Deloitte.

Deloitte & Touche LLP
695 East Main Street
Stamford, CT 06901-2141

Tel: +1 203 708 4000
Fax: +1 203 708 4797
www.deloitte.com

November 4, 2016

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

File Reference No. 2016-310
Re: Proposed Accounting Standards Update, *Targeted Improvements to Accounting for Hedging Activities*

Dear Ms. Cosper:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Targeted Improvements to Accounting for Hedging Activities*.

We fully support the Board's objectives of more clearly portraying the effects of hedging on an entity's financial statements and reducing the complexity in the hedge accounting model under U.S. GAAP. We believe that the proposed amendments generally achieve those objectives and will improve financial reporting; accordingly, we support their adoption.

While we support the Board's objectives for this project and generally support the proposed amendments, we believe that there are a number of additional potential enhancements that the FASB should consider to further improve the standard.

Although the proposed amendments represent a significant incremental improvement to the hedge accounting model, we believe that the model could be further enhanced by making the benchmark interest rate risk guidance more principles-based. We believe that this approach would promote more consistent application by entities that operate in the U.S. markets (for which the Board has enumerated the acceptable benchmark interest rates) and those that operate outside the United States (which must identify benchmark interest rates solely on the basis of the concepts embodied in the benchmark interest rate definition because there is no list of Board-designated benchmark interest rates that applies to such entities).

The *FASB Accounting Standards Codification* (ASC or the "Codification") master glossary already states that a benchmark interest rate should be "widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions." The benchmark interest rate definition also states that the rate should be a "widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market." The Board should retain these concepts as its benchmark interest rate principle in the Codification.

We note that the ASC master glossary's definition of benchmark interest rate also states that "[i]n theory, the benchmark interest rate should be a risk-free rate (that is, has no risk of default)," and we further observe that some may fear that adoption of a solely principles-based approach would preclude the use of certain rates that are considered benchmark interest rates today in the United States, such as the London Interbank Offered Rate swap rate (the "LIBOR rate"). We understand the original rationale underlying the Board's decision to designate the LIBOR rate as a benchmark interest rate, and we agree that the pervasive use of the LIBOR rate in U.S. markets is a compelling reason to permit such a designation. Accordingly, even if the Board continues to hold the view that a critical aspect of the principle that defines a benchmark interest rate is that such a rate should be risk free, we believe that in certain limited circumstances, it would be appropriate to provide practical expedients that may be an exception to the overriding principle. Therefore, in our view, the final ASU should (1) set forth a clear principle for a benchmark interest rate, (2) provide robust application guidance that illustrates application of that principle, and (3) provide limited practical expedients that permit the designation of the Securities Industry and Financial Markets Association Municipal Swap Rate (the "SIFMA rate") and the LIBOR rate as benchmark interest rates even though those rates are not risk free (if the benchmark interest rate principle established by the Board continues to include the concept that such a rate should be essentially risk free). Establishing such a principle would achieve closer convergence with principles used in IFRSs and would greatly reduce the need for future standard setting if the financial markets evolve and other rates that satisfy the benchmark interest rate principles emerge.

For cash flow hedges of forecasted purchases or sales of nonfinancial assets, the proposal would permit an entity to designate as a hedged risk the variability in cash flows attributable to changes in a contractually specified component stated in the contract. Allowing designation of such contractually specified components is clearly an incremental improvement over existing requirements because doing so would allow entities to better reflect their risk management activities in their financial reporting, and we support this amendment.

We observe, however, that some constituents desire a model that would also permit an entity to designate as a hedged risk certain components that are not contractually specified. Such a model might be similar to the model in IFRS 9, *Financial Instruments*, that would allow designation of components that are "separately identifiable" and "reliably measurable." Adoption of a principles-based model that is not limited to contractually specified components has appeal beyond the convergence benefits since it might allow certain preparers to better reflect their risk-management practices in their financial reporting. We understand, however, the operability concerns associated with such a model, and we share some of those concerns. We encourage the Board to monitor entities' implementation of IFRS 9 and, if the IFRS 9 criteria prove operable in practice, to consider adding a convergence project to the Board's agenda to explore the merits of adopting the IFRS 9 criteria for U.S. GAAP.

Appendix A of this letter contains our responses to the proposed ASU's questions for respondents, including our recommended improvements. Appendix B contains an editorial comment on certain paragraphs in the proposed ASU for the Board's consideration.

We would like to compliment the Board and its staff on their management of this project. We believe that both the efficiency and the effectiveness of the standard-setting process benefited from the decision to initially hold extensive educational sessions to identify and research all of the project's root issues and their interaction before making any decisions about them. We encourage the Board to use this process in future projects, provided that there is full transparency into the Board's decision making that affords constituents sufficient opportunity to react and provide feedback.

We appreciate the opportunity to comment on the proposed ASU. If you have any questions about our comment letter, please feel free to contact Jon Howard at (203) 761-3235 or Mark Bolton at (203) 761-3171.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Appendix A
Deloitte & Touche LLP
Responses to the Proposed ASU's Questions for Respondents

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.*

We agree that in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, allowing 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 is an improvement to existing U.S. GAAP, and we support this incremental improvement. The ability to make such a designation will allow many entities to better reflect their risk management strategies in their financial reporting and make hedge accounting for financial items and nonfinancial items more similar.

However, we question whether the proposed ASU's example of how an entity would hedge the exposure associated with a contractually specified component in a not-yet-existing contract (in ASC 815-20-55-26A through 26C, as added) portrays a realistic scenario. We encourage the Board to conduct more outreach to ensure that the example will provide meaningful implementation guidance.

As noted in our cover letter, further moving the component hedging model to a more principles-based model, such as that included in IFRS 9, would have appeal if IFRS 9's "separately identifiable" and "reliably measurable" criteria prove operable in practice. Use of that model for U.S. GAAP could yield a number of benefits, including (1) more closely converging the FASB's and IASB's respective hedging models and (2) allowing closer alignment of an entity's financial reporting and risk management practices in those limited circumstances in which a component that is not contractually specified would satisfy the IFRS 9 criteria but would not qualify for designation under a contractually specified "bright-line" criterion. We encourage the Board to (1) monitor entities' implementation of IFRS 9 to assess whether entities are able to apply the IFRS 9 criteria consistently in practice and (2) consider adding a convergence project to the FASB's agenda if the operability of the IFRS 9 criteria is demonstrated.

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.*

We agree that the Board should retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments and forecasted issuances or purchases of fixed-rate financial instruments. In addition, we agree that designation of the SIFMA rate as an acceptable benchmark interest rate in the United States is appropriate. We are not aware of any other interest rates that should be considered benchmark interest rates at this time.

As indicated in our cover letter, we support a principles-based approach for determining the interest rates that qualify as benchmark interest rates. We believe that the concepts embodied in the definition of a benchmark interest rate in the ASC master glossary, including the notion that the rate is or will become widely used, are appropriate. We also believe that if the benchmark interest rate principle established by the Board continues to include the concept that such a rate should be essentially risk free, certain exceptions to the principle should be allowed in limited circumstances in which there is a compelling reason to grant a practical expedient. The final ASU should (1) set forth a clear principle for a benchmark interest rate, (2) provide robust application guidance that illustrates application of that principle, and (3) if necessary, provide limited practical expedients that permit the designation of the SIFMA and LIBOR rates as benchmark interest rates even though those rates are not risk free.

The final ASU also should clarify whether an entity would be able to hedge an inflation risk component of a financial item when that inflation risk is contractually specified (e.g., through an explicit reference to a specific inflation index). IFRS 9 would potentially allow such a risk designation in limited circumstances, but it does not appear that such a hedging strategy would be allowed under U.S. GAAP under the proposed amendments. However, permitting such a designation would appear to be consistent with the proposed amendment to allow designation of contractually specified components of forecasted purchases or sales of nonfinancial assets.

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.*

We agree with the Board's decision to 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 to calculate the change in the fair value of the hedged item attributable to interest rate risk. We believe that this amendment will improve U.S. GAAP because it will allow entities to more clearly reflect their risk management strategy in their financial reporting. We also support the Board's view that an entity should be required to use full contractual coupon cash flows when the current market yield of the financial instrument is below the benchmark interest rate at hedge inception.

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?*

In our experience, it is uncommon for entities to have an established accounting policy that specifies what constitutes a "pattern." We believe that an entity should assess the underlying facts and circumstances associated with each missed forecast (or group of forecasts) to determine whether the missed forecast was the result of (1) deficiencies in the entity's internal forecasting processes or (2) circumstances that were beyond the entity's ability to prevent and reasonably foresee despite the entity's good-faith efforts at hedge inception to critically assess the transaction's probability of occurring. An entity should be able to exclude missed forecasts in the second category from its consideration of whether a pattern exists.

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.*

Because there are fundamental differences between the proposed hedging model and the IFRS 9 model (as discussed in paragraph BC161 of the proposed ASU), there are hedging relationships that would be eligible to meet the requirements in the proposed ASU and IFRS 9, but whose results would be recognized and presented differently under the respective models. For example, under IFRS 9, an entity would recognize periodic ineffectiveness in a qualifying cash flow hedging relationship by applying the "lower of" method, and there would be no prescription of where an entity must present the hedging results and periodic ineffectiveness in the statement of performance. Under the proposed ASU, an entity would not recognize periodic cash flow hedge ineffectiveness, and all hedging results would be presented in the same line item in the statement of performance as the earnings effect of the hedged item.

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.*

We generally agree with the proposed presentation requirements discussed above. However, we believe that when a hedged forecasted transaction is probable of not occurring, an entity should not be required to recognize amounts reclassified out of accumulated other comprehensive income 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. Instead, an entity should retain discretion over where to record the reclassified amounts in the statement of financial performance, and the entity should be required to disclose the location of such reclassifications in the statement of financial performance in the notes to the financial statements.

Although we agree that the effects of hedging associated with missed forecasts represent a cost of hedging, prescribing where those amounts should be recorded might make financial reporting less transparent in some circumstances.

For example, if an entity records the hedging effects associated with missed forecasted purchases in its cost of goods sold (where the earnings effect of the hedged item would have been presented), the entity could distort the representational faithfulness of its reported gross profit margins because the margins for transactions that actually occurred would be reduced by hedging costs associated with transactions that never occurred.

With respect to the revised accounting model, the final ASU also should allow an entity to exclude the foreign currency basis spread from its designation of the hedging instrument when the entity assesses hedge effectiveness for hedges of foreign currency risk. This treatment would seem to be consistent with that for the time value of options and the forward element of forward contracts, and it also would be consistent with what is allowed under IFRS 9.

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.*

We generally agree with the proposed disclosure requirements discussed above. However, the final ASU should further clarify the nature and extent of disclosure envisioned for (b) above, particularly in circumstances in which an entity enters into hundreds of hedging relationships.

We also encourage the Board to consider constituent feedback regarding the relative costs and benefits of providing the disclosures in both interim and annual periods. For example, the Board could potentially reduce an entity's financial reporting costs and still ensure that useful information is provided to financial statement users by requiring the entity to repeat the disclosure addressed in (b) above in subsequent interim periods only if either (1) the hedge accounting goals changed from what was reported in the annual report or (2) the entity's status of meeting or not meeting such goals changed from what was disclosed in the annual report.

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.*

We agree that (1) an entity should be required to perform an initial prospective quantitative assessment of hedge effectiveness for all hedging relationships (unless one of the exceptions listed in the amendments is met) and (2) in certain circumstances, it would be appropriate to allow the entity to perform only qualitative assessments in subsequent periods (unless facts and circumstances change). The proposed amendments provide useful factors that entities can consider when they assess whether they can reasonably support performing assessments of effectiveness after hedge inception on a qualitative basis.

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.*

It is conceivable that situations could arise in which an entity could no longer assert qualitatively that a hedging relationship continued to be highly effective, but a quantitative assessment of that relationship would indicate that it was still highly effective. For example, if facts and circumstances lead an entity to conclude that the degree of correlation between, or the alignment of, the critical terms of the hedging instrument and the hedged item has changed since hedge inception, the entity may feel compelled to perform a quantitative assessment to support a continued assertion that the hedging relationship is highly effective; however, the hedging relationship may still be highly effective.

An entity should be allowed to return to qualitative testing after a change in facts and circumstances precluded such testing in a prior period if the entity can demonstrate that the hedging relationship meets all of the proposed ASU's criteria to qualify for subsequent qualitative assessment of hedge effectiveness. Although it may be uncommon that the hedging relationship would meet those criteria after the change in facts and circumstances, there should not be a blanket prohibition against returning to subsequent qualitative assessments.

The proposed amendments indicate that an entity should "assess effectiveness for similar hedges in a similar manner." The final ASU should clarify whether an entity's conclusion that it is unable to continue to assess hedge effectiveness qualitatively for a specified hedging relationship because of a change in facts and circumstances would also have to be applied to all similar hedging relationships.

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.*

Yes, we agree with the Board's decision to provide entities with greater flexibility to determine when they complete the initial quantitative testing portion of their hedge documentation. Although the proposed amendment relieves the pressure associated with having to complete the quantitative test at hedge inception, it retains the discipline and rigor associated with qualifying for hedge accounting by still requiring all of the other hedge documentation (such as the description of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged, and the method that will be used to retrospectively and prospectively assess hedge effectiveness) to be in place at hedge inception.

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 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.*

Because an entity's application of hedge accounting is voluntary, there does not appear to be any compelling reason that would justify having different requirements about the content or timing of the preparation of hedge documentation for public entities and private companies.

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

As long as early adoption is permitted, we would not object to granting entities other than public business entities an additional year to implement the guidance in the final ASU if they believe that such additional time is necessary. We agree that all entities should be allowed to early adopt this guidance as of the beginning of a fiscal year.

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?*

While we defer to preparers' feedback on the time needed to implement the proposed amendments, it would not seem that the transition period would have to be lengthy because the proposed amendments are simplifying the existing hedging model. As indicated in our response to Question 12, we would not object to granting entities other than public business entities an additional year to implement the final ASU; however, those entities should be permitted to early adopt the ASU to take advantage of the simplified hedge accounting model if they desire.

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.*

Yes, we agree with the proposed transition method and disclosures in ASC 815-20-65-3 and with the Board's decision not to allow a retrospective transition approach. The benefits of allowing full retrospective transition would not appear to outweigh the related implementation costs.

Appendix B
Deloitte & Touche LLP
Editorial Comment

We wish to provide an editorial comment on the following Codification paragraphs that would be amended or added by the proposed ASU:

- *ASC 815-20-35-1(d)* — In describing the accounting for net investment hedging activity under the proposed amendments, ASC 815-20-35-1(d) states that the "**gain or loss on the** hedging derivative or **nonderivative instrument** in a hedge of a net investment in a foreign operation shall be reported in other comprehensive income (outside earnings) as part of the cumulative translation adjustment" (emphasis added).
- *ASC 815-20-45-1E* — This proposed additional Codification paragraph states that "[f]or qualifying net investment hedges, an entity shall record in the currency translation adjustment section of other comprehensive income and reclassify to earnings in the same period or periods during which the hedged net investment affects earnings in accordance with Subtopic 830-30 **the change in the fair value of a** derivative or **nonderivative financial instrument designated as a hedging instrument** (or a proportion of a change in the fair value of the derivative or nonderivative financial instrument designated as a hedging instrument) except for amounts excluded from the assessment of hedge effectiveness that are included currently in earnings in accordance with this Subtopic" (emphasis added).
- *ASC 815-35-35-1* — This paragraph states that the "**gain or loss on a hedging derivative instrument (or the foreign currency transaction gain or loss on the nonderivative hedging instrument)** that is designated as, and is effective as, an economic hedge of the net investment in a foreign operation shall be reported in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of other comprehensive income)" (emphasis added).

The language in these three paragraphs related to nonderivative financial instruments should be conformed. Specifically, each of these paragraphs should refer to the foreign currency transaction gain or loss on the nonderivative hedging instrument.