

Appendix A: Text of 60-day FRN describing revisions to the FFIEC 002 Instructions

4. “Last-of-Layer” Hedging

In ASU No. 2017-12, Derivatives and Hedging (Topic 815)-Targeted Improvements to Accounting for Hedging Activities, the FASB added the last-of-layer method to its hedge accounting standards to lessen the difficulties institutions encountered under existing accounting rules when seeking to enter into a fair value hedge of the interest rate risk of a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments. Typically, prepayable financial assets would be loans and AFS debt securities. Under ASU 2017-12, there are no limitations on the types of qualifying assets that could be grouped together in a last-of-layer hedge other than meeting the following two criteria: (1) They must be prepayable financial assets that have a contractual maturity date beyond the period being hedged and (2) they must be eligible for fair value hedge accounting of interest rate risk (for example, fixed-rate instruments). For example, fixed-rate residential mortgages, auto loans, and collateralized mortgage obligations could all be grouped and hedged together in a single last-of-layer closed portfolio. For a last-of-layer hedge, ASC paragraph 815-10-50-5B states that an institution may need to allocate the related fair value hedge basis adjustment (FVHBA) “to meet the objectives of disclosure requirements in other Topics.” This ASC paragraph then explains that the institution “may allocate the basis adjustment on an individual asset basis or on a portfolio basis using a systematic and rational method.” Due to the aggregation of assets in a last-of-layer closed portfolio, institutions may find it challenging to allocate the related FVHBA to the individual loan or AFS debt security level when necessary for financial reporting purposes.

In March 2018, the FASB added a project to its agenda to expand last-of-layer hedging to multiple layers, thereby providing more flexibility to entities when applying hedge accounting to a closed portfolio of prepayable assets. In connection with this project, the FASB anticipated that there would be diversity in practice if entities were required to allocate portfolio-level, last-of-layer FVHBAs to more granular levels, which in turn could potentially hamper data quality and comparability. In addition, the allocation would increase operational burden on institutions with little, if any, added value to risk management or to users of the financial statements. As such, for financial reporting purposes, the FASB Board has tentatively decided that it would require these FVHBAs to be presented as a reconciling item, *i.e.*, in the aggregate for loans and AFS debt securities, in disclosures required by other areas of GAAP.

FFIEC 002 Revisions

For regulatory reporting purposes, the agencies proposed similar treatment for last-of-layer FVHBAs on FFIEC 002 Schedule C, Part I, Loans, and Schedule RAL, Assets and Liabilities, Memorandum item 3.b, “Amortized cost of available-for-sale securities,” following the FASB’s adoption of a final last-of-layer hedge accounting standard. The instructions for Schedule C, Part I, item 10, “LESS: Any unearned income on loans reflected in items 1-8 above,” would be revised to explicitly state that last-of-layer FVHBAs associated with the loans reported in Schedule C, Part I, should be included in this item.

In addition, the agencies are proposing to revise the FFIEC 002 instructions to state that institutions should report amounts for last-of-layer FVHBAs applicable to available-for-sale debt securities in Schedule RAL, Memorandum item 3.b, “Amortized cost of available-for-sale securities.”