ISDA® Safe, Efficient Markets

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Sagar S. Teotia
SEC Chief Accountant
Office of the Chief Accountant
US Securities and Exchange Commission
Accounting Interpretations via email
OCARequest@sec.gov

Re: Relief from Certain Requirements of ASC 815 *Derivatives and Hedging*

CC: Financial Accounting Standards Board

Ladies and Gentlemen,

The International Swaps and Derivatives Association's (ISDA)[1] North American Accounting Committee has extensive technical knowledge and practical experience with accounting policy matters related to financial instruments, and in particular, derivative financial instruments.

Efforts to limit the spread of the COVID-19 virus have and will continue to have devastating effects on the global economy as business disruptions, stay-at-home orders and limits on social gatherings have effectively frozen almost all economic activity. Many economists believe that the United States has already slipped into an economic recession, as the unemployment rate in April is expected to surpass the high reached in 2008-09.

[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 850 member institutions from 67 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.

In the United States, various local, state and federal governments are implementing numerous urgent relief programs to mitigate the expected economic toll. This relief is designed to inject liquidity and stability into the economy, primarily through government-sponsored lending and securities-purchase programs as well as other initiatives to assist business entities and consumers. Certain of these initiatives will be administered by banks and other financial institutions on behalf of the government, as these institutions have the direct relationships with the affected commercial entities and consumers.

Notwithstanding these mitigation programs, it is widely recognized that many business entities and consumers will be unable to service debt, fulfill lease commitments, pay suppliers and honor many other contractual obligations as the economy recovers from the COVID-19 pandemic. As a result, in addition to administering many of the government-sponsored lending programs to generate liquidity in the economy, banks and other financial institutions are also engaging with their customers to provide forbearance programs, contract modifications and other concessions.

However, certain of these emergency solutions have implications that give rise to technical accounting issues, including whether loan modifications should be considered to be troubled debt restructurings, whether lease modifications require certain accounting and whether there are hedge accounting implications if forecasted transactions that are (or were) hedged under cash flow hedge programs will occur on a delayed basis (or not at all).

We acknowledge and applaud the quick and responsive actions that have been taken thus far within the provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the filing relief provided by the Securities and Exchange Commission (SEC) staff on March 25 as well as SEC Staff Disclosure Guidance Topic No. 9, guidance provided by the banking regulatory agencies such as the Frequently Asked Questions (FAQ) document issued by the Federal Deposit Insurance Corporation (FDIC), and the Financial Accounting Standards Board's (FASB) responses to technical inquiries regarding lease modifications, cash flow hedges, income recognition and fair value measurement.

We support and agree with all of the above guidance that has been issued to date, but believe that additional specific technical accounting relief is required to allow existing cash flow hedges to continue hedge accounting when there is an expected delay in the forecasted cash flows beyond their originally specified expected time of occurrence, but the cash flows remain probable of occurring and the hedging relationship continues to be highly effective.

To that end, we ask the SEC to provide relief, as specified below, given the significance of the current and foreseeable impact of COVID-19.

Cash Flow Hedges – Probability of Executing Forecasted Hedged Transactions

Entities who have designated cash flow hedges of contractually-specified interest rate payments on individual financial instruments have specified the expected timing of those payments within their hedge documentation. Although entities continue to believe that the forecasted cash flows remain probable of occurring, it may be subsequent to the expected timing specified in the hedging documentation due to the impact of COVID-19 on the global economy. In other circumstances, entities who have designated cash flow hedges of contractually-specified interest rate payments on pools of financial instruments utilizing a first-payments-received technique may be facing a temporary shortfall in the volume of hedged items that generate the interest payments or receipts. Under current requirements, hedge accounting may not continue when the timing requirement specified in the hedge documentation is not met.

Specifically, ASC 815-20-25-16(c) states, in part:

> […] *As long as it remains probable that a forecasted transaction will occur by the end of the originally specified time period, cash flow hedge accounting for that hedging relationship would continue*.

The efforts and programs that continue to be implemented to combat the spread of the COVID-19 virus may cause some active cash flow hedges to violate this timing requirement, as entities would have estimated the timing of hedged forecasted transactions based on information known at hedge inception. The effects of the pandemic could not have reasonably been contemplated at the time the hedge documentation was prepared. As a result, absent relief, affected cash flow hedge relationships will need to be discontinued if the forecasted transactions are no longer probable of occurring by the end of the originally specified time-period.

We understand and appreciate that the FASB has provided a view on their interpretation of the guidance for discontinued cash flow hedges by explicitly confirming that the COVID-19 pandemic meets the requirements of ASC 815-30-40-4 whereby, "*In rare cases, extenuating circumstances that are related to the nature of the forecasted transaction and are outside the control or influence of the reporting entity may cause the forecasted transaction to be probable of occurring on a date that is beyond the additional two-month period of time*." This specific relief will allow entities to look beyond the two-month "window" that is available to execute forecasted transactions related to terminated hedge relationships in order to avoid consequences such as (1) accelerated reclassification of amounts from other comprehensive income and (2) calling into question an entity's ability to accurately predict forecasted transactions and use cash flow hedge accounting in the future for similar forecasted transactions.

While this clarification and relief provided by the FASB is valuable for *de-designated* hedges, there is no similar relief for *active* cash flow hedges to remain active if the forecasted transactions do not occur by the end of the originally specified time period as required by ASC 815-20-25-16(c).

As such, we are requesting similar relief for active cash flow hedges. It would be overly punitive to require de-designation of active cash flow hedges because of unforeseeable delays in the forecasted transactions due to COVID-19 when these hedges have been highly effective since inception and prior forecasts have been met. Cash flow hedges are not easily re-designated, because cash flow hedging derivatives, when de-designated, presumably have a non-zero value. As a result, in order to re-establish a cash flow hedging relationship, entities will be required to either incur the cost of terminating the existing derivative and executing a new derivative having a zero fair value, or incur the operational burden of assessing the effectiveness of a re-designated non-zero fair value derivative. In addition, if an existing non-zero value derivative were re-designated, entities would be precluded from using the change-in-variable-cash-flows method to assess effectiveness.

To address these concerns, we request that the SEC expand the scope of the timing relief available for terminated cash flow hedges to include active cash flow hedge relationships as long as the hedge relationships remain highly effective and the forecasted transactions remain probable of occurring.

To implement this relief, an entity would update the hypothetically perfect hedging derivative to match the new timing of the estimated forecasted cash flows, while retaining the other assumptions made at hedge inception that remain relevant. Amounts recorded in accumulated other comprehensive income will be released into earnings as the hedged forecasted transactions impact earnings, although potentially adjusted for changes in timing.

We do not see a potential for hedge accounting to be misrepresented if the requirements of ASC 815-30-40-4 were expanded to allow active cash flow hedge relationships to continue, as long as entities continue to believe that forecasted hedged transactions remain probable of occurring, the hedging relationship continues to be highly effective and the hedge effectiveness test captures potential changes in the timing of the forecasted cash flows from these extenuating circumstances..

If a hedging relationship ceases to be highly effective or if it becomes probable that the forecasted cash flows will not occur (including the change in timing), the entity will be required to de-designate the hedge and would look to ASC 815-30-40-4 (and the relief described above for terminated hedging relationships) for how to treat the amounts recorded in accumulated other comprehensive income.

Closing

Thank you for the opportunity to provide our views. 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.

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