

FASB FLASH REPORT

NOVEMBER 2018 / www.bdo.com

FASB Expands List of Benchmark Interest Rates for Hedge Accounting

The FASB issued [ASU 2018-16](#)¹ to permit the use of the Overnight Index Swap Rate based on the Secured Overnight Financing Rate as a U.S. benchmark interest rate for purposes of hedge accounting under Topic 815, *Derivatives and Hedging*. An entity must adopt the amendments concurrently with the adoption of [ASU 2017-12](#) if that standard has not yet been adopted.²

BACKGROUND

In November of 2014, the Alternative Reference Rates Committee (ARRC) was convened to identify an alternative reference rate due to concerns around the sustainability of LIBOR. The AARC identified the Secured Overnight Financing Rate (SOFR) and the Federal Reserve Bank of New York (Fed) began publishing the rate since April of 2018. The SOFR is calculated daily based on overnight transactions in specified segments of the U.S. Treasury repo market from the prior day's trading activity.

During deliberations leading to the issuance of ASU 2017-12, the Fed requested the FASB to consider making the Overnight Index Swap Rate (OIS) based on SOFR an eligible U.S. benchmark interest rate in applying hedge accounting under Topic 815. The FASB recognized that although the OIS rate based on SOFR is not yet widely recognized and quoted within the U.S. financial market, the attributes of the repo rates underlying the calculation of SOFR are.

¹ Accounting Standards Update (ASU) 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*

² Refer to our previous [Flash Report](#) for further information on ASU 2017-12

MAIN PROVISIONS

The amendments within this update permit the use of the OIS based on SOFR as a benchmark interest rate for purposes of applying hedge accounting under Topic 815. This is the fifth U.S. benchmark interest rate eligible for use in hedge accounting in addition to the following:

- ▶ Interest rates on direct Treasury obligations of the U.S. government (UST)
- ▶ London Interbank Offered Rate (LIBOR) swap rate
- ▶ Overnight Index Swap (OIS) Rate based on the Fed Funds Effective Rate
- ▶ Securities Industry and Financial Markets Association (SIFMA) municipal swap rate³

The Master Glossary defines the Secured Overnight Financing Rate (SOFR) Overnight Index Swap Rate as:

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

EFFECTIVE DATE AND TRANSITION REQUIREMENTS

The amendments in this ASU are required to be adopted concurrently with the amendments in ASU 2017-12 for entities that have not already adopted that guidance. For public business entities that have previously adopted ASU 2017-12, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities that have previously adopted ASU 2017-12, the amendments are effective after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted in any interim period if an entity already has adopted Update 2017-12.

An entity should apply the amendments in this ASU on a prospective basis for qualifying new or redesignated hedging relationships entered into on or after the date of adoption.

Other Matters

The Board decided to add to its agenda a project to more broadly consider changes to GAAP necessitated by the market-wide transition away from LIBOR, which includes but is not limited to the transition of existing hedging relationships referencing LIBOR.

³ ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, introduced the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate as a permissible U.S. benchmark rate.

CONTACT

GAUTAM GOSWAMI / National Assurance Partner
312-616-4631 / ggswami@bdo.com

TIM KVIZ / National Assurance Partner
703-245-8685 / tkviz@bdo.com

MEGHAN DEPP / National Assurance Senior Manager
312-240-3328 / mdepp@bdo.com

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your needs.

© 2018 BDO USA, LLP. All rights reserved.