

Technical Line

FASB – final guidance

A closer look at the FASB's amendments to its hedge accounting standard

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What you need to know

- ▶ The amendments to the FASB's hedge accounting guidance are intended to better reflect an entity's risk management activities in the financial statements.
- ▶ The amendments expand the hedged risks permitted to be hedged on a portfolio basis and increase the components eligible to be hedged in the forecasted purchase or sale of nonfinancial assets. They also eliminate the net written option test for certain interest rate hedges.
- ▶ In addition, the amendments simplify hedge accounting for choose-your-rate debt instruments and address application issues related to certain dual hedges.
- ▶ Because the amendments affect various hedging strategies, entities should evaluate which amendments apply to their hedging activities and determine whether changes to processes or controls are needed.
- ▶ The amendments are effective for public business entities for fiscal years beginning after 15 December 2026, and interim periods within those fiscal years. For all other entities, they are effective one year later. Early adoption is permitted.

Overview

The Financial Accounting Standards Board (FASB or the Board) issued **Accounting Standards Update** (ASU) 2025-09 amending Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*, to address issues related to implementing the hedge accounting guidance in



ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The amendments also address certain hedge accounting issues arising from reference rate reform.

The amendments address stakeholder feedback on the application of the guidance in ASU 2017-12 as well as input received through the Board's 2021 Invitation to Comment, *Agenda Consultation*. The amendments enhance or clarify the guidance in ASC 815 in the following five areas:

- Aggregating similar hedge risks in a group of forecasted transactions
- Hedging forecasted interest payments on choose-your-rate (CYR) debt instruments
- Hedging variable price components of nonfinancial forecasted transactions
- Using certain compound derivatives in interest rate hedges
- Accounting for dual hedge strategies

Consistent with the overarching objective of ASU 2017-12, the amendments are intended to more closely align hedge accounting with the economics of an entity's risk management activities and reduce unintuitive dedesignation events and instances of missed forecasted transactions for certain highly effective economic hedges. The Board believes this will result in more decision-useful information for financial statement users about an entity's risk management activities.

Background

The Board issued ASU 2017-12 to better align hedge accounting with an entity's risk management activities and simplify the application of the guidance. After the ASU's issuance in 2017, stakeholders identified areas that needed clarification, and the Board issued a proposed ASU in 2019 that was intended to address that feedback. However, numerous stakeholders said the proposal did not sufficiently resolve certain of their concerns.

In response to the 2021 Invitation to Comment, *Agenda Consultation*, stakeholders reiterated some concerns and requested that the Board address certain hedge accounting issues arising from the cessation of the London Interbank Offered Rate (LIBOR). After considering this feedback, the Board decided to clarify certain aspects of ASU 2017-12 and address additional issues arising from reference rate reform through the amendments discussed in this publication.

Key considerations

Issue 1 – Similar risk assessment for cash flow hedges of a group of forecasted transactions

The amendments expand the hedged risks that may be aggregated in a group of individual forecasted transactions in a single cash flow hedging relationship by allowing transactions with similar, rather than shared, risk exposures to be hedged together. The amendments also provide two methods for assessing whether hedged risks are similar:

- Assess whether the designated hedging instrument is highly effective in offsetting cash flow changes attributable to each individual hedged risk in the group (referred to as Method A in this publication)
- Assess whether each discrete hedged risk in the group is similar to every other hedged risk in the group using the same threshold applied to determine whether a hedge relationship is highly effective (referred to as Method B in this publication)

Permitting transactions with similar rather than shared risk exposures to be hedged as a group is intended to better reflect how entities manage risk; however, similarity needs to be reassessed on an ongoing basis.

Method A serves as a dual-purpose assessment because the same analysis is used to satisfy both the hedge effectiveness requirement and the similar risk requirement. The Board concluded that if a hedging instrument is highly effective against all hedged risks in the group, then each risk is sufficiently similar to every other risk in the group to be eligible to apply hedge accounting as a group. In addition, the Board noted that a dual-purpose assessment would reduce the cost and complexity of applying hedge accounting to a group of forecasted transactions.

Entities that do not elect to use Method A would use Method B, under which they assess whether each risk in the group is similar to every other risk in the group. Such an assessment is performed separately from the entity's assessment of hedge effectiveness since it does not consider the hedging instrument used. However, the guidance clarifies that the threshold used to determine whether the risks are similar should be consistent with the threshold applied to determine whether a relationship is highly effective (e.g., a dollar offset ratio of 80% to 125%).

At hedge inception, entities are required to document which method they will use to assess if hedged risks are similar and apply that method consistently to similar hedging relationships. Use of a different method for similar hedges should be justified. The conclusion about whether individual forecasted transactions in a group have similar risk exposures may differ depending on the method applied.

The following illustration shows how the amendments related to Issue 1 are applied.

Illustration 1 – Cash flow hedge of a group of variable-rate loans¹

Entity A issues loans to its customers that reference different interest rate indices, with interest payments for some loans indexed to 30-day Average SOFR, while others reference 1-month Term SOFR or the 30-day Average Effective Federal Funds Rate (EFFR).

Entity A determines it will have at least \$100 million of variable-rate loans outstanding indexed to any combination of 30-day Average SOFR, 1-month Term SOFR and 30-day Average EFFR throughout the next three years.

The entity executes a three-year, receive-fixed, pay-variable (30-day Average SOFR) interest rate swap with a \$100 million notional amount and coupons that settle at the end of each calendar month. The interest rate swap has a fair value of \$0 at inception.

Analysis

To hedge the interest payments on the loans based on 30-Day Average SOFR, 1-month Term SOFR and 30-day Average EFFR in a single hedging relationship, Entity A needs to demonstrate that all the loans have similar risk exposures using either Method A or Method B described above.

If Entity A elects Method A, it will need to demonstrate that the hedging instrument indexed to 30-day Average SOFR is highly effective in offsetting cash flow changes attributable to each hedged risk in the group (i.e., 30-day Average SOFR, 1-month Term SOFR and 30-day Average EFFR). In using Method A, Entity A performs a dual-purpose analysis that addresses both the similar risk and hedge effectiveness requirements. When performing this analysis, Entity A would consider differences between the individual forecasted transactions in the group and the contractual terms of the hedging instrument, including interest rates, payment dates, reset dates and interest rate floors (if any).

If Entity A elects Method B, it will need to demonstrate that each discrete hedged risk in the group (i.e., 30-day Average SOFR, 1-month Term SOFR and 30-day Average EFR) is similar to every other hedged risk in the group using the same threshold applied to determine whether a hedge relationship is highly effective. When performing this assessment, Entity A would consider differences between the respective hedged risk of the individual forecasted transactions in the group, including interest rates, reset dates and interest rate floors (if any). However, because Method B does not compare the hedged risk against the hedging instrument, Entity A would need to perform a separate hedge effectiveness test.

Entity A needs to document at hedge inception which method it elected to perform the similar risk assessment.

Question 1

In the illustration above, if all the loans issued by Entity A were indexed to a single interest rate index (e.g., 30-day Average SOFR), would the entity still need to perform a similar risk assessment?

Yes. As illustrated by Case A in Example 4: Variable Interest Payments on a Group of Variable-Rate, Interest-Bearing Loans as Hedged Item (ASC 815-20-55-91 thru 55-96A), a similar risk assessment would still be required because the forecasted interest payments being hedged represent a group of individual transactions as described in ASC 815-20-55-22(c). Accordingly, the entity would need to perform a similar risk assessment to designate them in a single hedge relationship. However, if the entity selects Method A to assess similar risks, it may use this same analysis to assess hedge effectiveness. As discussed in ASC 815-20-55-96A, this assessment would consider any differences in payment dates, reset dates and interest rate floors (if any).

How we see it

While the amendments clarify and expand the ability to aggregate similar hedge risks in a group of forecasted transactions, entities may continue to find it challenging to hedge loans with different payment frequencies (e.g., loans that pay interest coupons monthly, loans that pay interest coupons quarterly) in a single hedging relationship because of the mismatch in the size of the cash flows being hedged and the coupons on the hedging instrument.

For example, assume Bank A has \$100 million of 1-month Term SOFR loans and \$100 million of 3-month Term SOFR loans outstanding, all with five-year maturities. Because the loans were originated throughout the current year, Bank A receives interest payments each month on both groups of loans. Bank A enters into a five-year receive fixed, pay 1-month Term SOFR swap with a \$200 million notional amount that resets and settles monthly. Bank A proposes designating the swap as hedging the variability in the first monthly interest receipts from either 1-month or 3-month Term SOFR loans with principal totaling \$200 million.

In this example, Bank A will receive coupons monthly on the 1-month Term SOFR loans and on certain 3-month Term SOFR loans related to the \$200 million in outstanding loans (e.g., coupons on 3-month Term loans issued throughout July will be received throughout October, while coupons on similar loans issued throughout August will be received throughout November). Although the coupons on the interest rate swap are also settled monthly, the 3-month Term SOFR coupons cover three months of interest and therefore will significantly exceed the offsetting monthly swap receipts based on 1-month Term SOFR. As a result, this hedge may not pass the hedge effectiveness assessment.

One potential solution that was discussed with the FASB to address this issue was to change the cash flow model to focus on hedging forecasted accruals instead of forecasted cash flows. However, we understand that the Board did not make this change because it was considered beyond the scope of ASU 2025-09.

The similar risk assessment is required at hedge inception (prospectively) and on an ongoing basis (both prospectively and retrospectively).

An entity that applies a qualitative method, such as the critical terms match method, to assess effectiveness at hedge inception may also assume the hedged risks are similar under Method A because the hedging instrument is considered highly effective qualitatively against each hedged risk in the group.

An entity that performs its initial similar risk assessment on a qualitative basis may subsequently assess similarity qualitatively if it can reasonably support an expectation that the risk exposures in the group remain similar, consistent with ASC 815-20-35-2A through 35-2F.

An entity that determines, as part of its ongoing similar risk assessment, that one or more hedged risks in the group of individual forecasted transactions are no longer similar is required to dedesignate the entire hedging relationship as of the last date on which the similar risk criterion was met (unless it can determine the specific date when all hedged risks in the group were no longer similar). Any amounts previously recognized in accumulated other comprehensive income (AOCI) would remain in AOCI until the forecasted transactions affect earnings or become probable of not occurring. (i.e., the determination that hedged risks are no longer similar does not, in and of itself, result in a missed forecast).

How we see it

Certain stakeholders asked the Board to allow hedge accounting to continue when one or more designated hedge risks became dissimilar, provided that the forecasted transactions with risks that remained similar were sufficient to support the hedging relationship.

The Board decided against this approach, noting it could introduce hindsight into identifying the hedged transactions and that it would be conceptually inconsistent to permit existing hedges with dissimilar risks to continue uninterrupted while prohibiting new hedges of those same risks.

Question 2

Do the amendments on hedging a group of forecasted transactions in a single hedging relationship apply only to cash flow hedges of interest rate risk?

No. The amendments in Issue 1 apply to any cash flow hedge where the hedged item is designated as a group of individual forecasted transactions.

In paragraph BC 31 of the Background Information and Basis for Conclusions of the ASU, the Board noted that although this issue was initially raised in the context of hedging interest rate risk for a pool of variable-rate loans, the similar risk guidance would also apply to commodity price risk hedges designated on a pool basis. Similarly, the guidance may also be relevant for cash flow hedges of foreign exchange risk.

Application of similar risk assessment for hedges of not-yet-existing contracts

Entities may use derivatives to hedge cash flow variability associated with forecasted purchases and sales of nonfinancial assets, as well as forecasted purchases or issuances of financial assets and liabilities, before entering into the related purchase or sales/issuance contracts. These arrangements, commonly referred to as hedges of not-yet-existing contracts, may require a similar risk assessment to be performed if the entity is seeking to hedge a group of forecasted transactions in a single hedging relationship.

This concept is illustrated by Example 27² in ASU 2025-09 where Entity Y is seeking to hedge the variability in cash flows attributable to changes in the explicitly referenced component or components in not-yet-existing contracts to purchase 1,000 bushels of soybeans under a single hedge relationship.

On 1/1/20X1, Entity Y begins negotiations with multiple vendors to purchase 1,000 bushels of soybeans on 6/30/20X2. As of 4/1/20X1, the counterparties have not agreed on whether the pricing formula of the contracts will price the soybeans based on the ABC Soybean index or the DEF Soybean index. However, as of 4/1/20X1, Entity Y concludes it is probable that 1,000 bushels of soybeans will be purchased on 6/30/20X2 and that the pricing formula in the contracts will reference some combination of the ABC Soybean index and the DEF Soybean index. On that date, Entity Y enters into a futures contract for 1,000 bushels of ABC Soybeans maturing on 6/30/20X2.

Given the uncertainty of whether the pricing formulas of not-yet-existing contracts will reference the ABC Soybean index or the DEF Soybean index, Entity Y designates both indexes as the hedged risks in the cash flow hedge. Entity Y determines that both the ABC Soybean index and DEF Soybean index are components eligible to be hedged in accordance with the revised guidance in ASC 815-20-25-22C (see Issue 2 below for discussion on the revised guidance for hedging variable price components associated with the forecasted purchase or sale of nonfinancial assets).

In addition, Entity Y expects that the forecasted transactions will have multiple risks occurring at the same time (i.e., certain purchase agreements will reference the ABC Soybean index, and others will reference the DEF Soybean index) but is uncertain what combination of the ABC Soybean index and the DEF Soybean index will be explicitly referenced in the pricing formulas in the contracts. Given the uncertainty over the amount of purchased soybeans that will be based on each index, Entity Y seeks to hedge the entire expected purchase of 1,000 bushels in a single hedging relationship to limit the risk of a hedge accounting shortfall.

Because Entity Y expects that the individual hedged forecasted transactions in the group will have multiple risks occurring at the same time, it is required to perform a similar risk assessment. Entity Y uses Method A to conclude that the two indices are similar and that the hedge is expected to be highly effective by determining that the hedging instrument (ABC Soybean futures contract) is highly effective in achieving offsetting changes in cash flows attributable to each hedged risk in the group, on an individual basis.

How we see it

While Example 27 addresses a forecasted purchase of a nonfinancial asset, the Board observed in paragraph BC87 of the Basis for Conclusions that a similar risk assessment would be required in comparable hedges of not-yet-existing financial contracts when an entity expects that the hedged forecasted transactions will result in cash flows from multiple risks occurring at the same time. For example, a similar risk assessment would be required for a cash flow hedge of interest payments associated with the forecasted issuance of debt with different tenors (e.g., 10-year and 15-year fixed-rate debt) in a single hedging relationship.

Because the example does not explicitly address situations in which the hedged cash flows will stem from a single risk, but there is uncertainty about what that risk will be, some stakeholders questioned whether the amended guidance conflicts with the existing example in ASC 815-30-55-94 through 55-99 (Example 16: *Impact on Accumulated Other Comprehensive Income of Issuing Debt with a Term That Is Shorter Than Originally Forecasted*). In that example an entity assesses effectiveness based on its best estimate of the tenor of debt that will be issued while retaining the flexibility to issue debt with a different tenor without experiencing a missed forecast.

As the Board observed in paragraph BC87, the fact pattern in Example 16 was not explicitly addressed by the amended guidance. Accordingly, we believe the guidance in this example continues to apply to hedges of interest payments related to the forecasted issuance of debt where there is some uncertainty about the tenor that will be ultimately issued, provided the hedged interest payments will ultimately occur based on a single tenor (i.e., the hedge will not result in cash flows from multiple risks occurring at the same time).

However, the concept of assessing hedge effectiveness based on the entity's best estimate of the hedge risk contemplated in Example 16 should not be applied to other fact patterns when there is uncertainty about which component will ultimately be referenced.

Transition

The amendments are applied prospectively to hedges designated on or after the adoption date. However, the transition guidance related to Issue 1 allows entities to modify certain aspects of cash flow hedges of a group of forecasted transactions without dedesignating the relationship. For hedging relationships existing as of the date of adoption, an entity may elect any of the following options:

- 1) The entity may modify the method for assessing similar risk to a method described in ASC 815-20-55-23A (i.e., Method A and Method B discussed above). If the entity was already applying one of these methods, it may change to the other method upon adoption. An entity that elects to apply Method A may also choose to change its method of assessing hedge effectiveness to leverage the similar risk assessment in determining whether the hedging relationship is highly effective. In this case, the entity is not required to consider the guidance in ASC 815-20-25-81³ when comparing hedging relationships entered into before and after adoption.
- 2) The entity may modify the hedging relationship to add an additional hedged risk or risks to an existing portfolio if the hedging relationship continues to meet all other requirements to apply cash flow hedge accounting.
- 3) The entity may migrate some or all of the individual forecasted transactions from one existing pool or pools to a new pool or pools, an existing pool or pools, or a combination of new and existing pools.
- 4) The entity may reassign and reorder existing hedging instruments to a new or existing pool.
- 5) For hedges that were discontinued before adoption where amounts are still reported in AOCI as of the adoption date, entities may migrate the individual forecasted transactions to align with the pools of existing hedges considering the migration described in item 3 above.

Gains or losses on hedging instruments that are reported in AOCI at the adoption date are required to be reassigned using a systematic and rational manner to align with the pool or pools after the migrations, reassignments and reorderings described above. These amounts would be reclassified to earnings when the hedged forecasted transaction affects earnings in accordance with ASC 815-30-35-38 through 35-41.

If adopting the Issue 1 amendments results in a change to the designated hedged risk, the terms of the instrument used to estimate the change in the value of that risk (e.g., the hypothetical derivative) in the assessment of similar hedged risk and hedge effectiveness should be based on market data as of the inception of the hedging relationship.

In addition, an entity would update its hedge documentation as necessary upon applying the transition guidance to existing and discontinued hedging relationships, including documentation of critical terms, the hedged forecasted transactions, hedge effectiveness assessments and similar risk assessments.

Issue 2 – Hedging forecasted interest payments on CYR debt instruments

CYR debt, also referred to as “you-pick-‘em” debt, refers to variable-rate debt instruments that permit the borrower to change the interest rate index or tenor used to accrue interest from a list of rates and tenors specified in the contractual terms of the debt.

The amendments provide an optional simplified model for applying cash flow hedge accounting to hedges of forecasted interest payments on CYR debt instruments. Entities may apply the model to hedges of forecasted interest payments on existing CYR debt, forecasted issuances of CYR debt and subsequent replacements of CYR debt, on a hedge-by-hedge basis. However, the requirements and application of the model differ between hedges of interest payments on a forecasted issuance of CYR debt and hedges of forecasted interest payments on CYR debt that exists at hedge inception.

If elected, the guidance permits an entity to subsequently select an alternative interest rate index or tenor included in the CYR debt’s contractual terms without automatically dedesignating the hedging relationship, provided certain criteria are met. Entities are not permitted to apply this guidance by analogy to other circumstances.

The simplified model applies only to cash flow hedges of individual debt instruments. It cannot be applied to hedges designated under the first-payments-received technique or to hedges of CYR debt instruments classified as assets (i.e., CYR loans from the perspective of the lending institution).

How we see it

While the amendments provide a simplified model for applying hedge accounting to CYR debt and address the diversity in practice for this common hedging strategy, they eliminate the broader change-in-hedge-risk guidance introduced by ASU 2017-12 in ASC 815-30-35-37A and 815-20-55-56.

When deciding to narrow the change-in-hedged-risk guidance, the Board noted that other amendments in ASU 2025-09 address the risk of missed forecasts for certain types of hedges, thereby reducing the need for a broader solution.

The guidance on applying the simplified model to (1) existing CYR debt and the replacement of this debt and (2) the forecasted issuances of CYR debt is discussed below.

Existing CYR debt

An entity may apply the simplified model to hedges of forecasted interest payments on existing CYR debt (and eligible replacements) provided (1) the entity is hedging the cash flow variability attributable to changes in a contractually specified interest rate and (2) the hedged interest payments have begun to accrue.

In a cash flow hedge of the forecasted interest payments on existing CYR debt, an entity designates the currently selected interest rate index and tenor as the contractually specified interest rate being hedged. However, the entity is also required to (1) document all the interest rate indexes and tenors included in the existing CYR debt instrument and (2) assert that it is probable the forecasted interest payments on the existing CYR debt will occur based on one of those documented interest rate indexes and tenors during the hedge period.

When assessing hedge effectiveness, an entity would consider only the possible changes in cash flows of the forecasted transaction attributable to the currently selected interest rate index and tenor over the entire hedge period. The entity does not consider any possible interest rate index or tenor selections that it may make in the future.

Over the life of the hedge, the entity may change the contractually specified interest rate (altering the number and timing of the hedged forecasted interest payments within the hedge period) to an alternative interest rate index or tenor included in the CYR debt agreement without discontinuing hedge accounting. Upon making this change, the entity is required to (1) perform a final retrospective effectiveness assessment based on changes in cash flows attributable to the previously selected interest rate for the last period in which interest accrued at that rate and (2) prospectively assess hedge effectiveness based on changes in cash flows attributable to the newly selected contractually specified interest rate in the period in which interest begins accruing at that newly selected interest rate.

If the entity concludes based on this final retrospective assessment that the hedging relationship was not highly effective, it cannot apply hedge accounting for that period, and any changes in fair value of the hedging instrument for that period are recognized in earnings. However, the hedging relationship may continue if there is an expectation that it will be highly effective in future periods.

In performing its prospective assessment based on the newly selected rate, the entity assumes the newly selected rate was in effect from hedge inception and will remain in effect for the remaining hedge period. That is, the entity develops the terms of the hypothetical derivative using the market data as of hedge inception and also assumes that the newly selected rate was the designated rate for the entire hedge period.

Illustration 2- Hedging existing choose-your-rate debt⁴

On 1 January 20X1, Entity A issues a \$20 million, 5-year CYR note payable. The following interest rate indexes and tenors are included in the CYR note payable:

- a. 1-month Term SOFR (paid every 30 days)
- b. 3-month Term SOFR (paid every 90 days)
- c. 6-month Term SOFR (paid every 6 months)
- d. Prime (paid every 30 days)

Entity A selects 1-month Term SOFR as the rate at which interest on the note will accrue. In addition, because Entity A seeks to hedge the cash flow variability attributable to changes in the contractually specified interest rate on this CYR note payable, it enters into a five-year interest rate swap with a notional amount of \$20 million under which it will receive periodic payments based on the average daily SOFR over the last 30 days and make periodic payments at a fixed rate of 5%, with settlement and rate reset dates at the end of every calendar month. The fair value of the swap is zero at inception.

On 1 January 20X1, Entity A designates the swap as hedging the variability in cash flows attributable to changes in the contractually specified interest rate on the 5-year, \$20 million CYR note payable, and any related replacement debt thereof. On that date, Entity A documents in its hedge documentation the interest rate indexes and tenors included in the CYR note payable as listed above.

At hedge inception, Entity A performs a prospective hedge effectiveness assessment based on 1-month Term SOFR (i.e., the rate at which the debt currently accrues). In accordance with the simplified model, this assessment considers only the currently selected rate and does not consider other index or tenor options included in the CYR note payable that could be selected in the future.

The discussion below highlights the application of the simplified model under several different scenarios:

► **Scenario A – Entity A chooses another contractual rate included in the CYR note payable and passes the final retrospective and prospective hedge effectiveness assessments**

On 1 January 20X4, Entity A changes the interest rate upon which interest will accrue from 1-month Term SOFR (payable every 30 days) to 3-month Term SOFR (payable every 90 days). Under the simplified model, the contractually specified interest rate in the hedging relationship automatically changes to 3-month Term SOFR. The resulting change in the number and frequency of hedged interest payments does not result in mandatory hedge dedesignation.

Entity A performs a final retrospective assessment of hedge effectiveness based on changes in cash flows attributable to 1-month Term SOFR interest payments, assuming that the contractually specified interest rate will not change. Entity A concludes the hedging relationship was highly effective through 1 January 20X4.

Entity A then performs a prospective effectiveness assessment based on changes in cash flows attributable to 3-month Term SOFR. For this assessment, it develops the hypothetical derivative instrument using market data as of 1 January 20X1 (hedge inception) and the assumption that the 3-month Term SOFR was and will continue to be the contractually specified interest rate designated in the hedging relationship. Entity A concludes the revised hedging relationship is expected to remain highly effective on a prospective basis and continues to apply hedge accounting.

► **Scenario B – Entity A chooses another contractual rate included in the CYR debt agreement and passes the final retrospective assessment of hedge effectiveness but fails the prospective assessment**

On 1 January 20X4, Entity A changes the interest rate on the CYR note payable from 1-month Term SOFR (payable every 30 days) to Prime (payable every 30 days). Under the simplified model, the contractually specified interest rate in the hedging relationship automatically changes to Prime.

Entity A performs the final retrospective assessment of hedge effectiveness as in Scenario A and concludes the hedging relationship was highly effective through 1 January 20X4. Entity A then performs a prospective effectiveness assessment in the same manner as described in Scenario A, except that the contractually specified interest rate is now Prime. Entity A concludes that the revised hedging relationship is not expected to be highly effective at offsetting cash flows attributable to changes in Prime on a prospective basis. As a result, Entity A discontinues hedge accounting. The previously recognized gain or loss on the hedging instrument remains in AOCI until the forecasted interest payments affect earnings or until it becomes probable that the forecasted interest payments will not occur.

- ▶ **Scenario C – Entity A chooses another contractual rate included in the CYR debt agreement and fails the final retrospective assessment of hedge effectiveness but passes the prospective assessment**

On 1 January 20X4, Entity A changes the interest rate on the CYR note payable from 1-Month Term SOFR (payable every 30 days) to 6-Month Term SOFR (payable every 6 months). Under the simplified model the contractually specified interest rate in the hedging relationship automatically changes to 6-Month Term SOFR. The resulting change in the number and frequency of hedged interest payments does not result in mandatory hedge dedesignation.

Entity A performs the final retrospective assessment as in Scenario A and concludes the hedging relationship was not highly effective for the period ending 1 January 20X4. Therefore, Entity A does not apply hedge accounting for this period and recognizes the changes in fair value of the hedging instrument during the period in earnings. Entity A then performs a prospective effectiveness assessment as in Scenario A, except that the contractually specified interest rate is now 6-month Term SOFR (6-month reset). Entity A concludes that the revised hedging relationship is expected to be highly effective at offsetting cash flows attributable to changes in 6-month Term SOFR on a prospective basis. As a result, Entity A continues to apply hedge accounting prospectively.

- ▶ **Scenario D – Entity A chooses another contractual rate included in the CYR debt agreement but fails both the final retrospective assessment and the prospective hedge effectiveness assessments**

As in Scenario C, on 1 January 20X4, Entity A changes the interest rate on the CYR note payable from 1-month Term SOFR (payable every 30 days) to 6-month Term SOFR (payable every six months).

Entity A performs the final retrospective hedge effectiveness assessment in the same manner as in Scenario A and concludes that the hedging relationship was not highly effective for the period ending 1 January 20X4. Therefore, Entity A does not apply hedge accounting for this period and recognizes changes in fair value of the hedging instrument during the period in earnings.

Entity A then performs a prospective effectiveness assessment with the 6-month Term SOFR as the contractually specified interest rate and concludes that the revised hedging relationship is not highly effective at offsetting cash flows attributable to changes in the 6-month Term SOFR on a prospective basis. As a result, Entity A discontinues hedge accounting. Consistent with Scenario B, the previously recognized gain or loss on the hedging instrument remains in AOCI until the forecasted interest payments affect earnings or until it becomes probable the forecasted interest payments will not occur.

Question 3

Can an entity apply the simplified model to a partial term hedge of existing CYR debt?

It depends. To apply the simplified model to an existing CYR debt instrument, ASC 815-30-35-37B(b)(1) requires that “the forecasted interest payments designated as being hedged have begun to accrue.”

For example, in Illustration 2 above, if the entity wants to execute a partial term hedge of the interest payments in years one through three based on the then-selected interest rate of 1-month Term SOFR, it may apply the simplified model because the forecasted interest payments being hedged have begun to accrue.

However, the entity could not apply the simplified model to a partial term hedge of the interest payments in years three through five, because those interest payments have not begun to accrue.

Question 4

Can an entity use a qualitative assessment to perform hedge effectiveness under the CYR model?

It depends. For the initial hedge effectiveness assessment, an entity may use a qualitative assessment method if it qualifies for one of the exceptions in ASC 815-20-25-3(b)(2)(iv)(01). However, if the entity later selects an alternative interest rate index or tenor in the CYR debt, that rate would no longer match the swap's variable leg, and therefore, the qualitative method used at hedge inception (e.g., critical terms match method) would no longer be applicable. As such, entities should also document an appropriate quantitative method to apply in accordance with ASC 815-20-25-3(b)(2)(iv)(03) if a subsequent rate selection causes the hedge effectiveness to no longer qualify for the qualitative method.

Hedge accounting can continue when CYR debt is replaced, if the replacement debt accrues interest at an interest rate index and tenor documented in the original hedging relationship.

Replacements of existing CYR debt

An entity can hedge forecasted interest payments on a debt instrument that replaces existing CYR debt without dedesignating the hedging relationship, provided (1) the notional amount of the replacement debt is equal to or greater than the amount of the principal hedged under the original CYR debt instrument and (2) the contractually specified interest rate at which interest accrues on the replacement debt was originally documented in the existing CYR debt hedging relationship. The interest rate indexes and tenors previously documented for the original CYR debt when the hedging relationship was initially designated remain the eligible hedged risks throughout the hedge period.

To hedge replacement debt, an entity designates the forecasted interest payments to include debt that is expected to replace the existing CYR debt. This designation is made at the inception of the original hedge of existing CYR debt.

It is worth noting that the replacement debt does not need to be CYR debt for hedge accounting to continue uninterrupted. It may reference a single contractual variable rate. Similarly, if the replacement debt is CYR debt, the list of possible contractual interest rate indexes and tenors from which the borrower may select does not need to perfectly match that of the original CYR debt. Instead, hedge accounting can continue as long as the replacement debt accrues interest based on an interest rate index and tenor that matches one of the interest rate index and tenor options included in the original CYR debt.

For example, in Illustration 2 above, if the entity replaces the original CYR debt on 1 January 20X4 with a two-year, \$20 million single variable rate debt instrument indexed to 6-month Term SOFR, the hedge would continue, as this rate was included in the original CYR debt instrument. Similarly, if the replacement debt was a two-year, \$20 million CYR debt instrument that allows the entity to select either 1-month Term SOFR or the 1-month US Treasury Rate as the contractually specified rate, the hedge would continue provided the entity elected to have the replacement debt accrue interest based on 1-month Term SOFR, as this rate was included in the original CYR debt.

However, an entity would discontinue hedge accounting and immediately reclassify into earnings the entire gain or loss on the hedging instrument recognized in AOCI when one of the following scenarios becomes probable:

- The interest rate index or tenor at which interest will accrue on the replacement debt will not match one of the interest rate index or tenor options included in the original CYR debt (e.g., in the example above, if it becomes probable that the entity will choose the 1-month US Treasury Rate, as this rate was not included in the original CYR debt).

- ▶ The entity will issue single variable rate debt with an interest rate index or tenor that was not included in the original CYR debt (e.g., in the example above, if it becomes probable that the entity will issue a single variable rate indexed to 12-month Term SOFR, as this rate was not included in the original CYR debt).
- ▶ The entity will issue fixed-rate debt.

Question 5

Can an entity continue hedge accounting if it issues an eligible replacement debt that matures before the end of the hedge period?

It depends. If the replacement debt matures before the end of the hedge period, an entity is required to determine whether it is probable it will issue eligible replacement debt for the remaining hedge period, which is similar to the core hedge accounting requirements for cash flow hedges of replacement debt. If it is probable, hedge accounting can continue uninterrupted.

Forecasted issuance of CYR debt

An entity may apply the simplified model to hedges of interest payments associated with the forecasted issuance of debt if it is probable that it (1) will issue CYR debt and (2) will initially select for the first interest period one of the interest rate indexes and tenors documented at hedge inception when the CYR debt is issued.

When designating the hedged risk at the inception of the hedge, the entity documents the interest rate indexes and tenors included in CYR debt being offered in the market. In addition, the entity designates the contractually specified interest rate being hedged based on its best estimate of the interest rate index and tenor that it will initially select for the first interest period when the CYR debt instrument is issued. This rate is used to assess hedge effectiveness⁵ during the period before the CYR debt is issued.

How we see it

While hedging interest payments associated with the forecasted issuance of CYR debt could be considered conceptually similar to hedging interest payments associated with replacement debt for existing CYR debt, the guidance treats these situations differently.

For example, when hedging interest payments associated with the forecasted issuance of CYR debt, an entity is bound by the interest rate indices and tenors prevalent in the market at the inception of the hedge, whereas replacement debt is bound by the interest rate indices and tenors included in the originally issued CYR debt agreement. In addition, the hedged forecasted interest payments related to replacement debt can come from debt that references only a single contractual variable rate (i.e., the interest payments are not required to stem from CYR debt).

However, it is important to note that once the hedged forecasted CYR debt is issued, the guidance for replacing that debt is consistent with that for replacing existing CYR debt.

During the period prior to CYR debt issuance, if an entity changes its best estimate of the interest rate index or tenor that it will initially select to another option documented at hedge inception, it is required to perform both (1) a final retrospective assessment of hedge effectiveness based on the previous best estimate and (2) a prospective assessment of hedge effectiveness based on the new best estimate.

If the hedge is not highly effective in the final retrospective assessment, hedge accounting cannot be applied for that period (i.e., the change in the fair value of the hedging instrument during the period is recognized in earnings). However, the hedging relationship may continue prospectively if it is expected to be highly effective based on the prospective effectiveness assessment using the new best estimate.

If the hedge is expected not to be highly effective based on the prospective assessment, hedge accounting would be discontinued, but the previously recognized gain or loss on the hedging instrument would remain in AOCI until (1) the forecasted interest payments affect earnings or (2) it becomes probable that the forecasted interest payments will not occur.

The prospective assessment is performed as if the new best estimate of interest rate index and tenor had been designated for the entire hedge period, and the instrument used to estimate changes in cash flows of the revised hedged risk is developed using market data as of hedge inception.

In contrast, if it becomes probable that the entity will select an interest rate index and tenor that was not documented at hedge inception for the first interest period (e.g., this could occur when the debt is expected to include a variable rate that was not documented at inception), or that the entity will not issue CYR debt (e.g., it will issue a single variable-rate debt or fixed rate debt), the entity would need to discontinue hedge accounting and immediately reclassify into earnings the entire gain or loss on the hedging instrument recognized in AOCI.

Consistent with the general hedge accounting model, the entity would consider whether it has demonstrated a pattern of determining that hedged forecasted transactions are probable of not occurring. Such a pattern would call into question the entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions.

Once the forecasted CYR debt is issued and the entity chooses the first interest rate index and tenor in accordance with the original hedge documentation, the entity transitions from the forecasted issuance of CYR debt model to the guidance for hedging existing CYR debt and related replacements (discussed above) without dedesignating and redesignating the hedging relationship. As part of this transition, the entity updates its hedge documentation to reflect the interest rate indexes and tenors included in the actual CYR debt. This allows the entity to subsequently choose an interest rate index or tenor that was not captured in the initial hedge documentation but is referenced as one of the choices in the actual CYR debt issued.

Illustration 3 – Hedging forecasted issuance of CYR debt⁶

On 1 January 20X1, Entity A determines that it is probable it will enter into a CYR debt arrangement with a bank for a five-year, \$20 million variable-rate note payable to be issued on 1 April 20X1, with the principal due at maturity.

To hedge the cash flow variability attributable to changes in the contractually specified interest rate on this CYR debt, Entity A enters into a forward-starting receive-variable, pay-fixed, five-year, \$20 million notional interest rate swap on 1 January 20X1. The swap requires settlement and resets every 30 days starting after 1 April 20X1. Under the terms of the swap, Entity A receives variable interest payments every 30 days that are indexed to the 30-day Average SOFR (in arrears) and pays a fixed rate of 5%. The fair value of the interest rate swap on 1 January 20X1 is zero.

Entity A designates the swap as hedging the cash flow variability attributable to changes in the contractually specified interest rate on the CYR debt to be issued on 1 April 20X1 and on any related replacement debt thereof. Entity A determines and documents that the following interest rate indexes and tenors of CYR debt are currently being offered in the market:

- 1-month Term SOFR (paid every 30 days)
- 3-month Term SOFR (paid every 90 days)
- 6-month Term SOFR (paid every 6 months)
- 1-month U.S. Treasury Rate (paid every 30 days)
- Prime (paid every 30 days)

Entity A asserts that it is probable that it will issue CYR debt and initially select one of the interest rate indexes and tenors currently being offered in the market as documented above. In addition, Entity A's best estimate of the interest rate index and tenor that it will initially select for the first interest period after the debt is issued is 1-month Term SOFR (paid every 30 days), which it designates as the contractually specified interest rate being hedged in accordance with ASC 815-30-35-37C.

Entity A performs an initial quantitative hedge effectiveness assessment based on this best estimate (i.e., 60 monthly interest payments that begin to accrue on 1 April 20X1 based on 1-month Term SOFR with the rate resetting immediately following each payment due date) and concludes that the hedging relationship is highly effective. In accordance with ASC 815-20-25-79B, this effectiveness assessment only considers the entity's best estimate of the 1-month Term SOFR in estimating changes in the hedged forecasted cash flows.

During the forecast period before 1 April 20X1, Entity A may change its best estimate of the interest rate index and tenor that it will initially select for the first interest period of the CYR debt to another interest rate index and tenor that was documented at hedge inception without an automatic dedesignation of the hedging relationship.

When the debt instrument is issued, its contractual rate options include the five rates Entity A documented at hedge inception and the Effective Federal Funds Rate, which was not included in the original hedge documentation. If Entity A initially selects any rate other than the EFFR for the first interest period, hedge accounting may continue because the rate selected was documented at hedge inception. Entity A then transitions to the guidance for existing CYR debt and updates its hedge documentation, without dedesignating the hedging relationship, to replace the market-based list documented at hedge inception with the complete list of indexes and tenors included in the issued debt agreement. Accordingly, the EFFR becomes an eligible rate for a future selection even though it was not documented at hedge inception.

After issuance, Entity A performs prospective and retrospective hedge effectiveness assessments based on the rate actually selected for the debt instrument (e.g., 1-month Term SOFR) and does not consider the optionality embedded in the CYR debt. If Entity A subsequently selects another rate permitted by the issued debt agreement, including the EFFR, it performs a final retrospective assessment using the previously selected rate for the last period in which interest accrued at that rate and begins prospectively assessing effectiveness using the newly selected rate. For the prospective assessment, Entity A develops the hypothetical derivative using market data as of hedge inception as if the newly selected rate had been designated for the entire hedge period.

Question 6

If an entity is uncertain about whether it will issue fixed or variable rate debt, can it apply the simplified model for hedging interest payments associated with the forecasted issuance of CYR debt?

No. To apply the simplified model, an entity needs to assert that issuing CYR debt is probable.

If the entity cannot determine whether the debt expected to be issued will be fixed rate or variable rate CYR debt, it may still be able to apply the core cash flow hedging model during the forecasted period. In that case, the interest rate designated as the hedged risk needs to qualify both as a benchmark interest rate (if the debt is ultimately fixed-rate) and as a contractually specified interest rate (if the debt is ultimately variable rate).

Transition

The amendments are applied on a prospective basis to hedges designated on or after the adoption date. However, the transition guidance related to Issue 2 allows entities to modify certain aspects of hedging relationships existing as of the adoption date without dedesignating the hedge, as described below.

For hedges of forecasted interest payments on an existing CYR debt instrument, an entity may (1) amend the hedging relationship to include interest payments on replacement debt and (2) specify the quantitative method it will use if it is required to assess hedge effectiveness on a quantitative basis in subsequent periods (for entities assessing hedge effectiveness on a qualitative basis).

For hedges of forecasted interest payments that may include interest payments on an existing CYR debt instrument designated as part of a group of forecasted transactions under the first-payments-received technique, an entity may (1) amend the hedging relationship to include only interest payments on the individual existing CYR debt instrument and replacement debt or (2) specify the quantitative method it will use if it is required to assess hedge effectiveness on a quantitative basis in subsequent periods (for entities assessing hedge effectiveness on a qualitative basis).

If adopting the amendments related to Issue 2 results in a change to the designated hedged risk, the terms of the instrument used to estimate the change in value of the hedged risk (e.g., the hypothetical derivative) in the assessment of hedge effectiveness should be determined based on market data as of the inception of the hedging relationship. In addition, an entity would amend its hedge documentation upon adoption to apply the transition guidance for existing hedging relationships, including documentation of critical terms, the hedged forecasted transactions, and hedge effectiveness assessments, as needed.

Issue 3 – Cash flow hedges of nonfinancial forecasted transactions

The guidance expands the variable price components eligible to be designated as the hedged risk in the forecasted purchase or sale of nonfinancial assets. Entities can designate components (or subcomponents) that meet the criteria of being clearly and closely related to the nonfinancial asset being purchased or sold as described in ASC 815-10-15-32(a) through (b) of the normal purchases and normal sales (NPNS) scope exception guidance⁷ as follows:

- If the purchase or sales price of the nonfinancial asset is not determined in accordance with a pricing formula in an agreement (e.g., when the asset will be purchased or sold in a spot transaction), the hedged variable component is required to be clearly and closely related to the nonfinancial asset being purchased or sold.

- ▶ If the purchase or sales price of the nonfinancial asset is determined in accordance with a pricing formula in an agreement (e.g., in a forward contract), the hedged variable component is either of the following:
 - ▶ Explicitly referenced in the agreement's pricing formula and clearly and closely related to the nonfinancial asset being purchased or sold
 - ▶ A subcomponent that is clearly and closely related to the variable component explicitly referenced in the agreement's pricing formula, and the referenced price component is clearly and closely related to the nonfinancial asset being purchased or sold

At hedge inception, an entity is required to document the component (or subcomponent) of the price of a nonfinancial asset that is being designated as the hedged risk.

The guidance also clarifies that entities may hedge a variable price component in a forecasted transaction relating to the purchase or sale of a nonfinancial item under a contract that is accounted for as a derivative under ASC 815 if this transaction is otherwise eligible to be hedged.

Under existing US GAAP, an entity can only hedge a contractually specified component in a contract meeting the definition of a derivative if the NPNS scope exception is applied to that contract. If the NPNS exception cannot be applied (e.g., if the entity cannot assert it is probable that a specific contract will physically settle), component hedging is prohibited.

How we see it

The amendments increase the nonfinancial risk components that can be hedged by allowing entities to hedge components of forecasted spot-market transactions, as well as components or subcomponents in forward contracts. This improves the effectiveness of certain hedge strategies and limits dedesignation risk.

Currently, entities can only hedge risk components that are contractually specified in the purchase or sale transaction.

ASU 2025-09 includes various new examples illustrating how the amended guidance applies to hedges of nonfinancial components (or subcomponents). The discussion below summarizes each example.

Example 24 (ASC 815-30-55-149 through 55-151) – Designation of a price component as the hedged risk in a forecasted purchase of nonfinancial assets in a cash flow hedge for which any contractual shortfall is expected to be purchased in the spot market.

This example illustrates an entity that plans to purchase soybeans under forward contracts with suppliers. Each contract permits net settlement if the quality of the soybeans delivered does not meet the entity's specifications. If that happens, the entity will net settle the affected forward contracts and purchase soybeans of the appropriate specifications in the spot market to make up for any shortfall. The forward contracts meet the definition of a derivative but do not qualify for the NPNS scope exception because physical settlement is not probable.

Based on the guidance in ASC 815-20-25-15(e), the entity determines it is able to designate a variable price component (or subcomponent) of the derivative as the hedged risk if all other hedge criteria are satisfied. Because the entity is uncertain about whether the soybeans will be purchased through the existing supplier contracts that include a pricing formula or in the spot market, it needs to determine whether the ABC soybean index is eligible to be hedged as a component under either situation. The entity performs two distinct assessments to determine that the ABC soybean index is deemed to be clearly and closely related (under the NPNS guidance) to the nonfinancial asset being purchased (soybeans) based on the requirements in both ASC 815-20-25-22C(a) and ASC 815-20-25-22C(b)(1).

Non-contractually specified components that are clearly and closely related to the nonfinancial asset being purchased or sold may be designated as a hedged risk.

This example illustrates an entity that plans to purchase soybeans under forward contracts with suppliers. Each contract permits net settlement if the quality of the soybeans delivered does not meet the entity's specifications. If that happens, the entity will net settle the affected forward contracts and purchase soybeans of the appropriate specifications in the spot market to make up for any shortfall. The forward contracts meet the definition of a derivative but do not qualify for the NPNS scope exception because physical settlement is not probable.

Based on the guidance in ASC 815-20-25-15(e), the entity determines it is able to designate a variable price component (or subcomponent) of the derivative as the hedged risk if all other hedge criteria are satisfied. Because the entity is uncertain about whether the soybeans will be purchased through the existing supplier contracts that include a pricing formula or in the spot market, it needs to determine whether the ABC soybean index is eligible to be hedged as a component under either situation. The entity performs two distinct assessments to determine that the ABC soybean index is deemed to be clearly and closely related (under the NPNS guidance) to the nonfinancial asset being purchased (soybeans) based on the requirements in both ASC 815-20-25-22C(a) and ASC 815-20-25-22C(b)(1).

Example 25 (ASC 815-30-55-152 through 55-155) – Designation of a price subcomponent of an explicitly referenced component in an agreement as the hedged risk in a cash flow hedge of a forecasted purchase of nonfinancial assets.

This example illustrates how to apply the guidance when determining whether a subcomponent of a component explicitly referenced in an agreement can be designated as the hedged risk in a cash flow hedge of a forecasted purchase of a nonfinancial asset.

An entity enters into an agreement to purchase copper wire each month under a supply contract where the price of the wire is based on the ABC Copper Wire index plus a basis differential. The contract meets the definition of a derivative, and the entity elects to apply the NPNS scope exception.

To hedge the pricing variability associated with the contract, the entity executes a series of COMEX Copper futures contracts (maturing in successive months). COMEX Copper futures are used as the hedging instrument because derivatives referencing the ABC Copper Wire index are less liquid. The entity determines that the COMEX Copper index is an eligible risk subcomponent because (1) the ABC Copper Wire index explicitly referenced in the forward contract is clearly and closely related (under the NPNS guidance) to the copper wire being purchased and (2) the COMEX copper index is clearly and closely related (under the NPNS guidance) to the ABC Copper Wire index explicitly referenced in the supply contract.

Example 26 (ASC 815-30-55-156 through 55-159) – Designation of a price component as the hedged risk in a cash flow hedge of a forecasted purchase of nonfinancial assets in the spot market.

This example illustrates how to apply the guidance when determining whether a price component can be designated as the hedged risk in a cash flow hedge of a forecasted spot-market purchase of a nonfinancial asset.

An entity forecasts that it will purchase natural gas in the spot market. To hedge the price risk associated with this purchase, it executes a futures contract tied to the XYZ National NatGas index. The entity observes that agreements to purchase natural gas in the region are commonly priced based on either (1) the ABC Regional NatGas index plus a fixed spread or (2) the XYZ National NatGas index plus transportation costs and a fixed spread.

Purchases of natural gas in the region are often tied to the ABC Regional NatGas index because it reflects the natural gas prices of the closest geographical proximity to an entity. Additionally, the XYZ National NatGas index is a nationally recognized index that is commonly used by market participants to price contracts throughout the country, adjusted for the cost to transport that natural gas to various hubs for sale. The entity determines that neither index is extraneous to changes in the fair value of natural gas in the region in which the forecasted purchase will occur.

Because the forecasted purchase will occur in the spot market, the entity evaluates the designated component based on the requirements of ASC 815-20-25-22C(a). It concludes that the XYZ National NatGas index is clearly and closely related (under the NPNS guidance), to the natural gas to be purchased and is, therefore, eligible to be designated as the hedged risk. The ABC Regional NatGas index also would have qualified to be designated as the hedged risk because it meets the requirements in ASC 815-20-25-22C(a).

How we see it

Example 26 illustrates that more than one index may qualify as an eligible hedged risk in the forecasted purchase or sale of a nonfinancial asset. Eligibility is based on whether a component is considered clearly and closely related to the nonfinancial asset being purchased or sold under the NPNS guidance in ASC 815-10-15-32(a) and (b).

Under that guidance, an entity first considers whether an underlying (or in this case the component) is extraneous (i.e., irrelevant and not pertinent) to changes in the cost and fair value of the asset being purchased or sold (including an ingredient or direct factor in its production). If the component is not extraneous, the entity considers whether the magnitude and direction of the component is significantly disproportionate to the changes in the asset's cost or fair value, such as when the component is adjusted by an explicit leverage factor.

In Example 26, both the national and regional indexes were considered clearly and closely related to the natural gas being purchased because neither was deemed extraneous to changes in the fair value of natural gas in the region in which the forecasted purchase will occur.

In our view, the ability to consider changes in the asset's fair value (as opposed to changes in cost)⁸ provides flexibility to incorporate market-based pricing considerations into the assessment of whether a component is clearly and closely related to the asset being purchased or sold. We do not believe a correlation analysis is necessarily required as part of this assessment. Consistent with paragraph BC74 of the Basis for Conclusions, a quantitative analysis is generally limited to assessing whether leverage features exist.

While Example 26 addresses determining whether a component can be designated as the hedged risk in a spot market transaction, the same principles apply when assessing whether a subcomponent may be designated as the hedged risk in a forward market transaction.

Example 27 (ASC 815-30-55-160 through 55-164) – Designation of multiple price components as the hedged risks in a group of forecasted purchases of nonfinancial assets in not-yet-existing contracts.

This example illustrates the guidance on hedging a group of individual forecasted transactions in a single hedging relationship (Issue 1) and the designation of a component or subcomponent as the hedged risk in the forecasted purchase or sale of a nonfinancial asset (Issue 3).

An entity plans to purchase soybeans under not-yet-existing contracts and expects the contracts' pricing formulas to reference some combination of the ABC Soybean and DEF Soybean indexes. As discussed under section on Issue 1 above, the entity needs to perform a similar risk assessment because it expects the individual hedged forecasted transactions in the group to have multiple risks occurring at the same time.

From an Issue 3 perspective, the example illustrates that an entity may designate multiple price components as the hedged risks in a group of forecasted purchases of nonfinancial assets when there is uncertainty about which component or components will be explicitly referenced in the pricing formulas of not-yet-existing contracts. To designate both the ABC Soybean and DEF Soybean indexes as eligible hedged risks, the entity needs to determine that each index meets the requirements in ASC 815-20-25-22C(b)(1).

Transition

The amendments are applied prospectively to hedges designated on or after the adoption date. However, under the transition guidance related to Issue 3, entities can modify certain aspects of existing cash flow hedges and update related hedge documentation without dedesignation as follows:

- ▶ For hedges of variability in cash flows attributable to changes in the overall price or the contractually specified component of the price in a forecasted purchase or sale of a nonfinancial asset, an entity may modify the hedging relationship to designate the hedged risk as variability in cash flows attributable to changes in a component (or subcomponent) of the forecasted purchase price or sales price of a nonfinancial asset in accordance with ASC 815-20-25-22C. The entity is not required to amend its hedge documentation for hedges of a contractually specified component to reflect amendments in accordance with ASC 815-20-25-22C if the hedged risk is unchanged.
- ▶ If adoption changes the designated hedged risk, the entity would create the terms of the instrument used to estimate the change in value of the hedged risk (under the originally designated method, for example, the hypothetical derivative method, or another acceptable method in ASC 815-30) in the assessment of hedge effectiveness, if applicable, based on market data as of the inception of the hedging relationship. Additionally, an entity would amend its hedge documentation upon adoption, including documentation of critical terms, the hedged forecasted transactions and hedge effectiveness assessments, as needed to apply the amendments for all existing hedging relationships.

Issue 4 – Net written options as hedging instruments

The amendments eliminate the requirement to apply the net written option test to hedging relationships where the hedging instrument is a combination of a written option and a non-option derivative instrument (e.g., an interest rate swap where the variable pay leg is floored) if all of the following conditions are met:

- ▶ The derivative is designated as the hedging instrument in a cash flow hedge or fair value hedge of interest rate risk (including the interest rate risk portion of a hedge of both interest rate risk and foreign exchange risk).
- ▶ The hedging instrument is a combination of a written option and a swap.
- ▶ The notional amount of the written option matches the notional amount of the swap.

A compound derivative that meets the above criteria is not considered a written option and, therefore, is not subject to the net written option test. However, entities are still required to perform an effectiveness assessment in order to apply hedge accounting.

The written option test is no longer required when a swap combined with a written option is used to hedge interest rate risk, if certain conditions are met.

Prior to the amendments, ASC 815-20-25-88 explicitly required any derivative instrument that results from combining a written option and any other non-option derivative instrument to be treated as a written option. As a result, such a derivative was required to pass the net written option test in ASC 815-20-25-4 to qualify for hedge accounting.

Certain lending institutions seeking to hedge variable-rate loans that include a floor prefer to use pay-variable, receive-fixed interest rate swaps with mirror-image floors to mitigate the interest rate risk on these loans. When LIBOR was the primary interest rate benchmark, the variable leg of the interest rate swap and the variable-rate loan were generally tied to the same LIBOR tenor. As a result, the compound derivative that was deemed to be a written option (i.e., the interest rate swap with the floor) could satisfy the net written option test.

Following the cessation of LIBOR and the adoption of SOFR as the primary interest rate benchmark in the US, it is common for the variable leg of an interest rate swap to reference a different SOFR index (e.g., Daily SOFR) than the variable-rate loan (e.g., Term SOFR). As a result of differences in the underlying rates (and minor differences in forecasted payment or reset dates associated with those rates), these relationships would fail the written option test even though the economic substance of the hedging relationships was similar before and after LIBOR cessation.

The following illustration highlights how the amendments address this issue.

Illustration 4 – Application of the net written option test⁹

Bank A holds a portfolio of variable-rate loans indexed to 1-month Term SOFR, each of which contains an embedded 0% interest rate floor (a purchased option from Bank A's perspective). To hedge the variability in cash flows attributable to the contractually specified interest rate, Bank A designates a receive-fixed, pay-variable interest rate swap indexed to Daily SOFR as the hedging instrument in a cash flow hedge of interest rate risk.

To more closely align the hedge with the interest rate risk in the loans, Bank A includes a 0% floor (a written option from Bank A's perspective) on the variable leg of the swap. The notional amount of the interest rate swap and the notional amount of the written floor are the same.

In this fact pattern, Bank A would not be required to apply the net written option test to the hedging relationship. Although the hedging instrument is a combination of a written option (the interest rate floor) and a non-option derivative (the interest rate swap) it meets the criteria to not be deemed a written option as it is designated in a cash flow hedge of interest rate risk, and the notional amounts of the swap and the written floor are the same. Accordingly, the hedging relationship is not subject to the net written option test. However, the difference in the underlying for the loans (i.e., 1-month Term SOFR) and the hedging instrument (i.e., Daily SOFR) would need to be captured in assessing the effectiveness of the hedge.

How we see it

The amendments apply even when the hedged item does not contain optionality that mirrors the written option in the hedging instrument. For example, an entity could use an interest swap that includes a written floor to hedge interest rate risk within specified parameters of a variable rate asset that does not include a floor if the swap is deemed to be highly effective at offsetting the designated hedge risk.

As noted in paragraph BC104 of the Basis for Conclusions, the Board observed that the ability for an entity to include a written option to reduce the interest rate protection provided by a swap may represent a valid risk management strategy in certain instances. However, the entity still needs to demonstrate that the hedging relationship is highly effective.

Transition

There are no specific transition provisions for the amendments relating to the net written option guidance. As noted by the Board in paragraph BC125 of the Basis for Conclusions, the transactions addressed by the amendments do not qualify for hedge accounting under the existing guidance, and as such, the amendments would only be applied prospectively to hedges designated on or after the adoption date.

Issue 5 – Dual hedge strategy

A dual hedge strategy involves designating a foreign-currency-denominated debt instrument as both the hedging instrument in a net investment hedge and the hedged item in a fair value hedge of interest rate risk. These hedging relationships address separate risk types that may be hedged individually under ASC 815.

To address the recognition and presentation mismatch for this strategy that resulted from the elimination of the separate measurement and recognition of hedge ineffectiveness by ASU 2017-12, the amendments require entities to exclude the foreign-currency-denominated debt instrument's fair value hedge basis adjustment from the assessment of hedge effectiveness in the net investment hedge. As a result, the remeasurement of this basis adjustment (based on changes in the spot exchange rate) is immediately recognized in earnings, offsetting the foreign exchange remeasurement of the derivative designated as the hedging instrument in the fair value hedge of interest rate risk. This outcome is consistent with the accounting outcome before the adoption of ASU 2017-12.

For purposes of applying hedge accounting, the notional amount of the foreign-currency-denominated debt instrument designated as the hedging instrument in the net investment hedge is not deemed to change over time due to the fair value hedge basis adjustment and, therefore, will continue to match the portion of the net investment being hedged.

If the fair value hedge is subsequently discontinued, the basis adjustment is considered prospectively when assessing the effectiveness of the net investment hedge. This aligns the effectiveness assessment with that of other net investment hedges once the source of the presentation mismatch has been eliminated.

Transition

There are no specific transition provisions for the amendments relating to dual hedges. Accordingly, the amendments are applied prospectively to hedges designated on or after the adoption date.

How we see it

The Board decided not to provide transition guidance for existing dual-purposes hedges based on stakeholder feedback that this strategy had lost its utility after the issuance of ASU 2017-12, which inadvertently created a recognition and presentation mismatch for these hedges. As noted in paragraph BC125 of the Basis for Conclusions, the Board was unaware of entities continuing to apply hedge accounting to this strategy after adopting ASU 2017-12.

As a result, we believe any entities that are applying hedge accounting to existing dual-purpose hedge relationships need to dedesignate and redesignate the net investment hedge relationship to apply the guidance to these hedges.

Effective date, transition and disclosures

Effective date

ASU 2025-09 is effective for public business entities for fiscal years beginning after 15 December 2026, and interim periods within those fiscal years. For all other entities, it is effective for fiscal years beginning after 15 December 2027, and interim periods within those fiscal years. Early adoption is permitted.

Transition and disclosures

The amendments are applied on a prospective basis to hedges designated on or after the adoption date. However, as noted in the discussion of the individual issues, the Board provided transition guidance that allows entities to modify certain aspects of existing hedging relationships without dedesignating the hedge to enable the application of the amendments to those hedges.

Entities that adopt the amendments are required to disclose the nature of and reason for the change in accounting principle, as well as the method of applying the change, in both the interim and annual reporting periods of adoption.

Endnotes:

- ¹ This illustration is based on Example 4: Variable interest payments on a group of variable-rate, interest-bearing loans as hedged items (ASC 815 -20-55-88 through 55-99E) that was added by the ASU.
- ² Example 27: Designation of Multiple Price Components as the Hedged Risks in a Group of Forecasted Purchases of NonFinancial Assets in Not-Yet-Existing Contracts (ASC 815 -30-55-160 through 55-164).
- ³ ASC 815-20-25-81 states that ordinarily an entity should assess effectiveness for similar hedges in a similar manner, including whether a component of the gain or loss on a derivative instrument is excluded in assessing effectiveness for similar hedges. Use of different methods for similar hedges shall be justified.
- ⁴ This illustration is based on Example 28: Hedges of forecasted interest payments on choose-your-rate debt (ASC 815 -30-55-165 through 55-181) that was added by the ASU.
- ⁵ Consistent with general hedge accounting guidance, an entity performs its assessments of effectiveness on a periodic basis in accordance with ASC 815-20-25-3(b)(2)(iv)(X2) and ASC 815-20-25-79.
- ⁶ This illustration is based on Example 28: Hedges of forecasted interest payments on choose-your-rate debt (ASC 815 -30-55-165 through 55-181) that was added by the ASU.
- ⁷ ASC 815-10-15-32 states that "the underlying in a price adjustment incorporated into a contract that otherwise satisfies the requirements for the normal purchases and normal sales scope exception shall be considered to be not clearly and closely related to the asset being sold or purchased in any of the following circumstances:
 - a. The underlying is extraneous (that is, irrelevant and not pertinent) to both the changes in the cost and the changes in the fair value of the asset being sold or purchased, including being extraneous to an ingredient or direct factor in the customary or specific production of that asset.
 - b. If the underlying is not extraneous as discussed in (a), the magnitude and direction of the impact of the price adjustment are not consistent with the relevancy of the underlying. That is, the magnitude of the price adjustment based on the underlying is significantly disproportionate to the impact of the underlying on the fair value or cost of the asset being purchased or sold (or of an ingredient or direct factor, as appropriate)."
- ⁸ ASC 815-10-15-32(a) indicates that an underlying would not be considered clearly and closely related to an asset if it is extraneous to both cost changes and fair value changes of the asset. Use of the term "and" in this condition is significant as it indicates an underlying that is not extraneous to changes in fair value but not necessarily to costs (or vice versa), may still qualify as being clearly and closely related.
- ⁹ Based on example included in ASU 815-20-25-88

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