Deloitte.

Deloitte & Touche LLP
695 East Main Street
Stamford, CT 06901-2150
USA

Tel:+1 203 708 4000
Fax:+1 203 705 5455
www.deloitte.com

October 7, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2019-770
Re: Proposed Accounting Standards Update, *Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

Dear Mr. Kuhaneck:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Facilitation of the Effects of Reference Rate Reform on Financial Reporting.*

We support the Board's efforts to provide optional expedients and exceptions to the requirements in U.S. GAAP related to contracts, hedging relationships, and other transactions affected by reference rate reform. Such accommodations will facilitate the market-wide transition from the London Interbank Offered Rate (LIBOR) and other interbank offered rates.

We recognize the challenges that financial statement preparers and users may face related to reference rate reform and agree that application of existing GAAP to modifications of contracts or hedging relationships caused by such reform could impose operational burdens on preparers. Further, the financial reporting that results from such application may not ultimately provide decision-useful information to financial statement users or faithfully represent entities' intended risk management strategies. We also understand that the pace of reform is unpredictable and that the proposed expedients need to incorporate flexibility to provide meaningful relief.

We believe, however, that any relief provided should be limited to modifications that are directly related to reference rate reform. This also seems to be the Board's intent; however, it appears that such linkage would not necessarily be required for certain hedging relief granted by the expedients.

For example, the proposed relief from the guidance in ASC 815 regarding changes to the critical terms of an existing hedging relationship would allow an entity to rebalance a fair value hedge or modify the designated hedging instrument in a fair value or cash flow hedging relationship to add new derivatives if the hedging instrument, the hedged forecasted transaction, or the designated benchmark rate refers to a rate affected by the reform. This relief may be necessary to enable continued application of certain hedging strategies, but it would be unnecessary for other strategies. Given the broad scope of the proposed relief, entities would be allowed to fundamentally change the hedging relationship without having to dedesignate the hedge even in situations in which there is no compelling need for such relief.

Similarly, an expedient for new cash flow hedges would allow an entity to disregard the eligibility criterion for the shortcut method, under which the "terms [must be] typical of those derivative instruments and [must] not invalidate the assumption of perfect effectiveness." To use that expedient, an entity would need to demonstrate that either the hedged forecasted transaction or the hedging instrument refers to a rate affected by the reform; however, it would not need to show that the effects of reference rate reform directly caused the hedging relationship's inability to otherwise satisfy that criterion. Without having to establish such a linkage, an entity could apply the shortcut method to a hedging relationship that never would have qualified for that method even if rate reform had not occurred.

We encourage the Board to limit an entity's ability to apply the optional expedients to only those circumstances in which the entity can demonstrate that reference rate reform directly caused the hedging relationship's inability to otherwise satisfy the existing hedge accounting requirements.

In addition, although we recognize that entities may have a need for optional expedients related to new cash flow hedging relationships that are expected to be affected by reference rate reform, we do not believe that the expedients should permit entities to apply hedge accounting to hedging relationships that would not have been highly effective at hedge inception under existing hedging requirements had rate reform not occurred. In our response to Question 7 in the appendix, we list examples of criteria that we believe new cash flow hedging relationships should be required to satisfy to qualify for the optional expedients. The appendix also contains our responses to the proposed ASU's other questions for respondents.

We would be happy to share additional perspectives and suggestions with the Board and FASB staff on the matters discussed in our comment letter.

*****

We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Jonathan Howard at (203) 761-3235.

Yours truly,

Deloitte & Touche LLP

cc: Mark Bolton

Robert Uhl

Appendix
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents

General

Question 1 — Costs and Complexities: Are the amendments in this proposed Update operable and auditable? If not, which proposed amendment(s) pose operability or auditability issues and why?

We generally believe that the amendments in the proposed ASU are both operable and auditable.

Question 2 — Additional Issues: Are there additional accounting issues or optional expedients related to reference rate reform that the Board should consider? Please be as specific as possible and explain why those issues require consideration.

Although there is some discussion of the applicability of the relief to net investment hedges in the proposed ASU's Summary and the Background Information and Basis for Conclusions, there is no explicit reference to net investment hedges in the body of the proposal. It would be helpful if the guidance in the final ASU clearly specified the relief that is potentially available for net investment hedges.

Contract Modifications

Question 3 — Expedients: Do you agree with the proposed expedients for the accounting for contract modifications? If not, please explain which proposed amendment(s) you disagree with and why.

We generally agree with the proposed expedients for the accounting for contract modifications.

Proposed ASC 848-20-15-5 and 15-6 provide examples of terms that would or would not be considered related to the replacement of the reference rate. Specifically, proposed ASC 848-20-15-5(b) notes that "[c]hanges for a spread adjustment for the difference between an existing reference rate and the replacement reference rate" would be considered related; however, proposed ASC 848-20-15-6(d) indicates that changes to the counterparty credit spread (other than the change described in 15-5(b)) would not. In practice, it may be difficult for entities to determine whether a spread adjustment is solely related to a change in reference rates or whether a portion of the spread adjustment is related to a change in counterparty credit spread since contract inception. It would be helpful if the final ASU further clarified how entities should make the determination.

Further, it is unclear whether the expedient for modifications of contracts that are not within the scope of the ASC topics referred to in proposed ASC 848-20-35-2 (the expedient discussed in proposed ASC 848-20-35-3) is optional or must be applied.

Question 4 — Election Level: Do you agree that the optional expedients for contract modifications should be applied at the relevant Topic, Subtopic, or Industry Subtopic level? If not, what alternative do you suggest and why?

We agree that the optional expedients for contract modifications should be applied at the relevant ASC topic, subtopic, or industry subtopic level. However, it would be helpful if the final ASU included an additional example of how the guidance would apply to intersecting industry subtopics.

Hedge Accounting

Question 5 — Change in Critical Terms: Do you agree with the proposed exceptions to the requirement in Topic 815 to dedesignate a hedging relationship for a change in critical terms of the hedging relationship? If not, please explain which proposed amendment(s) you disagree with and why.

We generally agree that entities should be able to modify certain critical terms of hedging relationships that are directly affected by reference rate reform without having to dedesignate the hedging relationships.

With respect to the optional expedient described in proposed ASC 848-30-25-8, we understand that the transition to a new reference rate may, for certain hedging strategies, create a need to rebalance the hedging relationship or to redefine the designated hedging instrument by combining new derivatives with the existing hedging instrument. However, because making such modifications has a greater impact on a hedging relationship than simply changing hedging documentation to refer to a replacement reference rate, entities should be required to demonstrate that the need for such changes is a direct result of reference rate reform. The mere fact that an existing hedging relationship refers to a rate affected by the reform should not entitle an entity to rebalance a hedging relationship or introduce new hedging instruments without triggering dedesignation unless the entity can demonstrate that the need for such changes is directly linked to use of the replacement rate.

Question 6 — Fair Value Hedges: Do you agree with the proposed optional expedients for fair value hedge accounting? If not, please explain which proposed amendment(s) you disagree with and why.

We generally agree with the proposed optional expedients for fair value hedge accounting. However, we believe that certain aspects of the proposal should be further refined or clarified.

Proposed ASC 848-40-25-4 states that "[i]f an entity elects the optional expedient . . . to change the designated benchmark interest rate, it shall, **at a minimum**, revise the rate used to discount the cash flows associated with the hedged item reflecting the change in the designated benchmark interest rate" (emphasis added). However, according to proposed ASC 848-40-25-4(b), an entity **is also permitted to adjust** the "revised rate used to discount the cash flows associated with the hedged item." It is unclear how those two provisions interact, and we encourage the Board to provide clarification in the final ASU.

Proposed ASC 848-40-25-5 permits entities that elect to change the designated benchmark interest rate to either (1) adjust the hedged item's cumulative fair value hedge basis adjustment to reflect the change or (2) apply an approach that results in no adjustment to the hedged item's cumulative basis adjustment. We understand that the Board rejected guidance that would have prescribed a specific method because of its belief that different methods may be reasonable for different entities depending on their facts and circumstances; however, we recommend that the Board require entities to adjust the cumulative fair value hedge basis adjustment to reflect the new benchmark interest rate. We do not believe that an entity should be able to maintain the hedged item's cumulative basis adjustment immediately before the date of change because doing so would not provide a faithful representation of the change that has occurred in the hedging relationship.

In addition, in the final ASU the Board should clarify the interaction between proposed ASC 848-40-25-5(a) and proposed ASC 848-40-25-7(b). Proposed ASC 848-40-25-5(a) describes an approach in which an entity would adjust the hedged item's cumulative fair value hedge basis adjustment upon election of the expedient; however, application of proposed ASC 848-40-25-7(b) would not appear to result in a basis adjustment being made upon the election.

Proposed ASC 848-40-25-8 states that "[i]f an entity elects the practical expedient . . . for an existing fair value hedge for which the shortcut method is applied, the entity is not required to periodically evaluate the conditions in paragraph 815-20-25-104 **for the remaining life of the hedging relationship**" (emphasis added). The final ASU should clarify whether an entity would be required to evaluate the criteria in ASC 815-20-25-104 after December 31, 2022.

Question 7 — Cash Flow Hedges: Do you agree with the proposed optional expedients for cash flow hedge accounting? If not, please explain which proposed amendment(s) you disagree with and why.

We generally agree with the proposed optional cash flow hedge accounting expedients for existing hedging relationships. However, we believe that certain aspects of the proposal should be further refined or clarified.

New Hedging Relationships

We believe that the optional expedients should be more restrictive for new hedging relationships. For existing hedging relationships, an entity previously would have had to demonstrate that those hedging relationships were highly effective. Although it is possible that as a result of applying the optional expedients, an entity could continue to apply hedge accounting to a hedging relationship that is no longer highly effective, the fact that the hedging relationship was previously highly effective provides some assurance that the increased ineffectiveness is directly attributable to reference rate reform and is likely to be temporary. That level of assurance does not exist for new hedging relationships.

Allowing an entity to apply the optional expedients to new hedging relationships could run counter to the basic principles of hedge accounting because doing so could result in the entity's application of hedge accounting to hedging relationships that, even in the absence of reference reform, would have never been highly effective. We agree that certain expedients should be available for new cash flow hedging relationships that will be affected by reference rate reform; however, those expedients should be more restrictive than those available for existing hedging relationships and should not allow application of hedge accounting to hedging relationships that would not have been highly effective at hedge inception under existing hedging requirements had reference rate reform not occurred. For example, the final ASU should not allow an entity to (1) enter into a new hedging relationship that designates a LIBOR-based interest rate swap as a hedge of a prime-rate indexed loan that will not be modified as a result of reference rate reform and (2) apply the shortcut method to that hedge and assume perfect hedge effectiveness.

We believe that to avoid such a potential outcome, the Board should require new cash flow hedging relationships to satisfy criteria such as the following to qualify for the optional exceptions or expedients:

- The entity should expect that both the hedged forecasted transaction and the hedging instrument will be affected by reference rate reform.
- When the hedged item is a group of forecasted transactions, the individual transactions in the group should, at the inception of the hedge, share the same risk exposure for which they are designated as being hedged.

Transactions with different risk exposures should be hedged in different groups. An entity's ability to apply the proposed guidance, as currently drafted, would not be limited to situations in which items shared the same risk exposure at inception but, as a result of reference rate reform, no longer do so because some of the items in the group were modified before other items in the group.
- To apply the shortcut method or other methods that allow an assumption of perfect hedge effectiveness, an entity should be permitted to disregard the specified eligibility criteria for those methods only to the extent that mismatches in the terms of the hedging instrument and the hedged item are directly attributable to reference rate reform.
- For hedging relationships in which effectiveness is assessed on the basis of an option's terminal value, an entity should not be permitted to disregard the criterion that requires the strike price (or prices) of the hedging option (or combination of options) to match the specified level (or levels) beyond (or within) which the entity's exposure is being hedged in accordance with ASC 815-20-25-129(b).

Other Areas

The flowchart in proposed ASC 848-50-55-1 does not appear to accurately depict the guidance in the amendments. The middle of the flow chart indicates that if an entity that uses an optional expedient determines that a hedging relationship does not pass the hedge effectiveness assessment, the entity would then evaluate whether the hedging relationship is highly effective by using the guidance in ASC 815-20 and ASC 815-30. Proposed ASC 848-50-35-3 states, in part, "[I]f an entity elects to change the method of assessing hedge effectiveness for an existing cash flow hedge to an optional expedient method in accordance with paragraphs 848-50-35-4 through 35-16, the entity shall amend its hedge documentation"; therefore, the entity should not be given the option to use the guidance in ASC 815-20 and ASC 815-30 to assess the effectiveness of the hedging relationship because doing so would not be consistent with the revised hedge documentation. To apply the guidance in ASC 815-20 and ASC 815-30, the entity would need to elect to cease to apply the expedient in accordance with proposed ASC 848-50-35-17. Accordingly, the flowchart should be modified or deleted in the final ASU.

Question 8 — Election Level: Do you agree that the proposed exceptions and optional expedients related to hedge accounting should be applied on an individual hedging relationship basis? If not, please explain why

We agree that the proposed exceptions and optional expedients related to hedge accounting should be applied on an individual hedging relationship basis.

Disclosures

Question 9 — Contracts or Holdings: What quantitative and qualitative disclosures should be provided to help users understand a reporting entity's current contracts or holdings (as of the reporting date) that are affected by reference rate reform? For financial statement preparers, what costs would be incurred in providing these disclosures? For financial statement users, what alternative sources of information would be used if a reporting entity does not provide any quantitative and qualitative disclosures? What costs would be incurred to obtain quantitative and qualitative information to better understand a reporting entity's exposure to reference rate reform? Should the quantitative and qualitative disclosures, if any, have a termination date after December 31, 2022? If not, when should such disclosures expire and why?

Although we generally believe that an entity's disclosures under existing

U.S. GAAP and SEC rules and regulations would provide useful information about any material effects of reference rate reform, we would not object to incremental disclosure requirements if feedback from preparers and financial statement users indicates that such guidance would be beneficial.

Question 10 — Hedge Accounting: What quantitative and qualitative disclosures should be provided to help users understand the financial reporting effects of expedients elected by a reporting entity? For financial statement preparers, what costs would be incurred in providing these disclosures? For financial statement users, what costs would be incurred if a reporting entity does not provide any quantitative and qualitative disclosures to help financial statement users understand the financial reporting effects of any hedge accounting expedients elected?

Although we generally believe that an entity's disclosures under existing U.S. GAAP and SEC rules and regulations would provide useful information about any material effects of reference rate reform, we would not object to incremental disclosure requirements if feedback from preparers and financial statement users indicates that such guidance would be beneficial.

Question 11 — Transition: Do the proposed transition disclosure requirements provide decision-useful information? If not, what would you recommend and why?

We believe that decision-useful information would be available to investors under the proposed transition disclosure requirements.

Transition and Termination Date

Question 12 — Transition: Do you agree that the proposed optional expedients should be applied on a prospective basis upon election? If not, what alternative do you suggest and why?

We agree that the proposed optional expedients should be applied on a prospective basis upon election.

Question 13 — Termination Date: Do you agree that the proposed amendments should not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022? If not, when should the proposed amendments expire and why?

We agree that the proposed amendments should not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022.