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Financial Accounting Standards Board  
Technical Director  
File Reference No. 2016-310  
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Dear Sir/Madam:

**Re: Comments on the Board's Exposure Draft *Proposed Accounting Standards Update, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities***

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.

We fully support the Financial Accounting Standards Board's objective of improving the actual hedge accounting model. We agree with the recommendations that would more closely align the results of cash flow and fair value hedge accounting strategies with risk management activities. Overall, we think that the Financial Accounting Standards Board's proposed Update, which retains the "highly effective" threshold but eliminates the measurement of ineffectiveness, really attains the objective of reducing complexity and the workload required in the application of hedge accounting, much more than the International Accounting Standard Board's model which reduces the level of effectiveness required to apply hedge accounting but maintains the complex calculations of ineffectiveness. In addition, unlike IFRS 9, we support that the Financial Accounting Standard Board maintains the voluntary dedesignation of hedging relationships.

Hydro-Québec is a major North American producer, transmission provider and distributor of electricity, operating mainly in the province of Québec, Canada. Its sole shareholder is the Québec government. In Québec, the transmission and distribution of electricity are regulated by the Régie de l'énergie, which sets rates on the basis of cost of service plus a reasonable return on the rate base. In the course of its operations, Hydro-Québec carries out transactions that expose it to certain risks, such as currency risk, interest rate risk and risk associated with energy and aluminum prices. Exposure to such risks and the impact on results are reduced through careful monitoring and implementation of strategies that include the use of derivatives instruments and hedge accounting.

Attached are our detailed responses to the questions in the Exposure Draft.

Should you wish to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Lise Croteau'.

Lise Croteau, FCPA, FCA  
Executive Vice President and Chief Financial Officer

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**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 with the decision to permit designating the hedged risk as the variability in cash flows attributable to changes in a contractually specified component stated in a contract to purchase or sell a nonfinancial asset. This is actually a very interesting proposal since it will offer new possibilities for applying hedge accounting and give a better reflection in income of the economic spirit of the hedging strategies adopted for this type of contract. The current model obliges us to consider all the variability of the contract price and forces us to consider cash flows that include expenses we do not wish to hedge or cannot hedge. As you mention in the Basis for Conclusions, the current model requires us to record a hedge ineffectiveness that is confusing and potentially misleading. In many cases, this could even make hedge accounting impossible.

This proposal will also make the application of hedge accounting to nonfinancial items similar to its application to financial items.

To harmonize the FASB model with the IASB model, we wonder if it would not be possible to adopt this concept according to the same conditions as IFRS 9, i.e. requiring that the designated component be a separately identifiable and reliably measurable component rather than a contractually specified one.

Nonetheless, if you were to maintain the concept of a “contractually specified component”, it should be clear that, in spite of the illustrations presented, the hedging possibilities would apply as much to components that represent stock market indices as to unquoted components that are correlated with such indices. For instance, for a complex construction contract which includes a monthly price adjustment for the diesel fuel for which there’s no active market at the delivery point, it would be possible to hedge the “diesel fuel” component provided that this component is contractually specified and an effective derivative is available, for example a NYMEX contract.

Finally, we question the relevance of conditions b. and c. listed in paragraph 815-20-25-22A. In our opinion, some clarifications would be helpful.

**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.*

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- 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 with the Board's decision to maintain the concept of benchmark interest rates for hedges of fixed-rate financial instrument and forecasted issuances or purchases of fixed-rate financial instruments. However, we question the relevance of maintaining an exhaustive list of permissible rates for the United States, knowing that such a list would have to be updated periodically according to market developments, while other jurisdictions simply require that the interest rates be the most widely used and quoted rates.

**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 proposal. Using cash flows associated with the benchmark rate rather than the full contractual coupon cash flows would better align the accounting result with the economics of an entity's risk management strategy.

We agree with the Board's decision to allow a choice, for practical reasons, between the current method (the full contractual coupon cash flows) and the new proposed method (cash flows associated with benchmark rate). As mentioned in the Basis for Conclusions, paragraph BC117, an entity may want to continue using the current methodology for economic reasons.

**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?*

The process of forecasting transactions must be very thorough, considering that such forecasts must be highly probable to qualify for hedging purposes. In situations where the forecasted transactions are probable of not occurring, an analysis must be initiated to understand the cause and effects this could have on the forecasting process.

**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.*

In spite of the efforts deployed by both the IASB and the FASB to improve the rules governing eligibility for hedge accounting and simplify its application, differences still remain. These differences lead to

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different results and a different presentation, and thereby contribute to reducing the comparability of financial statements among entities.

For example, in the proposed ASU, the requirement for entities to recognize hedge ineffectiveness each reporting period is eliminated. However, IFRS 9 requires entities to perform measurement and recognition of hedge ineffectiveness in each reporting period.

In addition, the proposed ASU requires presentation of the change in the hedging instrument's fair value in the same income statement line as the earnings effect of the hedged item while IFRS 9 does not prescribe income statement presentation of hedging results.

**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 agree with the Board's proposals on presentation. The choice of presenting the effect of fair value, cash flow and net investment hedges in the same income statement line item as the hedged item is entirely relevant and gives financial statement users a better understanding of the effect of a hedging strategy. This approach is completely consistent with the main objective of applying hedge accounting, which is to change the entity's exposure to one or more risks and ensure that the gains, losses, income and expenses related to the hedged item and the hedging instrument that offset each other are recorded in income during the same period or periods.

With regard to presentation in the same income statement line item of the portion of the effect of changes in the fair value of the hedging instrument excluded from the assessment of effectiveness (except for net investment hedges), it seems totally justified to us to defend this point of view with the cost of hedging model.

Presentation of reclassified amounts in the same income statement line item when realization of the hedged item is no longer probable of occurring could be debatable. However, even though the relationship

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between the hedged item and the hedging instrument is terminated, this choice of presentation also respects the cost of hedging model, in our opinion, considering the initial intention of the hedge.

Finally, these proposals could also eliminate disparities in the practice.

**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 partially agree with the proposed disclosure amendments.

We agree with the presentation of the cumulative basis adjustments related to fair value hedges and a revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items.

However, we strongly disagree with the presentation of quantitative hedge accounting goals that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals.

On the one hand, it is not very clear how, in practice, entities should apply this recommendation, which specifically concerns hedge accounting rather than risk management strategies adopted by these entities. As a result, given the ban on applying hedge accounting to a net position, a strategy that economically would target, for instance, the hedging of net cash flows in euros, made up of expected inflows of 100 euros, net of expected outflows of 70 euros, would result in a quantitative objective of hedging 30% of the expected inflows while, economically, 100% of them would be hedged.

On the other hand, strategies applied by entities are not necessarily static. They often arise from active management and can depend on market developments, among other things. Under these conditions, it would not be fair to measure an organization's performance based on the achievement or failure to achieve a hedging strategy. As a result, the measurement of the level of achievement of hedge accounting goals and strategies is not, in our opinion, a relevant performance indicator.

Lastly, we question the relevance of requiring the disclosure of quantitative hedge accounting goals that an entity sets when developing its hedge accounting objectives and strategies given that the following information is already required periodically:

- Objectives for holding or issuing derivative instruments;
- The context needed to understand those objectives;
- Entity's strategies for achieving those objectives;
- Volume of entity's activity in derivative instruments;
- Effect on income of derivative instruments designated as hedges, by the type of hedge;
- Effect on income of derivative instruments not designated as hedges.

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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?*

We agree with this proposed change to allow an entity to perform subsequent hedge effectiveness assessments qualitatively after performing an initial quantitative test. It is in fact very interesting to note that the manner of performing effectiveness assessments of hedging relationships has been streamlined.

However, it should not be expected that companies that have already invested in the implementation of sophisticated systems will necessarily benefit. In fact, well-established systems in place will continue to be used for initial testing and in cases where qualitative tests are not or are no longer appropriate. For a company like Hydro-Québec, which manages large volumes of several types of hedges and which has developed complex systems to support the application of hedge accounting, it may be more time-consuming to establish when qualitative tests should or should not apply than to maintain the status quo and continue with quantitative tests.

**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.*

In our view, there may actually be cases in which it becomes difficult to justify the application of qualitative testing but where quantitative testing would show that the hedging relationship is highly effective.

For hedging relationship for which certain changes in the facts and circumstances in subsequent periods require a quantitative assessment of effectiveness to be performed, it should be allowed, in our opinion, to be able to go back to the qualitative testing after having obtained conclusive quantitative assessments and show that the hedging relationships will be highly effective prospectively.

Moreover, in the context where qualitative testing would be allowed, we question the reference to the 80-125 range for quantitative effectiveness testing. Even though this range is not clearly specified in the standard, it has become, in practice, a strictly applied benchmark. Given the relaxation of effectiveness testing, compliance with this range must be eased, in practice, in order to be in line with the eligibility of qualitative testing which allows some inaccuracy.

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**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 Board's proposal to provide entities with greater flexibility to perform the initial quantitative testing portion of hedge documentation. It is indeed demanding to assemble all the documentation required at the hedge inception date (identification of the hedged item, the hedging instrument, the risk managed, the method for assessing the effectiveness used retrospectively and prospectively, etc.). Consequently, the change proposed provides flexibility without setting aside the discipline required to ensure, as soon as it is put into place, that the hedging relationship is clearly identified to avoid any possible manipulation of the results.

**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.*

We do not see any reason why the content or the timing of the preparation of hedge documentation should be different 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?*

We are of the opinion that it is not absolutely necessary for the effective application date of the proposed changes be the same for public entities and entities other than public entities.

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

Given that the proposed changes mainly concern relaxation of the application of the hedging standard, we are of the opinion that a period between 6 and 12 months would be sufficient.

In addition, we completely agree with permitting early application of the proposed changes so as to allow entities to be able to benefit from the proposed relaxation as quickly as possible.

**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 the proposed transition method and disclosures in paragraph 815-20-65-3.

We also agree with the Board's proposal of using a modified retrospective approach. On the one hand, the adoption of a prospective approach could momentarily require the use of both methods for hedge accounting application, i.e. until the existing relationships at the implementation date mature. On the other hand, adopting a full retrospective approach could be complex and costly.