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VIA ELECTRONIC MAIL (director@fasb.org)

April 18, 2013

Ms. Susan M. Cosper
Technical Director and Chairman, Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. EITF-13A

Dear Ms. Cosper:

Chatham Financial ("Chatham") appreciates the opportunity to provide overall comments and specific responses to the questions for respondents on the Financial Accounting Standards Board's ("FASB" or the "Board") Proposed Accounting Standards Update, *Derivatives & Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes* (the "proposed Update").

Chatham serves as a hedging advisor to over 1,000 companies globally in a wide variety of industries. Several hundred of our clients apply the hedge accounting provisions of Topic 815 and will be directly impacted by the proposed amendments to the benchmark interest rate. Chatham assists companies with the implementation of Topic 815 on a daily basis for thousands of derivative transactions. Our services include providing assistance with hedge designation memos, effectiveness testing, derivative valuations, journal entries, and footnote disclosures for many different types of hedging relationships. Given our role, we believe that we are well-positioned to understand the impact and ramifications of the proposed Update on a broad spectrum of derivative end users and share the following comments and recommendations from that perspective.

<u>Overall Comments</u>

We applaud the efforts of the Emerging Issues Task Force ("EITF") and FASB to address, in a timely fashion, the inclusion of the Fed Funds Effective Swap Rate (OIS) as a benchmark rate for hedge accounting purposes. We recognize that the Board is planning to comprehensively address hedge accounting in the near future, but agree that this is a very limited-scope and important issue that warrants immediate attention given the substantial changes occurring in the marketplace and the impact of those changes on the hedging activities of many companies.

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As noted in the proposed Update, the increased focus by banks on their sources of funding (particularly overnight interbank borrowings through the Federal Reserve), the sometimes volatile spread risk between LIBOR and OIS, and the new regulatory requirements imposed under Dodd-Frank (including increased clearing of derivatives and the associated collateralization requirements) have amplified the exposure to and demand for hedging the Fed Funds rate. In light of these changes in the marketplace, valuation techniques for derivatives are also evolving. For example, the OIS curve is now commonly used to price new derivative transactions and to discount the cash flows of collateralized derivatives.[1] Given the prevalence and importance of OIS in today's financial markets, we concur with the EITF that it meets the criteria to be a benchmark rate, including the stipulations that it be a widely recognized and quoted rate that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in the U.S. market. We also believe that the Fed Funds effective rate benefits from being based on actual transactions that occur daily in the market, rather than hypothetical borrowing rates.

Accordingly, we are very supportive of the consensus reached by the EITF in the proposed Update. Notably, we believe the amendments will:

- Significantly improve the hedge accounting model in Topic 815 by better aligning the accounting results with entities' economic and risk management objectives for many common hedging relationships, including (1) hedges of financial instruments indexed to the Fed Funds effective rate, (2) forward hedges of anticipated debt financings, and (3) hedges of fixed-rate debt that entities desire to swap to a floating rate.
- Eliminate "accounting noise" (modeling inconsistencies) and reduce confusion for financial statement users. For example, assume an entity discounts its derivative cash flows using the OIS curve and desires to swap its fixed-rate debt to a floating rate. Under the current accounting model, any volatility in the LIBOR-OIS basis will create earnings volatility <u>simply because the entity is not permitted to use the OIS discount curve in measuring the changes in fair value of the hedged item attributable to changes in the benchmark interest rate</u>. In contrast, under the proposed Update, entities can eliminate that accounting noise by entering into a fixed-for-Fed Funds interest rate swap and designating the Fed Funds Effective Swap Rate (OIS) as the benchmark rate being hedged. Thus, the real economic basis differences would continue to be measured and recognized as ineffectiveness; however, the accounting noise would be eliminated by creating alignment between the discount curve used for the derivative, the discount curve used for the hedged item, and the index on the floating leg of the swap.
- Achieve further convergence with IFRS, which is less prescriptive than U.S. GAAP in terms of designating the benchmark interest rate.

[1] Chatham's core derivative models now use OIS discounting with dual-curve bootstrapping to establish a market standard "base price" for <u>all derivative transactions</u>, with appropriate economic adjustments related to credit risk and funding differentials then being applied to uncollateralized or partially-collateralized transactions.

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In discussions with our clients, we would like to highlight one potential concern that we hope can be appropriately addressed by the EITF and FASB. Specifically, we are concerned that entities' ability to effectively pursue prudent risk management practices may be unnecessarily restricted by the guidance in paragraph 815-20-25-6 that states:

> "Ordinarily, an entity shall designate the same benchmark interest rate as the risk being hedged for similar hedges…The use of different benchmark interest rates for similar hedges shall be rare and shall be justified." [Emphasis added]

We acknowledge that the guidance noted above is not being introduced by the proposed Update and, prior to the proposed amendments, there were already two potential benchmark rates that could be designated (Treasuries and LIBOR). However, based on our experience, the Treasury rate is designated only infrequently in comparison to LIBOR for hedges of interest rate risk due to (1) the inability to customize the terms of the derivative to match the terms of the underlying exposure (issuance date, maturity date, cash flow dates, etc.) and (2) the lack of liquidity associated with Treasury locks beyond a relatively short period (about three months). In our experience, with the exception of very short-dated Treasury locks used to lock-in interest rates related to anticipated debt issuances, LIBOR-based products are almost always used to hedge interest rate risk. In contrast, derivatives indexed to Fed Funds are much more akin to LIBOR-based products, particularly from a customization perspective (and we anticipate that liquidity for such products will continue to increase, especially if the accounting restrictions are removed). **As a result, the desire for companies to designate "different benchmark interest rates for similar hedges" will be heightened significantly if OIS is permitted as a benchmark.**

Going forward, certainly there will be situations in which entering into a LIBOR-based derivative will be prudent from a risk management perspective, and situations in which entering into a Fed Funds-based derivative will be most prudent from a risk management perspective. We believe those decisions will be "justified" and have a very sound economic basis, but we are concerned that such situations may not be "rare" (even for similar hedges) as stipulated by the current guidance. Examples include the following:

1. An entity desires to lock-in interest rates related to its anticipated fixed-rate financings approximately six months to one year before the expected debt issuance dates. The entity may alternatively prefer to use a forward-starting LIBOR-based swap or forward-starting swap indexed to Fed Funds, depending on which product best meets its risk management and economic objectives at a given point in time. The ultimate decision likely depends on the current risk management strategy, pricing, and marketplace liquidity. Current market liquidity generally favors LIBOR-based forward-starting swaps. However, when an entity desires to minimize variability in swap spreads (a significant consideration for many risk managers), forward-starting swaps indexed to Fed Funds generally are preferable (or would be with the more favorable accounting treatment afforded in the proposed Update).

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2. A community or regional bank originates a mix of Prime-based loans and LIBOR-based loans (which is very common for our banking clients). The bank is seeking to manage the interest rate risk and basis risk inherent in its portfolio by swapping a portion of its fixed-rate debt to floating. Given the cash flow characteristics of its floating-rate assets, from a risk management perspective, the bank may need to swap a portion of its debt to LIBOR (matching the cash flow characteristics of its LIBOR-based assets) and a portion of its debt to the Fed Funds effective rate (which likely provides much better correlation with its Prime-based assets).

Accordingly, we are concerned that retaining the "shall be rare" language in Topic 815 may unnecessarily restrict many prudent risk management practices, which we do not believe was the intent of the EITF or FASB, and <u>we genuinely cannot conceive of any potential harm or abuse or meaningful additional complexity that would result from permitting the use of different benchmark interest rates for similar hedges</u>. Thus, although the inclusion of OIS as a benchmark rate is a welcome improvement to the hedge accounting model, we are concerned (1) about how the "shall be rare" guidance will be interpreted in practice and (2) that prudent risk management may be needlessly restricted, even when such decisions are clearly justified.

Our sole recommendation, therefore, would be to simply remove "shall be rare and" from paragraph 815-20-25-6, which we believe would significantly increase the usefulness of the proposed amendments and alleviate potential implementation challenges and concerns.

<u>Answers to Specific Questions to Respondents</u>

Question 1: *Do you agree that the Fed Funds Effective Swap Rate (OIS) should be included as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to UST and LIBOR? Why or why not?*

Yes. We strongly agree that the Fed Funds Effective Swap Rate (OIS) should be included as a benchmark interest rate. Adding OIS as a benchmark rate will better align the hedge accounting results with the economics of various common interest rate hedging strategies and will simplify the application of hedge accounting for many hedging relationships. As noted above, given the changes in today's marketplace, we believe the proposed amendments are both timely and appropriate.

Question 2: *Do you agree that no additional disclosures should be required? If not, please explain why.*

Yes, we agree. We believe the existing disclosure requirements provide sufficient information for investors to evaluate how companies use derivatives to manage risk, the associated risks being hedged, and how hedge accounting is being applied and impacts the financial statements.

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Question 3: *Do you agree that the proposed amendments only should be applied on a prospective basis for qualifying new or redesignated hedging relationships? If not, please explain why.*

Yes, we agree that the proposed amendments should be applied only on a prospective basis, which we believe is appropriate and consistent with the current provisions of Topic 815.

Question 4: *Should the effective date of the amendments in the proposed Update coincide with the issuance date of a final Update? If not, when should the amendments be effective? Please explain why.*

Yes, we believe the effective date of the amendments should coincide with the issuance date of a final Update. Given the current marketplace demand for hedging the Fed Funds rate, the elective nature of the proposed amendments, and the expectation that the proposed amendments would apply only on a prospective basis for qualifying new or redesignated hedging relationships, we see no reason for a delayed effective date.

Question 5: *If the effective date of the amendments in the proposed Update does not coincide with the issuance date of a final Update, should early adoption be permitted? If not, please explain why.*

Yes, early adoption should be permitted if the effective date of the amendments does not coincide with the issuance date of a final Update.

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We thank the Board for its consideration of our comments and recommendations and would be pleased to discuss these issues in more detail with the EITF, Board, or staff at your convenience. Please do not hesitate to contact me at (484) 731-0235 or at cmaxwell@chathamfinancial.com should you have any questions or desire further clarification on the topics discussed in this letter.

Sincerely,

/s/ Clark B. Maxwell

Clark B. Maxwell
Managing Director, Accounting Services
Chatham Financial

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