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Ms. Hillary Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

**File Reference No. 2021-002**

Dear Ms. Salo:

RSM US LLP is pleased to provide feedback on the proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815): Fair Value Hedging-Portfolio Layer Method*. We support the efforts the Financial Accounting Standards Board is putting forth to facilitate portfolio fair value hedges, and we are generally in agreement with the proposed amendments. We believe, for the most part, the amendments are operable, logical and better aligned with entities' risk management objectives. We understand that this is a limited-scope project but encourage the Board to consider extending the scope beyond closed portfolios of prepayable financial assets, through a separate new project if necessary to avoid significant delays in finalizing this standard. We elaborate on these sentiments and include additional suggestions in the remainder of this letter through our responses to the questions posed to respondents, as well as in a section titled *Other Suggested Changes* that follows.

**Responses to Questions for Respondents**

***Question 1—Operability:*** *Are the amendments in this proposed Update operable and auditable? If not, which proposed amendment or amendments pose operability or auditability issues and why?*

> We believe the portfolio layer method for fair value hedges as set forth in the proposed amendments appears to be generally operable and auditable. The proposed ASU requires, at hedge inception and on an ongoing basis, an entity to properly support and document its expectation that a hedge layer(s) will remain outstanding at the end of the period(s) hedged. We believe this requirement is integral to the operability and auditability of the proposed amendments because the entity's expectation drives whether and how it dedesignates a hedged layer(s) and the accounting impact of such dedesignation under the proposed amendments. We believe that, in practice, there will be need for sufficient rigor and consistency around the ongoing analysis required by ASC 815-25-35-7A. Rigor and consistency should help to minimize the risk that an anticipated breach is inappropriately identified with the use of hindsight to achieve a desired accounting consequence. In addition, if an entity hedges multiple layers and segregates a closed portfolio into subgroups, it will be important for the entity to clearly document how it constructed and how it will track those subgroups and how each subgroup of the closed portfolio supports the hedged layer that it is designed to support. This will help ensure the operability of the proposed amendments because the application of the guidance on hedge dedesignation considers the relationship between the hedged layers and their supporting subgroups of assets.

As it relates to operability, an entity may incur some cost to update systems and processes such as those to maintain fair value hedge basis adjustments on a closed portfolio basis rather than an individual asset basis. Once an entity implements these changes, the cost of ongoing application and compliance with the proposed amendments should not be significant. As the Board noted in paragraph BC8 of the proposed ASU, an entity may be able to leverage existing systems and processes when implementing the changes to comply with the proposed amendments.

We also discuss potential operability issues related to the follow-the-asset method in our response to Question 6 below.

***Question 2—Risk Management:*** *As proposed, would the multiple-layer model align with entities' risk management objectives? Please explain why or why not.*

We believe the proposed multiple-layer model would further align hedge accounting with the interest rate risk management objectives of many entities and therefore better portray in their financial statements the economic results of those entities' risk management activities.

In accordance with the last-of-layer method under current GAAP, the amount of principal to which an entity can apply hedge accounting in a closed portfolio is limited to the amount the entity expects to be outstanding at a particular point in time. Stakeholders have noted that restricting hedge accounting to the last-of-layer method may not be consistent with the interest rate risk management objectives of many entities and does not maximize the usefulness of a fair value hedge layering model because, as noted in paragraph BC10 of the proposed ASU, it can leave an amount of principal that is subject to interest rate risk ineligible for hedge accounting. Allowing entities to hedge multiple layers in a single closed portfolio would allow them to apply hedge accounting to different stated amounts at different points in time, which is more consistent with how entities manage interest rate risk and would enable entities to maximize the amount of outstanding principal to which they can apply hedge accounting. This should further align interest rate risk management and hedge accounting.

Although the proposed amendments would narrow the gap between interest rate risk management and hedge accounting, we believe more can be done to further align the two. In paragraphs BC110 and BC111 of ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, the Board noted that there are similarities between the last-of-layer method and the "first dollar amount" approach under the cash flow hedge model. We note that under the cash flow hedge model, forecasted transactions are not required to stem from a closed population, which based on our understanding is consistent with interest rate risk management practices. We believe extending an open-portfolio concept to the portfolio layer method for fair value hedges would further align interest rate risk management and hedge accounting and further align the cash flow hedge and fair value hedge models.

***Question 3—Scope:*** *Do you agree with the Board's decision to limit the scope of the types of instruments eligible for portfolio layer method hedging to prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments? Please explain why or why not.*

As noted in our response to Question 2, we believe portfolio hedging should be extended to open portfolios. Additionally, we understand that stakeholders requested the Board to expand the scope of the types of instruments eligible for portfolio layer method hedging to nonprepayable financial assets as well as to financial liabilities and the Board considered, but rejected such scope expansion as noted in paragraph BC28 of the proposed ASU. We appreciate that the Board views the proposed amendments as a narrow-scope project with the primary objective of clarifying and improving the amendments of ASU 2017-12. However, we believe expanding the scope of the types of instruments eligible for portfolio layer method hedging to nonprepayable financial assets and to financial liabilities would further align interest rate risk management and hedge accounting and, as a result, would improve financial reporting as the Board noted in BC6 of the proposed ASU.

Similar to the way prepayment risk tends to make achieving and maintaining hedge accounting a challenge for hedging prepayable financial assets, it also makes achieving and maintaining hedge accounting a challenge for hedging prepayable financial liabilities. These challenges can be seen when hedging securitized debt obligations and certificates of deposit that are puttable back to the issuer contingent upon the occurrence of an event (e.g., in the case of the death of the depositor) as the Board noted in paragraph BC27 of the proposed ASU. Also as noted in paragraph BC27, portfolios of nonprepayable financial assets, like portfolios of prepayable financial assets, may have uncertain cash flows for reasons other than prepayment risk, such as default risk. It seems that many of the challenges involved with achieving and maintaining hedge accounting may be overcome by expanding the scope of portfolio layer method hedging to nonprepayable financial assets and financial liabilities.

We also note that by allowing entities to apply the portfolio layer method to nonprepayable financial assets, an entity would not need to keep prepayable financial assets separate from nonprepayable financial assets for the sake of applying hedge accounting, which would ease operability and possibly reduce the cost of hedging. In addition, we note that the prepayable financial assets comprising certain subgroups under a multiple-layer method do contain an element of nonprepayability. That is, for a closed portfolio with multiple hedged layers, ASC 815-20-25-12A(e)(2), as proposed, would require that all financial assets in the closed portfolio be or become prepayable by the end of the latest-ending hedge period of hedges associated with the closed portfolio. This means that some of the assets in the closed portfolio may be nonprepayable during the hedge periods prior to the latest-ending hedge period. This then raises the question as to why nonprepayable financial assets should be excluded from the closed portfolio to which a hedge layering method applies. Because there is no substantive difference in the interest rate risk associated with the portion of a portfolio of prepayable financial assets eligible for hedge accounting under the proposed amendments and financial assets that are not prepayable at any time, we encourage the Board to reconsider its decision to limit the scope of the types of financial instruments eligible for the portfolio layer method.

In addition, we believe allowing entities to apply the portfolio layer method to nonprepayable financial assets and financial liabilities would further achieve the Board's intention "to reduce the need to construct separate closed portfolios and designate more hedging relationships to achieve the same economic outcome that could be achieved with fewer closed portfolios and hedging relationships."[1]

As previously mentioned, we suggest that any scope expansion that could significantly delay the issuance of a final standard be addressed as a separate project.

***Question 4—Dedesignation Sequencing:*** *Do you agree with the Board's proposed amendments on hedge dedesignation sequencing under the multiple-layer model? Please explain why or why not.*

Under the proposed amendments, if an entity anticipates a breach, it would have to fully or partially dedesignate one or more hedges to reduce the aggregate hedged item(s) to an amount anticipated to remain outstanding for the hedged period. This dedesignation applies only to the hedge amount and not to a particular time period (e.g., dedesignating the last year of a five-year hedged layer would not be permitted). We believe allowing an entity to fully or partially dedesignate an amount of the hedged

[1] See paragraph BC17 in the proposed ASU.

layer (but not a time period) if it anticipates a breach is consistent with typical interest rate risk management objectives as well as the fundamentals of applying hedge accounting to a layer of prepayable financial assets. We also agree with the Board's observation in paragraph BC20 of the proposed ASU that an entity should be able to proactively tailor its hedging strategies to a changing interest rate environment and that hedge accounting should reflect such changes. As a result, we support the Board's decision to not require a preestablished dedesignation sequence for hedged layers if a breach has not occurred.

If a breach occurs, the proposed amendments prescribe that an entity would first dedesignate the hedge with the shortest period remaining until the hedged item's assumed maturity and then dedesignate the second shortest if necessary, and so on until the entity could support that the stated amount hedged is anticipated to be outstanding for the remainder of the hedged period. We agree that, as noted in paragraph BC22 of the proposed ASU, an entity should not have optionality in determining which hedge to dedesignate in the instance of a breach because that would allow the entity to select the earnings effect of the breach.

***Question 5—Basis Adjustments:*** *Do you agree with the Board's proposed amendments on accounting for basis adjustments and disclosure of those basis adjustments in disclosures required by other areas of GAAP outside hedge accounting? Please explain why or why not.*

We agree with the Board's proposed amendments that would prohibit an entity from allocating basis adjustments associated with a closed portfolio during an existing portfolio layer method hedge either to the individual financial assets in the closed portfolio or to financial assets removed from the closed portfolio. Such basis adjustments relate to the hedged layer and not the individual assets.

We agree with the Board's decision to prohibit an entity from considering basis adjustments on existing portfolio layer method hedges when it measures credit losses or impairment on the financial assets included in the closed portfolio. As the Board articulated in paragraph BC32 of the proposed ASU, while the guidance in ASC 815 and ASC 326, *Financial Instruments—Credit Losses*, indicates that an entity should consider the fair value hedge basis adjustment when estimating and recognizing credit losses, a critical assertion of the portfolio layer method is that prepayments, defaults and other factors affecting the timing and amount of cash flows from the closed portfolio relate to financial assets that do not make up any hedged layer. Thus we agree that the basis adjustment associated with the hedged layer should not be considered when recognizing credit losses.

We agree with the proposed amendments to prohibit an entity from disclosing portfolio layer method basis adjustments on a more disaggregated basis than the closed portfolio basis (after the basis adjustments are disaggregated by balance sheet line item) to meet the disclosure requirements in Topics other than ASC 815. We also agree that, to avoid confusing users of the financial statements, an entity should be required to disclose the total amount of the basis adjustments in existing hedges as a reconciling amount for other areas of GAAP that require the disaggregated disclosure of the amortized cost basis of items within the hedged portfolio.

***Question 6—"Follow the Asset" Method:*** *In the case of a breach, do the expected costs of identifying which assets in the closed portfolio that caused the breach justify the expected benefits of aligning the derecognition guidance with other Topics in GAAP? Please explain why or why not.*

Under the follow-the-asset method, an entity would account for the portion of the basis adjustment associated with a breach in the income statement line item affected by the financial asset(s) that caused the breach. If the breach was caused by prepayments, the associated basis adjustment would be recognized immediately in interest income. However, if the breach was caused by defaults, the associated basis adjustment would be recognized as a credit loss. As the Board noted in paragraph BC37 of the proposed ASU, the last asset that was prepaid that resulted in the outstanding amount of the closed portfolio to fall below the stated hedged amount would be considered the "cause" of the breach. To apply the follow-the-asset method, an entity would need to be able to identify the particular financial asset that "caused" the breach, which, as the Board has learned from limited outreach, may require incremental accounting processes. While we defer to reporting entities to comment on the expected costs to make this identification, we believe it could be burdensome to identify the specific financial asset that caused the breach such that the costs of the proposed approach to follow the asset may outweigh the related benefits.

We also are concerned that the proposed approach could result in illogical accounting consequences given that the prepayment, default or sale that triggers a breach would likely be only one of several events that cause the outstanding amount of the closed portfolio to fall below the stated hedged amount. It is possible that the event that "causes" a breach could be a one-off type of event that had a very minor impact on the overall breach (e.g., a situation where significant unanticipated prepayments were the greatest contributing factor to a breach, but an insignificant default "caused" the breach). In this case, as proposed, the entity would recognize the basis adjustment associated with the breach as a credit loss, which is not representative of the bigger picture. Given this potentially illogical consequence, as well as the costs that may be incurred to identify the specific asset that caused the breach, a preferred approach may be for entities to account for the basis adjustment associated with the breach in interest income in a manner consistent with the presentation of the income statement effect of the hedged item. Another potential approach would be to require the income statement presentation to be consistent with the major contributing factor to the breach (i.e., prepayments in our example). We anticipate it generally will be easy for an entity to identify the major contributing factor, given that the overall level of events, such as asset prepayments, sales and defaults, typically are tracked for various reasons.

***Question 7—Certain Private Companies and Not-for-Profit Entities:*** *Would any of the proposed amendments require special consideration for private companies that are not financial institutions and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market)? If so, which proposed amendment or amendments would require special consideration and why?*

We are not aware of any proposed amendments that would require special consideration for private companies or not-for-profit entities.

***Question 8—Transition:*** *Do you agree with the proposed transition guidance? Please explain why or why not.*

We agree with the prospective adoption of a multiple-layer hedge strategy because retrospective adoption would be inconsistent with the application of hedge accounting (i.e., hedge accounting cannot be applied retroactively). Given the nature of fair value hedge basis adjustments, we also agree that the proposed amendments related to accounting for the basis adjustments associated with the portfolio layer method should be applied on a modified retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings and the balance sheet line items (as appropriate) as of the date of adoption as proposed at ASC 815-20-65-6(g).

We agree that entities should have the option to apply the proposed amendments related to disclosures required by Topics other than ASC 815 on a prospective basis as of the date of adoption or on a retrospective basis to each prior period presented after the date of adoption of ASU 2017-12.

We also agree that an entity should be able to reclassify a debt security from the held-to-maturity category to the available-for-sale category if the security qualifies for the portfolio layer method upon transition to the final standard, which is similar to the relief granted upon the adoption of ASU 2017-12.

We agree with the proposed amendment at ASC 815-20-65-6(e) that would allow an entity on any date on or after adoption, to modify its documentation without dedesignating a portfolio layer method hedging relationship existing as of the date of adoption to add one or more portfolio layer method hedges to the closed portfolio. Similarly, we agree with the proposed amendment at ASC 815-20-65-6(f) that would allow an entity to separate a single closed portfolio into subgroups based on the contractual maturity date of the assets within the closed portfolio and use only specific subgroups to correspond to hedged layers on a prospective basis for multiple-layer hedges designated on or after the date of adoption. Although we agree with these proposed amendments, we believe the Board should be more explicit about the type of modifications to existing documentation that are acceptable. Additionally, given that as proposed, both ASC 815-20-65-6(e) and 65-6(f) remain relevant after the date of adoption, we recommend their provisions also be captured outside of the transition guidance in ASC 815-20-65 (e.g., in a location such as ASC 815-20-25-3 and/or ASC 815-20-55-56).

Lastly, as it relates to transition, we believe the Board should permit early adoption.

***Question 9—Implementation:*** *How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.*

We believe financial statement preparers are in the best position to estimate the time that would be needed to implement the proposed amendments.

**Other Suggested Changes**

***Basis adjustments related to mortgage loans held for sale***

If the proposed amendments are finalized as written, ASC 948-310-35-1 would state:

> "Mortgage loans held for sale shall be reported at the lower of amortized cost basis cost or fair value, determined as of the balance sheet date. If a mortgage loan has been the hedged item in a fair value hedge (as addressed in Topic 815), the loan's amortized cost basis used in lower-of-amortized-cost-basis or-fair value accounting shall reflect the effect of the adjustments of its carrying amount made pursuant to paragraphs 815-25-35-1(b) and 815-25-40-9 through 40-9A."

We believe this paragraph could be read to mean that individual mortgage loans held for sale that are included in a closed portfolio to which the portfolio layer method is applied would have basis adjustments allocated directly to them. We ask the Board to consider whether this is how it intended the proposed guidance to be applied, because the guidance would be contrary to the Board's decision to require the basis adjustments related to prepayable financial assets that are part of a closed portfolio to which the portfolio layer method is applied to be maintained on a portfolio basis. To avoid any unintended consequences, we recommend the Board clarify ASC 948-310-35-1.

***Hedge documentation***

We noticed that the hedge documentation requirements in ASC 815-20-25-3 have not been expanded upon in the proposed ASU to fully accommodate the portfolio layer method. To avoid divergent views and uncertainty over the level of documentation that will suffice, we believe it would be beneficial to expand

ASC 815-20-25-3 to articulate what should be documented as it relates to the hedged layer(s), subgroups and the respective hedge period each is hedging. It also would be beneficial to refer to the illustrations that begin at ASC 815-20-55-14C.

We appreciate the efforts the Board has put forth to improve the accounting for fair value hedges using a portfolio layer method. We also appreciate the opportunity to provide feedback on the proposed amendments. We would be pleased to respond to any questions the Board or its staff may have concerning our comments and ask that questions be directed to Faye Miller at 410.246.9194 or Mike Gaiso at 212.372.1709.

Sincerely,

RSM US LLP

RSM US LLP