Appendix A: Text of 60-day FRN Describing New Hedging Item

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.

Call Report Revisions

For regulatory reporting purposes, the agencies proposed similar treatment for last-of-layer FVHBAs on Call Report Schedule RC-C, Part I, Loans and Leases, and Schedule RC-B, Securities. As such, following the FASB's adoption of a final last-of-layer hedge accounting standard, the instructions for Schedule RC-C, Part I, item 11, "LESS: Any unearned income on loans reflected in items 1-9 above," would be revised to explicitly state that last-of-layer FVHBAs associated with the loans reported in Schedule RC-C, Part I, should be included in this item.

In addition, the agencies are proposing on Schedule RC-B, Securities, to rename existing item 7, "Investments in mutual funds and other equity securities with readily determinable fair values," as "Unallocated last-of-layer fair value hedge basis adjustments." Institutions would report amounts for last-of-layer FVHBAs on AFS debt securities only in item 7, column C, "Available-for-sale: Amortized Cost." To note, only a small number of institutions that have not have yet adopted ASU 2016-01, which includes provisions governing the accounting for investments in equity securities, continue to report

Appendix A (continued)

amounts in item 7. Because all institutions are required to adopt ASU 2016-01 for Call Report purposes by the December 31, 2020, report date, the agencies had previously determined that existing item 7 in Schedule RC-B would no longer be applicable to institutions for reporting purposes and could be removed as of that report date. Thus, the need for a new item in Schedule RC-B for reporting unallocated FVHBAs applicable to AFS debt securities following the FASB's adoption of a final last-of-layer hedge accounting standard can be readily accommodated through the redesignation of existing item 7, column C, for this purpose.