

October 5, 2015

Susan Coper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

By email: director@fasb.org

Re: EITF-15D - Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships

Dear Ms. Coper,

The International Swaps and Derivatives Association's ("ISDA")¹ Accounting Policy Committee appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB" or the "Board") Proposed Accounting Standards Update *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships* (the "Exposure Draft"). Collectively, the membership of ISDA has substantial professional expertise and practical experience addressing accounting policy issues related to financial instruments and specifically derivative financial instruments. This letter provides our organization's overall views on the Exposure Draft and feedback to your questions for respondents.

Overview

ISDA welcomes the amendments provided in the Exposure Draft. We agree with the Exposure Draft's conclusion that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in a hedging

¹ Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient. ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool. Today, ISDA has over 800 member institutions from 68 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

relationship under Topic 815, should not, in and of itself, require dedesignation of the relationship, provided that all other hedge accounting criteria continue to be met. The ability to continue a hedge accounting relationship under Topic 815 upon novation of a designated derivatives contract would help eliminate diversity in practice, simplify the application of hedge accounting, and provide more decision-useful information to users of financial statements.

The intent of hedge accounting under Topic 815 is to faithfully represent the risk management activities of a reporting entity in its financial statements. Because a novation of a designated derivative by one counterparty to a new counterparty results in an uninterrupted hedge of an entity's designated risk exposure, we fully support the ability to continue hedge accounting without dedesignation.

However, we propose the following revisions to the proposed amendments for additional certainty on the scope of the clarification and its application:

1. "815-25-40-1A For the purposes of applying the guidance in paragraph 815-25-40-1**(b)**, **any** change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument."
2. "815-30-40-1A For the purposes of applying the guidance in paragraph 815-30-40-1**(b)**, **any** change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument."
3. "815-20-55-56A For the purposes of applying the guidance in paragraph 815-20-55-56, **any** change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a change in a critical term of the hedging relationship."

Further, although not specifically addressed by the proposal, we support wider application of this clarification under Topic 815. For example, we support explicitly broadening the scope to clarify that a derivative novation, in and of itself, should not be considered a termination followed by the execution of a new trade that an entity is required to assess for an other-than-insignificant financing element according to paragraphs 815-10-45-11 through 45-15. If what was originally an at-market derivative reaches the point at which its cumulative unrealized loss is other-than-insignificant, it would not be within the scope of the aforementioned guidance. Therefore, simply changing the counterparty at such time should not pull the derivative into the scope of the aforementioned guidance.

Responses to FASB's Questions for Respondents

Question 1: Do you agree that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedge accounting relationship should not, in and of itself, require dedesignation of that hedge accounting relationship?

As noted above in our overall remarks, we agree that a change in counterparty to a derivative instrument in a hedging relationship should not, in and of itself, require dedesignation. Provided the replacement counterparty is of sufficient credit quality (as required by paragraph 815-30-35-15), the replacement of a derivative contract's counterparty does not change any of the contractual terms that serve to accomplish an entity's risk management objectives. Instead, it simply allows a new counterparty to assume the original counterparty's rights and obligations.

As the key economic terms remain unchanged, the only potential difference between the original and post-novation relationship is counterparty risk. However, we observe that most derivative novations result in counterparty risk that remains the same or is reduced, such as in the frequent circumstance of a party novating to a central counterparty ("CCP"). Moreover, Topic 815 requires credit be considered in the application of hedge accounting. Accordingly, concerns about the credit risk of a replacement counterparty are addressed by existing guidance. Based on this, we agree with the FASB's conclusion that a novation by itself does not constitute a change in the critical terms of a derivative contract, and therefore does not constitute a termination, nor require dedesignation.

Question 2: Do you agree that the effects of initially adopting the amendments in this proposed Update should be applied on a prospective basis to all existing and new hedge accounting relationships in which a change in the counterparty to a derivative instrument occurs after the effective date of the proposed guidance?

We agree with the FASB's conclusion that the effects of adopting the amendments in the proposed update should be applied prospectively. Prospective adoption would be the least complex method of implementation of this change. Further, any sort of retrospective adoption would be subject to information quality issues related to novation information maintained by entities.

Question 3: There may be circumstances in which entities have previously dedesignated a hedge accounting relationship upon the occurrence of a novation that, under the proposed amendments, would no longer result in a dedesignation. Those entities may have been following an abbreviated qualitative method of hedge accounting (for example, the shortcut method) before the dedesignation and either (a) redesignated the hedge under the long-haul method or (b) chose not to redesignate the hedge as a result of the complexities of applying the long-haul method when using an off-market derivative as the hedging instrument. Is the scenario described above prevalent? If so, for those entities that had been applying an abbreviated qualitative method of hedge accounting before a dedesignation resulting from a past novation, should the Task Force consider permitting, but not requiring, retrospective transition?

It is difficult to quantify the prevalence of the situation described above. However, the situation exists. We expect that entities having large hedging programs that apply abbreviated qualitative methods would encounter this fact pattern periodically. We believe that permitting, but not requiring, a *modified* retrospective transition to the proposed guidance would appropriately address this issue. It is our opinion that the FASB could allow entities to elect to use the modified retrospective method, and bring any adjustments through beginning retained earnings. Entities following an abbreviated qualitative method of hedge accounting would have the opportunity to restore those relationships and reverse the effects of the designation and any subsequent redesignations. Using a modified retrospective approach, instead of full retrospective implementation, would ensure easy, quick transition and minimize the need for large adjustments and restatements.

Question 4: The proposed amendments would apply to all entities. Should the proposed amendments be different for entities other than public business entities? If so, please describe how and why you think they should be different.

In our opinion, the proposed amendments should be consistent for both public and non-public entities. As described further below, we believe the implementation of the guidance to be a very straightforward procedure, and therefore do not believe that any variation would be required to meet the needs of non-public entities.

Question 5: How much time would be needed to implement the proposed amendments and should the implementation period differ for public business entities versus all other entities? Should this guidance be effective upon issuance? If the guidance is not effective upon issuance, should early adoption be allowed? Please explain why.

Implementation of this guidance should be straightforward and not require a substantial amount of time, especially under prospective adoption, as its main effect would potentially reduce the number of dedesignations and redesignations that occur. This will be true for both public and non-public entities. Therefore, we believe this guidance should be effective upon issuance. If the FASB determines that the guidance should not be effective upon issuance, then we believe that early adoption should be allowed for entities to take advantage of the reduced dedesignation and redesignations.

Question 6: Should a reporting entity be required to provide the transition disclosures specified in this proposed Update? Should any other disclosures be required? If so, please explain why.

We agree with the FASBs conclusion that entities should be required to provide the transition disclosures outlined in ASC 250-10-50-1(a) and 250-10-50-2. We do not believe that any other disclosures would be required in order to give financial statement users sufficient information to understand the change.

If an entity has previously dedesignated a hedge accounting relationship upon the occurrence of a novation, and all hedging requirements (under the guidance, as clarified) have been met, and that entity elects to retrospectively apply the amendments to recognize a financial statement impact, then that entity should disclose the impact of the adoption of the guidance.

Closing

We hope you find ISDA's comments and responses informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter please do not hesitate to contact the undersigned.

Daniel Palomaki
Citigroup
Chair, N.A. Accounting Policy Committee
International Swaps and Derivatives Association
212.816.0572