FINANCIAL ACCOUNTING SERIES

ACCOUNTING STANDARDS UPDATE

No. 2022-01
March 2022

Derivatives and Hedging (Topic 815)

Fair Value Hedging—Portfolio Layer Method

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

On August 28, 2017, the FASB issued Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The amendments in that Update made targeted improvements to the optional hedge accounting model with the objective of improving hedge accounting to better portray the economic results of an entity's risk management activities in its financial statements.

Before the issuance of the amendments in Update 2017-12, entities had difficulty achieving fair value hedge accounting for interest rate risk hedges of portfolios of prepayable financial assets. Update 2017-12 added the last-of-layer method to make portfolio fair value hedge accounting for hedges of those types of assets more accessible.

For a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, the last-of-layer method allows an entity to hedge a stated amount of the asset or assets in the closed portfolio that is anticipated to be outstanding for the designated hedge period. If the requirements for the last-of-layer method are met, prepayment risk is not incorporated into the measurement of the hedged item.

Following the issuance of Update 2017-12, entities and practitioners asked the Board:

1. Whether only a single hedged layer could be designated (that is, one hedging relationship associated with the closed portfolio) or whether an entity could designate multiple hedged layers (that is, multiple hedging relationships associated with a single closed portfolio).
2. Whether the scope of last-of-layer hedging could be expanded.
3. To clarify what types of hedging instruments are permitted when a single hedged layer is designated and when multiple hedged layers are designated.
4. To provide additional guidance on how to account for and disclose hedge basis adjustments of an existing last-of-layer hedge. Current guidance on the last-of-layer method does not explicitly address the accounting for basis adjustments other than when the hedge is partially or fully dedesignated. For example, Topic 815 does not provide guidance on whether basis adjustments in an existing last-of-layer hedge should be maintained on a closed portfolio basis or on an individual asset basis. There also is no explicit guidance on how to recognize and present in the income statement the portion of the basis adjustment associated with a

hedged layer if the closed portfolio falls below the amount of the hedged layer (that is, how to recognize and present the basis adjustment associated with the breached layer). Topic 815 states that an entity should follow other generally accepted accounting principles (GAAP) to determine whether allocation on either a portfolio basis or an individual asset basis is appropriate for disclosure purposes.

5. How the accounting for last-of-layer hedge basis adjustments interacts with the guidance on credit losses.

The amendments in this Update address those questions by:

1. Expanding the current last-of-layer method that permits only one hedged layer to allow multiple hedged layers of a single closed portfolio. To reflect that expansion, the last-of-layer method is renamed the portfolio layer method.
2. Expanding the scope of the portfolio layer method to include nonprepayable financial assets.
3. Specifying that eligible hedging instruments in a single-layer hedge may include spot-starting or forward-starting constant-notional swaps, or spot- or forward-starting amortizing-notional swaps and that the number of hedged layers (that is, single or multiple) corresponds with the number of hedges designated.
4. Providing additional guidance on the accounting for and disclosure of hedge basis adjustments that are applicable to the portfolio layer method whether a single hedged layer or multiple hedged layers are designated.
5. Specifying how hedge basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all entities that elect to apply the portfolio layer method of hedge accounting in accordance with Topic 815.

What Are the Main Provisions, How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP), and Why Are They an Improvement?

Scope

Current GAAP permits only prepayable financial assets and one or more beneficial interests secured by a portfolio of prepayable financial instruments to be included in a last-of-layer closed portfolio. The amendments in this Update allow nonprepayable financial assets also to be included in a closed portfolio hedged using the portfolio layer method. That expanded scope permits an entity to apply the same portfolio hedging method to both prepayable and nonprepayable financial assets, thereby allowing consistent accounting for similar hedges.

Multiple Hedged Layers of a Single Closed Portfolio

The amendments in this Update allow multiple hedged layers to be designated for a single closed portfolio of financial assets or one or more beneficial interests secured by a portfolio of financial instruments. As a result, an entity can achieve hedge accounting for hedges of a greater proportion of the interest rate risk inherent in the assets included in the closed portfolio, further aligning hedge accounting with risk management strategies.

In applying hedge accounting to multiple hedged layers, an entity has the flexibility to achieve hedge accounting using different types of derivatives and layering techniques that best align with their individual circumstances (for example, spot-starting swaps, forward-starting swaps, or a combination of both). Furthermore, the amendments in this Update specify that an entity hedging multiple amounts in a closed portfolio with a single amortizing-notional swap is executing a single-layer hedge, not hedges of multiple layers.

If multiple hedged layers are designated, the amendments in this Update require that an entity perform an analysis to support its expectation that the aggregate amount of the hedged layers is anticipated to be outstanding for the designated hedge periods. While only closed portfolios may be hedged under the portfolio layer method (that is, no assets can be added to the closed portfolio once established), an entity is permitted to designate new hedging relationships and dedesignate existing hedging relationships associated with the closed portfolio any time after the closed portfolio is established and designated in a portfolio layer method hedge. This allows the accounting to better reflect changes in an entity's risk management activities in a dynamic interest rate environment.

If the aggregate amount of the hedged layers is no longer anticipated to be outstanding in future hedged periods (that is, a breach is anticipated), an entity is required to partially or fully dedesignate a hedged layer or layers until a breach is no longer anticipated. If the aggregate amount of the hedged layers currently exceeds the amount of the closed portfolio (that is, a breach has occurred), an entity is similarly required to partially or fully dedesignate a hedged layer or layers until the aggregate amount of the hedged layers no longer exceeds the closed portfolio. If there are multiple hedged layers, an entity should determine which hedges to dedesignate or partially dedesignate in accordance with an accounting policy election that specifies a systematic and rational approach to determining which hedge or hedges to dedesignate (or partially dedesignate). That policy should be consistently applied when a breach is anticipated and when a breach has occurred.

Accounting for Hedge Basis Adjustments under the Portfolio Layer Method

The amendments in this Update clarify the accounting for and promote consistency in the reporting of hedge basis adjustments applicable to both a single hedged layer and multiple hedged layers as follows:

1. An entity is required to maintain basis adjustments in an existing hedge on a closed portfolio basis (that is, not allocated to individual assets).
2. An entity is required to immediately recognize and present the basis adjustment associated with the amount of the dedesignated layer that was breached in interest income. In addition, an entity is required to disclose that amount and the circumstances that led to the breach.
3. An entity is required to disclose the total amount of the basis adjustments in existing hedges as a reconciling amount if other areas of GAAP require the disaggregated disclosure of the amortized cost basis of assets included in the closed portfolio.
4. An entity is prohibited from considering basis adjustments in an existing hedge when determining credit losses.

When Will the Amendments Be Effective and What Are the Transition Requirements?

For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. Early adoption is permitted on any date on or after the issuance of this Update for any entity that has adopted the amendments in Update 2017-12 for the corresponding period. If an entity adopts the amendments in an interim period, the effect of adopting the amendments related to basis adjustments should be reflected as of the beginning of the fiscal year of adoption (that is, the initial application date).

Upon adoption, any entity may designate multiple hedged layers of a single closed portfolio solely on a prospective basis. All entities are required to apply the amendments related to hedge basis adjustments under the portfolio layer method, except for those related to disclosures, on a modified retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings on the initial application date. Entities have the option to apply the amendments related to disclosures on a prospective basis from the initial application date or on a retrospective basis to each prior period presented after the date of adoption of the amendments in Update 2017-12.

An entity may reclassify debt securities classified in the held-to-maturity category at the date of adoption to the available-for-sale category only if the entity applies portfolio layer method hedging to one or more closed portfolios that include those debt securities. The decision of which securities to reclassify must be made within 30 days after the date of adoption, and the securities must be included in one or more closed portfolios that are designated in a portfolio layer method hedge within that 30-day period.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Amendments to the Accounting Standards Codification

1. The following table provides a summary of the amendments to the Accounting Standards Codification.

Codification Subtopic	Description of Changes
Subtopic 310-10, Receivables—Overall	• Consequential amendments.
Subtopic 320-10, Investments—Debt Securities—Overall	• Consequential amendments.
Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost	• Added guidance to prohibit an entity from considering a hedge basis adjustment in an existing portfolio layer method hedge in measuring expected credit losses of the assets included in the closed portfolio.
Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities	• Added guidance to prohibit an entity from considering a hedge basis adjustment related to an existing portfolio layer method hedge in determining whether an available-for-sale security included in the closed portfolio is impaired.
Subtopic 815-10, Derivatives and Hedging—Overall	• Amended guidance to prohibit an entity from disclosing portfolio layer method basis adjustments on a more disaggregated basis than the closed portfolio basis to meet the disclosure requirements in Topics other than Topic 815 after the basis adjustments are disaggregated by balance sheet line item.

Codification Subtopic	Description of Changes
	• Added guidance to require that an entity disclose the total unallocated amount of portfolio layer method basis adjustments. • Added guidance to require that an entity disclose the amount of the hedge basis adjustment recognized in current-period interest income because of a portfolio layer method hedge breach and the circumstances that led to the breach.
Subtopic 815-20, Derivatives and Hedging—Hedging—General	• Amended guidance to allow an entity to designate multiple hedged layers for a single closed portfolio under the portfolio layer method. • Expanded the scope of financial assets eligible to be included in a closed portfolio hedged using the portfolio layer method to nonprepayable financial assets. • Added guidance to clarify how to present a portfolio layer method basis adjustment in the statement of financial position if an entity presents the assets included in the closed portfolio in different line items in the statement of financial position. • Added guidance to specify that an entity that designates an amortizing-notional swap as the hedging instrument in a portfolio layer method hedge is designating a single hedging relationship. • Added guidance to specify that an entity using an amortizing-notional swap as the hedging instrument in a portfolio layer method hedge may perform a qualitative similar-asset assessment. • Added guidance that demonstrates how to determine a hedged layer in a portfolio layer method hedge.

Codification Subtopic	Description of Changes
Subtopic 815-25, Derivatives and Hedging—Fair Value Hedges	• Added guidance to require that an entity maintain portfolio layer method hedge basis adjustments on a closed portfolio basis. • Added guidance to allow the assumed maturity date of a hedged item in a partial-term hedge to be at the end of the designated hedge period, which does not need to be a contractual coupon payment date. • Added guidance to allow partial dedesignation of a hedge or hedges when a breach has occurred. • Added guidance to require that if multiple hedged layers are designated and a breach is anticipated or a breach has occurred, an entity should determine which hedge or hedges to dedesignate or partially dedesignate in accordance with an accounting policy. That accounting policy should specify a systematic and rational approach for determining which hedges to dedesignate or partially dedesignate to bring the closed portfolio as a whole back into compliance with the requirements of portfolio layer method hedging. • Added guidance to require that an entity immediately recognize the basis adjustment associated with the amount of the dedesignated layer that was breached in interest income. • Added guidance that demonstrates how an entity should apply certain aspects of the portfolio layer method if it elects to designate multiple hedged layers of a single closed portfolio.
Subtopic 860-20, Transfers and Servicing—Sales of Financial Assets	• Consequential amendments.

Codification Subtopic	Description of Changes
Subtopic 948-310, Financial Services—Mortgage Banking—Receivables	• Consequential amendments.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–28. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

3. Add the new Master Glossary term *Hedged Layer*, with a link to transition paragraph 815-20-65-6, as follows:

<u>**Hedged Layer**</u>

<u>The hedged item designated in a portfolio layer method hedging relationship, representing a stated amount or stated amounts of a closed portfolio of financial assets or one or more **beneficial interests** secured by a portfolio of **financial instruments** that is not expected to be affected by prepayments, defaults, or other factors affecting the timing and amount of cash flows for the designated hedge period.</u>

Amendments to Subtopic 310-10

4. Add paragraph 310-10-35-31A, with a link to transition paragraph 815-20-65-6, as follows:

[Note: The pending content is not shown for paragraphs 310-10-35-30 through 35-31 because the amendments apply to guidance that is effective before an entity adopts the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.]

Receivables—Overall

Subsequent Measurement

> Impairment of Loans and Receivables

> > Loans That Are Identified for Evaluation or That Are Individually Considered Impaired

> > > Measurement of Impairment

310-10-35-30 There are two considerations related to measurement of impairment:

a. Impact of hedging
b. Measurement of impairment when foreclosure is probable.

> > > > Impact of Hedging

310-10-35-31 Section 815-25-35 implicitly affects the measurement of impairment under this Topic by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted recorded investment in a hedged loan. When the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. The adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under Section 815-25-35 shall be considered to be an adjustment of the loan's recorded investment. Paragraph 815-25-35-11 explains that the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value.

<u>**310-10-35-31A** Paragraph 815-25-35-11 also explains that an entity shall not adjust the recorded investment or the discount rate of the individual assets or individual beneficial interest included in the closed portfolio for a basis adjustment that is maintained on the closed portfolio basis in accordance with paragraph 815-25-35-1(c).</u>

Amendments to Subtopic 320-10

5. Amend paragraph 320-10-35-1 and add paragraphs 320-10-35-18A and 320-10-35-20A, with a link to transition paragraph 815-20-65-6, as follows:

[Note: The pending content is not shown for paragraphs 320-10-35-18 through 35-20 because the amendments apply to guidance that is effective before an entity adopts the amendments in Update 2016-13.]

Investments—Debt Securities—Overall

Subsequent Measurement

320-10-35-1 Investments in **debt securities** shall be measured subsequently as follows:

a. **Trading securities**. Investments in debt securities that are classified as **trading** shall be measured subsequently at **fair value** in the statement of financial position. Unrealized **holding gains and losses** for trading securities shall be included in earnings.
b. **Available-for-sale securities**. Investments in debt securities that are classified as available for sale shall be measured subsequently at fair value in the statement of financial position. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) shall be excluded from earnings and reported in other comprehensive income until realized except as indicated in the following sentences ~~sentence~~. All or a portion of the unrealized holding gain and loss of an available-for-sale security that is designated as being hedged in a fair value hedge that is not a portfolio layer method hedge shall be recognized in earnings during the period of the hedge, pursuant to paragraphs 815-25-35-1(b), 815-25-35-4, and 815-25-35-6 ~~815-25-35-1 and 815-25-35-4~~. The portion of the unrealized holding gain and loss of a closed portfolio that includes an available-for-sale security or securities that is designated as being hedged in a portfolio layer method hedge pursuant to paragraph 815-20-25-12A shall be recognized in earnings during the period of the hedge pursuant to paragraphs 815-25-35-1(c), 815-25-35-4, and 815-25-35-6.
c. Held-to-maturity securities. Investments in debt securities classified as held to maturity shall be measured subsequently at amortized cost in the statement of financial position. A transaction gain or loss on a held-to-maturity foreign-currency-denominated debt security shall be accounted for pursuant to Subtopic 830-20.

> Impairment of Individual Available-for-Sale and Held-to-Maturity Debt Securities

> > Steps for Identifying and Accounting for Impairment

320-10-35-18 For individual securities classified as either available for sale or held to maturity, an entity shall determine whether a decline in fair value below the amortized cost basis is other than temporary. Providing a general allowance for unidentified impairment in a portfolio of securities is not appropriate.

<u>**320-10-35-18A** An entity shall not consider a basis adjustment related to an existing portfolio layer method hedge designated in accordance with paragraph 815-20-25-12A in either of the following situations:</u>

a. <u>When determining whether a decline in fair value below the amortized cost basis of a security is other than temporary</u>
b. <u>If measuring impairment of the individual investments or individual beneficial interest included in a closed portfolio hedged using the portfolio layer method.</u>

320-10-35-19 The following are specific steps an entity shall take in identifying and accounting for impairment of individual securities classified as either available for sale or held to maturity.

> > > Step 1: Determine Whether an Investment Is Impaired

320-10-35-20 Impairment shall be assessed at the individual security level (referred to as an investment). Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt securities. (For example, debt securities of an issuer bearing the same Committee on Uniform Security Identification Procedures [CUSIP] number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the debt securities of the issuer.)

<u>**320-10-35-20A** For the individual securities or individual beneficial interest in a closed portfolio hedged using the portfolio layer method, the impairment assessment performed at the individual security level shall not consider the basis adjustment related to an existing portfolio layer method hedge.</u>

Amendments to Subtopic 326-20

6. Amend paragraphs 326-20-30-4 and 326-20-30-5, with a link to transition paragraph 815-20-65-6, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

326-20-30-4 If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's **effective interest rate**. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows. <u>See paragraph 815-25-35-10 for guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge.</u> If the financial asset's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset's effective interest rate (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-20-30-4A. Subtopic 310-20 on receivables—nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

326-20-30-4A As an accounting policy election for each class of financing receivable or major security type, an entity may adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments. However, if the asset is restructured in a troubled debt restructuring, the effective interest rate used to discount expected cash flows shall not be adjusted because of subsequent changes in expected timing of cash flows.

326-20-30-5 If an entity estimates expected credit losses using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. For example, if an entity uses a loss-rate method, the numerator would include the expected credit losses of the amortized cost basis (that is, amounts that are not expected to be collected in cash or other consideration, or recognized in income). In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses. An entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the following components of the amortized cost basis, including all of the following:

a. Amortized cost basis, excluding applicable accrued interest, premiums, discounts (including net deferred fees and costs), foreign exchange, and fair value hedge accounting adjustments (that is, the face amount or unpaid principal <u>balance).</u> ~~balance)~~
b. Premiums or discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments<u>. See paragraph 815-25-35-10 for guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge.</u>
c. Applicable accrued interest. See paragraph 326-20-30-5A for guidance on excluding accrued interest from the calculation of the allowance for credit losses.

7. Amend paragraph 326-20-55-9, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Effect of a Fair Value Hedge on the Discount Rate When Using a Discounted Cash Flow Model

326-20-55-9 Section 815-25-35 implicitly affects the measurement of credit losses under this Topic by requiring the present value of expected future cash flows to be discounted by the new **effective interest rate** based on the adjusted **amortized cost basis** in a hedged **loan**. When the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective interest rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. The adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under Section 815-25-35 shall be considered to be an adjustment of the loan's amortized cost basis. Paragraph 815-25-35-11 explains that the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Paragraph 815-25-35-11 also explains that an entity should not adjust the amortized cost basis or the discount rate of the individual assets or individual beneficial interest included in the closed portfolio for a basis adjustment that is maintained on the closed portfolio basis in accordance with paragraph 815-25-35-1(c).

Amendments to Subtopic 326-30

8. Add paragraph 326-30-35-1A and amend paragraph 326-30-35-4, with a link to transition paragraph 815-20-65-6, as follows:

Financial Instruments—Credit Losses—Available-for-Sale Debt Securities

Subsequent Measurement

> Impairment of Individual Available-for-Sale Securities

> > Identifying and Accounting for Impairment

326-30-35-1 An investment is impaired if the **fair value** of the investment is less than its **amortized cost basis**.

326-30-35-1A An entity shall not consider a basis adjustment related to an existing portfolio layer method hedge designated in accordance with paragraph 815-20-25-12A when measuring impairment of the individual investments or individual beneficial interest included in a closed portfolio hedged using the portfolio layer method.

326-30-35-4 Impairment shall be assessed at the individual security level (referred to as an investment). The impairment assessment of the individual securities or individual beneficial interest in a closed portfolio hedged using the portfolio layer method shall not consider the basis adjustment related to an existing portfolio layer method hedge. Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt securities. (For example, debt securities bearing the same Committee on Uniform Security Identification Procedures [CUSIP] number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the debt securities.) Providing a general allowance for an unidentified impairment in a portfolio of debt securities is not appropriate.

Amendments to Subtopic 815-10

9. Amend paragraphs 815-10-50-4EEE and 815-10-50-5B and its related heading and add paragraph 815-10-50-5C, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Overall

Disclosure

> Overall Quantitative Disclosures

815-10-50-4EE An entity shall disclose in tabular format the following for items designated and qualifying as hedged items in fair value hedges:

a. The carrying amount of hedged assets and liabilities recognized in the statement of financial position. For an available-for-sale debt security, the amount disclosed is the amortized cost basis.
b. The cumulative amount of fair value hedging adjustments to hedged assets and liabilities included in the carrying amount of the hedged assets and liabilities recognized in the statement of financial position.
c. The line item in the statement of financial position that includes the hedged assets and liabilities.
d. The cumulative amount of fair value hedging adjustments remaining for any hedged assets and liabilities for which hedge accounting has been discontinued.

The disclosures required by (b) and (d) shall exclude cumulative basis adjustments related to foreign exchange risk.

815-10-50-4EEE For each line item disclosed in accordance with paragraph 815-10-50-4EE(c) that includes hedging relationships designated under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, the following information shall be disclosed separately:

a. The amortized cost basis of the closed portfolio(s) of ~~prepayable~~ financial assets or the beneficial interest(s)
b. The amount that represents the hedged item(s) (that is, the **hedged layer** or layers ~~designated last of layer~~)
c. The basis adjustment associated with the hedged item(s) (that is, the hedged layer or layers ~~designated last of layer~~).

Example 20 (see paragraph 815-10-55-181) illustrates these disclosures.

> Basis Adjustment Considerations under the ~~Last-of-Layer~~ Portfolio Layer Method

815-10-50-5B For existing hedging relationships designated under the ~~last-of-layer~~ portfolio layer method, an entity ~~may need to allocate~~ shall not disclose the ~~outstanding~~ basis adjustment on a more disaggregated basis than the portfolio layer method closed portfolio to meet the objectives of disclosure requirements in other Topics unless that disaggregation is required in accordance with paragraph 815-20-45-4. After an entity allocates a basis adjustment in accordance with paragraph 815-20-45-4 (if applicable), if other Topics require the disclosure of the amortized cost basis of assets included in the closed portfolio on a basis that requires disaggregating the assets included in the closed portfolio, the entity shall exclude the portfolio layer method basis adjustment from the amortized cost basis of those assets. In that case, the entity shall disclose the total amount of the portfolio layer method basis adjustment excluded from the amortized cost basis of the assets included in the closed portfolio. ~~For purposes of those disclosure requirements, the entity may allocate the basis adjustment on an individual asset basis or on a portfolio basis using a systematic and rational method.~~

815-10-50-5C For hedging relationships designated under the portfolio layer method, if the outstanding amount of the closed portfolio is less than the hedged layer or layers in accordance with paragraph 815-25-40-8(b) (that is, a breach occurred), an entity shall disclose:

a. The amount of the hedge basis adjustment recognized in current-period interest income because of the breach
b. The circumstances that led to the breach.

10. Amend paragraph 815-10-55-181 and its related heading, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 20: Disclosure of Qualitative Information by Underlying Risk and ~~Fair Value~~ Hedge Basis Adjustment Disclosures

815-10-55-181 This Example illustrates the disclosure of objectives and strategies for using derivative instruments by underlying risk, including volume of activity (see paragraph 815-10-50-1A(d)). It also illustrates the ~~fair value~~ hedge basis adjustment disclosures in paragraphs 815-10-50-4EE through 50-4EEE.

The Entity is exposed to certain risks relating to its ongoing business operations. The primary risks managed by using derivative instruments are commodity price risk and interest rate risk. Forward contracts on various commodities are entered into to manage the price risk associated with forecasted purchases of materials used in the Entity's manufacturing process. Interest rate swaps are entered into to manage interest rate risk associated with fixed-rate loans issued by the Entity's financing subsidiary.

FASB ASC 815-10 requires that an entity recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with that Subtopic, the Entity designates commodity forward contracts as cash flow hedges of forecasted purchases of commodities and interest rate swaps as fair value hedges of fixed-rate receivables.

Cash flow hedges

For derivative instruments that are designated and qualify as a cash flow hedge, the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings and is presented in the same income statement line item as the earnings effect of the hedged item. Gains and losses on the derivative instrument representing hedge components excluded from the assessment of effectiveness are recognized currently in earnings and are presented in the same line of the income statement expected for the hedged item.

As of December 31, 20X2, the Entity had the following outstanding commodity forward contracts that were entered into to hedge forecasted purchases:

Commodity	Number of Bushels (000s)
Wheat	10,000
Corn	20,000
Oats	15,000

Fair value hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. The Entity includes the gain or loss on the hedged items (that is, fixed-rate receivables) in the same line item—interest income—as the offsetting loss or gain on the related interest rate swaps.

As of December 31, 20X2, and 20X1, the following amounts were recorded on the balance sheet related to cumulative basis adjustments for fair value hedges.

Line Item in the Statement of Financial Position in Which the Hedged Item Is Included	Carrying Amount of the Hedged Assets/(Liabilities)		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets/(Liabilities)	
	20X2	20X1	20X2	20X1
Loans receivable [(a)]	$115	$124	$10 [(b)]	$20

(a) These amounts include the amortized cost basis of closed portfolios of loans receivable used to designate hedging relationships in which the hedged item is the ~~last layer expected~~ stated amount of assets in the closed portfolios anticipated to be outstanding for the designated hedge period ~~to be remaining at the end of the hedging relationship~~. At December 31, 20X2, and 20X1, the amortized cost basis of the closed portfolios used in these hedging relationships was $52 and $60, respectively, the cumulative basis adjustments associated with these hedging relationships was $5 and $7, respectively, and the amounts of the designated hedged items were $16 and $18, respectively.

(b) The balance includes $2 of hedging adjustment on a discontinued hedging relationship.

As of December 31, 20X2, and 20X1, the total notional amount of the Entity's pay-fixed/receive-variable interest rate swaps was $79 and $82, respectively.

Amendments to Subtopic 815-20

11. Amend paragraphs 815-20-25-3(c), 815-20-25-12A, 815-20-25-118A and its related heading, and paragraph 815-20-25-139 and add paragraph 815-20-25-12B, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Formal Designation and Documentation at Hedge Inception

815-20-25-3 Concurrent designation and documentation of a hedge is critical; without it, an entity could retroactively identify a hedged item, a hedged **transaction**, or a method of assessing effectiveness to achieve a desired accounting result. To qualify for hedge accounting, there shall be, at inception of the hedge, formal documentation of all of the following:

c. Documentation requirement applicable to fair value hedges only:
    1. For a fair value hedge of a **firm commitment**, a reasonable method for recognizing in earnings the asset or liability representing the gain or loss on the hedged firm commitment.

2. For ~~a~~ one or more interest rate risk hedging relationships ~~relationship~~ designated under the ~~last-of-layer~~ portfolio layer method, an analysis to support the entity's expectation that the **hedged layer** or layers ~~hedged item~~ is anticipated to be outstanding ~~as of~~ for the designated hedge period ~~hedged item's assumed maturity date~~ (see paragraph 815-20-25-12A ~~815-20-25-12A(a)~~ for additional guidance).

> Eligibility of Hedged Items and Transactions

> > Hedged Item Criteria Applicable to Fair Value Hedges Only

815-20-25-12A For a closed portfolio of ~~**prepayable**~~ financial assets or one or more **{add glossary link}**beneficial interests**{add glossary link}** secured by a portfolio of ~~prepayable~~ financial instruments, an entity may designate as the hedged item or items a hedged layer or layers if the following criteria are met ~~a stated amount of the asset or assets that are not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows if the designation is made in conjunction with the partial-term hedging election in paragraph 815-20-25-12(b)(2)(ii)~~ (this designation is referred to throughout Topic 815 as the ~~"last-of-layer method").~~ "portfolio layer method"):

a. As part of the initial hedge documentation, an analysis ~~shall be~~ is completed and documented to support the entity's expectation that the hedged item or items (that is, the ~~designated last of~~ hedged layer or layers in aggregate) is anticipated to be outstanding for the designated hedge period ~~as of the hedged item's assumed maturity date in accordance with the entity's partial-term hedge election~~. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors ~~events~~ affecting the timing and amount of cash flows associated with the closed portfolio ~~of prepayable financial assets or beneficial interest(s) secured by a portfolio of prepayable financial instruments~~.
b. For purposes of its analysis in (a), the entity ~~may assume~~ assumes that as prepayments, defaults, and other factors ~~events~~ affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio ~~of prepayable financial assets or one or more beneficial interests~~ that is not hedged ~~part of the hedged item (that is, the designated last of layer)~~.
c. The entity applies the partial-term hedging guidance in paragraph 815-20-25-12(b)(2)(ii) to the assets or beneficial interest used to support the entity's expectation in (a). An asset that matures on a hedged layer's assumed maturity date meets this requirement.

See paragraphs 815-25-55-1A through 55-1E for implementation guidance related to a closed portfolio with multiple hedged layers.

815-20-25-12B After a closed portfolio is established in accordance with paragraph 815-20-25-12A, an entity may designate new hedging relationships associated with the closed portfolio without dedesignating any existing hedging relationships associated with the closed portfolio if the criteria in paragraph 815-20-25-12A are met for those newly designated hedging relationships.

> Hedge Effectiveness

> > Hedge Effectiveness Criterion Applicable to Fair Value Hedges Only—Effectiveness Horizon

> > > Consideration of Prepayment Risk Using the ~~Last-of-Layer~~ Portfolio Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk (if applicable) when measuring the change in fair value of the hedged item attributable to interest rate risk.

> Hedge Accounting Provisions Applicable to Certain Private Companies

> > Timing of Hedge Documentation for Certain Private Companies If Simplified Hedge Accounting Approach Is Not Applied

> > > Concurrent Hedge Documentation

815-20-25-139 Concurrent with hedge inception, a **private company** that is not a financial institution as described in paragraph 942-320-50-1 shall document the following:

a. The hedging relationship in accordance with paragraph 815-20-25-3(b)(1)
b. The hedging instrument in accordance with paragraph 815-20-25-3(b)(2)(i)
c. The hedged item in accordance with paragraph 815-20-25-3(b)(2)(ii), including (if applicable) firm commitments or the analysis supporting a ~~last-of-layer~~ portfolio layer method designation in paragraph 815-20-25-3(c), or forecasted transactions in paragraph 815-20-25-3(d)
d. The nature of the risk being hedged in accordance with paragraph 815-20-25-3(b)(2)(iii).

12. Add paragraphs 815-20-45-1CC and 815-20-45-4 and its related heading, with a link to transition paragraph 815-20-65-6, as follows:

Other Presentation Matters

> Income Statement Classification

<u>**815-20-45-1CC** If a breach of a portfolio layer method hedge has occurred in accordance with paragraph 815-25-40-8(b), an entity shall present in interest income the basis adjustment associated with the **hedged layer** (or portion thereof) that is no longer outstanding.</u>

<u>**> Balance Sheet Classification**</u>

<u>**815-20-45-4** For an existing portfolio layer method hedge, if the assets included in the same closed portfolio are presented in different line items in the statement of financial position, an entity shall allocate the portfolio layer method basis adjustment to the assets' associated line items in the statement of financial position using a systematic and rational method.</u>

13. Amend paragraphs 815-20-55-4A and 815-20-55-14A and add paragraphs 815-20-55-14B and 815-20-55-15A through 55-15D and the related headings, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Eligibility of Hedged Items

> > > Hedged Items in Fair Value Hedges Only

815-20-55-4A This implementation guidance on hedged items in fair value hedges only is organized as follows:

a. Subparagraph superseded by Accounting Standards Update No. 2017-12.
b. Application of the definition of firm commitment
c. Determining whether risk exposure is shared within a portfolio
d. Servicing rights as a hedged item.
<u>e. **Hedged layer** in a portfolio layer method hedge.</u>

> > > > Determining Whether Risk Exposure Is Shared within a Portfolio

815-20-55-14 This implementation guidance discusses the application of the guidance in paragraph 815-20-25-12(b)(1) that the individual assets or individual liabilities within a portfolio hedged in a fair value hedge shall share the risk exposure for which they are designated as being hedged. If the change in fair value of a hedged portfolio attributable to the hedged risk was 10 percent during a reporting period, the change in the fair values attributable to the hedged risk for each item constituting the portfolio should be expected to be within a fairly narrow range, such as 9 percent to 11 percent. In contrast, an expectation that the change in fair value attributable to the hedged risk for individual items in the portfolio would range from 7 percent to 13 percent would be inconsistent with the requirement in that paragraph.

815-20-55-14A If both of the following conditions exist, the quantitative test described in paragraph 815-20-55-14 may be performed qualitatively on a hedge-by-hedge basis and only at hedge inception:

a. The hedged item is a hedged layer in a portfolio layer hedge ~~closed portfolio of prepayable financial assets or one or more beneficial interests~~ designated in accordance with paragraph 815-20-25-12A.
b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows in accordance with paragraph 815-25-35-13.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk (if applicable) does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows.

815-20-55-14B If the hedging instrument is a derivative with a notional amount that changes over time (for example, an amortizing-notional interest rate swap), the condition in paragraph 815-20-55-14A(b) can be satisfied because the swap has a contractual fixed rate and, thus, the hedged item can be measured on the basis of a single benchmark component of the contractual coupon cash flows in accordance with paragraph 815-25-35-13. An entity that designates a derivative with a notional amount that changes over time as a hedging instrument is designating a single hedging relationship with a single benchmark rate component of the contractual coupon cash flows.

> > > > Hedged Item in a Portfolio Layer Method Hedge

815-20-55-15A This implementation guidance describes the hedged item in a portfolio layer method hedge in several scenarios.

> > > > > Scenario A

815-20-55-15B For a closed portfolio of financial assets of $100 million, Entity A designates a single hedged item of $10 million of the assets that is expected to be outstanding for the hedge period of Years 1–5. Entity A designates as the hedging instrument a spot-starting constant-notional pay-fixed, receive-variable interest rate swap with a notional amount of $10 million and a term of 5 years. In this single-layer hedge, the hedged layer represents $10 million of assets in the closed portfolio that is not expected to be affected by prepayments, defaults, or other factors affecting the timing or amount of cash flows for the hedge period of Years 1–5.

> > > > > Scenario B

815-20-55-15C For a closed portfolio of financial assets of $100 million, Entity A designates a hedged item of $20 million of assets that is expected to be outstanding for the hedge period of Years 1–3. It also designates a hedged item of $10 million of the assets in the closed portfolio that is expected to be outstanding for the hedge period of Years 1–5. For the $20 million hedged item, Entity A designates as the hedging instrument a spot-starting constant-notional pay-fixed, receive-variable interest rate swap with a notional amount of $20 million and a term of 3 years. For the $10 million hedged item, Entity A designates as the hedging instrument a spot-starting constant-notional pay-fixed, receive-variable interest rate swap with a notional amount of $10 million and a term of 5 years. In this scenario, there are two hedged layers:

a. A hedged layer representing $20 million of assets in the closed portfolio that is not expected to be affected by prepayments, defaults, or other factors affecting the timing or amount of cash flows for the hedge period of Years 1–3
b. A hedged layer representing $10 million of assets in the closed portfolio that is not expected to be affected by prepayments, defaults, or other factors affecting the timing or amount of cash flows for the hedge period of Years 1–5.

Although the $10 million and $20 million hedged layers are separately designated, Entity A should consider the aggregate hedged amount of $30 million in Years 1–3 when assessing whether the hedged layers are anticipated to be outstanding in accordance with paragraphs 815-20-25-12A(a) and 815-25-35-7A.

> > > > > Scenario C

815-20-55-15D For a closed portfolio of financial assets of $100 million, Entity A designates a single hedged item of $30 million for Year 1 that decreases to an amount of $20 million for Year 2 and $10 million for Year 3. Entity A designates a single amortizing-notional swap as the hedging instrument. In this single-layer hedge, the hedged layer represents a $30 million stated amount for Year 1, a $20 million stated amount for Year 2, and a $10 million stated amount for Year 3, which reflects the amortizing-notional swap’s features.

Amendments to Subtopic 815-25

14. Amend paragraphs 815-25-35-1, 815-25-35-6, 815-25-35-7A and its related heading, 815-25-35-9 through 35-12, and 815-25-35-13B, with a link to transition paragraph 815-20-65-6, as follows:

[Note: Paragraphs 815-25-35-10 through 35-12 have amendments to current content as well as new pending content linked to paragraph 815-20-65-6. These paragraphs are shown with both the current content and all of the associated pending content for the convenience of the user.]

Derivatives and Hedging—Fair Value Hedges

Subsequent Measurement

> Changes in Fair Value in General

815-25-35-1 Gains and losses on a qualifying **fair value hedge** shall be accounted for as follows:

a. The gain or loss on the hedging instrument shall be recognized currently in earnings, except for amounts excluded from the assessment of effectiveness that are recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A. All amounts recognized in earnings shall be presented in the same income statement line item as the earnings effect of the hedged item.
b. The gain or loss (that is, the change in **fair value**) on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized currently in earnings except as described in (c).
c. For one or more existing **hedged layer** or layers that are designated under the portfolio layer method in accordance with paragraph 815-20-25-12A, the gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall not adjust the carrying value of the individual beneficial interest or individual assets in or removed from the closed portfolio. Instead, that amount shall be maintained on a closed portfolio basis and recognized currently in earnings.

815-25-35-6 If a hedged item is otherwise measured at fair value with changes in fair value reported in **other comprehensive income** (such as an available-for-sale debt security), the adjustment of the hedged item's carrying amount discussed in paragraph 815-25-35-1(b) shall be recognized in earnings rather than in other comprehensive income to offset the gain or loss on the hedging instrument. If the hedged item is a hedged layer designated in a portfolio layer method hedge on a closed portfolio in accordance with paragraph 815-20-25-12A and the closed portfolio includes only available-for-sale debt securities, the entire gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall be recognized in earnings rather than in other comprehensive income to offset the gain or loss on the hedging instrument. If the closed portfolio includes available-for-sale debt securities and assets that are not available-for-sale debt securities, an entity shall determine the portion of the change in fair value on the hedged item attributable to the hedged risk associated with the available-for-sale debt securities using a systematic and rational method. That amount shall be recognized in earnings rather than in other comprehensive income. However, an entity shall not adjust the carrying amount of the individual available-for-sale debt securities included in the closed portfolio in accordance with paragraph 815-25-35-1(c).

> Existing Portfolio Layer Method Hedges ~~Estimating the Remaining Balance under the Last-of-Layer Method~~

815-25-35-7A ~~When the hedged item is~~ For each closed portfolio with one or more hedging relationships designated and accounted for under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, an entity shall perform and document at each effectiveness assessment date an analysis that supports the entity's expectation that the hedged layer or layers in aggregate ~~item (that is, the designated last of layer)~~ is still anticipated to be outstanding for the designated hedge period ~~as of the hedged item's assumed maturity date~~. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other factors ~~events~~ affecting the timing and amount of cash flows associated with the closed portfolio using a method consistent with the method used to perform the analysis in paragraph 815-20-25-12A(a) and (b).

> Changes in Fair Value of Hedged Item

815-25-35-8 The adjustment of the carrying amount of a hedged asset or liability required by paragraph 815-25-35-1(b) shall be accounted for in the same manner as other components of the carrying amount of that asset or liability. For example, an adjustment of the carrying amount of a hedged asset held for sale (such as inventory) would remain part of the carrying amount of that asset until the asset is sold, at which point the entire carrying amount of the hedged asset would be recognized as the cost of the item sold in determining earnings.

815-25-35-9 An adjustment of the carrying amount of a hedged interest-bearing **financial instrument** that is required by paragraph 815-25-35-1(b) and an adjustment that is maintained on a closed portfolio basis in a portfolio layer method hedge in accordance with paragraph 815-25-35-1(c) shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

815-25-35-9A If, as permitted by paragraph 815-25-35-9, an entity amortizes the adjustment to the carrying amount of the hedged item during an ~~outstanding~~ existing partial-term hedge of an interest-bearing financial instrument or amortizes the basis adjustment in an existing portfolio layer method hedge, the entity shall fully amortize that adjustment by the hedged item's assumed maturity date in accordance with paragraph 815-25-35-13B. For a discontinued hedging relationship, all remaining adjustments to the carrying amount of the hedged item shall be amortized over a period that is consistent with the amortization of other discounts or premiums associated with the hedged item in accordance with other Topics (for example, Subtopic 310-20 on receivables—nonrefundable fees and other costs). See paragraphs 815-25-40-9 through 40-9A for further guidance on accounting for a basis adjustment attributable to a discontinued portfolio layer method hedge.

> > Impairment of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment requirements to the hedged asset or liability.

In addition, amend the following current content for paragraph 815-25-35-10, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) December 16, 2022; (N) December 16, 2023* | **Transition Guidance:** 815-20-65-6

> > Impairment of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not be considered when assessing the individual assets or individual beneficial interest included in the closed portfolio for impairment or when assessing a portfolio of assets for impairment. An entity may not apply this guidance by analogy to other components of the **recorded investment**. Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment requirements to the hedged asset or liability.

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2022* | **Transition Guidance:** 326-10-65-1

Editor's Note: *The content of paragraph 815-25-35-10 will be amended upon transition, together with a change in the heading noted below.*

> > Impairment or Credit Losses of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment or credit loss requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

In addition, amend the following pending content for paragraph 815-25-35-10, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) December 16, 2022; (N) December 16, 2023* | **Transition Guidance:** 815-20-65-6

> > Impairment or Credit Losses of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment or credit losses for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment or credit loss requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not be considered when assessing the individual assets or individual beneficial interest included in the closed portfolio for impairment or credit losses or when assessing a portfolio of assets for impairment or credit losses. An entity may not apply this guidance by analogy to other components of amortized cost basis. Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

> > > Interaction with Loan Impairment

815-25-35-11 This Subtopic implicitly affects the measurement of impairment under Section 310-10-35 by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted **recorded investment** in a hedged loan. Paragraph 310-10-35-31 requires that, when the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. That paragraph states that the adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's recorded investment. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's carrying amount be adjusted for hedge accounting before the impairment requirements of Subtopic 310-10 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted recorded investment.

In addition, amend the following current content for paragraph 815-25-35-11, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) December 16, 2022; (N) December 16, 2023* | **Transition Guidance:** 815-20-65-6

> > > Interaction with Loan Impairment

815-25-35-11 This Subtopic implicitly affects the measurement of impairment under Section 310-10-35 by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted **recorded investment** in a hedged loan. Paragraph 310-10-35-31 requires that, when the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. That paragraph states that the adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's recorded investment. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's carrying amount be adjusted for hedge accounting before the impairment requirements of Subtopic 310-10 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted recorded investment. A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not adjust the recorded investment of the individual assets or individual beneficial interest included in the closed portfolio. An entity may not apply this guidance by analogy to other components of the recorded investment.

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2022* | **Transition Guidance:** 326-10-65-1

Editor's Note: *The content of paragraph 815-25-35-11 will be amended upon transition, together with a change in the heading noted below.*

> > > Interaction with Measurement of Credit Losses

815-25-35-11 This Subtopic implicitly affects the measurement of credit losses under Subtopic 326-20 on financial instruments measured at amortized cost by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted amortized cost basis in a hedged loan. Paragraph 326-20-55-9 requires that, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. That paragraph states that the adjustment under fair value hedge accounting for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's amortized cost basis. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's amortized cost basis be adjusted for hedge accounting before the requirements of Subtopic 326-20 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted amortized cost basis.

In addition, amend the following pending content for paragraph 815-25-35-11, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) December 16, 2022; (N) December 16, 2023* | **Transition Guidance:** 815-20-65-6

> > > Interaction with Measurement of Credit Losses

815-25-35-11 This Subtopic implicitly affects the measurement of credit losses under Subtopic 326-20 on financial instruments measured at amortized cost by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted amortized cost basis in a hedged loan. Paragraph 326-20-55-9 requires that, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. That paragraph states that the adjustment under fair value hedge accounting for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's amortized cost basis. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's amortized cost basis be adjusted for hedge accounting before the requirements of Subtopic 326-20 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted amortized cost basis. <u>A portfolio layer method basis adjustment that is maintained on a closed portfolio basis for an existing hedge in accordance with paragraph 815-25-35-1(c) shall not adjust the amortized cost basis of the individual assets or individual beneficial interest included in the closed portfolio. An entity may not apply this guidance by analogy to other components of amortized cost basis.</u>

815-25-35-12 This guidance applies to all entities applying Subtopic 310-10 to financial assets that are hedged items in a fair value hedge, regardless whether those entities have delayed amortizing to earnings the adjustments of the loan's carrying amount arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's carrying amount.

In addition, amend the following current content for paragraph 815-25-35-12, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) December 16, 2022; (N) December 16, 2023* | **Transition Guidance:** 815-20-65-6

815-25-35-12 This guidance applies to all entities applying Subtopic 310-10 to financial assets that are hedged items in a fair value hedge, regardless whether those entities have delayed amortizing to earnings the adjustments of the loan's carrying amount arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's carrying amount and is not intended to be applied to the individual assets or individual beneficial interest in an existing portfolio layer method hedge closed portfolio.

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2022* | **Transition Guidance:** 326-10-65-1

815-25-35-12 This guidance applies to all entities applying Subtopic 326-20 to financial assets that are hedged items in a fair value hedge, regardless of whether those entities have delayed amortizing to earnings the adjustments of the loan's amortized cost basis arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's amortized cost basis.

In addition, amend the following pending content for paragraph 815-25-35-12, with a link to transition paragraph 815-20-65-6, as follows:

Pending Content:

Transition Date: *(P) December 16, 2022; (N) December 16, 2023* | **Transition Guidance:** 815-20-65-6

815-25-35-12 This guidance applies to all entities applying Subtopic 326-20 to financial assets that are hedged items in a fair value hedge, regardless of whether those entities have delayed amortizing to earnings the adjustments of the loan's amortized cost basis arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan’s amortized cost basis and is not intended to be applied to the individual assets or individual beneficial interest in an existing portfolio layer method hedge closed portfolio.

> > > Measuring the Change in Fair Value of the Hedged Item in Partial-Term Hedges of Interest Rate Risk Using an Assumed Term

815-25-35-13B For a fair value hedge of interest rate risk in which the hedged item is designated for a partial term ~~as selected contractual cash flows~~ in accordance with paragraph 815-20-25-12(b)(2)(ii), an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an assumed term that begins when the first hedged cash flow begins to accrue and ends at the end of the designated hedge period ~~when the last hedged cash flow is due and payable~~. The assumed issuance of the hedged item occurs on the date that the first hedged cash flow begins to accrue. The assumed maturity of the hedged item occurs at the end of the designated hedge period ~~on the date in which the last hedged cash flow is due and payable~~. An entity may measure the change in fair value of the hedged item attributable to interest rate risk in accordance with this paragraph when the entity is designating the hedged item in a hedge of both interest rate risk and foreign exchange risk. In that hedging relationship, the change in carrying value of the hedged item attributable to foreign exchange risk shall be measured on the basis of changes in the foreign currency spot rate in accordance with paragraph 815-25-35-18. Additionally, an entity may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument (for example, 2 outstanding hedging relationships for consecutive interest cash flows in Years 1–3 and consecutive interest cash flows in Years 5–7 of a 10-year debt instrument).

15. Add paragraphs 815-25-40-7A and its related heading and paragraph 815-25-40-8A and 815-25-40-9A, and amend paragraphs 815-25-40-8 through 40-9 and their related headings, with a link to transition paragraph 815-20-65-6, as follows:

Derecognition

> Discontinuing Hedge Accounting

> > Hedged Item Is Designated under the ~~Last-of-Layer~~ Portfolio Layer Method

> > > Voluntary Dedesignations

815-25-40-7A An entity may elect to discontinue (or partially discontinue) hedge accounting prospectively for all or a portion of the **hedged layer** for one or more hedging relationships associated with the closed portfolio at any time if a breach has not occurred in accordance with paragraph 815-25-40-8(b) and a breach is not anticipated in accordance with paragraph 815-25-40-8(a). If multiple hedged layers are associated with the closed portfolio, the entity may voluntarily elect to dedesignate (or partially dedesignate) any hedges associated with that closed portfolio.

> > > Breaches of the Closed Portfolio

815-25-40-8 For ~~a~~ one or more hedging relationships ~~relationship~~ designated under the ~~last-of-layer~~ portfolio layer method in accordance with paragraph 815-20-25-12A, an entity shall discontinue (or partially discontinue) hedge accounting in ~~either of~~ the following circumstances:

a. If the entity cannot support on a subsequent testing date that the hedged layer or layers ~~hedged item (that is, the designated last of layer) is~~ are anticipated to be outstanding for the designated hedge period in accordance with paragraph 815-25-35-7A (that is, a breach is anticipated), it shall ~~at a minimum~~ discontinue (or partially discontinue) hedge accounting for one or more hedging relationships for the portion of the hedged item that is no longer anticipated ~~expected~~ to be outstanding for the designated hedge period ~~at the hedged item's assumed maturity date~~.
b. If on a subsequent testing date the outstanding amount of the closed portfolio of ~~prepayable~~ financial assets or one or more beneficial interests is less than the hedged layer or layers (that is, a breach has occurred) ~~item~~, the entity shall discontinue (or partially discontinue) hedge ~~accounting.~~ accounting for one or more hedging relationships for the portion of the hedged item that is no longer outstanding.

815-25-40-8A In the event of either an anticipated breach (as described in paragraph 815-25-40-8(a)) or a breach that has occurred (as described in paragraph 815-25-40-8(b)), if multiple hedged layers are associated with a closed portfolio, an entity shall determine which hedge or hedges to discontinue (or partially discontinue) in accordance with an accounting policy election. That accounting policy election shall specify a systematic and rational approach to determining which hedge or hedges to discontinue (or partially discontinue). An entity shall establish its accounting policy no later than when it first anticipates a breach or when a breach has occurred (whichever comes first). After an entity establishes its accounting policy, it shall consistently apply its accounting policy to all portfolio layer method breaches (anticipated and occurred).

> > > Accounting for Basis Adjustments

815-25-40-9 If a ~~last-of-layer~~ portfolio layer method hedging relationship is discontinued (or partially discontinued) in a voluntary dedesignation in accordance with paragraph 815-25-40-7A or in anticipation of a breach in accordance with paragraph 815-25-40-8(a), the ~~outstanding~~ basis adjustment associated with the dedesignated amount ~~(or portion thereof)~~ as of the discontinuation date shall be allocated to the remaining individual assets in the closed portfolio that supported the dedesignated hedged layer using a systematic and rational method. An entity shall amortize those amounts over a period that is consistent with the amortization of other discounts or premiums associated with the respective assets in accordance with other Topics (for example, Subtopic 310-20 on receivables—nonrefundable fees and other costs).

815-25-40-9A For a portfolio layer method hedging relationship that is discontinued because a breach has occurred in accordance with paragraph 815-25-40-8(b), as of the discontinuation date an entity shall:

a. Determine the portion of the basis adjustment associated with the amount of the hedged layer that exceeds the closed portfolio (that is, the portion of the basis adjustment associated with the breach) using a systematic and rational method and immediately recognize that amount in interest income in accordance with paragraph 815-20-45-1CC
b. Disclose the information specified in paragraph 815-10-50-5C for the breach.

A closed portfolio may simultaneously have a layer or layers that have been breached and a layer or layers that it anticipates will be breached. In that case, an entity shall apply the guidance in this paragraph for the breach or breaches that have occurred and the guidance in paragraph 815-25-40-9 for the anticipated breach or breaches.

16. Supersede paragraph 815-25-55-1 and its related heading and add paragraphs 815-25-55-1A through 55-1D and their related headings, with a link to transition paragraph 815-20-65-6, and paragraph 815-25-55-1E and its related headings, with no link to a transition paragraph, as follows:

Implementation Guidance and Illustrations

~~> Illustrations~~

~~> > Example 1: Fair Value Hedge of Natural Gas Inventory with Futures Contracts~~

815-25-55-1 ~~This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness and measure hedge ineffectiveness in a **fair value hedge** of natural gas inventory with futures contracts. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.~~ **[Content moved to paragraph 815-25-55-1E]**

Pending Content:

Transition Date: *(P) December 16, 2018; (N) December 16, 2020* | **Transition Guidance:** 815-20-65-3

815-25-55-1 ~~This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness in a **fair value hedge** of natural gas inventory with futures contracts. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.~~ **[Content moved to paragraph 815-25-55-1E]**

> Implementation Guidance

> > Portfolio Layer Method Hedges—Multiple Hedged Layers

815-25-55-1A This implementation guidance demonstrates how an entity should apply the following aspects of the portfolio layer method if it elects to designate multiple **hedged layers** of a single closed portfolio:

a. Performing the similar-asset assessment upon initial designation of a portfolio layer method hedge
b. Evaluating whether the entity may continue to apply the guidance for a portfolio layer method hedge after initial designation.

815-25-55-1B For the purposes of illustrating the guidance in paragraph 815-25-55-1A, the implementation guidance in paragraphs 815-25-55-1C through 55-1D assumes that Entity A designates multiple hedged layers of a closed portfolio of 5-year and 10-year prepayable loans originated on the hedge inception date.

> > > Similar-Asset Assessment at Hedge Designation

815-25-55-1C Entity A designates hedged layers with assumed maturity dates of three years and seven years, respectively. When applying the similar-asset assessment for a portfolio hedge in accordance with paragraph 815-20-25-12(b)(1), Entity A should consider all assets in the closed portfolio for the 3-year hedged layer but consider only the 10-year assets for the 7-year hedged layer. That is, an entity should consider the assets that support the hedged layer.

> > > Subsequent Assessment

815-25-55-1D After initial hedge designation, Entity A should continue to assess whether the individual three-year and seven-year hedged layers meet the requirements in paragraph 815-25-35-7A on the basis of the same assets used to perform the similar-asset assessments in accordance with paragraph 815-25-55-1C. For Years 1–3, the entity should consider whether the hedged layers in aggregate are anticipated to be outstanding.

> Illustrations

> > Example 1: Fair Value Hedge of Natural Gas Inventory with Futures Contracts

815-25-55-1E This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness and measure hedge ineffectiveness in a **fair value hedge** of natural gas inventory with futures contracts. Assume that the hedge satisfied all of the criteria for hedge accounting at inception. **[Content moved from paragraph 815-25-55-1]**

Pending Content:

Transition Date: *(P) December 16, 2018; (N) December 16, 2020* | **Transition Guidance:** 815-20-65-3

815-25-55-1E This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness in a **fair value hedge** of natural gas inventory with futures contracts. Assume that the hedge satisfied all of the criteria for hedge accounting at inception. **[Content moved from paragraph 815-25-55-1]**

Amendments to Subtopic 860-20

17. Amend paragraphs 860-20-40-1A through 40-1B, with a link to transition paragraph 815-20-65-6, as follows:

Transfers and Servicing—Sales of Financial Assets

Derecognition

> Sale of a Participating Interest

860-20-40-1A Upon completion of a **transfer** of a **participating interest** that satisfies the conditions in paragraph 860-10-40-5 to be accounted for as a sale, the **transferor (seller)** shall:

a. Allocate the previous carrying amount of the entire **financial asset** between both of the following on the basis of their relative fair values at the date of the transfer:
   1. The participating interest(s) sold
   2. The participating interest that continues to be held by the transferor.
b. **Derecognize** the participating interest(s) sold
c. Apply the guidance in paragraphs 860-20-25-1 and 860-20-30-1 on recognition and measurement of assets obtained and liabilities incurred in the sale
d. Recognize in earnings any gain or loss on the sale
e. Report any participating interest(s) that continue to be held by the transferor as the difference between the following amounts measured at the date of the transfer:
   1. The previous carrying amount of the entire financial asset
   2. The amount derecognized.

For the transfer of a participating interest in a financial asset included in a closed portfolio hedged in an existing portfolio layer method hedge in accordance with Topic 815 on derivatives and hedging, when applying the guidance in (a) through (e) an entity shall not include any portion of the hedge basis adjustment that is maintained on the closed portfolio basis in accordance with paragraphs 815-20-25-12A(b) and 815-25-35-1(c).

> Sale of an Entire Financial Asset or Group of Entire Financial Assets

860-20-40-1B Upon completion of a transfer of an entire financial asset or a group of entire financial assets that satisfies the conditions in paragraph 860-10-40-5 to be accounted for as a sale, the transferor (seller) shall:

a. Derecognize the **transferred financial assets**
b. Apply the guidance in paragraphs 860-20-25-1 and 860-20-30-1 on recognition and measurement of assets obtained and liabilities incurred in the sale
c. Recognize in earnings any gain or loss on the sale.

If the transferred financial asset was accounted for under Topic 320 as available for sale before the transfer, item (a) requires that the amount in other comprehensive income be recognized in earnings at the date of transfer. If the transferred financial asset was included in a closed portfolio hedged in an existing portfolio layer method hedge in accordance with Topic 815 before the transfer, when applying the guidance in (a) through (c) an entity shall not include any portion of the hedge basis adjustment that is maintained on the closed portfolio basis in accordance with paragraphs 815-20-25-12A(b) and 815-25-35-1(c).

Amendments to Subtopic 948-310

18. Amend paragraph 948-310-35-1 and add paragraph 948-310-35-1A, with a link to transition paragraph 815-20-65-6, as follows:

Financial Services—Mortgage Banking—Receivables

Subsequent Measurement

> Loans Held for Sale

948-310-35-1 Mortgage loans held for sale shall be reported at the lower of amortized cost basis cost or fair value, determined as of the balance sheet date. If a mortgage loan has been the hedged item in a fair value hedge that is not a portfolio layer method hedge (as addressed in Topic 815), the loan's amortized cost basis used in ~~lower-of-amortized-cost-basis-or-fair value~~ lower-of-amortized-cost-basis-or-fair-value accounting shall reflect the effect of the adjustments of its carrying amount made pursuant to paragraph 815-25-35-1(b) ~~815-25-35-1~~.

948-310-35-1A If a mortgage loan that is held for sale is included in a closed portfolio hedged in an existing portfolio layer method hedge, the loan's amortized cost basis used in lower-of-amortized-cost-basis-or-fair-value accounting shall not reflect the effect of the adjustments made pursuant to paragraph 815-25-35-1(c). If that portfolio layer method hedge is discontinued pursuant to paragraphs 815-25-40-7A through 40-8, the loan's amortized cost basis used in lower-of-amortized-cost-basis-or-fair-value accounting shall reflect the effect of the adjustments of its carrying amount made pursuant to paragraphs 815-25-35-1(b) and 815-25-40-9 through 40-9A.

19. Add paragraph 815-20-65-6 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2022-01, *Derivatives and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method*

815-20-65-6 The following represents the transition and effective date information related to Accounting Standards Update No. 2022-01, *Derivatives and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method:*

a. For **public business entities** the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years.
b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years.
c. Early adoption is permitted on any date on or after the issuance of Update 2022-01 for any entity that has adopted the amendments in Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* for the corresponding period. If an entity early adopts the pending content that links to this paragraph in an interim period, the cumulative-effect adjustment for adopting the amendments related to basis adjustments described in (e) shall be reflected as of the beginning of the fiscal year that includes the interim period (that is, the initial application date).
d. An entity shall apply the pending content that links to this paragraph to designate more than one portfolio layer method hedging relationship for a single closed portfolio on a prospective basis as of the date of adoption of the amendments in this Update.
e. An entity shall apply the pending content that links to this paragraph on basis adjustments, except for the pending content in Subtopic 815-10 (related to disclosures), on a modified retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings and the balance sheet line items (as appropriate) as of the date of initial application for portfolio layer method hedges existing as of the date of adoption of the amendments in this Update.
f. An entity may elect to adopt the pending content that links to this paragraph in Subtopic 815-10 (related to disclosures) on a prospective basis from the date of initial application of the amendments in Update 2022-01 or on a retrospective basis to each prior period presented after the date of adoption of the amendments in Update 2017-12.
g. An entity may reclassify one or more debt securities from held to maturity to available for sale if the debt securities are:
    1. Hedged under the portfolio layer method in accordance with paragraph 815-20-25-12A.
    2. Classified as held to maturity immediately before the date of adoption of the pending content that links to this paragraph.
h. An entity reclassifying one or more debt securities shall:
    1. Determine which debt securities to reclassify no later than 30 days after the date of adoption of the pending content that links to this paragraph. For an entity that has not yet adopted the amendments in Update 2016-13, any unrealized gain or loss on the reclassified debt security at the date of reclassification shall be recorded in accumulated other comprehensive income. For an entity that has adopted the amendments in Update 2016-13, for each reclassified debt security it shall:

i. Reverse in retained earnings any allowance for credit losses previously recorded on the held-to-maturity debt security at the date of reclassification.
ii. Reclassify the debt security to the available-for-sale category at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses).
iii. Determine whether an allowance for credit losses is necessary by following the guidance in Subtopic 326-30. If so, that allowance shall be recorded in retained earnings at the date of reclassification.
iv. Report in accumulated other comprehensive income any unrealized gain or loss on the debt security at the date of reclassification, excluding the amount recorded in the allowance for credit losses in accordance with (iii).

2. Include those reclassified debt securities in one or more closed portfolios that are designated in a portfolio layer method hedge no later than 30 days after the date of adoption of the pending content that links to this paragraph. Neither a minimum amount of the closed portfolio nor a minimum hedge period must be designated to meet this requirement.
3. An entity shall provide the disclosures in accordance with paragraph 320-10-50-10 for reclassified debt securities in the period of reclassification.
4. That reclassification, in and of itself, would not call into question the entity's assertion at the most recent reporting date that it had the intent and ability to hold to maturity those debt securities that continue to be classified as held to maturity.

i. An entity shall disclose the following in the period that the entity adopts the pending content that links to this paragraph:
1. The nature of and reason for the change in accounting principle related to accounting for hedge basis adjustments.
2. The effect of adoption on any line item in the statement of financial position, if material, as of the beginning of the first period for which the pending content that links to this paragraph is applied. Presentation of the effect on financial statement subtotals is not required.
3. The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the first period for which the pending content that links to this paragraph is applied.

j. An entity that issues interim financial statements shall provide the disclosures in (i) in each interim financial statement of the fiscal year of adoption and the annual financial statement of the fiscal year of adoption.

Amendments to Status Sections

20. Amend paragraph 310-10-00-1, by adding the following item to the table, as follows:

310-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
310-10-35-31A	Added	2022-01	03/28/2022

21. Amend paragraph 320-10-00-1, by adding the following items to the table, as follows:

320-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
320-10-35-1	Amended	2022-01	03/28/2022
320-10-35-18A	Added	2022-01	03/28/2022
320-10-35-20A	Added	2022-01	03/28/2022

22. Amend paragraph 326-20-00-1, by adding the following items to the table, as follows:

326-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
326-20-30-4	Amended	2022-01	03/28/2022
326-20-30-5	Amended	2022-01	03/28/2022
326-20-55-9	Amended	2022-01	03/28/2022

23. Amend paragraph 326-30-00-1, by adding the following items to the table, as follows:

326-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
326-30-35-1A	Added	2022-01	03/28/2022
326-30-35-4	Amended	2022-01	03/28/2022

24. Amend paragraph 815-10-00-1, by adding the following items to the table, as follows:

815-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Beneficial Interests	Added	2022-01	03/28/2022
Hedged Layer	Added	2022-01	03/28/2022
815-10-50-4EEE	Amended	2022-01	03/28/2022
815-10-50-5B	Amended	2022-01	03/28/2022
815-10-50-5C	Added	2022-01	03/28/2022
815-10-55-181	Amended	2022-01	03/28/2022

25. Amend paragraph 815-20-00-1, by adding the following items to the table, as follows:

815-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Beneficial Interests	Added	2022-01	03/28/2022
Hedged Layer	Added	2022-01	03/28/2022
815-20-25-3	Amended	2022-01	03/28/2022
815-20-25-12A	Amended	2022-01	03/28/2022
815-20-25-12B	Added	2022-01	03/28/2022
815-20-25-118A	Amended	2022-01	03/28/2022
815-20-25-139	Amended	2022-01	03/28/2022
815-20-45-1CC	Added	2022-01	03/28/2022
815-20-45-4	Added	2022-01	03/28/2022
815-20-55-4A	Amended	2022-01	03/28/2022
815-20-55-14A	Amended	2022-01	03/28/2022

Paragraph	Action	Accounting Standards Update	Date
815-20-55-14B	Added	2022-01	03/28/2022
815-20-55-15A through 55-15D	Added	2022-01	03/28/2022
815-20-65-6	Added	2022-01	03/28/2022

26. Amend paragraph 815-25-00-1, by adding the following items to the table, as follows:

815-25-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Beneficial Interests	Added	2022-01	03/28/2022
Hedged Layer	Added	2022-01	03/28/2022
815-25-35-1	Amended	2022-01	03/28/2022
815-25-35-6	Amended	2022-01	03/28/2022
815-25-35-7A	Amended	2022-01	03/28/2022
815-25-35-9 through 35-12	Amended	2022-01	03/28/2022
815-25-35-13B	Amended	2022-01	03/28/2022
815-25-40-7A	Added	2022-01	03/28/2022
815-25-40-8	Amended	2022-01	03/28/2022
815-25-40-8A	Added	2022-01	03/28/2022
815-25-40-9	Amended	2022-01	03/28/2022
815-25-40-9A	Added	2022-01	03/28/2022
815-25-55-1	Superseded	2022-01	03/28/2022
815-25-55-1A through 55-1E	Added	2022-01	03/28/2022

27. Amend paragraph 860-20-00-1, by adding the following items to the table, as follows:

860-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
860-20-40-1A	Amended	2022-01	03/28/2022
860-20-40-1B	Amended	2022-01	03/28/2022

28. Amend paragraph 948-310-00-1, by adding the following items to the table, as follows:

948-310-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
948-310-35-1	Amended	2022-01	03/28/2022
948-310-35-1A	Added	2022-01	03/28/2022

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The Board introduced the last-of-layer method in Update 2017-12 for fair value hedges of interest rate risk of portfolios of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments. That hedging method allows an entity to designate as the hedged item the stated amount of the asset or assets in the portfolio that is anticipated to remain outstanding for the designated hedge period. While assets may be removed from the portfolio because of prepayments, defaults, sales, and reclassifications, new assets may not be added (this is referred to throughout the remainder of the basis for conclusions as a *closed portfolio*).

BC3. The amendments in Update 2017-12 also provide guidance on breaches and anticipated breaches of last-of-layer hedges. The guidance indicates that a breach has occurred when the outstanding amount of the closed portfolio is less than the stated amount of the asset or assets in the closed portfolio hedged in the current period. In those cases, an entity should dedesignate the hedging relationship associated with the closed portfolio. The guidance states that the basis adjustment should then be allocated to the remaining assets in the closed portfolio on a systematic and rational basis. However, the amendments in Update 2017-12 do not provide guidance on the accounting treatment for the portion of the basis adjustment related to the breached amount. An anticipated breach occurs when the hedged layer is no longer anticipated to be outstanding during the designated hedge period. In those cases, an entity would either partially dedesignate the hedge to align the designated amount of the hedged item with revised expectations about the closed portfolio or fully dedesignate the hedge. The basis adjustment associated with any partially or fully dedesignated hedge in an anticipated breach should be allocated to all assets in the closed portfolio on a systematic and rational basis.

BC4. Following the issuance of Update 2017-12, stakeholders asked questions about the implementation of the last-of-layer method that can be separated into two groups. The first group relates to whether an entity is permitted to designate multiple last-of-layer hedging relationships associated with a single closed portfolio. The second group relates to hedge basis adjustment issues applicable to both a single hedged layer and multiple hedged layers, including the accounting treatment for the portion of a basis adjustment associated with the amount of a dedesignated layer that was breached. On March 28, 2018, the Board added a project to its technical agenda to address those questions.

BC5. On May 5, 2021, the Board issued the proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Fair Value Hedging—Portfolio Layer Method*, with comments due July 5, 2021. The Board received 25 comment letters. Overall, respondents supported the amendments in the proposed Update, noting that they would better align hedge accounting with an entity's risk management activities. Feedback received on specific topics is incorporated below.

Benefits and Costs

BC6. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC7. The Board believes that allowing multiple hedged layers will improve financial reporting because this amendment is expected to align hedge accounting more closely with an entity's risk management activities. The Board also believes that the additional guidance on hedge basis adjustments will provide more clarity and consistency in financial reporting outcomes.

BC8. Because hedge accounting is optional within GAAP, not all entities will bear the costs of implementing the amendments in this Update. For entities that elect to apply hedge accounting, the Board anticipates that they will not incur significant costs as a result of the amendments. However, the Board acknowledges that certain reporting entities will incur implementation costs to educate employees, establish new accounting methods, and update systems and processes (for example, to maintain hedge basis adjustments on a closed portfolio basis rather than on an individual asset basis).

BC9. The Board believes that after implementing the amendments in this Update, entities will have minimal, if any, incremental costs to comply with the amendments on an ongoing basis. Moreover, the Board believes that entities largely will be able to leverage existing systems and processes. Overall, the Board concluded that the expected benefits of the amendments justify the expected costs.

Basis for Conclusions

Multiple Hedged Layers

BC10. After the Board added the last-of-layer hedging method in Update 2017-12, stakeholders asked the Board to make it more broadly applicable. Specifically, stakeholders asked that the Board allow multiple hedging relationships to be designated for a single closed portfolio. They also asked the Board to expand the scope of the last-of-layer method to include hedges of financial liabilities and nonprepayable financial assets. Preparers indicated that they would be able to reflect the effect of their risk management activities on their financial performance more clearly and efficiently if multiple hedged layers were permitted to be designated.

Multiple Hedged Layers of a Single Closed Portfolio

BC11. For a single closed portfolio, the amendments in this Update allow multiple hedging relationships to be designated. After the issuance of Update 2017-12, stakeholders asked the Board to consider that change to further align hedge accounting with risk management strategies. Stakeholders indicated that, in practice, the ability to designate only one hedging relationship per closed portfolio results in a significant amount of interest rate risk remaining in the closed portfolio that is ineligible to be hedged under hedge accounting guidance.

BC12. To reduce the amount of interest rate risk in the closed portfolio that is ineligible to be hedged under hedge accounting guidance, stakeholders asked the Board to allow entities to hedge different stated amounts in different periods, which would allow a greater portion of the closed portfolio’s interest rate risk to qualify for hedge accounting. Hedging different stated amounts could be accomplished by designating multiple hedged layers of a single closed portfolio, with a larger stated amount hedged in earlier periods and a smaller stated amount hedged in later periods. That layering technique would allow the total hedged amount to change with anticipated changes in the amount of the closed portfolio outstanding. The Board agreed with stakeholders that there is no conceptual reason to allow only one hedging relationship for a closed portfolio designated under the last-of-layer method and that the same core principles for designating a single hedged layer should be expanded to apply to designating multiple hedged layers.

BC13. To reflect the expansion of the last-of-layer method to permit an entity to designate multiple hedged layers, the Board renamed the last-of-layer method the portfolio layer method. That change is reflected throughout Topic 815. The Board concluded that the portfolio layer method more aptly describes the strategies that qualify for hedge accounting under the amendments in this Update because the amount hedged in a given layer need not be the last layer in the closed portfolio if multiple hedged layers are designated. In feedback received on the proposed Update, stakeholders broadly supported expanding the portfolio layer method to allow an entity to designate multiple hedged layers of a single closed portfolio.

The Aggregation of Hedged Items Associated with a Single Closed Portfolio

BC14. To designate a hedge under the last-of-layer method under current GAAP, an entity must apply the partial-term hedging guidance such that all assets have the same assumed maturity date. An entity also must support its expectation on a quarterly basis that the hedged layer is not expected to be affected by prepayments, defaults, or other factors affecting the timing and amount of cash flows.

BC15. The Board decided to retain but refine those core concepts of the single hedged layer when expanding to multiple hedged layers because it concluded that those concepts continue to align with an entity's risk management objectives if multiple hedged layers of a closed portfolio are designated. As a result, if an entity designates multiple hedged layers of a closed portfolio, the entity is required to apply the partial-term hedging guidance or full-term hedging guidance if assets in the closed portfolio will mature on the date that the designated hedge period ends. In either case, the amount hedged is subject to the benchmark interest rate risk for the same period. In addition, the entity should support its expectation that all hedged amounts in aggregate are anticipated to be outstanding for the designated hedge periods. For example, if an entity designates 2 spot-starting swaps, one in a hedging relationship with a hedged layer of $20 million and another in a hedging relationship with a hedged layer of $10 million that overlap during Years 1–3, the entity should support its expectation that the aggregate amount of at least $30 million is anticipated to be outstanding for the period during which the 2 hedges overlap.

Eligible Derivative Hedging Instruments

BC16. The Board decided that an entity should have the flexibility to apply hedge accounting for hedging strategies that economically accomplish the same objective using the derivatives and layering techniques that best align with their individual circumstances. Consequently, for the purposes of qualifying for hedge accounting, the amendments in this Update do not restrict an entity from using any particular types of derivatives to achieve its risk management objectives if it designates multiple hedged layers. For example, an entity may use multiple spot-starting constant-notional swaps with different term lengths, a combination of spot-starting and forward-starting constant-notional swaps, multiple spot-starting or forward-starting amortizing-notional swaps, or any combination of those derivatives to hedge different amounts of the closed portfolio and qualify for hedge accounting. Comment letter respondents supported that flexibility. Consistent with current GAAP, an entity should perform the similar-asset assessment for each individual hedge designated.

BC17. With respect to the types of hedging instruments eligible to be designated in a portfolio layer method hedge, stakeholders asked whether using an amortizing-notional swap should be considered one hedging relationship or multiple hedging relationships. The amendments in this Update specify that an entity that designates an amortizing-notional swap as a hedging instrument is designating a single hedging relationship with a single benchmark rate component of the contractual coupon cash flows. The Board observes that because an entity is not permitted to designate different partial terms of a derivative instrument in different hedging relationships, an amortizing-notional swap cannot be split into a series of individual hedges by swaplet (that is, the portion of the swap that corresponds to one swap payment). In addition, the single hedge conclusion is consistent with the example in paragraphs 815-20-55-173 through 55-178 in the Codification. The amendments also specify that an entity using an amortizing-notional swap as the hedging instrument may apply the qualitative similar-asset assessment.

Financial Instruments within the Scope

BC18. Current GAAP permits only prepayable financial assets and one or more beneficial interests secured by a portfolio of prepayable financial instruments to be included in a last-of-layer closed portfolio.

BC19. Comment letter respondents asked the Board to broaden the scope of financial instruments eligible for portfolio layer method hedging so that more instruments qualify for the method. Some respondents provided feedback that portfolios of nonprepayable financial assets may have uncertain cash flows for reasons other than prepayment risk, such as default risk. They noted that for both portfolios of nonprepayable assets and portfolios of financial liabilities, the challenges associated with achieving hedge accounting could be largely overcome by expanding last-of-layer hedging to those types of instruments.

BC20. With respect to liabilities, some stakeholders indicated that the prepayment risk that historically made it challenging to achieve hedge accounting for portfolios of prepayable financial assets similarly makes it challenging to achieve hedge accounting for portfolios of prepayable financial liabilities, such as securitized debt obligations and certificates of deposit (CD) with a feature that permits a beneficiary to put the instrument to the issuing financial institution upon the death of the original holder (referred to as a death put). Some preparers also observed that prepayment risk is akin to mortality, morbidity, and lapse risk found in insurance liabilities. In feedback on the proposed Update, those preparers supported broadening the scope of financial instruments eligible for portfolio layer method hedging to include insurance liabilities on the basis that the option to extinguish an insurance liability is often not controlled by the reporting entity in the same way that the option to prepay a financial asset, such as a residential mortgage, is often not controlled by the lender.

BC21. Considering that feedback in redeliberations, the Board decided to expand the scope to nonprepayable financial assets and to continue to exclude financial liabilities. The expanded scope permits an entity to apply the same portfolio hedging method to financial assets that qualify for fair value hedge accounting, thereby allowing consistent accounting for similar hedges. The Board concluded that allowing both prepayable and nonprepayable financial assets to qualify for the same hedge accounting method better reflects risk management activities in financial statements because it allows assets that are managed for interest rate risk in the same way to qualify for the same accounting, reducing complexity for users of financial statements. The Board decided not to expand the scope of the current project to financial liabilities to keep the project narrow, mitigate potential unintended consequences, and facilitate a timely issuance of a final Update.

Composition of the Closed Portfolio If Multiple Hedged Layers Are Designated

BC22. The amendments in the proposed Update indicated that if multiple hedged layers are designated, all assets in the closed portfolio would have to be prepayable by the end of the latest-ending hedge period, which would have required that all assets be or become prepayable during the period that the closed portfolio has a hedged layer. Because the Board decided in redeliberations to expand the scope of portfolio layer method hedging to nonprepayable financial assets, that requirement no longer applies.

BC23. The Board also decided in initial deliberations leading to the proposed Update that all assets would have to have a contractual maturity date on or after the end of the earliest-ending hedge period but may have a contractual maturity date before the end of the latest-ending hedge period. The Board decided to allow flexibility for assets with different maturity profiles to be combined and hedged in a single closed portfolio to reduce the need to construct separate closed portfolios and designate more hedging relationships to achieve the same accounting outcome that could be achieved with fewer closed portfolios and hedging relationships. In doing so, the Board rejected the alternative that would have required that all assets included in the closed portfolio have a contractual maturity profile such that they could support all hedged layers associated with the closed portfolio.

BC24. Some comment letter respondents questioned whether a contractual maturity requirement was necessary. Those respondents highlighted that the partial-term hedging requirement accomplishes the objective of ensuring that the hedged amount can be anticipated to be outstanding for the designated hedge period. In addition, they indicated that because the contractual maturity requirement would be based on hedges designated on the date that the closed portfolio is established, that requirement could restrict assets eligible to be included in the closed portfolio to a specific maturity profile based on those hedges. Those respondents expressed that because hedges on a closed portfolio may change over time, limiting assets eligible to be included in the closed portfolio to hedges designated at any given point in time could be unnecessarily restrictive.

BC25. The Board agreed with those comment letter respondents and decided to remove the contractual maturity requirement in the final Update, relying instead on the partial-term hedge requirement to ensure that hedged layers can be supported by assets anticipated to be outstanding during the designated hedge period. The Board observes that assets included in the closed portfolio need not have the same coupon payment dates to apply the partial-term hedging guidance.

BC26. Because all assets included in the closed portfolio do not need to have a contractual maturity date after the latest-ending hedge period, an entity may use assets to support some but not all hedged layers as long as all hedged layers are sufficiently supported by the assets in the closed portfolio in the aggregate. The Board observes that an asset that matures on the same date as the end of a designated partial-term hedge period can support that hedged layer because assets supporting the hedged layer that are hedged for a partial term have the same assumed maturity date as an asset that matures on the date that the hedge period ends. An asset that matures before the end of a designated partial-term hedge period cannot support that hedged layer because that asset would not be subject to the same benchmark interest rate as assets hedged for a partial term. For example, the amendments in this Update allow assets with 5 years remaining until contractual maturity to support a hedged layer designated for Years 1–3, but not a hedged layer designated for Years 1–10; however, assets with 10 years remaining until contractual maturity could support either hedged layer. This is because a 5-year asset hedged for changes in the designated benchmark rate does not exhibit the interest rate risk profile of a 10-year asset hedged for changes in the designated benchmark rate, while a 10-year asset hedged for changes in the designated benchmark rate for a 5-year partial term exhibits the interest rate risk profile of a 5-year asset hedged for changes in the designated benchmark rate.

BC27. The Board observes that its decision to remove the contractual maturity requirement allows greater flexibility when initially establishing closed portfolios. That is, it allows an entity to include an asset in a closed portfolio that does not support any hedged layers at the time that the closed portfolio is established because all hedged layers have an assumed maturity date after the maturity date of the asset. This provides an entity with the flexibility to include assets in the closed portfolio that may not support any currently designated hedges but could support hedges designated in the future.

Dedesignation

BC28. During initial deliberations and redeliberations, the Board considered several dedesignation alternatives to best achieve its objective of balancing accountability and flexibility in the event of a breach. In initial deliberations, the Board considered, but rejected, an alternative that would have provided an entity with the option 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. That proposed guidance would have related only to breaches that had occurred, not to anticipated breaches. The Board decided against that alternative because of the complexity that would have resulted from the need to resequence if hedges associated with the closed portfolio changed over time (for example, if new hedges were added).

BC29. To avoid those complexities, the proposed Update would have required that an entity dedesignate hedges in accordance with a predefined sequence based on the time remaining until a hedged layer's assumed maturity date. That proposed requirement would have related only to breaches that had occurred, not to anticipated breaches. The Board made that decision to avoid introducing optionality in determining which hedge to dedesignate in the instance of a breach because that would allow an entity to potentially manage the earnings effect of the breach on the basis of which hedge it chooses to dedesignate.

BC30. In feedback received on the proposed Update, some preparers indicated that a preestablished dedesignation sequence specified in GAAP may not align with an entity's specific risk management objectives. In addition, some practitioners indicated that auditing different dedesignation models for breaches and anticipated breaches may be challenging. The Board decided to ease the potential inconsistency with risk management activities in redeliberations by allowing an entity to establish a dedesignation accounting policy. Furthermore, the Board decided to address some of the complexity in having disparate breach models by aligning the dedesignation requirements for all breaches with respect to the ability to partially dedesignate hedges and the requirement to apply the same dedesignation accounting policy.

BC31. The amendments in this Update allow an entity to fully or partially dedesignate any hedge associated with the closed portfolio at any time if a breach has not occurred and one is not anticipated. If a breach is anticipated, an entity is required to fully or partially dedesignate one or more hedges to reduce the aggregate hedged item to an amount anticipated to remain outstanding for the designated hedge period. If a breach has occurred, an entity is required to fully or partially dedesignate one or more hedges to reduce the aggregate hedged item to an amount that does not exceed the remaining amount of the closed portfolio outstanding. The Board concluded that an entity should be able to partially dedesignate hedges in both cases to avoid entities having to dedesignate more of a hedge than would be necessary to bring the closed portfolio as a whole back into compliance with the requirements of portfolio layer method hedging.

BC32. The Board concluded that an entity should establish an accounting policy in accordance with Topic 250, Accounting Changes and Error Corrections, to determine which hedges to dedesignate if multiple hedged layers are designated and there is a breach or an anticipated breach. That accounting policy should set forth a systematic and rational approach for determining which hedges to dedesignate. The Board concluded that the consistent application of a systematic and rational accounting policy should prevent an entity from selecting hedges to dedesignate to derive a particular financial reporting outcome in a given period. The Board observes that the guidance in paragraph 250-10-45-1 on a change in accounting principle is applicable to the adoption and modification of an entity's accounting policy for portfolio layer method dedesignations.

BC33. In addition, for each breach that has occurred, the Board concluded that an entity should disclose the amount of the basis adjustment that was recognized in current-period earnings (in interest income as discussed in paragraph BC44) and the circumstances that led to the breach. The new disclosure requirements provide financial statement users with transparent information necessary to understand the noncash, nonrecurring basis adjustment amount recognized in interest income each time there is a breach, as well as what caused the breach.

Hedge Basis Adjustment Issues

BC34. The Board's decisions related to basis adjustments apply to both a single hedged layer and multiple hedged layers.

Allocation to Individual Assets in an Existing Hedge

BC35. After the issuance of Update 2017-12, stakeholders indicated that the guidance on accounting for basis adjustments in an existing last-of-layer hedge (that is, a hedge that is currently designated) is unclear. Stakeholders highlighted that the amendments in Update 2017-12 do not provide guidance on the accounting treatment for basis adjustments during an existing last-of-layer hedge. However, paragraph BC121 of the basis for conclusions in Update 2017-12 states that an entity *need not allocate* basis adjustments in an existing last-of-layer method hedging relationship because those basis adjustments relate to the designated last of layer and not to the assets that make up the closed portfolio. Additionally, that paragraph states that allocating basis adjustments to assets sold from the closed portfolio would lead to noneconomic gains or losses on extinguishment because of hedge accounting adjustments that would have naturally reversed over the life of the hedging relationship. Stakeholders asked the Board to codify and further clarify the information contained in the basis for conclusions of Update 2017-12.

BC36. On the basis of that feedback, the Board decided to clarify in the proposed Update that an entity is prohibited from allocating basis adjustments associated with a closed portfolio during an existing portfolio layer method hedge either to the individual assets in the closed portfolio or to assets removed from the closed portfolio (for example, through prepayment, default, or voluntary sale or reclassification out of the closed portfolio) for the reasons discussed in paragraph BC35. The Board decided to affirm that decision in the amendments in this final Update. While some comment letter respondents supported entities having the option to allocate basis adjustments, the Board rejected that option because allocation may lead to uneconomic results if an asset is sold or otherwise removed from the closed portfolio. Additionally, an allocation election would lead to a lack of comparability across entities and a potential for earnings management. The Board acknowledges that its decision may require some systems changes for entities to maintain basis adjustments on a closed portfolio basis. However, the Board concluded that the conceptual merits of not allocating basis adjustments justify any potential implementation costs.

BC37. The Board decided to clarify in the final Update that if a closed portfolio includes available-for-sale debt securities and assets that are not available-for-sale debt securities, an entity is required to determine the portion of the change in the fair value of the hedged item attributable to the hedged risk associated with the available-for-sale debt securities using a systematic and rational method. That amount is then recognized in earnings each period, but it should not be used to adjust the carrying amount of the individual available-for-sale debt securities in the closed portfolio. Determining the portion of the change in the hedged layer's basis adjustment associated with available-for-sale debt securities is necessary to appropriately report other comprehensive income. However, because the basis adjustment associated with the available-for-sale debt securities does not adjust any individual security's carrying amount while the hedge remains designated, if a security is sold, then no amount of the hedged layer's basis adjustment would be used to determine the gain or loss on sale.

Interaction of Basis Adjustments with Credit Loss Guidance

BC38. Stakeholders asked about the interaction of the accounting for last-of-layer basis adjustments with the credit loss guidance. Topic 815 requires that a credit loss be considered *after* the basis of the hedged item has been adjusted for fair value hedge accounting. Additionally, the guidance in Topic 326, Financial Instruments—Credit Losses, requires that an entity's estimate of credit losses on the amortized cost basis of financial assets (which includes basis adjustments) include a measure of the expected risk of credit loss even if that risk is remote. Therefore, in theory, an entity should consider the expected risk of credit loss on a hedge basis adjustment in a last-of-layer hedge.

BC39. However, a critical assertion of the last-of-layer method is that prepayments, defaults, and other factors affecting the timing and amount of cash flows from the closed portfolio during the partial term hedged relate to assets that do not make up the hedged item. Therefore, in theory, the basis adjustment associated with the hedged item also should be free from those factors.

BC40. To eliminate that inconsistency, in the proposed Update the Board decided to prohibit an entity from considering basis adjustments on existing portfolio layer method hedges when measuring credit losses on the assets included in the closed portfolio. The Board concluded that the costs of calculating a credit loss that is likely to be immaterial on a portfolio layer method hedge basis adjustment do not justify the benefits. Comment letter respondents supported that decision, and the Board affirmed it in this final Update.

Portion of the Basis Adjustment Associated with a Breach

BC41. Stakeholders asked about the accounting treatment for the portion of the basis adjustment associated with the amount of the dedesignated layer that was breached because Update 2017-12 did not explicitly address that issue. Because the portion of the basis adjustment associated with a breach relates to an asset or assets (or portion thereof) no longer in the closed portfolio, stakeholders asked what approach they would need to apply to recognize and present that portion of the basis adjustment in earnings.

BC42. The proposed Update included guidance that would have required that the portion of the basis adjustment associated with the breached amount be accounted for consistent with the accounting for any premium or discount on the asset or assets (or portion thereof) that caused the breach (a “follow-the-asset” approach). For example, if the breach was caused by prepayments, the associated basis adjustment would be recognized immediately in interest income. If the breach was caused by defaults, the associated basis adjustment would be recognized in earnings as a credit loss similar to how other premiums or discounts would be recognized as a component of the amortized cost basis of an asset with credit deterioration. In other words, the income statement line-item presentation would be the same as if an entity had recorded an anticipated breach of the same hedges. The Board chose the follow-the-asset approach in initial deliberations because it believed that approach would be consistent with the current guidance on expected credit losses in Topic 326 and the guidance in Topic 815 on the accounting treatment for basis adjustments in dedesignated hedges.

BC43. In feedback received on the proposed Update, most stakeholders indicated that the follow-the-asset approach would be challenging and costly to operationalize because it would require incremental accounting processes and system updates. Those stakeholders also indicated that the follow-the-asset approach would not provide users of financial statements with decision-useful information because it focused on individual assets, which is inconsistent with the risk management objectives of applying the portfolio layer method.

BC44. On the basis of that feedback, the Board decided to simplify the accounting for the portion of the basis adjustment associated with a breach. The Board decided that the basis adjustment associated with a breached amount should be immediately recognized in interest income because recognizing the basis adjustment in a single line item promotes greater consistency and transparency about the effect of a breach on an entity's financial statements. The Board concluded that a single-line-item presentation approach provides users with the most visibility about situations in which an entity did not accurately anticipate factors that affected the timing and amount of the closed portfolio's cash flows such that the entity's strategy did not work as intended. That transparency is further achieved by the breach-specific disclosure requirements described in paragraph BC33. The Board also observes that an entity is permitted to disaggregate and separately present the change in the basis adjustment amount as a component of interest income in its income statement.

BC45. The Board also concluded that when it is complex to determine which specific assets caused the breach, basis adjustments generated by an interest rate risk hedging strategy should be recognized in interest income. The Board observes that purposefully causing a breach by selling assets would be inconsistent with an entity's assertion underlying the portfolio layer method (that it expects the hedged amount to be outstanding for the period hedge).

Disclosures outside of Hedge Accounting and Balance Sheet Presentation

BC46. Paragraph 815-10-50-5B states that an entity *may need to allocate* the last-of-layer basis adjustments to fulfill objectives of disclosure requirements in other Topics. Because of its decision to require that the basis adjustments be maintained on a closed portfolio level, in the proposed Update the Board decided to amend the guidance in paragraph 815-10-50-5B to prohibit an entity from allocating basis adjustments in nonhedging disclosures on a more disaggregated basis than the closed portfolio basis (after any disaggregation by balance sheet line item, if necessary). Instead, the Board decided that an entity should present those basis adjustments as a total amount in disclosures that require that the entity disaggregate the underlying assets in the closed portfolio. The Board observes that this guidance is similar to the election under Topic 326 to disclose accrued interest receivable separately from the associated financial assets. Comment letter respondents supported that decision, and the Board affirmed it in this final Update.

BC47. The Board's decision to prohibit an entity from allocating basis adjustments in nonhedging disclosures on a more disaggregated basis than the closed portfolio basis is not intended to affect the balance sheet presentation of basis adjustments. Because an entity is permitted to include assets presented in different balance sheet line items in one closed portfolio (for example, loans and available-for-sale debt securities), there could be circumstances in which a basis adjustment related to one closed portfolio must be assigned to different balance sheet line items for presentation purposes. Accordingly, the Board decided that a basis adjustment arising from a portfolio layer hedge must be presented in the balance sheet line item to which it relates. If an entity includes assets from different balance sheet line items in the same closed portfolio, it must assign portions of the portfolio layer method basis adjustment to the appropriate separate line-item captions on the face of the balance sheet. For an entity that includes loans and available-for-sale debt securities in the same closed portfolio, its determination of which portion of the hedge layer's basis adjustment to present in the loans line item and which portion to present in the available-for-sale debt securities line item should reflect the amounts assigned to the loans and available-for-sale debt securities for recognition in earnings.

Hedge Accounting Disclosures

BC48. The Board concluded that no new or amended disclosures are required to accompany the expansion of the last-of-layer method to multiple hedged layers apart from the breach-specific disclosures described in paragraph BC33 because the current last-of-layer method is not fundamentally changed when applied to multiple hedged layers except for the ability to dedesignate or partially dedesignate multiple hedges when there is a breach or anticipated breach. Comment letter respondents supported the Board's conclusion.

BC49. The amendments in Update 2017-12 require that an entity disclose information about cumulative basis adjustments for last-of-layer hedges each reporting period. Those disclosures allow financial statement users to isolate basis adjustments recorded on the balance sheet, which do not affect future cash flows. Although those disclosures were developed for a single hedged layer, the relevant information for disclosures has not changed if multiple hedged layers are designated, which is simply an extension of the existing last-of-layer method. Accordingly, the Board decided that an entity should provide the same portfolio layer method disclosures for both a single hedged and multiple hedged layers.

Effective Date and Transition

BC50. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. In response to feedback received on the proposed Update, the Board decided to permit early adoption on any date on or after the issuance of this Update for any entity that has adopted the amendments in Update 2017-12 for the corresponding period.

BC51. In the proposed Update, the Board separated entities into adoption buckets based on when they are required to adopt the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* Because the effective date of the amendments in Update 2016-13 is before the effective date of the amendments in this Update, the Board concluded that there would be no meaningful benefit to separating entities into buckets based on whether they had adopted the amendments in Update 2016-13.

BC52. The Board concluded that the implementation of the amendments in this Update will not require significant effort or result in significant operational cost because the clarifications related to accounting for basis adjustments are understood in current practice and the designation of multiple hedged layers is optional on a prospective basis. In addition, because the amendments do not fundamentally change the current last-of-layer method, the Board understands that preparers will be able to use existing systems and processes with minimal modifications. Accordingly, the Board concluded that the benefits of a shorter implementation period justify the costs.

BC53. The Board concluded that an entity should apply the amendments in this Update on designating multiple hedged layers prospectively as of the date of adoption because the entity may not designate multiple hedged layers under the amendments in Update 2017-12. Transition guidance in the proposed Update indicated that on or after the date of adoption, an entity may add one or more portfolio layer method hedges to a closed portfolio with a single hedged layer existing as of the date of adoption. Comment letter respondents asked why that transition provision would be needed if an entity is permitted to add new portfolio layer method hedges to an existing closed portfolio at any time, regardless of whether those new hedges are being added in transition or otherwise. In response to that feedback, the Board decided to remove that guidance from transition and, instead, include it in paragraph 815-20-25-12B to clarify that an entity may add new portfolio layer method hedges to an existing closed portfolio at any time without dedesignating existing hedges associated with that closed portfolio. That is, the Board intends for an entity to be able to add new hedges in transition to the amendments in this Update and at any time after adopting the amendments in this Update.

BC54. The Board concluded that an entity should apply the amendments in this Update on accounting for portfolio layer method hedge basis adjustments on a modified retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings and the balance sheet line items (as appropriate) as of the beginning of the fiscal year of adoption (that is, as of the date of initial application). The date of initial application is different from the date of adoption only if an entity adopts the amendments in an interim period. Because the amendments on basis adjustments are aligned with what the Board understands to be the most widely accepted interpretation of the last-of-layer guidance added by the amendments in Update 2017-12 and consistent with the basis for conclusions in that Update, the Board expects that most entities will make no adjustments under the modified retrospective application approach. For entities that did allocate basis adjustments to individual assets in the closed portfolio during a last-of-layer hedge, the Board concluded that a modified retrospective approach is the simplest method to adjust the financial statement effects of doing so. For example, if an entity considered a last-of-layer basis adjustment when determining credit losses before adopting the amendments in this Update and the effect was material, the entity would adjust its opening balance of retained earnings and the allowance for credit losses to remove the effect of those basis adjustments.

BC55. For the amendments in the proposed Update on disclosures, the Board decided that an entity should have the option to elect either prospective application as of the date of initial application or retrospective application to each period presented after the date of adoption of Update 2017-12. The Board supported that option because prospective application aligns with the modified retrospective application of the amendments on accounting for portfolio layer method hedge basis adjustments that does not affect prior fiscal years, while retrospective application allows an entity to maintain comparability between periods presented in its financial statements. The Board did not want to prohibit disclosure comparability between periods presented in an entity's financial statements for amounts that may have been accounted for consistently across those periods. Comment letter respondents supported the proposed optionality, and the Board affirmed it in this final Update.

Transferring Debt Securities from Held to Maturity to Available for Sale

BC56. Some preparers classify certain debt securities in the held-to-maturity category rather than the available-for-sale category because prepayment features make fair value hedge accounting difficult to obtain (for example, prepayment features embedded in the collateral for beneficial interests). In addition, an entity may have classified certain nonprepayable debt securities, such as municipal securities, as held to maturity before the adoption of the amendments in this Update because they are ineligible to be hedged under the last-of-layer method before the adoption of the amendments.

BC57. Because the amendments in this Update allow an entity to designate multiple hedged layers, the entity will be able to apply hedge accounting for hedges of a greater proportion of the interest rate risk inherent in beneficial interests and nonprepayable financial assets included in the closed portfolio. Consequently, some preparers requested transition relief to reclassify debt securities that qualify for the portfolio layer method from the held-to-maturity category to the available-for-sale category without calling into question an entity's assertion that it has the intent and ability to hold to maturity those debt securities that continue to be classified as held to maturity. The proposed Update included transition guidance that would have allowed for those reclassifications consistent with the transition guidance in Update 2017-12.

BC58. In redeliberations, the Board concluded that an entity may reclassify held-to-maturity debt securities only if it applies portfolio layer method hedging to the closed portfolio or portfolios that include those debt securities. An entity must reclassify those securities within 30 days after the date of adoption of the amendments in this Update. In addition, within that 30-day period, those securities must be included in one or more closed portfolios that are designated in a portfolio layer method hedge. That transition guidance is consistent with the Board's view that the option to reclassify debt securities should be associated with changing a hedge accounting methodology for debt securities.

Amendments to the GAAP Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). Those improvements, which will be incorporated into the proposed 2023 GAAP Taxonomy, are available through GAAP Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.