July 1, 2021

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

RE: File Reference No. 2021-002

Dear Ms. Salo:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815), Fair Value Hedging – Portfolio Layer Method*. We commend the FASB for its continuing efforts to expand the use of hedge accounting to more closely align the accounting model with entities' risk management activities. We support the proposed principles that are fundamental to the portfolio layer method hedging model. We believe the FASB should continue its efforts to review the guidance in Topic 815, clarify existing guidance, and further align the hedge accounting model with an entity's risk management activities through additional separate projects.

We support the Board's decision to expand the current single-layer hedging model to allow for multiple hedging layers and allow for subgroups within a closed portfolio of prepayable assets. In addition, we support expanding the instruments eligible to be used in portfolio layer method hedging relationships to include amortizing notional and forward starting swaps. In the interest of issuing this guidance in a timely manner, we support the Board's decision to limit the scope of instruments eligible for the portfolio layer method to prepayable financial assets. However, we believe the Board should explore further expanding the instruments eligible to be designated as hedged items under this model to include pools of prepayable liabilities and nonprepayable instruments. We do not believe that the current project should be further delayed, so we believe that expansion of its scope should be addressed by future standard setting.

Given the proposed scope of the current project, we agree with the proposed eligibility criteria for a hedge strategy that involves multiple hedged layers based on the contractual maturity and the timing in which the hedged assets become prepayable. We believe this allows for flexibility in constructing a closed portfolio of assets (and subgroups therein), which will allow entities to efficiently create a multiple layer hedge program. We also agree with the Board's decision to allow an entity to apply these criteria to a beneficial interest or pool of beneficial interests by looking at the beneficial interest itself and not require looking at the individual assets securing the beneficial interest, which we believe would add unnecessary complexity to the model.

We support the Board's decisions on fair value hedge basis adjustments relating to a portfolio layer method hedge. We believe the requirement to maintain basis adjustments for active portfolio layer method hedging relationships on a closed portfolio basis rather than allocating the basis adjustments to individual assets is consistent with the principles of a hedging strategy that, by its nature, does not specifically identify which assets within a pool are the hedged items that will remain outstanding through the life of the hedging relationship. We note that while this treatment will alleviate concerns raised regarding the interaction of a portfolio layer method hedge with other aspects of the accounting literature, such as the impairment guidance, there may be certain operational complexities in applying the guidance that may require changes to current systems, processes, and controls.

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We have some suggestions that we believe would help clarify and simplify the proposed guidance for stakeholders. First, we believe that the guidance would benefit from an example to clarify how hedge relationships with multiple layers and multiple subgroups within those layers should be designated. We also believe that more explicit guidance is needed on the impact of basis adjustments relating to active portfolio layer method hedges of closed portfolios with investments accounted for as available for sale (AFS) under Topic 320 and for loans accounted for as held for sale. We are concerned that without additional clarification, there will be confusion as to when basis adjustments should be considered (e.g., in determining the amounts reported in AOCI relating to AFS securities) and when they should not be considered (e.g., in determining lower of cost or market adjustments). We believe inclusion of more explicit guidance and illustrative examples would eliminate potential confusion.

The guidance requires an entity to support its expectations that the hedged item is anticipated to be outstanding for the period(s) hedged at hedge inception and at each effectiveness assessment date. We believe clarifying that this analysis should be performed using a "best estimate" of cash flows would help increase alignment with other areas of GAAP and improve consistency. We also believe removing the word "current" may eliminate confusion as these expectations will need to consider both current and future expectations.

We understand the Board's decision to provide a specific dedesignation sequence when an entity has multiple portfolio layer method hedges in the case of an "actual breach" in which the underlying assets are no longer sufficient to support the hedging relationships. However, we believe that the proposed guidance may be unclear and complex to apply as this sequence may not be consistent with an entity's risk management policy. Given that actual breaches can often be avoided by closely monitoring the portfolio, we believe the dedesignation guidance for actual breaches should be the same as the guidance for anticipated breaches and voluntary dedesignations, which allows an entity to select which hedged layer or layers to dedesignate. If the Board does not wish to align the dedesignation guidance for anticipated and actual breaches, we believe that the proposed guidance for dedesignations in an actual breach is not clear and appears to be internally inconsistent.

We do not support the proposed amendments to the partial term hedging guidance in paragraph 815-25-35-13B. The proposed change from "when the first hedged cash flow begins to accrue" to "at hedge inception" would eliminate an entity's ability to use forward starting swaps as hedging instruments under the partial term hedging guidance. This change would have a broader impact beyond portfolio layer hedging relationships and would result in entities being unable to obtain hedge accounting for certain risk management strategies. We believe that the current guidance in paragraph 815-25-35-13B is operable, including for portfolio layer method hedges, and would not disqualify instruments with different payment or maturity dates from being included in a portfolio layer method layer hedge provided they meet the similar asset and effectiveness criterion.

The appendix contains our responses to the Questions for Respondents and other comments and suggestions that expand on the above comments for the Board's consideration.

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If you have any questions regarding our comments, please contact Chip Currie at (908) 581-4208 or Heather Horn at (310) 874-5449.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Appendix

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

While we believe the amendments in the proposed update are operable and auditable, it is likely that preparers will have to amend processes, controls, and systems to implement multiple layer hedging relationships. In addition, as we noted in our cover letter, we believe that additional clarification and illustrative examples would assist in avoiding potential misapplication of the guidance.

We believe that the guidance would benefit from additional clarity on how hedge relationships with multiple layers and multiple subgroups within those layers should be designated. We understand the guidance is intended to require that each layer in a multiple layer hedge be a separate hedge relationship with separate hedge documentation and similar asset and effectiveness tests. We believe that the concept of subgroups within a closed portfolio of prepayable financial assets is designed to:

- allow for the creation of different hedged items for different hedging relationships that are designated as hedges of a single pool of prepayable assets and
- not require an entity to identify the specific financial assets that comprise each subgroup.

This will permit specific assets within a pool of prepayable assets to be available to support different hedging relationships depending on the activity within a pool. For example, a five-year loan could support a five-year hedging relationship or if needed, a hedging relationship with a shorter duration if loans within the same pool with shorter maturities experience unanticipated prepayments. We believe the addition of an example that illustrates the requirements for a hedging program with multiple layers and multiple subgroups would provide clarity for those looking to implement these strategies.

The concept articulated above appears to be supported by paragraph 815-20-25-3(c)(2), which implies that each hedged layer would be its own designated hedging relationship requiring separate hedge documentation. However, paragraph 815-20-25-12A(a) could be read to imply that multiple hedged layers should be documented together as single hedging relationship. Further, the contractual maturity criteria must be assessed at a hedged layer level as described in paragraph 815-20-25-12A(d)(2), while the prepayment criteria as described in paragraph 815-20-25-12A(e)(2) must be assessed at a closed portfolio level. This may cause confusion about at which level the hedge designation and documentation should occur.

In addition, under the proposed guidance in paragraphs 815-20-25-12A and 815-25-35-7A, an entity is required to support its expectations that the hedged item is anticipated to be outstanding for the period(s) hedged at hedge inception and at each effectiveness assessment date using the entity's "current expectations" of prepayments, defaults, and other factors, such as sales that affect the timing and amount of cash flows. We believe clarifying that this analysis should be performed using a "best estimate" of those cash flows would help to increase alignment with other areas of GAAP and improve consistency. We also believe removing the word "current" may eliminate confusion as these expectations will need to consider both current and future expectations.

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

We believe that the proposed portfolio layer method hedging model further aligns the application of hedge accounting with entities' risk management strategies and objectives. The ability to designate multiple layers in hedging relationships allows for a greater amount of the interest rate risk of a portfolio of

prepayable financial assets to be hedged under Topic 815. However, we believe the FASB should continue its efforts to review the guidance in Topic 815, clarify existing guidance, and further align the accounting model with an entity's risk management activities through additional separate projects. We believe that there are additional opportunities for aspects of the hedge accounting model to be clarified and improved, including with regard to the ability to change the hedged risk in cash flow hedging.

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.

In the interest of issuing this guidance in a timely manner, we support the Board's decision to limit the scope of instruments eligible for the portfolio layer method to prepayable financial assets or one or more beneficial interest secured by a portfolio of prepayable financial instruments. However, we believe the Board should explore further expanding the instruments eligible to be designated as hedged items under this hedge accounting model to include pools of prepayable liabilities and nonprepayable instruments.

We do not believe that the current project should be further delayed, so we believe that additional expansion of its scope should be addressed by future standard setting.

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

We understand the Board's decision to provide a specific dedesignation sequence when an entity has multiple portfolio layer method hedges in the case of an "actual breach" in which the underlying assets are no longer sufficient to support the hedging relationships. However, we believe that the proposed guidance may be complex to apply and that the benefits would not support the effort needed to implement this guidance. The guidance requires an entity to support its expectation that the hedged layer(s) are anticipated to be outstanding for the period hedged on a quarterly basis. An entity can perform this assessment on a more frequent basis and voluntarily dedesignate a portfolio layer method hedge at any time before a breach occurs, choose which layer to dedesignate, and avoid the application of the guidance relating to actual breaches. As a result, we expect that actual breaches may be caused by sudden unusual and unexpected events.

Additionally, if the closed portfolio of prepayable financial assets experiences unexpected levels of prepayments, defaults, sales, or other events, it is likely that consistent with existing risk management policies, an entity will adjust its hedging activities. The proposed methodology for identifying which hedges must be dedesignated in the event of an actual breach may not align with the entity's risk management strategy. As a result, additional hedging relationships may need to be dedesignated and hedging relationships that were required to be dedesignated may be redesignated in new hedging relationships. This could be avoided if an entity had discretion to choose which hedge relationships to dedesignate in the event of an actual breach (similar to the guidance for anticipated breaches). Thus, the requirement to have a specific dedesignation sequence in the event of an actual breach may add unnecessary complexity to the model. Therefore, we support aligning the dedesignation guidance for actual breaches with the guidance for anticipated breaches and voluntary dedesignations to allow an entity the ability to elect which hedged layer or layers to dedesignate in the event of an actual breach.

If the Board does not wish to align the dedesignation guidance for anticipated and actual breaches, we believe that the proposed guidance for dedesignations in an actual breach is not clear and may be internally inconsistent. Paragraph 815-25-40-8(b)(2) states that if there are multiple hedged layers at the time of an actual breach, the entity shall dedesignate the hedged layer with the shortest remaining period

first and would continue dedesignating layers based on the next shortest maturity date, until all requirements in paragraph 815-25-35-7A are met. However, the implementation guidance in paragraph 815-20-55-14N illustrates that in the event of an actual breach, the hedge with the longest remaining period can be dedesignated because, with the dedesignation of that single hedging relationship, the assets remaining in the designated closed portfolio are sufficient to support the remaining hedges. As we understand it, in the event of an actual breach, an entity should first determine if the de-designation of a single layer would result in the sufficient assets remaining in the designated closed pool to support the remaining hedge layers. If there are multiple hedging relationships whereby dedesignation of one of them would result in sufficient assets remaining in the designated closed pool to support the remaining hedge layers, the entity should dedesignate the one with the shortest maturity. If this is the Board's intent, we believe that changes to the proposed guidance in paragraph 815-25-35-7A would be needed. In addition, it is unclear what an entity would be required to do in a situation when the dedesignation of a single layer would not be sufficient and multiple hedges would need to be designated. In these instances, it is unclear if an entity would first look to minimize the number of dedesignations required or simply follow a sequence of dedesignating hedges based on which have the shortest maturities.

Question 5—Basis Adjustments: Do you agree with the Board's proposed amendments regarding 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 support the Board's decisions on fair value hedge basis adjustments relating to a portfolio layer method hedge. We believe the requirement to maintain basis adjustments for active portfolio layer method hedging relationships on a closed portfolio basis rather than allocating the basis adjustments to individual assets is consistent with the principles of a hedging strategy that, by its nature, does not specifically identify which assets within a pool are the hedged items that will remain outstanding through the life of the hedging relationship. We note that while this treatment will alleviate concerns raised with the interaction of a portfolio layer method hedge with other aspects of the accounting literature, such as the impairment guidance, there may be certain operational complexities in applying the guidance which may require changes to current systems, processes, and controls. For example, upon dedesignation of a hedging relationship, the basis adjustment associated with a portfolio layer method hedge must be allocated to the individual assets within the portfolio designated as the hedged item. This allocation will change the amortized cost basis of those instruments, which may in turn have other accounting impacts. For example, a change to the amortized cost basis of the asset upon dedesignation may result in an immediate impact to the amount of credit losses recorded through the application of ASC 326-20.

We believe that more explicit guidance on the impact of basis adjustments relating to active portfolio layer method hedges of closed portfolios with investments accounted for as available for sale (AFS) under Topic 320 and for loans accounted for as held for sale is needed. The proposed guidance is clear that basis adjustments for active portfolio layer hedges should not be allocated to individual assets when determining if an AFS debt security is impaired or when measuring the impairment under Subtopic 326-30. It is also clear that, for the purposes of classification within the statement of financial position, basis adjustments relating to active portfolio layer method hedges should be allocated to the relevant financial statement line items for the assets comprising the hedged portfolio. We understand that it is the Board's intent that any basis adjustments allocated to a portfolio of AFS securities should adjust the amount recorded in AOCI relating to those debt securities, but not adjust the carrying amount of the AFS securities as this would result in these securities not being reported at fair value. Paragraph 320-10-35-1(b) of the proposed amendments states: "Similarly, all or a portion of the unrealized holding gain and loss of a closed portfolio of available-for-sale securities designated as being hedged in a portfolio layer method hedge in accordance with paragraph 815-20-25-12A shall be recognized in earnings during the period of the hedge pursuant to paragraph 815-25-35-1(c)." This is consistent with the model in Topic 815 whereby changes in fair value due to changes in the hedged risk of an AFS security are reported in earnings as opposed to

AOCI. We are concerned that without additional clarification there will be confusion as to when basis adjustments should or should not be considered. We believe inclusion of specific language stating the Board's intent and an illustrative example would eliminate potential confusion.

A portfolio of prepayable financial assets designated as the hedged item in a portfolio layer method hedge may include loans or AFS debt securities where the entity has an intention to sell the assets. While an entity could elect to remove these assets from the closed pool designated as the hedged item, there is no requirement to remove them prior to their sale. For these assets, the impairment analysis is based on a lower of cost or market (LOCOM) model. We understand that the intention of the guidance is that the basis adjustments associated with outstanding portfolio layer method hedges would not be considered when computing the LOCOM adjustments consistent with how these basis adjustments are not considered when applying the impairment models. We believe including explicit language within the guidance would eliminate potential confusion and distinguish this treatment from how such basis adjustments may impact amounts reported in AOCI for AFS securities. We also note that, after allocation of portfolio level basis adjustments to these assets for presentation in the statement of financial position, these financial statement line items will no longer reflect LOCOM.

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.

We understand the "follow the asset" model that the Board has proposed for how to recognize basis adjustments in the case of a breach when the assets within the closed portfolio are no longer sufficient to support the designated hedging instruments. In a voluntary dedesignation or dedesignation as a result of an anticipated breach, the basis adjustment associated with the dedesignated portion of the hedge is allocated to the individual assets. This would result in these basis adjustments being recorded through earnings on an individual asset basis in the income statement line item driven by future events (i.e., prepayments, credit losses, sales) associated with that asset. Thus, the "follow the asset" method aligns the geography of income statement recognition of basis adjustments of actual breaches with how they would be recognized in a voluntary dedesignation.

We believe preparers would be best to answer questions regarding implementation costs.

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 required 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.

Yes, we support the transition guidance proposed by the Board. We believe that the guidance relating to multiple layer relationships should be adopted prospectively upon their designation and that entities should be allowed to modify their current portfolio layer hedge relationships as of the date of adoption to take advantage of the new guidance without dedesignation.

We also believe that the effects to basis adjustments on existing portfolio layer hedges should be adopted as a cumulative-effect adjustment to opening retained earnings on a modified retrospective basis. This will allow for consistency in reporting of basis adjustments for all portfolio layer hedges regardless of when the hedge was designated and simplify the application of hedge accounting for existing hedges following adoption of the new 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 that this question is best addressed by financial statement preparers, but we note that the application of hedge accounting including a portfolio layer method hedging relationship is optional. We encourage the FASB to issue this guidance as soon as practicable and permit early adoption of the guidance upon its issuance. We understand that many institutions have not implemented "last of layer" hedging strategies in anticipation of the issuance of this new guidance.

We are not aware of any reason why entities other than public business entities would need more time than that provided to public business entities.