November 27, 2019

To: Director of Research and Technical Activities (Project No. 26-8)
c/o Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Comments to GASB Exposure Draft on LIBOR Replacement

Swap Financial Group, LLC (“SFG”) applauds GASB and its efforts in tackling the many issues surrounding hedge accounting and the transition away from LIBOR. As a municipal advisor to many state and local governmental entities that use interest rate hedges, SFG offers the following comments to GASB’s Exposure Draft on the Replacement of Interbank Offered Rates, dated September 16, 2019.

• As a general comment, SFG agrees that amending the critical terms of a hedging derivative should require the termination of hedge accounting, but we also agree that transitioning away from LIBOR warrants exceptions to the current hedge accounting termination provisions. As stated in the Exposure Draft, reference rate reform is truly a “unique circumstance” and there should be avenues available for issuers to amend or replace LIBOR-based hedges where hedge accounting may continue, under certain conditions.

• Comments to Paragraph 4 of the Proposed Statement:

  o Regarding the criteria outlined for an exception to the termination of hedge accounting, it appears the exception is only possible when the original hedging derivative instrument is LIBOR-based. Some issuers have already taken prudent and proactive steps in transitioning away from LIBOR to other rates such as Fed Funds or SIFMA. However, it is possible that these issuers may find it advisable to switch to SOFR (daily compounded or term rate) in the future as liquidity in the SOFR derivatives market grows and the issuer would want to continue hedge accounting. For many hedges (e.g. option products), converting to a SOFR-based hedge may not
be possible currently and the rules should not incentivize issuers to wait to transition away from LIBOR. We believe the rules should allow flexibility for issuers that previously moved to Fed Funds or SIFMA – prompted by future LIBOR discontinuation – to later convert to SOFR (daily compounded or term rate), SIFMA, or Fed Funds, and still continue with hedge accounting.

- We would suggest allowing for some time period between the termination of the original hedge and the new replacement hedge. Consider the hypothetical case where a banking counterparty is suddenly eager to terminate the original LIBOR-based hedge at a discount on short notice. The issuer may want to seize this opportunity to terminate at a favorable level, but may not yet be trade-ready with respect to the replacement hedge. We would propose an allowable window of 30 calendar days.

- We believe GASB should align with IRS initial guidance that counterparties can receive upfront payments to compensate for rate conversion, in lieu of adjustments to ongoing floating leg resets, without triggering the termination of hedge accounting.

- Paragraph 5. Since the publication of the GASB exposure draft, ISDA has made progress on standard SOFR conventions for derivatives. GASB should confirm all permutations are captured with respect to changes in reset dates, reset methodology, payment dates, day count fraction, etc.

- Paragraph 6 and B18. With respect to the modification of the hedged item, we believe the rules should allow some flexibility on the conversion of a LIBOR-based hedged item to other types of floating rate debt. For example, an issuer may refund LIBOR-based Floating Rate Notes (without any proper LIBOR fallback language) with new variable rate demand bonds (VRDBs). We believe there should be a way to maintain hedge accounting for such a change in the hedged item.

- Paragraph 8(b). Has GASB considered other appropriate benchmark rates beyond U.S. Treasury yields, the Effective Federal Funds Rate (EFFR), and SOFR? We would suggest considering Ameribor and the ICE Bank Yield Index. While the current use of derivative products tied to these other rates is currently limited, more liquidity may develop.

- Paragraph 12. Regarding the removal of LIBOR as an appropriate benchmark rate (for the qualitative testing of a hedging relationship), we question the advantage of specifying an exact date, such as “after December 15, 2020”. It is possible that the relevant regulators and LIBOR panel banks agree to extend the timeline for the availability of LIBOR. Rather than specify an exact date after which LIBOR is no longer an appropriate benchmark, we are wondering if it would be better to tie this determination to ISDA’s trigger for LIBOR fallback rates.

- B8. SFG agrees that effectiveness should be tested at end of reporting period and not also at the time of the amendment or inception of LIBOR replacement.
• B11. We agree that GASB should not limit the use of any replacement reference rates. Entities should be free to choose reference rates that best fit their specific circumstances. Furthermore, additional reference rates may emerge in the future.

• B20. We agree that LIBOR-based forward transactions should still be eligible for hedge accounting.

• B29. We agree that appropriate benchmark rates should include both daily compounded SOFR and term SOFR, despite the fact that term SOFR rates are not yet being published.

If there are any questions regarding the above, please do not hesitate to contact us. As mentioned, we appreciate all of GASB’s efforts with this undertaking and we want to offer our assistance in this important transition.

Sincerely,

Swap Financial Group, LLC

Swap Financial Group, LLC is an established derivatives and bond pricing advisor. SFG is registered as a Municipal Advisor with the U.S. Securities and Exchange Commission and the Municipal Securities Rulemaking Board.