Alvarez & Marsal Valuation Services, LLC
700 Louisiana Street, Suite 900
Houston, TX 77002
Phone: +1 713 571 2400
Fax: +1 713 547 3697

November 2, 2016

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

File Reference No. 2016-310

Dear Ms. Cosper,

I started my career on a trading desk executing commodity derivatives and then transitioned to Arthur Andersen in 2000 as a subject matter expert assisting companies implement SFAS 133. Since then and currently as a Managing Director at Alvarez and Marsal Valuation Services, LLC, I continue to provide clients across various industries with valuation, financial reporting, and implementation of hedge accounting for interest rate, foreign currency, and commodity instruments.

Over my 16 years working with the standard, I have advised numerous commodity hedging clients to <u>not</u> adopt hedge accounting based on the current hurdles to safely and consistently apply hedge accounting. I believe the Board's Proposed Accounting Standards Update (ASU), "Targeted Improvement to Accounting for Hedging Activities" takes a giant step towards the goal of aligning the risk management programs of companies and the financial reporting while alleviating needless administrative burdens that will enable companies to utilize hedge accounting.

I appreciate the opportunity to comment on the Board's Proposed Accounting Standards Update (ASU), "Targeted Improvement to Accounting for Hedging Activities". My comments are my opinions and not the necessarily the opinions of Alvarez and Marsal. I strongly support the Board's efforts to make hedge accounting more accessible for companies. This leads to financial statements accurately reflecting companies' risk management activities. My responses in the appendix will highlight a few areas where I believe the Board could further refine the ASU to accomplish their goals of aligning financial reporting and risk management activities as well as the added benefit of aligning with IFRS 9. In my opinion, with a few changes to the Board's proposed guidance, hedge accounting would be accessible to all companies that are actively hedging market risk with derivative instruments.

Alvarez & Marsal Valuation Services, LLC
700 Louisiana Street, Suite 900
Houston, TX 77002
Phone: +1 713 571 2400
Fax: +1 713 547 3697

Thank you for your time and consideration of the detailed responses attached. I would be happy to discuss my comments with the FASB or staff and request the opportunity to participate in the roundtable meetings. My contact information can be found below.

Sincerely,

Chandu Chilakapati
Managing Director
Alvarez & Marsal Valuation Services, LLC
Telephone: (713) 547-3647
E-mail: cchilakapati@alvarezandmarsal.com

APPENDIX A: RESPONDENT QUESTIONS

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

Response: I generally agree with the notion of component hedging as this provides access to hedge accounting for certain commodity hedgers that previously could not qualify as highly effective due to the “all in risk” requirement under the current guidance. I believe that the “contractually specified” language of the proposed guidance is too restrictive based on the current contracts of many commodity hedgers.

For example, many commodity hedgers have contracts that specify the end product and possibly even the specifications of that product that would be delivered at a fixed price that qualifies for the normal purchase or sale exclusion. This would require them to value these contracts as derivatives along with the component hedge instrument which would then create earnings volatility related to the basis differential. There are also many contracts that are physical contracts that simply assure delivery of specific end product at a variable price that do not define the components utilized to build up the variable price. These situations would not meet the currently defined “contractually specified” requirements under the proposed guidance.

I would ask the Board to consider reducing the burden of “contractually specified” and changing it to be a risk component that is highly correlated to the price of the end product. The Board could use an example of purchaser of diesel fuel in a remote location that hedges based with a global Crude Oil index such as Brent or WTI. The purchaser demonstrates that the diesel price negotiated each month is highly correlated to the price of Brent Crude with a one month lag. Diesel is refined from Crude Oil and is therefore priced based on the refiner’s cost and then sold after refining leading to a one month lag in the correlation between the end price of diesel and the cost of the diesel to the refiner.

The benefits would include a sound risk management strategy aligning with the financial reporting, less divergence from IFRS 9, and limited opportunity for abuse. The risk management strategy would be sound and highly effective. IFRS 9 allows for a component hedging and based on a hedge ratio which will result in a similar solution to the suggestion above. Combine that with the simplification of the proposed financial reporting within OCI, this change would make the proposed guidance more accessible than IFRS 9 without divergence. This change in language does not create an opportunity for abuse as the risk management strategy must be in place, the risk component must be highly correlated to the end product, and it still requires a highly effective quantitative assessment. If the change is not implemented those purchasers of end products of a refining process that don’t have liquid markets for the refined product available

APPENDIX A: RESPONDENT QUESTIONS

will be forced to forgo hedge accounting. For those that have both IFRS and US GAAP reporting will have to disclose under US GAAP their risk management strategy and explain that their earnings volatility from their highly effective, non-speculative hedge program does not qualify for hedge accounting due to contract language that is not negotiable. The cost of changing contracts and requiring distributors to specify the component charges and build in a margin would be great if not impossible given the lack of leverage of smaller purchasers.

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

a. Should the Board retain the current concept of benchmark interest rates for fair value hedges of fixed-rate financial instruments and for cash flow hedges of forecasted issuances or purchases of fixed-rate financial instruments? Please explain why or why not.
b. If the Board continues to maintain the current concept of benchmark interest rates, should the Board consider within the concept expectations that a rate will become widely used?
c. If the Board continues to maintain a list of rates, are there any other rates that should be added to the list? Please explain why a particular rate meets the definition of a benchmark rate.
d. Are there other alternatives to the current concept of benchmark interest rates the Board should consider (for example, a principles-based approach)? Please describe those alternatives.

Response: It is my opinion that the concept of benchmark interest rates is difficult to maintain and leads to instances of companies not qualifying for hedge accounting while their hedging program is highly effective. It is difficult for any written document to maintain a list of rates that will qualify for hedge accounting in the wake of financial engineering. If the Board prefers to maintain the highly effective threshold for qualifying for hedge accounting, there is limited potential for abuse of structured instruments or new rates to hide risk. The increased disclosure requirements around the hedge program should provide users of financial statements the necessary transparency.

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

Response: The negative basis associated with the contractual coupon cash flow should not allow for the risk of that negative basis to be hidden by hedging the benchmark interest rate. I don't see this in practice, but I agree with the concept.

APPENDIX A: RESPONDENT QUESTIONS

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

Response: I believe the ability to utilize hedge accounting should remain a privilege and allowing companies to take the entire fair value of the hedging instrument to OCI until the hedged item affects earnings is an even greater privilege. The ability to forecast accurately varies greatly depending on many operational factors. In my opinion, there should not be a black line as to what constitutes a pattern of missed hedged forecasted transactions. Companies that demonstrate a good feedback loop between operations, finance/treasury, and accounting whereby changes in forecasts lead to changes in hedge volume should not be penalized for managing their operational and financial risk well.

This determination is often left to the judgment of the external auditor. The external auditor bears risk when a client has a restatement due to application of the hedge accounting standard and might prefer clients to not implement hedge accounting. Any black line will be adhered to strictly and may slip down the slope to abandoning hedge accounting and misalignment of financial statements and the risk management strategy. I believe a sound policy that states what the controls around forecasting and feedback throughout the organization should lead to an ability test the controls and allow for continued cash flow hedge accounting of forecasted transactions. An example of this would be intermittent renewable power plants. These resources are not predictable and yet require hedging for financing. In my opinion, those companies that are proactively managing their hedges and testing forecasts should be allowed to maintain hedge accounting while disclosing operational risk.

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

Response: There are instances where companies will be able to attain hedge accounting under IFRS 9 that will not qualify under the current proposed guidance. Please see response to Question 1 as one example. IFRS 9 also introduces the idea of rebalancing which could allow for a hedge relationship that would continue to qualify for hedge accounting under IFRS 9 that might lead to dedesignation under the current proposed guidance based on the US GAAP idea of missed forecast or the forecasted transaction is no longer probable of occurring. Under the current proposed guidance, the concept of ineffectiveness is removed whereas under IFRS 9 that concept continues and would lead to differences in recognition.

APPENDIX A: RESPONDENT QUESTIONS

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

a. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would modify current GAAP by requiring the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is presented.
b. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would retain current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded currently in earnings. For qualifying fair value and cash flow hedges, the proposed amendments would modify current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. For qualifying net investment hedges, there will be no prescribed presentation requirements for changes in the fair value of the hedging instrument excluded from the assessment of effectiveness.
c. For cash flow hedges in which the hedged forecasted transaction is probable of not occurring, the proposed amendments would retain current GAAP by requiring amounts recorded in accumulated other comprehensive income to be reclassified to earnings immediately. However, the proposed amendments would require presentation of reclassified amounts in the same income statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.

Response: I agree with the Board decisions. I believe that companies will benefit from the simplified presentation and will be more inclined to adopt hedge accounting which will benefit users. My only comment to c. is captured in my response to Question 4. Although I recognize that the day 1 gains issues of dedesignation and redesignation will not be as big an issue with the new presentation, but could lead to hedge relationships not qualifying for hedge accounting and would prefer that the presentation remain without a dedesignation event where forecasts changed and the company appropriately adjusted their hedge volume.

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

a. Cumulative basis adjustments related to fair value hedges
b. Quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals
c. Revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items.

Response: I agree with the proposed disclosure amendments as they allow for the company to describe their risk management strategy and explain the impact of hedge accounting on their income statement. This is a benefit to the users and while adding some burden on the company, it is offset by the benefit of the changes in presentation.

APPENDIX A: RESPONDENT QUESTIONS

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

Response: I agree with this proposed change as it will decrease the burden on many companies that have straightforward hedge and hold strategies. The ongoing quantitative test requirement is more aptly handled by companies engaging in more sophisticated hedging strategies.

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

Response: I believe situations can and will arise where the facts and circumstances change and a company that initially performed a qualitative test would perform a quantitative test and still qualify as highly effective. There will be changes to an index specified in a hedge relationship that may require a quantitative test, but the hedge relationship remains highly effective. The quantitative tests after a period of time may consistently demonstrate high effectiveness. In my opinion it is a waste of resources to continue to perform quantitative tests and a company should be allowed to document their historic results and move to a qualitative assessment that specifies factors that would lead back to quantitative testing.

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

Response: In my opinion the contemporaneous testing requirement was a significant burden to many companies. The increased time to perform the assessment will be appreciated. I believe that one of the reasons to perform contemporaneous documentation and assessment was to prevent companies from picking and choosing winners and losers to impact earnings. This is less of a risk with the disclosure requirements to state hedge strategy versus trading strategy.

Question 11: The proposed amendments related to the timing of the preparation of hedge documentation and subsequent qualitative testing apply to both public entities and private companies. Are there valid

APPENDIX A: RESPONDENT QUESTIONS

reasons why the content of or the timing of the preparation of hedge documentation should be different for public entities and private companies? If so, please describe the specific types of transactions for which different treatment should be considered.

Response: In my opinion the proposed guidance decreases the burden sufficiently such that there is no need to have separate requirements for public and private companies.

Question 12: Should the effective date be the same for both public business entities and entities other than public business entities?

Response: Yes, in my opinion, the companies that currently utilize hedge accounting will be inclined to early adopt and those that will be moving towards hedge accounting will have sufficient time. I believe this will be true for public and other than public entities.

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

Response: I believe that this can be implemented within one year. I don't believe other than public entities will require more time.

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

Response: I do not agree with the Board's decision to not allow a retrospective transition period. I believe that a retrospective transition will allow users to compare company results across years more easily. I further believe that companies that have not implemented hedge accounting should have the option to implement upon adoption as if they had adopted hedge accounting all along. Similar companies that have been utilizing hedge accounting and those who have not will have different presentation until all hedges have ultimately been designated. There will be a presentation difference that will be difficult for users to compare results across similar companies. I believe it would benefit users to see like companies with like presentation of financial results.