October 7, 2019

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

By email: director@fasb.org


Dear Mr. Kuhaneck,

Chatham Financial Corp. ("Chatham") is pleased to comment on the Financial Accounting Standards Board’s ("FASB" or "Board") Proposed Accounting Standards Update, Reference Rate Reform (the "Exposure Draft" or "proposal"). Chatham serves as a hedging and debt advisor to more than 2,500 clients annually across the globe and in many industries. More than 600 of our clients apply the hedge accounting provisions of either Accounting Standards Codification ("ASC") 815, International Accounting Standards ("IAS") 39, or International Financial Reporting Standards ("IFRS") 9. Additionally, we advise more than 200 of our clients on their debt instruments, providing technology to administer the debt and valuations to support financial reporting and management activities. This role in the marketplace grants us a unique perspective for end users and financial institutions up to $50 billion in assets.

We applaud the Board’s efforts to support reference rate reform. We generally feel that the proposal provides appropriate relief. We are pleased with the process the FASB has conducted, reaching out to a large number of market participants including preparers, users, and advisors. We believe that the transition away from USD-LIBOR to the Secured Overnight Financing Rate ("SOFR") is one of the most significant changes that the financial markets have ever experienced. We congratulate the Board for its willingness and enthusiasm in providing guidance that will facilitate the transition.

In this letter we have summarized our feedback in response to the Exposure Draft, including responses to the questions included in the proposal. We believe the most pressing items to consider are as follows.

**Relief granted for quantitative assessments should be expanded to include fair value and net investment hedging relationships**

The same questions that prompt relief for cash flow hedges are valid for fair value and net investment hedging relationships. In each of these hedging relationships the future derivative cash flows need to be estimated, which could presume a transition to a replacement rate. Additionally, fair value hedge relationships project the benchmark rate to discount the hedged item. Estimating the benchmark rate over the remaining life of the hedging relationship would necessitate projecting the change in the benchmark rate. Without this relief fair value and net investment hedges will need complex effectiveness assessments.
The sunsetting of this proposal should be principles based
A sunset provision may encourage market participants to adopt a replacement reference rate more rapidly than they otherwise might. We believe that it is prudent to allow the market sufficient time to achieve this transformation. The replacement of USD-LIBOR is one of the largest market transformations in history. Consider also the history of the Sterling Overnight Index Average (“SONIA”) as a potential replacement for GBP-LIBOR. In its nearly 20-year history it has not yet equaled the liquidity of GBP-LIBOR. The effort to complete reference rate reform is enormous. As a result, we recommend a principles-based sunset for Topic 848.

The proposal should include a rebuttable presumption that contract modifications are related to reference rate reform
Contract modifications should be presumed to be related to reference rare reform unless there is substantial evidence to the contrary. Entities may inadvertently face a high burden of proof to support an assertion that changes to contracts are solely related to reference rate reform. We believe that modifications that are not related to reference rate reform will be obvious.

The election level for all types of contracts should be at the Topic level
The proposal would allow inconsistent application of the optional expedients to hedging relationships but require consistent application for all other contracts. We believe that the proposal should be applicable only at the Topic, Subtopic, or Industry Subtopic level for all contract types. In addition, if a contract does not qualify under the scope of the proposal, it should not prevent the optional expedients from being applied to other contracts.

We thank the Board for its consideration of our comments and would be pleased to discuss these issues in more detail with the Board or staff. Please do not hesitate to contact me at (484) 731-0228 or at digentzel@chathamfinancial.com.

Sincerely,

Dan Gentzel
Managing Director, Hedge Accounting
Chatham Financial Corp.
Answers to 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?

Overall, we believe that the proposal is cost effective and entities should be able to apply it using existing personnel and systems, once those systems have been updated to accommodate for replacement reference rates.

We believe that there are several provisions in the proposal that pose operational and/or audit challenges.

In general, we believe that the proposal should include a rebuttable presumption that any changes to contracts within the scope of ASC 848 are due solely to reference rate reform unless there is substantial evidence to the contrary. Generally, the factors listed in 848-20-15-6 would be indicators that the contractual changes are not solely due to reference rate reform, subject to the modifications that we propose below.

We also believe that the items listed in 848-20-15-6 should be qualified such that only substantive modifications would refute the rebuttable presumption mentioned in the previous paragraph.

**Credit spread adjustment**

848-20-15-5(b) and 848-20-15-6(d) describe that a spread adjustment may be considered related or unrelated to reference rate reform. These criteria pose significant audit challenges and we recommend removing 848-20-15-6(d). We recommend that 848-20-15-5 should include a rebuttable presumption that the spread adjustment is solely related to reference rate reform, unless there is substantial evidence to the contrary, supported by the criteria in 848-20-15-6.

As currently drafted, the proposal would require entities to prove that the amendments are related solely to reference rate reform. We believe that this burden of proof creates undue cost and complexity for preparers and auditors. We believe it will be obvious when contract amendments are not related to reference rate reform.

We recommend the following revisions to the proposal:

848-20-15-5

b. Changes for a spread adjustment shall be considered related to reference rate reform unless there is substantive evidence to the contrary for the difference between an existing reference rate and the replacement reference rate (for example, adding or adjusting a spread to the interest rate index, amending the fixed rate for an interest rate swap, or paying or receiving a cash settlement for any difference intended to compensate for the difference in reference rates)

848-20-15-6

d. Changes to the counterparty credit spread (other than an adjustment of the overall spread to include the spread adjustment described in paragraph 848-20-15-5(b))
In-the-money options
848-20-15-5(e) allows the addition of an out-of-the-money option and 848-20-15-6(f) disallows the addition of an in-the-money option. We believe that the Board intended for this guidance to apply to additions of new options, amendments of existing options, and a change in the reference rate that results in an option in the modified contract that had been previously out-of-the-money, but is now in-the-money. Additionally, the “moneyness” of an option can be viewed in several ways: based on the current spot rate, based on the swap rate, or based on the forward rate on each exercise date. We believe that the Board intended this analysis to be performed based on the spot rate.

We recommend the following revisions to the proposal:

848-20-15-5
e. Addition or modification that results in an interest rate floor or cap that is out-of-the-money-interest rate floor or cap based on the spot rate at the time of the amendment of the contract.

848-20-15-6
f. The substantive addition or modification that results in an interest rate floor or cap that is in-the-money-cap or floor based on the spot rate at the time of the amendment of the contract when the previous floor or cap was out-of-the-money based on the spot rate at the time of the amendment of the contract.

Payment frequency
848-20-15-5(c) allows changes in the payment dates, among other items. We note that SOFR, as currently constituted, is only an overnight rate with no term structure. However, SOFR may be compounded over any period that is negotiated by the parties to the transaction. Much of current debt pays monthly or quarterly. Given the shift in how the reference rate will work, we anticipate that entities may change the frequency of payments as part of the conversion to an alternative reference rate. A change in payment frequency does not change the overall cash flows from the relationship and there is a minimal impact to valuation given slight discounting differences. We believe that a change in payment frequency is not indicative of a new underwriting or credit decision.

We recommend the following revisions to the proposal:

848-20-15-5
c. Changes to the reset period, reset dates, day-count conventions, business-day conventions, payment dates, payment frequency and repricing calculation (for example, a change from a forward-looking term rate to an overnight rate or a compounded overnight rate in arrears with the same, or modified, payment frequency)

Counterparty
848-20-15-6(l) prohibits changes to the counterparty to the agreement. This seems to conflict with the guidance in ASU 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (a consensus of the Emerging Issues Task Force). Our outreach to market participants indicates that there is a possibility that some centrally cleared transactions may be novated to a different clearing house depending on the market conditions at the time of the transition. ASU 2016-05 recognizes that a counterparty, in and of itself, is not a critical term of a hedging relationship.
We recommend removing 848-20-15-6(l) or revising it as follows:

848-20-15-6
l. Substantive changes Changes to the counterparty to the agreement, except for derivatives and the designated hedged item in a qualifying hedging relationship.

Change in maturity date
848-20-15-6(b) prohibits changes in the maturity date of the instrument. However, this strict prohibition seems to be in conflict with BC30 in which the Board indicates that a minor change in maturity date would be permissible.

We recommend the following revisions to the proposal:

848-20-15-6
b. Changes to the maturity date, other than those necessary to conform to an allowable change in payment frequency, business days, or other market convention such as those indicated in 848-20-15-5

Fall back provisions
848-20-15-5 does not mention the addition or modification of fall back provisions. Industry wide the modification of fall back provisions is one of the key tools intended to facilitate the transition to alternative reference rates. While changes to the rate index are mentioned in 848-20-15-5(a), this item can be interpreted as the actual amendment of the index rather than the insertion or modification of language that predetermines what the successor rate index will be in case one or more triggering events occur.

We recommend the following revisions to the proposal:

848-20-15-5
f. Addition or amendment of language that determines the successor rate index, with appropriate other conforming changes, based on one or more triggering events that are related to reference rate reform

Policy level addendum to hedge documentation
848-30-25-4 allows an entity to create an addendum to hedge documentation in order to apply the optional expedients and exceptions. We note that hedge documentation can be prepared for an individual hedging relationship or at a policy level. We believe that the proposal should not restrict the level of the addendum.

We recommend the following revisions to the proposal:

848-30-25-4
If an entity elects an optional expedient in paragraphs 848-30-25-5 through 25-9, that should not, in and of itself, be considered a dedesignation of the hedging relationship. The entity shall provide an addendum to its hedge documentation noting the changes made to the hedging relationship at the time it performs its first assessment of effectiveness after the change was identified in accordance with paragraph 815-20-25-3(b)(2)(iv)(02). The addendum may be documented at either an individual hedging relationship or at a higher level.
**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.

*Presumption that hedge accounting should continue regardless of the change in hedged risk*

BC59(b) describes the Board’s presumption that hedge accounting should not be discontinued regardless of how the hedged risk and the hedged forecasted transaction are documented. We believe that including this thought process in the body of Topic 848 would be helpful. We recommend the following revision:

**848-30-05-2** For the avoidance of doubt, an entity would not be required to discontinue hedge accounting if it can assert that the underlying cash flows remain probable of occurring regardless of how the hedged risk and the hedged forecasted transaction are documented.

*Assessment relief for fair value and net investment hedging relationships*

848-40-25-8 through 25-9 provides relief for fair value hedging relationships that use the shortcut method to assess effectiveness. However, we believe that relief should be available for all methods of assessing effectiveness for fair value hedges, similar to that provided for cash flow hedges in 848-30. Many entities use long haul assessment methods and techniques. The proposal should grant the ability to modify these approaches or apply practical expedients to these relationships as well.

We also note that the proposal does not contain any explicit assessment relief for net investment hedging relationships. Cross currency swaps are frequently designated as net investment hedges, including float-float cross currency swaps which will be subject to reference rate reform. We recommend that the proposal extend comparable relief to fair value and net investment hedging relationships as it has to cash flow hedging relationships.

If these revisions are accepted, we also believe that BC11 should be updated accordingly.

*Net investment hedging relationships*

We believe that net investment hedging relationships qualify for the relief granted in 848-10, 848-20, and 848-30 that are not restricted to cash flow hedges. We believe that explicitly stating that net investment hedging relationships qualify for this relief would be helpful to prevent inconsistent application of the proposal. We also believe that the assessment relief that is granted to cash flow hedging relationships should be extended to net investment hedging relationships.

Additionally, it would be helpful to note in 848-20-15-5 that certain derivatives may be amended multiple times and different jurisdictions may transition to an alternative reference rate at different times. Multiple amendments of the contract should not invalidate the relief granted in the proposal.

If these revisions are accepted, we also believe that BC11 should be updated accordingly.

848-30-25-8 allows for rebalancing of fair value and cash flow hedging relationships, including addition of additional derivatives into the hedging relationship without redesignation. We believe that this relief should also be extended to net investment hedging relationships.
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.

Please refer to our response to question 1.

Additionally, we note that contracts may be amended in ways that are not contemplated in the proposal. Contracts that are centrally cleared are amended by terminating the original contract and executing a new contract. In the exchange-traded and over-the-counter derivatives markets, a modification can also be documented in several ways, such as an amendment to the original contract or a termination of the original contract and the execution of a new contract, which may have a non-zero value.

We believe that simultaneous termination of a contract and execution of a new contract should be allowable within the scope of the proposal.

We also note that 848-20-15-5(d) allows a change in strike price of an embedded interest rate option. We believe that a change in strike rate should be allowed for both embedded and freestanding options. We recommend the following amendments:

848-20-15-5
d. Changes to the strike price of a freestanding interest rate option or an existing embedded interest rate option

**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?

Yes, we agree with the proposal. Additionally, it would be helpful to provide a clear statement that amendments to contracts that disqualify them from relief are outside of the scope of Topic 848 and, therefore, do not impact the application of the proposal to the remaining contracts within the same Topic, Subtopic or Industry Subtopic.

Hedge Accounting

**Question 5—Change in Critical Terms:** Do you agree with the proposed exceptions to the requirement in Topic 815 to redesignate 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 with the proposed exceptions for changes in critical terms. Please see our response to question 1.

**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 optional expedients for fair value hedges. We feel that the assessment relief granted to cash flow hedges should be extended to fair value hedges and net investment hedges. Please refer to our response to question 1.

**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.

In general, we agree with the proposed expedients and exceptions related to cash flow hedges, subject to our responses to question 1.

**Benchmark rate designations**
We note that there are certain paragraphs that seem to not consider cash flow hedging relationships when a benchmark rate is designated in the hedged item. Benchmark rate designations continue to be an important topic, even though ASU 2017-12 permits an entity to hedge the contractually specified interest rate rather than a benchmark rate. Examples include cash flow hedge designations of commercial paper, repo transactions, short-term fixed-rate advances from the Federal Home Loan Bank, and hedges of future issuances of debt.

We believe that the proposal should not exclude benchmark rate hedging relationships from qualifying for this relief. We believe that certain paragraphs could be amended that would allow the relief to be applied in benchmark rate scenarios.

848-50-25-11(a) makes the qualitative assessment relief available only if both the hedged forecast transaction and the hedging instrument have a qualifying reference rate. In the hedging relationships listed above, the hedged items are existing fixed rate instruments or one or more future fixed rate instruments and will not reference a floating rate.

We recommend the following revisions to the proposal:

848-50-25-11
a. If both the hedged forecast transaction and the hedging instrument have hedging relationship designates a reference rate that meets the scope of paragraph 848-10-15-3, an entity may assume that the reference rate will not be replaced for the remainder of the hedging relationship. That is, an entity does not need to consider the likelihood of whether or when the reference rate will be discontinued or changed due to reference rate reform.

Conforming changes may be required to other paragraphs throughout Topic 848.

**Assessments based on an options’ terminal value**
The purpose of 848-50-25-7(c) is not clear to us. We note that there are several factors that drive the overall amount of cash flows on an option’s maturity date, including the notional amount. We believe that the proposal should not grant relief for notional mismatches. We recommend clarifying the intent of this relief.

Additionally, 848-50-25-11 through 25-12 and 848-50-35-15 through 35-16 propose a set of optional expedients to use for quantitative assessments. These expedients consider the fact pattern when the assessment is based on an option’s terminal value, but do not contemplate scenarios where elements of the option’s valuation have been excluded from the assessment of effectiveness. We recommend that the proposal be updated with
additional optional expedients for scenarios where items have been excluded from the assessment of effectiveness.

We also believe that the strike rate element of 848-50-35-16 should be extended to 848-50-25-12 as that fact pattern can be present both at inception and in subsequent assessments.

**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.

No, we believe hedging relationships should be subject to the same election level as all other contracts. We believe that the selective application of the optional expedients and exceptions could lead to earnings recognition of amounts deferred in other comprehensive income that otherwise would not be recognized.

The proposal appears to rely on the change in hedged risk guidance in 815-30-35-37A to prevent unintended recognitions of gains and losses. In our experience this guidance is not consistently interpreted or applied in practice. In addition, we understand the Board is in process of issuing changes to the codification aimed at providing additional clarity around applying 815-30-35-37A. It is challenging to determine if our concerns would be possible to occur without seeing the proposed codification changes related to 815-30-35-37A. As a result, we believe the guidance proposed in Topic 848 should be applied to all hedging relationships.

**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?

We believe that there should not be any required disclosure for this Topic other than those proposed in 848-10-65-1(c). Any other meaningful disclosures related to this Topic are market risk related and are best discussed in Management’s Discussion and Analysis. We believe that the disclosure requested by the Securities and Exchange Commission (“SEC”) Staff Statement on LIBOR Transition, dated July 12, 2019, requires adequate public company disclosure for stakeholders to understand the risks that are inherent within an entity’s transition plan.

As private companies and non-U.S. entities are not subject to SEC requirements, we feel it is appropriate to include comparable disclosure information in the footnotes. However, we note that Management’s Discussion and Analysis is not audited and we believe that these disclosures should not be subject to audit. We recommend the following edits to 848-10-65-1(c):
3. For entities that are not subject to the disclosure requirements of the U.S. Securities and Exchange Commission

   i. Assessment of the risks presented by the discontinuation of the contractual reference rate on each contract type
   ii. The actions the entity is taking to mitigate this risk
   iii. The impact to strategy, systems, models, and processes

**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?

Please see our response to question 9.

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

We believe that high level recognition that this Topic provides exceptions and optional expedients, which the entity has applied in its reporting, is appropriate. Any further disclosure would likely be costly and overly detailed for any reader of the financial statements.

**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?

No.

We believe that the optional expedients and exceptions should be available to apply retrospectively to the beginning of the fiscal year in which this Topic is adopted. The International Swaps and Derivatives Association expects in the first quarter of 2020 to publish a protocol to amend the fallback provisions in derivative contracts. Contracts can start to be amended for reference rate reform issues as soon as that protocol becomes available, which may occur before Topic 848 is issued. Transition activities are not likely to be contained to a single event in the marketplace. Some entities will take proactive steps to begin the transition while others will wait until they are compelled by the market or by regulators. Given the uncertainty with how the transition will be enacted across the market we suggest maximum flexibility in application of these expedients and exceptions.

**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?
No.

While there is a general expectation that LIBOR will no longer be available after 2021, there is still substantial work to be done. We note that the Sterling Overnight Index Average ("SONIA"), the expected replacement rate for GBP-LIBOR, has been available for more than 20 years, it has not yet exceeded 2/3 of the market liquidity as GBP-LIBOR.

We believe that the end of this relief should be principles based. A principle to consider is that the relief would end for a particular contract or hedging relationship when the ambiguity regarding its transition to an alternative reference rate, and any associated hedged items, is resolved.

Alternatively, this Topic could be applicable indefinitely with future standard setting to set the end of relief.