FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: September 5, 2019
Comments Due: October 7, 2019

Reference Rate Reform (Topic 848)

Facilitation of the Effects of Reference Rate Reform on Financial Reporting

The Board issued this Exposure Draft to solicit public comment on the addition of Topic 848 to 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. 2019-770, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

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 October 7, 2019. 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. 2019-770
- Sending a letter to "Technical Director, File Reference No. 2019-770, 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®

Proposed Accounting Standards Update

Reference Rate Reform (Topic 848)

Facilitation of the Effects of Reference Rate Reform on Financial Reporting

September 5, 2019

Comment Deadline: October 7, 2019

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

The Board is proposing optional guidance for a limited time to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting.

In response to concerns about structural risks of interbank offered rates (IBORs), and, particularly, the risk of cessation of the London Interbank Offered Rate (LIBOR), regulators in several jurisdictions around the world have undertaken reference rate reform initiatives to identify alternative reference rates that are more observable or transaction based and less susceptible to manipulation.

Stakeholders raised certain operational challenges likely to arise in accounting for contract modifications and hedge accounting due to reference rate reform. Some of those challenges relate to the significant volume of contracts and other arrangements, such as debt agreements, lease agreements, and derivative instruments, which will need to be modified to replace references to discontinued rates with references to replacement rates. For accounting purposes, such contract modifications are required to be evaluated in determining whether the modifications result in the establishment of new contracts or the continuation of existing contracts. Stakeholders indicated that due to the significant volume of affected contracts and other arrangements, together with a compressed time frame for making contract modifications, the application of existing accounting standards on assessing modifications versus extinguishments could be costly and burdensome and financial reporting results should reflect the intended continuation of such contracts and arrangements.

Stakeholders raised additional accounting issues specific to hedge accounting. Specifically, changes in a reference rate could disallow the application of certain hedge accounting guidance, and certain hedging relationships may not qualify as highly effective during the period of the market-wide transition to a replacement rate. Stakeholders indicated that the inability to apply hedge accounting because of reference rate reform would result in financial reporting outcomes that do not reflect entities’ intended hedging strategies when those strategies continue to operate as effective hedges.

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

The amendments in this proposed Update would be elective and would apply to all entities, subject to meeting certain criteria, for contract modifications or hedging relationships that are referencing LIBOR or another reference rate expected to be discontinued due to reference rate reform.

What Are the Main Provisions?

The amendments in this proposed Update would provide optional expedients and exceptions for applying generally accepted accounting principles (GAAP) to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met.

The amendments in this proposed Update would apply only to contracts and hedging relationships that reference LIBOR or another reference rate expected to be discontinued due to reference rate reform. The proposed expedients and exceptions provided by the amendments would not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022.

Optional Expedients for Contract Modifications

The amendments in this proposed Update would apply to contract modifications that replace a reference rate affected by reference rate reform (including rates referenced in fallback provisions) and contemporaneous modifications of other contract terms related to the replacement of the reference rate.

The following optional expedients for applying the requirements of certain Topics and Subtopics in the Codification would be permitted for contracts that are modified due to reference rate reform and that meet certain scope guidance:

1. Modifications of contracts within the scopes of Topic 310, Receivables, and Topic 470, Debt, would be accounted for by prospectively adjusting the effective interest rate in the agreement.
2. Modifications of contracts within the scope of Topic 842, Leases, would be accounted for as a continuation of the existing contract with no reassessments or remeasurements that otherwise would be required under that Topic.
3. Modifications of contracts would not require a reassessment under Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, of whether an embedded derivative should be accounted for as a separate instrument.

For other Topics and Subtopics in the Codification, the amendments in this proposed Update also include a general principle that would permit entities to:

1. Consider modifications of contracts due to reference rate reform to be a continuation of those contracts
2. Not reassess previous determinations.

When elected, the optional expedients for contract modifications would be applied consistently for all contracts or transactions within the relevant Topic, Subtopic, or Industry Subtopic within the Codification that contains the guidance that otherwise would be required to be applied.

Exceptions to Topic 815 Guidance Related to Changes in Critical Terms of a Hedging Relationship

The amendments in this proposed Update would provide exceptions to the guidance in Topic 815 related to changes to the critical terms of an existing hedging relationship due to reference rate reform. The following changes would not result in the dedesignation of the hedging relationship if certain criteria are met:

1. Certain changes in the critical terms of a designated hedging instrument in a fair value, cash flow, or net investment hedge.
2. A change to rebalance or adjust the hedging relationship as follows:
   a. In a fair value hedge, a change in the proportion of the derivative designated as the hedging instrument or in the proportion of the designated hedged item or both.
   b. In a fair value hedge or a cash flow hedge, a change in the designated hedging instrument to add one or more additional derivatives (or proportions of those derivatives).
3. For a cash flow hedge, a change in the method used to assess hedge effectiveness when initially applying an optional expedient method and when reverting to the requirements in Subtopics 815-20, Derivatives and Hedging—Hedging—General, and 815-30, Derivatives and Hedging—Cash Flow Hedges.

Optional Expedients for Fair Value Hedges

The amendments in this proposed Update would provide the following optional expedients for existing fair value hedging relationships for which the derivative designated as the hedging instrument is affected by reference rate reform if certain criteria are met:

1. An entity may change the designated benchmark rate documented at hedge inception to a different eligible benchmark rate under Subtopic 815-20. The proposed amendments would permit two approaches for accounting for the change in the benchmark rate with flexibility in the

method used to implement each approach. The approach selected to account for the change in the benchmark rate would be an accounting policy election that would be required to be applied consistently across similar hedging relationships.

2. An entity that applied the shortcut method of accounting may continue to apply that method for the remainder of the hedging relationship notwithstanding certain qualifying conditions that would not have been met because of reference rate reform.

The optional expedients for fair value hedging relationships would be permitted to be elected on an individual hedging relationship basis.

Optional Expedients for Cash Flow Hedges

The amendments in this proposed Update would provide the following temporary optional expedients for cash flow hedging relationships affected by reference rate reform if certain criteria are met:

1. If the designated hedged risk is a rate that is affected by reference rate reform:
   a. An entity would disregard the potential change in the designated hedged risk that may occur due to reference rate reform when the entity assesses whether the hedged forecasted transaction is probable in accordance with the requirements of Topic 815.
   b. An entity would be permitted to continue hedge accounting for an existing cash flow hedge for which the hedged risk changes if either the hedge is highly effective under an assessment method in Subtopics 815-20 and 815-30 or an optional expedient method is elected.
2. For existing cash flow hedges for which the shortcut method or another method that assumes perfect hedge effectiveness is applied in accordance with Subtopic 815-20, an entity would be permitted to continue to apply that method notwithstanding certain qualifying conditions that would not have been met due to reference rate reform.
3. For new cash flow hedges for which either the hedging instrument or hedged forecasted transactions would reference a rate that is expected to be affected by reference rate reform, an entity would be permitted to adjust the application of the methods in Subtopics 815-20 and 815-30 used to initially assess whether cash flow hedge accounting may be applied (including the shortcut method and other assessment methods that assume perfect hedge effectiveness) to disregard the mismatch in variable interest rate indexes between the designated hedging instrument and the hedged item.
4. For new cash flow hedges of portfolios of forecasted transactions that reference a rate that is expected to be affected by reference rate reform, an entity may disregard the requirement in Subtopic 815-20 that the group

of individual transactions share the same risk exposure for which they are designated as being hedged.

5. For both existing and new cash flow hedges, an entity may adjust the application of the methods in Subtopics 815-20 and 815-30 used to subsequently assess whether cash flow hedge accounting may be applied (including the shortcut method and other methods that assume perfect hedge effectiveness) to disregard the mismatch in variable interest rate indexes between the designated hedging instrument and the hedged item due to reference rate reform. Alternatively, an entity may elect an optional expedient to continue cash flow hedge accounting if certain qualitative criteria are met each period, effectively suspending subsequent cash flow hedge effectiveness assessments that would otherwise be required by Subtopics 815-20 and 815-30.

The optional expedients for cash flow hedging relationships would be permitted to be elected on an individual hedging relationship basis. After electing an optional expedient method, an entity would be permitted to revert to existing hedge accounting requirements in Subtopics 815-20 and 815-30 without a dedesignation of the hedging relationship. Use of the optional expedients (including the optional expedient for application of the shortcut method and other methods that assume perfect hedge effectiveness) would be required to be discontinued either as of the date that neither the hedging instrument nor the hedged forecasted transaction references a rate that is affected by reference rate reform or after December 31, 2022. If a cash flow hedging relationship would continue after the entity ceases to apply an optional expedient method, the entity would be required to revert to applying the qualifying criteria and hedge assessment methods in Subtopics 815-20 and 815-30.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be effective for all entities upon issuance of a final Update. Upon adoption, an entity may elect to apply the proposed amendments prospectively to contract modifications made and to hedging relationships existing as of or entered into on or after the date of adoption and through December 31, 2022. The proposed amendments would not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022.

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.

General

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?

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.

Contract Modifications

Question 3—Expedients: Do you agree with the proposed expedients for the accounting for contract modifications? If not, please explain which proposed amendment(s) you disagree with and why.

Question 4—Election Level: Do you agree that the optional expedients for contract modifications should be applied at the relevant Topic, Subtopic, or Industry Subtopic level? If not, what alternative do you suggest and why?

Hedge Accounting

Question 5—Change in Critical Terms: Do you agree with the proposed exceptions to the requirement in Topic 815 to dedesignate 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.

Question 6—Fair Value Hedges: Do you agree with the proposed optional expedients for fair value hedge accounting? If not, please explain which proposed amendment(s) you disagree with and why.

Question 7—Cash Flow Hedges: Do you agree with the proposed optional expedients for cash flow hedge accounting? If not, please explain which proposed amendment(s) you disagree with and why.

Question 8—Election Level: Do you agree that the proposed exceptions and optional expedients related to hedge accounting should be applied on an individual hedging relationship basis? If not, please explain why.

Disclosures

Question 9—Contracts or Holdings: What quantitative and qualitative disclosures should be provided to help users understand a reporting entity's current contracts or holdings (as of the reporting date) that are affected by reference rate reform? For financial statement preparers, what costs would be incurred in providing these disclosures? For financial statement users, what alternative sources of information would be used if a reporting entity does not provide any quantitative and qualitative disclosures? What costs would be incurred to obtain quantitative and qualitative information to better understand a reporting entity's exposure to reference rate reform? Should the quantitative and qualitative disclosures, if any, have a termination date after December 31, 2022? If not, when should such disclosures expire and why?

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?

Question 11—Transition: Do the proposed transition disclosure requirements provide decision-useful information? If not, what would you recommend and why?

Transition and Termination Date

Question 12—Transition: Do you agree that the proposed optional expedients should be applied on a prospective basis upon election? If not, what alternative do you suggest and why?

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?

Amendments to the *FASB Accounting Standards Codification®*

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–7.

Addition of Topic 848

2. Add the General Note to the following Sections as follows:

Note on Reference Rate Reform: Some of the contract modifications subject to the guidance in this Section may qualify for application of the guidance in Topic 848.

Subtopics	Sections
310-20	310-20-35
310-40	310-40-05, 310-40-10, 310-40-15, 310-40-25, 310-40-30, 310-40-35, 310-40-40, 310-40-50, 310-40-55
470-50	470-50-40
470-60	470-60-05, 470-60-10, 470-60-15, 470-60-35, 470-60-45, 470-60-50
606-10	606-10-05, 606-10-10, 606-10-15, 606-10-25, 606-10-32, 606-10-45, 606-10-50, 606-10-55
810-10	810-10-05, 810-10-10, 810-10-15, 810-10-25, 810-10-30, 810-10-35, 810-10-40, 810-10-45, 810-10-50, 810-10-55
815-10	815-10-05, 815-10-10, 815-10-15, 815-10-25, 815-10-30, 815-10-35, 815-10-40, 815-10-45, 815-10-50, 815-10-55
815-15	815-15-05, 815-15-15, 815-15-25, 815-15-30, 815-15-35, 815-15-40, 815-15-45, 815-15-50, 815-15-55

Subtopics	Sections
842-10	842-10-05, 842-10-10, 842-10-15, 842-10-25, 842-10-30, 842-10-35, 842-10-55
842-20	842-20-05, 842-20-15, 842-20-25, 842-20-30, 842-20-35, 842-20-40, 842-20-45, 842-20-50, 842-20-55
842-30	842-30-05, 842-30-15, 842-30-25, 842-30-30, 842-30-35, 842-30-40, 842-30-45, 842-30-50, 842-30-55
842-40	842-40-05, 842-40-15, 842-40-25, 842-40-30, 842-40-50, 842-40-55
842-50	842-50-05, 842-50-15, 842-50-25, 842-50-30, 842-50-35, 842-50-45, 842-50-50, 842-50-55
944-30	944-30-05, 944-30-15, 944-30-25, 944-30-30, 944-30-35, 944-30-40, 944-30-45, 944-30-50, 944-30-55

3. Add Subtopic 848-10, with a link to transition paragraph 848-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Reference Rate Reform—Overall

Overview and Background

General

848-10-05-1 The Reference Rate Reform Topic includes the following Subtopics:

a. Overall
b. Contract Modifications
c. Hedging—General
d. Fair Value Hedges
e. Cash Flow Hedges.

848-10-05-2 Reference rates such as the London Interbank Offered Rate (LIBOR) are widely used in a broad range of financial instruments and other agreements. Regulators and market participants in various jurisdictions have undertaken efforts, generally referred to as reference rate reform, to eliminate certain reference rates and introduce new reference rates that are based on a larger and more liquid population of observable transactions. As a result of the reference rate reform initiative, certain widely used reference rates such as LIBOR are expected to be discontinued.

848-10-05-3 This Topic provides optional expedients for applying the guidance in certain Topics and Subtopics for contract modifications or other situations affected by reference rate reform. The guidance in this Topic is temporary in accordance with the guidance in paragraph 848-10-65-1(a).

Scope and Scope Exceptions

General

> Overall Guidance

848-10-15-1 The Scope and Scope Exceptions Section of the Overall Subtopic establishes the pervasive scope for the Reference Rate Reform Topic. Unless explicitly addressed within the specific Subtopics, the following guidance applies to all Subtopics of the Reference Rate Reform Topic.

> Entities

848-10-15-2 The guidance in this Topic applies to all entities.

> Scope

848-10-15-3 The guidance in this Topic, if elected by an entity, shall apply to contracts or other transactions that reference the London Interbank Offered Rate (LIBOR) or a reference rate that is expected to be discontinued as a result of reference rate reform.

> > Identifying an Eligible Reference Rate

848-10-15-4 The guidance in this Topic applies to all maturities of LIBOR in all jurisdictions and currencies. For other reference rates, an expectation of the discontinuance of the rate may result from any of the following:

a. A public statement or publication of information by or on behalf of the administrator of the relevant reference rate or by the regulatory supervisor for the administrator
b. Initiatives of market participants to move away from the reference rate
c. The production method for the calculation of the published reference rate is either:
    1. Fundamentally restructured
    2. Reliant on another rate that is expected to discontinue.

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2019-XX, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

848-10-65-1 The following represents the transition, end of application, and effective date information related to Accounting Standards Update No. 2019-XX, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting:*

a. The pending content that links to this paragraph shall be effective for all entities upon issuance of Update 2019-XX through December 31, 2022.
    1. Upon adoption, an entity may elect to apply the pending content that links to this paragraph prospectively to contract modifications made and hedging relationships existing as of or entered into on or after the date of adoption and through December 31, 2022.
    2. The pending content that links to this paragraph shall not be applied to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022.
b. An entity may elect the optional expedients in Subtopics 848-30, 848-40, and 848-50 only if it has adopted the amendments in Accounting Standards Update No. 2017-12*, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.
c. An entity shall provide the following disclosures:
    1. The nature of and reason for electing to apply the pending content that links to this paragraph
    2. The disclosures in (1) in each interim and annual financial statement period in the fiscal year of application.

4. Add Subtopic 848-20, with a link to transition paragraph 848-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Reference Rate Reform—Contract Modifications

Overview and Background

General

848-20-05-1 This Subtopic provides optional expedients for contract modifications undertaken due to reference rate reform. It specifically addresses the accounting for modifications of contracts within the scope of Topics 310 on receivables, 470 on debt, and 842 on leases. This Subtopic also provides a principle to account for modifications of contracts within the scope of other Topics and Subtopics not specifically addressed within this Subtopic.

Scope and Scope Exceptions

General

848-20-15-1 This Subtopic provides guidance on optional expedients for accounting for contract modifications when one or more terms are modified due to reference rate reform.

> Modifications of Terms

848-20-15-2 The guidance in this Subtopic, if elected, shall apply to contract modifications if the terms that are modified directly replace, or have the potential to replace, a reference rate within the scope of paragraph 848-10-15-3 with another interest rate index. If other terms are contemporaneously modified, those modifications shall be related to the replacement of a reference rate. For the purposes of this Subtopic, terms that may be modified are those that change, or have the potential to change, the amount or timing of contractual cash flows.

848-20-15-3 The guidance in this Subtopic shall not apply if a contract modification is made to a term that changes, or has the potential to change, the amount or timing of contractual cash flows and is unrelated to the replacement of a reference rate. That is, this Subtopic shall not apply if contract modifications are made contemporaneously to terms that are unrelated to the replacement of a reference rate.

848-20-15-4 Contemporaneous modifications of contract terms that do not change, or do not have the potential to change, the amount or timing of contractual cash flows shall be permissible without an assessment of whether those contemporaneous contract modifications are related or unrelated to the replacement of a reference rate.

> > Identifying Changes to Terms Related and Unrelated to the Replacement of the Reference Rate

848-20-15-5 Changes to terms that are related to the replacement of the reference rate are those that are made to effect the transition for reference rate reform. Examples of changes to terms that are related to the replacement of a reference rate in accordance with the guidance in paragraph 848-20-15-2 include the following:

a. Changes to the referenced interest rate index (for example, a change from London Interbank Offered Rate [LIBOR] to another interest rate index)
b. Changes for a spread adjustment for the difference between an existing reference rate and the replacement reference rate (for example, adding or adjusting a spread to the interest rate index, amending the fixed rate for an interest rate swap, or paying or receiving a cash settlement for any difference intended to compensate for the difference in reference rates)
c. Changes to the reset period, reset dates, day-count conventions, business-day conventions, payment dates, and repricing calculation (for example, a change from a forward-looking term rate to an overnight rate or a compounded overnight rate in arrears with the same payment frequency)
d. Changes to the strike price of an existing embedded interest rate option
e. Addition of an out-of-the-money interest rate floor or cap.

848-20-15-6 Changes to terms that are unrelated to the replacement of the reference rate include those that are made as a result of a new underwriting or business decision that is separate from or in addition to changes to the terms of a contract to effect the transition for reference rate reform. Examples of changes to terms that are unrelated to the replacement of a reference rate in accordance with paragraph 848-20-15-3 include the following:

a. Changes to the notional amount
b. Changes to the maturity date
c. Changes to the loan structure (for example, changing a term loan to a revolver loan)
d. Changes to the counterparty credit spread (other than an adjustment of the overall spread to include the spread adjustment described in paragraph 848-20-15-5(b))
e. The addition of an underlying or variable unrelated to the referenced rate index (for example, addition of payments that are indexed to the price of gold)
f. The addition of an in-the-money cap or floor
g. A concession granted to a debtor experiencing financial difficulty
h. The addition or removal of a prepayment or conversion option
i. The addition or removal of a leverage feature
j. The addition or termination of a right to use one or more underlying assets
k. Changes to renewal, termination, or purchase option provisions in a lease contract
l. Changes to the counterparty to the agreement.

> Modifications before the Discontinuance of a Reference Rate

848-20-15-7 An entity may modify the terms of a contract in anticipation of the discontinuance of the reference rate (that is, before the actual discontinuance of the reference rate).

Subsequent Measurement

General

> Option to Apply Expedients

848-20-35-1 An entity may elect to apply the guidance in this Subtopic to account for contract modifications that meet the scope of paragraphs 848-20-15-2 through 15-3. If an entity elects to apply the guidance in this Subtopic, the entity shall apply it for all contract modifications that meet the scope of paragraphs 848-20-15-2 through 15-3 that otherwise would be accounted for in accordance with the same Topic or Subtopic (including the intersecting Subtopics within the Industry Topics). For example:

a. If an entity applies the guidance in this Subtopic to modifications of a lease for a lessee accounted for in accordance with Topic 842, it shall apply the guidance in this Subtopic to all modifications of leases accounted for in accordance with Topic 842 that meet the scope of paragraphs 848-20-15-2 through 15-3.
b. If an insurance entity applies the guidance in this Subtopic to modifications of a contract accounted for in accordance with Topic 310 on receivables, it shall apply the guidance in this Subtopic to all modifications of contracts accounted for in accordance with Subtopic 944-310 that meet the scope of paragraphs 848-20-15-2 through 15-3. The entity does not need to apply the guidance in this Subtopic to contracts within the scope of other Subtopics of Topic 944 that meet the scope of paragraphs 848-20-15-2 through 15-3.

> Optional Expedient: Contract Modifications due to Reference Rate Reform

848-20-35-2 This Subtopic provides optional expedients for accounting for modifications of contracts accounted for in accordance with the following Topics that meet the scope of paragraphs 848-20-15-2 through 15-3:

a. Topic 310 on receivables
b. Topic 470 on debt
c. Topic 842 on leases.

848-20-35-3 If an entity has modified a contract that meets the scope of paragraphs 848-20-15-2 through 15-3 but that contract is not within the scope of the Topics referenced in paragraph 848-20-35-2, the entity shall account for and present the modified contract as a continuation of the contract existing before the modification for reference rate reform—that is, an entity shall follow the guidance that applies to a modification that does not result in the derecognition (or extinguishment) of a contract and the initial recognition of a new contract. In addition, a modification that meets the scope of paragraphs 848-20-15-2 through 15-3 shall not be considered an event that requires reassessment of a previous determination required under the relevant Topic or Subtopic. Paragraph 848-20-55-2 includes examples that illustrate the application of that guidance.

848-20-35-4 If the optional expedient in paragraphs 848-20-35-2 through 35-3 is elected, it shall be applied to all contracts accounted for under the relevant Topic or Subtopic as described in paragraph 848-20-35-1.

> > Contracts within the Scope of Topic 310

848-20-35-5 If the optional expedient in this paragraph is elected, an entity shall account for a modification of a contract within the scope of Topic 310 that meets the scope of paragraphs 848-20-15-2 through 15-3 in accordance with paragraph 310-20-35-10 as if the modification was only minor.

848-20-35-6 If the optional expedient in paragraph 848-20-35-5 is elected, it shall be applied to all contracts subject to Topic 310 as described in paragraph 848-20-35-1.

> > Contracts within the Scope of Topic 470

848-20-35-7 If the optional expedient in this paragraph is elected, an entity shall account for a modification of a contract within the scope of Topic 470 that meets the scope of paragraphs 848-20-15-2 through 15-3 in accordance with paragraphs 470-50-40-14 through 40-17 and 470-50-40-18(b) as if the modification was not substantial. That is, the original contract and the new contract shall be accounted for as if they were not substantially different from one another, and the modification shall not be accounted for in the same manner as a debt extinguishment in accordance with paragraph 470-50-40-13.

848-20-35-8 If the optional expedient in paragraph 848-20-35-7 is elected, it shall be applied to all contracts under Topic 470 as described in paragraph 848-20-35-1.

> > > Debt Exchanges or Modifications within a Year of the Current Modification

848-20-35-9 If the optional expedient in paragraph 848-20-35-7 is elected, an entity that applies the 10 percent cash flow test described in paragraph 470-50-40-

10 for any subsequent contract modification shall consider a modification in paragraph 848-20-35-7 to be substantially different from other exchanges or modifications within a year for the purpose of paragraph 470-50-40-12(f).

> > Contracts within the Scope of Topic 842

848-20-35-10 If the optional expedient in this paragraph is elected for a modification of a contract within the scope of Topic 842 that meets the scope of paragraphs 848-20-15-2 through 15-3, an entity shall not reassess lease classification and the incremental borrowing rate, remeasure lease payments, or perform other reassessments or remeasurements that would otherwise be required under Topic 842 when a modification of a lease contract is not accounted for as a separate contract.

848-20-35-11 If the optional expedient in paragraph 848-20-35-10 is elected, it shall be applied to all contracts under Topic 842 as described in paragraph 848-20-35-1(a).

> > > Lessees

848-20-35-12 If the optional expedient in paragraph 848-20-35-10 is elected, the modification of the reference rate and other terms related to the replacement of the reference rate on which variable lease payments in the original contract depended shall not cause remeasurement of the lease liability. The change in the reference rate shall be treated in the same manner as the variable lease payments that were dependent on the reference rate in the original lease. That change shall not be included in the calculation of the lease liability; that is, the change shall be recognized in profit or loss in the period in which the obligation for those payments is incurred.

> > Embedded Derivatives within the Scope of Subtopic 815-15

848-20-35-13 If the optional expedient in this paragraph is elected, modification of a contract that meets the scope of paragraphs 848-20-15-2 through 15-3 shall not change an entity's conclusion about whether that contract contains an embedded derivative that is clearly and closely related to the economic characteristics and risks of the host contract for the purposes of paragraph 815-15-25-1(a).

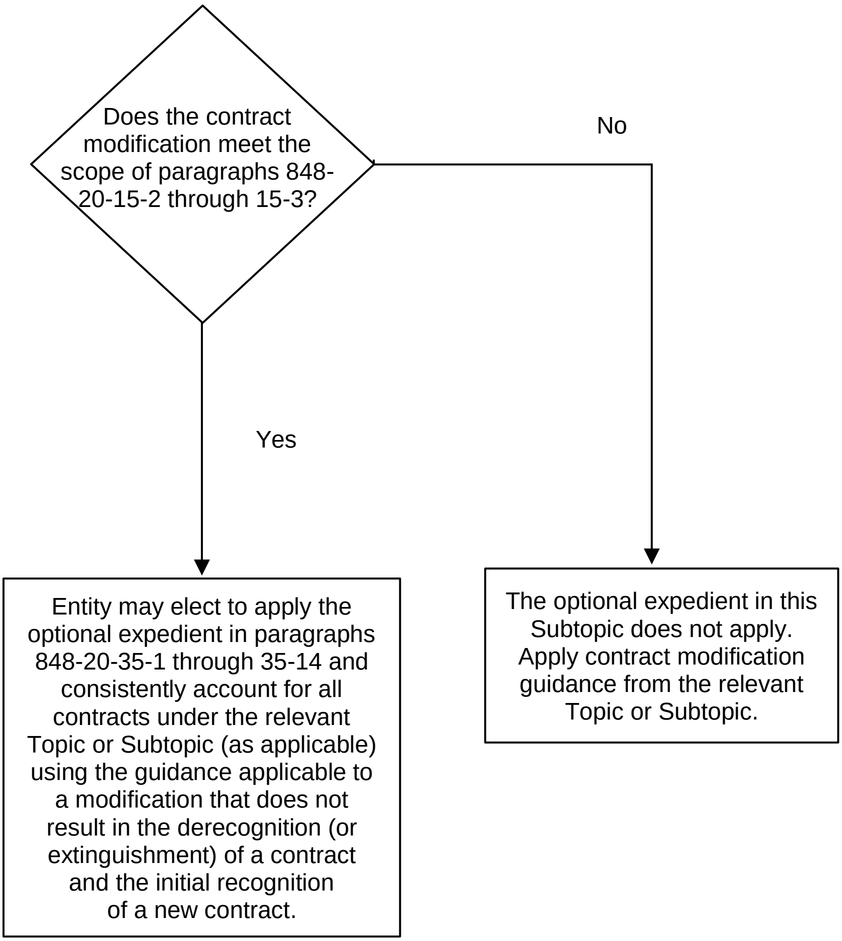
848-20-35-14 If the optional expedient in paragraph 848-20-35-13 is elected, it shall be applied to all contracts under Subtopic 815-15 as described in paragraph 848-20-35-1.

Implementation Guidance and Illustrations

General

> Implementation Guidance

848-20-55-1 The following flowchart summarizes the guidance in this Subtopic.



848-20-55-2 The following table illustrates the potential outcomes of applying the guidance in paragraph 848-20-35-3 to contract modifications that meet the scope of paragraphs 848-20-15-2 through 15-3 but are not within the scope of the Topics listed in paragraph 848-20-35-2. This table is not intended to be all-inclusive of the potential application of paragraph 848-20-35-3.

Contract or Instrument Modified as a Result of Reference Rate Reform	**Potential Outcome of Applying Paragraph 848-20-35-3**
An instrument accounted for as a derivative instrument in accordance with Subtopic 815-10	An entity should not reassess the modified instrument to determine whether it includes a financing element in accordance with paragraphs 815-10-45-11 through 45-15. The modified instrument should be accounted for and presented in the same manner as the instrument existing before the modification.
A contract issued by an insurance entity and accounted for in accordance with Topic 944	An entity should not reassess the modified contract to determine whether it is substantially unchanged in accordance with Subtopic 944-30. The modified contract should be accounted for and presented as a continuation of the contract existing before the modification.
A contract accounted for in accordance with Topic 606 on revenue from contracts with customers	An entity should not reassess the modified contract in accordance with the contract modification guidance in paragraphs 606-10-25-10 through 25-13. Cash flow changes resulting from variability in the replacement reference rate should be accounted for and presented in the same manner as the cash flow changes that resulted from variability in the replaced reference rate before the modification for reference rate reform.

Contract or Instrument Modified as a Result of Reference Rate Reform	Potential Outcome of Applying Paragraph 848-20-35-3
A contract with a counterparty entity that is within the scope of the Variable Interest Entities (VIE) Subsections in accordance with Topic 810 on consolidation	An entity should not reconsider the determination of the counterparty entity's VIE status in accordance with paragraph 810-10-35-4. The counterparty entity's VIE status should remain unchanged from the VIE status determined before the modification.

5. Add Subtopic 848-30, with a link to transition paragraph 848-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Reference Rate Reform—Hedging—General

Overview and Background

General

848-30-05-1 This Subtopic provides guidance on optional expedients for allowing hedging relationships to continue when one or more of the critical terms of the hedging relationship change due to reference rate reform.

Scope and Scope Exceptions

General

848-30-15-1 The guidance in this Subtopic provides optional expedients to the requirements of Subtopic 815-20 related to changes in the critical terms of a hedging relationship that may be applied if the hedging instrument or the hedged item or the hedged forecasted transaction in the hedging relationship references a rate that meets the scope of paragraph 848-10-15-3.

Recognition

General

848-30-25-1 This Section sets forth the conditions that allow amendments to be made to the formal designation and documentation of existing hedging relationships upon a change due to reference rate reform.

> Option to Apply Expedients

848-30-25-2 An entity may elect to apply the guidance in this Subtopic for hedging relationships affected by reference rate reform on an individual hedging relationship basis. In addition, an entity may elect to apply the different optional expedients specified in paragraphs 848-30-25-5 through 25-9 on an individual hedging relationship basis. That is, each optional expedient may be elected for each individual hedging relationship and may not be elected for other similar hedging relationships. For example, for an individual cash flow hedge, an entity may elect to apply the optional expedient for the changes in the critical terms of the hedging instrument in accordance with paragraphs 848-30-25-5 through 25-6 and not elect to apply the optional expedient for changes to the method designated for use in assessing hedge effectiveness in accordance with paragraph 848-30-25-7.

> Change in Critical Terms: Amendments to the Formal Designation and Documentation

848-30-25-3 This paragraph provides optional expedients to the guidance in paragraph 815-20-55-56. A change in any of the following shall not, in and of itself, be considered a dedesignation of the hedging relationship:

a. The terms of a designated hedging instrument in accordance with paragraphs 848-30-25-5 through 25-6
b. The hedged risk of a hedged item in accordance with paragraph 848-40-25-2
c. The hedged risk in a forecasted transaction in accordance with paragraph 848-50-25-3.

848-30-25-4 If an entity elects an optional expedient in paragraphs 848-30-25-5 through 25-9, that should not, in and of itself, be considered a dedesignation of the hedging relationship. The entity shall provide an addendum to its hedge documentation noting the changes made to the hedging relationship at the time it performs its first assessment of effectiveness after the change was identified in accordance with paragraph 815-20-25-3(b)(2)(iv)(02).

> > Optional Expedient: Changes in the Critical Terms of the Hedging Instrument

848-30-25-5 An entity may change the contractual terms of an existing hedging instrument that is affected or expected to be affected by reference rate reform and not be required to dedesignate the hedging relationship if the changes to the hedging instrument's contractual terms meet the scope of paragraphs 848-20-15-2 through 15-3.

848-30-25-6 A change to the interest rate used for margining, discounting, and contract price alignment for a centrally cleared derivative that is an existing hedging instrument shall not be considered a change to the critical terms of the hedging relationship that requires dedesignating the hedging relationship due to that change.

> > Optional Expedient: Changes to the Method Designated for Use in Assessing Hedge Effectiveness in a Cash Flow Hedge

848-30-25-7 An entity may change the method designated for use in assessing hedge effectiveness and documented at hedge inception if both of the following criteria are met:

a. Either the hedging instrument or the hedged forecasted transaction references a rate that meets the scope of paragraph 848-10-15-3
b. The new method designated for use in assessing hedge effectiveness is an optional expedient specified in Subtopic 848-50.

This expedient may be elected for an existing hedging relationship at the date an entity elects to apply any optional expedient method under this Subtopic. An entity also may change the method designated for use in assessing hedge effectiveness as discussed in paragraph 848-50-35-19. An entity is not required to assess whether the replacement method is an improved method for assessing effectiveness or is a preferable method of applying an accounting principle under Topic 250 on accounting changes and error corrections.

> > Optional Expedient: Changes to the Proportion of a Hedged Item or a Hedging Instrument in a Fair Value Hedge and to the Hedging Instruments That Are Designated in a Fair Value Hedge or a Cash Flow Hedge

848-30-25-8 If the hedging instrument or the hedged forecasted transaction or the designated benchmark rate in a fair value hedge references a rate that meets the scope of paragraph 848-10-15-3, an entity may change:

a. The proportion of a designated hedged item or a derivative instrument that is designated as a hedging instrument in an existing fair value hedge relationship. An entity may elect to rebalance the hedging relationship through any of the following approaches, including any combination of these approaches:
    1. Increasing the designated notional amount of the hedging instrument
    2. Decreasing the designated notional amount of the hedging instrument
    3. Increasing the designated portion of the hedged item
    4. Decreasing the designated portion of the hedged item.

If an entity applies the optional expedient in (3) or (4), the cumulative effect of changing the designated proportion of the hedged item shall be recognized as an adjustment to the basis adjustment that shall be recognized in accordance with paragraph 848-40-25-7.

b. The designated hedging instrument to combine two or more derivative instruments, or proportions of those instruments, to be jointly designated as the hedging instrument in an existing hedge relationship.

848-30-25-9 If an entity changes the designated hedging instrument in a fair value hedge to combine two or more derivative instruments, or proportions of those instruments, in accordance with paragraph 848-30-25-8(b), the entity shall assess the hedge effectiveness of the amended hedging relationship using a method under Subtopics 815-20 and 815-25.

848-30-25-10 If an entity changes the designated hedging instrument in a cash flow hedge to combine two or more derivative instruments, or proportions of those instruments, in accordance with paragraph 848-30-25-8(b), the entity shall assess the hedge effectiveness of the amended hedging relationship using one of the following:

a. A method in accordance with Subtopics 815-20 and 815-30
b. An optional expedient for the subsequent assessment methods for assuming perfect effectiveness in accordance with paragraphs 848-50-35-6 through 35-9
c. An optional expedient for the subsequent quantitative methods in accordance with paragraphs 848-50-35-15 through 35-16.

6. Add Subtopic 848-40, with a link to transition paragraph 848-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Reference Rate Reform—Fair Value Hedges

Overview and Background

General

848-40-05-1 This Subtopic provides guidance on optional expedients for the accounting for and financial reporting of fair value hedges under Topic 815 that are affected by reference rate reform.

Scope and Scope Exceptions

General

848-40-15-1 The guidance in this Subtopic provides optional expedients to certain requirements of Subtopics 815-20 and 815-25 related to fair value hedges. An entity shall continue to apply all other requirements applicable to fair value hedges in Subtopics 815-20 and 815-25.

Recognition

General

> Option to Apply Expedients

848-40-25-1 An entity may elect to apply the guidance in this Subtopic for existing fair value hedges affected by reference rate reform on an individual hedging relationship basis. In addition, an entity may elect to apply the different optional expedients specified in paragraphs 848-40-25-2 through 25-7 on an individual hedging relationship basis. For example, an entity may elect to apply the optional expedient in this Subtopic for the change in the designated benchmark interest rate and not elect to apply the optional expedient for the shortcut method for assessing hedge effectiveness. An entity may disregard the guidance in paragraph 815-20-25-81 when applying this Subtopic and shall not be required to assess effectiveness for similar hedges in a similar manner.

> Optional Expedient: Change in the Designated Benchmark Interest Rate

848-40-25-2 If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged may be the risk of changes in its fair value attributable to changes in the designated benchmark interest rate in accordance with paragraph 815-20-25-12(f)(2). In an existing hedge of the changes in fair value attributable to the benchmark interest rate, if the referenced interest rate index of the hedging instrument changes or an entity changes the designated hedging instrument to combine two or more derivative instruments to be jointly designated as the hedging instrument in accordance with paragraph 848-30-25-8(b), an entity may change the designated benchmark interest rate and the component of cash flows and continue to apply hedge accounting without dedesignation if all of the following criteria are met:

a. The designated benchmark interest rate being changed is a rate within the scope of paragraph 848-10-15-3
b. The replacement designated benchmark interest rate is an eligible benchmark interest rate in accordance with paragraph 815-20-25-6A
c. The hedging instrument is expected to be prospectively highly effective at achieving offsetting changes in fair value attributable to the revised hedged risk.

848-40-25-3 An entity shall amend its hedge documentation in accordance with paragraph 848-30-25-4 upon a change in the designated benchmark interest rate in accordance with paragraph 848-40-25-2.

> > Change in Fair Value of Hedged Item due to a Change in the Designated Benchmark Interest Rate

848-40-25-4 If an entity elects the optional expedient in paragraphs 848-40-25-2 through 25-3 to change the designated benchmark interest rate, it shall, at a minimum, revise the rate used to discount the cash flows associated with the hedged item reflecting the change in the designated benchmark interest rate in accordance with paragraph 848-40-25-2. In addition, an entity may adjust either of the following:

a. The remaining designated cash flows
b. The revised rate used to discount the cash flows associated with the hedged item.

848-40-25-5 To apply the guidance in paragraph 848-40-25-4, an entity may either:

a. Apply an approach that adjusts the hedged item's cumulative fair value hedge basis adjustment attributable to changing from the originally designated benchmark interest rate to the replacement designated benchmark interest rate
b. Apply an approach that results in no adjustment to the hedged item's cumulative basis adjustment (that is, maintain the hedged item's cumulative basis adjustment immediately before the date of the change).

This Subtopic does not specify a single method for applying those approaches. The method shall be reasonable, and an entity shall use a similar method for similar hedges and shall justify the use of different methods for similar hedges.

848-40-25-6 In calculating the subsequent changes in the hedged item's fair value attributable to changes in the replacement benchmark interest rate, an entity shall use the remaining adjusted cash flows or adjustment to the revised discount rate as determined upon the application of the optional expedient in paragraph 848-40-25-4.

848-40-25-7 If an entity adjusts the cumulative basis adjustment due to the change in the designated benchmark interest rate in accordance with paragraph 848-40-25-5(a), the entity may make an accounting policy election that is applied consistently across similar hedge relationships to either:

a. Recognize the adjustment currently in earnings.
b. Record an offsetting entry to the carrying amount of the hedged asset or liability and subsequently recognize the adjustment in earnings in the same manner as other components of the carrying amount of the hedged

asset or liability in accordance with paragraph 815-25-35-9 or 815-25-35-9A.

An entity shall present the recognition of the adjustment in the same income statement line item that is used to present the earnings effect of the hedged item.

> Optional Expedient: Assessment of Hedge Effectiveness When Assuming Perfect Hedge Effectiveness in a Hedge with an Interest Rate Swap (Shortcut Method)

848-40-25-8 For existing fair value hedges for which the shortcut method is applied in accordance with paragraphs 815-20-25-102 through 25-109 and 815-20-25-111 through 25-117, the following conditions from paragraph 815-20-25-104 that apply to fair value hedges may be disregarded in determining whether the hedging relationship continues to qualify for the shortcut method upon a change in the contractual terms of the hedging instrument in accordance with paragraph 848-30-25-5:

a. The formula for computing net settlements under the interest rate swap is the same for each net settlement in accordance with paragraph 815-20-25-104(d).
b. The terms are typical of those instruments, and the terms do not invalidate the assumption of perfect effectiveness in accordance with paragraph 815-20-25-104(g).

If an entity elects the practical expedient in this paragraph for an existing fair value hedge for which the shortcut method is applied, the entity is not required to periodically evaluate the conditions in paragraph 815-20-25-104 for the remaining life of the hedging relationship.

848-40-25-9 If an entity elects to apply the optional expedient for the shortcut method in paragraph 848-40-25-8, the entity shall amend its hedge documentation in accordance with paragraph 848-30-25-4.

7. Add Subtopic 848-50, with a link to transition paragraph 848-10-65-1, as follows:

[For ease of readability, the new Subtopic is not underlined.]

Reference Rate Reform—Cash Flow Hedges

Overview and Background

General

848-50-05-1 This Subtopic provides guidance related to optional expedients for the accounting for and financial reporting of cash flow hedges under Topic 815 that are affected by reference rate reform.

Scope and Scope Exceptions

General

848-50-15-1 The guidance in this Subtopic provides optional expedients to certain requirements of Subtopics 815-20 and 815-30 related to the assessment of hedge effectiveness and the designation of cash flow hedges. An entity shall continue to apply all other cash flow hedge accounting requirements specified in Subtopics 815-20 and 815-30.

Recognition

General

> Option to Apply Expedients

848-50-25-1 An entity may elect to apply the optional expedients for the assessment of hedge effectiveness in this Subtopic to cash flow hedges affected by reference rate reform on an individual hedging relationship basis. In addition, an entity may elect to apply the different optional expedients for the assessment of hedge effectiveness in this Subtopic on an individual hedging relationship basis. An entity may disregard the guidance in paragraph 815-20-25-81 when applying this Subtopic and shall not be required to assess effectiveness for similar hedges in a similar manner.

> Eligibility of Existing Cash Flow Hedges Affected by Reference Rate Reform

> > Probability of the Hedged Forecasted Transaction

848-50-25-2 If the designated hedged risk in a cash flow hedge of a forecasted transaction is a reference rate that meets the scope of paragraph 848-10-15-3, an entity may assert that the hedged forecasted transaction (for example, the future interest receipts of a financial asset or future interest payments of a financial liability or the forecasted issuance or purchase of a debt instrument) remains probable in accordance with paragraph 815-20-25-15(b) regardless of the modification or expected modification of terms in accordance with paragraphs 848-20-15-2 through 15-3. An entity shall continue to assess whether the underlying hedged forecasted transaction (for example, the future interest receipts of a financial asset or future interest payments of a financial liability or the forecasted issuance or purchase of a debt instrument) remains probable in accordance with paragraph 815-20-25-15(b).

> > Change in the Designated Hedged Interest Rate Risk

848-50-25-3 Paragraph 815-30-35-37A specifies that the designated hedged risk for a cash flow hedge of a forecasted transaction may change during a hedging relationship and an entity may continue to apply hedge accounting if the hedge remains highly effective. For purposes of applying that guidance to a cash flow hedge affected by reference rate reform, a cash flow hedge may continue hedge accounting subject to either the hedging relationship remaining highly effective in accordance with Subtopics 815-20 and 815-30 or electing an optional expedient method to assess hedge effectiveness in accordance with paragraphs 848-50-35-1 through 35-16. If an entity elects to change the designated hedged interest rate risk for an existing cash flow hedge, the entity shall amend its hedge documentation in accordance with paragraph 848-30-25-4.

> Initial Assessment of Hedge Effectiveness

> > New Cash Flow Hedges: Optional Expedients for Initial Assessment of Hedge Effectiveness

848-50-25-4 For new cash flow hedges for which either the hedged forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3, an entity may perform its initial hedge effectiveness assessment in a manner that adjusts the application of certain guidance in Subtopics 815-20 and 815-30 as specified in paragraph 848-50-25-5. For subsequent hedge effectiveness assessments, an entity may use the eligible optional expedients for hedge effectiveness assessment in paragraphs 848-50-35-4 through 35-16.

848-50-25-5 In accordance with paragraph 815-20-25-3(b)(2)(iv)(01), an entity shall perform an initial prospective assessment of hedge effectiveness on a quantitative basis unless one of the methods listed in paragraph 815-20-25-3(b)(2)(iv)(01) applies. Paragraphs 848-50-25-6 through 25-10 describe certain modifications to the relevant methods for performing an initial assessment of hedge effectiveness for cash flow hedges within the scope of this Subtopic. Paragraphs 848-50-25-11 through 25-12 describe certain modifications for performing an initial hedge effectiveness assessment using a quantitative method if one of the methods listed in paragraph 815-20-25-3(b)(2)(iv)(01) is not applied.

848-50-25-6 An entity may disregard the following conditions in determining whether the shortcut method for assuming perfect hedge effectiveness in a cash flow hedge with an interest rate swap may be applied in accordance with paragraphs 815-20-25-102 through 25-109 and 815-20-25-111 through 25-117:

a. The formula for computing net settlements under the interest rate swap is the same for each net settlement in accordance with paragraph 815-20-25-104(d).
b. The terms are typical of those derivative instruments and do not invalidate the assumption of perfect effectiveness in accordance with paragraph 815-20-25-104(g).
c. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way in accordance with paragraph 815-20-25-106(d).
d. The index on which the variable leg of the interest rate swap is based matches the contractually specified interest rate designated as the interest rate being hedged for that hedging relationship in accordance with paragraph 815-20-25-106(g).

848-50-25-7 For cash flow hedges when an option's terminal value is used to assess hedge effectiveness, an entity may disregard the following conditions in determining whether a cash flow hedge of the option's terminal value may be considered perfectly effective in accordance with paragraphs 815-20-25-126 through 25-129A:

a. The underlying of the hedging instrument needs to match the underlying of the hedged forecasted transaction in accordance with paragraph 815-20-25-129(a).
b. The strike price (or prices) of the hedging option (or combination of options) matches the specified level (or levels) beyond (or within) which the entity's exposure is being hedged in accordance with paragraph 815-20-25-129(b).
c. The hedging instrument's inflows (outflows) at its maturity date completely offset the change in the hedged transaction's cash flows for the risk being hedged in accordance with paragraph 815-20-25-129(c).

If all other conditions in paragraph 815-20-25-129 are met, the hedging relationship may be considered perfectly effective.

848-50-25-8 An eligible entity in accordance with paragraph 815-20-25-135 may disregard the following conditions in determining whether a cash flow hedge of a variable-rate borrowing with a receive-variable pay-fixed interest rate swap using the simplified hedge accounting approach may be considered perfectly effective in accordance with paragraphs 815-20-25-133 through 25-138:

a. Both the variable rate on the swap and the borrowing are based on the same index and reset period in accordance with paragraph 815-20-25-137(a).
b. The terms of the swap are typical in accordance with paragraph 815-20-25-137(b).
c. The repricing and settlement dates for the swap and the borrowing match in accordance with paragraph 815-20-25-137(c).

If all other conditions of paragraph 815-20-25-137 are met, the hedging relationship may apply the simplified hedge accounting approach.

848-50-25-9 For the change-in-variable-cash-flows method in accordance with paragraphs 815-30-35-16 through 35-24, an entity may disregard the following critical terms in assessing whether the method will result in a perfectly effective hedge in accordance with paragraph 815-30-35-22:

a. The variable-rate leg of the interest rate swap and the hedged variable cash flows of the asset or liability are based on the same interest rate index in accordance with paragraphs 815-30-35-22(a) and 815-30-35-23(a).
b. The interest rate reset dates applicable to the variable-rate leg of the interest rate swap and to the hedged variable cash flows of the asset or liability are the same in accordance with paragraphs 815-30-35-22(b) and 815-30-35-23(b).

If all other conditions in paragraph 815-30-35-22 are met, the hedging relationship may be considered perfectly effective. If all other conditions in paragraph 815-30-35-22 are not met, an entity shall not consider that the method will result in a perfectly effective hedge and shall consider any differences in critical terms other than those in (a) and (b) in an initial quantitative assessment of hedge effectiveness in accordance with paragraphs 815-30-35-16 through 35-23 or paragraph 848-50-25-11.

848-50-25-10 For the hypothetical derivative method in accordance with paragraphs 815-30-35-25 through 35-29, an entity may disregard the following critical terms in assessing whether the method will result in a perfectly effective hedge:

a. The same repricing dates in accordance with paragraph 815-30-35-25(b)(2)
b. The same index in accordance with paragraph 815-30-35-25(b)(3).

If all other conditions in paragraph 815-30-35-25 are met, the hedging relationship may be considered perfectly effective. If all other conditions in paragraph 815-30-35-25 are not met, an entity shall not consider that the method will result in a perfectly effective hedge and shall consider any differences in critical terms other than those in (a) and (b) in an initial quantitative assessment of hedge effectiveness in accordance with paragraphs 815-30-35-25 through 35-29 or paragraph 848-50-25-11.

> > > Optional Expedient: Initial Assessment Performed Using a Quantitative Method

848-50-25-11 An entity may adjust any of the three methods of assessing hedge effectiveness in paragraphs 815-30-35-10 through 35-32 when hedge effectiveness is assessed on a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) as follows:

a. If both the hedged forecasted transaction and the hedging instrument have a reference rate that meets the scope of paragraph 848-10-15-3, an entity may assume that the reference rate will not be replaced for the remainder of the hedging relationship. That is, an entity does not need to consider the likelihood of whether or when the reference rate will be discontinued or changed due to reference rate reform.
b. If either the hedged forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3, the terms of the hedged forecasted transaction may be altered to match the hedging instrument for the following:
    1. The referenced interest rate index
    2. The reset period, reset dates, day-count conventions, business-day conventions, and repricing calculation (for example, forward-looking calculation or in-arrears calculation)
    3. A spread adjustment for the difference between the existing reference rate and the replacement reference rate.

> > > Optional Expedient: Initial Assessment Based on an Option's Terminal Value

848-50-25-12 If an entity assesses hedge effectiveness on the basis of an option's terminal value in accordance with paragraph 815-20-25-126 and if either the hedged forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3, an entity may adjust the critical terms of the perfectly effective hypothetical hedging instrument in accordance with paragraph 815-20-25-129 to match the hedging instrument for the following:

a. The underlying reference rate
b. The strike price (or prices) of the hedging option (or combination of options)
c. The hedging instrument's inflows (outflows) at its maturity date.

> > Hedging a Group of Forecasted Transactions

848-50-25-13 This paragraph provides an optional expedient for assessing a group of individual forecasted transactions in a cash flow hedge affected by reference rate reform. An entity may elect this optional expedient if a forecasted transaction in the hedged group of forecasted transactions references a rate that meets the scope of paragraph 848-10-15-3.

848-50-25-14 An entity may disregard the guidance in paragraph 815-20-25-15(a)(2) that a group of individual transactions shall share the same risk exposure for which they are designated as being hedged. However, other limitations in paragraph 815-20-25-15(a)(2) shall continue such that a forecasted purchase (including debt issuance) and a forecasted sale shall not both be included in the same group of individual transactions that constitute the hedged transaction.

Subsequent Measurement

General

> Subsequent Assessment of Hedge Relationships

848-50-35-1 This guidance provides optional expedients that may be elected for existing cash flow hedges and new cash flow hedges affected by reference rate reform for the purposes of determining whether an entity shall be allowed to continue applying hedge accounting for the hedging relationship. An entity may elect these optional expedient methods if either the forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3. Paragraph 848-50-55-1 includes a flowchart that illustrates the application of this guidance.

848-50-35-2 If an entity elects to apply an optional expedient method in this Subtopic for an existing hedging relationship, the entity need only apply the optional expedient method prospectively beginning on the date that the expedient method is first applied in determining whether the entity can continue to apply hedge accounting to that hedging relationship. After the date on which the optional expedient method is first applied (if the hedging relationship continues), the entity shall assess the hedging relationship using the optional expedient method both prospectively and retrospectively from the date on which the expedient method is first applied.

848-50-35-3 If an entity elects to change the method of assessing hedge effectiveness for an existing cash flow hedge to an optional expedient method in accordance with paragraphs 848-50-35-4 through 35-16, the entity shall amend its hedge documentation in accordance with paragraph 848-30-25-4.

> > Optional Expedient: Subsequent Assessments Using a Method That Assumes Perfect Effectiveness

848-50-35-4 For existing and new cash flow hedges that applied a method in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) and new cash flow hedges that applied a method in accordance with paragraphs 848-50-25-6 through 25-10 for the assessment of initial hedge effectiveness, paragraphs 848-50-35-5 through 35-9 describe certain modifications to the relevant methods for performing an ongoing assessment of hedge effectiveness for cash flow hedges.

848-50-35-5 The following conditions from paragraphs 815-20-25-104 and 815-20-25-106 that apply to cash flow hedges may be disregarded in determining whether the hedging relationship continues to qualify for the shortcut method upon a change in the contractual terms of the hedging instrument in accordance with paragraph 848-30-25-5:

a. The formula for computing net settlements under the interest rate swap is the same for each net settlement in accordance with paragraph 815-20-25-104(d).
b. The terms are typical of those derivative instruments and do not invalidate the assumption of perfect effectiveness in accordance with paragraph 815-20-25-104(g).
c. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way in accordance with paragraph 815-20-25-106(d).
d. The index on which the variable leg of the interest rate swap is based matches the contractually specified interest rate designated as the interest rate being hedged for that hedging relationship in accordance with paragraph 815-20-25-106(g).

848-50-35-6 For cash flow hedges when an option's terminal value is used in assessing hedge effectiveness, an entity may disregard the following conditions in determining whether a cash flow hedge of the option's terminal value may continue to be considered perfectly effective in accordance with paragraphs 815-20-25-126 through 25-129A:

a. The underlying of the hedging instrument needs to match the underlying of the hedged forecasted transaction in accordance with paragraph 815-20-25-129(a).
b. The strike price (or prices) of the hedging option (or combination of options) matches the specified level (or levels) beyond (or within) which the entity's exposure is being hedged in accordance with paragraph 815-20-25-129(b).
c. The hedging instrument's inflows (outflows) at its maturity date completely offset the change in the hedged transaction's cash flows for the risk being hedged in accordance with paragraph 815-20-25-129(c).

If all other conditions of paragraph 815-20-25-129 are met, the hedging relationship may continue to be considered perfectly effective.

848-50-35-7 An eligible entity in accordance with paragraph 815-20-25-135 may disregard the following conditions in determining whether a cash flow hedge of a variable-rate borrowing with a receive-variable pay-fixed interest rate swap using the simplified hedge accounting approach may continue to be considered perfectly effective in accordance with paragraphs 815-20-25-133 through 25-138:

a. Both the variable rate on the swap and the borrowing are based on the same index and reset period in accordance with paragraph 815-20-25-137(a).

b. The terms of the swap are typical in accordance with paragraph 815-20-25-137(b).
c. The repricing and settlement dates for the swap and the borrowing match in accordance with paragraph 815-20-25-137(c).

If all other conditions of paragraph 815-20-25-137 continue to be met, the hedging relationship may continue to apply the simplified hedge accounting approach.

848-50-35-8 For the change-in-variable-cash-flows method in accordance with paragraphs 815-30-35-16 through 35-23, an entity may disregard the following critical terms in assessing whether the method will result in a perfectly effective hedge in accordance with paragraph 815-30-35-22:

a. The variable-rate leg of the interest rate swap and the hedged variable cash flows of the asset or liability are based on the same interest rate index in accordance with paragraphs 815-30-35-22(a) and 815-30-35-23(a).
b. The interest rate reset dates applicable to the variable-rate leg of the interest rate swap and to the hedged variable cash flows of the asset or liability are the same in accordance with paragraphs 815-30-35-22(b) and 815-30-35-23(b).

If all other conditions of paragraph 815-30-35-22 continue to be met, the hedging relationship may continue to be considered perfectly effective. If all other conditions of paragraph 815-30-35-22 are not met, an entity shall not consider that the method will result in a perfectly effective hedge and shall consider any differences in critical terms other than those in (a) and (b) in a subsequent quantitative assessment of hedge effectiveness in accordance with paragraphs 815-30-35-16 through 35-23 or paragraph 848-50-35-15.

848-50-35-9 For the hypothetical-derivative method in accordance with paragraphs 815-30-35-25 through 35-29, an entity may disregard the following critical terms in assessing whether the method will result in a perfectly effective hedge:

a. The same repricing dates in accordance with paragraph 815-30-35-25(b)(2)
b. The same index in accordance with paragraph 815-30-35-25(b)(3).

If all other conditions of paragraph 815-30-35-25 continue to be met, the hedging relationship may continue to be considered perfectly effective. If all other conditions of paragraph 815-30-35-25 are not met, an entity shall not consider that the method will result in a perfectly effective hedge and shall consider any differences in critical terms other than those in (a) and (b) in a subsequent quantitative assessment of hedge effectiveness in accordance with paragraphs 815-30-35-25 through 35-29 or paragraph 848-50-35-15.

> > Optional Expedient: Subsequent Assessments Performed Using a Qualitative Method

848-50-35-10 An entity may qualitatively assess existing cash flow hedges and new cash flow hedges on an ongoing basis in accordance with paragraphs 848-50-35-11 through 35-14 if the entity performs an initial test of hedge effectiveness using either of the following:

a. A method in accordance with Subtopics 815-20 and 815-30
b. An optional expedient method in accordance with paragraphs 848-50-25-6 through 25-14.

An entity that elects this optional expedient may disregard the guidance in paragraphs 815-20-35-2A through 35-2F for performing hedge effectiveness assessments on a qualitative basis.

848-50-35-11 The following criteria must be met so that an entity may continue to assert qualitatively that it may continue to apply hedge accounting for a hedging relationship under this Subtopic:

a. The hedged forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3.
b. There have been no changes to the terms of the hedging instrument other than those specified in paragraphs 848-20-15-2 through 15-3.
c. An entity shall consider the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity.

848-50-35-12 An entity shall verify and document whenever financial statements or earnings are reported and at least every three months that only the facts and circumstances related to the hedging relationship in accordance with paragraph 848-50-35-11 have not changed such that the entity can assert qualitatively that the hedging relationship was and continues to qualify for this optional expedient method. No other facts and circumstances need to be assessed as part of this evaluation.

848-50-35-13 If the facts and circumstances change in accordance with paragraph 848-50-35-12 such that an entity no longer can assert qualitatively that the hedging relationship may continue to qualify for hedge accounting under this Subtopic, the entity shall assess hedge effectiveness on a quantitative basis using either the guidance in Subtopics 815-20 and 815-30 or a quantitative optional expedient method in this Subtopic to the extent that the quantitative optional expedient method is eligible to be used. An entity may change its method of assessing hedge effectiveness and amend its hedging documentation to reflect that change in accordance with paragraph 848-30-25-4. In addition, an entity may perform a quantitative assessment of hedge effectiveness in any reporting period, and the results of that quantitative assessment shall not preclude an entity from using the qualitative optional expedient method in paragraphs 848-50-35-11 through 35-12 in a subsequent reporting period.

848-50-35-14 When an entity determines that the facts and circumstances have changed and it no longer can assert that the criteria in paragraph 848-50-35-11 are met, the entity shall begin performing quantitative assessments of hedge effectiveness using either the guidance in Subtopics 815-20 and 815-30 or a quantitative optional expedient method in paragraphs 848-50-35-15 through 35-16 to the extent that the entity qualifies as of the period that the facts and circumstances changed. If there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship, the entity may begin performing quantitative assessments of effectiveness in the current period using either the guidance in Subtopics 815-20 and 815-30 or an optional quantitative expedient in paragraphs 848-50-35-15 through 35-16 to the extent that the hedging relationship qualifies. After performing an assessment of hedge effectiveness using a quantitative optional expedient method for one or more reporting periods, an entity may revert to a qualitative optional expedient method of hedge effectiveness under this Subtopic to the extent the qualitative optional expedient method is eligible to be used.

> > Optional Expedient: Subsequent Assessments Performed Using a Quantitative Method

848-50-35-15 An entity may adjust any of the three methods of assessing subsequent hedge effectiveness in paragraphs 815-30-35-10 through 35-32 when hedge effectiveness is assessed on a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) as follows:

a. If both the hedged forecasted transaction and the hedging instrument have a reference rate that meets the scope of paragraph 848-10-15-3, an entity may assume that the reference rate will not be replaced for the remainder of the hedging relationship. That is, an entity does not need to consider the likelihood of whether the reference rate will be discontinued or changed due to reference rate reform.
b. If either the hedged forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3, the terms of the hedged forecasted transaction may be altered to match the hedging instrument for the following:
    1. The referenced interest rate index
    2. The reset period, reset dates, day-count conventions, business-day conventions, and repricing calculation (for example, forward-looking calculation or in-arrears calculation)
    3. A spread adjustment for the difference between the existing reference rate and the replacement reference rate.

> > Optional Expedient: Subsequent Assessment Based on an Option's Terminal Value

848-50-35-16 If an entity assesses subsequent hedge effectiveness on the basis of an option's terminal value in accordance with paragraph 815-20-25-126 and if either the forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3, an entity may adjust the critical terms of the perfectly effective hypothetical hedging instrument in accordance with paragraph 815-20-25-129 to match the hedging instrument for the following:

a. The underlying reference rate
b. The strike price (or prices) of the hedging option (or combination of options)
c. The hedging instrument's inflows (outflows) at its maturity date.

> Failure to Meet the Criteria to Apply a Practical Expedient for Assessing Hedge Effectiveness and Reversion to Subtopics 815-20 and 815-30

848-50-35-17 An entity shall discontinue the use of the optional expedients for assessing cash flow hedge effectiveness in paragraphs 848-50-35-1 through 35-16 if any of the following occurs:

a. Neither the hedged item nor the hedging instrument reference a rate that meets the scope of paragraph 848-10-15-3.
b. The guidance in this Topic is superseded (see paragraph 848-10-65-1(d)).
c. The entity elects to cease to apply the optional expedients.

848-50-35-18 If an entity applies an optional expedient method for assessing hedge effectiveness in accordance with paragraphs 848-50-35-1 through 35-16 and the hedging relationship continues after the entity ceases applying the optional expedient method, the entity shall revert to applying the qualifying criteria and hedge assessment methods in Subtopics 815-20 and 815-30. For a hedging relationship that continues after ceasing application of an optional expedient method, an entity shall apply a hedge assessment method in accordance with Subtopics 815-20 and 815-30 both prospectively and retrospectively from the date on which that assessment method is first applied. For example, an entity that is using the shortcut method optional expedient for a new cash flow hedging relationship in accordance with paragraph 848-50-25-6 or for an existing cash flow hedging relationship in accordance with paragraph 848-50-35-5 shall revert to a hedge assessment method in accordance with Subtopics 815-20 and 815-30 in assessing whether the hedging relationship continues to qualify for hedge accounting from the date that the new assessment method is first applied.

848-50-35-19 A change in the method of assessing hedge effectiveness for an existing cash flow hedge upon ceasing application of an optional expedient method to a hedge assessment method in accordance with Subtopics 815-20 and 815-30 shall be a change in the critical terms that does not result in dedesignation of the hedging relationship. An entity shall amend its hedge documentation to reflect the change in the method of assessing hedge effectiveness in accordance with paragraph 848-30-25-4.

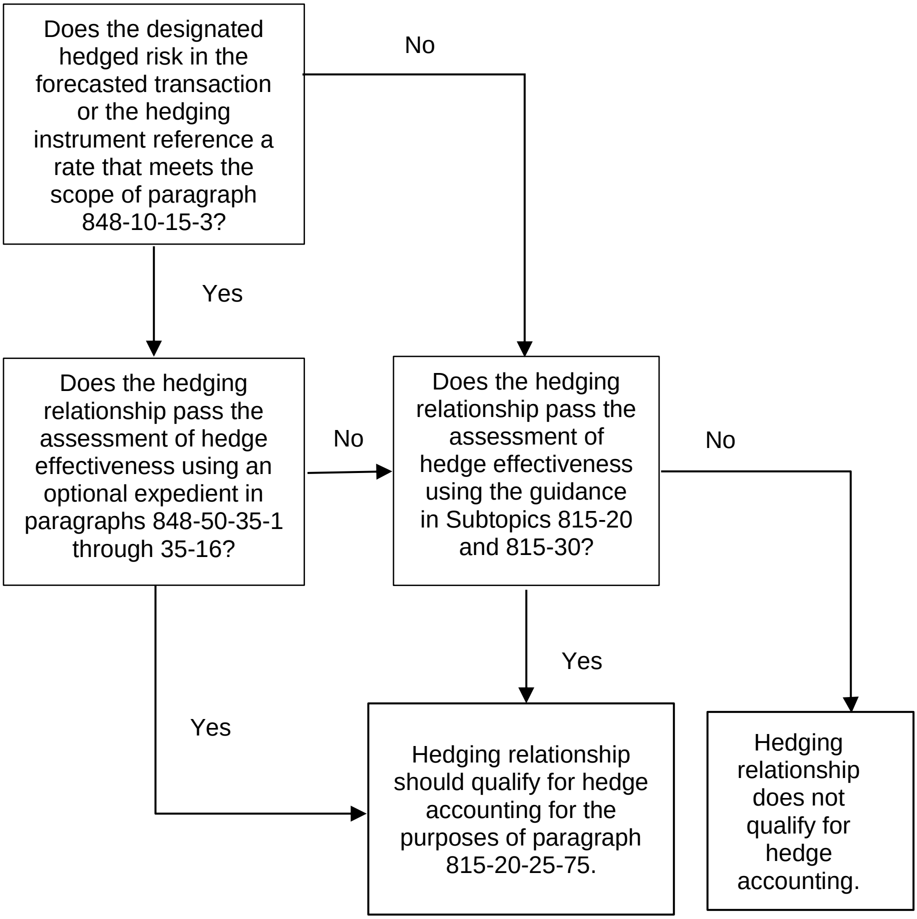
848-50-35-20 In general, if a periodic assessment indicates that neither the forecasted transaction nor the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3, an entity shall cease applying the optional expedient method for future periods and shall apply a hedge assessment method in accordance with Subtopics 815-20 and 815-30 both prospectively and retrospectively to the date on which the change to a method in those Subtopics is first applied in accordance with paragraph 848-50-35-19.

Implementation Guidance and Illustrations

General

> Implementation Guidance

848-50-55-1 The following flowchart summarizes an example of the application of Subtopic 848-50 for the subsequent assessment of hedge effectiveness in determining whether a new cash flow hedging relationship or an existing cash flow hedging relationship continues to qualify for hedge accounting.



Does the designated hedged risk in the forecasted transaction or the hedging instrument reference a rate that meets the scope of paragraph 848-10-15-3?
No
Yes
Does the hedging relationship pass the assessment of hedge effectiveness using an optional expedient in paragraphs 848-50-35-1 through 35-16?
No
Does the hedging relationship pass the assessment of hedge effectiveness using the guidance in Subtopics 815-20 and 815-30?
No
Yes
Yes
Hedging relationship should qualify for hedge accounting for the purposes of paragraph 815-20-25-75.
Hedging relationship does not qualify for hedge accounting.

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
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

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. In 2014, the Board began actively monitoring the reference rate reform initiative undertaken globally to identify suitable alternatives to unsecured market benchmarks based on interbank offered rates. At that time, 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 U.S. Dollar LIBOR and to create an adoption plan to facilitate the acceptance and use of one or more alternative reference rates. In 2017, the ARRC identified the Secured Overnight Financing Rate (SOFR) as its preferred alternative reference rate.

BC3. During the 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 overnight index swap rate based on SOFR be considered eligible as a U.S. benchmark interest rate for purposes of applying hedge accounting under Topic 815. In December 2017, the Board added a project to its agenda to consider that request. The Fed began publishing the daily SOFR rate on April 3, 2018, and announced a transition plan for its integration into the financial markets.

BC4. In 2018, the Board issued Accounting Standards Update No. 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. The Board limited the scope of the amendments in Update 2018-16 to newly designated hedging relationships based on SOFR to expedite the issuance of that new guidance. However, during the course of that project, stakeholders communicated to the Board that the reference rate reform initiative was expected to affect the ability to retain hedge accounting under Topic 815 for existing hedging relationships and asked the Board to consider potential relief to allow hedge accounting to continue in that circumstance. In addition, stakeholders indicated that reference rate reform was expected to create potential operational challenges in applying other areas of GAAP related to modifications of financial instruments. Because of those emerging issues, concurrent with the issuance of Update 2018-16, the Board added a project to its agenda to consider the need for potential accounting relief for existing hedging relationships and other areas of financial reporting beyond hedge accounting that may be affected by reference rate reform. The Board's objective for the project is to broadly consider changes to GAAP to facilitate the market-wide transition from LIBOR and other interbank offered rates (collectively referred to as IBORs).

BC5. The Board solicited feedback from preparers, auditors, and other stakeholders to identify the specific accounting issues in relation to the market-wide transition from IBORs. Stakeholder feedback indicated that one primary issue relates to the operational costs to preparers when assessing significant volumes of contract modifications under the guidance for accounting for contract modifications in accordance with various areas of GAAP. A second issue relates to the potential inability to retain hedge accounting for existing hedges due to anticipated changes to the critical terms of hedging relationships, which would require automatic dedesignation of a hedging relationship in accordance with current GAAP, as well as the potential inability to qualify for hedge accounting due to reference rate reform.

BC6. Addressing these issues presents several challenges from a standard-setting perspective, including determining the nature of appropriate relief from existing accounting requirements and the timing of issuing guidance to coincide with the timing of contract amendments occurring in the marketplace.

BC7. Regarding the nature of contracts requiring relief from accounting requirements, a challenge of reference rate reform is the pervasiveness of expected modifications across various types of contracts, including derivatives, investments, debt instruments, and leases.

BC8. In terms of timing, the Board understands that the International Swaps and Derivatives Association (ISDA) is amending protocols for derivative financial instrument fallback language referencing certain rates and also understands that in the United States, that language is expected to be incorporated into ISDA protocols referencing LIBOR as soon as early 2020. For cash instruments, the Board understands that the ARRC has recommended fallback language for certain financial products. However, the Board also acknowledges that contract modifications (for cash instruments as well as over-the-counter derivatives) are a result of negotiation and agreement between the counterparties to the contract and, therefore, it is difficult to predict both the timing of certain contract modifications and the terms that may be amended as a result of reference rate reform. In undertaking this project, the Board determined that any relief related to applying existing accounting requirements would need to be effective at the earliest time that contract modifications are occurring in the marketplace to achieve the cost-benefit objective of issuing any final guidance. Accordingly, the Board expedited the issuance of this proposed Update with the objective of providing final guidance in time for use by market participants to apply the guidance as contracts are being modified.

BC9. Furthermore, after issuance of any final guidance, the Board will continue to monitor developments in the marketplace about how contract modifications due to reference rate reform will be effectuated and is prepared to consider whether those future developments warrant changes to any final guidance issued or additional guidance, as appropriate.

Benefits and Costs (or Cost Savings)

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. The Board anticipates that the amendments in this proposed Update will reduce or mitigate the costs and complexity of accounting for contract modifications and hedging relationships affected by reference rate reform by providing elective optional expedients and exceptions to existing accounting requirements. For contracts, transactions, and hedging relationships affected by reference rate reform, the proposed amendments would provide temporary guidance that would achieve the following:

a. Simplify accounting analyses under current GAAP for contract modifications
b. Allow hedging relationships to continue without dedesignation upon a change in certain critical terms
c. Allow a change in the designated benchmark interest rate to a different eligible benchmark interest rate in an existing fair value hedging relationship and allow flexibility in the method used to account for the effect of that change
d. Simplify or temporarily suspend the assessment of hedge effectiveness for fair value and cash flow hedging relationships for which the shortcut method and other methods for assuming perfect hedge effectiveness are applied
e. Simplify or temporarily suspend the assessment of whether existing and new cash flow hedging relationships that are not assessed using a method in (d) can apply hedge accounting.

BC12. Given the pervasiveness of IBOR-based contracts, the Board believes that those elective optional expedients and exceptions would provide cost savings to a wide array of financial statement preparers. Furthermore, the amendments in this proposed Update would result in financial reporting that reflects the intended continuation of contracts and hedging relationships due to the replacement of a reference rate. Overall, the Board concluded that the expected benefits, including cost savings for financial statement preparers, would justify any potential costs of the proposed amendments.

Basis for Conclusions

General Principles

BC13. The Board concluded that the amendments in this proposed Update would result in financial reporting that captures the economic substance of the contract modifications occurring in the marketplace due to reference rate reform by treating the modified contract as a continuation of the existing contract. An entity would apply the relevant accounting guidance for a contract modification rather than the accounting guidance for a contract extinguishment. In contrast, the Board concluded that the application of existing guidance for changes to a hedging relationship and for assessing whether contract changes should be accounted for as a contract modification or as a contract extinguishment could be burdensome given the quantity of IBOR-based contracts and could result in financial reporting that is not reflective of an entity's business strategy or intent. Specifically, because reference rate changes relate to a market-wide reform initiative that is outside the control of an entity, thereby compelling an entity to make modifications to contracts or hedging strategies, the Board determined that the financial reporting outcomes of discontinuing such contracts (and treating the modified contract as an entirely new contract) and hedging relationships would not provide decision-useful information to users of financial statements. Therefore, the Board concluded that accounting relief should be broadly available to enable entities to continue accounting for affected contracts and hedging relationships through the period of market transition in a manner that would continue the previous accounting determinations for such arrangements before the effects of reference rate reform. Unless explicitly stated otherwise, continuing the previous accounting determinations for an arrangement would require that the changes to the contract be accounted for using the current accounting guidance for modifications. The Board concluded that the current accounting guidance for recognition and measurement of modifications captures the economic substance of contract modifications occurring in the marketplace due to reference rate reform.

BC14. For contract modifications, current GAAP for loans and debt instruments broadly requires that an entity assess both qualitatively and quantitatively whether a modified contract substantially differs from the contract before the modification to a degree that it is in substance a new contract rather than a continuation of an existing contract. The Board understands that loans and debt instruments that are modified solely to reflect the effects of reference rate reform may pass those tests if they are applied on an individual contract basis. However, stakeholders indicated that given the significant volume of contracts that are expected to be modified as a result of reference rate reform, applying those requirements on an individual contract basis would result in significant operational costs.

BC15. Other areas of GAAP, including Topic 842 on leases and Topic 815 on derivatives and hedging, require similar assessments of contract modifications or previous accounting determinations due to changes in terms. Given its view that financial reporting outcomes of discontinuing such contracts and hedging relationships would not necessarily provide decision-useful information to users of financial statements, the Board concluded that the expected benefit of applying existing accounting requirements for contract modifications on an individual contract basis likely would not justify the expected costs. Similarly, the Board determined that considering reference rate reform to be an event that requires reassessment of a previous accounting determination under GAAP on an individual contract or a transaction basis likely would not justify the expected costs. Therefore, the amendments in this proposed Update would provide various optional expedients and exceptions to applying certain accounting requirements to contacts, transactions, and hedging relationships affected by reference rate reform.

BC16. The Board concluded that because the amendments in this proposed Update are intended to provide relief related to the accounting requirements in GAAP due to the effects of the market-wide transition away from IBORs, the relief provided by the proposed amendments would be temporary in its application in alignment with the expected market transition period.

Overall Scope of Reference Rate Reform Guidance

BC17. The amendments in this proposed Update would establish the overall scope of the guidance for contract modifications, hedging relationships, or other transactions that would be eligible to apply optional expedients or exceptions to accounting requirements in GAAP.

BC18. The overall scope would be that the contract must reference LIBOR or a reference rate that is expected to be discontinued as a result of reference rate reform. The Board decided to explicitly reference LIBOR in this criterion because it determined that the primary objective of the amendments in this proposed Update would be to facilitate the market-wide transition away from LIBOR as a consequence of the United Kingdom’s Financial Conduct Authority announcing that it would no longer persuade, or compel, banks to submit to LIBOR as of the end of 2021. This applies to LIBOR in all jurisdictions and in all currencies.

BC19. However, the Board included within the scope guidance other reference rates that are expected to be discontinued due to reference rate reform and observed that, in applying that provision, judgment may be required to identify those rates. The Board observed that certain reference rates (for example, the

Singapore Dollar Swap Offer Rate) use an IBOR that is expected to be discontinued as an input into the calculation of the reference rate. The Board believes that contracts referencing interest rates that are computed using reference rates expected to be discontinued as an input also should be considered to meet the scope. In addition, the Board understands that for certain reference rates (for example, the Euro Interbank Offered Rate), there may be an effort to reform the production method of how the published reference rate is calculated, rather than discontinuing the publishing of the reference rate, which may be assessed by market participants to be a fundamental change in the reference rate such that in substance the previous reference rate is considered discontinued. The Board believes that if such an assessment is made, those rates also should meet the scope guidance.

BC20. In developing the scope guidance, the Board considered providing a prescriptive list of reference rates that would qualify for optional expedients for contract modifications. The Board decided not to include such a list within the scope guidance on the basis that it would require the Board to maintain and update that list on an ongoing basis as other reference rates undergo review. The Board understands that in addition to LIBOR, there are other rate reform initiatives that have recommended reducing reliance on certain other IBORs and other reference rates and that work is under way in multiple jurisdictions to transition away from those rates. The Board determined that it may be difficult to compile a complete list of all reference rates undergoing reform because some jurisdictions are still evaluating whether certain reference rates should be discontinued and that could affect its ability to provide relief in a timely manner.

BC21. The Board also considered restricting the replacement reference rate to one that is designated or endorsed by a regulator or private-public sector working group convened by the regulator. The Board received feedback from stakeholders that such a restriction may significantly limit the scope of the relief. There are various existing reference rates and potentially new reference rates that may replace the discontinued reference rates. The Board believes that it should be neutral on that matter and does not want to restrict the optional expedients in a manner that could influence the market-wide transition away from discontinued reference rates toward specific replacement rates. Therefore, the Board decided not to specify eligible replacement rates in the scope guidance.

Scope of Contract Modifications That Would Be Eligible for Accounting Relief

BC22. The amendments in this proposed Update would provide the scope of modifications to contracts that are eligible to apply optional expedients for the accounting requirements in GAAP to contract modifications. The scope would be intended to distinguish those contract modifications occurring solely due to reference rate reform from other contract modifications that occur in the ordinary course of business or for reasons unrelated to reference rate reform.

BC23. The Board decided that the scope of contract modifications that would be eligible for the optional expedients would include only changes being made to the terms that include the direct replacement of a reference rate or the potential to replace a reference rate from one variable rate to another variable rate. For the purpose of the amendments in this proposed Update, the Board determined that the terms that would be permitted to be modified are those that affect or have the potential to affect the amount or timing of future cash flows of a financial instrument. The potential to affect the amount or timing of contractual cash flows would include terms such as fallback provisions in a contract that are triggered upon a contingent event (such as the discontinuance of rate). In addition, contemporaneous changes to terms that do not affect the amount or timing of future cash flows would be permitted.

BC24. A change from a variable rate to a fixed rate would not be eligible for application of the optional expedients for contract modifications. The Board reached that decision because it believes that a negotiated fixed rate in a loan, debt instrument, or over-the-counter derivative could include spread components that would reflect a credit decision that is separate from reference rate reform. However, the Board does not intend to exclude modifications of the reference rate from applying the optional expedients if a fixed rate is predetermined on the basis of the most recent reset of a variable rate affected by reference rate reform.

BC25. To qualify for the optional expedients for contract modifications, other terms being contemporaneously modified would need to be *related* to the replacement of a reference rate due to reference rate reform. Modifications to terms that would be considered *related* to the replacement of the reference rate would be those that are made to effectuate the transition away from LIBOR or another reference rate expected to be discontinued. For example, the replacement of LIBOR with an overnight rate may require not only a change to the reference rate but also an additional spread adjustment and changes to the reset period.

BC26. The amendments in this proposed Update would not permit the optional expedients to be elected for contracts that are modified in a manner that changes the terms of a contract that are *unrelated* to the replacement of the reference rate due to reference rate reform. The proposed amendments include a presumption that modifications that are made as a result of a new underwriting, credit decision, or other business decision are unrelated to reference rate reform. In proposing that entities would be required to consider whether modifications of terms *that affect or have the potential to affect the amount or timing of future cash flows* are *related* to reference rate reform, the Board was intentionally broad such that this criterion would capture any changes in terms that could have a potential effect on future cash flows in certain circumstances, such as changes to collateral arrangements, changes in the priority of an obligation, and changes to debt covenants. The Board believes that such changes in terms that could affect the timing or amount of cash flows in future periods have economic consequences and that a decision to change such terms would be driven by factors unrelated to reference rate reform.

BC27. The amendments in this proposed Update would provide examples of changes to terms that are considered *related* to and *unrelated* to the replacement of the reference rate. The examples in paragraphs 848-20-15-5 through 15-6 would not be an exhaustive list of all the changes to terms that may be considered *related* to and *unrelated* to the replacement of the reference rate.

BC28. In the case of a loan, some examples of changes in terms that would be considered *unrelated* to the replacement of a reference rate are changes in borrower credit spread, changes in the maturity date, and changes in the loan amount. The Board considers such changes in terms to be unrelated to reference rate reform because they would generally require a new credit decision by a lender. For the same reason, the Board considers a concession granted by a lender to a borrower for the purposes of recovering its investment to be unrelated to reference rate reform, and, therefore, the amendments in this proposed Update would provide no optional expedient to the guidance in Subtopic 450-20, Contingencies—Loss Contingencies. Similarly, for a lease, the addition or removal of a right-of-use lease asset or change to the lease term would involve a separate business decision, and, therefore, the Board considers those changes in terms to be unrelated to reference rate reform.

BC29. The Board chose to include an in-the-money cap or floor in the list of examples of changes in terms that would be considered *unrelated* to a change in a reference rate because it believes that there would be some immediate transfer of value associated with that feature that is unrelated to reference rate reform. However, the Board believes that the addition of an out-of-the-money cap or floor would be considered *related* to a change in a reference rate because entities may be uncertain about the level of volatility associated with a new reference rate for which there is no history and may want protection from that exposure.

BC30. The Board also chose to include a change in the counterparty in the list of examples of changes in terms that would be considered *unrelated* to a change in a reference rate because the Board believes that a change in counterparty is a fundamental change to a contract and in some cases could change the risk profile of the contract. The Board also believes that in considering the list of examples, reasonable judgment should be applied. For example, the Board observed that if a maturity date of a loan changed by a few days potentially because of structural changes as a result of reference rate reform, the Board would not intend for the contract to be excluded from the scope of the amendments in this proposed Update.

BC31. The Board recognizes that there may be modifications to terms of a contract or an arrangement made concurrently with modifications due to reference rate reform that are administrative in nature and that do not affect or have the potential to affect the amount or timing of future cash flows. The amendments in this proposed Update would allow changes to those terms to be made without having to assess whether such changes would be related to reference rate reform.

BC32. In place of a principle with examples, the Board considered creating a prescriptive list of terms that would be eligible or ineligible for the optional practical expedients in this proposed Update. The Board observed that a prescriptive list would be more straightforward to apply and would reduce implementation questions, thereby facilitating the market-wide transition by minimizing accounting analysis and judgments. However, the Board determined on the basis of feedback from stakeholders that due to uncertainty about how the market-wide transition will be effectuated across the various types of contracts affected by reference rate reform, it would be difficult to identify a sufficiently complete list of terms that may be changed in the time frame necessary for accounting relief to be available to entities as the market transition occurs. The Board therefore determined that a prescriptive list may result in the optional expedients being more restrictive than otherwise intended.

BC33. The Board observed that modifications of fallback protocols as a result of reference rate reform would be captured within the scope of the amendments in this proposed Update because they are modifications to the terms of a contract that have the potential to change the amount or timing of contractual cash flows. The Board recognizes that changes to contract terms to change fallback protocols could occur before the discontinuance of the actual rate and that optional expedients would apply at that time. The Board decided that given the varied types of contracts that would be affected by reference rate reform and the differing processes and timelines that may be followed to amend such contracts, the proposed amendments would not provide any restrictions on how far in advance of the anticipated reference rate discontinuance an entity may modify a contract to qualify for the optional expedients.

Optional Expedients for Accounting for Contract Modifications

BC34. The amendments in this proposed Update would result in qualifying contract modifications being considered a continuation of the existing contract rather than an extinguishment of the existing contract and establishment of a new contract. Similarly, the proposed amendments would result in a contract modification to which the optional expedient being applied is not considered an event that requires reassessment of a previous accounting determination.

BC35. The Board determined that the qualitative criteria in the amendments in this proposed Update would be less operationally burdensome than the application of existing modification accounting guidance for a high volume of contract modifications. If a contract modification does not meet the criteria to apply the optional expedient, the contract modification would continue to be assessed using the guidance in the relevant Topic applicable to that contract.

BC36. The amendments in this proposed Update would provide specific optional expedients for accounting for contract modifications within the scope of Topic 310 on receivables, Topic 470 on debt, and Topic 842 on leases. On the basis of stakeholder feedback, the Board determined that the most significant number of contract modifications expected to be made for reference rate reform would otherwise be required to apply the accounting guidance in those Topics. Therefore, the Board decided to tailor the proposed amendments to those areas to provide explicit guidance on practical expedients that would be easily understandable in the context of the requirements of each of those Topics. The optional expedients for Topics 310 and 470 would result in applying the provisions of those Topics related to the accounting for a continuation of the original contract rather than an extinguishment of the original contract and the issuance of a new contract.

BC37. The amendments in this proposed Update would allow for contract modifications that would otherwise be assessed under the contract modification guidance in Topic 842 to be accounted for as if no lease modification occurred. That would result in a lessee or a lessor not reassessing the lease classification, not remeasuring the lease liability, and not adjusting the right-of-use asset.

BC38. In deciding to provide an optional expedient, the Board determined that the expected costs to preparers of following current GAAP for lease modifications would outweigh the potential benefits to users. In addition, the expected benefits of what effectively would be a gross-up to the balance sheet (that is, because the change in the lease liability for changes in the reference rate would result in a corresponding change to the right-of-use asset) would not justify the expected costs to preparers of doing so. The Board noted that the total lease-related expenses recognized in profit or loss by a lessee would be the same for operating leases and substantially the same for finance leases, regardless of whether the lessee remeasures the lease liability for changes to the rate. The Board further concluded that users would be able to reasonably assess the effect of future rent increases dependent upon the replacement rate on the basis of the disclosures provided by Topic 842 on (a) variable lease expense each period and (b) the terms and conditions of the variable lease payment arrangement.

BC39. Under the amendments in this proposed Update, contract modifications that apply the optional expedient would not be subject to an embedded derivative analysis under Subtopic 815-15. An embedded derivative in which the only underlying is an interest rate that alters net interest payments that otherwise would be paid or received on an interest-bearing host contract is generally considered to be clearly and closely related to the host contract unless it meets either of the conditions in paragraph 815-15-25-26(a) and (b). To determine the existence of those conditions, a reporting entity would perform an embedded derivative analysis at the date the hybrid instrument is acquired (or incurred) either at issuance of the hybrid instrument or upon acquisition in the secondary market. The Board concluded that an entity's conclusions before the modification of a hybrid instrument on whether to bifurcate the embedded derivative from the host contract would be maintained if the hybrid instrument met the criteria to apply the practical expedient. The Board concluded that clarifying that no embedded derivative reassessment is required for the purposes of this guidance would reduce costs to preparers but would not reduce the usefulness of financial reporting.

BC40. The Board acknowledged that there may be contract modifications due to reference rate reform that would not be accounted for under Topics 310, 470, and 842 and Subtopic 815-15. Therefore, the Board decided that the amendments in this proposed Update would include a principle that may be applied to determine whether contract modifications accounted for in accordance with other relevant Topics or Subtopics would be eligible for an optional expedient to the accounting requirements of other relevant Topics or Subtopics. The Board decided to provide this principle because stakeholder feedback indicated that entities may encounter issues other than those for which explicit relief is proposed when transitioning away from IBORs. The Board expected that these issues would be less pervasive than those for which explicit relief was proposed and decided that a principle would provide flexible relief that would generally guide entities to account for in-scope contract modifications consistent with the accounting afforded to a contract modification that does not result in the derecognition (or extinguishment) of a contract and the initial recognition of a new contract. Such accounting would be consistent with the intent of the optional expedients explicitly provided in the proposed amendments.

BC41. The amendments in this proposed Update would allow an entity to elect the optional expedients for contract modifications on a Topic, Subtopic, and Industry Subtopic basis. For example, if an entity elects the lease modification expedient, it must apply the optional expedient to all of its lease contract modifications arising from reference rate reform that would otherwise be accounted for in accordance with Topic 842. The Board considered but rejected an alternative that would mandatorily require an entity to apply the optional expedients for contract modifications arising from reference rate reform across all Topics because a mandatory requirement would preclude an entity from applying current GAAP, which in certain circumstances may be operationally less burdensome for entities. The Board also considered but rejected allowing an application on a contract-by-contract basis because the Board wanted to preclude an entity from selectively applying the optional expedients on the basis of the effect to earnings.

Hedge Accounting

BC42. The amendments in this proposed Update would provide several exceptions and optional expedients for applying hedge accounting guidance. Stakeholders requested the following relief to address potential challenges for applying hedge accounting for hedging relationships expected to be affected by reference rate reform:

a. For existing hedging relationships, upon a change to the critical terms of the hedging relationship, allow an entity to continue hedge accounting rather than dedesignating the hedging relationship.
b. For existing fair value hedges, allow an entity to change the designated hedged benchmark interest rate and continue fair value hedge accounting.

c. For existing and new cash flow hedges, adjust the guidance for assessment of hedge effectiveness to allow an entity to apply hedge accounting.

Exceptions to Accounting Requirements for a Change in Critical Terms of a Hedging Relationship

BC43. Generally, under current GAAP, hedge accounting must be discontinued if critical terms of an existing hedging relationship are modified. If an entity wishes to continue to apply hedge accounting, it may do so by designating a new hedging relationship. As a result of amendments to Topic 815 in Update 2017-12*,* current GAAP includes a narrow exception to this requirement that allows a change to the hedged risk in a cash flow hedge of a forecasted transaction without dedesignation of the hedging relationship if the hedging instrument continues to be highly effective at offsetting the revised hedged risk. That guidance has limited applicability and does not apply to a change to the terms of a hedging instrument or a change to any terms of fair value or net investment hedging relationships.

BC44. Stakeholders requested that entities be permitted to continue applying hedge accounting for existing hedging relationships for which a derivative designated as a hedging instrument is modified. Stakeholders indicated that the following changes to derivatives are expected to occur as a result of reference rate reform:

a. The reference interest rate (for example, changing from LIBOR to another variable rate)
b. The payment terms of the derivative (for example, the addition of a spread adjustment)
c. Reset period (for example, changing from a forward-looking term rate that resets quarterly to an overnight rate that resets daily).

BC45. In the ordinary course of business, modifications of contractual terms of a hedging instrument are initiated by two or more counterparties that are acting in their respective interests to make changes to the terms. As a result of reference rate reform, the counterparties are being compelled to amend the contractual terms of the derivatives, including those designated as hedging instruments, because the reference rate is discontinued. The Board determined that the financial reporting outcome of forcing a discontinuance of hedge accounting would not provide decision-useful information to users of financial statements, particularly since entities will, in most circumstances, continue to use the modified derivative for the same risk management purposes as the contract before the modification. The Board concluded that a dedesignation of a hedging relationship due to a change in critical terms and potential designation of a new hedging relationship due to the discontinuation of a rate outside the entity's control without an accompanying change in a risk management objective would result in financial reporting that would be confusing to users.

BC46. Therefore, the amendments in this proposed Update would provide an exception to the guidance on changes in the critical terms of a hedging relationship to allow that the hedging relationship continue without dedesignation if the changes to the contractual terms of the hedging instrument meet the criteria for contractual modifications related to the replacement of the reference rate. The Board decided that the proposed amendments on the optional expedient for changes in critical terms would apply to fair value hedges, cash flow hedges, and net investment hedges because derivatives designated in any type of hedging relationship could be affected by reference rate reform.

BC47. The amendments in this proposed Update would provide an exception to the guidance on changes in the critical terms of a hedging relationship to allow a change to the method of assessing hedge effectiveness documented at hedge inception without requiring dedesignation of the hedging relationship. The optional expedient would be eligible if the critical terms of the hedging instrument or the hedged item or hedged transaction references LIBOR or another rate that is expected to be discontinued and the new method designated for assessing hedge effectiveness is an optional expedient in the proposed amendments. The Board determined that this exception would be required to enable entities to continue hedge accounting for existing hedges using the optional expedients for fair value hedges and cash flow hedges without hedge dedesignation.

BC48. On the basis of stakeholder feedback, the Board understands that it may be necessary for duration-weighted fair value hedges that transition to a different eligible replacement benchmark rate to rebalance the hedge ratio to adjust for the changes in the hedged risk and instrument terms. Similarly, the Board understands that on the basis of stakeholder feedback there are a number of potential methods that an entity may use to manage its transition of an existing hedging relationship from a discontinued reference rate to a replacement rate, such as adding a new interest rate basis swap to an existing interest rate swap designated as the hedging instrument in a cash flow hedge. The Board agreed that it may be necessary for existing hedging relationships to be adjusted due to changes in the terms of hedging instruments and hedged items resulting from reference rate reform.

BC49. Therefore, the amendments in this proposed Update would provide exceptions to the guidance related to changes in critical terms that would allow entities to rebalance hedging relationships as needed. The proposed amendments would allow an entity to change either the proportion of a designated hedging instrument or the proportion of the hedged item (or both) designated in a fair value hedge eligible to apply the optional expedients for fair value hedge accounting. Similarly, the proposed amendments would allow an entity to change the designated hedging instrument to combine two or more derivative instruments in a hedging relationship eligible to apply the optional expedients.

Optional Expedient for Fair Value Hedges: Change in the Designated Benchmark Interest Rate

BC50. The amendments in this proposed Update would allow an optional expedient to change the designated benchmark interest rate in an existing fair value hedge if the derivative designated as the hedging instrument references LIBOR or another rate that is expected to be discontinued as a result of reference rate reform and if certain criteria are met. The Board decided to provide this optional expedient for circumstances in which an existing hedging instrument has a change to its reference rate that could affect the effectiveness of the hedging relationship for the remainder of its term. For example, if a LIBOR swap was designated as the hedging instrument in a fair value hedge and an entity selected the LIBOR swap rate as its designated hedged risk, the change in fair value of the swap and the change in fair value of the hedged item based on a LIBOR swap rate would diverge if the swap's variable rate changes to another rate, such as SOFR.

BC51. The Board decided that it would be appropriate to allow an entity to bring such hedges into realignment by allowing a change to the benchmark rate to a different eligible benchmark rate, assuming that the hedging instrument is expected to be highly effective in offsetting changes in fair value attributable to the revised hedged risk. The Board determined that the financial reporting outcome of forcing an entity to discontinue fair value hedge accounting because of changes in the terms of the hedging instrument would not result in decision-useful information to users of financial statements. The Board also determined that dedesignation of a fair value hedge and potential designation of a new hedging relationship without an accompanying change in a risk management objective would result in financial reporting that could be confusing to users.

BC52. Because a change in the designated benchmark interest rate is not allowed in current GAAP, there is no guidance on how to calculate the change in fair value attributable to a change from one benchmark interest rate to another eligible benchmark interest rate. Stakeholders provided feedback on multiple possible methods. Some of those methods would maintain the current cumulative basis adjustment to be carried forward by adjusting the hedged benchmark cash flows or by adjusting the rate used to discount the original hedged benchmark cash flows. Other methods would adjust the current cumulative basis adjustment to be carried forward as a result of changing the hedged benchmark cash flows and the subsequent discount rate. The Board decided that the method selected would need to be reasonable and that an entity would be required to use a similar method for similar hedges. The Board considered but rejected prescribing a specific method because different methods may be reasonable for different entities depending on their facts and circumstances.

BC53. The amendments in this proposed Update would require the change in fair value of a hedged item attributable to a change from one benchmark interest rate to another eligible benchmark interest rate to be presented in the same line item that is used to present the earnings effect of the hedged item. The Board determined that this would be consistent with its basis for conclusions in Update 2017-12 that if an entity designates a hedging instrument, all effects of that hedging instrument should be presented together with the earnings effect of the hedged item.

BC54. The amendments in this proposed Update would allow an entity to make an accounting policy election that is applied consistently across similar hedging relationships to recognize the change in fair value attributable to a change in an eligible benchmark interest rate either in current earnings or over time in the same manner as other components of the carrying amount of the hedged asset or liability. The Board considered allowing an adjustment to opening retained earnings but rejected that alternative on the basis that allowing a retained earnings adjustment is inconsistent with accounting for the modified contract as a continuation of the original contract. In addition, changes to the critical terms of hedging instruments in fair value hedges that would drive a change in the designated benchmark interest rate may occur across different reporting periods, particularly if an entity has derivatives designated as fair value hedges with various reference rates that may be replaced at different times. The Board believes that allowing retained earnings adjustments across multiple reporting periods could be confusing to users.

Optional Expedient for Fair Value Hedges: Shortcut Method for Existing Hedges

BC55. Current GAAP allows an entity to apply the shortcut method for assessing hedge effectiveness of fair value hedges if certain conditions are met. For existing fair value hedges applying the shortcut method, the amendments in this proposed Update would provide an optional expedient to allow an entity to continue to use the shortcut method if the reference rate in the hedging instrument is replaced by another eligible benchmark interest rate. For an entity that qualifies for and elects to use the optional expedient, the entity would continue to use the shortcut method and recognize the change in fair value of the hedging instrument as a basis adjustment of the hedged item.

BC56. The Board believes that an entity that applies the shortcut method should not be penalized because the entity is compelled to change the terms of a derivative due to reference rate reform. While a change in a derivative's reference rate would not meet the condition for the shortcut method of accounting because the settlements of the swap would not be computed in the same manner in all periods, the Board decided that the condition may be disregarded in this circumstance and that an entity could elect to continue to apply the shortcut method for the remainder of the hedging relationship.

Eligibility of Existing Cash Flow Hedges: Probability of the Hedged Forecasted Transaction and Change in the Designated Hedged Risk

BC57. For a cash flow hedge to qualify for hedge accounting in accordance with GAAP, an entity must assert that the hedged forecasted transaction is probable of occurring. A change in the probability of the forecasted transaction may require that an entity discontinue hedge accounting and may affect the timing of recognizing in current earnings amounts deferred in accumulated other comprehensive income.

BC58. The amendments in this proposed Update would clarify that if the designated hedged risk in a hedged forecasted transaction references LIBOR or another rate that is expected to be discontinued due to reference rate reform, an entity may assert that the hedged forecasted transaction remains probable of occurring if the reference rate is expected to be replaced with another rate. However, the proposed amendments would require that an entity assess whether the underlying hedged forecasted transaction (that is, the future interest receipts of a financial asset or the future interest payments of a financial liability or the forecasted issuance or purchase of a debt instrument) remains probable of occurring. For example, if the hedged forecasted transaction is the future interest payments on specific debt and that identified debt is prepaid by the entity and the entity does not replace the debt, the hedged forecasted transaction would be probable of not occurring.

BC59. In addition, the amendments in this proposed Update would clarify that a change to the designated hedged risk (for example, a change from LIBOR to another variable rate) would not require a dedesignation of a cash flow hedge of a forecasted transaction if the hedge is expected to be highly effective, which may be asserted if an entity applies an optional expedient in the proposed amendments for cash flow hedges. The Board believes that it is important to clarify that in applying the proposed amendments, an entity would not be required to dedesignate a cash flow hedge for a technical reason related to the designation and documentation of the hedge. That is, the Board wanted to clarify that both:

a. The guidance in Topic 815 on a permissible change in the hedged risk in a cash flow hedge of a forecasted transaction applies in the circumstance of reference rate reform.
b. An entity would not be required to discontinue hedge accounting if it can assert that the underlying cash flows remain probable of occurring regardless of how the hedged risk and the hedged forecasted transaction are documented.

Optional Expedients for Cash Flow Hedges: Application of Cash Flow Hedge Accounting

BC60. For a cash flow hedge to qualify for hedge accounting in accordance with current GAAP, an entity must assess that the hedging instrument is expected and is actually shown to be highly effective in offsetting the changes in cash flows due to changes in the hedged risk during the period that the hedge is designated. An entity is required to perform hedge effectiveness assessments at hedge inception and on an ongoing basis to continue to qualify for hedge accounting. Current GAAP describes various methods for assessing hedge effectiveness for the initial assessment and subsequent assessments. Certain methods permit an entity to assume that the hedge is perfectly effective if certain qualifying conditions are met.

BC61. Similar to its reasoning for fair value hedges, the Board concluded that existing cash flow hedges that are affected by reference rate reform should be permitted to continue without dedesignation because those hedging relationships continue to reflect an entity's intended risk management strategy. The Board also concluded that new cash flow hedges that are affected by reference rate reform because either the hedging instrument or the hedged item references LIBOR or another rate expected to be discontinued should be permitted to qualify for hedge accounting because those hedging strategies also would reflect an entity's intended risk management strategy.

BC62. The Board concluded that without the optional expedients in the amendments in this proposed Update, there would be an increased level of complexity in performing hedge effectiveness assessments for cash flow hedges that are expected to be affected by reference rate reform. For example, in an existing cash flow hedge that qualifies for hedge accounting, the reference rate in the hedging instrument and the reference rate in the hedged forecasted transaction may be replaced at different times during the hedging relationship. An entity would need to estimate the expected timing of when the hedging instrument and the hedged forecasted transaction will transition to the replacement rates—including for hedges of groups of forecasted transactions in which individual forecasted transactions in the group may have different transition timing—and incorporate those timing estimates into the hedge effectiveness assessment.

BC63. In addition, without the amendments in this proposed Update, there may be periods of time during the transition to replacement rates that a hedge would not be considered highly effective for the purposes of Subtopic 815-20 because of the basis differences between the reference rates in the hedging instrument and the reference rates in the hedged forecasted transaction. The Board determined that the discontinuance of hedge accounting in those cases would not provide decision-useful information to users of financial statements.

BC64. In proposing the optional expedients for cash flow hedges affected by reference rate reform, the Board placed importance on several other provisions in hedge accounting guidance as a counterbalance to the flexibility that would be provided by those optional expedient methods. First, the amendments in this proposed Update rely on the guidance in Subtopic 815-20 that was added in Update 2017-12 to remove the concept of separately measuring and recognizing hedge ineffectiveness. Accordingly, if a hedging relationship qualifies for cash flow hedge accounting, all changes in the fair value of the derivative designated as the hedging instrument are deferred into accumulated other comprehensive income and recognized in earnings when the hedged forecasted transaction affects earnings.

BC65. Second, the amendments in Update 2017-12 added presentation guidance for hedging relationships, such that the effects of the hedging instrument are required to be recorded in the same line item as the earnings effect of the hedged item. The Board considers that presentation guidance to be a safeguard for the application of the proposed optional expedients for cash flow hedges. That is, the Board acknowledges that cash flow hedges for which an entity would elect the proposed optional expedients may not satisfy the requirement that the hedging instrument is expected and actually shown to be highly effective in offsetting changes in cash flows due to changes in the hedged risk during the period that the hedge is designated. The Board accepts that hedging relationships that are not highly effective may qualify for hedge accounting as an outcome of proposing relief provisions that will enable an entity to continue to reflect its intended risk management strategies in the financial statements for the period that reference rates are expected to transition to replacement rates.

BC66. Third, the Board observes that the guidance can be applied for a limited time and would not apply to hedging relationships entered into or evaluated after December 31, 2022. An entity would be required to revert to the cash flow hedge accounting requirements in Subtopics 815-20 and 815-30 for any cash flow hedging relationships that would remain in place.

Existing Cash Flow Hedges

BC67. For existing cash flow hedges, if either the hedged forecasted transaction or the hedging instrument references LIBOR or another rate expected to be discontinued due to reference rate reform, the amendments in this proposed Update would allow an entity to effectively suspend subsequent hedge assessments as long as the entity determines qualitatively that the following conditions continue to be met each period:

a. The hedged forecasted transaction or the hedging instrument references a rate that meets the scope of paragraph 848-10-15-3.
b. There have been no changes to the terms of the hedging instrument other than those specified in paragraphs 848-20-15-3 through 15-4.
c. An entity considers the likelihood of the counterparty’s compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity.

BC68. The Board decided that an entity would be allowed to switch to the shortcut method if it elects to apply that optional expedient for existing cash flow hedges. However, the Board decided not to provide similar relief for existing fair value hedges. The Board reasoned that under the fair value shortcut method, a change in fair value of a swap designated as the hedging instrument would be used as a proxy for the change in fair value of the hedged item, and if the variable rate on the swap did not match the designated benchmark rate, there would be a true fair value difference. However, because all changes in a swap designated as a hedging instrument in a cash flow hedge are recorded in other comprehensive income, there is no difference between the reporting effect of a cash flow shortcut method and the reporting effect of a quantitative method if the hedge is highly effective.

BC69. An entity also may elect optional expedients that would allow it to adjust the methods for assessing hedge effectiveness in current GAAP so that the entity could remove from its assessment the differences between the hedged forecasted transaction and the hedging instrument that are due to the changes in the reference rates and the timing of when the rates reset. The Board determined that an entity should have the option to adjust existing methods of assessing hedge effectiveness rather than suspending hedge effectiveness and assessing certain conditions each period, which introduces a new process for hedging relationships affected by reference rate reform. The Board anticipates that some entities may want to adjust existing methods and processes for hedging relationships that would extend beyond the December 31, 2022 expiration of the optional expedients and would be required to revert to existing GAAP.

BC70. The Board observes that because existing cash flow hedges have already qualified for hedge accounting by (at a minimum) satisfying an initial hedge effectiveness assessment in accordance with the requirements of Subtopics 815-20 and 815-30, the hedge has already passed a high hurdle to apply hedge accounting. Therefore, the Board believes that it would be unlikely that the hedging relationship would significantly deviate from the results of those previous hedge effectiveness assessments and that a change in the terms as a result of reference rate reform would not be expected to introduce excessive levels of hedge ineffectiveness. The Board also believes that for the periods of an expected or actual mismatch in reference rates between the hedging instrument and the hedged item, an entity should be able to continue to portray in its financial statements the continuation of its original risk management strategy, especially considering that any mismatch will be reflected in earnings.

BC71. For similar reasons, the Board decided that an entity would be allowed to disregard the shared risk exposure guidance in Subtopic 815-20 for a group of individual forecasted transactions in a cash flow hedge if a single forecasted transaction in the hedged group of forecasted transactions references LIBOR or another rate that is expected to be discontinued. However, an entity would not be allowed to group interest receipts with interest expenses or forecasted purchases (including debt issuances) with forecasted sales.

BC72. The amendments in this proposed Update would require that an entity discontinue use of the optional expedients for assessing hedge effectiveness at the earlier of any of the following events:

a. Neither the hedged item nor the hedging instrument references LIBOR or another rate that is expected to be discontinued.
b. The guidance in Topic 848 is superseded.
c. The entity elects to cease to apply the guidance in Topic 848.

BC73. On the basis of stakeholder feedback, the Board believes that those provisions for discontinuing the application of optional expedients will be sufficient to allow hedging relationships to continue until the effects of reference rate reform are resolved. Upon one of those events occurring, an entity would be allowed to change the method of assessing subsequent hedge effectiveness. The Board decided that an entity should be allowed to continue hedge accounting without disruption by changing from an optional expedient method to a method of assessing hedge effectiveness in accordance with Subtopics 815-20 and 815-30 without dedesignation of the hedge.

New Cash Flow Hedges

BC74. The amendments in this proposed Update would allow an entity to apply optional expedients for the purpose of assessing initial hedge effectiveness for new cash flow hedges if either the hedged forecasted transaction or the hedging instrument references LIBOR or another rate that is expected to be discontinued as a result of reference rate reform. The proposed amendments would allow new hedges to apply the same optional expedient methods as existing hedges for subsequent assessments.

BC75. The Board decided that extending relief to new hedges affected by reference rate reform would be appropriate during the period of transition to replacement reference rates because it believes that an entity will enter into hedging relationships during that period that could have an immediate mismatch in rates. Because of the uncertainty on how reference rate reform will be effectuated in the respective markets, including across different derivatives and other financial instrument products, the immediate mismatch may be due to market-wide developments outside the control of an entity’s risk management activities such as the lack of liquidity of certain derivatives to match the underlying reference rate index of a replacement reference rate. The Board determined that the lack of hedge accounting should not hinder the development of those new markets. The Board also believes that given the uncertainty about the timing of the transition of different instruments and products, it is unclear whether an entity would be able to obtain derivatives referencing desired rates.

BC76. The amendments in this proposed Update do not include incremental criteria for determining whether an optional expedient for new cash flow hedges may be elected. The Board notes that it would be challenging to create criteria that would not diminish the objective of providing relief for application of the existing hedge accounting requirements during the period of market transition to replacement reference rates. The Board considered an approach that would limit the reference rates that could be incorporated into a hedging relationship that qualifies for optional expedients. However, as noted in paragraph BC21, the Board believes that the proposed amendments should remain neutral on eligible replacement rates, which creates a challenge for introducing such a limitation.

BC77. As an alternative, the Board considered requiring an initial assessment of hedge effectiveness using an existing method in Subtopics 815-20 and 815-30 to align new cash flow hedges with existing hedges (without adjustment for the effects of reference rate reform). However, the Board recognizes that when the reference rate of the hedging instrument and the hedged item differ at the inception of the hedging relationship, the requirement of an expectation that the hedge will be highly effective may not satisfied. The Board observed that this would be no different in the case of an initial assessment for a new hedge as compared with a subsequent assessment for an existing hedge.

BC78. As noted in paragraph BC63, the Board acknowledges that cash flow hedges for which an entity would elect the proposed optional expedients may not satisfy that requirement during the period that the hedge is designated, and the Board accepts that as an outcome of proposing temporary relief provisions enabling an entity to continue to reflect its intended risk management strategies in the financial statements during the transition period.

BC79. The Board noted that it was important to provide entities with the option to apply the expedients to new cash flow hedges using either a qualitative method that assumes perfect effectiveness or quantitative methods to enable entities of all levels of sophistication to avail themselves of the relief. The Board observed that without this option, an entity that applies only the simplified method would be required to apply a "long haul" method to apply the relief when it potentially would have not applied that method in practice before.

BC80. The Board also considered developing criteria for new cash flow hedges similar to the criteria for contract modifications that would require an assessment of the terms of hedging instruments and hedged items that would qualify for the optional expedients. That would be similar to the proposed requirement to apply the qualifying criteria for contract modifications to derivatives designated as hedging instruments in existing cash flow hedges when electing the optional expedient related to a change in critical terms. The Board ultimately decided against that approach for several reasons.

BC81. First, the Board expects that an entity employs derivatives as hedging instruments to execute a particular risk management strategy, and there would be natural limitations including internal risk management guidelines to incorporating speculative features into hedging relationships. Second, the results of an entity's hedging relationships will be reflected in an income statement line item that is typically an important metric for entities that have significant interest rate risk hedging programs. Therefore, the Board believes that the results of systematically entering into drastically ineffective hedges would raise questions on the part of users of financial statements.

BC82. Third, the Board designed the initial assessment to qualify for the optional practical expedient to be constrained in that it would allow only a mismatch in the base rate, but not the introduction of unrelated risks or other features (such as a leverage factor) to avoid introducing elements into a hedging relationship that may be speculative in nature. For example, if the hedged forecasted transaction references three-month LIBOR, but the derivative hedging instrument references a non-LIBOR rate and a leverage factor, an entity that elected to apply the optional expedient in paragraph 848-50-25-11(b) should model the hedged forecasted cash flows using the non-LIBOR interest rate index; however, the derivative instrument's leverage factor should not be used to model the hedged forecasted cash flows. As noted in paragraph BC65, the Board considers the income statement presentation requirements in Topic 815 to be an important safeguard. The Board also believes that detailed scope requirements may impose costs to an entity to qualify for the relief that outweigh the expected benefits of the relief.

Option to Apply Proposed Exceptions and Expedients for Hedge Accounting

BC83. The amendments in this proposed Update would allow an entity to elect each of the optional expedients for hedge accounting on an individual hedging relationship basis. The election of optional expedients would be eligible to be applied for each individual hedging relationship without requiring the elections to be applied to other existing hedging programs or other hedging relationships. The Board determined that an entity may want to continue to use its existing hedge assessment processes for certain hedging relationships if the optional expedients are not needed to maintain hedge accounting. The Board decided that an entity should be free to determine whether the hedging relationship continues to qualify for hedge accounting using either current GAAP in Topic 815 or one or more optional expedients in the proposed amendments. Furthermore, the Board concluded that if an entity did not elect an optional expedient to maintain hedge accounting and that resulted in a discontinuance of hedge accounting in Topic 815, the same outcome as if the entity had voluntarily discontinued hedge accounting under current GAAP would occur.

Sunset Provision

BC84. The Board proposed that an entity would no longer be permitted to apply the proposed exceptions and proposed optional expedients for contract modifications, changes in critical terms of a hedging relationship, and cash flow hedges after December 31, 2022. The Board notes that reference rate reform is expected to be temporary in nature, and the objective of the amendments in this proposed Update is to facilitate the effects of the reform on financial reporting for the market-wide transition period in which an entity replaces the use of reference rates with alternative reference rates. Therefore, after it stops applying the proposed amendments, an entity would apply existing accounting requirements for contract modifications and hedging relationships.

BC85. As noted in paragraph BC18, while LIBOR is expected to be discontinued by the end of 2021, there are still uncertainties about when LIBOR and other reference rates will cease being published. Therefore, the Board decided to provide an extra year beyond the expected discontinuation date of LIBOR. The Board will monitor the market-wide IBOR transitions. As noted in paragraph BC9, the Board will consider whether future developments warrant any changes, including changes to the end date of the application of the proposed amendments.

Transition and Disclosures

BC86. The Board decided that the amendments in this proposed Update would be effective for all entities upon issuance of a final Update. Upon adoption, an entity may elect to apply the proposed amendments prospectively to contract modifications made and hedging relationships existing as of or entered into on or after the date of adoption and through December 31, 2022. The proposed amendments would not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022. As a practical matter, the Board anticipates that final guidance would be issued contemporaneously with the time frame in which an entity would begin modifying contracts for reference rate reform. Therefore, the Board believes that prospective application would provide an entity with the ability to temporarily simplify or suspend application of certain areas of current GAAP for contracts and hedging relationships affected by reference rate reform.

BC87. The Board decided that the proposed optional expedients for hedge accounting would only be allowed if an entity has adopted the amendments in Update 2017-12. As noted in paragraph BC65, the Board considers the income statement presentation requirements in Topic 815 to be an important safeguard. Furthermore, the amendments in Update 2017-12 removed the requirement to separately measure and report the amount by which the hedging instrument does not offset the hedged item, generally referred to as the “ineffective” amount. The amendments in this proposed Update on hedge accounting are in contemplation of those significant changes in Update 2017-12. If an entity does not elect to apply an optional expedient for hedge accounting, the entity would not need to adopt the amendments in Update 2017-12 to be able to elect the optional expedients for contract modifications in this proposed Update.

BC88. The Board decided that an entity would disclose the nature of and reason for electing the optional expedients in each interim and annual financial statement period in the fiscal year of application. A majority of the Board believes that this disclosure (a) would highlight for users of financial statements that an entity is encountering the effects of reference rate reform and (b) would help users understand an entity's decision to apply relief to specific types of contracts and hedging relationships.

BC89. The Board considered whether private entities and not-for-profit entities should have a delayed effective date compared with that of public entities. The Board decided to not have a delayed effective date for private entities and not-for-profit entities because the proposed guidance is optional and is aimed at providing expedients and exceptions to reduce accounting analyses and related costs that are triggered when the contracts or hedging relationships are modified. The Board determined that reference rate reform is a market-wide initiative that affects all entities that have contract modifications and hedging relationships that reference the discontinued reference rates and that the proposed optional expedients should be available to all entities during the same effective period.

BC90. The Board considered including additional disclosures for entities that elect to apply the optional expedient for a change in the designated benchmark interest rate for fair value hedges. The amendments in this proposed Update would allow an entity to use a method to change the designated benchmark interest rate that results in a change to the hedged item's cumulative fair value basis adjustment and recognize that amount in current earnings. Although some Board members favored an approach that would require that the amount recognized in current earnings be reported separately because the amount may be viewed as additional information related to the effect of reference rate reform, the Board decided to not propose that this amount be reported separately because the disclosures for hedge accounting in current GAAP would be inclusive of the amounts that would be recognized due to an entity using the optional expedients for hedge accounting.

BC91. The Board is considering whether additional required disclosures would be beneficial to financial statement users to understand the effects of reference rate reform on a reporting entity's current contracts (as of a reporting date) that are affected by reference rate reform. Additional disclosures related to existing contracts that are currently in the financial statements may be particularly useful to a user because reference rate reform could significantly alter future cash flows related to those contracts. An improved understanding of those future cash flow changes would be helpful to users' analyses. An example of qualitative disclosures could include a description of management's approach and its progress on addressing an entity's exposure to anticipated discontinued reference rates. An example of quantitative disclosures could include identifying the broad categories of existing financial instruments that reference those rates as of the reporting date and the percentage or dollar amounts of those existing financial instruments (based on the notional amounts or the carrying amounts of the financial instruments) that contain contract provisions that adequately contemplate the discontinuance of the reference rate and the percentage or dollar amounts of those existing financial instruments that do not contain contract provisions that adequately contemplate the discontinuance of the reference rate and would require some degree of additional negotiation. Over time, a reporting entity could quantitatively disclose those contracts that have replaced the reference rate with an alternative rate. Such disclosures would be required only during the period of the market-wide transition and could have an expiration date that is aligned with the sunset provision in the amendments in this proposed Update or another date. A reporting entity's exposure to specific variable interest rates, such as IBORs, is not required under current GAAP; therefore, in the absence of requiring such a disclosure, it may be difficult and costly for a user to understand a reporting entity's exposure to reference rate reform. Using a management approach to provide these types of quantitative and qualitative disclosures should minimize the expected costs of providing the information for preparers of financial statements. To assist in its decision-making process, the Board has included questions in this proposed Update on what additional disclosures should be provided, if any, about the effects of reference rate reform.

International Financial Reporting Standards (IFRS Standards)

BC92. In May 2019, the International Accounting Standards Board (IASB) published an Exposure Draft, *Interest Rate Benchmark Reform.* The Exposure Draft proposed exceptions to specific hedge accounting requirements in IFRS 9, *Financial Instruments*, and IAS 39, *Financial Instruments: Recognition and Measurement*. In its outreach with stakeholders, the IASB identified the following two groups of accounting issues that could have financial reporting implications:

a. Pre-replacement issues—issues affecting financial reporting in the period before the reform and/or replacement of an existing interest rate benchmark with an alternative interest rate
b. Replacement issues—issues that might affect financial reporting when an existing interest rate benchmark is reformed and/or replaced with an alternative interest rate.

BC93. The IASB decided to prioritize the pre-replacement issues because they are more urgent. Therefore, the IASB Exposure Draft addresses only the following hedge accounting requirements that are based on forward-looking analyses:

a. The highly probable requirement
b. Prospective assessments
c. Separately identifiable risk components.

BC94. Before finalizing its Exposure Draft, the IASB will consider whether it should provide an exception from the retrospective assessment required by IAS 39. Other than the specific amendments listed in paragraph BC93, IASB hedge accounting requirements would remain unchanged.

Amendments to the XBRL Taxonomy

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