FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: May 5, 2021
Comments Due: July 5, 2021

Derivatives and Hedging (Topic 815)

Fair Value Hedging—Portfolio Layer Method

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 815 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2021-002, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until July 5, 2021. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2021-002
- Sending a letter to "Technical Director, File Reference No. 2021-002, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Derivatives and Hedging (Topic 815)

Fair Value Hedging—Portfolio Layer Method

May 5, 2021

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

On August 28, 2017, the FASB issued Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The amendments in that Update made targeted improvements to the optional hedge accounting model with the objective of improving hedge accounting to better portray the economic results of an entity's risk management activities in its financial statements.

Before the issuance of the amendments in Update 2017-12, entities had difficulty achieving fair value hedge accounting of interest rate risk for portfolios of prepayable financial assets. Update 2017-12 added the last-of-layer method to make portfolio fair value hedge accounting of interest rate risk for those types of assets more accessible.

For a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, the last-of-layer method allows an entity to hedge a stated amount of the asset or assets in the closed portfolio that is anticipated to be outstanding for the period hedged (that is, the hedged layer). If the requirements for the last-of-layer method are met, prepayment risk is not incorporated into the measurement of the hedged layer.

Following the issuance of Update 2017-12, entities and practitioners asked the Board:

1. Whether only single-layer strategies are allowed (that is, one hedging relationship associated with the closed portfolio) or whether an entity could employ multiple-layer strategies (that is, more than one hedging relationship associated with a single closed portfolio).
2. To clarify what types of hedging instruments are permitted in single-layer and multiple-layer strategies.
3. To provide additional guidance on how to account for and disclose fair value hedge basis adjustments during an existing last-of-layer hedge. Current guidance on the last-of-layer method does not explicitly address the accounting for basis adjustments other than when the hedge is partially or fully dedesignated. For example, Topic 815 does not provide guidance on whether basis adjustments in an existing last-of-layer hedge should be maintained on a closed portfolio basis or on an individual asset basis. There also is no explicit guidance on how to recognize and present in the income statement the portion of the basis adjustment associated with a hedged layer if the closed portfolio falls below the amount of the hedged layer (that is, how to recognize and present the basis adjustment

associated with the breached layer). Topic 815 states that an entity should follow other generally accepted accounting principles (GAAP) to determine whether allocation either on a portfolio basis or an individual asset basis is appropriate for disclosure purposes.

4. How last-of-layer fair value hedge basis adjustments interact with the guidance on credit losses.

The amendments in this proposed Update would address those questions by:

1. Expanding the current single-layer model to allow multiple-layer hedges of a single closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments. To reflect that expansion, the last-of-layer method would be renamed as the portfolio layer method.
2. Specifying that eligible hedging instruments in a single-layer strategy may include spot-starting or forward-starting constant-notional swaps, or spot- or forward-starting amortizing-notional swaps and that the number of hedged layers (that is, single or multiple) corresponds with the number of hedges designated.
3. Providing additional guidance on the accounting for and disclosure of fair value hedge basis adjustments that would be applicable to both the current single-layer model and the proposed multiple-layer model.
4. Indicating how fair value hedge basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities that elect to apply the portfolio layer method (currently referred to as the last-of-layer method) of hedge accounting in accordance with Topic 815.

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

Multiple-Layer Hedges of a Single Closed Portfolio

The amendments in this proposed Update would allow multiple-layer hedging relationships to be designated for a single closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments. As a result, an entity would be able to achieve hedge accounting for hedges of a greater proportion of the interest rate risk inherent in the assets included in the closed portfolio, further aligning hedge accounting with risk management strategies.

In applying hedge accounting to multiple-layer strategies, an entity would have the flexibility to use different types of derivatives and structures that best align with their individual circumstances (for example, spot-starting swaps, forward-starting swaps, or a combination of both). Furthermore, the amendments in the proposed Update would specify that an entity hedging multiple amounts in a single closed portfolio with a single amortizing-notional swap, which may achieve the same benefits of a multiple-layer strategy, would apply guidance specific to the single-layer model rather than guidance specific to the multiple-layer model.

To facilitate a multiple-layer model, the amendments in the proposed Update would require that an entity perform an analysis to support its expectation that the aggregate amount of the hedged layers is anticipated to be outstanding for the periods hedged. In addition, all assets in the closed portfolio would be required to have a contractual maturity date after the earliest-ending hedge period and become prepayable before the latest-ending hedge period. Those criteria would not apply to the individual financial instruments securing a beneficial interest (that is, an entity would not "look through" a beneficial interest to its underlying financial instruments). The criterion on contractual maturity date would allow an entity to separate a single closed portfolio into subgroups based on the contractual maturity dates of the assets in the closed portfolio and use only specific subgroups to correspond to hedged layers.

An entity would be permitted to designate new hedging relationships and dedesignate existing hedging relationships associated with the closed portfolio any time after the closed portfolio is established in a designated portfolio layer method hedge.

If the aggregate amount of the hedged layers is anticipated to be in excess of the amount of the closed portfolio in future hedged periods (that is, a breach is anticipated), an entity would be required to, at a minimum, partially or fully dedesignate the hedged layer or layers until a breach is no longer anticipated.

If the aggregate amount of the hedged layers is currently in excess of the amount of the closed portfolio (that is, a breach has occurred), an entity would be required to fully dedesignate the hedged layer or layers that were affected by the breach. If there are multiple hedged layers at the time of the breach, the entity would dedesignate the hedged layer with the shortest remaining period until the hedged item's assumed maturity date such that the remaining hedges would continue to qualify for portfolio layer method hedging. If multiple hedged layers need to be dedesignated, those hedges would similarly be dedesignated on the basis of the shortest periods remaining until the hedged items' assumed maturity dates, dedesignating the hedge with the shortest remaining period until maturity first, second shortest, second, and so forth, until the remaining hedges qualify for portfolio layer method hedging. If there are multiple hedged layers with the same period remaining until hedge maturity, the entity would first dedesignate the hedge that was most recently designated.

Accounting for Fair Value Hedge Basis Adjustments under the Portfolio Layer Method

The amendments in this proposed Update would clarify the accounting for and promote consistency in the reporting of fair value hedge basis adjustments applicable to both the current single-layer model and the proposed multiple-layer model as follows:

1. An entity would be required to maintain basis adjustments in an existing hedge on a closed portfolio basis (that is, not allocated to individual assets).
2. An entity would be required to recognize and present basis adjustments associated with a breach in the income statement line item affected by the asset or assets (or portion thereof) that caused the breach. For example, if the breach was caused by prepayments, the entity would recognize the associated basis adjustments immediately in interest income; if the breach was caused by credit deterioration, the entity would recognize the associated basis adjustments in accordance with applicable impairment guidance.
3. An entity would be required to disclose the total amount of the basis adjustments in existing hedges as a reconciling amount if other areas of GAAP require the disaggregated disclosure of the amortized cost basis of assets included in the closed portfolio.
4. An entity would be prohibited from considering basis adjustments in an existing hedge when determining credit losses.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The effective date will be determined after the Board considers stakeholder feedback on the amendments in this proposed Update. Any entity wishing to adopt a multiple-layer hedge strategy would be able to do so on a prospective basis upon adoption. All entities would be required to apply the proposed amendments related to fair value hedge basis adjustments under the portfolio layer method, except for those related to disclosures required by Topics other than Topic 815, on a modified retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings on the date of adoption. Entities would have the option to apply the proposed amendments related to disclosures required by Topics other than Topic 815 on a prospective basis as of the date of adoption or on a retrospective basis to each prior period presented after the date of adoption of the amendments in Update 2017-12. Entities would be able to reclassify debt securities that qualify for the portfolio layer method from the held-to-maturity category to the available-for-sale category at the date of adoption.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1—Operability: Are the amendments in this proposed Update operable and auditable? If not, which proposed amendment or amendments pose operability or auditability issues and why?

Question 2—Risk Management: As proposed, would the multiple-layer model align with entities' risk management objectives? Please explain why or why not.

Question 3—Scope: Do you agree with the Board's decision to limit the scope of the types of instruments eligible for portfolio layer method hedging to prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments? Please explain why or why not.

Question 4—Dedesignation Sequencing: Do you agree with the Board's proposed amendments on hedge dedesignation sequencing under the multiple-layer model? Please explain why or why not.

Question 5—Basis Adjustments: Do you agree with the Board's proposed amendments on accounting for basis adjustments and disclosure of those basis adjustments in disclosures required by other areas of GAAP outside hedge accounting? Please explain why or why not.

Question 6—"Follow the Asset" Method: In the case of a breach, do the expected costs of identifying which assets in the closed portfolio that caused the breach justify the expected benefits of aligning the derecognition guidance with other Topics in GAAP? Please explain why or why not.

Question 7—Certain Private Companies and Not-for-Profit Entities: Would any of the proposed amendments require special consideration for private companies that are not financial institutions and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market)? If so, which proposed amendment or amendments would require special consideration and why?

Question 8—Transition: Do you agree with the proposed transition guidance? Please explain why or why not.

Question 9—Implementation: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Subtopic	Description of Changes
Subtopic 310-10, Receivables—Overall	• Consequential amendments.
Subtopic 320-10, Investments—Debt Securities—Overall	• Consequential amendments.
Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost	• Added guidance to prohibit an entity from considering a fair value hedge basis adjustment in an existing portfolio layer method hedge in measuring expected credit losses of the assets included in the closed portfolio.
Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities	• Added guidance to prohibit an entity from considering a fair value hedge basis adjustment related to an existing portfolio layer method hedge in determining whether an available-for-sale security included in the closed portfolio is impaired.
Subtopic 815-10, Derivatives and Hedging—Overall	• Amended guidance to prohibit an entity from disclosing portfolio layer method basis adjustments on a more disaggregated basis than the closed portfolio basis to meet the disclosure requirements in Topics other than Topic 815 after the basis adjustments are disaggregated by balance sheet line item.

Codification Subtopic	Description of Changes
	• Added guidance to require that an entity disclose the total unallocated amount of portfolio layer method basis adjustments.
Subtopic 815-20, Derivatives and Hedging—Hedging—General	• Amended guidance to allow an entity to designate multiple-layer hedging relationships for a single closed portfolio under the portfolio layer method. • Added guidance to clarify the composition of the assets in the closed portfolio under the multiple-layer model. • Added guidance to clarify how to present a portfolio layer method basis adjustment in the statement of financial position if an entity presents the assets included in the closed portfolio in different line items in the statement of financial position. • Added guidance to specify that an entity that designates an amortizing-notional swap as the hedging instrument in a portfolio layer method hedge is designating a single-layer hedging relationship. • Added guidance to specify that an entity using an amortizing-notional swap as the hedging instrument in a portfolio layer method hedge may perform a qualitative similar-asset assessment if certain requirements are met. • Added guidance that demonstrates how to determine a hedged layer in a portfolio layer method hedge. • Added guidance that demonstrates how an entity should apply certain aspects of the portfolio layer method if it elects to separate a single closed portfolio into subgroups based on the contractual maturity dates of the assets within the closed portfolio and use only specific subgroups to correspond to hedged layers.

Codification Subtopic	Description of Changes
Subtopic 815-25, Derivatives and Hedging—Fair Value Hedges	• Added guidance to require that an entity maintain portfolio layer method hedge basis adjustments on a closed portfolio basis. • Added guidance to require that if a breach occurs, an entity should dedesignate hedges in a multiple-layer strategy on the basis of the shortest period remaining until hedge maturity that would bring the portfolio as a whole back into compliance with the requirements of portfolio layer method hedging. If there are multiple hedged layers with the same period remaining until the hedged items' assumed maturity dates, the entity should first dedesignate the hedge that was most recently designated. • Added guidance to require that an entity recognize the basis adjustment associated with a breach in earnings in the same income statement line item as the asset or assets (or portion thereof) that caused the breach.
Subtopic 948-310, Financial Services—Mortgage Banking—Receivables	• Consequential amendments.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–17. 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 Master Glossary

3. Add the new Master Glossary term *Hedged Layer*, with a link to transition paragraph 815-20-65-6, as follows:

Hedged Layer

The hedged item designated in a portfolio layer method hedging relationship, representing a stated amount or stated amounts of a closed portfolio of **prepayable** financial assets or one or more **beneficial interests** secured by a portfolio of prepayable **financial instruments** that is not expected to be affected by prepayments, defaults, or other factors affecting the timing and amount of cash flows for the period hedged.

Amendments to Subtopic 310-10

4. Add paragraph 310-10-35-31A, with a link to transition paragraph 815-20-65-6, as follows:

[Note: The pending content is not shown for paragraphs 310-10-35-30 through 35-31 because the proposed amendments apply to guidance that is effective before an entity adopts the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.]

Receivables—Overall

Subsequent Measurement

> Impairment of Loans and Receivables

> > Loans That Are Identified for Evaluation or That Are Individually Considered Impaired

> > > Measurement of Impairment

310-10-35-30 There are two considerations related to measurement of impairment:

a. Impact of hedging
b. Measurement of impairment when foreclosure is probable.

> > > > Impact of Hedging

310-10-35-31 Section 815-25-35 implicitly affects the measurement of impairment under this Topic by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted recorded investment in a hedged loan. When the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. The adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under Section 815-25-35 shall be considered to be an adjustment of the loan's recorded investment. Paragraph 815-25-35-11 explains that the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value.

310-10-35-31A Paragraph 815-25-35-11 also explains that a portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) is not an adjustment to the recorded investment or the discount rate of the individual asset or individual assets included in the closed portfolio.

Amendments to Subtopic 320-10

5. Amend paragraph 320-10-35-1 and add paragraphs 320-10-35-18A and 320-10-35-20A, with a link to transition paragraph 815-20-65-6, as follows:

[Note: The pending content is not shown for paragraphs 320-10-35-18 through 35-20 because the proposed amendments apply to guidance that is effective before an entity adopts the amendments in Update 2016-13.]

Investments—Debt Securities—Overall

Subsequent Measurement

320-10-35-1 Investments in **debt securities** shall be measured subsequently as follows:

a. **Trading securities**. Investments in debt securities that are classified as **trading** shall be measured subsequently at **fair value** in the statement of financial position. Unrealized **holding gains and losses** for trading securities shall be included in earnings.
b. **Available-for-sale securities**. Investments in debt securities that are classified as available for sale shall be measured subsequently at fair value in the statement of financial position. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) shall be excluded from earnings and reported in other comprehensive income until realized except as indicated in the following sentences ~~sentence~~. All or a portion of the unrealized holding gain and loss of an available-for-sale security that is designated as being hedged in a fair value hedge that is not a portfolio layer method hedge shall be recognized in earnings during the period of the hedge, pursuant to

paragraphs 815-25-35-1 and 815-25-35-4. Similarly, all or a portion of the unrealized holding gain and loss of a closed portfolio of available-for-sale securities designated as being hedged in a portfolio layer method hedge in accordance with paragraph 815-20-25-12A shall be recognized in earnings during the period of the hedge pursuant to paragraph 815-25-35-1(c).

c. Held-to-maturity securities. Investments in debt securities classified as held to maturity shall be measured subsequently at amortized cost in the statement of financial position. A transaction gain or loss on a held-to-maturity foreign-currency-denominated debt security shall be accounted for pursuant to Subtopic 830-20.

> Impairment of Individual Available-for-Sale and Held-to-Maturity Debt Securities

> > Steps for Identifying and Accounting for Impairment

320-10-35-18 For individual securities classified as either available for sale or held to maturity, an entity shall determine whether a decline in fair value below the amortized cost basis is other than temporary. Providing a general allowance for unidentified impairment in a portfolio of securities is not appropriate.

320-10-35-18A An entity shall not consider a basis adjustment related to an existing portfolio layer method hedge designated in accordance with paragraph 815-20-25-12A in either of the following situations:

a. When determining whether a decline in fair value below the amortized cost basis of a security is other than temporary
b. If measuring impairment of the individual investment or individual investments included in a portfolio layer method closed portfolio.

320-10-35-19 The following are specific steps an entity shall take in identifying and accounting for impairment of individual securities classified as either available for sale or held to maturity.

> > > Step 1: Determine Whether an Investment Is Impaired

320-10-35-20 Impairment shall be assessed at the individual security level (referred to as an investment). Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt securities. (For example, debt securities of an issuer bearing the same Committee on Uniform Security Identification Procedures [CUSIP] number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the debt securities of the issuer.)

320-10-35-20A <u>For the individual security or individual securities in a portfolio layer method closed portfolio, the impairment assessment performed at the individual security level shall not consider the basis adjustment related to an existing portfolio layer method hedge.</u>

Amendments to Subtopic 326-20

6. Amend paragraphs 326-20-30-4 and 326-20-30-5, with a link to transition paragraph 815-20-65-6, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

326-20-30-4 If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's **effective interest rate**. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows. <u>See paragraph 815-25-35-10 for guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge.</u> If the financial asset's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset's effective interest rate (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects change in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-20-30-4A. Subtopic 310-20 on receivables—nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

326-20-30-4A As an accounting policy election for each class of financing receivable or major security type, an entity may adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments. However, if the asset is restructured in a troubled debt restructuring, the effective interest rate used to discount expected cash flows shall not be adjusted because of subsequent changes in expected timing of cash flows.

326-20-30-5 If an entity estimates expected credit losses using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. For example, if an entity uses a loss-rate method, the numerator would include the expected credit losses of the amortized cost basis (that is, amounts that are not expected to be collected in cash or other consideration, or recognized in income). In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses. An entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the following components of the amortized cost basis, including all of the following:

a. Amortized cost basis, excluding applicable accrued interest, premiums, discounts (including net deferred fees and costs), foreign exchange, and fair value hedge accounting adjustments (that is, the face amount or unpaid principal balance)
b. Premiums or discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments<u>. See paragraph 815-25-35-10 for guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge.</u>
c. Applicable accrued interest. See paragraph 326-20-30-5A for guidance on excluding accrued interest from the calculation of the allowance for credit losses.

7. Amend paragraph 326-20-55-9, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Effect of a Fair Value Hedge on the Discount Rate When Using a Discounted Cash Flow Model

326-20-55-9 Section 815-25-35 implicitly affects the measurement of credit losses under this Topic by requiring the present value of expected future cash flows to be discounted by the new **effective interest rate** based on the adjusted **amortized cost basis** in a hedged **loan**. When the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective interest rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. The adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under Section 815-25-35 shall be considered to be an adjustment of the loan's amortized cost basis. Paragraph 815-25-35-11 explains that the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. <u>Paragraph 815-25-35-11 also explains that for a basis adjustment that is maintained on a closed portfolio basis for an existing portfolio layer method hedge in accordance with paragraph 815-25-35-1(c), an entity should not adjust the amortized cost basis or the discount rate of the individual asset or individual assets included in the closed portfolio.</u>

Amendments to Subtopic 326-30

8. Add paragraph 326-30-35-1A and amend paragraph 326-30-35-4, with a link to transition paragraph 815-20-65-6, as follows:

Financial Instruments—Credit Losses—Available-for-Sale Debt Securities

Subsequent Measurement

> Impairment of Individual Available-for-Sale Securities

> > Identifying and Accounting for Impairment

326-30-35-1 An investment is impaired if the **fair value** of the investment is less than its **amortized cost basis**.

<u>**326-30-35-1A** An entity shall not consider a basis adjustment related to an existing portfolio layer method hedge designated in accordance with paragraph 815-20-25-12A when measuring impairment of the individual investment or individual investments included in a portfolio layer method closed portfolio.</u>

326-30-35-4 Impairment shall be assessed at the individual security level (referred to as an investment). <u>The impairment assessment of an individual security or the individual securities in a portfolio layer method closed portfolio shall not consider the basis adjustment related to an existing portfolio layer method hedge.</u> Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt securities.

(For example, debt securities bearing the same Committee on Uniform Security Identification Procedures [CUSIP] number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the debt securities.) Providing a general allowance for an unidentified impairment in a portfolio of debt securities is not appropriate.

Amendments to Subtopic 815-10

9. Amend paragraphs 815-10-50-4EEE and 815-10-50-5B and its related heading, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Overall

Disclosure

> Overall Quantitative Disclosures

815-10-50-4EE An entity shall disclose in tabular format the following for items designated and qualifying as hedged items in fair value hedges:

a. The carrying amount of hedged assets and liabilities recognized in the statement of financial position. For an available-for-sale debt security, the amount disclosed is the amortized cost basis.
b. The cumulative amount of fair value hedging adjustments to hedged assets and liabilities included in the carrying amount of the hedged assets and liabilities recognized in the statement of financial position.
c. The line item in the statement of financial position that includes the hedged assets and liabilities.
d. The cumulative amount of fair value hedging adjustments remaining for any hedged assets and liabilities for which hedge accounting has been discontinued.

The disclosures required by (b) and (d) shall exclude cumulative basis adjustments related to foreign exchange risk.

815-10-50-4EEE For each line item disclosed in accordance with paragraph 815-10-50-4EE(c) that includes hedging relationships designated under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, the following information shall be disclosed separately:

a. The amortized cost basis of the closed portfolio(s) of prepayable financial assets or the beneficial interest(s)
b. The amount that represents the hedged item(s) (that is, the **hedged layer or layers** ~~designated last of layer~~)

c. The basis adjustment associated with the hedged item(s) (that is, the hedged layer or layers ~~designated last of layer~~).

Example 20 (see paragraph 815-10-55-181) illustrates these disclosures.

> Basis Adjustment Considerations under the ~~Last-of-Layer~~ Portfolio Layer Method

815-10-50-5B For existing hedging relationships designated under the ~~last-of-layer~~ portfolio layer method, an entity ~~may need to allocate~~ shall not disclose the ~~outstanding~~ basis adjustment on a more disaggregated basis than the portfolio layer method closed portfolio to meet the objectives of disclosure requirements in other Topics unless that disaggregation is required in accordance with paragraph 815-20-45-4. After an entity allocates a basis adjustment in accordance with paragraph 815-20-45-4 (if applicable), if other Topics require the disclosure of the amortized cost basis of assets included in the closed portfolio on a basis that requires disaggregating the assets included in the closed portfolio, the entity shall exclude the portfolio layer method basis adjustment from the amortized cost basis of those assets. In that case, the entity shall disclose the total amount of the portfolio layer method basis adjustment excluded from the amortized cost basis. ~~For purposes of those disclosure requirements, the entity may allocate the basis adjustment on an individual asset basis or on a portfolio basis using a systematic and rational method.~~

10. Amend paragraphs 815-10-55-181, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 20: Disclosure of Qualitative Information by Underlying Risk and Fair Value Hedge Basis Adjustment Disclosures

815-10-55-181 This Example illustrates the disclosure of objectives and strategies for using derivative instruments by underlying risk, including volume of activity (see paragraph 815-10-50-1A(d)). It also illustrates the fair value hedge basis adjustment disclosures in paragraphs 815-10-50-4EE through 50-4EEE.

> The Entity is exposed to certain risks relating to its ongoing business operations. The primary risks managed by using derivative instruments are commodity price risk and interest rate risk. Forward contracts on various commodities are entered into to manage the price risk associated with forecasted purchases of materials used in the Entity's manufacturing process. Interest rate swaps are entered into to manage interest rate risk associated with fixed-rate loans issued by the Entity's financing subsidiary.

FASB ASC 815-10 requires that an entity recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with that Subtopic, the Entity designates commodity forward contracts as cash flow hedges of forecasted purchases of commodities and interest rate swaps as fair value hedges of fixed-rate receivables.

Cash flow hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings and is presented in the same income statement line item as the earnings effect of the hedged item. Gains and losses on the derivative instrument representing hedge components excluded from the assessment of effectiveness are recognized currently in earnings and are presented in the same line of the income statement expected for the hedged item.

As of December 31, 20X2, the Entity had the following outstanding commodity forward contracts that were entered into to hedge forecasted purchases:

Commodity	Number of Bushels (000s)
Wheat	10,000
Corn	20,000
Oats	15,000

Fair value hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. The Entity includes the gain or loss on the hedged items (that is, fixed-rate receivables) in the same line item—interest income—as the offsetting loss or gain on the related interest rate swaps.

As of December 31, 20X2, and 20X1, the following amounts were recorded on the balance sheet related to cumulative basis adjustments for fair value hedges.

Line Item in the Statement of Financial Position in Which the Hedged Item Is Included	Carrying Amount of the Hedged Assets/(Liabilities)		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets/(Liabilities)	
	20X2	20X1	20X2	20X1
Loans receivable [(a)]	$115	$124	$10 [(b)]	$20

(a) These amounts include the amortized cost basis of closed portfolios <u>of loans receivable</u> used to designate hedging relationships in which the hedged item is the ~~last layer expected~~ <u>stated amount of assets in the closed portfolios anticipated to be outstanding for the period hedged</u> ~~to be remaining at the end of the hedging relationship~~. At December 31, 20X2, and 20X1, the amortized cost basis of the closed portfolios used in these hedging relationships was $52 and $60, respectively, the cumulative basis adjustments associated with these hedging relationships was $5 and $7, respectively, and the amounts of the designated hedged items were $16 and $18, respectively.

(b) The balance includes $2 of hedging adjustment on a discontinued hedging relationship.

As of December 31, 20X2, and 20X1, the total notional amount of the Entity's pay-fixed/receive-variable interest rate swaps was $79 and $82, respectively.

Amendments to Subtopic 815-20

11. Amend paragraphs 815-20-25-3(c), 815-20-25-12A, and 815-20-25-118A and its related heading and add paragraph 815-20-25-12B, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Formal Designation and Documentation at Hedge Inception

815-20-25-3 Concurrent designation and documentation of a hedge is critical; without it, an entity could retroactively identify a hedged item, a hedged **transaction**, or a method of assessing effectiveness to achieve a desired accounting result. To qualify for hedge accounting, there shall be, at inception of the hedge, formal documentation of all of the following:

c. Documentation requirement applicable to fair value hedges only:
   1. For a fair value hedge of a **firm commitment**, a reasonable method for recognizing in earnings the asset or liability representing the gain or loss on the hedged firm commitment.
   2. For ~~a~~ <u>one or more interest rate risk</u> hedging <u>relationships</u> ~~relationship~~ designated under the ~~last-of-layer~~ <u>portfolio layer</u> method, an analysis to support the entity's expectation that the <u>**hedged layer**</u> ~~hedged item~~ is anticipated to be outstanding ~~as of~~ <u>for</u> the <u>period</u> hedged

~~item's assumed maturity date~~ (see paragraph 815-20-25-12A ~~815-20-25-12A(a)~~ for additional guidance).

> Eligibility of Hedged Items and Transactions

> > Hedged Item Criteria Applicable to Fair Value Hedges Only

815-20-25-12A For a closed portfolio of **prepayable** financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria are met ~~a stated amount of the asset or assets that are not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows the designation is made in conjunction with the partial-term hedging election in paragraph 815-20-25-12(b)(2)(ii)~~ (this designation is referred to throughout Topic 815 as the ~~"last-of-layer method")~~. "portfolio layer method"):

a. As part of the initial hedge documentation, an analysis ~~shall be~~ is completed and documented to support the entity's expectation that the hedged item (that is, the ~~designated last of~~ hedged layer or layers) is anticipated to be outstanding for the period ~~as of the~~ hedged ~~item's assumed maturity date in accordance with the entity's partial-term hedge election~~. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors ~~events~~ affecting the timing and amount of cash flows associated with the closed portfolio ~~of prepayable financial assets or beneficial interest(s) secured by a portfolio of prepayable financial instruments~~.
b. For purposes of its analysis in (a), the entity shall ~~may~~ assume that as prepayments, defaults, and other factors ~~events~~ affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio ~~of prepayable financial assets or one or more beneficial interests~~ that is not hedged ~~part of the hedged item (that is, the designated last of layer)~~.
c. The entity elects to apply the partial-term hedging guidance in paragraph 815-20-25-12(b)(2)(ii) or the asset's or assets' contractual maturity date is the same as the end of the designated hedge period.
d. With respect to the assets in the closed portfolio, the following contractual maturity criteria are met:
    1. For a closed portfolio with a single hedged layer, all assets in the closed portfolio shall have a contractual maturity date on or after the end of the hedge period.
    2. For a closed portfolio with multiple hedged layers, all assets in the closed portfolio shall have a contractual maturity date on or after the end of the earliest-ending hedge period of hedges associated with the closed portfolio. For each period hedged, the closed portfolio shall include an amount of assets with a contractual maturity date on

or after the end of the hedge period that is greater than the aggregate amount of the hedged layers. See paragraphs 815-20-55-14G through 55-14N for implementation guidance related to separating a single closed portfolio into subgroups based on the contractual maturity dates of the assets in the closed portfolio and using only specific subgroups to correspond to hedged layers.

e. With respect to the assets in the closed portfolio, the following prepayment criteria are met:
   1. For a closed portfolio with a single hedged layer, all assets in the closed portfolio are or become prepayable by the end of the hedge period.
   2. For a closed portfolio with multiple hedged layers, all assets in the closed portfolio are or become prepayable by the end of the latest-ending hedge period of hedges associated with the closed portfolio. For example, if an entity designates two spot-starting hedged layers of a closed portfolio, one for three years and the other for five years, all assets in the closed portfolio are or become prepayable by the end of Year 5.

If the closed portfolio includes one or more beneficial interests, the criteria in this paragraph shall not apply to the individual financial instruments securing the beneficial interest or interests.

815-20-25-12B An entity may designate one or more new hedging relationships associated with a closed portfolio for which there are one or more existing hedging relationships designated in accordance with paragraph 815-20-25-12A if the criteria in that paragraph are met for those new hedging relationships.

> Hedge Effectiveness

> > Hedge Effectiveness Criterion Applicable to Fair Value Hedges Only—Effectiveness Horizon

> > > Consideration of Prepayment Risk Using the ~~Last-of-Layer~~ Portfolio Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

12. Add paragraph 815-20-45-4 and its related heading, with a link to transition paragraph 815-20-65-6, as follows**:**

Other Presentation Matters

> Balance Sheet Classification

815-20-45-4 For an existing portfolio layer method hedge, if the assets included in the same closed portfolio are presented in different line items in the statement of financial position, an entity shall allocate the portfolio layer method basis adjustment to the assets' associated line items in the statement of financial position using a systematic and rational method.

13. Amend paragraphs 815-20-55-4A and 815-20-55-14A and add paragraphs 815-20-55-14B through 55-14N and the related headings, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Eligibility of Hedged Items

> > > Hedged Items in Fair Value Hedges Only

815-20-55-4A This implementation guidance on hedged items in fair value hedges only is organized as follows:

a. Subparagraph superseded by Accounting Standards Update No. 2017-12.
b. Application of the definition of firm commitment
c. Determining whether risk exposure is shared within a portfolio
d. Servicing rights as a hedged item.
e. Hedged layer in a portfolio layer method hedge
f. Subgroups in a multiple-layer portfolio layer method hedge.

> > > > Determining Whether Risk Exposure Is Shared within a Portfolio

815-20-55-14 This implementation guidance discusses the application of the guidance in paragraph 815-20-25-12(b)(1) that the individual assets or individual liabilities within a portfolio hedged in a fair value hedge shall share the risk exposure for which they are designated as being hedged. If the change in fair value of a hedged portfolio attributable to the hedged risk was 10 percent during a reporting period, the change in the fair values attributable to the hedged risk for each item constituting the portfolio should be expected to be within a fairly narrow range, such as 9 percent to 11 percent. In contrast, an expectation that the change in fair value attributable to the hedged risk for individual items in the portfolio would range from 7 percent to 13 percent would be inconsistent with the requirement in that paragraph.

815-20-55-14A If both of the following conditions exist, the quantitative test described in paragraph 815-20-55-14 may be performed qualitatively <u>on a hedge-by-hedge basis</u> and only at hedge inception:

a. The hedged item is a <u>**hedged layer**</u> ~~closed portfolio of prepayable financial assets or one or more beneficial interests~~ designated in accordance with paragraph 815-20-25-12A.
b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows in accordance with paragraph 815-25-35-13.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows.

<u>**815-20-55-14B** If the hedging instrument is a derivative with a notional amount that changes over time (for example, an amortizing-notional interest rate swap), the condition in paragraph 815-20-55-14A(b) can be satisfied because the swap has a single contractual fixed rate and, thus, the hedged item can be measured on the basis of a single benchmark component of the contractual coupon cash flows in accordance with paragraph 815-25-35-13. An entity that designates a derivative with a notional amount that changes over time as a hedging instrument is designating a single hedging relationship with a single benchmark rate component of the contractual coupon cash flows.</u>

<u>**> > > > Hedged Item in a Portfolio Layer Method Hedge**</u>

<u>**815-20-55-14C** This implementation guidance describes the hedged item in a portfolio layer method hedge in several scenarios.</u>

<u>**> > > > > Scenario A**</u>

<u>**815-20-55-14D** For a closed portfolio of prepayable financial assets of $100 million, Entity A designates a single hedged item of $10 million of the assets that is expected to be outstanding for the hedge period of Years 1–5. Entity A designates as the hedging instrument a spot-starting constant-notional pay-fixed, receive-variable interest rate swap with a notional amount of $10 million and a term of 5 years. In this single-layer strategy, the hedged layer represents $10 million of assets in the closed portfolio that is not expected to be affected by prepayments, defaults, or other factors affecting the timing or amount of cash flows for the hedge period of Years 1–5.</u>

<u>**> > > > > Scenario B**</u>

815-20-55-14E For a closed portfolio of prepayable financial assets of $100 million, Entity A designates a hedged item of $20 million of assets that is expected to be outstanding for the hedge period of Years 1–3. It also designates a hedged item of $10 million of the assets in the closed portfolio that is expected to be outstanding for the hedge period of Years 1–5. For the $20 million hedged item, Entity A designates as the hedging instrument a spot-starting constant-notional pay-fixed, receive-variable interest rate swap with a notional amount of $20 million and a term of 3 years. For the $10 million hedged item, Entity A designates as the hedging instrument a spot-starting constant-notional pay-fixed, receive-variable interest rate swap with a notional amount of $10 million and a term of 5 years. In this multiple-layer strategy, there are two hedged layers:

a. A hedged layer representing $20 million of assets in the closed portfolio that is not expected to be affected by prepayments, defaults, or other factors affecting the timing or amount of cash flows for the hedge period of Years 1–3
b. A hedged layer representing $10 million of assets in the closed portfolio that is not expected to be affected by prepayments, defaults, or other factors affecting the timing or amount of cash flows for the hedge period of Years 1–5.

> > > > > Scenario C

815-20-55-14F For a closed portfolio of prepayable financial assets of $100 million, Entity A designates a single hedged item of $30 million for Years 1–3 that decreases to an amount of $10 million for Years 4 and 5. Entity A designates a single amortizing-notional swap as the hedging instrument. In this single-layer strategy, the hedged layer represents a $30 million stated amount for Years 1–3 and a $10 million stated amount for Years 4 and 5, which reflects the amortizing-notional swap's features. In this scenario, designation of an amortizing-notional swap as the hedging instrument achieves results that are comparable with the multiple-layer strategy using two constant-notional swaps as the hedging instruments, as described in paragraph 815-20-55-14E.

> > > > Subgroups in a Multiple-Layer Portfolio Layer Method Hedge

815-20-55-14G This implementation guidance demonstrates how an entity should apply the following aspects of the portfolio layer method if it elects to separate a single closed portfolio into subgroups based on the contractual maturity dates of the assets within the closed portfolio and use only specific subgroups to correspond to hedged layers as permitted by paragraph 815-20-25-12A(d)(2):

a. Performing the similar-asset assessment upon initial designation of a portfolio layer method hedge
b. Evaluating whether the entity may continue to apply the guidance for a portfolio layer method hedge after initial designation

c. Identifying the hedged layer or layers to be dedesignated in the event of either an anticipated breach or an actual breach and the resulting allocation of fair value hedge basis adjustments.

815-20-55-14H For the purposes of illustrating that guidance, the implementation guidance in paragraphs 815-20-55-14I through 55-14N assumes that an entity (Entity A) enters into a multiple-layer strategy of a closed portfolio of prepayable loans with 5 years and 10 years remaining until contractual maturity. For purposes of this illustration, assume that all loans were originated on the date of hedge inception, and, thus, the periods remaining until contractual maturity correspond to their contractual terms. In that case, the two subgroups within the closed portfolio are as follows:

a. A subgroup that includes all loans in the closed portfolio
b. A subgroup that includes only 10-year loans in the closed portfolio.

Subgroups are based on the periods remaining until the contractual maturity dates of the assets in the closed portfolio. In this illustration, any hedge of Years 1–5 or periods within those years would correspond to the subgroup described in (a). Any hedge of Years 6–10 or periods within those years would correspond to the subgroup described in (b).

> > > > > Similar-Asset Assessment at Hedge Designation

815-20-55-14I Entity A designates hedged layers with assumed maturity dates of three years and seven years, respectively. When applying the similar-asset assessment for a portfolio fair value hedge in accordance with paragraph 815-20-25-12(b)(1), Entity A should consider the subgroup described in paragraph 815-20-55-14H(a) for the three-year hedged layer and the subgroup described in paragraph 815-20-55-14H(b) for the seven-year hedged layer.

> > > > > Subsequent Assessment

815-20-55-14J After initial hedge designation, Entity A should continue to assess whether the individual three-year and seven-year hedged layers meet the requirements in paragraph 815-25-35-7A on the basis of the respective subgroups used to perform the similar-asset assessments described in paragraph 815-20-55-14I.

> > > > > Dedesignation

815-20-55-14K In the following scenarios, Entity A applies the dedesignation guidance in paragraphs 815-25-40-8 through 40-9A, considering the subgroup described in paragraph 815-20-55-14H(a) for the three-year hedged layer and the subgroup described in paragraph 815-20-55-14H(b) for the seven-year hedged layer.

> > > > > > Scenario A

815-20-55-14L After Year 1, Entity A anticipates that the amount of the seven-year hedged layer will exceed the closed portfolio (that is, a breach is anticipated). Entity A should discontinue or partially discontinue the portion of the seven-year hedged layer no longer anticipated to be outstanding in accordance with paragraph 815-25-40-8(a). The basis adjustment associated with all or the portion of the 7-year hedged layer dedesignated should be allocated only to the subgroup described in paragraph 815-20-55-14H(b) (that is, only to the 10-year loans remaining in the closed portfolio at the dedesignation date) using a systematic and rational method in accordance with paragraph 815-25-40-9(b).

> > > > > > Scenario B

815-20-55-14M After Year 1, Entity A identifies that the aggregate amount of the hedged layers exceeds the amount of loans in the closed portfolio (that is, a breach has occurred) because five-year loans were prepaid. Entity A determines that dedesignating either the 3-year hedged layer or the 7-year hedged layer would bring the closed portfolio as a whole back into compliance with the requirements of paragraph 815-25-35-7A because sufficient 10-year loans would remain to support the 7-year hedged layer. In accordance with paragraph 815-25-40-8(b)(2), Entity A should dedesignate the three-year hedged layer because it is the hedged item with the shortest remaining hedge period that, if dedesignated, would bring the closed portfolio as a whole back into compliance with the requirements of paragraph 815-25-35-7A. Entity A should determine the portion of the three-year hedged layer's basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio using a systematic and rational method in accordance with paragraph 815-25-40-9A(a). Entity A should immediately derecognize the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio and recognize that amount in interest income in accordance with paragraph 815-25-40-9A(b)(1) because the loans that caused the breach were prepaid (and, thus, affected interest income when the breach occurred). Entity A should allocate the three-year hedged layer's remaining basis adjustment to the individual loans remaining in the subgroup described in paragraph 815-20-55-14H(a) (that is, to all loans in the closed portfolio) in accordance with paragraph 815-25-40-9A(c). After that allocation, Entity A should account for those basis adjustments consistent with any other premium or discount on the loans to which they were allocated in accordance with paragraph 815-25-40-9A(c).

> > > > > > Scenario C

815-20-55-14N After Year 1, Entity A identifies that the aggregate amount of the hedged layers exceeds the amount of loans in the closed portfolio (that is, a breach has occurred) because 10-year loans were prepaid. Entity A determines that the seven-year hedged layer is the only hedged layer that can be solely dedesignated to bring the closed portfolio as a whole back into compliance with the requirements of paragraph 815-25-35-7A. In this scenario, solely dedesignating the three-year hedged layer would not bring the closed portfolio as a whole back into compliance with the requirements of paragraph 815-25-35-7A. This is because even if the 3-year hedged layer were to be dedesignated, given the extent of the prepayment of 10-year loans in this scenario, the entity also would anticipate a breach of the 7-year hedged layer and, therefore, also would have to dedesignate (or partially dedesignate) the 7-year hedged layer for the strategy to continue to qualify. Therefore, in accordance with paragraph 815-25-40-8(b)(2), Entity A should dedesignate the seven-year hedged layer. Entity A should determine the portion of the seven-year hedged layer's basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio using a systematic and rational method in accordance with paragraph 815-25-40-9A(a). Entity A should immediately derecognize the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio and recognize that amount in interest income in accordance with paragraph 815-25-40-9A(b)(1) because the loans that caused the breach were prepaid (and, thus, affected interest income when the breach occurred). Entity A should allocate the 7-year hedged layer's remaining basis adjustment to the individual loans remaining in the subgroup described in paragraph 815-20-55-14H(b) (that is, only to the 10-year loans remaining in the closed portfolio at the dedesignation date) in accordance with paragraph 815-25-40-9A(c). After that allocation, Entity A should account for those basis adjustments consistent with any other premium or discount on the loans to which they were allocated in accordance with paragraph 815-25-40-9A(c).

Amendments to Subtopic 815-25

14. Amend paragraphs 815-25-35-1, 815-25-35-7A and its related heading, 815-25-35-9 through 35-12, and 815-25-35-13B, with a link to transition paragraph 815-20-65-6, as follows:

[Note: Paragraphs 815-25-35-10 through 35-12 have amendments to current content as well as new pending content linked to paragraph 815-20-65-6. These paragraphs are shown with both the current content and all of the associated pending content for convenience of the user.]

Derivatives and Hedging—Fair Value Hedges

Subsequent Measurement

> Changes in Fair Value in General

815-25-35-1 Gains and losses on a qualifying **fair value hedge** shall be accounted for as follows:

a. The gain or loss on the hedging instrument shall be recognized currently in earnings, except for amounts excluded from the assessment of effectiveness that are recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A. All amounts recognized in earnings shall be presented in the same income statement line item as the earnings effect of the hedged item.
b. The gain or loss (that is, the change in **fair value**) on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized currently in earnings except as described in (c).
c. For one or more existing **hedged layer** or layers that are designated under the portfolio layer method in accordance with paragraph 815-20-25-12A, the gain or loss (that is, the change in fair value) of the hedged item attributable to the hedged risk shall not adjust the carrying value of the individual assets or beneficial interest or interests in or removed from the closed portfolio. Instead, that amount shall be maintained on a closed portfolio basis.

> Existing Portfolio Layer Method Hedges ~~Estimating the Remaining Balance under the Last-of-Layer Method~~

815-25-35-7A ~~When the hedged item is~~ For each hedging relationship designated and accounted for under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, an entity shall perform and document at each effectiveness assessment date an analysis that supports the entity's expectation that the hedged layer ~~item (that is, the designated last of layer)~~ is still anticipated to be outstanding for the period hedged ~~as of the hedged item's assumed maturity date~~. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors (for example, voluntary sales or reclassifications out of the closed portfolio) ~~events~~ affecting the timing and amount of cash flows associated with the closed portfolio using a method consistent with the method used to perform the analysis in paragraph 815-20-25-12A(a) and (b). For a closed portfolio with multiple hedged layers, an entity shall determine at each effectiveness assessment date whether the asset or assets in the closed portfolio continue to meet the contractual maturity and prepayment criteria in paragraph 815-20-25-12A(d) and (e), respectively.

> Changes in Fair Value of Hedged Item

815-25-35-8 The adjustment of the carrying amount of a hedged asset or liability required by paragraph 815-25-35-1(b) shall be accounted for in the same manner as other components of the carrying amount of that asset or liability. For example, an adjustment of the carrying amount of a hedged asset held for sale (such as inventory) would remain part of the carrying amount of that asset until the asset is sold, at which point the entire carrying amount of the hedged asset would be recognized as the cost of the item sold in determining earnings.

815-25-35-9 An adjustment of the carrying amount of a hedged interest-bearing **financial instrument** that is required by paragraph 815-25-35-1(b) and an adjustment that is maintained on a closed portfolio basis in a portfolio layer method hedge in accordance with paragraph 815-25-35-1(c) shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

815-25-35-9A If, as permitted by paragraph 815-25-35-9, an entity amortizes the adjustment to the carrying amount of the hedged item during an ~~outstanding~~ existing partial-term hedge of an interest-bearing financial instrument or amortizes the basis adjustment in an existing portfolio layer method hedge, the entity shall fully amortize that adjustment by the hedged item's assumed maturity date in accordance with paragraph 815-25-35-13B. For a discontinued hedging relationship, all remaining adjustments to the carrying amount of the hedged item shall be amortized over a period that is consistent with the amortization of other discounts or premiums associated with the hedged item in accordance with other Topics (for example, Subtopic 310-20 on receivables—nonrefundable fees and other costs). See paragraphs 815-25-40-9 through 40-9A for further guidance on accounting for a basis adjustment attributable to a discontinued portfolio layer method hedge.

> > Impairment of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment requirements to the hedged asset or liability.

In addition, amend the following current content for paragraph 815-25-35-10, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) To Be Decided; (N) To Be Decided* │**Transition Guidance:** 815-20-65-6

> > Impairment of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). <u>A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not be considered when assessing the individual asset or assets included in the closed portfolio for impairment or when assessing a portfolio of assets for impairment. An entity may not apply this guidance by analogy to other components of the **recorded investment**.</u> Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment requirements to the hedged asset or liability.

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2022* │**Transition Guidance:** 326-10-65-1

Editor's Note: *The content of paragraph 815-25-35-10 will be amended upon transition, together with a change in the heading noted below.*

> > Impairment or Credit Losses of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment or credit loss requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

In addition, amend the following pending content for paragraph 815-25-35-10, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) To Be Decided; (N) To Be Decided* │**Transition Guidance:** 815-20-65-6

> > Impairment or Credit Losses of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment or credit loss requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). <u>A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not be considered when assessing the individual asset or assets included in the closed portfolio for impairment or credit losses or when assessing a portfolio of assets for impairment or credit losses. An entity may not apply this guidance by analogy to other components of amortized cost basis.</u> Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

> > > Interaction with Loan Impairment

815-25-35-11 This Subtopic implicitly affects the measurement of impairment under Section 310-10-35 by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted **recorded investment** in a hedged loan. Paragraph 310-10-35-31 requires that, when the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. That paragraph states that the adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's recorded investment. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's carrying amount be adjusted for hedge accounting before the impairment requirements of Subtopic 310-10 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted recorded investment.

In addition, amend the following current content for paragraph 815-25-35-11, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) To Be Decided; (N) To Be Decided* │**Transition Guidance:** 815-20-65-6

> > > Interaction with Loan Impairment

815-25-35-11 This Subtopic implicitly affects the measurement of impairment under Section 310-10-35 by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted **recorded investment** in a hedged loan. Paragraph 310-10-35-31 requires that, when the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. That paragraph states that the adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's recorded investment. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's carrying amount be adjusted for hedge accounting before the impairment requirements of Subtopic 310-10 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted recorded investment. <u>A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not adjust the recorded investment of the individual asset or individual assets included in the closed portfolio. An entity may not apply this guidance by analogy to other components of the recorded investment.</u>

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2022* │**Transition Guidance:** 326-10-65-1

Editor's Note: *The content of paragraph 815-25-35-11 will be amended upon transition, together with a change in the heading noted below.*

> > > **Interaction with Measurement of Credit Losses**

815-25-35-11 This Subtopic implicitly affects the measurement of credit losses under Subtopic 326-20 on financial instruments measured at amortized cost by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted amortized cost basis in a hedged loan. Paragraph 326-20-55-9 requires that, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. That paragraph states that the adjustment under fair value hedge accounting for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's amortized cost basis. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's amortized cost basis be adjusted for hedge accounting before the requirements of Subtopic 326-20 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted amortized cost basis.

In addition, amend the following pending content for paragraph 815-25-35-11, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) To Be Decided; (N) To Be Decided* │**Transition Guidance:** 815-20-65-6

> > > **Interaction with Measurement of Credit Losses**

815-25-35-11 This Subtopic implicitly affects the measurement of credit losses under Subtopic 326-20 on financial instruments measured at amortized cost by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted amortized cost basis in a hedged loan. Paragraph 326-20-55-9 requires that, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. That paragraph states that the adjustment under fair value hedge accounting for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's amortized cost basis. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's amortized cost basis be adjusted for hedge accounting before the requirements of Subtopic 326-20 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted amortized cost basis. A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not adjust the amortized cost basis of the individual asset or individual assets included in the closed portfolio. An entity may not apply this guidance by analogy to other components of amortized cost basis.

815-25-35-12 This guidance applies to all entities applying Subtopic 310-10 to financial assets that are hedged items in a fair value hedge, regardless whether those entities have delayed amortizing to earnings the adjustments of the loan's carrying amount arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's carrying amount.

In addition, amend the following current content for paragraph 815-25-35-12, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) To Be Decided; (N) To Be Decided* │**Transition Guidance:** 815-20-65-6

815-25-35-12 This guidance applies to all entities applying Subtopic 310-10 to financial assets that are hedged items in a fair value hedge, regardless whether those entities have delayed amortizing to earnings the adjustments of the loan's carrying amount arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's carrying amount and is not intended to be applied to the individual asset or individual assets in an existing portfolio layer method hedge closed portfolio.

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2022* │**Transition Guidance:** 326-10-65-1

815-25-35-12 This guidance applies to all entities applying Subtopic 326-20 to financial assets that are hedged items in a fair value hedge, regardless of whether those entities have delayed amortizing to earnings the adjustments of the loan's amortized cost basis arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's amortized cost basis.

In addition, amend the following pending content for paragraph 815-25-35-12, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) To Be Decided; (N) To Be Decided* │**Transition Guidance:** 815-20-65-6

815-25-35-12 This guidance applies to all entities applying Subtopic 326-20 to financial assets that are hedged items in a fair value hedge, regardless of whether those entities have delayed amortizing to earnings the adjustments of the loan's amortized cost basis arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's amortized cost basis and is not intended to be applied to the individual asset or individual assets in an existing portfolio layer method hedge closed portfolio.

> > > Measuring the Change in Fair Value of the Hedged Item in Partial-Term Hedges of Interest Rate Risk Using an Assumed Term

815-25-35-13B For a fair value hedge of interest rate risk in which the hedged item is designated for a partial term ~~as selected contractual cash flows~~ in accordance with paragraph 815-20-25-12(b)(2)(ii), an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an assumed term that begins at hedge inception ~~when the first hedged cash flow begins to accrue~~ and ends at the end of the designated hedge period ~~when the last hedged cash flow is due and payable~~. The assumed issuance of the hedged item occurs at hedge inception ~~on the date that the first hedged cash flow begins to accrue~~. The assumed maturity of the hedged item occurs at the end of the designated hedge period ~~on the date in which the last hedged cash flow is due and payable~~. An entity may measure the change in fair value of the hedged item attributable to interest rate risk in accordance with this paragraph when the entity is designating the hedged item in a hedge of both interest rate risk and foreign exchange risk. In that hedging relationship, the change in carrying value of the hedged item attributable to foreign exchange risk shall be measured on the basis of changes in the foreign currency spot rate in accordance with paragraph 815-25-35-18. Additionally, an entity may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument (for example, 2 outstanding hedging relationships for consecutive interest cash flows in Years 1–3 and consecutive interest cash flows in Years 5–7 of a 10-year debt instrument).

15. Amend paragraphs 815-25-40-8 through 40-9 and the related heading and add paragraphs 815-25-40-8A and its related heading and 815-25-40-9A, with a link to transition paragraph 815-20-65-6, as follows:

Derecognition

> Discontinuing Hedge Accounting

> > Hedged Item Is Designated under the ~~Last-of-Layer~~ Portfolio Layer Method

> > > Anticipated Breaches and Breaches in the Closed Portfolio

815-25-40-8 For ~~a~~ one or more hedging relationships ~~relationship~~ designated under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, an entity shall discontinue ~~(or partially discontinue)~~ hedge accounting in ~~either of~~ the following circumstances:

a. If the entity cannot support on a subsequent testing date that the **hedged layer** or layers ~~hedged item (that is, the designated last of layer) is~~ are anticipated to be outstanding for the period hedged in accordance with paragraph 815-25-35-7A (that is, a breach is anticipated), it shall at a minimum discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item no longer anticipated ~~expected~~ to be outstanding for the period hedged ~~at the hedged item's assumed maturity date~~. If multiple hedged layers are associated with the closed portfolio or subgroups of the closed portfolio, the entity may elect which hedged layer or layers to dedesignate (or partially dedesignate).
b. If on a subsequent testing date the outstanding amount of the closed portfolio of prepayable financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach occurred) ~~item~~, the entity shall discontinue hedge ~~accounting.~~ accounting as of the date of the breach, as follows:
    1. For a closed portfolio with a single hedged layer, the entity shall discontinue hedge accounting for that layer.
    2. For a closed portfolio with multiple hedged layers, the entity shall discontinue one or more hedging relationships associated with the closed portfolio such that the entity can support that the remaining hedged layer or layers are anticipated to be outstanding for the period hedged in accordance with paragraph 815-25-35-7A. If there are multiple hedged layers at the time of the breach, the entity shall dedesignate the hedged layer with the shortest remaining period until

the hedged item's assumed maturity date that would result in the remaining hedges fully meeting the requirements in paragraph 815-25-35-7A. If multiple hedged layers need to be dedesignated for the remaining hedges to fully meet the requirements in paragraph 815-25-35-7A, those hedges shall be dedesignated on the basis of the shortest periods remaining until the hedged items' assumed maturity dates, dedesignating the hedge with the shortest remaining period until the hedged item's assumed maturity date first, second shortest, second, and so forth until the requirements in paragraph 815-25-35-7A are met. If there are multiple hedged layers with the same period remaining until the hedged item's assumed maturity date, the entity shall first dedesignate the hedge that was most recently designated.

> > > Voluntary Dedesignations

815-25-40-8A An entity may elect to discontinue or partially discontinue hedge accounting prospectively for all or a portion of the hedged layer for one or more hedging relationships associated with the closed portfolio absent an anticipated breach in accordance with paragraph 815-25-40-8(a) or a breach occurring in accordance with paragraph 815-25-40-8(b). If multiple hedged layers are associated with the closed portfolio or subgroups of the closed portfolio, the entity may voluntarily elect any hedged layer or layers to dedesignate (or partially dedesignate).

> > > Accounting for Basis Adjustments

815-25-40-9 If a ~~last-of-layer~~ portfolio layer method hedging relationship is discontinued (or partially discontinued) in anticipation of a breach in accordance with paragraph 815-25-40-8(a) or in a voluntary dedesignation in accordance with paragraph 815-25-40-8A, the ~~outstanding~~ basis adjustment associated with the dedesignated amount ~~(or portion thereof)~~ as of the discontinuation date shall be allocated as follows using a systematic and rational method:

a. For a closed portfolio with a single hedged layer, to the remaining individual assets in the closed portfolio ~~using a systematic and rational method~~.
b. For a closed portfolio with multiple hedged layers, to the remaining individual assets in the closed portfolio with a contractual maturity date on or after the assumed maturity date of the dedesignated layer.

An entity shall amortize those amounts over a period that is consistent with the amortization of other discounts or premiums associated with the respective assets in accordance with other Topics (for example, Subtopic 310-20 on receivables–nonrefundable fees and other costs).

815-25-40-9A For a portfolio layer method hedging relationship that is discontinued because a breach has occurred in accordance with paragraph 815-25-40-8(b), as of the discontinuation date an entity shall:

a. Identify the asset or assets (or portion thereof) that caused the breach as those involved in the most recent event (for example, a prepayment or default) that resulted in the amount of the hedged layer exceeding the closed portfolio and determine the portion of the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio (that is, the portion of the basis adjustment associated with the breach) using a systematic and rational method.
b. Account for the portion of the basis adjustment associated with the breach in the same manner as any premium or discount on the asset or assets that caused the breach. For example:
    1. A basis adjustment associated with an asset or assets (or portion thereof) affected by prepayment (and therefore derecognized) shall be recognized immediately in interest income.
    2. A basis adjustment associated with an asset or assets (or portion thereof) affected by credit deterioration shall be recognized in accordance with applicable impairment guidance.
c. Allocate and account for the remainder (if any) of the basis adjustment not associated with the breach in the same manner as a voluntary dedesignation or anticipated breach in accordance with paragraph 815-25-40-9.

Amendments to Subtopic 948-310

16. Amend paragraph 948-310-35-1, with a link to transition paragraph 815-20-65-6, as follows:

Financial Services—Mortgage Banking—Receivables

Subsequent Measurement

> Loans Held for Sale

948-310-35-1 Mortgage loans held for sale shall be reported at the lower of amortized cost basis cost or fair value, determined as of the balance sheet date. If a mortgage loan has been the hedged item in a fair value hedge (as addressed in Topic 815), the loan's amortized cost basis used in lower-of-amortized-cost-basis-or-fair value accounting shall reflect the effect of the adjustments of its carrying amount made pursuant to paragraphs 815-25-35-1(b) and 815-25-40-9 through 40-9A ~~paragraph 815-25-35-1~~.

17. Add paragraph 815-20-65-6 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2021-XX, *Derivatives and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method*

815-20-65-6 The following represents the transition and effective date information related to Accounting Standards Update No. 2021-XX, *Derivatives and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method:*

a. For entities required to adopt the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, for fiscal years beginning after December 15, 2019, in accordance with paragraph 326-10-65-1(a)(1), and for all other entities that elected to early adopt the amendments in Update 2016-13 before the issuance date of Update 2021-XX, the pending content that links to this paragraph shall be effective for fiscal years beginning after [date to be inserted after exposure], and interim periods within those fiscal years.
b. For all other entities that did not elect to early adopt the amendments in Update 2016-13 before the issuance date of Update 2021-XX, except for those described in (c), the pending content that links to this paragraph shall be effective for fiscal years beginning after [date to be inserted after exposure], and interim periods within those fiscal years. For those entities, the pending content that links to this paragraph that also links to paragraph 326-10-65-1 shall be effective when the pending content that links to paragraph 326-10-65-1 is first applied.
c. For all other entities that adopt the amendments in Update 2016-13 on or after the issuance date of Update 2021-XX but before [date to be inserted after exposure] and apply portfolio layer method hedging during that period, the pending content that links to this paragraph shall be effective for fiscal years, and interim periods within those fiscal years, on the date of adoption of Update 2016-13.
d. An entity shall apply the pending content that links to this paragraph to designate more than one portfolio layer method hedging relationship for a single closed portfolio on a prospective basis as of the date of adoption.
e. On any date on or after adoption, an entity may modify documentation without dedesignating a portfolio layer method hedging relationship existing as of the date of adoption to add one or more portfolio layer method hedges to the closed portfolio.
f. An entity may separate a single closed portfolio into subgroups based on the contractual maturity date of the assets within the closed portfolio and use only specific subgroups to correspond to hedged layers as permitted

by paragraph 815-20-25-12A(d)(2) on a prospective basis for multiple-layer hedges designated on or after the date of adoption.

g. Except for the pending content that links to this paragraph in Subtopic 815-10 (related to disclosures), an entity shall apply the pending content that links to this paragraph on portfolio layer method fair value hedge basis adjustments on a modified retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings and the balance sheet line items (as appropriate) as of the date of adoption.

h. An entity may elect to adopt the pending content that links to this paragraph in Subtopic 815-10 (related to disclosures) on a prospective basis from the date of adoption of the amendments in Update 2021-XX or on a retrospective basis to each prior period presented after the date of adoption of the amendments in Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.

i. An entity may reclassify a debt security from held to maturity to available for sale if the debt security is classified as held to maturity at the date of adoption and eligible to be hedged under the portfolio layer method in accordance with a paragraph 815-20-25-12A.

   1. Reclassification elections shall be determined at the date of adoption.
   2. For an entity that has not yet adopted the amendments in Update 2016-13, any unrealized gain or loss on the reclassified debt security at the date of adoption shall be recorded in accumulated other comprehensive income. For an entity that has adopted the amendments in Update 2016-13, for each reclassified debt security it shall:
      i. Reverse in retained earnings any allowance for credit losses previously recorded on the held-to-maturity debt security at the date of adoption.
      ii. Reclassify the debt security to the available-for-sale category at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses).
      iii. Determine whether an allowance for credit losses is necessary by following the guidance in Subtopic 326-30. If so, that allowance shall be recorded in retained earnings at the date of adoption.
      iv. Report in accumulated other comprehensive income any unrealized gain or loss on the debt security at the date of adoption, excluding the amount recorded in the allowance for credit losses in accordance with (iii).
   3. An entity shall provide the disclosures in accordance with paragraph 320-10-50-10 for reclassified debt securities.
   4. That reclassification, in and of itself, would not result in any of the following:

i. Call into question the entity's assertion at the most recent reporting date that it had the intent and ability to hold to maturity those debt securities that continue to be classified as held to maturity.
ii. Require that the entity designate the reclassified security in a hedging relationship under the portfolio layer method.
iii. Restrict the entity from selling the reclassified security.

j. An entity shall disclose the nature of and reason for the change in accounting principle related to accounting for fair value hedge basis adjustments in the period that the entity adopts the pending content that links to this paragraph. An entity that issues interim financial statements shall provide that disclosure in each interim financial statement of the fiscal year of adoption and the annual financial statement of the fiscal year of adoption.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The Board introduced the last-of-layer method in Update 2017-12 for fair value hedges of interest rate risk of portfolios of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments (referred to throughout the remainder of the basis for conclusions as a *closed portfolio*). That hedging method allows an entity to designate as the hedged item the stated amount of the asset or assets in the closed portfolio that is anticipated to remain outstanding for the period hedged (that is, a hedged layer).

BC3. The amendments in Update 2017-12 also provide guidance on breaches and anticipated breaches of last-of-layer hedges. A breach occurs when the outstanding amount of the closed portfolio is less than the stated amount of the asset or assets in the closed portfolio hedged in the current period. In those cases, an entity should dedesignate the hedging relationship associated with the closed portfolio. The guidance states that the basis adjustment should then be allocated to the remaining assets in the closed portfolio on a systematic and rational basis. However, the amendments in Update 2017-12 do not provide guidance on the accounting treatment for the portion of the basis adjustment related to the breached amount. An anticipated breach occurs when the last-of-layer hedge is anticipated to be breached in a future period. In those cases, an entity would either partially dedesignate the hedge to align the hedged item with revised expectations about the closed portfolio or fully dedesignate the hedge. The basis adjustment associated with any partially or fully dedesignated hedge in an anticipated breach should be allocated to all assets in the closed portfolio on a systematic and rational basis.

BC4. Following the issuance of Update 2017-12, stakeholders asked questions about the implementation of the last-of-layer method that can be separated into two groups. The first group relates to whether an entity is permitted to designate multiple last-of-layer hedging relationships associated with a single closed portfolio. The second group relates to fair value hedge basis adjustment issues in the current single-layer model and the proposed multiple-layer model, including the accounting treatment for the portion of a basis adjustment associated with a breach.

Benefits and Costs

BC5. 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.

BC6. The Board believes that the amendments in this proposed Update that would allow a multiple-layer model would improve financial reporting because those amendments would more closely align hedge accounting with an entity's risk management activities. The Board also believes that the additional guidance on fair value hedge basis adjustments would provide more clarity and consistency in financial reporting outcomes.

BC7. Because hedge accounting is optional within GAAP, not all entities would bear the costs of implementing the amendments in this proposed Update. For entities that elect to apply hedge accounting, the Board anticipates that they would not incur significant costs as a result of the proposed amendments. However, the Board acknowledges that certain reporting entities would incur implementation costs to educate employees, establish new accounting methods, and update systems and processes (for example, to maintain fair value hedge basis adjustments on a closed portfolio basis rather than on an individual asset basis).

BC8. The Board believes that after implementing the amendments in this proposed Update, entities would have minimal, if any, incremental costs to comply with the proposed amendments on an ongoing basis. Moreover, the Board believes that entities largely would be able to leverage existing systems and processes. Overall, the Board decided that the expected benefits of the proposed amendments would justify the expected costs.

Basis for Conclusions

Multiple-Layer Model

BC9. After the Board added the last-of-layer hedging method in Update 2017-12, stakeholders asked the Board to make it more broadly applicable. Specifically, stakeholders asked that the Board allow multiple hedging relationships to be designated for a single closed portfolio. They also asked the Board to expand the scope of the last-of-layer method to include hedges of financial liabilities and nonprepayable financial assets.

Multiple-Layer Hedges of a Single Closed Portfolio

BC10. For a single closed portfolio, the amendments in this proposed Update would allow multiple hedging relationships to be designated. After the issuance of Update 2017-12, stakeholders asked the Board to consider that change to further align hedge accounting with risk management strategies. Stakeholders indicated that, in practice, the ability to designate only one hedging relationship per closed portfolio results in a significant amount of interest rate risk remaining in the closed portfolio that is ineligible to be hedged under hedge accounting.

BC11. To reduce the amount that exists under the single-layer model that is ineligible to be hedged under hedge accounting, stakeholders asked the Board to allow entities to hedge different stated amounts in different periods, which would allow a greater portion of the closed portfolio's interest rate risk to qualify for hedge accounting. Hedging different stated amounts could be accomplished by designating multiple-layer hedges for a single closed portfolio, with a larger stated amount hedged in earlier periods and a smaller stated amount hedged in later periods. That structure would allow the total hedged amount to change with anticipated changes in the amount of the closed portfolio outstanding. The Board agreed with stakeholders that there is no conceptual reason to allow only one hedging relationship for a closed portfolio designated under the last-of-layer method and that the same core principles of the single-layer model could be expanded to apply to a multiple-layer model.

BC12. To reflect the expansion from a single-layer to a multiple-layer model, the last-of-layer method would be renamed as the portfolio layer method. That change would be reflected throughout Topic 815. The Board believes that the portfolio layer method more aptly describes the strategies that would qualify for hedge accounting under the amendments in this proposed Update because the amount hedged in a given layer need not be the last in the closed portfolio under a multiple-layer strategy.

The Aggregation of Hedged Items Associated with a Single Closed Portfolio

BC13. To designate a hedge under the last-of-layer method under current GAAP, an entity must apply the partial-term hedging guidance such that all assets have the same assumed maturity date. An entity also must support its expectation on at least a quarterly basis that the hedged layer is not expected to be affected by prepayments, defaults, or other factors affecting the timing and amount of cash flows.

BC14. The Board decided to retain but refine those core concepts of the single-layer model when constructing the multiple-layer model because it believes that those concepts would continue to align with an entity's risk management objectives under the multiple-layer model. As a result, under the multiple-layer model, an entity would be required to apply the partial-term hedging guidance or, if hedging an asset's full term, the asset's contractual maturity date must be on the date that the designated hedge period ends. In either case, the amount hedged is subject to the same benchmark interest rate risk. In addition, the entity would support its expectation that all hedged amounts in aggregate are anticipated to be outstanding for the period hedged, rather than on an individual hedge basis.

Structuring Multiple-Layer Hedges

BC15. The Board decided that an entity should have the flexibility to apply hedge accounting for hedging strategies that economically accomplish the same objective using the derivatives and structures that best align with their individual circumstances. Consequently, the amendments in this proposed Update would not restrict an entity from using any particular type of derivatives to achieve its risk management objectives under a multiple-layer model for the purposes of qualifying for hedge accounting. For example, an entity could use multiple spot-starting constant-notional swaps with different term lengths, a combination of spot-starting and forward-starting constant-notional swaps, multiple spot-starting or forward-starting amortizing-notional swaps, or any combination of those derivatives to hedge different amounts of the closed portfolio. An entity would perform the similar-asset assessment for each individual hedge designated.

BC16. With respect to the types of hedging instruments eligible to be designated in a portfolio layer method hedge, stakeholders asked whether the use of an amortizing-notional swap should be considered one hedging relationship or multiple hedging relationships. The amendments in this proposed Update would specify that an entity that designates an amortizing-notional swap as a hedging instrument is designating a single hedging relationship with a single benchmark rate component of the contractual coupon cash flows. The Board observed that because an entity is not permitted to designate different partial terms of a derivative instrument in different hedging relationships, an amortizing-notional swap cannot be split into a series of individual hedges by swaplet (that is, the portion of the swap that corresponds to one swap payment). In addition, the single hedge conclusion is consistent with the example in paragraphs 815-20-55-173 through 55-178 in current GAAP. The proposed amendments also would specify that an entity using an amortizing-notional swap as the hedging instrument could apply the qualitative similar-asset assessment.

Composition of the Closed Portfolio under the Multiple-Layer Model

BC17. The Board decided that under the multiple-layer model, all assets in the closed portfolio would have to be prepayable by the end of the latest-ending hedge period, which would require that all assets be or become prepayable during the period that the closed portfolio has a hedged layer. The Board also decided that all assets would have to have a contractual maturity date on or after the end of the earliest-ending hedge period, which is equivalent to the requirement under the single-layer model that the assets must have a contractual maturity date on or after the end of the hedge period. Those decisions allow some flexibility for assets with different maturity profiles and prepayment features to be combined and hedged in a single closed portfolio. The Board's intent is to reduce the need to construct separate closed portfolios and designate more hedging relationships to achieve the same economic outcome that could be achieved with fewer closed portfolios and hedging relationships.

Subgroups in a Multiple-Layer Portfolio Layer Method Hedge

BC18. The Board's decision to require that all assets have a contractual maturity on or after the end of the earliest-ending hedge period allows for entities to separate a single closed portfolio into subgroups based on the contractual maturity dates of the assets within the closed portfolio and use only specific subgroups to support hedged layers. If an entity elects to separate its closed portfolio into subgroups based on contractual maturity date, the Board decided that all other criteria of the portfolio layer method should be applied on the subgroup basis. The Board believes that constructing subgroups based on the underlying assets' contractual maturity dates is consistent with the fundamental premise of the portfolio layer method because each asset in the subgroup supporting a given hedged layer would be subject to the interest rate risk being hedged. For example, the amendments in this proposed Update would allow a subgroup made up of assets with 5 years remaining until contractual maturity to support a hedged layer designated for Years 1–3, but not a hedged layer designated for Years 1–10; however, a subgroup made up of assets with 10 years remaining until contractual maturity could support either hedged layer. This is because a 5-year asset does not exhibit the interest rate risk profile of a 10-year asset, while a 10-year asset that is hedged for a 5-year partial term does exhibit the interest rate risk profile of a 5-year asset. Moreover, if a hedged layer is dedesignated before the end of the hedge period, the Board believes that it would misrepresent the underlying economics if a basis adjustment associated with a 10-year benchmark interest rate was allocated to a 5-year asset.

BC19. With respect to when assets in the closed portfolio with time-based contingencies must become prepayable for purposes of qualifying to apply the portfolio layer method, the Board decided that to be eligible to apply the portfolio layer method, the assets must become prepayable during one of the hedged periods associated with the closed portfolio. An entity would not be required to separate the single closed portfolio by subgroups based on the timing of assets with time-based contingencies becoming prepayable. Because the hedged layers are assumed to be nonprepayable, the Board believes that there is no conceptual basis for excluding assets with time-based contingencies that have not yet been resolved when considering whether any particular hedged layer is supported by the closed portfolio's assets. Unlike the decision to require that the contractual maturity dates of assets included in a subgroup equal or exceed the period of a corresponding hedge because of the relationship between maturity and benchmark rate risk exposure, there is no comparable relationship between prepayment features of the assets and the hedged layer because, as noted, the layers are designed to be nonprepayable. Rather, the prepayable nature of the assets is a means to establish the scope and applicability of the portfolio layer method. Accordingly, given the absence of a conceptual basis for a more restrictive requirement, the Board believes that the cost of including assets with time-based contingencies in separate closed portfolios and designating separate portfolio layer method hedges for those separate closed portfolios based on the timing of those contingencies being resolved would not justify the benefits.

Dedesignation

BC20. The amendments in this proposed Update would allow an entity to fully or partially dedesignate any hedge associated with the closed portfolio at any time if a breach has not occurred and one is not anticipated. If a breach is anticipated, an entity would be required to fully or partially dedesignate one or more hedges to reduce the aggregate hedged item to an amount anticipated to remain outstanding for the period hedged. However, that guidance on partial dedesignation would apply only to the amount of the hedged item and would not permit an entity to fully or partially dedesignate a hedged layer on the basis of a time period (for example, dedesignating Years 4–5 of a 5-year hedged layer). The Board believes that an entity should be able to proactively tailor its hedging strategies to changing interest rate environments and hedge accounting should reflect that. Thus, the Board decided that an entity should not have a preestablished sequence to dedesignate hedges associated with a closed portfolio if a breach has not occurred.

BC21. If a breach has not occurred, an entity would allocate the basis adjustments associated with the dedesignated hedge to all assets remaining in the closed portfolio that have a contractual maturity on or after the dedesignated hedge's assumed maturity date on a systematic and rational basis. Those allocated basis adjustments are amortized over a period that is consistent with the period used for the amortization of other discounts or premiums associated with the asset to which the basis adjustments are allocated. Consequently, an entity would recognize the earnings effect of the dedesignated basis adjustments over the remaining life of the asset to which those basis adjustments are allocated. The Board believes that recognizing those basis adjustments over time inherently limits the potential for abuse or earnings management related to dedesignation.

BC22. In contrast, in the instance of a breach, the amendments in this proposed Update would require that an entity dedesignate hedging relationships on the basis of the shortest period remaining until the hedged item's assumed maturity date, dedesignating the hedge with the shortest period remaining until the hedged item's assumed maturity first, second shortest, second, and so forth until the entity could support that the stated amount hedged is anticipated to be outstanding for the period hedged. If there are multiple hedged layers with the same period remaining until the hedged items' assumed maturity dates, the entity should first dedesignate the hedge that was most recently designated. The Board believes that an entity should not have optionality in determining which hedge to dedesignate in the instance of a breach because that would allow the entity to select the earnings effect of the breach on the basis of which hedge it chooses to dedesignate.

BC23. The Board decided that hedged layers should be dedesignated on the basis of layer duration because that approach is expected to be most consistent with how an entity would construct multiple-layer hedges. In addition, the Board decided that if multiple hedged layers have the same maturity date but different inception dates, the most recently designated layer should be dedesignated first on the basis that the most recently designated layer should not have been added because the assets in the closed portfolio were ultimately insufficient to support it. If multiple layers begin and end on the same dates, then there would be no meaningful difference between the basis adjustment recognized upon a breach.

BC24. The Board conducted outreach on an alternative that would have required that entities document their predefined dedesignation sequence at hedge inception. In that outreach, stakeholders expressed concern that even if a hedge was never breached, an entity would have to apply the error correction guidance in Topic 250 if it had not documented a dedesignation sequence at hedge inception. To address that concern, the Board decided that it would establish a predefined dedesignation sequence in the guidance. As a result, an entity would avoid potentially having to apply error correction guidance to past results if the entity subsequently discovers that it did not document a dedesignation sequence at hedge inception. The Board believes that applying the error correction guidance in that circumstance would not provide users with relevant information because an entity would have to reverse the effect of hedge accounting for periods in which no component of hedge documentation was deficient to accurately apply it.

BC25. The Board considered, but rejected, an alternative that would have provided an entity with the option to document a dedesignation sequence, but if a dedesigation sequence was not documented at hedge inception and a breach occurred, the entity would have been required to dedesignate all hedges associated with the closed portfolio. The Board decided against that alternative because of the complexity that would have resulted from the need to resequence if hedges associated with the closed portfolio changed over time (for example, if new hedges were added).

BC26. The Board also considered, but rejected, an alternative that would have required that an entity dedesignate all hedges associated with the closed portfolio if there is a breach. The Board decided against that alternative because it could have resulted in dedesignation of hedges that continue to be highly effective and meet all other requirements of hedge accounting. The Board considered that outcome as being overly punitive and misrepresenting the economics of an entity's risk management activities.

Financial Instruments within the Scope

BC27. Stakeholders indicated that the prepayment risk that historically made it challenging to achieve hedge accounting for portfolios of prepayable financial assets similarly makes it challenging to achieve hedge accounting for prepayable financial liabilities, such as consolidated securitized debt obligations and certificates of deposit (CD) with a feature that permits the CD holder to put the CD back to the financial institution upon death (referred to as a death put). In addition, some stakeholders provided feedback that portfolios of nonprepayable financial assets may have uncertain cash flows for reasons other than prepayment risk, such as default risk. They noted that for both portfolios of financial liabilities and nonprepayable assets, the challenges associated with achieving hedge accounting could be largely overcome by expanding last-of-layer hedging to those types of instruments.

BC28. The Board considered, but rejected, expanding the scope of the types of instruments eligible for the portfolio layer method. The Board's primary objective of this narrow-scope project is to clarify and improve the amendments in Update 2017-12, rather than broadly reconsider portfolio hedging. The Board understands that its decision to keep the scope of the project narrow requires that an entity hedge in separate closed portfolios assets that are not prepayable during the latest-ending hedge period associated with a closed portfolio and the portion of prepayable assets assumed not to be affected by prepayments under the portfolio layer method. However, the Board believes that the requirements to qualify as prepayable are not unduly prohibitive. Thus, the Board believes that the portfolio layer method is a beneficial tool under the scope established in Update 2017-12.

Fair Value Hedge Basis Adjustment Issues

BC29. The Board's decisions related to basis adjustments would apply to the single-layer model in current GAAP and the proposed multiple-layer model.

Allocation to Individual Assets in an Existing Hedge

BC30. After the issuance of Update 2017-12, stakeholders indicated that the guidance on accounting for basis adjustments in existing last-of-layer hedges is unclear. Stakeholders highlighted that the amendments in Update 2017-12 do not provide guidance on the accounting treatment for basis adjustments during an existing last-of-layer hedge. However, paragraph BC121 of the basis for conclusions in Update 2017-12 states that an entity *need not allocate* basis adjustments in an existing last-of-layer method hedging relationship because those basis adjustments relate to the designated last of layer and not to the assets that make up the closed portfolio. Additionally, that paragraph states that allocating basis adjustments to assets sold from the closed portfolio would lead to noneconomic gains or losses on extinguishment because of hedge accounting adjustments that would have naturally reversed over the life of the hedging relationship. Stakeholders asked the Board to codify and further clarify the information contained in the basis for conclusions of Update 2017-12.

BC31. On the basis of that feedback, the Board decided to clarify that an entity would be prohibited from allocating basis adjustments associated with a closed portfolio during an existing portfolio layer method hedge either to the individual assets in the closed portfolio or to assets removed from the closed portfolio (for example, through prepayment, default, or voluntary sale or reclassification out of the closed portfolio) for the reasons discussed in paragraph BC30. The Board rejected an election to allocate basis adjustments because allocation may lead to uneconomic results if an asset is sold or otherwise removed from the closed portfolio. Additionally, an allocation election would lead to a lack of comparability across entities and a potential for earnings management. The Board acknowledges that its decision may require some systems changes for entities to maintain basis adjustments on a closed portfolio basis. However, the Board believes that the conceptual merits of not allocating basis adjustments justify any potential implementation costs.

Interaction of Basis Adjustments with Credit Loss Guidance

BC32. Stakeholders asked about the interaction of the accounting for last-of-layer basis adjustments with the credit loss guidance. Topic 815 requires that a credit loss be considered *after* the basis of the hedged item has been adjusted for fair value hedge accounting. Additionally, the guidance in Topic 326, Financial Instruments—Credit Losses, requires that an entity's estimate of credit losses on the amortized cost basis of financial assets (which includes basis adjustments) include a measure of the expected risk of credit loss even if that risk is remote. Therefore, in theory, an entity should consider the expected risk of credit loss on a fair value hedge basis adjustment in a last-of-layer hedge.

BC33. However, a critical assertion of the last-of-layer method is that prepayments, defaults, and other factors affecting the timing and amount of cash flows from the closed portfolio during the partial term hedged relate to assets that do not make up the hedged item. Therefore, in theory, the basis adjustment associated with the hedged item also should be free from those factors.

BC34. To eliminate that inconsistency, the Board decided that it would prohibit an entity from considering basis adjustments on existing portfolio layer method hedges when measuring credit losses on the assets included in the closed portfolio. The Board believes that the costs of calculating a credit loss on a portfolio layer method hedge basis adjustment that is likely to be immaterial would not justify the benefits.

Portion of the Basis Adjustment Associated with a Breach

BC35. Stakeholders asked about the accounting treatment for the portion of the basis adjustment associated with a breach because Topic 815 is unclear on that issue. Because the portion of the basis adjustment associated with a breach relates to an asset or assets (or portion thereof) no longer in the closed portfolio, stakeholders asked what model they would need to apply to recognize and present that portion of the basis adjustment in earnings.

BC36. The Board decided that the portion of the basis adjustment associated with the breached amount would be accounted for consistent with the accounting for any premium or discount on the asset or assets (or portion thereof) that caused the breach (a "follow-the-asset" approach). For example, if the breach was caused by prepayments, the associated basis adjustment would be recognized immediately in interest income. If the breach was caused by defaults, the associated basis adjustment would be recognized in earnings as a credit loss similar to how other premiums or discounts would be recognized as a component of the amortized cost basis of an asset with credit deterioration. In other words, the income statement line item presentation would be the same as if an entity had recorded an anticipated breach of the same hedges. The Board chose the follow-the-asset approach because it believes that approach would be consistent with the current expected credit losses model in Topic 326 and the guidance in Topic 815 on the accounting treatment for basis adjustments in dedesignated hedges.

BC37. Under the follow-the-asset approach, an entity would need to know which asset or assets (or portion thereof) in the closed portfolio caused the breach. An entity would determine that on the basis of recency. Accordingly, identifying the assets that caused the breach would be a time-based determination. For example, the last asset that was prepaid that resulted in the outstanding amount of the closed portfolio falling below the stated amount hedged would be identified as the asset that caused the breach. The Board learned through limited outreach that the follow-the-asset approach generally would be operable but could require incremental accounting processes. To gain additional feedback on the costs and benefits of the follow-the-asset approach, the Board decided to ask a question in this proposed Update.

Disclosures outside of Hedge Accounting and Balance Sheet Presentation

BC38. Paragraph 815-10-50-5B states that an entity *may need to allocate* the last-of-layer basis adjustments to fulfill objectives of disclosure requirements in other Topics. As a consequence of its decision to require that the basis adjustments be maintained on a closed portfolio level, the Board decided to amend the guidance in paragraph 815-10-50-5B to prohibit an entity from allocating basis adjustments in nonhedging disclosures on a more disaggregated basis than the closed portfolio basis (after any disaggregation by balance sheet line item, if necessary). An entity would present those basis adjustments as a total amount in disclosures that require disaggregation of the underlying assets in the closed portfolio. The Board observed that this proposed guidance would be similar to the election under Topic 326 to disclose accrued interest receivable separately from the associated financial assets.

BC39. The Board's decision to prohibit an entity from allocating basis adjustments in nonhedging disclosures on a more disaggregated basis than the closed portfolio basis is not intended to affect the balance sheet presentation of basis adjustments. Accordingly, a fair value hedge basis adjustment arising from a portfolio layer hedge must be presented together with the balance sheet line item to which it relates. If an entity includes assets from different balance sheet line items in the same closed portfolio, it must assign portions of the portfolio layer method basis adjustments to the appropriate separate line-item captions on the face of the balance sheet. For example, if the entity included loans and available-for-sale debt securities in the same portfolio layer method closed portfolio, it would need to determine which portion of the hedge's basis adjustment to assign to the loans line item and which portion to assign to the available-for-sale debt securities line item.

Hedge Accounting Disclosures

BC40. The Board decided that no new or amended disclosures should be required to accompany the expansion of the single-layer model to the proposed multiple-layer model because the current last-of-layer method would not fundamentally change under the proposed multiple-layer model. The amendments in Update 2017-12 require that an entity disclose information about cumulative basis adjustments for last-of-layer hedges. Those disclosures allow financial statement users to isolate fair value basis adjustments, which do not affect future cash flows. Although those disclosures were designed in contemplation of the single-layer model, the Board believes that the relevant information for disclosures has not changed under the multiple-layer model, which simply extends the existing single-layer model. Accordingly, the Board decided that an entity would be required to provide the same portfolio layer method disclosures for both single-layer and multiple-layer strategies.

Effective Date and Transition

BC41. The Board has not proposed an effective date for the amendments in this proposed Update. However, the Board decided that if an entity has not yet adopted the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* as of the issuance date of a final Update of these proposed amendments, the entity would be required to adopt the proposed portfolio layer method amendments related to Update 2016-13 upon the adoption of the amendments in Update 2016-13. Regardless of an entity's forthcoming adoption date of the amendments in Update 2016-13, the Board believes that it would not be burdensome for entities to amend their implementation of that Update because the proposed portfolio layer method amendments would simplify the implementation of the credit losses guidance.

BC42. Additionally, the Board decided that for an entity that has not yet adopted the amendments in Update 2016-13 as of the issuance date of a final Update of these proposed amendments and chooses to early adopt the amendments in Update 2016-13 before the effective date of a final Update of these proposed amendments and applies portfolio layer method hedging during that period, the entity would be required to adopt all amendments in a final Update upon adopting the amendments in Update 2016-13. That decision does not affect when an entity is required to adopt the amendments in Update 2016-13. The Board believes that transition approach would be the simplest to apply for affected entities because it would prevent those entities from having to include portfolio layer method basis adjustments in their determination of credit losses upon adoption of the amendments in Update 2016-13 and then exclude those basis adjustments from their determination of credit losses upon adoption of the amendments in this Update. The Board acknowledges that those affected entities would be required to adopt the amendments in this proposed Update at an earlier date than entities that adopt the amendments in Update 2016-13 *after* the effective date of a final Update. However, the Board understands that few entities would be applying that proposed transition guidance because few entities are expected to early adopt the amendments in Update 2016-13.

BC43. With respect to the effective date of a final Update, the Board will consider the comments received on the proposed amendments. When the Board determines the effective date, it also will consider whether to allow early adoption.

BC44. The Board decided that an entity would apply the amendments in this proposed Update related to the multiple-layer model prospectively as of the date of adoption of a final Update. The Board believes that prospective application would be appropriate because the multiple-layer model is not permitted by the amendments in Update 2017-12.

BC45. The Board decided that an entity would apply the amendments in this proposed Update related to accounting for portfolio layer method fair value hedge basis adjustments on a modified retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings and the balance sheet line items (as appropriate) as of the date of adoption. Because the proposed amendments related to basis adjustments are aligned with what the Board understands to be the most widely accepted interpretation of the last-of-layer guidance added by the amendments in Update 2017-12 and consistent with the basis for conclusions in that Update, the Board believes that most entities would make no adjustments under the modified retrospective application approach. For entities that did allocate basis adjustments to individual assets in the closed portfolio during a last-of-layer hedge, the Board believes that a modified retrospective approach would be the simplest method to adjust the financial statement effects of doing so.

BC46. For the amendments in this proposed Update related to disclosures required by Topics other than Topic 815, the Board decided that an entity would have the option to elect either prospective application as of the date of adoption of a final Update or retrospective application to each period presented after the date of adoption of Update 2017-12. The Board supports that choice of options because prospective application would align with the modified retrospective application of the proposed amendments related to accounting for portfolio layer method fair value hedge basis adjustments that does not affect prior fiscal years while retrospective application would allow an entity to maintain comparability between periods presented in its financial statements if it wishes to do so. The Board did not want to prohibit disclosure comparability between periods presented in an entity's financial statements for amounts that may have been accounted for consistently across those periods.

Transferring Debt Securities from Held to Maturity to Available for Sale

BC47. Certain financial institution stakeholders classify certain debt securities in the held-to-maturity category rather than the available-for-sale category because prepayment features embedded in the collateral make fair value hedge accounting difficult to obtain (for example, for beneficial interests). By introducing the multiple-layer model in this proposed Update, an entity will be able to hedge a greater proportion of the interest rate risk inherent in the beneficial interests included in the closed portfolio. Consequently, financial institution stakeholders requested transition relief to reclassify debt securities that qualify for the portfolio layer method from the held-to-maturity category to the available-for-sale category. The Board provided that transition relief when the single-layer model was introduced in the amendments in Update 2017-12. Consistent with that decision, the Board decided that an entity should be able to reclassify held-to-maturity debt securities that qualify for the portfolio layer method in the transition to this proposed Update.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.