October 7, 2019

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

Dear Mr. Kuhaneck:


Thank you for the opportunity to comment on the proposed Reference Rate Reform (Topic 848). We applaud the proactive approach to addressing reference rate reform as it applies to numerous accounting standards.

Hedge Trackers, LLC is a hedging and derivative accounting advisory practice and provider of related tools and software. Our clients include a full spectrum of public and private companies, as well as financial institutions. Our clients generally execute derivatives to protect their margins from interest rate, currency or commodity price fluctuations. Our reactions and responses to the proposed update reflect our experience as a service provider and our understanding of our clients and their hedging requirements.

We welcome the proposed guidance and believe the provision of optional expedients and temporary exceptions to GAAP achieves the FASB’s objective of easing the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting.

In the attached document please find our comments in response to selected questions posed by the Board, as well as our observations in areas not directly addressed in the proposal that the FASB may yet consider. If you require additional clarification or have questions on our response, please contact me at hkane@hedgetrackers.com or 408.350.8580.

Sincerely,

Helen Kane  
CEO  
Hedge Trackers, LLC
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?

The proposal recognizes that reference rate reform will likely drive changes to interest rate swap critical terms beyond the reference rate, including possible changes to the reset period, reset dates, day-count conventions, business-day conventions, repricing calculations and a spread adjustment for the difference between the existing reference rate and the replacement reference rate. For high volume end users of interest rate derivatives the proposal would require the modification of hundreds of individual derivative contracts with numerous counterparties to maintain special hedge accounting. High volume end-users could re-cast their hedge portfolio most efficiently by exiting existing derivatives and re-executing new derivatives. This would very likely result in changes to the counterparties. Without this exception, end users will be at a disadvantage in negotiating the critical terms when counterparties realize end-users cannot exit the contract and redesignate the relationship in a cost effective manner. There are substantial opportunities for abuse (cost) in a new, undeveloped marketplace. Hedging entities should be permitted an optional expedient to replace an existing derivative with a new derivative referencing another interest rate index and pointing to the original hedge designation documentation when the changes to the derivative are consistent with the “changes to terms that are related to the replacement of the reference rate” as outlined in 848-20-15-5 in the proposal and do not incorporate changes outlined in 848-20-15-6 (except 848-20-15-6 l Changes to the counterparty to the agreement) and identified as “terms that are unrelated to the replacement of the reference rate”. For example, an entity should be free to replace an outstanding pay-fixed receive-variable interest rate swap referencing 3M LIBOR for $250M expiring on 12/31/2030 with a pay-fixed receive-variable interest rate swap referencing SOFR for $250M expiring on 12/31/2030. This avoids the additional costs associated with the lengthy documentation and extensive effectiveness testing associated with new hedge relationships, especially as new effectiveness testing protocols are under construction and interpretation.

Additional costs are also likely to be associated with acquisition or derivation of effectiveness testing data in new undeveloped marketplaces as various practitioners develop and auditors evaluate new testing methodologies. We invite the FASB to add an optional expedient to use historically appropriate reference rates and rate changes as one (of many) appropriate proxies for effectiveness testing of new interest rates (both US and international markets), at least through December 31, 2022.

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.

Due to the costs identified above we reiterate the need for additional optional expedients related to reference rate reform:

Hedging entities should be permitted an optional expedient to replace an existing derivative with a new derivative referencing another interest rate index and point to the original hedge designation documentation when the changes to the derivative are consistent with the “changes to terms that are related to the replacement of the reference rate” as outlined in 848-20-15-5 in the proposal and do not incorporate changes outlined in 848-20-15-6 (except 848-20-15-6 l) and identified as “terms that are unrelated to the replacement of the reference rate”. For example, an entity should be free to replace an outstanding pay-fixed receive-variable interest rate swap referencing 3M LIBOR for $250M expiring on 12/31/2030 with a pay-fixed receive-variable interest rate swap referencing SOFR for $250M expiring on 12/31/2030.

The FASB would assist end users of derivatives by specifically permitting the use of historical (i.e. LIBOR) reference rate and historical rate change data as one (of many) appropriate proxies for effectiveness testing of new interest rates (both US and international markets), at least through December 31, 2022.

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 agree with the critical terms outlined in 848-20-15-5 and would propose specific to derivative instruments the addition of “Changes to the counterparty to the agreement” as a related change, and its removal from 848-20-15-6 to provide end users with sufficient leverage in renegotiating derivative instruments.

**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?

One useful quantitative disclosure would be the notional value of derivative contracts in hedge relationships where the rates subject to rate reform for derivatives and hedged items are not currently synchronized. Such a disclosure would highlight imperfect hedge relationships that are not otherwise disclosed. For example, $250M of the company’s debt continues to reprice on 3m LIBOR, while the $250M pay-fixed receive-variable interest rate derivative hedging this debt reprices on SOFR.

**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?

The termination date appears rational for US LIBOR based contracts. However, the transition to a new reference rate will be wholly dependent on the market place and market makers. In addition, many US constituents execute contracts in numerous currencies around the world which are indexed to non-USD reference rates. Those transitions will also be dependent on the market place and market makers. The proposed timeline may not be adequate, especially if a marketplace transitions to multiple rates before settling on a globally acceptable rate.