October 7, 2019

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

Via Email to director@fasb.org

Re: File Reference No. 2019-770

Dear Mr. Kuhaneck:

Grant Thornton LLP appreciates the opportunity to comment on proposed Accounting Standards Update (ASU), Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting.

We appreciate and support the Board’s efforts to ease the potential burden for preparers in accounting for the effects of reference rate reform.

We agree with the proposed guidance on accounting for contract modifications related to reference rate reform. However, we believe that the proposed guidance in ASC 848-20 could be amended for clarity. Please see the Appendix to this letter for suggested edits.

In addition, we note that ASC 848-20-15-5(b) refers to “paying or receiving a cash settlement for any difference intended to compensate for the difference in reference rates,” as an example of a spread adjustment that is related to the replacement of the reference rate. We believe that a cash payment made in connection with a modification could indicate a change unrelated to the replacement of the reference rate. For example, in a situation where variable rate debt is amended solely to replace LIBOR with SOFR as the reference rate, we expect that the spread would be adjusted so that the fair value of the debt is the same before and after the amendment, and thus there would be no payment from one party to the other in connection with the modification. We believe that an example would be helpful to clarify how to identify situations in which the fair value of a contract changes solely due to the change in the reference rate, including those where a cash payment occurs.
Regarding the Board’s proposed expedients related to hedge accounting, we are concerned about the potential for reporting entities to continue applying hedge accounting to hedging relationships that are no longer highly effective due to changes associated with reference rate reform. For cash flow hedges, we think that a hedge could fail to be highly effective prospectively due to either a temporary or permanent difference between the underlyings of the hedging instrument and the hedged item.

A temporary difference might exist because the hedging entity updates the reference rate associated with the derivative in one period but will not update the reference rate associated with the hedged item until a future period, or vice versa. A permanent difference might exist because the hedging entity amends the derivative to refer to one rate, such as SOFR, and amends the hedged item to refer to another rate, such as Prime.

We believe that entities should not be permitted to apply an expedient to continue hedge accounting without assessing effectiveness if a permanent difference in underlyings exists as a result of amending the contracts for reference rate reform. Rather, such arrangements should be subject to an updated effectiveness assessment to support a continuation of hedge accounting.

For temporary differences, we believe the proposed expedients are appropriate provided that the hedging entity expects to resolve the difference between the hedging instrument and the hedged item within a reasonably short period of time, such as one year. If the difference is not resolved within that period, then the hedging entity should re-assess hedge effectiveness.

We would be pleased to discuss our comments with you. If you have any questions, please contact Ryan Brady, Partner, at 312.602.8741 or ryan.brady@us.gt.com, or Graham Dyer, Partner, at 312.602.8107 or graham.dyer@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP
Appendix

Suggested edits

Following are our suggested edits to clarify the proposed guidance. Suggested additions are underlined and suggested removals are struck out.

848-20-15-2 The guidance in this Subtopic, if elected, shall apply to contract modifications if the terms that are modified directly replace, or have the potential to replace, a reference rate within the scope of paragraph 848-10-15-3 with another interest rate index. If other terms are contemporaneously modified in a manner that changes, or has the potential to change, the amount or timing of contractual cash flows, the guidance in this Subtopic shall apply only if those modifications are related to the replacement of a reference rate. For the purposes of this Subtopic, terms that may be modified are those that change, or have the potential to change, the amount or timing of contractual cash flows.

848-20-15-3 The guidance in this Subtopic shall not apply if a contract modification is made to a term that changes, or has the potential to change, the amount or timing of contractual cash flows and is unrelated to the replacement of a reference rate. That is, this Subtopic shall not apply if contract modifications are made contemporaneously to terms that are unrelated to the replacement of a reference rate.

848-20-15-4 Contemporaneous modifications of contract terms that do not change, or do not have the potential to change, the amount or timing of contractual cash flows shall not preclude application of the guidance in this Subtopic, regardless be permissible without an assessment of whether those contemporaneous contract modifications are related or unrelated to the replacement of a reference rate.