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Ms. Susan M. Cosper
Technical Director FASB
401 Merritt 7
PO Box 5116
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File Reference No. 2016-310

Dear Ms. Cosper:

Thank you for the opportunity to participate in the process of reviewing and amending ASC 815 Accounting for Derivative Instruments and Hedging Activities. Since its initial adoption – and through subsequent years of interpretive guidance – special hedge accounting has remained a challenge for both practitioners and their accounting advisers. We applaud your outreach, thoughtful deliberation and intention to simplify hedge accounting in an effort to make financial reporting of hedge activities useful and transparent.

Hedge Trackers, LLC is a derivative accounting advisory practice and provider of derivative accounting outsourcing services and software. Our clients include Fortune 100 companies, newly public companies, companies with well-established hedge programs and those just implementing hedge programs. These clients generally execute derivatives to protect their margins from currency, interest rate or commodity price fluctuations. Our reactions and responses to the proposed update reflect our experience as a service provider and our understanding of our clients and their hedging requirements.

Overall, we welcome the proposed guidance and believe it achieves the FASB's objective of better portraying the economic results of risk management activities in company financial statements.

In the attached document please find our comments in response to selected questions posed by the Board, as well as our observations in areas not directly addressed in the proposal that the FASB may yet consider. If you require additional clarification or have questions on our response, please contact me at hkane@hedgetrackers.com or 408.350.8580.

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Respectfully,

Helen Kane
CEO
Hedge Trackers, LLC

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Attachment 1 – Responses to Select Questions

Question 1:
We agree that the ability to hedge a contractually specified component is a significant improvement in ASC815, and encourage the FASB to evaluate opportunities to make hedge accounting even more accessible to companies facing commodity risk by further expanding opportunities to bifurcate risk and protect margins with special hedge accounting. We believe the IFRS concept of "separately identifiable and reliably measurable" provides adequate clarity.

Question 2: a.
The inclusion of "changes in *the benchmark interest rate as the hedged risk*" (815-20-25-19 A a.) as eligible for designation in cash flow hedge relationship for a forecasted issuance of debt suggests that the future issuance of CDs may continue to be hedged items in a cash flow hedge of benchmark risk. However, the strike out of CD related language (815-20-05-10) raises a question if CDs no longer qualify. Additional clarity is required if CDs are ineligible under the new proposal.

As the original guidance highlighted, CDs are an important source of funds for banks and other financial institutions. The loss of this accounting treatment would limit the ability of smaller financial institutions to manage risk. We would oppose any restrictions on hedging the benchmark interest rate on the future issuance of CDs.

Question 2: b.
It is unclear why the FASB would choose to be the driver of interest rate hedge indexes in US markets. By defining which indexes qualify as benchmarks the FASB is influencing the capital markets and may be limiting the markets ability to create new or move away from old indexes.

Question 3:
Hedges are generally designed to protect users from changes in benchmark rates. The FASB has not explained sufficiently why an entity with excellent credit, able to issue debt below the index, should be unable to protect itself from ***changes*** in the benchmark rate.

Question 4:
We have seen companies miss forecasted transactions in a period. In rare cases the amount of the miss was substantive (unintended plant shut-down, Japanese tsunami interrupting shipping, intercompany shipments to subsidiaries moved from monthly shipments to quarterly, etc.). Generally the miss has not been substantive. The total amount of over-hedged units for a period exceeded the gross purchases or sales by less than a percent. The guidance limits hedging to probable amounts frequently associated with an 80% or higher probability. Not a 100% probability. A single unit higher than hedged can cause a "strike", especially for middle market and smaller public companies; whereas larger companies rarely even validate actual units hedged due to materiality. Generally over-hedge scenarios arise from significant and quick change in the economy.

A second source of missed forecasted transactions relates to large projects and hedges designated for periods when construction is to be completed and either the project financing doesn't change on the date or in the month expected or hedged outputs from the completed project are delayed. In the cases above it was prudent for the entity to be hedging in spite of operational uncertainty. Without a hedge the profitability of the project would have been at risk to market forces. We believe it should be a rare circumstance where an entity should lose the ability to use special hedge accounting and that strikes against an entity should reflect a substantive over-hedge (over-hedge amount as % of gross exposure in the hedge period).

Question 6: a.
The requirement to record the hedge gains/losses in earnings in the same income statement line item as the earnings effect of the hedged item could allow one company hedging an intercompany exposure to record the gain/loss in *Revenue* while a second company recorded the same gain/loss hedge to *COGS*. Assume a USD parent and a EUR functional subsidiary. Company A set a EUR transfer price for widgets at the start of the year and hedged the first EUR1M of intercompany widget sales after June 1. In contrast, Company B established a USD transfer price for similar widgets and the EUR functional sub hedged the first USD1.3M of intercompany widget purchases after June 1. The transfer price exposure is a proxy for the global corporate exposure for a company with currency margin risk that sells in EUR and sources in USD. Both companies may prefer to record the gain/loss in *Revenue* (the 3rd party

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consolidated exposure), but proposed accounting rules would dictate that Company B must record the gain/loss in *COGS*. Company B may or may not prefer the mandated *COGS* geography. We recommend that preparers hedging intercompany transactions in cash flow relationships be free to elect in inception documentation the income statement geography of derivative gains/losses based on the intercompany or third party transaction.

Question 7: b.
Hedge programs quantitative goals and the reporting on the hedge performance against those goals are important internal controls. Neither is appropriate to include in disclosure. Current disclosures require the objective of hedge programs and strategies to be disclosed. A robust disclosure of the objectives of the hedge program would provide users of the financial statements with the information they need to understand the expected results of the hedge program. Most objectives that are disclosured are inadequate and reflect a lack of enforcement rather than a lack of regulation. The example disclosure provided in the proposed guidance does not provide any clarity. What does a quantitative goal “to apply hedge accounting to 80% of commodity purchases” mean? That all purchases associated with a purchase order will be hedged at 80%? That over the 12 months prior to purchase that hedges will be added until on the date of purchase the hedge layers will accumulate to 80% of forecast? Does 80% reflect the net of purchases vs. sales in a period and the target 80% represents 100% of the net exposure (not a qualifying hedge accounting concept but very much a potential quantitative goal of a hedge program). Or at reporting period end that they have 80% of the then anticipated transactions hedged? Was the 80% reflective of the accuracy across commodities (60% of wheat purchases, 90% of corn purchases and 50% of oats purchases averaged to 80%)?

What does “achieved the goal” mean? Did the amount hedged equal precisely 80% each year? Are we rounding to the nearest 10%? Did the company hit the target precisely 3 years in row? Hitting a hedge goal of 80% of your existing debt may be a realistic objective, but to have met the goal each year for 3 years on hedges of anticipated transactions seems an unlikely example. Presenting an unrealistic example suggests a lack of understanding of the nature of forecast accuracy or is providing the reader with insufficient information to evaluate the performance reported on. Why did the example include a quantitative goal for commodities, but not interest rates? If there are no quantitative goals should that be stated or ignored?

We applaud the intent to focus management on the goals and performance of their hedge programs. However, we believe that this is important and valuable information for management and not appropriate to accounting disclosures. Current guidance does not require management to report on the performance against forecast for sales, cost of sales, or operating income. It does not seem appropriate to move this element of management reporting to disclosures. We believe this is a key control in a derivative environment, and one that too many firms fail to implement. We support the concept, but would prefer this analysis be a requirement to continue to qualify for hedge accounting (similar to effectiveness assessment) rather than a disclosure. If the FASB chooses to keep the requirement we recommend consulting with active hedge programs on a realistic example. We hope that this requirement will not motivate companies to abandon internal quantitative targets to protect themselves from external reporting on forecast accuracy.

In addition, middle market and smaller corporations feel the combination of quantitative hedge goal disclosures and volume of trade disclosures could reveal important competitive information.

Question 7: c.
Why would the reporting impact of hedges by line item be limited to hedges in a special hedge accounting relationships? The table should be titled *Location and Amount of Gain/(Loss) Recognized in Income on Derivatives* not just Cash Flow or Fair Value Hedges. If users elect to use derivatives not designated in hedge relationships and report the gains and losses in operating margin lines, why would that information not be included in the analysis of derivatives on the financial statements. The FASB has already made a distinction between not designated derivatives that are hedges and derivatives for trading which might be an additional useful breakdown. The reporting of gains/losses on derivatives amounts and geography should apply to all derivatives.

For all derivative tables, the requirement to present derivative gains/losses year over year would suggest that users of the financial statements expect the hedge results to provide useful information from a year over year comparison. The only useful information this might provide is that the market being hedged (currency, interest rate, commodity, etc.) had continued to move in the same direction or had changed directions. Unlike sales or operating expenses, the effectiveness of a hedge program is not measured by comparing gains or losses last year versus this year. These may be effective metrics for a “trading” program, but not for a hedge program. The hedge result is designed to provide a result vis a vis changes in the underlying exposure, not a sustained gain or sustained loss.

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Should the *Location and Amount of Gain/(Loss) Recognized in Income on Fair Value and Cash Flow Hedging Relationships* be presented both quarterly and year-to-date or is a single year-to-date report appropriate? We have seen a disparity in practice related to derivative accounting tables in the past.

Question 9:
We would like clarification that preparers can apply quantitative effectiveness testing at inception using expected case scenarios and subsequently apply qualitative testing so long as the critical terms of the hedged item have not changed outside of the tested parameters. For example, Company A enters into a pay-fixed receive-3M LIBOR swap resetting on the first day of each calendar quarter to hedge the changes in the 1M or 3M LIBOR component of their u pick-em debt. The inception quantitative test compares the proposed swap against 2 hypothetical swaps (1M LIBOR resets and 3M LIBOR resets) each resetting in the middle of the month/quarter to show that the swap will be highly effective at hedging LIBOR interest on debt resetting within the month or quarter. The entity should be able to qualitatively assume that the hedge relationship will continue to be highly effective if the hedged debt has monthly or quarterly LIBOR resets, the hedge notional exceeds the swap notional and the counterparty is probable to perform.

Question 10:
Effectiveness testing at inception is an internal control that a company should undertake prior to trade execution to ensure that the derivative structure contemplated is expected to be highly effective in offsetting changes in the exposure. The value of the prospective quantitative testing pre-execution has been diminished as the focus over the last decade has drifted towards quantitative testing of the specific instrument executed (available only post trade execution) and the specific hedged item. It would strengthen internal controls if the standard encouraged rather than prohibited performance of inception quantitative testing prior to or at trade execution. Paragraph 815-20-55-79D indicates that preparers "may perform the initial prospective quantitative effectiveness assessment at any time **after hedge designation**…" and in the Basis for Conclusions we find "The Board decided that an entity may perform the initial prospective quantitative assessment of hedge effectiveness at any time **after hedge designation…**". The Internal Control Issues in Derivatives Usage: An Information Tool for Considering the COSO Internal Control—Integrated Framework in Derivatives Application (prepared by Deloitte in 1996 and underwritten by the Committee of Sponsoring Organizations of the Treadway Commission p. 14) recommended that in recognition that the use of derivatives introduces additional risk, "A decision to use derivatives introduces the need for reapplying risk measurement analysis to determine net exposures that include the effects of using the derivatives." An analysis that should be performed when considering strategies--not post-execution. Consider a company that routinely hedges EUR exposures with a 6 month maturity with EUR forwards that matures in 9 months. An analysis at the start of a month with data points from the last 12 months affirming the relationship is highly effective over the life of the relationship, should be adequate to support numerous transactions executed throughout the month. Likewise if an analysis of 5 year pay-fixed receive 3M LIBOR interest rate swaps that reset at the start of each quarter and a 5 year hedged item that resets quarterly at mid-month prepared at the start of a month is highly effective, this test should support similar hedge relationships transacted throughout the month. Neither of these relationships needs to be analyzed individually. While we appreciate the extra time contemplated in the proposed guidance; we feel it would benefit control structures around hedge programs for the guidance to re-affirm that testing of the expected relationship prior to trade execution is not only appropriate and acceptable, but preferred. The FASB might insert effectiveness examples clearly prepared in anticipation of trade execution used to cover a like relationship or a series of like relationships to protect and affirm testing prior to hedge execution as an appropriate control. This would likewise support the FASB's stated mission to ease the application of current guidance related to the assessment of hedge effectiveness.

Currently many practitioners evaluate the effectiveness of a hedge relationship at a point in time of the hedge relationship, for example at inception. Using the example above the test would compare the EUR 6-month forward regressed against the EUR 9-month forward. This supports the relationship at inception, but gives no information about the nature of the relationship over time: will the relationship be effective when the remaining life of the EUR exposure is 2 months and the derivative's is 5 months. The guidance does not specify that in include time value relationships effectiveness testing should cover both the passage of time and the change in market risk.

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Attachment 2 – Additional Comments

Effectiveness impacted by counterparty creditworthiness, credit spreads, funding spreads
Most examples provided have been amended to clearly highlight the underlying assumption that "no changes in the derivative counterparty's creditworthiness, credit spreads, or funding spreads that would alter the effectiveness of the hedging relationship" are contemplated in the example. Clearly the FASB contemplates that creditworthiness, credit spreads and funding spreads could and should alter the effectiveness of the hedge relationship as the clarification that it has not been contemplated in current guidance is detailed in 15 paragraphs.

It would be useful to see a single robust example where a derivative counterparty's credit deterioration does impact an ongoing hedge relationship. A second example highlighting an approach where the credit deterioration is contemplated in the inception analysis, but doesn't provide a credit effect substantial enough to fall below the highly effective requirement would be useful. Examples that could be analogized across asset classes would be most useful.

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Limitations of functional currency environment
The present functional currency environment reflects technology constraints of the 1980s. Prior to spreadsheet and ERP technology the inability to keep track of non-monetary items at historical rates and reclassify them into income at historical rates led to a systematic adoption of the local currency as the functional currency for US corporations. Even cost plus entities, where the foreign subsidiary was only responsible for identifying prospects and making sales or for parent directed research/development were not considered extensions of the parent, but classified as "relatively self-contained" local currency functional subsidiaries. There is a generation of controllers and auditors that have only seen foreign functional subsidiaries. However, these subsidiaries are generally extensions of the parent who is very involved in the operations and reporting, and those same parent companies are increasingly desperate to hedge the results of their subsidiaries into their US consolidated financial statements. A strong need to limit currency related volatility in earnings has driven as least one company to claim in external reporting that they hedge subsidiary translation risk using cash flow hedges of AFS security purchases. (Once purchased, the securities are held to meet ASC815 criteria, but are hedged back into USD during that period.) The historical lack of technology and subsequent avoidance of dollar functional entities together with changing global tax structures and a lack of "significant changes in facts and circumstances" have boxed corporations into scenarios where global profits are generated by and held in foreign functional entities that truly are extensions of the parent.

In conjunction with the targeted improvements to hedge accounting the FASB should offer an opportunity (or perhaps a requirement) to re-evaluate foreign entities and an invitation to change their functional currency without inviting a restatement. Please note this would not be a fast or easy change as most ERP system providers and related service providers continue to struggle with parent currency functional implementations.

Net Settlement
While the FASB is making targeted improvements, we would like to detail a net settlement practice that has been used inconsistently to prevent normal purchase normal sale qualification of purchases/sales that are clearly "normal" and should qualify for the exception. In the delivery of some commodities the physical amount delivered may vary from the expected volume delivered: e.g. a railcar of corn. The railcar has a specific assumed capacity. When the railcar arrives and the actual corn is delivered and measured, that value will be more or less than the assumed measurement. It is a common practice for the buyer and seller to "net settle" the difference between the assumed measurement and the actual measurement. This net settlement on the volume difference has been used to disqualify these commodity purchases and sales from normal purchase/sale treatment. The net settlement as presented in the guidance suggests full net settlement of the contract, not net settlement of an insignificant notional difference. It is an unnecessary burden to capture and report these contracts as derivatives. We recommend a clarification indicating that the net settlement of volume differences for imprecise delivery mechanisms (i.e. railcars) would not preclude a normal purchase normal sale election.

Normal Purchase/Sale Election
IFRS requires an election to treat "normal" purchases and sales as derivatives, whereas ASC815 requires an election to not treat "normal" purchases and sales as derivatives. We are unaware of misuse of the IFRS approach and invite the FASB to further simplify ASC815 to reduce the risks of "material weaknesses" at companies purchasing and selling commodities as a normal part of their business. The current application is difficult and inconsistent. There is no perceived value by management and we are skeptical that a restatement related to a failure to identify and

document a normal purchase that fixed the price of electricity or metals used in operations would provide any value to users of financial statements. The identification and documentation of these contracts is an exercise that happens at the operational level.

Complex Option Structures
There is diversity in practice associated with complex option structures that include time value. With the elimination of ineffectiveness measurement, the appeal of include time value multi-leg strategies will grow. The FASB needs to clarify the circumstances where time value can be included in complex option structures and the appropriate modeling of hedged items for quantitative evaluations of effectiveness. Please clarify if only vanilla puts, calls and zero-cost collars strategies can include time value.