

**MEMO# 31962**

September 16, 2019

# FASB Proposes Relief for LIBOR Transition

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September 16, 2019 TO: ICI Members SUBJECTS: Fund Accounting & Financial Reporting RE: FASB Proposes Relief for LIBOR Transition

The Financial Accounting Standards Board recently released for public comment a proposed Accounting Standards Update that would provide temporary optional relief intended to ease the transition from LIBOR to alternative reference rates.[\[1\]](#) The proposal would permit an entity to not apply certain modification accounting requirements in GAAP to contracts affected by the transition from LIBOR to alternative reference rates. For contracts in scope, the entity would present and account for the modified contract as a continuation of the existing contract. The relief would be effective upon issuance of a final accounting standards update and would apply to contract modifications through December 31, 2022. Comments on the proposal are due to the FASB by October 7, 2019.

## Background

LIBOR is used as a reference rate in a broad range of financial instruments, including loans and debt securities, but banks that report information used to set the rate will no longer be required to do so after 2021. Regulators have undertaken reference rate reform initiatives to identify alternative reference rates that are more observable, or transaction based. The transition to alternative reference rates will require contracts to be modified. For accounting purposes, such contract modifications are required to be evaluated to determine whether the modification results in the establishment of a new contract or the continuation of the existing contract. For an investment company, a modification that results in the establishment of a new contract may cause termination of the existing contract or security and result in realized gain/loss and portfolio turnover.

According to the proposal, stakeholders have raised operational challenges likely to arise in accounting for contract modifications due to reference rate reform. Those challenges relate to the significant number of contracts, including loans, debt agreements and derivatives which will need to be modified. The application of existing accounting standards on modifications may be costly and burdensome due to significant volumes and compressed time frames and may affect financial reporting results.

## Proposal

Modified contracts that meet the following criteria would be eligible for relief from the

modification accounting requirements in GAAP:

- Contracts that reference LIBOR or a reference rate that is expected to be discontinued as a result of reference rate reform; and
- The modifications change, or have the potential to change, the amount and timing of contractual cash flows related to the replacement of the reference rate.

The relief does 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, the relief does not apply if contract modifications are made contemporaneously to terms that are unrelated to the replacement of a reference rate.

The proposal includes examples of changes to contractual terms that are related to the replacement of the reference rate. For example, changes for a spread adjustment for the difference between LIBOR and the replacement rate, as well as changes to the reset period, reset dates, day count conventions, and repricing calculations (e.g., a change from a forward-looking term rate to a compounded overnight rate in arrears) would all be considered related to the replacement of the reference rate.

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 effect the transition for reference rate reform. Such changes include, for example, changes to the notional amount, changes to the maturity date, or a concession granted to a debtor experiencing financial difficulty.

For contracts in scope, the proposal generally would allow an entity to account for and present the modified contract as a continuation of the existing contract, rather than derecognition of a contract and initial recognition of a new contract. Under the proposal if an entity elects to apply the optional relief, it would need to do so for all contract modifications in scope that otherwise would be accounted for in accordance with the same Topic or Subtopic in the accounting standards codification.

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#### endnotes

[1] See FASB Exposure Draft, Proposed Accounting Standards Update, Reference Rate Reform (Topic 848), *Facilitation of the Effects of Reference Rate Reform on Financial Reporting* (September 5, 2019) available at <https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175805074609>.