March 29, 2018

Ms. Susan M. Cosper
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. 2018-220, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116

Dear Ms. Cosper,

Chatham Financial ("Chatham") is pleased to comment on the Financial Accounting Standards Board's ("FASB") Proposed Accounting Standards Update, *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 "Exposure Draft" or "proposal"). Chatham serves as a hedging advisor to over 2,000 companies globally in many different industries and executes more than $2 billion of OTC derivative notional each day in the global financial markets on behalf of its clients. More than 600 of our clients apply the hedge accounting provisions of Topic 815, so the proposal will affect many of our clients. Chatham assists companies with the application of Topic 815 on a daily basis for thousands of derivative transactions, including 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 we are well positioned to understand the impact and ramifications of the proposal on a broad spectrum of derivative end users and share the following comments and recommendations from that perspective.

Chatham supports the FASB's efforts to address concerns regarding the sustainability of LIBOR by adding additional U.S. benchmark interest rates under Topic 815. We believe the proposed changes will help companies prepare for the expected replacement of LIBOR; however, we believe it would be more helpful to add a broader SOFR swap rate as a benchmark interest rate rather than only adding the SOFR OIS rate. We also believe that it will be necessary to provide transition relief for existing hedging relationships to facilitate a smooth transition process. Additional detail on our comments is included in the Answer to Questions for Respondents section below. We would be happy to discuss our comments in more detail upon your request.

Answers to Questions for Respondents

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?

We are supportive of the Board's efforts to address concerns regarding the sustainability of LIBOR by adding the SOFR OIS rate as a benchmark U.S. interest rate under Topic 815. The proposal to add SOFR OIS as a benchmark U.S. interest rate will help ensure that companies will be able to choose from a relevant selection of benchmark rates given the Alternative Reference Rates Committee's ("ARRC") planned transition away from LIBOR after 2021. The ARRC's Second Report issued in March 2018 indicates that the establishment of a SOFR term reference rate is expected to develop by the end of 2021. However, given the demand for term SOFR rates by borrowers and end-users seeking to maintain the existing operational efficiencies that term rates offer, we are hopeful that term rates will become available sooner and are making this point to the ARRC and its workgroups. We believe it would be prudent to modify the definition of the SOFR benchmark rate to permit a broader SOFR swap rate to be added as a U.S. benchmark interest rate. We have provided a suggested modification of the SOFR OIS swap rate definition below that would accommodate the inclusion of a broader SOFR swap rate:

> **Secured Overnight Financing Rate (SOFR) ~~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 Secured Overnight Financing Rate (SOFR) or its term-based equivalents ~~(an overnight rate),~~ with no additional spread over SOFR or its term-based equivalents 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.

Once a liquid SOFR OIS market develops, including trading of short-term futures based on the OIS rate, it is expected that SOFR-based term rates are likely to develop soon thereafter. We believe such rates inevitably will develop based on our interactions with many financial institutions and their related corporate borrowers that seek reliability and predictability in forecasting interest expense and have long histories of borrowing at LIBOR-based term rates and will be seeking to transition to a similar SOFR-based term rate. Further support for this is included in the following excerpt from page 15 of the ARRC's Second Report:

> *"But while SOFR should be relatively easy to incorporate into derivatives, instruments in which many market participants are already familiar with contracts that reference an overnight rate rather than a term rate, participants in many cash products may find use of an overnight rate unfamiliar, even if it is averaged over time. Some participants and products might be able to adapt to the use of an overnight rate, perhaps especially larger firms with more sophisticated financing infrastructures or in consumer products, which require a safe and robust rate but not necessarily a forward-looking rate. <u>But other market participants</u>*

might find this type of transition more difficult. To address this issue, the ARRC has explicitly included a goal of producing a forward looking term rate for use in cash products in its Paced Transition Plan...”

Term interest rates (e.g., one month LIBOR, three month LIBOR) provide the benefit of fixing at the beginning of an accrual period. As a result, companies are able to predict what their interest expense will be for a given period. This facilitates accurate liquidity forecasting and enables companies to have cash available to make payments to lenders/counterparties on a timely basis. By comparison, the SOFR OIS rate would be a daily average that would change each day through the end of the accrual period. As a result, the payment amount due for interest on loans and interest rate swaps would not be known until the end of the accrual period. Payments for such amounts are typically due shortly thereafter, which could needlessly increase liquidity risk for companies trying to ensure they have adequate funds available in time to meet payment obligations.

The FASB’s proposal to add the SOFR OIS rate as a U.S. benchmark interest rate has helped the ARRC’s paced transition plan continue to move forward. Similarly, we believe support from the FASB to accommodate a broader SOFR-based swap rate rather than just the OIS rate would also prove helpful in expediting the development of a SOFR-based term market.

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.

We believe transition relief is necessary for existing hedging relationships based on LIBOR that will transition to SOFR in the following situations:

- **To address changes in critical terms and hedged risk**
  Hedging instruments with a LIBOR variable rate index will incur a change in that index to a SOFR-based rate prior to 2021. The fixed rate of the hedging instrument is likely to change as well (or the floating leg will adjust to SOFR plus a spread). Under current ASC 815 guidance, we believe these changes to the hedging instrument represent a change in critical terms that require a dedesignation and redesignation of the hedging relationship. We believe an exception should be added to Topic 815 to specifically permit changes in hedging instruments (without requiring dedesignation and redesignation of the hedging relationships) stemming from the LIBOR index changing to SOFR, including the addition of a fixed spread to the variable index and/or changes to the fixed swap rate, when done “at-market” relative to then-current fair value of the LIBOR-based hedging instrument as part of transitioning to SOFR. In contrast, if the transition to SOFR is “off-market” relative to then-current fair value of the LIBOR-based hedging instrument, then we believe it would make sense for the hedging relationship to be dedesignated and redesignated because the original economics of the transaction were changed. We believe this is an important feature to include in the final guidance, as the transition to SOFR could afford opportunities to restructure trades to achieve different economic results prospectively than were originally executed. We do not believe this is a desirable outcome, and permitting hedging relationships to continue without requiring a dedesignation and redesignation of the hedging relationship only when transition changes are made “at-market” will help prevent inappropriate changes from being made.

In addition, in both fair value hedges of fixed rate debt instruments and cash flow hedges of forecasted fixed rate debt issuances where the hedged risk is the change in fair value or cash flows attributable to changes in the benchmark LIBOR swap rate, we believe an exception should be added to Topic 815 to specifically permit changes in the designated hedged risk from the LIBOR swap rate to the SOFR benchmark rate when the variable rate of the hedging instrument changes from LIBOR to SOFR without requiring a dedesignation and redesignation of the hedging relationship. We believe this change should be permitted regardless of whether the hedging relationship has been designated using the Shortcut method or a long-haul method of assessing hedge effectiveness.

- **To address probability of forecasted transactions**
  When the maturity date of a cash flow hedging relationship of LIBOR-based interest payments extends beyond the SOFR transition date, a question arises as to whether or not the hedged transactions continue to be probable to occur. Topic 815 requires hedged transactions in a cash flow hedging relationship to be probable of occurring for hedge accounting to continue to apply. Further, if hedged transactions become probable not to occur, gains and losses recorded to other comprehensive income related to those hedged transactions are required to be reclassified immediately to earnings. We believe an exception should be added to Topic 815 to specifically permit companies a one-time opportunity to update existing hedge documentation to discuss the impact of the ARRC's planned transition away from LIBOR to SOFR on their hedged transactions, which will continue to be probable to occur but will be based on a different index. We acknowledge that the guidance in ASU 2017-12 permits a company to revise its hedged risk without requiring a dedesignation and resignation of the hedging relationship. However, we believe there is diversity in practice regarding how this change will be treated and, as a result, we recommend that the FASB update Topic 815 to explicitly allow companies the opportunity to update their original hedge documentation to address the impact of this specific change.

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

No, we do not believe that additional disclosures are necessary to reflect the addition of adding SOFR as a U.S. benchmark interest rate.

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.

We believe the proposed amendments should be applied prospectively to both new and existing hedging relationships. However, we believe it is important to add the transition provisions described in our response to Question 3 that will allow existing hedging relationships to continue post transition without the need to dedesignate and redesignate those hedging relationships when LIBOR is replaced with SOFR.

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.

Yes we believe it is reasonable to have the effective date of the proposed amendments coincide with the effective date of ASU 2017-12, including the ability to early adopt the guidance upon issuance.