ISDA Safe, Efficient Markets

June 6th, 2022

Ms. Hillary Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

By email: director@fasb.org

Re: File Reference No. 2022-001, Reference Rate Reform (Topic 848) and Derivatives and Hedging (Topic 815)

Dear Ms. Salo,

The International Swaps and Derivatives Association's (ISDA)[1] Accounting Policy Committee appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update, *Reference Rate Reform* (Topic 848) and *Derivatives and Hedging* (Topic 815) (the "Proposed ASU" or "Exposure Draft"). Collectively, the Committee members have substantial professional and practical expertise addressing accounting policy issues related to financial instruments. This letter provides our organization's overall views and priorities on the Proposed ASU.

ISDA supports the FASB's proposals in the Exposure Draft to defer the sunset date of Topic 848 and clarify the definition of the Secured Overnight Financing Rate (SOFR). We believe the Exposure Draft achieves the FASB's objective to ease the burden associated with the accounting and disclosing for interbank offered rate IBOR transition that will continue over the course of the next several years as well as the evolving nature of SOFR-based interest rates in financial markets. However, we have identified several areas where the proposed ASU could be further enhanced.

Substantive Comments for Clarifications

Issue 1: Deferral of the Sunset Date of Topic 848

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

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Question 1: Do you agree with the Board's decision to defer the sunset date of Topic 848 to a December 31, 2024 sunset date? If not, what date would you choose and why

Question 2: Do you agree with the proposed transition guidance and effective date for this issue? If not, please explain why not.

The Committee supports the Board's decision to defer the sunset date of Topic 848 to December 31, 2024, given the ongoing transition of legacy benchmark rates that will take place post the existing sunset of December 31, 2022. Our support notwithstanding, we believe Topic 848 provides appropriate safeguards to ensure appropriate application through the scoping criteria for when the guidance can be applied (ASC 848-10-15-3 to 15-4). Further, ASC 848-50-35-19(a) is a further safeguard to end the application of relief for cash flow hedges in advance of the sunset provision as hedges no longer qualify when neither the hedged item nor hedging instruments reference LIBOR. In Basis for Conclusion 10, due to the extension of USD LIBOR's publication to June 30, 2023, the Board indicated the sunset date would not cover contract modifications for USD LIBOR between December 31, 2022, and June 30, 2023, which is inconsistent with their intent for providing relief. However, as stated in the Committee's comment letter[2] on ASU 2020-04 – *Reference Rate Reform (Topic 848)*, a USD LIBOR-centric approach is not consistent with providing global relief from reference rate reform, as different jurisdictions are in different stages of identifying, approving, and implementing replacement reference rates. The Canadian Dollar Offered Rate is expected to be discontinued on June 30, 2024, and the Tokyo Interbank Offered Rate is expected to be discontinued on December 31, 2024, while the date for permanent discontinuation of EURIBOR (a widely used benchmark for debt and derivative instruments denominated in Euro) has yet to be identified. While the final cessation dates for these rates are within the time frame of the proposed sunset date, the final interest period on certain contracts will not come due until after the end of 2024. As a result, contract modifications and hedging relationships may not be impacted until after the sunset date and companies will no longer have the benefit of the relief in Topic 848.

While the Committee supports the extension of the Topic 848 sunset date, we believe a principles-based sunset date may be more appropriate given the ongoing nature of reference rate reform/IBOR transition. This approach would ease the burden associated with the uncertain transition timeline for other benchmark rates, such as the Euro Interbank Offered Rate (EURIBOR). Potential approaches for a principles-based sunset date could include a 12 month period after the final publication of the rate subject to cessation. The Committee believes the scoping criteria in ASC 848-10-14-3 to 15-4 and the conceptual sunset date would be sufficient to prevent abuse of the relief guidance.

[2] https://www.isda.org/a/mYVTE/ISDA-letter-to-FASB-File-Ref-no-2019-770-on-RRR-topic-848.pdf

Issue 2: Amendments to the Definition of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate

Question 3: Are the amendments in this proposed Update to the definition of the term Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate clear that other rates based on SOFR, such as SOFR term, are within the scope of the revised definition? If not, what clarifications would you make and why?

Question 4: Do you agree with the proposed transition guidance and effective date for this issue? If not, please explain why not.

The Committee supports the broadening of the definition of SOFR eligible to be considered a benchmark interest rate, but we believe further clarifications are required to make implementation of the proposed guidance operable. Within the definition and Basis for Conclusions, the Exposure Draft only provides a SOFR term rate, commonly referred to in the market as Term SOFR[3], as an example. As written, we believe there could be different interpretations regarding whether only SOFR OIS and the SOFR term rate are permissible or other SOFR OIS based rates are also permissible. Other commonly used variations of daily SOFR in the debt and derivatives markets include the SOFR Index and SOFR averages published by the Federal Reserve Bank of New York[4]. These variations are derived from the daily SOFR rate published by the Federal Reserve Bank of New York though vary in terms of how the final rate in the interest period is set.

Additionally, the Alternative Reference Rate Committee has recommended using CME Term SOFR and limiting the use of that Term SOFR rate to the interest rate index for certain debt instruments (e.g., loans and trade finance) and in derivatives executed by end-users that are intended to hedge cash products that reference the SOFR term rate. The Committee suggests clarifying within the codification that the definition of the SOFR Swap Rate includes any rate based on SOFR and suggests including a list of other examples such as the SOFR averages, SOFR index published by the Federal Reserve Bank of New York, Term SOFR published by Chicago Mercantile Exchange or Term SOFR published by Intercontinental Exchange.

Additionally, there is an ongoing project on the FASB's technical agenda "Reference Rate Reform – Fair Value Hedging". The Committee supports the FASB's initiative to develop a principle based approach to identifying interest rates eligible for fair value hedging of interest rate risk.

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[3] CME Term SOFR has been formally endorsed by the Alternative Reference Rate Committee. CME Term SOFR Reference Rates are administered by CME Group Benchmark Administration Limited (CBA) which is registered under Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019 (SI 2019/657) is authorized and supervised by the UK Financial Conduct Authority (FCA) and is aligned to the IOSCO Principles for Financial Benchmarks.

[4] https://www.newyorkfed.org/markets/reference-rates/sofr-averages-and-index

Other Accounting Issues Related to Reference Rate Reform

In addition to the deferral of the Topic 848 sunset date and definition of SOFR, the Committee believes there are several other accounting issues, as previously included in our response to the FASB's invitation to comment[5], that need to be addressed as part of the Reference Rate Reform project or another project in the short-term.

1. Application of the shortcut method when using SOFR
    a. It is unclear if entities can apply the shortcut method when the hedging relationship is based on the Federal Reserve Board of New York's published SOFR averages or index. As stated above in our response to question 3, the Committee believes additional clarification is needed around the definition of SOFR and if other rates based on SOFR OIS, such as the SOFR averages and index, are permissible. Given the operational intensity associated with calculating SOFR compounded daily in arrears, corporate hedgers swapping their fixed rate debt to SOFR are considering using swaps whose floating leg is indexed to the SOFR Index. As such, explicit inclusion of the SOFR Index as an eligible benchmark interest rate would allow companies to appropriately reflect the economics of the hedge in their financial statements.
    b. Additionally, when using SOFR OIS swaps, there could be payment date mismatches on the fixed leg of OIS swaps versus fixed rate debt instruments when seeking to apply the shortcut method. There is diversity in practice today regarding whether the payment date has to match in order to apply the shortcut method, and the Committee believes existing guidance needs to be amended to continue to allow entities the ability to use the shortcut method.

2. Due to the use of transition to overnight rates in some markets and continued use of legacy term rates in others, there is an inherent challenge when seeking to use float-for-float cross-currency swaps in a net investment hedge post the proposed Topic 848 sunset date as the reset periods will not match in certain circumstances. Under Topic 815, *Derivatives and Hedging*, there is a requirement that both sides have the same repricing interval but if a swap has one floating rate leg referencing SOFR OIS (which resets daily), and the other referencing EURIBOR (which resets monthly, quarterly, or semi-annually) there will be a mismatch. The Committee believes this requirement is unnecessary and should be removed to allow entities to continue to use float-for-float cross-currency swaps with different reset periods.

3. When creating pools of cash receipts or payments to consider for cash flow hedge accounting, there is limited guidance when determining if hedged items in the same pool share the same risk exposure other than it is to be assessed at inception and not on an ongoing basis. As part of the change in hedge risk guidance, the FASB should explicitly state that the similar (or same) risk criteria is only to be assessed at inception and not on an ongoing basis. Further, the guidance should be clarified that hedge effectiveness testing completed on the different rates within the pool when highly effective would satisfy this similar risk criteria and that a separate test is not required. After reference rate reform, this would allow entities to apply portfolio

[5] https://www.isda.org/a/QyigE/ISDA-Submits-Letter-to-FASB-on-Future-Agenda.pdf

hedging to portfolios that include different versions SOFR and/or that include different floors as long as those hedges continue to test highly effective. Further, as cash receipts and cash payments cannot be combined in one hedge, this would guard against macro hedging.

Absent explicit guidance, there may be diversity in practice on what can be combined and how testing is to be completed which may result in entities reclassifying gains/losses from Accumulated Other Comprehensive Income related to highly/perfectly effective LIBOR based cash flow hedges to current earnings when the cash flows are replaced by SOFR rate loans and are no longer able to apply the expedients in Topic 848. We believe this could be accomplished by modifying 848-50-35-20 through 848-50-35-23 to specifically permit ignoring similar risk assessment on hedged transactions. The Committee also believes this guidance should be incorporated in ASC 815 when the FASB addresses the change in hedged risk guidance. Due to the lack of guidance in cash flow hedging on how to assess if hedged items in the same pool share the same risk exposure, this would address diversity in practice.

4. For permanent amendments to ASC 815, differentiating hedged item and hedged risk including application to cash flow hedges of pooled cash receipts or payments with potentially differing characteristics (including inclusion of multiple interest rate floors, reset dates, payment dates, averaging methodologies, etc.). As noted in our response to the Invitation to Comment, the Committee believes continuing re-deliberations on this project are a high priority.

5. There were two items the FASB included Proposed ASU 2019-790 that the Committee believes were technical corrections and should be finalized expeditiously to allow pre ASU 2017-12 hedging practices to resume.

    a. Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)
        i. A dual hedge is one in which a foreign-currency-denominated debt instrument is designated as the hedging instrument in a hedge of a net investment in a foreign entity and the hedged item in a fair value hedge of interest rate risk designated in accordance with paragraph 815-20-55-38. Stakeholders indicated that a recognition and presentation mismatch for the dual hedging strategy was created by the amendments in paragraph 815-20-55-129. As a result, stakeholders indicated that the economics of the hedging strategy is not accurately reflected under hedge accounting. The mismatch resulted from the deferral of the foreign exchange remeasurement of the fair value hedge basis adjustment in accumulated other comprehensive income.
        ii. The ability to utilize dual hedges was inadvertently removed as a part of ASU 2017-12 and was expected to be fixed as part of ASU 2019-790. Below were the proposed amendments in ASU 2019-790:
            1. 815-20-55-129 As permitted by paragraph 815-20-55-38, Parent A may designate the EUR-denominated debt instrument as a hedge of its net investment in the German subsidiary and also as the hedged item in a fair value hedge of the debt instrument's foreign-currency-

denominated fair value attributable to changes in the designated benchmark interest rate. As a result of applying fair value hedge accounting, the debt's carrying amount will be adjusted to reflect changes in its foreign-currency-denominated fair value attributable to interest rate risk. Parent A should exclude the fair value hedge basis adjustment from the assessment of effectiveness in the designated net investment hedging relationship. Accordingly, The ~~the~~ notional amount of the debt that is designated as the hedging instrument in the net investment hedge will not change over time as a result of applying fair value hedge accounting such that it may ~~not~~ continue to match the ~~notional amount~~ portion of the net investment being hedged ~~net investment~~. The entity then applies the net investment hedge guidance in Subtopic 815-35 and the fair value hedge guidance in Subtopic 815-25. Because the debt's fair value hedge basis adjustment is not included in the assessment of effectiveness of the net investment hedging relationship, the effect of changes in the spot rate on the fair value hedge basis adjustment is recognized currently in earnings in accordance with Subtopic 830-20.

b. Applying the normal purchase and normal sales scope exception to a forecasted transaction to be eligible for contractually specified component risk hedging.
    i. The proposed amendments would clarify that for forecasted transactions that qualify for cash flow hedging and contractually specified components that qualify for contractually specified component risk hedging an entity would need to apply only the portion of the normal purchases and normal sales scope exception that requires all underlyings in the agreement to be clearly and closely related to the asset being sold or purchased.

Closing

We hope you find ISDA's comments and responses informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter please do not hesitate to contact the undersigned.

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