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November 22, 2016

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

Dear Ms. Cosper,

Re: File Reference No. 2016-310

The Canadian Bankers Association[1] (CBA) would like to thank the Board for the opportunity to comment on the Proposed Accounting Standards Update, "Derivatives and Hedging (Topic 815): *Targeted Improvements to Accounting for Hedging Activities* (the "Proposal") issued by the FASB. Canadian banks are required to comply with IFRS for financial reporting purposes. However, some Canadian banks have significant operations in the U.S. that may require regulatory or financial reporting filings in accordance with U.S. GAAP. Therefore, we are very interested in the FASB's future accounting developments. We appreciate the Board's efforts towards improving financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. We believe that the Board has made progress in simplifying the application of the current hedge accounting guidance.

We are supportive of the following conceptual aspects within the Proposal:

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[1] The Canadian Bankers Association works on behalf of 59 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

- **Component of contractual coupon:** For fair value hedges, we support the option to perform the measurement on the change in fair value of the hedged item on the basis of the benchmark rate component of the contractual coupon cash flows rather than the full contractual coupon cash flows. We believe this measurement reflects an entity's risk management objectives in its financial results more accurately and aligns with IAS 39 and IFRS 9.

- **Partial-term fair value hedge:** In our view, risk management activities include managing overall fixed/floating cash flow profile in various time buckets. As such, entities may choose to enter into a partial-term fair value hedge. We agree with the changes in the Proposal to make a simplifying assumption for hedge accounting purposes that the hedged item has the same implicit maturity date as the derivative, and thus achieve convergence with IAS 39 and IFRS 9.

- **Benchmark interest rate:** We are in agreement with the Board to retain the benchmark interest rate concept for fair value hedges of fixed rate instruments. The addition of SIFMA Municipal Swap Rates as an eligible benchmark interest rate will improve the hedge accounting model as there is widespread demand for hedging this rate. The quality of hedging activities is very important as it can impact financial statement users' understanding of risk exposure and risk management activities undertaken by entities. By retaining the current concept of benchmark interest rates, we expect that this will aid user's understanding of the risk profile readily identifiable and provide more comparable information.

- **Shortcut method:** Permitting the continuation of a highly effective hedge (subject to certain conditions) if the shortcut is no longer met is an improvement that provides financial statement users with better information.

- **Time to complete initial quantitative assessment:** Extension of the time frame to perform the initial prospective quantitative assessment will ease the burden of preparing this analysis and related documentation contemporaneously with hedge designation.

Summary of Significant Comments

We have the following comments and suggestions that we would like the Board to consider, which support the Board's objective of better portraying an entity's risk management activities and are also in alignment with IFRS 9:

Recognition and presentation of the change in the fair value of hedging instrument: We disagree that the entire change in fair value of a hedging instrument for a fair value hedge relationship should be required to be presented in the same income statement line as the earnings effect of the hedged item. We believe that ineffectiveness or excluded components should be reflected in earnings; however, we do not agree these are considered costs of hedging that should be reflected in the same income statement line. The Board The preparers should be given the choice on the income statement geography for ineffectiveness and excluded components related to fair value hedges, which is consistent with IAS 39 and IFRS 9.

Separately identifiable and reliably measurable risks: We believe that the approach under IAS 39 and IFRS 9 related to designation of "separately identifiable and reliably measurable" risks in a hedging relationship is one that the Board should consider for inclusion in the Proposal for both financial and non-financial instruments. Risk component hedging is in line with the economics of risk management activities and would simplify the application of hedge accounting while reducing ineffectiveness and hedge costs. An example of this application for Canadian banks is the designation of the OIS or LIBOR benchmark risk component of Prime-based contractual interest rates in a cash flow hedge of Prime-based loans. Using the risk component approach, an entity can isolate the significant risk component of Prime (OIS or LIBOR with credit or liquidity spreads) and use an OIS or LIBOR-based interest rate swap to hedge this risk exposure. In addition to increased effectiveness under the Proposal, the swap costs to the entity executing the derivative transaction would be decreased since Prime-based swaps are generally more expensive than a plain vanilla OIS or LIBOR-based interest rate swap.

Treatment of time value component of hedging derivatives: Under IFRS 9, the time value component of a hedging derivative (i.e. time value of an option or forward points of a forward contract) is deferred in AOCI at the initial designation since they are excluded from effectiveness assessment as "cost of hedging". The Board should consider including the same concept in the Proposal to allow an entity the ability to defer the aligned "cost of hedging" that is excluded from hedge effectiveness in a qualifying hedge accounting relationship. Subsequently, the deferred amounts would be reclassified into earnings as the hedge item affects earnings or by using a systematic and rational basis over the period during which the hedged risk affects earnings. The benefit of this approach is that the time value component of a derivative is truly a cost of hedging and should not be fair valued through earnings. In our view, this provides a better representation of the financial results of a hedging relationship using a forward or option contract while keeping effectiveness testing operationally more straight forward (i.e. effectiveness testing using spot rates/intrinsic values).

Foreign currency basis risk: A foreign currency basis spread is a cost to convert one currency into another, mainly reflecting the differences in credit and liquidity risks of each currency. IFRS 9 permits foreign currency basis spread to be accounted for as a cost of hedging and deferred in AOCI if the foreign currency basis spread of a financial instrument is excluded from the designation of a hedging instrument. This approach is the same as the treatment of time value component as discussed above, and the Board should consider including this in its Proposal which would further align with IFRS 9.

Managing expected prepayment risk: Prepayment options are commonly featured in fixed rate bank lending products such as mortgages and home equity lines of credit. The portfolio fair value hedge model under IAS 39 and IFRS 9 accommodates prepayment risk more readily than the normal fair value hedge model for individual or similar groupings of assets given that the behavioural prepayment risk rather than the contractual prepayments can be modelled and hedged with an interest rate swap. Further, under this model, the hedged item designated is an amount of currency within the scheduled time buckets such that portions of fair value exposure can be hedged. Given this approach, it is not required to group similar hedged items with fair value changes attributable to the hedged risk in a portfolio fair value hedging relationship. The fair value portfolio hedge accounting model under IFRS together with the permitted periodic rebalancing of the expected hedged fixed rate cash flow dollar amounts achieves better alignment with risk management. We believe the Board should consider allowing this requirement to further align with risk management and IFRS.

Credit risk fair value option: Due to the difficulty to separately identify credit risk, and given that the IASB believes it is an overlay risk dependent on interest rate, it does not meet the eligibility criteria for risk components under IFRS 9. IFRS 9 permits a new fair value option approach on credit risk exposures under the condition that the full or a portion of financial instrument is managed with a credit derivative that matches the credit exposure by name and seniority. The credit risk fair value option can be designated subsequent to initial recognition of the financial instrument, and it can be revoked any time subsequent to designation. We believe the Board should also consider this approach to reduce complexity of hedging credit exposures and align financial statement measurement.

Rebalancing: Under IFRS 9, hedge ratios at inception are established based on a 1:1 relationship. When the hedge ratio is imbalanced resulting in ineffectiveness in the subsequent periods, without changes of the risk management objective, an entity must rebalance as opposed to de-designate and re-designate a hedging relationship. However, de-designation and subsequent re-designation would be required under U.S. GAAP. In our view, rebalancing is beneficial for cash flow hedging relationships, specifically to reduce the ineffectiveness throughout the hedged terms when measuring ineffectiveness using the original hypothetical derivative. We also agree with the Board to retain voluntary de-designation because hedge accounting is optional. In addition, voluntary de-designation provides flexibility to better manage changes in the risk profile of the underlying hedged exposure which may create a need to remove, add, or change existing hedging relationships.

Hedge of group of items including derivatives: An aggregated exposure is a combination of an exposure that may include a derivative and non-derivative item as a combined hedged item. The aggregated exposure is eligible as a hedged item for interest rate and foreign currency risks under IFRS 9 not currently considered under the Proposal. For example, a 3-year foreign currency fixed rate loan combined with a 3-year pay fixed, receive LIBOR swap may qualify as a synthetic foreign currency floating interest rate hedged item. A cross-currency float-to-float swap hedging 2 years from foreign currency to USD would be permitted to hedge the aggregate exposure. We recommend the Board consider permitting the hedge of aggregate exposures including derivatives as this approach will further align accounting with an entity's risk management strategies and provide better flexibility in managing interest rate and foreign currency risks over different time horizons.

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Our comments on the specific questions presented in the Proposal are addressed in the Appendix attached to this letter. We look forward to participating in further dialogue and would be pleased to discuss our position and concerns with the Board or its staff.

Sincerely,

Attachment

Responses to 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.

As stated in our Summary of Significant Comments section, we strongly believe that several concepts within IAS 39 and IFRS 9 would work well within the FASB hedge accounting proposal. Under IAS 39, it is permissible to hedge the risk component of financial assets or liabilities. One example is hedging the significant benchmark risk component (e.g. OIS or LIBOR) of Prime. Although the contractual cash flows of loans or mortgages are tied to Prime, OIS or LIBOR are significant risk components embedded in Prime with additional credit and liquidity considerations. IFRS 9 further expanded this approach to non-financial items.

In concert with our views above on being able to better reflect entities' hedged risk profile, this principles-based approach seems to be in line with the Board's objective of aligning the accounting model more closely with risk management practices. As adopters of IFRS, we believe the IFRS 9 model is operational for all entities wishing to employ these types of hedging arrangements.

· **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.

a. Although we believe 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, we recommend the Board to consider using a principles-based approach as opposed to maintaining a list. In our view, use of the benchmark interest rate is a transparent way of hedging an identified risk in a fixed rate instrument, and benchmark hedging has been applied for many years and has been an effective way of applying hedge accounting. We would also suggest that the Board allow hedging benchmark interest rates that exist within the contractual rate for cash flow hedges (e.g. LIBOR or OIS). By allowing this, it will allow for a broader set of swaps to use as hedges, for example, swaps with floating legs that are not priced on the same index as the hedged forecasted transaction.

b. We also agree that if the current concept of benchmark interest rate is retained, the Board should consider within the concept, expectations that if a rate was to become widely used then it would be added as an eligible benchmark interest rate. The widely used concept should be on a principle-based approach, similar to IFRS based on identification of significant risks within the contractual rates.

c. There are no other rates for suggestions at this time.

d. As discussed above, we believe the principles-based approach is the right direction, similar to that of IAS 39 or IFRS 9 focusing on risks that can be "separately identifiable and reliably measurable". That is, allow a hedge of risk associated with only a portion of cash flows or fair value provided that effectiveness can be reliably measured. This will also reduce the burden with proposed accounting standard updates on every new eligible benchmark rate.

- **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 decision to allow the use of either the full contractual coupon cash flows or those associated with the benchmark rate.

The current requirement to use the total contractual coupon cash flows in determining fair value is not always in line with an entity's risk management objective. For example, a fair value hedge of total contractual coupon cash flows will include a credit spread on top of the benchmark rate such as OIS or LIBOR. When using an interest rate swap to hedge a fixed rate bond, significant ineffectiveness is attributable to the credit spreads between the OIS or LIBOR swap rate and the full contractual coupon cash flows even though only the benchmark interest rate was designated in the hedge.

We suggest that the Board provide further changes to the proposed guidance to allow an expanded scope on hedgeable items under cash flow hedges on both financial and non-financial instruments, consistent with IFRS 9. Use of contractual coupon cash flow can generate substantial ineffectiveness if the available hedging derivative variable cash flow leg is not based on the contractual rate such as Prime but rather OIS or LIBOR. Currently both the existing guidance and the proposed guidance do not allow hedging a benchmark rate within a contractual rate for cash flow hedges. This limits hedging with swaps that have floating legs that are not priced on the same index as the hedged item. With the ability to hedge benchmark rate cash flows as a significant risk component, the hedging relationship will be more effective and in line with companies' risk management.

· **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 the context of banking, timing differences typically exist through prepayment risk within on-balance sheet hedged transactions rather than when hedging forecasted transactions. Similar to forecasted transactions, we believe that entities should be permitted to hedge their forecasted exposures based on their best estimates of prepayment risk and rebalance their hedging relationship if their expectations change similar to concepts set out under IFRS 9.

· **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.

There are several banking examples that will have different hedge results even though the hedging relationships are eligible under the Proposal and IFRS 9:

- Since the hedged risk must be contractually specified under the Proposal, a hedge of Prime-based loans using an OIS or LIBOR swap will have a different outcome from those under IFRS 9. To achieve high effectiveness under the Proposal, Prime-based swaps would be the ideal but not practical choice. However, under IFRS 9, an OIS/LIBOR based swap could be used as the specific OIS or LIBOR benchmark risk component for hedge designation. With the two approaches under the Proposal and IFRS 9, when we hedge the cash flow variability of Prime-based loans with OIS/LIBOR based swaps, there will be instances where the hedging instrument and hedge forecasted transaction are not perfectly matched. The Proposal requires the entire change in fair value of the hedging derivatives to be recorded in AOCI until the hedged forecasted transaction impacts earnings while IFRS 9 requires ineffectiveness to be recorded immediately in earnings. Changes in fair value of the hedging instrument greater than the amount of risk hedged would be considered ineffectiveness and separately identified. Under the Proposal, any ineffectiveness during the life of the hedge is not recognized as all results are presented in the same income statement line item.

- A fair value hedge of equity securities that are fair valued through AOCI will not be recorded in earnings under IFRS 9. The full fair value change of the derivatives will also go through AOCI, inclusion of its ineffectiveness as a separate line item. It will be recycled into retained earnings upon derecognition of the securities.

- Under IFRS 9, hedge ratios at inception are established based on a 1:1 relationship, different than U.S. GAAP and IAS 39. When the hedge ratio is imbalanced with high ineffectiveness in the subsequent periods, without changes of the risk management objective, an entity must rebalance the hedging relationship as opposed to de-designate and re-designate under U.S. GAAP or IAS 39. The subsequent treatment of the same hedging relationship is a divergence of application in practice.

- IASB does not believe the credit risk component is separately identifiable since the nature of credit risk is an overlay risk dependent on interest rate risk. IFRS 9 permits a new fair value option approach on credit risk exposures under the condition that the full or a portion of financial instrument is managed with a credit derivative that match the credit exposure by name and seniority. The credit risk fair value option can be designated subsequent to initial recognition of the financial instrument, and it can be revoked any time subsequent to designation. While U.S. GAAP permits hedging credit risk in the current guidance, it is unlikely to be an effective hedge due to the complexity of measuring the changes in credit risk exposure of the underlying financial instruments.

- Costs of hedging as discussed in the Summary of Significant Comments are treated differently under both the Proposal and IFRS 9. Under IFRS 9, these costs are presented in AOCI. Amounts are released out of AOCI in the same period hedged items affects earnings on a systematic or rational basis. We believe the IFRS 9 approach is the most appropriate application for these costs because it provides more opportunities to align with company's risk management.

- Further, under IFRS 9, ineffectiveness is presented as a separate line item while the Proposal will no longer separate ineffectiveness.

· **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 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 disagree with the Board's decision, that for qualifying fair value hedges, the change in fair value excluded from the assessment of effectiveness is to be presented in the same income statement line in which the earnings affect the hedged item. We believe this Proposal may introduce volatility in key financial metrics such as Net Interest Margin. We believe the Board should stay silent on geography and allow entities to determine according to their policy choice in which income statement line to record the change in fair value of the hedging instrument excluded from the assessment of effectiveness.

· **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 agree with the proposed new disclosures since they align closer with IFRS 9. Under the current disclosures, it is not clear how the hedged risks or the hedged items link to the hedging instruments.

The absence of any type of reconciliation between the hedging instrument risk and the hedged item risk may cause confusion for financial statement users who seek to analyse the structure of the hedging relationship. We think revised tabular disclosures that focus on the effect of hedge accounting impacts on the relative income statement line items, along with (potentially) an explanatory note would provide more context surrounding the hedging strategies, and make it easier to interpret the hedging results holistically. We do not believe the linkage to the income statement line item, in addition to a reconciliation, would be helpful to financial statement users.

· **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 with the proposed changes. However under IFRS 9, entities are permitted to use a qualitative assessment in assessing hedge effectiveness at hedge inception and in subsequent periods. A qualitative hedge effectiveness assessment is permissible when the economic relationships, hedge ratio, and minimal credit risk exposure are demonstrated and documented at inception without subsequent changes in the facts and circumstances. The use of a qualitative hedge effectiveness assessment both at inception and subsequently would help ease the operational burden and cost of applying hedge accounting.

· **Question 9:** The Board decided that an entity may elect at hedge inception to perform subsequent assessment 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.

In our view, an entity should be permitted to apply professional judgement in determining whether a quantitative assessment is necessary if there are certain temporary changes in facts and circumstances related to a hedging relationship, consistent with IFRS 9. For example, an irregular market activity may cause the management to reassess if a quantitative assessment is needed. However, given some events can be extraordinary, we believe that entities should be permitted to exercise judgement and continue to assess effectiveness on a qualitative basis prospectively.

· **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.

We agree with the proposed amendment because the main benefit is relieving operational burden at inception, and entities are still required to perform the quantitative testing based on the applicable and relevant information as of 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.

There are no valid reasons we are aware of as to why the content or timing of the preparation of hedge documentation should be different 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?

We believe separate effective dates for public and private entities are not necessary, given the theoretical and operational complexities of applying hedge accounting has been reduced by the Proposal.

· **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?

We propose the guidance to become effective for years beginning after December 15, 2017 with early adoption permitted. We believe this will provide sufficient time for public business entities.

· **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.

We agree with proposed modified retrospective transition method. We believe that the recognition of a cumulative effect in opening retained earnings would reduce the complexity and related costs of transition. We also agree with the Board's decision to not allow a retrospective transition approach. In our view, hedge accounting should not be applied with hindsight, and the efforts associated with preparing a full retrospective transition would greatly outweigh any perceived benefits.

We agree with the modification of hedge documentation for existing hedging relationships regarding effectiveness assessments without requiring de-designation. In addition, we believe the guidance allowing a quantitative assessment for shortcut method hedges that will be applying long haul is a positive addition to the guidance.