



**Mario Mastrantoni**  
Head of Accounting Policy  
& SEC Reporting

MAC D1185-080  
11625 N Community House Rd  
Charlotte, NC 28277-1581  
980-260-6399 (w)  
[Mario.Mastrantoni@wellsfargo.com](mailto:Mario.Mastrantoni@wellsfargo.com)

July 5, 2021

Via email

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

**Re: File Reference No. 2021-002: Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method***

Dear Ms. Salo:

Wells Fargo & Company (“Wells Fargo”) is a diversified, community-based financial services company with \$2.0 trillion in assets providing banking, insurance, investments, mortgage, and consumer and commercial finance services. We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method* (the “Proposal”).

### **Summary**

Wells Fargo largely supports the Proposal which permits reporting entities to designate multiple-layer hedges against a single closed portfolio of prepayable financial assets (e.g., mortgage loans) or beneficial interests secured by a portfolio of prepayable financial instruments (e.g., mortgage-backed securities). The Proposal broadens risk management strategies that qualify for hedge accounting. Reporting entities will be able to hedge a greater proportion of assets in the closed portfolio, relative to current guidance which permits only single-layer hedges. The ability to use spot or forward-starting swaps, and fixed or amortizing notional swaps, or combination thereof, provide risk managers additional tools to tailor strategies to accomplish risk management objectives in a portfolio hedge accounting construct. We applaud the efforts of the Board and support substantially all of the provisions of the Proposal as it further aligns hedge accounting with risk management strategies.

However, we have the following comments for the Board to consider:

1. Expand the scope of the portfolio layer method to include all prepayable assets, provided the contractual maturity criteria are met;
2. Simplify the accounting model for a dedesignation scenario caused by an actual breach;
3. Conform the one-time HTM<sup>1</sup> to AFS<sup>2</sup> debt security reclassification election with ASU 2017-12<sup>3</sup>;
4. Permit early adoption; and
5. Evaluate expanding the portfolio layer (or similar) to prepayable liabilities and non-prepayable assets and liabilities, as part of the “Hedge Accounting – Phase 2” project.

### **Specific Comments on the Proposal**

A more comprehensive description of our comments and our recommended improvements to the

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<sup>1</sup> Held-to-maturity

<sup>2</sup> Available-for-sale

<sup>3</sup> Accounting Standards Update (“ASU”) 2017-12, *Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities*

Proposals are included below.

1. Expand the scope of the portfolio layer method to include all prepayable assets, provided the contractual maturity criteria are met.

The Proposal requires assets in a closed portfolio to be or become prepayable by the end of the latest-ending hedged period.<sup>4</sup> Accordingly, assets that become prepayable after the latest-ending hedged period do not qualify for a portfolio layer method hedge. We recommend this criteria be removed.

That is, we recommend the Board expand the scope of portfolio layer method to include all prepayable assets, provided the contractual maturity in 815-20-25-12A(d) are met. The timing aspect of the prepayment criteria within paragraph 815-20-25-12A(e) is unnecessarily restrictive and reduces the operability of the portfolio layer method. That is, the costs of requiring financial assets to be or become prepayable within the hedged period outweighs the benefits as entities would be required identify the timing of prepayment triggers within individual assets in the closed portfolio to determine whether each individual asset qualifies for the portfolio layer method.

By removing the timing aspect of the prepayable assets within paragraph 815-20-25-12A(e), the principals of the portfolio layer method would align with those of the existing partial-term hedge guidance that allows for fair value hedges of prepayable and non-prepayable assets in partial-term hedges of interest rate risk using an assumed term.<sup>5</sup> Additionally, this would further advance the Board's intent 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.<sup>6</sup> Entities would be able to achieve the same risk management objectives under a single portfolio layer method hedge as opposed to having to execute many partial-term fair value hedges of interest rate risk.<sup>7</sup>

2. Simplify the accounting model for a dedesignation scenario caused by an actual breach.

The Proposal states an "actual breach" occurs when the aggregate hedged amount exceeds the current closed portfolio amount. Upon an actual breach, entities are required to sequentially remove portions or entire amounts of hedged layers beginning with the layer with the shortest hedge period until remaining hedged layers are expected to remain outstanding for the remainder of the hedge period.<sup>8</sup>

We request the Board to consider allowing entities to determine the order in which they would be required to remove portions of or entire amounts of hedged layers upon an actual breach. The Proposal's current dedesignation sequencing of layers beginning with the shortest hedged period remaining may not necessarily be reflective of the economic activities of assets within the closed portfolio. We understand the Board considered an alternative that would have enabled entities to document a dedesignation sequence, but if a dedesignation sequence was not documented at hedge inception and a breach occurred, the entity would have been required to dedesignate all hedges associated with the closed portfolio. The Board rejected that alternative due to the complexity that would have resulted from the need to resequence if hedged layers were added over time.<sup>9</sup> However, the Board may want to consider a separate alternative that would provide entities with the option to document a dedesignation sequence at hedge inception and an on-going ability to update such documentation. To the extent an entity did not elect the option to document or update its documentation upon resequencing, the entity would default to the current proposed order of sequencing such that it would be required to remove layers beginning with the shortest hedged period remaining until remaining hedged layers are expected to remain outstanding for the remainder of the hedge period.

Upon an actual breach, the Proposal also requires entities to adjust the cost basis of individual assets affected by the most recent breach event by derecognizing the affected portion of cost basis adjustments to earnings. Actual breaches triggered by prepayments would be recorded to interest income, and those

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<sup>4</sup> See paragraph 815-20-25-12A(e) of the Proposal

<sup>5</sup> 815-25-35-13B

<sup>6</sup> See paragraph BC17 of the Proposal

<sup>7</sup> 815-25-35-13B

<sup>8</sup> See paragraph 815-25-40-8(b) of the Proposal

<sup>9</sup> See paragraph BC25 of the Proposal

triggered by credit deterioration events would be recorded to earnings according to applicable impairment guidance.<sup>10</sup> The Proposal refers to this approach as the “follow-the-asset” method.

The Board should consider providing entities with flexibility to make an accounting policy election that permits an entity to select the specific income statement line item to record the affected cost basis amounts upon an actual breach. At the same time, entities would disclose breached amounts and the income statement line item use to record such cost basis adjustments.

The appropriate identification of individual assets and events that caused a breach would require entities to enhance existing accounting and reporting systems to identify specific assets and events that triggered those breaches. We expect the probability of an actual breach to be a less than remote occurrence because the existing requirements within the Proposal are designed to significantly mitigate the occurrence of an actual breach. That is, entities are required to perform and document an analysis, at inception and on each effectiveness assessment date, to support the expectation that the hedged layers are anticipated to remain outstanding for hedged periods. If an entity cannot support that the hedged layers are anticipated to be outstanding for the period hedged, an entity is required to discontinue hedged layers no longer anticipated to be outstanding for the period hedged.<sup>11</sup>

While the “follow-the-asset” attempts to identify the specific asset and events that were affected by the actual breach trigger, the time-based approach (based on recency) as described within paragraph BC37 within the Basis for Conclusions, would not accurately identify the individual assets and events that caused an actual breach. An alternative method would have required a judgmentally based analysis that documents the actual drivers of assets and events that caused unexpected dissimilarities between anticipated versus actual amounts. However, this judgmentally based analysis would add to the existing complexities related to the “follow-the-asset method” and would further create imbalances between the existing costs and benefits.

The incremental benefits of applying the “follow-the-asset approach” would only lead to the grossed-up recognition of hedge basis adjustments released to earnings based upon prepayment driven events within interest income, and credit impairment related events in accordance with other applicable impairment guidance. We do not believe the gross-up of recognition of hedge basis adjustments released to earnings would provide investors with decision useful information. As such, the expected costs of implementing the “follow-the-asset method” do not justify the incremental benefits of aligning the derecognition guidance with other Topics in GAAP.

3. Conform the one-time HTM to AFS debt security reclassification election to ASU 2017-12.

We appreciate the Board including a one-time reclassification election of debt securities that qualify for the portfolio layer method from the HTM to AFS category on the adoption date. We recommend the Board clarify in the transition provisions that public business entities have until the first hedge effectiveness assessment following the date of adoption to make the election, which is similar to the transition provisions in ASU 2017-12<sup>12</sup>.

Aligning the transition elections within ASU 2017-12 would reduce the incremental operational burden of having to identify and reclassifying securities during the same time period we would be performing accounting close activities for the previous interim or fiscal year period.

4. Permit early adoption.

We recommend the Board permit public business entities to elect early adoption in any interim reporting period between the period that includes the issuance date of the final standard and the mandatory effective date. We believe this approach provides enough flexibility for all entities, as facts and circumstances will vary across individual reporting entities related to operational readiness and risk management strategies.

5. Evaluate expanding the portfolio layer (or similar) to prepayable liabilities and non-prepayable assets

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<sup>10</sup> See paragraph 815-25-40-9A(a) and 40-9A(b)

<sup>11</sup> 815-25-40-8(a)

<sup>12</sup> 815-20-65-3(g)

and liabilities, as part of the “Hedge Accounting – Phase 2” project.

We agree that the Board’s primary objective should be to maintain the narrow-scope of the Proposal while clarifying and improving amendments in ASU 2017-12 as opposed to broadly reconsidering portfolio hedging.<sup>13</sup> As such, we recommend the Board to consider as part of its broader “Hedge Accounting – Phase 2” accounting project expanding the scope of the portfolio layer (or similar) method to include prepayable liabilities, and non-prepayable assets and liabilities.

**Conclusion**

We encourage the FASB to consider our recommendations described in this letter. We believe that our recommendations will accomplish the project goals of simplification and reduced complexity as well as improve the transparency and understanding of information for financial statement users.

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We appreciate the opportunity to comment on the issues contained in the Board’s invitation. If you have any questions, please contact Aaron Netten at 612-269-4712.

Sincerely,

/s/ Mario Mastrantoni

Mario Mastrantoni  
Head of Accounting Policy & SEC Reporting

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<sup>13</sup> See paragraph BC28 of the Proposal