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cc: Financial Accounting Standards Board

Executive Summary

The Alternative Reference Rate Committee Accounting and Tax subgroup (ARRC), is requesting that the SEC confirm our interpretation that equity-classified preferred stock instruments (whether classified in permanent or temporary equity), with dividends or other terms that reference LIBOR qualify for the same measurement scope exception that the Financial Accounting Standards Board (FASB) has proposed for other contracts with interbank offer rates (IBORs), including LIBOR.

Proposal

Regulators in various jurisdictions have warned that certain benchmark IBORs such as the LIBOR should be expected to stop, and have formed National Working Groups to nominate other reference rates to serve as market benchmarks in those jurisdictions for broad ranges of financial instruments and other legal agreements. This initiative is generally referred to by FASB as Reference Rate Reform.

Given this, agreements that reference IBORs will generally need to be modified to incorporate a new reference rate. Because this is a market-wide issue that will impact innumerable legal agreements, the FASB has issued an exposure draft (ED) that proposes the provision of elective accounting relief in connection with the effects of the transition away from IBORs.

Specifically, under the proposed guidance, for contracts and other transactions that reference eligible IBORs, entities will be relieved from applying existing accounting guidance to assess whether (a) changes in a reference rate should be considered a minor modification of the contract (as opposed to an extinguishment), and (b) existing hedge accounting relationships may continue without de-designation. Instead, if certain conditions are met, entities may apply the elective relief and conclude, without quantitative analysis, that changes in contractual terms made in connection with Reference Rate Reform represent minor modifications and not extinguishments, and do not require the de-designation of any existing hedge accounting relationships. As it relates to preferred stock instruments, the former concept provides relief from applying the guidance in ASC 260-10-S99-2 as it relates to modifications or exchanges of preferred stock instruments that are accounted for as *extinguishments*, specifically the requirement to adjust income available to common shareholders in the calculation of earnings per share for the difference between the (1) fair value of the consideration transferred to the holders of the preferred stock instrument and (2) the carrying amount of the preferred stock instrument. Further, it is our interpretation that the FASB proposal will also provide relief from the recognition of a similar adjustment as it relates to modifications or exchanges of preferred stock instruments that are accounted for as *modifications*.

Inherent in the FASB proposed relief as it relates to debt instruments (including preferred stock instruments classified as such) is that the measurement of the change in fair value of the existing versus amended terms would not be required given an entity would assume a "modification" outcome. In other words, in addition to providing relief from the administrative process of performing quantitative analyses for each amendment, practically the relief will ensure that entities do not recognize any gain/loss upon transition for debt instrument, including where a cash payment may be necessary to effect transition. Consistent with this, the ARRC interprets that the FASB relief will not only allow entities to conclude that changes in the relevant terms of affected preferred stock instruments are not extinguished in the context of ASC 260-10-S99-2, but will also relieve entities from having to measure the impact of the changes in terms for the modification. In practice, even where the preferred stock instrument is not extinguished, entities often analogize to the guidance under ASC Subtopic 718-20, *Compensation--Stock Compensation -- Awards Classified as Equity*, which addresses modifications to equity-classified share-based payment awards. Under this guidance, if the modified instrument's fair value exceeds the fair value of the original instrument, then the entity generally recognizes the additional fair value in retained earnings as a deemed dividend. However, it would be inconsistent with the relief provided to debt instruments – both as it relates to measurement as well as the administrative burden of performing the quantitative analyses – to still apply this guidance. Also, the aforementioned guidance is intended to capture value transfer whereas the intention of amending terms in preferred stock instruments as part of Reference Rate Reform is actually to preserve value and minimize differences to the greatest extent possible; as a result, as a conceptual matter it may not be appropriate analogize to the aforementioned guidance in this specific context. Therefore, extending relief to the measurement calculation would ensure consistency between debt and equity instruments.

Background

The provisions of many preferred stock instruments, including perpetual preferred stock, that offer variable dividend returns based on LIBOR contain fallback terms that appear well-suited to address a temporary interruption of LIBOR, commonly requiring a fixed rate based on the last published value of LIBOR to be used during the disruption, but these provisions, known as "fallback" provisions, generally do not seem to anticipate a permanent cessation of LIBOR as a market benchmark reference rate.

Investors in preferred shares purchase them in part for the variable dividend return and to eliminate or reduce their exposure to interest rate risk related to this instrument. However, current fallback terms that would expose investors to interest rate risk if they became effective on a non-temporary basis. While some of these instruments have features that allow for an issuer call after a certain date, all of the instruments are perpetual. Therefore, amendment of the current fallback language to include more robust language related to a permanent cessation of IBOR would be the most appropriate remedy to ensure a smooth transition away from IBOR-based rates.

The underlying purpose is to transition markets away from IBOR-based rates, and was not intended to change the market structure of these instruments from variable-rate instruments to fixed-rate instruments, nor was it intended to create or introduce leverage where it didn't previously exist or to result in the transfer of significant value between the counterparties. The intent of the ARRC is to ensure the continuity of markets using a more appropriate reference rate and to maintain, to the extent possible, each counterparty's economic positions as if IBOR had not ceased. The ARRC believes application of the FASB's proposed measurement relief to modifications or exchanges of preferred stock instruments that are accounted for as modifications aligns with this intent.

Accounting Guidance

While there is no codified accounting guidance addressing modification accounting for equity-classified preferred stock, industry practice and interpretive guidance is generally consistent with the views expressed by T. Kirk Crews at the 2014 AICPA National Conference on Current SEC and PCAOB Developments, that analogizes to the debt modification test, and further defines the measurement of a modification conclusion by analogy to ASC 718-20.

Appendix I: SEC speech by T. Kirk Crews, Remarks before the 2014 AICPA National Conference on Current SEC and PCAOB Developments.

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The ARRC Accounting and Tax Sub-Committee members appreciate the Staff's consideration of this issue and would welcome the opportunity to discuss it further. Should you have any questions or desire further clarification on any of the matters discussed in this submission, please do not hesitate to contact Jeannine Hyman at (212) 816 - 2114.

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