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Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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June 19, 2018

Re: Agenda Request – Cash Flow Hedges: Hedging Functional-Currency-Equivalent Proceeds to Be Received from a Forecasted Foreign-Currency-Denominated Debt Issuance

Dear Ms. Cosper,

The International Swaps and Derivatives Association's ("ISDA")[1] Accounting Committee (the "Committee") appreciates the opportunity to provide an agenda request to the Financial Accounting Standards Board ("FASB"). Collectively, the Committee members have extensive professional expertise and practical experience addressing accounting policy issues related to financial instruments and specifically derivative financial instruments.

The Committee requests that the FASB consider an agenda topic that involves a cash flow hedge practice issue that was previously deliberated by the Board but never finalized. This cash flow hedge involves hedging the functional-currency-equivalent proceeds to be received from a forecasted foreign-currency-denominated debt issuance. A consensus was not reached because the Board at the time thought it would be included in a larger hedging project.

This letter provides the Committee's formal agenda request and overall views on why this topic should be added to the agenda. Overall, the Committee believes this is a practice issue that is pervasive across industries, narrow in nature, and can be resolved in a short-time frame.

We appreciate the Board recently issued Accounting Standards Update (ASU) 2017-12 – Derivatives and Hedging (Topic 815): *Targeted Improvements to Accounting for Hedging*

[1] Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient. ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool. Today, ISDA has over 850 member institutions from 67 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework. Information about ISDA and its activities is available on the Associations web site: www.isda.org.

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Activities, which has been well received by stakeholders. This practice issue was outside the scope of the recent hedging project that led to the issuance of ASU 2017-12. Given the FASB commented that issues incremental to the project could be considered by the Board at a subsequent time, we believe the timing of this request is now appropriate.

Overview

In December 2006, the Board invited comments on a draft of Derivatives Implementation Group (DIG) Issue H17 (Titled: Foreign Currency Hedges: Hedging Functional-Currency-Equivalent Proceeds to Be Received from a Forecasted Foreign-Currency-Denominated Debt Issuance) which was never finalized. The draft DIG Issue H17 tentatively concluded that the variability in functional-currency-equivalent proceeds attributable to foreign exchange risk that is to be received from the forecasted issuance of debt denominated in a currency other than the reporting entity's functional currency is not eligible for designation as the hedged transaction in a cash flow hedge of foreign currency risk.

The rationale for this tentative conclusion was that the variation in the amount of functional-currency-equivalent proceeds that an entity will receive upon borrowing at a specified date in the future exposes the company to a risk that does not impact reported earnings, as required by ASC 815-20-25-15(c)(2). In other words, changes in exchange rates from hedge inception to the borrowing date will only impact the initial measurement of the liability. This view was predicated on the concept that the effect on reported earnings should be directly related to the forecasted transaction itself (for example, functional-currency-equivalent proceeds from foreign-currency-denominated debt) as opposed to a tangential relationship (for example, the debt service to be paid after the debt is issued).

However, certain Board members disagreed with the tentative conclusion, which eventually led to a consensus not being reached to issue a final DIG Issue. These Board members believed the hedged transaction does affect earnings and provided three different reasons:

1. Topic 830 transaction gains/losses once the debt has been recognized on the entity's books
2. Extinguishment gain/loss once the debt is a recognized liability
3. The change in net cash flows received creates an implied discount or premium that should be amortized to interest expense over the life of the debt.

One Board member provided an example of a zero-coupon liability to demonstrate there could be a direct impact to earnings as the liability is accreted to par over its stated life and that accretion can be impacted by foreign-exchange rates. These Board members also disagreed with the view expressed in the tentative conclusion that there should be direct relationship between the gain or loss on the hedging instrument and the earnings effect of a forecasted transaction. ASC 815 does

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not include a requirement to that effect. Rather, the effectiveness of a cash flow hedge is assessed based on achieving offsetting cash flows attributable to the hedged risk. The Board members noted that other common cash flow hedges, such as a forecasted purchase of a machine in a non-functional foreign currency, do not give right to an immediate earnings effect and have potential earnings effects that may be either unrelated to changes in exchange rates (e.g., depreciation) or related to exchange rates.

The Board members that agreed with the tentative conclusions in the proposed DIG Issue H17 were not swayed be these points, as they believed currency risk in the hedging relationship does not affect the entity's reported earnings because future transaction gains or losses bear no relationship to the difference in functional-currency-equivalent proceeds received due to changes in exchanges rates between the hedge inception date and the issuance date.

At the Board meeting on March 21, 2007, the Board decided not to complete their deliberations as they expected to pursue a larger hedge project and did not want to address specific issues prior to that larger project. Therefore, no consensus was reached and this practice issue was not resolved.

Although this issue was not included in the scope of the recent targeted improvements project, the Committee notes that this issue continues to be extremely pervasive in practice today in that entities frequently issue foreign-denominated debt and seek to hedge the foreign-currency risk associated with that anticipated issuance. The Committee has provided, in the below table, the amount of foreign denominated proceeds its members have observed U.S. companies issue in 2017[2]:

Currency	# of Deals	USD Total**
Euro	123	$114,294,413
Canadian Dollar	26	$14,459,847
British Pound	22	$11,838,910
Japanese Yen	29	$5,393,247
Australian Dollar	13	$3,614,082
South Korean Won	40	1,166,506
Chinese Yuan	14	$938,163
Other Currencies	28	$3,445,056
USD Total	295	$155,150,224

* Amounts reported in 000s
** Converted using exchange rates as of 12/31/17

Discussions continue in practice for whether entities can (and should be able to) apply hedge accounting under ASC 815 when hedging the variability in functional-currency-equivalent

[2] The information on foreign-denominated proceeds was sourced through Dealogic (dealogic.com)

proceeds attributable to foreign exchange risk that is to be received from the forecasted issuance of debt denominated in a currency other than the reporting entity's functional currency. A company may seek to mitigate its economic exposure to movements in foreign exchange rates prior to the issuance of foreign-denominated debt by entering into a forward exchange contract that locks in the amount of functional-currency-equivalent proceeds to be received.

To facilitate the Board's review of this agenda request, the Committee has included: (1) its view on this practice issue, (2) the nature of amendments that could be made to the Codification, to demonstrate only narrow changes are necessary; and (3) an illustrative example as an appendix to this request.

Committee View

The Committee agrees with the view of those Board members that believed the variability in functional-currency-equivalent proceeds attributable to foreign exchange risk that is to be received from the forecasted issuance of debt denominated in a currency other than the reporting entity's functional currency should be eligible for designation as the hedged transaction in a cash flow hedge of foreign exchange risk. The Committee agrees with this position for the reasons cited above.

The Committee believes there is a genuine economic exposure to foreign exchange risk prior to issuance of foreign-denominated debt, but entities are precluded from designating a qualifying accounting hedge to minimize this exposure. As a result, entities must elect either to economically hedge the exposure in such a way that creates income statement volatility or to leave the exposure unhedged. The objective of ASU 2017-12 was intended to allow entities a greater ability to apply hedge accounting, consistent with their risk management strategies, and the Committee believes this is another example where the Codification could be amended to further this objective.

If one did not hedge the exposure to changes in foreign exchange rates prior to a forecasted non-functional currency debt issuance, one could view this as an entity having to raise more (or less) proceeds (i.e., borrow more or less) in a foreign currency to achieve a desired fixed amount of functional-currency-equivalent proceeds (please see the Appendix for an illustrative example). Without the option of hedge accounting, many companies choose not to hedge this exposure because an economic hedge would create income statement volatility as the derivative is marked-to-market through earnings.

As was noted when DIG Issue H17 was previously deliberated, it could be read that current guidance, per ASC 815-20-25-15(j)(3) and ASC 815-20-25-29, implies that a hedge of a forecasted incurrence of a foreign-denominated liability whose carrying amount is remeasured under ASC 830 is already permitted to be the hedged item in a cash flow hedge:

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ASC 815-20-25-15(j) If the hedged transaction is the forecasted purchase or sale of a financial asset or liability (or the interest payments on that financial asset or liability) or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is any of the following:

> *3. The risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates (referred to as foreign exchange risk).*

ASC 815-20-25-29 The recognition in earnings of the foreign currency transaction gain or loss on a foreign-currency-denominated asset or liability based on changes in the foreign currency spot rate is not considered to be the remeasurement of that asset or liability with changes in fair value attributable to foreign exchange risk recognized in earnings, which is discussed in the criteria in paragraphs 815-20-25-15(d)[3] and 815-20-25-43(c)(3)[4]. Thus, those criteria are not impediments to either of the following:

a. A foreign currency fair value or cash flow hedge of such a foreign-currency-denominated asset or liability

*b. **A foreign currency cash flow hedge of the forecasted acquisition or incurrence of a foreign-currency-denominated asset or liability whose carrying amount will be remeasured at spot exchange rates under paragraph 830-20-35-1.***

As mentioned above, other stakeholders have concluded that such guidance is not determinative. Their interpretations of the hedging strategy is that there is no direct earnings impact and, as such, the designated hedged item would not be permissible under ASC 815. We understand that the guidance in IFRS is similar to US GAAP and, therefore, similar industry conclusions have been reached. However, if permitted, clarifications in US GAAP may then provide an opportunity for corresponding clarifications to the interpretations of IFRS.

Proposed language

If the Board concludes this practice issue should be added to the Agenda for further deliberation and if such final deliberation were to be consistent with the Committee's view, the Committee

[3] 815-20-25-15 A forecasted transaction is eligible for designation as a hedged transaction in a cash flow hedge if all of the following additional criteria are met:
d. The forecasted transaction is not the acquisition of an asset or incurrence of a liability that will subsequently be remeasured with changes in fair value attributable to the hedged risk reported currently in earnings.

[4] 815-20-25-43. Besides those hedged items and transactions that fail to meet the specified eligibility criteria, none of the following shall be designated as a hedged item or transaction in the respective hedges:
C3. An asset or liability that is remeasured with the changes in fair value attributable to the hedged risk reported currently in earnigs.

believes the amendments to the Codification could be narrow, as demonstrated below (the intent of the below is to demonstrate the amendments are not pervasive in Topic 815):

>> Hedged Items and Transactions Involving Foreign Exchange Risk

815-20-25-26 The functional currency concepts of Topic 830 are relevant if the foreign currency exposure being hedged relates to any of the following:

f. The forecasted issuance of debt denominated in a currency other than the reporting entity's functional currency

815-20-25-28 If the hedged item is denominated in a foreign currency, an entity may designate any of the following types of hedges of foreign currency exposure:

b. A cash flow hedge of any of the following:

5. The variability in functional-currency-equivalent proceeds attributable to foreign exchange risk that is to be received from the forecasted issuance of debt denominated in a currency other than the reporting entity's functional currency

Conclusion

Given the views expressed above, the impact of this issue across many industries, and the nature of the Board discussions during 2006 through 2007, the Committee believes this is a topic that would be worthwhile for the Board to revisit and seek final deliberation.

The Committee members appreciate the Board's consideration of this issue and would welcome the opportunity to discuss it further. Should you have any questions or desire further clarification on any of the matters discussed in this letter, please do not hesitate to contact Matt Esposito at (212) 816 - 5371.

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Citigroup Inc
Chair, North America Accounting Committee

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Appendix: Example Cash Flow Hedge of the Functional-Currency-Equivalent Proceeds to Be Received from a Forecasted Foreign-Currency-Denominated Debt Issuance

The Committee members believe the below example is consistent with other foreign currency hedges of forecasted transactions. Further, it shows that it is helping to alleviate a true financial risk that is driven by the amount of functional currency proceeds an entity ultimately receives.

Example:
Assume on January 1, a USD functional currency entity has the intention to borrow €100 million on June 30 at a time when the forward rate corresponding to the date of the expected borrowing was $1 to €.8. The entity would like to lock in the USD (functional-currency-equivalent) proceeds to be received upon issuance of the euro debt. To do this, on January 1, the entity enters into a forward exchange contract at the forward rate of $1 to €.8 on June 30. By locking in the exchange rate of $1 to €.8, the entity has effectively ensured that the combined USD-equivalent proceeds to be received from the debt issuance and the forward exchange contract settlement on June 30 is $125 million regardless of what the spot rate will be on June 30.

Upon issuance on June 30, the spot rate is $1 to €.75. As such, the amount of USD-equivalent proceeds that the entity will receive upon the borrowing is $133.33 million (€100/$1: €.75). The value of the forward contract at expiration on June 30 is $8.33 million (a liability), calculated as ((€100/($1: €.8) – (€100/$1: €.75). The net combined USD proceeds received from the debt issuance and the forward contract settlement are $125 million, the locked in amount.

If the forward contract were designated as a cash flow hedge of the variability in functional-currency-equivalent proceeds attributable to foreign exchange risk that is to be received from the forecasted issuance of debt denominated in a currency other than the reporting entity's functional currency, the change in fair value of the forward contact would be recorded in OCI over the term of the forward contact, resulting in the following net entry on June 30:

Dr. OCI	$8.33	
Cr. Forward contract		$8.33

The debt issuance will be recorded at the current spot exchange rate on June 30 while the actual cash received (net of the settlement of the forward contact) is the locked-in amount of $125.

Dr. Cash	$125	
Dr. Forward contract	$8.33	
Cr. Debt		$133.33

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If we assumed that the debt has a term of 1-year and pays a 10% coupon annually, the entity would recognize $13.33 of interest expense over the term of the security (assuming there are no further changes in USD/EUR spot exchange rates):

Dr. Interest expense	$13.33	
Cr. Cash		$13.33

Over the term of the debt, the deferred loss on the forward contract will be recognized in earnings:

Dr. Interest expense	$8.33	
Cr. OCI		$8.33