PUBLIC SECTOR

Proposal addresses replacement of Interbank Offered Rates

Some governments have entered into agreements in which variable payments made or received depend on an interbank offered rate (IBOR)—most notably, the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form at the end of 2021, prompting governments to amend or replace financial instruments to replace LIBOR with other reference rates.

Currently, Governmental Accounting Standards Board (GASB) Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, requires a government that renegotiates or amends a critical term of a hedging derivative instrument, such as the reference rate of a hedging derivative instrument's variable payment, to terminate hedge accounting. Also, replacement of the rate on which variable payments depend in a lease contract would require, under Statement No. 87, Leases, that a government apply the provisions for lease modifications, including remeasurement of the lease liability or lease receivable.

The GASB recently issued an Exposure Draft, Replacement of Interbank Offered Rates, to address accounting and financial reporting implications that result from the replacement of an IBOR. Proposed amendments include the following, among others:

- Providing an exception for certain hedging derivative instruments to the hedge accounting termination provisions when an IBOR is replaced as the reference rate of the hedging derivative instrument
- Clarifying the hedge accounting termination provisions when an IBOR is replaced as the reference rate of a hedged item
- Clarifying that the uncertainty related to the continued availability of IBORs does not, by itself, affect the assessment of whether a hedged expected transaction is probable
- Removing LIBOR as an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap
- Identifying the Secured Overnight Financing Rate and the Effective Federal Funds Rate as appropriate benchmark interest rates for the qualitative evaluation of the effectiveness of an interest rate swap
- Providing an exception to the lease modifications guidance in Statement 87 for certain lease contracts that are amended to replace an IBOR as the rate upon which variable payments depend
The proposed removal of LIBOR as an appropriate benchmark interest rate would be effective for reporting periods beginning after December 15, 2020. All other proposed requirements would be effective for reporting periods beginning after June 15, 2020. Earlier application would be encouraged.

The Exposure Draft is available for comment until November 27, 2019.

**FINANCIAL INSTITUTIONS**

**FDIC finalizes community bank leverage ratio framework**

On September 17, 2019, the Federal Deposit Insurance Corporation (FDIC) issued a final rule that creates the community bank leverage ratio (CBLR) framework. This is an optional framework designed to remove the calculation and reporting requirements related to risk-based capital ratios for qualifying community banking organizations that opt into the framework. Under the final rule, qualifying community banking organizations would be considered to have met the well-capitalized ratio requirements of section 38 of the Federal Deposit Insurance Act if they meet the following criteria:

- Opt into the CBLR framework
- Maintain a leverage ratio (Tier 1 capital/average total consolidated assets) of greater than 9 percent
- Have less than $10 billion in average total consolidated assets
- Have off-balance-sheet exposures of 25 percent or less of total consolidated assets
- Have trading assets plus trading liabilities of 5 percent or less of total consolidated assets
- Not be an advanced approaches banking organization (generally defined as having at least $250 billion in total consolidated assets or at least $10 billion in total on-balance sheet foreign exposures, as well as subsidiaries of these institutions)

The final rule is effective January 1, 2020 and would be reflected in call reports as of March 31, 2020.

A fact sheet summarizes the applicability and requirements of the CBLR framework, as well as what to do when the institution does not meet the requirements in a given period.

**SEC**

**Solicitations of interest prior to a registered public offering**

The SEC recently issued Final Rule 33-10699, Solicitations of Interest Prior to a Registered Public Offering, which enables all issuers to engage in “test-the-waters” communications with certain institutional investors regarding a contemplated registered securities offering prior to, or following, the filing of a registration statement related to such offering. The rule and related amendments expands the “test-the-waters” accommodation, which previously only was available to emerging growth companies, to all issuers, including fund issuers.

The “test-the-waters” communications are exempt from restrictions imposed by Section 5 of the Securities Act of 1933 on written and oral offers prior to or after filing a registration statement and are limited to qualified institutional buyers (QIBs) and institutional accredited investors (IAIs). Securities Act Rule 163B permits any issuer, or any person authorized to act on its behalf, to engage in oral or written communications with potential investors that are, or are reasonably believed to be, QIBs or IAIs, either prior to or following the filing of a registration statement, to determine whether such investors might have an interest in a contemplated registered securities offering.

The Final Rule will be effective 60 days after its publication in the Federal Register.
INTERNATIONAL

Amendments address interest rate benchmark uncertainty

International Financial Reporting Standards (IFRS) require companies to meet certain requirements to apply hedge accounting, including demonstrating that hedged transactions are highly probable of occurring, and demonstrating that there is an economic relationship between the hedged item and the hedging instrument or that the hedge is expected to be highly effective in achieving offsetting. Ongoing interest rate benchmark reform has led to uncertainty about when the current interest rate benchmarks, such as interbank offer rates (IBORs) will be replaced and with what interest rate. This uncertainty could result in a company having to discontinue hedge accounting solely because of the reform’s effect on its ability to comply with these requirements.

The International Accounting Standards Board (IASB) recently issued amendments to IFRS 9, Financial Instruments, International Accounting Standard 39, Financial Instruments: Recognition and Measurement, and IFRS 7, Financial Instruments: Disclosures. The amendments modify some specific hedge accounting requirements to provide relief from potential effects of the uncertainty caused by the IBOR reform. In addition, the amendments require companies to provide additional information to investors about the hedging relationships that are directly affected by these uncertainties.

The amendments are effective January 1, 2020. The IASB next will consider how to address any issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate.