FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: February 20, 2018
Comments Due: March 30, 2018

Derivatives and Hedging (Topic 815)

Inclusion of the Overnight Index Swap (OIS) Rate Based on the Secured Overnight Financing Rate (SOFR) as a Benchmark Interest Rate for Hedge Accounting Purposes

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 815 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2018-220, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until March 30, 2018. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2018-220
- Sending a letter to "Technical Director, File Reference No. 2018-220, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Topic 815, Derivatives and Hedging, provides guidance on the risks associated with financial assets or liabilities that are permitted to be hedged. Among those risks is the risk of changes in fair values or cash flows of existing or forecasted issuances or purchases of fixed-rate financial assets or liabilities attributable to the designated benchmark interest rate (referred to as interest rate risk). At present in the United States, eligible benchmark interest rates are the interest rates on direct Treasury obligations of the U.S. government (UST), the London Interbank Offered Rate (LIBOR) swap rate, the Overnight Index Swap (OIS) Rate based on the Fed Funds Effective Rate, and the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate.

Because of concerns about the sustainability of LIBOR, the Federal Reserve Board and the Federal Reserve Bank of New York (Fed) are leading an effort to introduce an alternative reference rate in the United States. In 2014, the Fed convened the Alternative Reference Rates Committee (ARRC), made up of a consortium of major financial institutions and other market participants, to identify a suitable alternative to LIBOR that is more firmly based on transactions in a robust market. In June 2017, the ARRC announced that it identified a broad Treasury repurchase agreement (repo) financing rate referred to as the Secured Overnight Financing Rate (SOFR) as its preferred alternative reference rate. SOFR is a volume-weighted median spot interest rate that will be calculated daily on the basis of overnight transactions from the prior day's trading activity in specified segments of the U.S. Treasury repo market.

During the hedge accounting project that led to the issuance of Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* the Fed requested that the OIS rate based on SOFR be considered eligible as a U.S. benchmark interest rate for purposes of applying hedge accounting under Topic 815. Similar to the Fed Funds Effective OIS rate, which is a swap rate based on the underlying overnight Fed Funds Effective Rate, the OIS rate based on SOFR will be a swap rate based on the underlying overnight SOFR rate. The Fed has indicated that including the OIS rate based on SOFR as a benchmark rate for hedge accounting purposes would be helpful in facilitating broader use of the underlying SOFR rate in the marketplace.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect all entities that elect to apply hedge accounting to benchmark interest rate hedges under Topic 815.

What Are the Main Provisions?

The amendments in this proposed Update would permit use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815 in addition to UST, the LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate, and the SIFMA Municipal Swap Rate.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

In the United States, eligible benchmark interest rates under Topic 815 are UST, the LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate, and the SIFMA Municipal Swap Rate. The amendments in this proposed Update would add the OIS rate based on SOFR as a fifth U.S. benchmark interest rate. Including the OIS rate based on SOFR as a benchmark rate for hedge accounting purposes is intended to help entities avoid the potential cost and complexity associated with using different cash flows and discount rates to measure the hedged item and the hedging instrument and, therefore, to enable entities to appropriately depict risk management strategies. Including the OIS rate based on SOFR as an eligible benchmark interest rate during the early stages of the marketplace transition will provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes.

When Would the Amendments Be Effective?

The effective date will be determined after the Board considers stakeholders' feedback on the amendments in this proposed Update. The amendments would be applied on a prospective basis for qualifying new or redesignated hedging relationships entered into on or after the date of adoption.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: The Board decided to propose that the OIS rate based on SOFR should be added as a U.S. benchmark interest rate. Should the OIS rate based on SOFR be included as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815? Why or why not?

Question 2: The Board's proposal to add the OIS rate based on SOFR, rather than a broader SOFR swap rate that would be the equivalent of the LIBOR swap rate, is based on the ARRC's paced transition plan, which indicates that OIS swaps referencing SOFR are expected to begin trading in 2018. Over a longer term horizon, swaps referencing a SOFR term rate (that is, tenors greater than overnight) may be developed in the marketplace. Should a broader SOFR swap rate be included as a U.S. benchmark interest rate instead of the OIS rate based on SOFR?

Question 3: For hedging relationships of benchmark interest rate risk for which the designated hedged risk will be changes in fair values or cash flows attributable to changes in the OIS rate based on SOFR, should the Board consider providing any transition relief upon designation of SOFR as a benchmark rate? If so, please describe the specific types of relief needed and whether relief is necessary for existing hedging relationships based on LIBOR that will transition to SOFR or newly designated hedging relationships based on SOFR.

Question 4: Should additional disclosures be required? If yes, please explain what specific additional disclosures should be required and why.

Question 5: Should the proposed amendments be applied on a prospective basis only for qualifying new or redesignated hedging relationships? If not, please explain why.

Question 6: Should the effective date of the proposed amendments coincide with the effective date of Update 2017-12? If not, when should the proposed amendments be effective? Please explain why.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Section	Description of Changes
Master Glossary	Added a new glossary term *Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate* Amended existing glossary terms *London Interbank Offered Rate Swap Rate* and *Fed Funds Effective Swap Rate (or Overnight Index Swap Rate)*
Recognition (815-20-25)	Added the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate as a new U.S. benchmark interest rate for hedge accounting purposes

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–6. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

3. Add the new Master Glossary term *Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate,* with a link to transition paragraph 815-20-65-4, as follows: **[Note: The definitions of *Benchmark Interest Rate* and *Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate* are shown for convenience.]**

<u>Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate</u>

<u>The fixed rate on a U.S. dollar, constant-notional interest rate swap that has its variable-rate leg referenced to the Secured Overnight Financing Rate (SOFR) (an overnight rate) with no additional spread over SOFR on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception because the present value of fixed cash flows, based on that rate, equates to the present value of the variable cash flows.</u>

Benchmark Interest Rate

A widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. It is a rate that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions.

In theory, the benchmark interest rate should be a risk-free rate (that is, has no risk of default). In some markets, government borrowing rates may serve as a benchmark. In other markets, the benchmark interest rate may be an interbank offered rate.

Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate

The fixed rate on a U.S. dollar, constant-notional interest rate swap that has its variable-rate leg referenced to the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index with no additional spread over the SIFMA Municipal Swap Index on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception because the present value of fixed cash flows, based on that rate, equates to the present value of the variable cash flows.

4. Amend the following Master Glossary terms, with a link to transition paragraph 815-20-65-4, as follows:

Fed Funds Effective <u>Overnight Index</u> Swap Rate ~~(or Overnight Index Swap Rate)~~

The fixed rate on a U.S. dollar, constant-notional interest rate swap that has its variable-rate leg referenced to the Fed Funds effective rate <u>(an overnight rate)</u> with no additional spread over the Fed Funds effective rate on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception because the present value of fixed cash flows, based on that rate, equates to the present value of the variable cash flows.

London Interbank Offered Rate <u>(LIBOR)</u> Swap Rate

The fixed rate on a single-currency, constant-notional interest rate swap that has its variable-rate leg referenced to the London Interbank Offered Rate (LIBOR) with no additional spread over LIBOR on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception because the present value of fixed cash flows, based on that rate, equate to the present value of the variable cash flows.

Amendments to Subtopic 815-20

5. Amend paragraph 815-20-25-6A, with a link to transition paragraph 815-20-65-4, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> > > Hedged Items Involving Interest Rate Risk

815-20-25-6 Hedges involving a **benchmark interest rate** are addressed in paragraphs 815-20-25-12(f) and 815-20-25-12A (for fair value hedges) and paragraph 815-20-25-15(j) (for cash flow hedges). Hedges involving a contractually specified interest rate are addressed in paragraph 815-20-25-15(j) (for cash flow hedges). The benchmark interest rate or the contractually specified interest rate being hedged in a hedge of **interest rate risk** shall be specifically identified as part of the designation and documentation at the inception of the hedging relationship. Paragraphs 815-20-25-19A through 25-19B provide guidance on the interest rate risk designation of hedges of forecasted issuances or purchases of debt instruments. An entity shall not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a **prepayable** instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the overall fair value of that prepayment option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an **embedded derivative** of the same risk class shall be considered in designating a hedge of an individual risk. For example, the effect of an embedded prepayment option shall be considered in designating a hedge of interest rate risk.

> > > > Benchmark Interest Rate

815-20-25-6A In the United States, the interest rates on direct Treasury obligations of the U.S. government, the **{add glossary link}**London Interbank Offered Rate (LIBOR) swap rate**{add glossary link}**, the **Fed Funds Effective <u>Overnight</u>**

Index **Swap Rate** ~~(also referred to as the Overnight Index Swap Rate)~~, ~~and~~ the **Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate**, and the **Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate** are considered to be benchmark interest rates. In each financial market, generally only the most widely used and quoted rates may be considered benchmark interest rates.

6. Add paragraph 815-20-65-4 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2018-XX, *Derivatives and Hedging (Topic 815): Inclusion of the Overnight Index Swap (OIS) Rate Based on the Secured Overnight Financing Rate (SOFR) as a Benchmark Interest Rate for Hedge Accounting Purposes*

815-20-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2018-XX, *Derivatives and Hedging (Topic 815): Inclusion of the Overnight Index Swap (OIS) Rate Based on the Secured Overnight Financing Rate (SOFR) as a Benchmark Interest Rate for Hedge Accounting Purposes:*

a. The pending content that links to this paragraph shall be effective for fiscal years and interim periods beginning on or after [date to be inserted after exposure].
b. The pending content that links to this paragraph shall be applied prospectively for qualifying new or redesignated hedging relationships entered into on or after the date of adoption.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. Topic 815 permits a bifurcation-by-risk approach for hedges of financial assets and liabilities. Among the risks permitted to be hedged is the risk of changes in fair values or cash flows of existing or forecasted fixed-rate financial assets or liabilities attributable to the designated benchmark interest rate (referred to as interest rate risk). For simplicity, the stated interest rate in a financial asset or liability can be characterized as containing two components—a risk-free rate and a credit spread. The concept of the benchmark interest rate attributes any credit spread associated with a specific borrower to credit risk rather than interest rate risk. In permitting hedges of benchmark interest rate risk, the Board provided a practical means to designate the risk of changes in the hedged item attributable to changes in the risk-free component of the interest rate in isolation, without requiring that an entity also hedge changes in the spread above the benchmark interest component (which is deemed to reflect credit risk).

BC3. Initially, in the United States, for hedge accounting purposes only the interest rates on direct Treasury obligations of the U.S. government (UST) and, for practical reasons, the London Interbank Offered Rate (LIBOR) swap rate were considered benchmark interest rates. In 2013, the FASB issued Accounting Standards Update No. 2013-10, *Derivatives and 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*, which added the Overnight Index Swap (OIS) rate based on the Fed Funds Effective Rate as a third benchmark rate in the United States. Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* introduced the SIFMA Municipal Swap Rate as the fourth permissible U.S. benchmark rate.

BC4. When the LIBOR swap rate was first permitted as a benchmark interest rate for hedging purposes, LIBOR was observed to be the most widely referenced rate in derivative instruments and also was used as a reference rate in certain nonderivative financial instruments, such as some variable-rate loans. LIBOR continues to be the most commonly used reference rate. However, concerns about the sustainability of LIBOR have led to an effort to identify an alternative reference rate that is more firmly based on actual transactions in a robust market.

BC5. The Financial Stability Board and the Financial Stability Oversight Council indicated that the decline in wholesale unsecured short-term funding by banks, especially since the financial crisis, poses structural risks for unsecured benchmarks based on interbank offer rates. They also indicated that because U.S. Dollar LIBOR is used in such a large volume and broad range of financial products and contracts, the risks surrounding it pose a potential threat to the safety and soundness of individual financial institutions and to U.S. financial stability. Consequently, in November 2014, with support from several agencies including the U.S. Department of the Treasury, the U.S. Commodity Futures Trading Commission, and the Office of Financial Research, the Federal Reserve Board and the Federal Reserve Bank of New York (Fed) convened the Alternative Reference Rates Committee (ARRC) to identify a suitable alternative to LIBOR and to create an adoption plan with means to facilitate the acceptance and use of one or more alternative reference rates.

BC6. In June 2017, the ARRC announced that it had identified a broad Treasury repo financing rate as its preferred alternative reference rate. The rate is referred to as the Secured Overnight Financing Rate (SOFR). The Fed has announced plans to publish the daily SOFR rate in the second quarter of 2018, and the ARRC has announced a transition plan for its integration into the financial markets. SOFR will be calculated by the Fed on the basis of a specific methodology applied to a pre-defined set of repo transactions. That set will include transactions from the prior day's trading activity in specified segments of the U.S. Treasury repo market that are overnight or that are open transactions that reset daily. The ARRC's transition plan assumes that liquidity will first be established in short-term derivative instruments referencing SOFR followed by the use of SOFR by central counterparties as a discount rate. The Board understands that the objective of the transition plan is to gradually increase the duration of derivatives based on SOFR to create liquidity in contracts with longer term maturities.

BC7. During the hedge accounting project that led to the issuance of Update 2017-12, the Fed requested that the OIS rate based on SOFR be considered eligible as a U.S. benchmark interest rate for purposes of applying hedge accounting under Topic 815. This rate would be determined in a manner similar to other benchmark rates in Topic 815, such as the Fed Funds Effective Overnight Index Swap Rate and the LIBOR swap rate, which are derived from their underlying published rates of the Fed Funds Effective Rate and LIBOR, respectively. In support of its request, the Fed indicated that including the OIS rate based on SOFR as a benchmark rate for hedging purposes would be an important step toward acceptance of the new SOFR rate in the marketplace.

BC8. In paragraph BC77 of Update 2017-12, the Board acknowledged this issue:

> The Board acknowledges the Federal Reserve's initiative and the importance that emerging benchmark rates have in the marketplace. Therefore, the Board is prepared to add to the list of eligible benchmark rates as necessary when those rates emerge. The Board understands that the ARRC has identified its preferred alternative reference rate and is prepared to add a project to its agenda to consider adding that rate to the list of eligible benchmark rates when the Board and the Federal Reserve deem it appropriate. The Board observed that its decision to add the OIS rate in 2013 exemplified that the current standard-setting process enabled the Board to use judgment in considering the relevant aspects of that rate, including its emerging importance in the marketplace. The Board notes that there was no impediment to resolving that issue in a timely manner.

Benefits and Costs

BC9. The Board believes that the addition of the OIS rate based on SOFR as an eligible benchmark rate in GAAP on a timely basis will eliminate some of the uncertainty that potentially could hamper market acceptance of the new underlying SOFR rate. In addition, it will assist entities in planning to change hedging strategies after the new rate is introduced. Adding the OIS rate based on SOFR as a benchmark rate is intended to help preparers that will designate OIS swaps based on SOFR as hedging instruments by aligning the cash flows and discount rates used to measure the change in fair value of the hedging instrument and the hedged item and, therefore, to appropriately depict risk management strategies. In addition, the OIS rate based on SOFR may qualify for hedge accounting under IFRS 9, *Financial Instruments,* because IFRS 9 allows both a separately identifiable and a reliably measurable component of the financial instrument to be designated as the hedged risk. Furthermore, the Board believes that because the OIS rate based on SOFR will be more firmly based on actual market transactions in a robust market, this rate has the potential to more appropriately represent and faithfully reflect a risk-free rate than other currently permitted benchmark rates. Thus, its permitted use would be more consistent with the original intent of allowing benchmark rate hedging.

BC10. The Board does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update. The Board notes that because hedge accounting is elective, not all reporting entities would bear the costs of the proposed amendments. Therefore, any additional costs would apply only to those entities that mitigate market risks by applying hedge accounting and the expected benefits would justify the expected costs.

Basis for Conclusions

BC11. The amendments in this proposed Update would add the OIS rate based on SOFR to the list of eligible benchmark interest rates in the United States. In reaching this decision, the Board acknowledges that OIS contracts based on SOFR do not yet exist in the U.S. financial markets. Nonetheless, the Board decided to propose that the OIS rate based on SOFR be added as a benchmark interest rate for several reasons.

BC12. The Board considered the circumstances surrounding the Fed's request to add the OIS rate based on SOFR as a benchmark rate for hedge accounting purposes before the rate is present in swap contracts. The Board recognizes the underlying reasons for the effort undertaken to identify an alternative reference rate as discussed in paragraph BC5 and understands that there is widespread support for the ARRC's transition plan to integrate the underlying SOFR rate into the U.S. financial markets. The Board also is aware of the effect of the substantial changes occurring in the marketplace on hedging activities.

BC13. In accordance with its standard process for considering whether a new benchmark interest rate should be added for hedge accounting purposes, the Board assessed whether the future OIS rate based on SOFR would be expected to meet the characteristics of a benchmark rate in GAAP. The Master Glossary of the Codification defines the term *benchmark interest rate* as follows:

> A widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market. It is a rate that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions.
>
> In theory, the benchmark interest rate should be a risk-free rate (that is, has no risk of default). In some markets, government borrowing rates may serve as a benchmark. In other markets, the benchmark interest rate may be an interbank offered rate.

BC14. Although the OIS rate based on SOFR is an emerging rate, the Board believes that it would satisfy the characteristics of a benchmark rate according to the Master Glossary definition based on an assessment of the attributes of the repo transaction rates supporting the SOFR rate (and the OIS rate based on SOFR), which reflect the financing rates on overnight repo transactions secured by U.S. Treasury securities. From a credit risk perspective, overnight repo transactions collateralized by U.S. Treasury securities, which are regarded as among the highest quality securities in the financial system, are nearly risk free. The Board also observes that the repo transaction rates supporting the SOFR rate (and the OIS rate based on SOFR) are widely recognized and quoted in the

Treasury repo market, which is larger than the Fed funds market that underlies the OIS rate based on the Fed Funds Effective Rate. Therefore, when considered from the perspective of the underlying rates, the Board believes that the characteristics of a benchmark rate are satisfied.

BC15. This is different from the FASB's approach when it added LIBOR as a benchmark rate. At that time, the FASB considered the characteristics referenced in the Master Glossary definition of benchmark interest rate mainly based on the volume of derivative instruments referencing LIBOR, rather than the volume of underlying market-based transactions that support that rate. Given market evolution, the Board believes that it is compelling to evaluate those characteristics by focusing on the depth of the market for the underlying overnight Treasury repo transactions that support the OIS rate based on SOFR.

BC16. While the OIS rate based on SOFR may not immediately meet the characteristics of widely recognized, quoted, and referenced given the lack of derivative transactions referencing that rate, this is similar to the situation that existed when the FASB added the OIS rate based on the Fed Funds Effective Rate as a benchmark rate. At that time, as stated in paragraph BC8 of Update 2013-10, the OIS rate based on the Fed Funds Effective Rate was "evolving as a widely recognized and quoted rate" and "becoming more widely used in the U.S. financial market as an underlying basis for determining the interest rates of certain individual financial instruments." Since the rate was added in 2013, the Board notes that available data indicate that there has been an increase in the volume of overnight index swaps based on the Fed Funds Effective Rate. The Board believes that it is reasonable to expect a similar development for derivatives based on the underlying SOFR rate.

BC17. The Board also notes that the benchmark rate concept in GAAP is meant to incorporate some flexibility into the guidance to allow the addition or the subtraction of benchmark interest rates if changes in the financial markets indicate that such a change is warranted. For the reasons discussed, the Board believes that the circumstances surrounding the introduction of the underlying SOFR rate into the marketplace warrant the addition of the OIS rate based on SOFR as a new U.S. benchmark rate for hedge accounting purposes at the current time. The Board understands that the ARRC's transition plan also includes the planned introduction of a term rate based on derivatives referencing the underlying SOFR rates that reflects common borrowing intervals for cash instruments in 2021. The Board decided to limit its proposal to adding the narrow OIS rate based on SOFR (rather than a swap rate that contemplates SOFR-indexed borrowings with tenors greater than overnight) because the ARRC's transition plan currently anticipates introducing just OIS swaps based on SOFR in the marketplace in the near term while introducing swaps based on a term SOFR rate may evolve over a longer time horizon. An OIS is a specific type of interest rate swap in which the floating-rate reference index is an overnight rate, while a broader swap can have a floating leg based on any tenor, including tenors longer than overnight. The Board is soliciting feedback on whether a more generic swap rate based on SOFR that would be comparable to the LIBOR swap rate should be permitted. The Board notes that the LIBOR swap rate is still a widely recognized, quoted, and referenced rate in the financial market and continues to be an eligible benchmark rate.

Transition

BC18. The Board decided to propose that the potential guidance including a new benchmark rate can be applied only on a prospective basis for qualifying new or redesignated hedging relationships entered into on or after the date of adoption. As a practical matter, the Board believes that this guidance will be issued contemporaneously with the emergence of OIS contracts based on SOFR. Furthermore, retrospective application would be contrary to the hedge documentation requirements. The Board also decided to propose no transition disclosures because it believes that disclosure is unnecessary for the addition of a new benchmark rate. This is consistent with the approach taken for past additions of new benchmark rates in the United States.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at www.fasb.org and finalized as part of the annual release process.