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November 22, 2024

Mr. Jackson M. Day
Technical Director
Financial Accounting Standards Board
801 Main Avenue
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2024-ED200

Dear Mr. Day:

RSM US LLP is pleased to provide feedback on the Financial Accounting Standards Board's (FASB or Board) proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815): Hedge Accounting Improvements (*proposed Update).

We support the Board's efforts to align hedge accounting more closely with the economics of an entity's risk management activities, clarify certain aspects of the guidance on hedge accounting and address several incremental hedge accounting issues arising from the global reference rate reform initiative.

Overall, we agree that the proposed amendments would clarify and improve the guidance related to the hedging strategies addressed in the proposed Update. We also believe that the proposed amendments would expand the application of hedge accounting to more hedges that are economically effective. As a result, we expect that this would better align entities' risk management strategies with their financial reporting results. However, we believe that additional clarification and implementation guidance is needed.

As explained more fully in our responses to Questions 1, 3 and 5, we believe the Board should provide additional implementation guidance or illustrative examples to help stakeholders better understand the intended application of the proposed amendments. We also believe that the Board should clarify application of the two methods described in paragraph 815-20-55-23A for assessing the similarity of the hedged risks within a group of forecasted transactions and amend the guidance in paragraph 815-20-25-88 for evaluating the eligibility of net written option as hedging instruments. These recommendations are explained in our responses to Questions 1 and 4.

Our responses to the questions posed in the proposed Update, other than those specifically directed solely at investors or preparers, are included in the remainder of this letter.

Responses to Questions for Respondents

Question 1—Similar Risk Assessment for Cash Flow Hedges: Do the amendments in this proposed Update clarify and improve the guidance on cash flow hedges of individual forecasted transactions hedged as a group? In addition, are the proposed amendments clear and operable? Please explain why or why not. If not, what changes would you suggest?

Yes, we believe that the amendments in this proposed Update clarify and improve the guidance on cash flow hedges of individual forecasted transactions hedged as a group. The proposed change to allow individual forecasted transactions within a group to have similar risks should enable entities to apply hedge accounting to broader portfolios of forecasted transactions while reducing the risk of dedesignation events and missed forecasts for highly effective hedging relationships.

We believe that the illustrative examples in Section 815-20-55 would help entities understand the requirements and apply the related guidance more consistently. However, we also believe that further clarification, as described below, would be helpful.

Paragraphs 815-20-55-88 through 55-99E of the proposed Update include an example with three cases (i.e., Case A, Case B and Case C) to illustrate application of the guidance in paragraph 815-20-55-23A for assessing the similarity of hedged risks within a group of forecasted transactions. These cases describe the method elected by the reporting entity for assessing similarity of risk exposure, the results of those assessments, and examples of the differences between the hedged risks of the forecasted transactions and the contractual terms of the hedging instrument. Each case also notes that the differences an entity should consider when applying one of the methods described in paragraph 815-20-55-23A include, for example, payment dates, reset dates and interest rate floors. However, those cases do not illustrate how an entity would perform the assessment to determine the similarity of hedged risks using either method described in paragraph 815-20-55-23A. We believe it would be useful if any final ASU included an example that illustrates application of the two methods, including how differences related to payment dates, reset dates and interest rate floors could be considered in the analysis.

Question 2—Hedging Forecasted Interest Payments on Choose-Your Rate Debt Instruments: Do the proposed amendments clarify and improve the guidance on cash flow hedges of interest payments on choose-your-rate debt instruments? In addition, are the proposed amendments clear and operable? Please explain why or why not. If not, what changes would you suggest?

Yes, we believe that the proposed amendments are operable, and they both clarify and improve the guidance on cash flow hedges of interest payments for choose-your-rate debt instruments. Current guidance is not clear as to whether electing a change in rate represents a change in the hedging relationship that would require dedesignation, or if the hedging relationship could continue if it remains highly effective. The proposed simplified assumptions to be used when assessing hedge effectiveness and assessing the probability of whether forecasted transactions will occur would reduce current diversity in practice while likely reducing the risk of dedesignation events and missed forecasts.

Question 3—Cash Flow Hedges of Nonfinancial Forecasted Transactions: Do the proposed amendments clarify and improve the guidance on cash flow hedges of nonfinancial forecasted transactions? In addition, are the proposed amendments, including those that require the application of the clearly-and-closely-related assessment, clear and operable? Please explain why or why not. If not, what changes would you suggest?

Yes, we believe the proposed amendments clarify and improve the guidance on cash flow hedges of nonfinancial forecasted transactions. Current GAAP limits designation of nonfinancial components to those that are contractually specified, which has been problematic for hedging price components of spot transactions and price components that are well understood but not written into a contract. The proposed amendments would expand today’s model to forecasted spot-market transactions and subcomponents of explicitly-referenced components in an agreement’s pricing formula and would thereby allow more economically effective risk mitigating strategies to qualify for hedge accounting.

The proposed amendments, including those that require the application of the clearly-and-closely-related assessment, appear clear and operable. However, we believe the application of the proposed amendments can be further clarified. While we appreciate the amendments to the implementation guidance in Section 815-20-55, we believe that it would be helpful if any final ASU contained an additional example that illustrates a common hedging strategy frequently applied in the domestic commodities markets involving forecasted spot-market transactions. Such an example could include an entity that forecasts the purchase of natural gas in its local market (e.g., New York) on a spot basis and hedges that forecasted transaction with a NYMEX Henry Hub Natural Gas futures contract. “Henry Hub” refers to a benchmark price for natural gas in Louisiana, which most market participants use as a reference point, adjusting for factors like transportation costs and regional supply and demand to determine the final price in the local market.

Question 4—Net Written Options as Hedging Instruments: Do the proposed amendments improve the guidance on net written options as hedging instruments? Please explain why or why not. If not, what changes would you suggest? In addition, the Board rejected an alternative to the proposed amendments related to the net written option test in paragraph 815-20-25-88 that would have removed the test from Topic 815 (see paragraph BC81). Do you have any views on the alternative rejected by the Board and whether it would be more operable, be less complex, and provide more decision-useful information compared with the proposed amendments?

Currently, paragraph 815-20-25-88 deems a compound derivative that results from combining a written option and any other non-option derivative instrument (e.g., an interest rate swap that contains an embedded written floor) to be a written option, which requires the application of the written option test in paragraphs 815-20-25-94 and 25-95.

As noted in paragraph BC81 of the proposed Update, the Board rejected an alternative that would have removed the written option test from Topic 815. Although this alternative would be operable and less complex than current guidance, we believe, as the Board noted in paragraph BC83, the written option test serves an important purpose that is incremental to hedge effectiveness assessment. As a result, we believe that the written option test should continue to apply in the context of hedging with combinations of options (e.g., a collar).

The Board also rejected another alternative described in paragraph BC82 which, rather than removing the written option test altogether, would have taken a more targeted approach by no longer requiring a compound hedging instrument comprised of a written option and any other non-option derivative instrument to be a considered written option. For the reasons that follow, we ask that the Board reconsider this alternative.

Consider an entity that wishes to hedge forecasted variable interest receipts that are subject to a floor with an interest rate swap referenced to the same variable rate index. This interest rate swap could be more effective if it contained an embedded written floor that mirrors the floor to which the hedged interest receipts are subject. However, the embedded written floor in the swap would make the swap a compound derivative that is considered a written option pursuant to paragraph 815-20-25-88. As a result, the entity would have to apply the written option test, which could prohibit hedge accounting even though the addition of the embedded written floor would result in a more effective hedge.

In today’s post-LIBOR environment, many hedging relationships that use an interest rate swap with an embedded written floor would fail the written option test and be rendered ineligible for hedge accounting for the reasons the Board noted in paragraphs BC77 and BC78. This is an unintuitive result given that embedding an interest rate floor in the interest rate swap would make the hedge described in the preceding paragraph more effective.

Although we agree that the proposed amendments would decrease the likelihood of such an unintuitive result, we believe that the Board should eliminate the sentence in paragraph 815-20-25-88 that states, "[f]urthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option" and make no further amendments to that paragraph. This would eliminate the need to apply the written option test in situations where the hedging instrument is a compound derivative that contains a written option. We recognize that the alternative we recommend is essentially the alternative that the Board rejected as explained in paragraph BC82. However, we believe that application of this alternative guidance would result in accounting outcomes that provide more intuitive economic results and would be more operable and less complex than the related proposed amendments.

Question 5—Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge): Do the proposed amendments improve the guidance on a foreign-currency-denominated debt instrument that is used as the hedging instrument and hedged item (commonly referred to as a "dual hedge")? In addition, are the proposed amendments on dual hedges clear and operable? Please explain why or why not. If not, what changes would you suggest?

We believe the proposed amendments would improve the guidance on dual hedges by eliminating the recognition and presentation mismatch that results from applying the current guidance to such hedges. However, it would be helpful to have a comprehensive example follow paragraph 815-20-55-129 to illustrate the application of that guidance. The example should illustrate the accounting for both the fair value hedge and the net investment hedge, as well as the net effect that the accounting for both hedging relationships has on the financial statements. The example should also illustrate the prospective accounting in the situation where the fair value hedge is discontinued.

Question 6—Transition: Are the proposed transition requirements operable? If not, why not, and what transition method would be more appropriate and why? Would the proposed transition disclosures be decision useful? Please explain why or why not.

Yes, we believe the proposed transition requirements would be operable because the proposed amendments would be applied prospectively for existing hedging relationships as of the adoption date. We defer to the users of financial statements to determine whether the proposed transition disclosures would be decision useful.

Question 7—Effective Date: In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities be different from the effective date for public business entities? Please explain why or why not. If the effective dates should be different, how much additional time would entities other than public business entities need to implement the proposed amendments?

We defer to the preparers of financial statements as to how much time would be needed to implement the proposed amendments, including whether the effective date for nonpublic business entities should be different from the effective date for public business entities. However, in our experience, providing nonpublic business entities with additional time (at least one year) to learn from the transition experiences and interpretations of public business entities is helpful for those other entities.

Question 8—General: Do you expect any unintended consequences of providing these proposed amendments? If so, please explain what those unintended consequences would be.

We do not foresee any unintended consequences of providing the proposed amendments.

Question 9—Benefits and Costs: Would the expected benefits of the proposed amendments justify the expected costs? If not, please describe the nature and magnitude of those costs, differentiating between one-time costs and recurring costs.

We defer to the preparers and users of financial statements as to whether the expected benefits of the proposed amendments justify the expected costs.

We appreciate this opportunity to provide feedback on the proposed Update and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Mike Gaiso 212.372.1709 or Joseph Cascio at 212.372.1139.

Sincerely,

RSM US LLP

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