About this guide

PwC is pleased to offer our Reference rate reform guide. Reference rate reform is the term used to refer to the efforts that have been undertaken by regulators and other market participants to introduce new reference rates that are based on a larger and more liquid population of observable transactions. This guide is intended to assist our clients and other interested parties in applying the accounting and financial reporting guidance in ASU 2020-04, Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.

This guide summarizes the applicable accounting literature, including relevant references to and excerpts from the FASB’s Accounting Standards Codification (the Codification), and should be read in conjunction with the applicable authoritative accounting literature.

References to US GAAP

Definitions, full paragraphs, and excerpts from the FASB’s Accounting Standards Codification are clearly labelled. In some instances, guidance was cited with minor editorial modification to flow in the context of the PwC Guide. The remaining text is PwC’s original content.

References to other chapters and sections in this guide

When relevant, the discussion includes general and specific references to other chapters of the guide that provide additional information. References to another chapter or section within a chapter are indicated by the abbreviation “REF” followed by the specific section number (e.g., REF 1.3.1.2 refers to section 1.3.1.2 in chapter 1 of this guide).

References to other PwC guidance

This guide provides general and specific references to our Derivatives and hedging guide. References to this guide are indicated by DH followed by the specific section number (e.g., DH 9.6).

Guidance date

This guide considers existing guidance as of April 30, 2020. Additional updates may be made to keep pace with significant developments. Users should ensure they are using the most recent edition available.

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Chapter 1: Reference rate reform
1.1 Overview of reference rate reform

To compensate counterparties for the time value of money, many contracts reference interest rate indices (reference rates). For example, a debt instrument may have a coupon that periodically resets based upon the then-current reference rate. The London Interbank Offered Rate (LIBOR) has been one of the most commonly used reference rates in the global financial markets. However, the United Kingdom’s Financial Conduct Authority announced that it would no longer persuade or compel banks to submit LIBOR as of the end of 2021. Concerns about the sustainability of LIBOR and other interbank offered rates (IBORs) globally has led to an effort to identify alternative reference rates, as it is currently expected that LIBOR will cease to exist beyond 2021. In the United States, the Alternative Reference Rates Committee (ARRC) convened by the Federal Reserve identified the Secured Overnight Financing Rate (SOFR) as its preferred alternative reference rate to US dollar LIBOR.

The shift away from the most widely used interest rate benchmarks to alternative reference rates is a significant change for the global financial markets. The impact of this change is not limited to financial services companies; it will impact all companies. IBOR rates are frequently used in financial instruments, such as debt agreements, investments, and derivatives, but may also be present in leases, compensation arrangements, and contracts with customers. Preparing for the impact of IBOR reform is likely to be a significant effort and will require a multidisciplinary team to identity where IBOR is used and negotiate changes to arrangements. Many institutions are already working to insert provisions frequently referred to as “fallback language” into new or existing agreements. These provisions specify how a replacement rate will be identified (and other terms, such as how the spread above the reference rate will be changed) once a trigger event (such as LIBOR no longer being quoted) occurs. Industry working groups continue to develop standard fallback terms for a number of financial instruments that they are recommending entities adopt.

From an accounting perspective, IBOR reform has the potential to create challenges when accounting for contract modifications and hedging relationships. For example, there may be a significant volume of contracts that will need to be modified and then assessed to determine whether the modification results in the establishment of a new contract or a continuation of the existing contract for accounting purposes. In addition, modifications related to reference rate reform to derivatives or hedged items involved in hedging relationships could result in de-designations of otherwise effective hedges.

As a result, on March 12, 2020, the FASB issued ASU 2020-04, Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting (the “ASU”). This ASU, which introduces ASC 848 to the Codification, provides relief that, if elected, will require less accounting analysis and less accounting recognition for modifications related to reference rate reform. The ASU provides specific guidance relating to instruments subject to ASC 310, Receivables, ASC 470, Debt, ASC 840 or ASC 842, Leases, and ASC 815, Derivatives and Hedging. It also includes a principle that provides relief from contract modification requirements in other guidance not explicitly addressed.

A number of entities are looking to amend agreements in preparation for reference rate reform in the short-term. As a result, the guidance could have been adopted upon issuance. However, the relief is designed to be temporary, and as a result, this guidance cannot be applied subsequent to December 31, 2022, except for certain optional expedients elected for hedging relationships (see REF 4.1.4 for additional information).
1.2 **Optional election of ASC 848**

The application of the guidance is elective, but if made, the election must be made for all contract modifications that:

- meet the scope of ASC 848 and
- would otherwise be accounted for in accordance with the same ASC Topic or Industry Subtopic.

For example, if a reporting entity elects to apply this guidance to the modification of a lease accounted for under ASC 842, the reporting entity must apply this guidance to all modifications of leases accounted for under ASC 842 that meet the scope of ASC 848. However, as discussed in more detail in REF 3, certain optional expedients related to the application of hedge accounting can be applied on a hedge-by-hedge basis.

Figure REF 1-1 provides a timeline of select IBOR reform milestones and when the optional relief within ASC 848 may be applied.

**Figure REF 1-1**
IBOR reform milestones

1.3 **Scope of ASC 848**

In order to qualify for the guidance in ASC 848, ASC 848-10-15-3 states that a contract must reference LIBOR (any maturity, jurisdiction, or currency) or a reference rate that is expected to be discontinued as a result of reference rate reform. Some indicators that a reference rate is expected to be discontinued are outlined in ASC 848-10-15-4.
ASC 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 by a significant number of market participants or by market participants representing a significant number of transactions to move away from the reference rate

c. The production method for the calculation of the published reference rate that is either:
   1. Fundamentally restructured
   2. Reliant on another rate that is expected to discontinue.

1.3.1 Qualifying modifications

The relief in ASC 848 applies to modifications of contracts that directly replace, or have the potential to replace, a reference rate that is expected to be discontinued. For example, if the contract is modified by replacing a reference to LIBOR with a reference to SOFR, this would be considered a direct replacement. Adding or modifying fallback language that would replace LIBOR with another reference rate upon a contingent event occurring is an example of a modification with the potential to replace a reference rate.

Only modifications to agreements that are made to affect the transition for reference rate reform will qualify for the guidance in ASC 848. If there are amendments to terms of the contract that change (or have the potential to change) the amount or timing of contractual cash flows that are unrelated to the replacement of the reference rate, the guidance in ASC 848 cannot be applied even if such amendments are made contemporaneous with amendments related to reference rate reform. If the modification does not qualify for the guidance in ASC 848, the modification (including any changes that are related to reference rate reform) should be assessed under other applicable guidance.

1.3.1.1 Modifications related to reference rate reform

Modifications to terms generally considered to be related to the replacement of a reference rate, and therefore should qualify for the relief in ASC 848, are outlined in ASC 848-20-15-5.

ASC 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 and are not the result of a business decision that is separate from or in addition to changes to the terms of a contract to effect that transition. 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. Addition of or changes to a spread adjustment (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, payment frequency, and repricing calculation (for example, a change from a forward-looking term rate to an overnight rate or a compounded overnight rate in arrears)

d. Changes to the strike price of an existing interest rate option (including an embedded interest rate option)

e. Addition of an interest rate floor or cap that is out of the money on the basis of the spot rate at the time of the amendment of the contract

f. Addition of a prepayment option for which exercise is contingent upon the replacement reference interest rate index not being determinable in accordance with the terms of the agreement

g. Addition of or changes to contractual fallback terms that are consistent with fallback terms developed by a regulator or by a private-sector working group convened by a regulator

h. Changes to terms (including those in the examples in paragraph 848-20-15-6) that are necessary to comply with laws or regulations or to align with market conventions for the replacement rate.

1.3.1.2 Modifications unrelated to reference rate reform

Modifications to terms that are generally considered to be unrelated to reference rate reform and therefore would not qualify for the relief in ASC 848 are outlined in ASC 848-20-15-6.

ASC 848-20-15-6

Examples of changes to terms that are generally 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 from a referenced interest rate index to a stated fixed rate

d. Changes to the loan structure (for example, changing a term loan to a revolver loan)

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 interest rate floor or cap that is in the money on the basis of the spot rate at the time of the amendment of the contract
g. A concession granted to a debtor experiencing financial difficulty

h. The addition or removal of a prepayment or conversion option, except for the addition of a prepayment option for which exercise is contingent upon the replacement reference interest rate index not being determinable in accordance with the terms of the agreement

i. The addition or removal of a feature that is intended to provide leverage

j. Changes to the counterparty except in accordance with paragraphs 815-20-55-56A, 815-25-40-1A, and 815-30-40-1A

k. Changes to the priority or seniority of an obligation in the event of a default or a liquidation event

l. The addition or termination of a right to use one or more underlying assets in a lease contract

m. Changes to renewal, termination, or purchase option provisions in a lease contract.

ASC 848 presumes that contractual fallback terms added or amended such that they are consistent with or substantially similar to recommendations from a regulator or a private-sector working group convened by a regulator (such as the ARRC) are related to reference rate reform. This includes a predefined method to replace the current reference rate upon the discontinuance (or an expected discontinuance) of the reference rate.

Although ASC 848-20-15-6(c) lists changing to a fixed rate as a modification unrelated to reference rate reform, ASC 848-20-15-9 clarifies that adding a provision that the rate in a contract becomes fixed at the last published rate of an interest rate index would not preclude application of ASC 848.

In addition, ASC 848-20-15-8 provides that if a modification to a contract includes a fallback provision which includes a term that would generally be considered unrelated to reference rate reform (such as the addition of a prepayment option or a possibility that the rate could become fixed), such provisions would be disregarded if a reporting entity concludes at the time the fallback terms are added or amended that activation of that term is not probable of occurring if the fallback terms are triggered. This was included in the guidance as in some instances, fallback language may specify that the terms would change based on a “waterfall preference” established in the contract. For example, upon discontinuance of LIBOR, the reference rate would change to a term SOFR rate, however if a term SOFR rate was not available it would change to SOFR, and if SOFR was not available it would change based upon a sequenced list and in the event that it is unable to change to another reference rate, change to a fixed rate or permit prepayment as a “last resort.” If this final change to a fixed rate is not probable of occurring at the time of amendment, the provision would not prevent application of ASC 848.
Chapter 2:  
Contract modifications relief
### 2.1 Contract modifications relief

ASC 848 includes optional expedients for qualifying modifications to financial assets under ASC 310, debt agreements under ASC 470, and leases under ASC 840 or ASC 842. ASC 848 also provides a principle that could be applied to contract modifications that fall within the scope of ASC 848 but are not explicitly specified in ASC 848 (e.g., contracts within the scope of ASC 606).

The optional expedients are meant to provide entities with the ability to conclude that qualifying contractual amendments should be treated as a modification or continuation of the existing contract without having to perform an assessment that would otherwise be required under GAAP.

#### 2.1.1 Optional expedients: qualifying modifications

A reporting entity may elect to apply an optional expedient in accordance with ASC 848-20 to contract modifications that:

- replace, or have the potential to replace, LIBOR or another reference rate expected to be discontinued (e.g., replacing LIBOR with SOFR), and
- do not modify terms that change, or have the potential to change, the amount and timing of cash flows unrelated to the replacement of LIBOR or another reference rate expected to be discontinued (ASC 848-20-15-2 through ASC 848-20-15-3).

An election to apply an optional expedient under ASC 848-20 must be applied consistently to all eligible contract modifications subject to the same ASC Topic or Industry Subtopic (see REF 1.2).

#### 2.1.2 Optional expedient for financial assets under ASC 310

A reporting entity may elect to apply an optional expedient pursuant to ASC 848-20-35-6 to qualifying modifications (see REF 2.1.1) of contracts within the scope of ASC 310. Under the expedient, a reporting entity will account for modifications as if they were a minor modification in accordance with ASC 310-20 and thus a continuation of the existing contract. As a result:

- the amortized cost basis remains unchanged,
- a new effective yield is established based upon the amortized cost basis and the revised cash flows, and
- no gain or loss is recognized.

#### 2.1.3 Optional expedient for debt agreements under ASC 470

A reporting entity may elect to apply an optional expedient pursuant to ASC 848-20-35-8 to qualifying modifications (see REF 2.1.1) of contracts within the scope of ASC 470. Under the expedient, a reporting entity will account for amendments as if the modification was not substantial in accordance with ASC 470-50 and thus a continuation of the existing contract. As a result:

- the amortized cost basis remains unchanged,
- a new effective yield is established based upon the amortized cost basis and the revised cash flows, and
The debt modification and extinguishment guidance in ASC 470-50-40-12(f) requires a “lookback period” such that if within a year of the current debt modification or exchange, the debt has been exchanged or modified without being deemed to be substantially different, the debt terms that existed prior to the most recent modification or exchange are required to be used to determine whether the current exchange or modification is substantially different. However, once a debt modification or exchange accounted for under ASC 848 occurs, all prior debt modifications or exchanges will no longer be subject to the “lookback period.” That is, ASC 848-20-35-10 requires any subsequent debt modification or exchange analysis to consider only the terms and provisions in effect immediately following the most recent modification or exchange under ASC 848.

2.1.4 Optional expedient for leases under ASC 840 or ASC 842

A reporting entity may elect to apply an optional expedient, pursuant to ASC 848-20-35-11 to qualifying modifications (see REF 2.1.1) of contracts within the scope of ASC 840 or ASC 842. Under the expedient, a reporting entity will not be required to:

- reassess lease classification,
- reassess the discount rate,
- remeasure lease payments, or
- perform other reassessments or remeasurements that would normally be required under ASC 840 or ASC 842 when a modification of the lease contract is not accounted for as a separate contract.

2.1.5 Principle in applying ASC 848 to other instruments

ASC 848-20 provides specific guidance for modifications of instruments subject to ASC 310, ASC 470, ASC 840, and ASC 842 as these topics cover instruments that will likely have the highest volume of contracts expected to be impacted by reference rate reform. However, ASC 848-20-35-3 through ASC 848-20-35-5 provide an optional election for instruments with modification guidance in other areas of GAAP not specifically addressed in ASC 848 if the contract modification qualifies under ASC 848-20 (see REF 2.1.1).

Under this principle, the modification should be treated as an event that does not require contract remeasurement at the modification or reassessment of a previous accounting determination under the relevant ASC Topic or Industry Subtopic. ASC 848-20-55-2 illustrates the potential outcomes in applying this expedient to contracts subject to guidance not specifically addressed in ASC 848.

2.1.6 Reassessment of embedded derivatives

A reporting entity may elect to apply an optional expedient pursuant to ASC 848-20-35-14 to qualifying modifications (see REF 2.1.1) to not have to reassess embedded derivatives under ASC 815-15. Under the expedient, a reporting entity will not be required to reassess its original conclusions as to whether the contract contains an embedded derivative that is clearly and closely related to the host contract under ASC 815-15-25-1(a).
2.2 **Reclassification or sale of held-to-maturity securities**

A reporting entity may make a one-time election prior to December 31, 2022 to sell or reclassify (or both sell and reclassify) debt securities classified as held-to-maturity (HTM) to either available-for-sale or trading pursuant to ASC 848-10-35-1. Under this guidance, the sale and/or reclassification, in and of itself, would not call into question the reporting entity’s previous assertions that it had the intent and ability to hold the securities to maturity. Both of the following criteria, however, must be met at the date of transfer:

- The debt security references a rate that meets the scope of ASC 848-10-15-3 (i.e., a contract must reference LIBOR or a reference rate that is expected to be discontinued as a result of reference rate reform) and
- The debt security was classified as HTM before January 1, 2020.

For securities that are reclassified, the measurement guidance in ASC 320-10-35-10 through ASC 320-10-35-16 should be applied and recognized in the period the transfer occurs.

2.2.1 **Required disclosures**

If a reporting entity elects to sell and/or reclassify securities, the disclosure requirements in ASC 320-10-50-10 for a sale or transfer of securities classified as held-to-maturity apply. Such disclosures include:

- the net carrying amount of the HTM security that was sold or transferred,
- any derivative gains or losses deferred in accumulated other comprehensive income resulting from a hedge of the acquisition of the HTM security,
- the related unrealized or realized gain or loss, and
- the circumstances leading to the decision to sell or reclassify the HTM security.
Chapter 3: Hedge accounting relief
3.1 **Hedge accounting relief**

ASC 848 provides a number of optional expedients designed to allow hedging relationships to continue, without de-designation, when one or more critical terms of the hedging relationship change, or are expected to change, due to reference rate reform.

3.1.1 **Scope ofASC 848: Hedging relationships**

Optional expedients under ASC 848 may be applied if the hedging instrument, the hedged item, or the hedged forecasted transaction in a hedging relationship:

- references LIBOR or a reference rate expected to be discontinued (see ASC 848-10-15-3), and
- includes only modifications that are made or expected to be made related to the replacement of LIBOR or a reference rate expected to be discontinued (see ASC 848-20-15-2 through ASC 848-20-15-3).

**ASC 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.

**ASC 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 in a manner that changes, or has the potential to change, the amount or timing of contractual cash flows, the guidance in this Subtopic shall apply only if those modifications are related to the replacement of a reference rate. For example, the addition of contractual fallback terms or the amendment of existing contractual fallback terms related to the replacement of a reference rate that are contingent on one or more events occurring has the potential to change the amount or timing of contractual cash flows and the entity potentially would be eligible to apply the guidance in this Subtopic.

**ASC 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.

Unlike the guidance for contract modifications under ASC 848-20, a reporting entity can apply the optional expedients to hedge accounting relationships designated under ASC 815 on an individual hedging relationship basis. That is, an optional expedient can be elected for some hedging relationships but not elected for other similar hedging relationships. In addition, a reporting entity may elect to apply multiple optional expedients to the same individual hedging relationship and may elect those optional expedients in different reporting periods. For example, a reporting entity may elect to apply the optional expedient to change the critical terms of a hedging relationship in one
period and then elect to apply the optional expedient to change the method used for assessing hedge effectiveness in a different reporting period. There is no requirement when electing optional expedients under ASC 848 to assess effectiveness for similar hedges in a similar manner.

3.1.2 **Updating hedge documentation**

ASC 848 requires a reporting entity to update its hedge documentation upon changing the critical terms of a hedging relationship due to the election of an optional expedient for a fair value, cash flow, or net investment hedging relationship. The hedge documentation needs to be updated, pursuant to ASC 848-30-25-4, no later than when the reporting entity is required to perform its first assessment of hedge effectiveness after electing the optional expedient.

**ASC 848-30-25-4**

If an entity elects the optional expedient in paragraph 848-30-25-3, the entity shall update its hedge documentation (as applicable) noting the changes made no later than when the entity performs its first assessment of effectiveness after the change was identified in accordance with paragraphs 815-20-25-3(b)(2)(iv)(02) and 815-20-25-3A.

3.1.3 **Changing critical terms of hedging instruments, hedged items, or forecasted transaction**

For a hedging instrument, hedged item, or forecasted transaction designated in a fair value, cash flow, or net investment hedge, a reporting entity may elect an optional expedient to change the contractual terms of the hedging instrument or hedged item. If the modification (a) directly replaces or has the potential to replace a reference rate within the scope of ASC 848-10-15-3 with another index and (b) does not modify a term that changes, or has the potential to change, the amount and timing of cash flows unrelated to the replacement of a reference rate (ASC 848-20-15-2 through ASC 848-20-15-3), a reporting entity may elect an optional expedient such that the modification would not trigger an automatic de-designation of the hedging relationship when the contractual terms are modified.

ASC 848 clarifies that this optional expedient applies to modifications to derivatives designated as hedging instruments, including changes that are effectuated by (1) entering into a fully offsetting derivative contract to effectively cancel the original derivative contract, and (2) contemporaneously entering into a new derivative contract with the revised terms. In these situations, even though a reporting entity entered into a new derivative contract, the reporting entity may still view the series of transactions as a modification of the original derivative contract that would not require an automatic de-designation of the hedging relationship (see ASC 848-30-25-5 through ASC 848-30-25-7).

3.1.4 **Rebalancing of hedging relationships**

Transitioning away from a discontinued reference rate to a replacement rate may result in certain hedging relationships needing to be adjusted because of changes in the terms of hedging instruments and hedged items. This may be the case, for example, when a reporting entity needs to rebalance the hedge ratio for duration-weighted fair value hedges that transition to another eligible benchmark interest rate. Additionally, a reporting entity may need to change the designated hedging instrument, for example, by adding a new interest rate basis swap to an existing interest rate swap designated as the hedging instrument in a cash flow hedge.
ASC 848-30-25-9 provides an optional expedient that can be elected to rebalance a hedging relationship without triggering an automatic de-designation. This optional expedient can be elected if the hedging instrument, the hedged forecasted transaction, or the designated benchmark interest rate in a fair value hedge references LIBOR, or a reference rate expected to be discontinued, and the hedging relationship is expected to be impacted by reference rate reform.

### 3.1.4.1 Fair value hedge rebalancing

For fair value hedge relationships, ASC 848-30-25-9(a) permits rebalancing of the hedging relationship by any of the following means (including any combination):

- Increasing or decreasing the designated notional amount of the hedging instrument
- Increasing or decreasing the designated portion of the hedged item.

If a reporting entity elects to change the designated portion of the hedged item, the cumulative effect on the basis adjustment of the hedged item should be recognized in earnings in the same income statement line item as the earnings effect of the hedged item.

A reporting entity can also change its designated hedging instrument to combine two or more derivative instruments, or proportions of those instruments, to be jointly designated as the hedging instrument in a fair value hedging relationship (see ASC 848-30-25-9(b)). If a reporting entity elects this alternative, it is required to assess hedge effectiveness of the amended relationship using an existing method outlined in ASC 815-20 and ASC 815-25. However, the method selected to assess hedge effectiveness does not need to be the original method designated for use at hedge inception; a reporting entity can elect to select another method under ASC 815-20 and ASC 815-25.

### 3.1.4.2 Cash flow hedge rebalancing

Similar to fair value hedges, for cash flow hedge relationships, a reporting entity can change the designated hedging instrument by combining two or more derivatives, or proportions of those instruments, to be jointly designated as the hedging instrument (see ASC 848-30-25-11). If a reporting entity elects this optional expedient, it is required to assess hedge effectiveness of the amended relationship using:

- a method in accordance with ASC 815-20 and ASC 815-30,
- an optional expedient for assuming perfect effectiveness (see ASC 848-50-35-4 through ASC 848-50-35-9),
- an optional expedient for the subsequent qualitative method after an initial assessment using a quantitative method in accordance with ASC 848-50-35-10 through ASC 848-50-35-16, or
- a quantitative method optional expedient (see ASC 848-50-35-17 and ASC 848-50-35-18).

### 3.1.5 Accounting for excluded components

ASC 815 allows for certain components of a hedging instrument to be excluded from a hedging relationship and recognized in earnings using either a mark-to-market approach or a systematic and rational method (see DH 6.3.1.2). When a hedging instrument’s contractual terms are changed to
replace, for example, LIBOR with an alternative reference rate, that change may affect the value of the hedging instrument’s component excluded from hedge effectiveness.

Under ASC 848-30-25-12, a reporting entity may elect to prospectively change its systematic and rational method used to recognize excluded components in earnings for fair value, cash flow, or net investment hedges if the changes to the contractual terms of a hedging instrument:

☑ directly replaces or has the potential to replace a reference rate within the scope of ASC 848-10-15-3 with another index, and

☑ does not modify a term that changes, or has the potential to change, the amount and timing of cash flows unrelated to the replacement of a reference rate (see ASC 848-20-15-2 through ASC 848-20-15-3).

The amended systematic and rational method may be subsequently amended for subsequent changes in the hedging instrument’s contractual terms that meet the scope of ASC 848-20-15-2 through ASC 848-20-15-3. That is, a reporting entity may elect to apply this optional expedient for each modification. If elected, the amended method must be applied for the remaining life of the hedging relationship, including periods subsequent to December 31, 2022.

If a change to the contractual term of the hedging instrument results in a change in the fair value of the excluded component, a reporting entity may elect to recognize the change in fair value currently in earnings pursuant to ASC 848-30-25-13. The recognition of the change in fair value should be reported in the same income statement line item used to present the effect of the hedged item.

ASC 848 does not, however, permit a reporting entity to change whether a component is excluded or not.

### 3.2 Fair value hedges

ASC 848 provides guidance on specific optional expedients for fair value hedging relationships affected by reference rate reform. Entities can elect the different optional expedients on an individual hedging relationship basis.

#### 3.2.1 Changing the designated benchmark interest rate

When the designated hedged risk is changes in fair value attributable to a benchmark interest rate (see DH 6.4.5.1), changing the designated benchmark interest rate may be desirable if (1) the referenced interest rate index of the hedging instrument changes or (2) a reporting entity rebalances an existing fair value hedge relationship by combining two or more hedging instruments that are jointly designated as the hedging instrument (e.g., adding a new interest rate basis swap to an existing interest rate swap). For example, if a LIBOR swap was designated as the hedging instrument in a fair value hedge and a reporting entity selected the LIBOR swap rate as its designated hedged interest rate 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 differ if the swap’s variable rate changes to SOFR. As a result, a reporting entity may need to change the designated benchmark interest rate from LIBOR to SOFR. If one of those two changes in the hedging instruments occur, a reporting entity may elect to change the designated benchmark interest rate and the component of cash flows related to the benchmark interest
Hedge accounting relief

rate and continue hedge accounting without de-designation if all the following criteria in ASC 848-40-25-2 are met:

□ The designated benchmark interest rate being changed is LIBOR or a reference rate expected to be discontinued (see ASC 848-10-15-3).

□ The replacement designated benchmark interest rate is an eligible benchmark interest rate in accordance with ASC 815-20-25-6A.

□ The hedging instrument is expected to be prospectively highly effective at achieving offsetting changes in fair value attributable to the revised hedged risk on the basis of the amended terms of the hedging relationship.

Upon electing this optional expedient, a reporting entity is required to revise the rate used to discount the cash flows associated with the hedged item to reflect the change in the designated benchmark interest rate. A reporting entity may include a spread adjustment to the revised benchmark interest rate used to discount the cash flows associated with the hedged item. In addition, an entity is permitted to adjust the cash flows for the designated term of the hedged item. If the hedging relationship extends beyond December 31, 2022 (i.e., the ASC 848 sunset date), ASC 848-40-25-6 requires a reporting entity to continue to use the revised discount rate (including the spread adjustment, if applicable) and any remaining revised cash flows over the life of the designated hedging relationship.

Changing the designated benchmark interest rate in a fair value hedge will, absent other changes to the calculation, change the cumulative basis adjustment to the hedged item. ASC 848 addresses this by providing two approaches in ASC 848-40-25-5:

□ Apply an approach that adjusts the cumulative basis of the hedged item attributable to changing from the originally designated benchmark interest rate to the replacement designated benchmark interest rate.

Under this approach, a reporting entity would be required to recognize the change to the hedged item’s basis adjustment immediately in earnings within the same income statement line used to present the earnings effect of the hedged item.

□ Apply an approach that results in no basis adjustment to the hedged item (i.e., maintain the same cumulative basis adjustment that existed prior to electing the optional expedient).

To accomplish this, one approach may include solving for a spread to include as an adjustment to the discount rate (the newly designated benchmark interest rate) such that, at the date the designated interest rate is changed, the present value of cash flows equals the carrying amount including the cumulative basis adjustment that existed prior to electing the optional expedient. This spread would remain constant throughout the life of the hedge (even if the hedge continues beyond December 31, 2022).

The guidance does not prescribe a specific method for applying the measurement approaches above. A reporting entity is required to use a method that is reasonable. However, a reporting entity is required by ASC 848-40-25-5 to use a similar method for similar hedges and to justify the use of different methods for similar hedges. Therefore, while a reporting entity can elect to change the benchmark interest rate designated on an individual hedging relationship basis, once this optional expedient is
elected, the approach to recognize the cumulative effect of the change in the designated benchmark interest rate must be applied in a similar manner to similar hedges. For instance, a reporting entity cannot elect the optional expedient in one hedge relationship and apply an approach that results in an immediate adjustment to earnings, while electing the optional expedient on another similar hedge and apply an approach that results in no basis adjustment (or no immediate earnings impact).

### 3.2.2 Applying the shortcut method (fair value hedge)

ASC 848 provides an optional expedient that can be elected to disregard certain criteria when determining whether a fair value hedging relationship continues to qualify for the shortcut method (see DH 9.4). The shortcut method provides criteria that, when met, allows for an assumption of perfect effectiveness in a fair value hedge relationship with an interest rate swap. The optional expedient may be elected upon a change in the contractual term of the hedging instrument that:

- directly replaces or has the potential to replace a reference rate within the scope of ASC 848-10-15-3 with another index, and
- does not modify a term that changes, or has the potential to change, the amount and timing of cash flows unrelated to the replacement of a reference rate (ASC 848-20-15-2 through ASC 848-20-15-3).

When a reporting entity changes an interest rate swap’s contractual terms, it may elect to disregard the criteria in ASC 848-40-25-8 when determining whether its fair value hedging relationship can continue to apply the shortcut method.

**ASC 848-40-25-8**

For 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 paragraphs 848-30-25-5 through 25-7:

- 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), and
- 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).

This optional expedient survives throughout the life of the fair value hedging relationship, which may extend beyond December 31, 2022 (the ASC 848 sunset date).

### 3.3 Cash flow hedges

ASC 848 provides a number of optional expedients for cash flow hedging relationships affected by reference rate reform, as well as guidance on assessing probability when the forecasted transaction will be affected by reference rate reform.
3.3.1 Probability of the forecasted transaction

In order to apply cash flow hedging, entities are required to document the forecasted transaction in a cash flow hedge and to support that the documented forecasted transaction remains probable of occurring throughout the life of the hedge relationship (see DH 6.3.3.4). Additionally, a change in the probability of a forecasted transaction may require that a reporting entity discontinue hedge accounting and may affect the timing of recognizing amounts deferred in accumulated other comprehensive income in earnings. To alleviate stakeholder concerns over how meeting these requirements might be affected by reference rate reform, ASC 848 provides an optional expedient on how to evaluate probability when the forecasted transaction references LIBOR or another reference rate expected to be discontinued.

When the designated hedged risk in a cash flow hedge of a forecasted transaction is LIBOR, or another reference rate expected to be discontinued, ASC 848-50-25-2 allows a reporting entity to assert that the hedged forecasted transaction remains probable of occurring regardless of a modification or expected modification that:

- directly replaces or has the potential to replace a reference rate within the scope of ASC 848-10-15-3 with another index, and
- does not modify a term that changes, or has the potential to change, the amount and timing of cash flows unrelated to the replacement of a reference rate (see ASC 848-20-15-2 through ASC 848-20-15-3).

That is, when a reporting entity modifies, or expects to modify, contractual terms that are related to the replacement of a reference rate in accordance with ASC 848, a reporting entity may continue to assert that the forecasted transaction (documented as the reference rate that will be replaced) continues to be probable of occurring (i.e., the hedge is not discontinued). The ability to continue to assess the forecasted transaction as probable of occurring applies when the change in contractual terms is expected to replace the reference rate (i.e., the rate designated in the cash flow hedge) with another reference rate. It would not, however, apply in circumstances when the underlying transaction (e.g., the forecasted interest payments) was probable of not occurring (e.g., a reporting entity expects to pay off its debt).

3.3.2 Change in the designated hedged risk

ASC 815-30-35-37A indicates that the designated hedged risk for a cash flow hedge of a forecasted transaction may change during a hedging relationship and a reporting entity may continue to apply hedge accounting if the hedge remains highly effective. ASC 848 expands how a reporting entity can evaluate whether a cash flow hedge relationship affected by reference rate reform remains highly effective. Specifically, upon a change in the designated hedge risk on a hedge impacted by reference rate reform (e.g., replacing LIBOR with SOFR), ASC 848 provides that an existing cash flow hedge relationship may continue hedge accounting subject to the hedging relationship remaining highly effective (ASC 848-50-25-3) based upon a reporting entity:

- assessing hedge effectiveness in accordance with ASC 815-20 and ASC 815-30, or
- electing an optional expedient method to assess hedge effectiveness in accordance with ASC 848-50.
3.3.3 **Hedging a group of forecasted transactions**

When hedging a group of forecasted transactions, ASC 815-20-25-15(a)(2) requires that the individual transactions in the group share the same risk exposure. However, if the group of forecasted transactions references LIBOR or another reference rate expected to be discontinued due to reference rate reform, a reporting entity may elect to disregard that guidance based on the guidance ASC 848-50-25-13 through ASC 848-50-25-14. However, the requirement prohibiting a forecasted purchase and a forecasted sale from both being included in a group continues to apply. As a result, forecasted interest receipts and forecasted interest payments are not permitted to be included in the same group, even if a reporting entity elects this optional relief.

3.3.4 **Changing the designated method of assessing effectiveness**

A reporting entity may elect to change the method designated for use in assessing hedge effectiveness in a cash flow hedge (ASC 848-50-35-1 through ASC 848-50-35-3) if both of the following criteria in ASC 848-30-25-8 are met:

- Either the hedging instrument or the hedged forecasted transaction (but not both) references LIBOR or a reference rate expected to be discontinued due to reference rate reform.

- The new designated method of assessing hedge effectiveness is an optional expedient specified in ASC 848-50 (see REF 3.3.5).

If a reporting entity applies this optional expedient and changes its method of assessing effectiveness, the replacement method is not required to be assessed to determine whether it is an improved method or if it is considered a preferable method.

Upon electing an optional expedient method, reporting entities are required to assess effectiveness using the newly designated method prospectively from the date in which the optional expedient method is elected to determine whether hedge accounting may continue to be applied. After the date on which the optional expedient is first applied (assuming the hedging relationship was highly effective), both retrospective and prospective hedge effectiveness need to be assessed using the optional expedient method.

3.3.5 **Optional expedients for initial and subsequent hedge effectiveness**

A reporting entity may perform its initial and subsequent hedge effectiveness assessment in a manner that adjusts how it applies certain guidance in ASC 815-20 and ASC 815-30 for cash flow hedges in which the hedged forecasted transaction or hedging instrument references LIBOR or a reference rate expected to be discontinued due to reference rate reform.

See REF 3.3.5.1 through REF 3.3.5.8 for the optional expedients for assessing initial and subsequent hedge effectiveness under ASC 848.

3.3.5.1 **Applying the shortcut method (cash flow hedge)**

ASC 815 provides a list of criteria that must be met in order to assume perfect hedge effectiveness in a cash flow hedge with an interest rate swap, which is referred to as the shortcut method (see DH 9.4). Under ASC 848, a reporting entity may elect to disregard the items in ASC 848-50-25-6 (and repeated
in ASC 848-50-35-5 for subsequent assessments) when assessing whether the shortcut method can be applied.

**Excerpt from ASC 848-50-25-6 and ASC 848-50-35-5**

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 variable-rate 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).

3.3.5.2 **Option’s terminal value method (assuming perfect effectiveness)**

When hedge effectiveness is based on an option’s terminal value, ASC 848 permits a reporting entity to disregard the criteria in ASC 848-50-25-7 (repeated in ASC 848-50-35-6 for subsequent assessments) when determining whether a hedging relationship is considered perfectly effective under ASC 815-20-25-126 through ASC 815-20-25-129A.

**Excerpt from ASC 848-50-25-7 and ASC 848-50-35-6**

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 due to the underlying reference rate and strike price (or prices) of the hedging option (or combination of options) 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).

See DH 9.6 for further details on the terminal value method of assessing hedge effectiveness for options.

3.3.5.3 **Option’s terminal value method (not considered perfectly effective)**

When hedge effectiveness is based upon an option’s terminal value but is not considered perfectly effective, a reporting entity may adjust the critical terms of the perfectly hypothetical hedging instrument in ASC 848-50-25-12 (repeated in ASC 848-50-35-18 for subsequent assessments) to match the hedging instrument.
Hedge accounting relief

Excerpt from ASC 848-50-25-12 and ASC 848-50-35-18

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 due to the underlying reference rate and strike price (or prices) of the hedging option (or combination of options).

In effect, the guidance permits a reporting entity to assume that certain attributes of the forecasted transaction are different than they may be for purposes of assessing hedge effectiveness.

3.3.5.4 Change-in-variable-cash-flows method (assuming perfect effectiveness)

When applying the change-in-variable-cash-flows method in ASC 815, a reporting entity may disregard the terms in ASC 848-50-25-9 (repeated in ASC 848-50-35-8 for subsequent assessments) when assessing whether the hedge is perfectly effective in accordance with ASC 815-30-35-22.

Excerpt from ASC 848-50-25-9 and ASC 848-50-35-8

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 paragraph 815-30-35-22(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 paragraph 815-30-35-22(b).

A reporting entity may also disregard the guidance in ASC 815-30-35-22(c), which addresses other potential basis differences (e.g., caps or floors) that would preclude a hedge from being perfectly effective, when applying ASC 848 if the basis differences are due to differences in a cap or floor between the variable-rate leg of the interest rate swap and the variable-rate asset or liability.

See REF 3.3.5.6 for the application of the change-in-variable-cash-flow method when the hedge is not considered perfectly effective.

3.3.5.5 Applying the hypothetical derivative method (assuming perfect effectiveness)

When applying the hypothetical derivative method in accordance with ASC 815-30-35-25 through ASC 815-30-35-29, a reporting entity may elect to disregard the critical terms detailed in ASC 848-50-25-10 (repeated in ASC 848-50-35-9 for subsequent assessments) when determining whether the hypothetical derivative will result in a perfectly effective hedge.

Excerpt from ASC 848-50-25-10 and ASC 848-50-35-9

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)
c. Mirror image caps and floors (including a cap or floor that exists in a variable-rate asset or a variable-rate liability and does not exist in a hedging instrument or vice versa) in accordance with paragraph 815-30-35-25(b)(4).

See REF 3.3.5.6 for the application of the hypothetical derivative method when the hedge is not considered perfectly effective.

### 3.3.5.6 Applying a quantitative assessment method of effectiveness

When assessing hedge effectiveness quantitatively, a reporting entity may elect to make certain adjustments when applying the (1) change-in-variable-cash-flows method, (2) the hypothetical derivative method, or (3) the change-in-fair-value method. In applying these methods:

- □ If both the hedged forecasted transaction and the hedging instrument reference LIBOR or another reference rate expected to be discontinued due to reference rate reform (see ASC 848-10-15-3), a reporting entity may assume the reference rates will not change for the remainder of the hedging relationship. This might be applied in situations when neither the hedged item nor the hedging instrument have been amended as a result of reference rate reform.

- □ In a cash flow hedge of a forecasted purchase, sale, or issuance of a fixed-rate instrument, if (1) the designated hedged interest rate risk is the benchmark interest rate and (2) the hedging instrument has a reference rate that meets the scope of ASC 848-10-15-3, a reporting entity may assume the reference rates will not change for the remainder of the hedging relationship.

- □ If either the hedged forecasted transaction or the hedging instrument references LIBOR or another reference rate expected to be discontinued due to reference rate reform, the terms of the hedged forecasted transaction may be altered to match the hedging instrument for the terms detailed in ASC 848-50-25-11 (repeated in ASC 848-50-35-17).

#### Excerpt from ASC 848-50-25-11 and ASC 848-50-35-17

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), and

3. A spread adjustment for the difference between the existing reference rate and the replacement reference rate.

4. A cap or floor (including a cap or floor that exists in a variable-rate asset or a variable-rate liability and does not exist in a hedging instrument or vice versa).

This might be applied if, for example, the referenced rate of the hedging instrument has been replaced, but the referenced rate of the hedged item has not yet been modified.
3.3.5.7 Applying a qualitative assessment method of effectiveness

ASC 848 provides an optional expedient when qualitatively assessing whether a hedging relationship is highly effective in periods subsequent to initial designation (i.e., after the initial hedge effectiveness assessment is performed applying ASC 815-20, ASC 815-30, or an optional expedient under ASC 848). A reporting entity may elect to disregard the guidance in ASC 815-20-35-2A through ASC 815-20-35-2F when assessing whether a cash flow hedging relationship is highly effective on a qualitative basis.

Under the optional expedient in ASC 848-50-35-10, a reporting entity may continue to assert qualitatively that it may continue to apply hedge accounting if the following criteria in ASC 848-50-35-11 are met:

- The hedged forecasted transaction or the hedging instrument references a rate that meets the scope of ASC 848-10-15-3 (i.e., it references LIBOR or a reference rate that is expected to be discontinued as a result of reference rate reform).
- There have been no changes to the terms of the hedging instrument or the forecasted transaction other than those specified in ASC 848-20-15-2 through ASC 848-20-15-3 (i.e., the only modifications made are to directly replace or have the potential to replace a reference rate (see REF 1.3.1.1)).
- A reporting 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 reporting entity.

If a qualitative assessment of effectiveness is applied, the reporting entity should verify and document whenever financial statements (or earnings) are reported, and at least every three months, that the facts and circumstances have not changed and that these criteria continue to be met. If the facts and circumstances have not changed and these criteria continue to be met, a reporting entity may continue to qualitatively assert that the hedging relationship continues to qualify for hedge accounting.

If the facts and circumstances have changed such that these criteria are no longer met, the reporting entity can no longer assert qualitatively that the hedging relationship continues to qualify for hedge accounting, the reporting entity should perform an assessment of effectiveness on a quantitative basis in accordance with ASC 815-20, ASC 815-30, or a quantitative optional expedient within ASC 848 (if eligible). A reporting entity may apply a method other than the method designated for use and documented at hedge inception but must update its hedge documentation as discussed in ASC 848-30-25-4.

If the date of the change in facts and circumstances that led to the criteria no longer being met cannot be identified, the reporting entity may begin performing their quantitative assessment from the beginning of the current period. Once a reporting entity has performed a quantitative assessment using an optional expedient for at least one period, the reporting entity may revert to a qualitative optional expedient assessment under ASC 848-50 if they qualify to do so.

3.3.5.8 Applying simplified hedge account approach

For certain entities (e.g., private companies other than financial institutions) that are able to apply ASC 815-20-25-135, the criteria in ASC 848-50-25-8 (repeated in ASC 848-50-35-7) may be disregarded 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 (see DH 11.2) may be considered perfectly effective in accordance with ASC 815-20-25-133 through ASC 815-20-25-138. This guidance may be applied if either the hedging instrument or the hedged forecasted transaction references LIBOR or reference rate expected to be discontinued due to reference rate reform.

Excerpt from ASC 848-50-25-8 and ASC 848-50-35-7

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).

3.4 Discontinuance of hedge effectiveness optional expedients

The guidance in ASC 848 is meant to provide temporary relief and, in many instances will require discontinuance.

3.4.1 Fair value hedge optional expedients

ASC 848 provides a reporting entity with an optional expedient when determining if a fair value hedging relationship can be assumed to be highly effective under the shortcut method (see REF 3.2.2.). This expedient may be applied throughout the life of the hedging relationship, even in instances when the life of the hedging relationship extends beyond December 31, 2022. That is, the ability to apply the shortcut method optional expedient may continue to be applied until (1) the hedging relationship ceases to exist or (2) a reporting entity voluntarily discontinues the hedging the relationship.

ASC 848 also provides a reporting entity with the ability to change the designated benchmark interest rate hedged and component of cash flows (see REF 3.2.1) and, when doing so, requires a reporting entity to update the discount rate used and permits it to incorporate other adjustments to the calculation. If the hedging relationship extends beyond December 31, 2022, ASC 848-40-25-6 states that a reporting entity should continue to use the revised discount rate (including any spread adjustment, if applicable) and any remaining revised cash flows over the life of the designated hedging relationship.

3.4.2 Cash flow hedge optional expedients

The guidance in ASC 848 is meant to provide relief on a temporary basis for both existing and new cash flow hedges. As a result, entities should discontinue using an optional expedient for assessing hedge effectiveness if any of the following occur prior to December 31, 2022 for each hedging relationship in which an optional expedient was elected:
Neither the hedged item nor the hedging instrument reference a rate that meets the scope of paragraph ASC 848-10-15-3 (i.e., references LIBOR or a reference rate that is expected to be discontinued as a result of reference rate reform).

The guidance in ASC 848 is superseded, which will occur after the December 31, 2022 sunset date (see REF 4.1.4 for certain exceptions).

The reporting entity elects to cease to apply the optional expedients.

For hedging relationships that cease to apply ASC 848 (e.g., extend beyond December 31, 2022 or a reporting entity no longer qualifies to apply the guidance), a reporting entity should apply the guidance in ASC 815-20 and ASC 815-30 to determine if hedge accounting should continue to be applied. Any eligible method for assessing effectiveness under ASC 815-20 and ASC 815-30 may be applied without requiring dedesignation, including a method other than the one designated for use prior to the optional expedient being applied. In accordance with ASC 848-50-35-21, if a reporting entity chooses to assess hedge effectiveness using the hypothetical derivative method, or another acceptable method under ASC 815-20 and ASC 815-30, the reporting entity may create the terms of the instrument used to estimate changes in the fair value of its hedged risk based on market data as of hedge inception.

If a new method is selected, a reporting entity should update its hedge documentation noting the changes made no later than when the reporting entity performs its first assessment of effectiveness after the change was identified in accordance with ASC 848-30-25-4. ASC 848 specifically notes that a reporting entity must continue to assess whether the underlying hedged forecasted transaction is probable of occurring.

If it is determined that the hedging relationship no longer qualifies for hedge accounting, hedge accounting should be discontinued prospectively and ASC 815-30-40-2 through ASC 815-30-40-6A should be applied.

### 3.4.3 Fair value, cash flow, and net investment hedge optional expedient

ASC 848 provides a reporting entity with an optional expedient to prospectively change its systematic and rational method used to recognize excluded components in earnings (see REF 3.1.5). If this optional expedient is elected for a cash flow hedge, fair value hedge, or net investment hedge, the amended systematic and rational method must be applied for the remaining life of the hedging relationship, including periods subsequent to December 31, 2022.
Chapter 4: Effective date and transition
4.1 Effective date and transition

The guidance in ASC 848 was available to be adopted upon issuance for all entities. While it provided immediate accounting relief (if adopted), the relief is meant to be temporary (see REF 4.1.4), as reference rate reform is considered temporary in nature due to the expectation that LIBOR will be discontinued by the end of 2021. The relief provided within ASC 848 lasts until December 31, 2022 and is meant to coincide with the period that global financial markets will transition away from reference rates that will cease to exist.

4.1.1 Contract modifications effective date and transition

As discussed in REF 1.3, the guidance must be elected for contract modifications for arrangements within a given ASC Topic or Industry Subtopic (e.g., all lease modifications within ASC 842). A reporting entity may elect to adopt the guidance for contract modifications:

- as of any date from the beginning of an interim period that includes or is subsequent to March 12, 2020, or
- prospectively from a date within an interim period that includes or is subsequent to March 12, 2020.

A calendar year-end company, for example, could have adopted the guidance in Q1 2020.

Once the application of ASC 848 is elected for an ASC Topic or an Industry Subtopic, it needs to be applied prospectively for all eligible contract modifications for that ASC Topic or Industry Subtopic (see REF 1.3) made prior to December 31, 2022. However, it may be elected for different ASC Topics or Industry Subtopics during different reporting periods. For example, a company may elect to apply an optional expedient for all contract modifications that would have been accounted for under ASC 310 in Q1 but elect to apply an optional expedient for all contract modifications that would have been accounted for under ASC 470 in Q2.

4.1.2 Hedge accounting effective date and transition

ASC 848 can be applied to eligible hedging relationships that exist as of the beginning of an interim period that includes March 12, 2020 and to new eligible hedging relationships designated in subsequent periods. The optional expedients may not be applied, however, to hedging relationships evaluated after December 31, 2022 (with limited exceptions described in REF 4.1.4).

Excerpt from ASC 848-10-65-1(a)(2)(i)

If an entity elects to apply any of the pending content that links to this paragraph for an eligible hedging relationship existing as of the beginning of the interim period that includes March 12, 2020, any adjustments as a result of those elections shall be reflected as of the beginning of that interim period and recognized in accordance with Subtopics 848-30, 848-40, and 848-50 (as applicable). If an entity elects to apply any of the pending content that links to this paragraph for a new hedging relationship entered into between the beginning of the interim period that includes March 12, 2020 and March 12, 2020, any adjustments as a result of those elections shall be reflected as of the
beginning of the hedging relationship and recognized in accordance with Subtopics 848-30, 848-40, and 848-50 (as applicable).

4.1.3 Transition disclosures

ASC 848-10-65-1(e) requires entities that have elected to apply the guidance in ASC 848 to disclose the nature of and reason for electing to apply an optional expedient under ASC 848. Disclosure must be made in each interim and annual period in the fiscal year of application.

4.1.4 ASC 848 sunset date

The guidance in ASC 848 cannot be applied to contract modifications or hedging relationships after December 31, 2022 with limited exceptions. Those limited exceptions relate to certain hedging optional expedients that, if elected, would continue to be applied subsequent to December 31, 2022. Those exceptions pertain to:

☐ the optional expedient to change the systematic and rational method used to recognize in earnings excluded components (see REF 3.1.5),

☐ the approach to measuring the hedged item in a fair value hedge resulting from the optional expedient to change the designated benchmark interest rate and component of cash flows (see REF 3.2.1), and

☐ the optional expedient to not periodically evaluate certain conditions when determining whether the shortcut method for assessing hedge effectiveness may continue to be applied for a fair value hedge (see REF 3.2.2).

4.1.5 Private company considerations

For entities that have not yet adopted ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, application of the hedging optional expedients in ASC 848 are limited to the following:

Excerpt from ASC 848-10-65-1(e)


2. An optional expedient allowing a change to the method designated for use in assessing hedge effectiveness in a cash flow hedge in paragraph 848-30-25-8 if the optional expedient method being elected is the simplified hedge accounting approach for eligible private companies for initial hedge effectiveness in paragraph 848-50-25-8 or for subsequent hedge effectiveness in paragraph 848-50-35-7.

3. An optional expedient allowing an entity to assume that the hedged forecasted transaction in a cash flow hedge is probable of occurring in paragraph 848-50-25-2.

4. An optional expedient allowing an entity to assume that the reference rate will not be replaced for the remainder of the hedging relationships in paragraph 848-50-25-11(a) for initial hedge
effectiveness and paragraph 848-50-35-17(a) for subsequent hedge effectiveness when the entity is using any of the methods for assessing and measuring hedge effectiveness in a cash flow hedge on a quantitative basis and if both the hedged forecasted transaction and the hedging instrument have a reference rate that meets the scope of paragraph 848-10-15-3.

5. An optional expedient allowing an entity to disregard certain requirements of the simplified hedge accounting approach for eligible private companies for initial hedge effectiveness in paragraph 848-50-25-8 or for subsequent hedge effectiveness in paragraph 848-50-35-7 in a cash flow hedge.

The other hedge accounting optional expediets in ASC 848 are not available to be elected until ASU 2017-12 is adopted.