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November 22, 2016

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

RE: File Reference No. 2016-310

Dear Technical Director:

The Federal Agricultural Mortgage Corporation ("Farmer Mac") appreciates the opportunity to comment on the FASB's proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities* (the "Exposure Draft"). We support the Board's overall goals of aligning the hedge accounting guidance with risk management activities, reducing the complexity of hedge accounting application, and improving transparency and understandability of financial reporting for hedging relationships.

Farmer Mac is a stockholder-owned, federally chartered corporation that combines private capital and public sponsorship to serve a public purpose. Congress has charged Farmer Mac with the mission of providing a secondary market for a variety of loans made to borrowers in rural America. Farmer Mac funds its purchases of eligible loans and guaranteed securities primarily by issuing debt obligations of various maturities in the public capital markets. As of September 30, 2016, Farmer Mac had \$14.1 billion of notes payable outstanding funding the assets it holds.

Farmer Mac is subject to interest rate risk on all interest earning assets retained on its balance sheet because of possible timing differences in the cash flows of the assets and related liabilities. Farmer Mac enters into interest rate swap contracts to adjust the characteristics of its short-term debt to match more closely the cash flow and duration characteristics of its longer-term loans and other assets, and also to adjust the characteristics of its long-term debt to match more closely the cash flow and duration characteristics of its short-term assets, thereby reducing interest rate risk. Farmer Mac designates certain financial derivative instruments as fair value hedges of fixed rate assets, primarily classified as available-for-sale, to protect against fair value changes in the assets related to changes in a benchmark interest rate (i.e., LIBOR). Farmer Mac designates other financial derivative instruments as cash flow hedges to mitigate the volatility of future interest rate payments on floating rate debt. Thus, Farmer Mac's use of derivative financial instruments is closely aligned with its risk management objectives and activities.

Farmer Mac agrees with most of the Board's decisions in the Exposure Draft as discussed in the attached responses to the questions for respondents. However, Farmer Mac does not agree with some of the Board's decisions, which, in Farmer Mac's case, would deviate from the Board's overall goal and in some instances even create additional complexities in the application of hedge accounting and in the clarity of the presentation of hedge accounting results in its financial statements.

Currently, Farmer Mac's net interest income does not present the complete spread between all of its interest earning assets and interest bearing liabilities because the interest accruals on interest rate derivatives that are not in hedge accounting relationships are not included in either interest income or interest expense. As a result, Farmer Mac has had to disclose a supplemental, non-GAAP measure, "Net Effective Spread", to present the complete spread between interest earning assets and interest bearing liabilities. Thus, as a match-funded investor in financial instruments, Farmer Mac supports broadening the availability of hedge accounting to include most, if not all, of the interest accruals from its interest rate derivatives within net interest income where it presents the effects of its interest earning assets and interest bearing liabilities. However, Farmer Mac does not support including the unrealized fair value changes of derivatives that are in hedge accounting relationships within the same income statement line item as the income statement effect of the hedged item (net interest income in Farmer Mac's case) because Farmer Mac's interest rate risk management strategy is designed to protect net interest income with regard to its match-funded investments without regard to periodic fluctuations in the fair values of its derivatives and investments. Farmer Mac supports allowing flexibility for entities to report unrealized fair value changes in a different income statement line item



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than where they report the interest accruals on interest rate derivatives that are in hedge accounting relationships. In Farmer Mac's case, these fluctuations are not expected to have a cumulative net impact on its financial condition or results of operations when the financial instruments are held for long-term investment or to maturity, which is generally expected.

Farmer Mac also supports providing entities with the choice between using the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in fair value of the hedged item attributable to interest rate risk. However, as a GSE, Farmer Mac regularly issues debt in the capital markets at rates that are below LIBOR or U.S. Treasury rates. Therefore, Farmer Mac does not support the rules-based proposed prohibition against using the cash flows associated with the benchmark interest rate determined at hedge inception when the current market yield of the hedged item is below the benchmark rate because that would require taking into account a negative spread that results from risks other than interest rate risk.

Detailed responses to some of your specific questions are enclosed with this letter.

Once again, Farmer Mac appreciates the opportunity to comment on the Exposure Draft. If you have any questions about this comment letter, please feel free to contact me at (202) 872-5546 or Larissa Kennedy at (202) 872-6697.

Yours truly,



Gregory N. Ramsey  
Controller and Principal Accounting Officer



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## Responses to Questions for Respondents

### 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:

- a. Farmer Mac agrees with the Board's decision to 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. Managing interest rate risk associated with fixed-rate financial instruments is one of the most commonly used risk management strategies. An important element in managing interest rate risk is that the information used in assessing, measuring, and managing that risk is reliable and readily available (i.e., interest rates are readily available at any point in time and widely observable in a given financial market). Farmer Mac agrees that the current concept of benchmark interest rates is an effective framework for applying hedge accounting programs with fixed-rate financial instruments.
- b. Farmer Mac believes that the Board should consider the expectation that a rate will become widely used within the concept of benchmark interest rate. This will allow the Board to proactively identify new benchmark rates as entities are beginning to use them rather than reactively responding to market practices.
- c. Farmer Mac is not aware of any other rates that should be added to the list of benchmark interest rates at this time.
- d. Farmer Mac believes a principles-based approach is a better alternative to the current concept of benchmark interest rates. A principles-based approach could retain the current U.S. GAAP definition of a benchmark interest rate as "a widely recognized and quoted rate in an active financial market" (and/or "expected to become widely used" if the Board decides to include it in the definition) and allow companies to select a benchmark interest rate that meets that definition, based on its interest rate risk management strategies. Interest rates identified under this principle-based approach should be disclosed in the financial statements.

### 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*



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*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:**

Farmer Mac agrees with the proposed amendment to allow companies to measure the change in fair value of the hedged item in a fair value hedge of interest rate risk based on the benchmark rate component of the contractual coupon cash flows. This provision would allow Farmer Mac to exclude changes in fair value attributable to risks other than interest rate risk, (i.e., credit risk and liquidity risk) that are embedded within the overall coupon rate from the analysis and measurement of the effectiveness of hedging relationships. This is important because Farmer Mac's risk management hedging strategy is designed to only hedge interest rate risk but no other risks. Therefore, only measuring and reporting changes in fair value of the hedged item that are attributable to changes in interest rates would clearly show the effectiveness of Farmer Mac's hedging relationships.

Farmer Mac does not agree, however, with the Board's decision to prohibit entities from measuring the change in fair value of the hedged item on the basis of the benchmark rate component of the contractual coupon cash flows determined at hedge inception when the current market yield of the hedged item at hedge inception is less than the benchmark rate. As a GSE, Farmer Mac often issues debt in the capital markets at rates that are below LIBOR or U. S. Treasury rates. The market yield on a financial instrument can be less than a benchmark rate due to a negative credit spread. A negative credit spread reflects the high credit quality of the issuer. However, credit risk is not the particular risk being managed and hedged in an interest rate risk hedging strategy. An interest rate risk hedging strategy's objective is to protect against changes in the level of interest rates and not in credit or other risks. The change in the level of interest rates is practically manifested in changes in the benchmark rate. Therefore, prohibiting an entity from calculating the *change* in fair value of a hedged item attributable to *changes* in the benchmark interest rate would introduce *changes* resulting from risks other than interest rate risk. Furthermore, the reason for prohibiting the use of the benchmark rate only in this one circumstance but allowing its use in all other circumstances is not entirely clear.

**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:**

Farmer Mac is not aware of any scenarios in which missed forecasts should not be incorporated into the consideration of a pattern that would call into question an entity's ability to accurately predict forecasted transactions. Farmer Mac believes that current guidance in this area is sufficient and does not require amendment or clarification.

**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*



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*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:**

- a. Farmer Mac disagrees with the proposed requirement to present the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness in the same income statement line item in which the earnings effect of the hedged item is presented for qualifying fair value or cash flow hedges.

Currently, Farmer Mac's net interest income does not present the complete spread between all of its interest earning assets and interest bearing liabilities, including financial derivative instruments, because the interest accruals on interest rate derivatives that are not in hedge accounting relationships are not included in either interest income or interest expense. As a result, Farmer Mac has had to disclose a supplemental, non-GAAP measure, "Net Effective Spread", to present the complete spread between its interest earning assets and interest bearing liabilities, including financial derivative instruments. Net Effective Spread principally differs from net interest income because it includes the accrual of income and expense related to the contractual amounts due on financial derivative instruments that are not designated in hedge accounting relationships. Farmer Mac uses financial derivative instruments to manage its interest rate risk exposure by synthetically modifying the interest rate reset or maturity characteristics of certain interest earning assets and interest bearing liabilities. The accrual of the contractual amounts due on derivative financial instruments designated in hedge accounting relationships is included as an adjustment to the yield or cost of the hedged item and is included in net interest income. Conversely, for undesignated financial derivative instruments, Farmer Mac does not record the income or expense related to the accrual of the contractual amounts due in net interest income but recognizes it in "(Losses)/gains on financial derivatives and hedging activities" as a separate line item on the consolidated statements of operations. However, the accrual of the contractual amounts due for undesignated financial derivatives are included in Farmer Mac's calculation of Net Effective Spread, which is intended to reflect the complete spread between all interest earning assets and all of their related funding, including any associated derivatives, whether or not they are in a hedge accounting relationship. Thus, as a match-funded investor in financial instruments, Farmer Mac generally supports including the interest accruals from its financial derivative instruments into net interest income where the income effect of its interest earning assets and the expense from its interest bearing liabilities is presented.

Farmer Mac does not support including the fair value changes of financial derivative instruments that are in hedge accounting relationships in the same income statement line item in which the income statement effect of the hedged item is presented, (i.e., net interest income) because Farmer Mac's interest rate risk management strategy is designed to protect net interest income with regard to its match-funded investments without regard to periodic fluctuations in the fair value of its derivatives and investments. Furthermore, for Farmer Mac as a long-term, held-for-investment or held-to-maturity match-funded investor, the effect of fair value fluctuations is not expected to have a cumulative net impact on financial condition or results of operations reported in accordance with GAAP when the related financial instruments are held for long-term investment or to maturity, as is generally expected.

Therefore, this proposed presentation requirement would have the unintended consequence of increasing both the necessity of Farmer Mac's non-GAAP measure and the difference between its non-GAAP measure and its financial results reported in accordance with GAAP.



- b. Farmer Mac agrees with the Board's decision to retain current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded in earnings. However, Farmer Mac disagrees with the proposed amendments to present changes in the fair value of the hedging instrument excluded from the assessment of effectiveness in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. As discussed in response to Question 6 a. above, such a presentation would further obscure the complete spread between Farmer Mac's interest earning assets and its interest bearing liabilities as a long-term, held-for-investment or held-to-maturity match-funded investor.
- c. For the same reasons as explained in response to Questions 6 a. and 6 b. above, Farmer Mac disagrees with the proposed requirement to present amounts reclassified from accumulated other comprehensive income into earnings in the same income statement line item as the income statement effect of the hedged item when the hedged item does not occur.

**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:**

- a. Farmer Mac disagrees with the proposed disclosure requirement for cumulative basis adjustments related to fair value hedges. As a match-funded investor in financial instruments, Farmer Mac hedges interest rate risk to protect net interest income from fluctuations in the overall level of interest rates. Periodic fluctuations in the fair value of hedged items and interest rate derivatives are of limited consequence to Farmer Mac or its investors because for a long-term, held-for-investment or held-to-maturity match-funded investor such as Farmer Mac, the effect of fair value fluctuations is not expected to have a cumulative net impact on financial condition or results of operations when the related financial instruments are held to maturity, as is generally expected. In meetings with Farmer Mac's equity and debt investors, they rarely, if ever, ask questions about the company's use of derivatives and hedge accounting. Moreover, the measures that investors are most interested in are Farmer Mac's non-GAAP measures, such as Net Effective Spread, because it presents the complete spread between Farmer Mac's interest earning assets and interest bearing liabilities, as explained above in detail in response to Question 6. Therefore, since fair value fluctuations, in and of themselves, are not meaningful to Farmer Mac's investors, then the cumulative basis adjustments on the hedged items in qualifying fair value hedges are similarly not meaningful or worthy of disclosure.
- b. Farmer Mac does not agree with the proposed requirement to disclose quantitative hedge accounting goals. Farmer Mac's goal for its hedge accounting program is to achieve the most cost-effective funding for its business activities. However, Farmer Mac does not quantify this goal because the interest rate environment and availability of funding is outside of Farmer Mac's control. Thus, in response to the dynamic interest rate market, Farmer Mac adjusts its hedging strategy accordingly. Farmer Mac's financial statement users have not asked for a description of any quantitative hedging goals. Furthermore, Farmer Mac believes that the disclosure of hedge accounting goals and practices is more within the spirit of public companies' risk management disclosures under Regulation S-K.
- c. Farmer Mac agrees with the amended disclosure requirement to disclose the effect of fair value and cash flow hedges on income statement line items in a tabular format.



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**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:**

Farmer Mac agrees with the proposal to perform an initial quantitative test of hedge effectiveness but then to perform subsequent hedge effectiveness assessments qualitatively, unless facts and circumstances warrant a quantitative assessment. It has been Farmer Mac's experience that when a prospective quantitative effectiveness test of a hedge relationship indicates that the hedge will be highly effective, the hedge remains highly effective throughout its term. Thus, the existing requirement to quantitatively retrospectively assess effectiveness seems unnecessary. However, a qualitative assessment would be simpler to administer, would identify unexpected and unusual dynamics that could call into question the effectiveness of a particular hedge accounting relationship and would identify when a quantitative assessment should be performed.

**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:**

Farmer Mac supports the notion of qualitatively assessing effectiveness for hedge accounting relationships that are expected to be highly effective. Farmer Mac also agrees that if circumstances change in subsequent periods a quantitative assessment of effectiveness may be necessary. However, Farmer Mac disagrees that a rule-based approach is necessary to prevent an entity from returning to performing a qualitative assessment of effectiveness if the circumstances that required the quantitative assessment would change such that a qualitative assessment would again be supportable and reasonable. The decision to use either a qualitative or a quantitative assessment of effectiveness is better left to the judgment of entities and their independent accountants than to a rule.

**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:**

Farmer Mac agrees with the proposed amendment to ease the rule that requires entities to perform the initial quantitative effectiveness assessment at the time of the inception of the hedge. Farmer Mac prepares its public financial statements on a quarterly basis; thus, the rule that requires a quantitative effectiveness assessment at the time of hedge inception is unnecessary and does not - in and of itself - improve internal control or financial reporting. Conversely, allowing entities to perform their quantitative effectiveness assessment within the quarter would provide flexibility in managing internal accounting resources and in designing effective internal controls over hedging and hedge accounting.



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**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:**

Farmer Mac believes that the implementation period should not be lengthy because the objective of the proposed amendments is to simplify the application of hedge accounting. Nevertheless, the implementation of the amended guidance will require some time to evaluate the impact on existing hedge relationships, to make decisions regarding the continuation of the existing hedge relationships, and to update relevant documentation, processes and internal controls. Therefore, a one-year implementation period from the date that the Board issues the ASU would seem to be sufficient. For example, if the Board issues the ASU in the first quarter of 2017, then it would seem reasonable for it to be effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2017. Naturally, if the Board issues the ASU later than the first quarter of 2017, then a correspondingly later effective date would be necessary.

**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:**

Farmer Mac agrees with the proposed modified retrospective transition method and disclosure requirements. Farmer Mac also agrees with the Board's decision not to allow a retrospective approach.

