Association is the voice of the nation's $18 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard more than $14 trillion in deposits, and extend $10.4 trillion in loans.

Overly Prescriptive Guidance May Reduce the Benefits of the Exposure Draft

ABA is concerned that certain aspects of the exposure draft may be overly prescriptive and may ultimately result in a return to a level of complexity that created the need for Update 2017-12 in the first place. Guidance in paragraph ASC 815-30-55-1T details a waterfall that provides a specific order in applying eligible transactions to specific hedging instruments. Specifically, the guidance requires that the entity first identify the transaction that occurred in the hedge period with an undocumented hedged risk; the entity may then identify transactions that occurred in the two-month period thereafter. Further when assessing transactions that occurred in the two-month period thereafter, an entity must first identify transactions that occurred with the documented hedge risk before identifying transactions based on the change in designated hedge risk. ABA believes this to be overly prescriptive, particularly in a dynamic environment in which the relevant factors may change frequently over a time period. There are many reasonable instances when selecting transactions in a different order would better reflect the ultimate aim of the risk management activities. Therefore, ABA recommends that, instead of a detailed waterfall, the Board state a general principle on how to select eligible transactions. As a result, each entity may document a policy (to be applied consistently) for identifying eligible hedged transactions after they occur when there has been a change in hedged risk that clearly reflect the objective of the risk management activities

Additionally, paragraph ASC 815-30-35-1B requires entities to assess hedge effectiveness using their then-best estimate of the hedged risk. As written, this language may disrupt the current practice used by some banks for portfolio hedges. After the adoption of ASU 2017-12, some banks utilize a "worst case" hypothetical derivative for assessing effectiveness since the measurement of ineffectiveness is no longer required. For example, if a portfolio is comprised of loans with both one month and three month tenors, and a derivative with a one month tenor is designated, the entity's effectiveness assessment would assume a hypothetical derivative with a three month tenor to represent the more draconian scenario. ABA believes the proposed amendments should not restrict an entity from utilizing this sort of approach and would encourage the Board to avoid using language so prescriptive that it changes current practice.

The Proposed Changes Should Also Apply to Hedges of Foreign Exchange Risk

The proposed amendments in the exposure draft would prohibit an entity from applying the change in hedged risk guidance to hedges of foreign exchange risk. The Board acknowledges in Basis of Conclusions paragraph BC65 that there is no conceptual basis for excluding such hedges. The board then indicates that it would be difficult to separate the hedged risk adequately from the hedged forecasted transaction, due to the current requirements that an entity document the exact foreign currency amount being hedged when designating the forecasted transaction in a hedge of foreign exchange risk. ABA believes that hedges of foreign exchange should be in scope and this concern could be mitigated by documenting a functional currency equivalent amount within hedges of foreign exchange risk.

More Guidance Is Needed Relating to the Assessment of Shared Risk Exposure

When an entity elects to apply cash flow hedge accounting over groups of transactions, the transactions in each group must prospectively share the risk exposure for which they are being hedged (paragraph ASC 815-20-55-23). In assessing this requirement, ABA asks the Board to provide an example regarding scenarios that fall between those discussed in Basis for Conclusions paragraph BC63. More specifically, BC63 appears to describe two ends of the spectrum:

> The Board believes that if the hedged risks of all forecasted transactions hedged in a group change from one identical contractually specified component or identical contractually specified interest rate (including tenor and reset date) to another, an entity could qualitatively conclude that all forecasted transactions continue to share the same risk exposure. However, if the hedged risk changes from the variability in a contractually specified component or contractually specified interest rate to the variability in overall price risk, an entity may need to perform a more robust correlation analysis to determine whether the forecasted transactions hedged in a group prospectively continue to share the same risk exposure.

ABA believes that scenarios will commonly fall in between these two cases, such as when an entity has a pool hedge which could be comprised of different tenors, calculation methodology (such as arrears vs. advance), or different domestic rates altogether (which may become more prevalent due to reference rate reform). In such instances, ABA believes that if the hedge remains highly effective, that would constitute sufficient evidence of shared risk. This point is supported by BC64, which indicates that a group of "transactions varying with indexes could be aggregated in a group and hedged with a single derivative that provides a highly effective offset to changes in the overall cash flow of the group." ABA, therefore, recommends that the Board clarify this through an example or elevate the guidance from BC64 into the codification to clarify that shared risk exposure is a broader concept than the designated hedged risk.

ABA appreciates the opportunity to share this feedback. Thank you for considering our comments. If you need additional information or have questions, please contact the undersigned (jstein@aba.com; 202-663-5318).

Sincerely,

Joshua Stein