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July 2, 2021

Ms. Hillary Salo
Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: File Reference No. 2021-002

Dear Ms. Salo:

We appreciate the opportunity to comment on Proposed Accounting Standards Update, *Derivates and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method* ("the Board's Proposal"). We applaud the Board's efforts to clarify and propose further enhancements to the hedging model applied to fair value hedges of closed portfolios of prepayable financial assets. While we generally support the Board's proposed amendments, we have included some suggestions for the Board to consider during its deliberations.

Our responses to the questions in the Board's Proposal have been attached as Appendix A.

Please contact Scott Lehman at (630) 574-1605 (scott.lehman@crowe.com) or Sean Prince at (646) 230-7285 (sean.prince@crowe.com) should you have any questions or would otherwise like to discuss our response.

Sincerely,

Crowe LLP

Crowe LLP

cc: Jim Dolinar, Partner, Crowe LLP
Chris Moore, Partner, Crowe LLP

Appendix A – Responses to Questions

<u>Overall</u>

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?

Overall, we believe the proposed amendments are operable and auditable. Refer to our response to Question 6 for certain concerns and suggestions regarding the Board's proposed "follow the asset" method.

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

The proposed amendments would further align the hedge accounting guidance with entities' risk management practices. Notwithstanding, we acknowledge that some organizations may still be unable to benefit from use of the proposed portfolio layer method given the dynamic nature of their fair value hedging strategies (e.g., use of an open portfolio approach).

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.

We agree with the scope of the proposed amendments. We appreciate the Board's decision to focus this project on addressing relevant practice issues that arose under the "last of layer" method rather than redefining the scope or other broad conceptual matters. If the Board wishes to undertake further enhancements to its hedging guidance, we encourage the Board to do so as part of a separate project so the current practice issues can be resolved timely.

Question 4—Dedesignation Sequencing: Do you agree with the Board's proposed amendments on hedge dedesignation sequencing under the multiple-layer method?

We support the Board's proposed hedge dedesignation sequencing guidance. While such guidance may not perfectly align with how an entity would otherwise choose to manage the underlying interest rate risk upon the occurrence of a breach, we understand and agree with the Board's basis for conclusions as articulated in paragraphs BC20 through BC26 of the Board's Proposal, in particular the Board's concerns about earnings management.

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 on accounting for basis adjustments and the related disclosure requirements. We believe the proposed amendments adequately address the key practice issues that arose under the "last of layer" method and do so in a practical way.

Question 6— "Follow the Asset" Method: In the case of a breach, do 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.

We agree with the Board's observation that prescribing the "follow the asset" method may be operationally challenging for some entities (see paragraph BC37 of the proposed ASU). We expect the complexity and cost of applying such an approach would be highest for entities seeking to hedge closed portfolios consisting of a large number of prepayable financial assets (e.g., a large portfolio of residential mortgage loans). We would also note that some entities who have historically applied the "last of layer" method may not have existing processes in place to identify which particular assets caused a breach as the "last of layer" method did not prescribe a specific approach to account for the income statement impact of a breach. While we acknowledge that applying hedge accounting frequently requires enhanced documentation and accounting processes, our primary concern of prescribing a specific approach for income statement treatment of a breach is that the potential incremental costs of implementing new processes may deter reporting entities – including those that have already applied the "last of layer" method – from otherwise applying the portfolio layer method.

One possible solution would be to not prescribe the "follow the asset" method and instead allow entities to adopt a "systematic and rational method" to account for the income statement impact of a breach. If an entity wishes to adopt the "follow the asset" method as its policy (which the Board could include in the application guidance as an example of an acceptable method), it could elect to do so. However, if internal constraints prevent it, the entity would have the flexibility to elect another reasonable "systematic and rational" accounting policy (e.g., accounting for the income statement impact of the breach through net interest income given the objective of the hedge strategy). We believe this solution, coupled with a requirement to disclose the policy elected, would provide entities with the opportunity to select a method most appropriate to that entity's facts and circumstances while at the same time providing decision-useful information to financial statement users.

If the Board ultimately decides to prescribe the "follow the asset" method, we suggest the Board address the following application items regarding the "follow the asset" method during its redeliberations:

- The Board should clarify whether application of the "follow the asset" method as prescribed in ASC 815-25-40-9A occurs immediately upon the initial breach of the affected hedged layer(s) or whether it applies to not only the initial breach event but also all events occurring after the breach but within the same reporting period that further reduce the outstanding amount of the hedged layer(s). We read the proposal to require the former and support that approach because it is conceptually consistent with the requirement to dedesignate the hedge upon a breach.
- If the "follow the asset" method applies to not only the cause of the initial breach but also all following events that further reduce the outstanding amount of the hedged layer(s) within the same reporting period, the Board should clarify how an entity should account for a cumulative breach that is caused by both unanticipated prepayment and credit events within the same reporting period (for example, the initial breach might have resulted from an unanticipated charge off whereas the further reduction of the hedged item may have been due to unanticipated prepayments). It is also unclear whether the entity would be required to allocate the income statement impact of the breach between prepayment events (interest income) and credit events (charge offs), or would the cause of the initial breach dictate the treatment for all subsequent events contributing to the cumulative breach within the reporting period. Consistent with our recommended alternative to the "follow the asset" method above, we believe one approach would be to allow entities to adopt a "systematic and rational method" to account for the income statement impact of the breach.
- The Board should clarify whether a reporting entity that is hedging a beneficial interest or interests as part of a portfolio layer method hedge would be required to "look through" the interest(s) when applying the "follow the asset" method. While it is clear that a reporting entity should not "look through" the interest(s) when setting up the hedging relationship (see ASC 815-20-15-12A), the proposed guidance is not clear on what to do under the "follow the asset" method. Like the Board's position on setting up the hedge, we support not requiring entities to "look through" to the underlying assets.

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 special considerations needed for private companies that are not financial institutions or the not-for-profit entities identified in the question.

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

We agree with the proposed transition guidance.

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 implementation of the proposed amendments would not require significant time and effort, except for the concerns mentioned earlier regarding the “follow the asset” method.

Further, we recommend the Board provide a delayed effective date for non-public business entities—with early adoption permitted—so that such entities can benefit from the learning cycle provided through public business entity implementations if so desired.