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Grant Thornton LLP appreciates the opportunity to comment on proposed Accounting Standards Update, *Clarifications to Accounting for Troubled Debt Restructurings by Creditors*. We support the Board's efforts to clarify whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring.

We have provided other general comments on the proposed ASU, as well as responses to the specific questions in the proposal.

General comments

Acquired loans with evidence of deteriorated credit quality

Given the recent increase in acquisitions of loans with evidence of deteriorated credit quality (loans accounted for under *FASB Accounting Standards Codification*TM (ASC or Codification) 310-30, *Receivables: Loans and Debt Securities Acquired with Deteriorated Credit Quality*), we believe that the Board should clarify when these loans would be considered troubled debt restructurings in the final ASU. Under ASC 310-30 a purchased loan for which cash flows are being received as originally expected would not be considered impaired, even though the cash flows may be less than the contractual cash flows. That is, an investor's determination of whether an acquired loan is impaired is based on the original expected cash flows, not on the contractual cash flows.

It is not clear from the current guidance in ASC 310-40, *Troubled Debt Restructurings by Creditors*, or the proposed ASU whether a restructured loan with terms consistent with, or even better than, originally expected cash flows would be deemed an impaired loan. The guidance in ASC 310-40 held the view that repapering a loan should not turn a loan that was not impaired prior to the restructuring into a loan that is impaired. As a result, we recommend that the determination of whether an acquired loan accounted for under ASC 310-40 is a troubled debt restructuring should be based on the investor's originally expected cash flows. Accordingly, if the investor modifies the loan to be consistent with or better than those expectations, we do not believe such modification should be a troubled debt restructuring.

Concessions

ASC 310-40-15-9 lists various concessions a creditor may grant a debtor. However, we believe that the Board should consider providing additional examples of concessions. Below we have outlined two situations that we believe the Board should specifically address in the final ASU.

Accrual versus pay rate

One very common situation not currently addressed is when the accrual rate of interest and the cash pay rate of interest are different. Consider the following fact pattern:

A creditor agrees with the debtor to reduce the pay rate of interest to a low level that can likely be serviced by the debtor. However, the restructured agreement requires that interest be accrued at a market rate for the risk. The difference between the pay rate and the accrual rate, commonly referred to as “paid-in-kind” interest, is either added to the final payment or otherwise due at some future date when it is hoped the debtor will be able to make the payment.

We believe that the extra accrued interest is speculative in nature due to the troubled condition of the debtor and that such speculative interest should not be considered in evaluating whether the loan is a troubled debt restructuring. Therefore, we believe this concession would be a troubled debt restructuring, assuming the debtor is in financial difficulty; however, we have observed diversity in practice as to whether this type of arrangement would be considered a troubled debt restructuring.

Increased risk with no change in interest rate

We have also noted another common scenario in which the interest rate on the new loan remains the same as it was before the loan became troubled. So even though the risks have clearly increased, the accrual rate in the restructured loan remains essentially the same as it was in the original loan. We believe this is a concession that should result in treatment of the new loan as a troubled debt restructuring.

Removal from impaired loan disclosures

We believe that the Board should clarify whether it would ever be appropriate to stop reporting a loan restructured in a troubled debt restructuring as an impaired loan or whether a troubled debt restructuring must always be reported as an impaired loan unless the conditions in ASC 310-40-50-2 are met. ASC 310-40-50-2 indicates that troubled debt restructurings need not continue to be reported as impaired loans in years after the restructuring if both of the following conditions are met:

- The restructuring agreement specifies an interest rate equal to or greater than the rate that the creditor was willing to accept at the time of the restructuring for a new loan with comparable risk.
- The loan is not impaired based on the terms specified by the restructuring agreement.

Further, we note that ASC 310-40-35-8 specifies that:

Paragraph 310-10-35-16 explains that a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. For a loan that has been restructured in a troubled debt restructuring, the contractual terms of the loan agreement refers to the contractual terms specified by the original loan agreement, not the contractual terms specified by the restructuring agreement.

Although we believe this guidance is clear, we have observed diversity in practice as to when a loan restructured in a troubled debt would no longer need to be reported as an impaired loan. This may be because there is an established practice in which a loan restructured in a troubled debt restructuring may be returned to accrual status, and therefore some believe the loan should no longer be reported as impaired. We believe this is an important issue for the Board to clarify, given the volume of troubled debt restructurings.

Insignificant delays

We agree with the Board's decision that a restructuring that results in an insignificant delay in contractual cash flows may still be considered a troubled debt restructuring. However, we have noted that some believe that the effect of the Board's amendment would prohibit entities from concluding that an insignificant delay is not a troubled debt restructuring. We believe the Board should provide additional guidance to clarify this amendment. We do not believe that the effect of the Board's amendment would be to preclude an entity from determining that an insignificant delay is not a troubled debt restructuring or from having an accounting policy that certain insignificant delays would not result in a troubled debt restructuring. Consistent with other GAAP, an entity would need to consider materiality in making such determinations.

Consequential amendment

As a consequence to the proposed amendment in ASC 310-40-55-10C and the Board's Basis for Conclusions in paragraph BC7, we believe that ASC 310-10-35-10 should be amended to indicate that a creditor should consider insignificant delays or shortfalls in evaluating whether a loan is impaired.

Responses to the Board's specific questions in the proposed Update

Question 1: Would precluding creditors from applying the guidance in paragraph 470-60-55-10, create any operational challenges for determining whether a troubled debt restructuring exists? If yes, please explain why.

We do not believe that precluding creditors from applying the guidance in ASC 470-60-55-10, *Debt: Troubled Debt Restructurings by Debtors*, would create any operational challenges for determining whether a troubled debt restructuring exists.

With the additional clarifications we have suggested above, we believe that ASC 310-40 provides a sound principle that requires a restructuring to be accounted for as a troubled debt restructuring if both (1) the debtor is in financial difficulty and (2) the creditor grants a

concession to the debtor that it would not otherwise consider. The application of this principle requires an analysis of all facts and circumstances surrounding the modification, as noted in ASC 310-40-15-3. We note that the debtor's test specified in ASC 470-60-55-10 would not necessarily incorporate all concessions that a creditor might make and that allowing a creditor to analogize to the debtor's test would therefore create the potential for a creditor to avoid both a troubled debt restructuring under ASC 310-40 and impairment under ASC 310-10. As a result, we agree that a creditor's application of the debtor's test in ASC 470-60-55-10 is not appropriate.

In addition, we believe that the principle in ASC 310-40 should be reiterated in the final ASU.

Question 2: Do you believe that the proposed changes to the guidance for determining whether a troubled debt restructuring exists would result in a more consistent application of troubled debt restructuring guidance? If not, please explain why.

We agree that most of the changes in the proposed ASU would result in a more consistent application of troubled debt restructuring guidance. However, as noted under "General comments" above, we believe that other clarifications should be considered by the Board. In addition, we have concerns about the proposed amendment in ASC 310-40-15-8A, which states that:

If a debtor does not otherwise have access to funds at a market rate for debt with similar risk characteristics as the restructured debt, the restructuring would be considered to be at below a market rate and therefore should be considered a troubled debt restructuring.

As written, this guidance appears to indicate the Board's view that the debtor's inability to obtain funds at a market rate from another lender is a determinative factor that indicates a restructuring is a troubled debt restructuring, and that other facts, terms, and circumstances of the restructuring should be ignored. We do not agree with this view, but rather believe that this clarification should be a nondeterminative indicator that a concession has been granted for the following reasons:

- As noted above, we believe that ASC 310-40 requires the consideration of all facts and circumstances. As a result, we question whether it would be cost beneficial for a creditor to evaluate the debtor's ability to obtain funds at a market rate from another lender for every modification when other factors may clearly indicate a concession has not been granted.
- We are unclear what the term "market rate" means, especially considering that all lenders do not lend at a "market rate," but rather at interest rates that consider various factors, such as a lender's underwriting policy, the compensation a lender requires for the perceived credit risk, and its current appetite to lend. This approach would require a lender to have insight into how other lenders underwrite loans (including knowledge of what a market rate is for a loan to a troubled borrower) and to make a supportable assertion that the borrower can get a loan from another lender at a market rate. Due to the limited transparency for most loan types, we do not believe this will be operational.

- We are also concerned about how this would impact a niche lender. For example, consider a lender that specializes in lending to a unique segment of the population and originally lent at a below-market interest rate simply because it specializes in this type of lending. As written, ASC 310-40-15-8A would require the lender to recognize a troubled debt restructuring, even though it would make a loan with similar terms to a new borrower. This would be a significant change in practice, in which we believe the principle of ASC 310-40 is a comparison to the interest rate that the creditor was willing to accept at the time of the restructuring for a new loan with comparable risk (as evidenced by the disclosure requirement in ASC 310-40-50-2(a)).
- This approach would ignore lack of liquidity in a market and therefore would require loans to be considered a troubled debt restructuring when lenders simply are not lending as has been the recent case.
- It appears that within the context of where the proposed wording is to be inserted in the Codification, a modification could be a troubled debt restructuring even if the borrower was not experiencing financial difficulty. This raises the question of whether the effects of the proposed amendments inadvertently eliminate the two-step process of evaluating a troubled debt restructuring in those situations.

Question 3: The Board decided that a creditor may consider that a debtor is experiencing financial difficulty when payment default is considered to be “probable in the foreseeable future.” Do you believe that this is an appropriate threshold for such an assessment? If not, please explain why.

While we agree this is an appropriate threshold under current U.S. GAAP, this threshold appears to be inconsistent with the conclusions reached by the Board in its financial instruments project, which removes probability from the impairment analysis. Further, we note that default, or the probability of default, should not be the only factor to be considered in evaluating whether a debtor is experiencing financial difficulty. Accordingly, we believe that the Board should not state a threshold, but rather that the guidance in ASC 310-40-55-10A should simply state:

In addition, a creditor may conclude that a debtor is experiencing financial difficulties, even though the debtor is not currently in default, ~~if a creditor determines that payment default is probable in the foreseeable future.~~

Question 4: Are the proposed transition and effective date provisions operational? If not, please explain why.

We believe the proposed transition and effective date provisions are not operational given the current requirement to retrospectively apply the guidance in the proposed ASU to the earliest period presented. While we agree that a retrospective approach is appropriate considering that the guidance in the proposed ASU consists of clarifications of existing practice, we question the cost benefit of requiring entities to go back and retrospectively apply these clarifications and reassess each and every loan modification that was previously not determined to be a troubled

debt restructuring. We believe that this process of reevaluating every loan modification cannot be done in the time period provided by the proposed ASU. We believe that the proposed ASU should be implemented as soon as possible and that retrospective application would delay implementation of these important clarifications.

While we note the determination of whether a loan is a troubled debt restructuring impacts which impairment model the loan may be evaluated under and whether a loan may be deemed to be impaired, we believe that for many financial institutions the concerns about understating impaired loans are mitigated by entities already evaluating many loans for impairment individually. As a result, this proposed ASU would likely have a significant effect only on residential mortgage loans and other loans that meet the scope exception in ASC 310-10-35-13. In addition, even if a loan is determined not to be a troubled debt restructuring and impairment is measured under ASC 450-20, *Contingencies: Loss Contingencies*, we believe the allowance for loan losses should reflect the impact of loan modifications.

We also believe that the Board's determination of the appropriate transition method should consider whether the ASU would result in a significant improvement in the application of ASC 310-40. In doing so, we recommend that the Board consider the creditor guidance issued by bank regulators over the past year and whether such guidance adequately addresses the clarifications made in the proposed ASU. While we acknowledge nonbank-regulated entities are also affected by this proposed ASU, we believe that those nonbank-regulated entities often consider guidance provided by bank regulators in the absence of other authoritative literature.

Finally, we note that there may be unintended consequences of retrospective application, such as the potential impact on the application of FASB Statement 167, *Amendments to FASB Interpretation No. 46(R)*, which eliminated the scope exception for troubled debt restructurings.

Question 5: Should the transition and effective date be different for nonpublic entities versus public entities? If so, please explain why.

We do not believe that the transition and effective date should be different for public and nonpublic entities. The amount of work required to implement the ASU will be dependent on the level of modifications specific to an entity, not on whether the entity is public.

Question 6: Should early adoption of the proposed amendments in this Update be permitted? If so, please explain why.

We believe that early adoption of the proposed amendments in this Update should be permitted, as we have noted that some of the clarifications are consistent with existing practice for certain entities.

We would be pleased to discuss our comments with you. If you have any questions, please contact Mark K. Scoles, Partner, Accounting Principles Consulting Group, at 312.602.8780 or Mark.Scoles@gt.com; or Jamie Mayer, Executive Director, Accounting Principles Consulting Group, at 312.602.8766 or Jamie.Mayer@gt.com.

Sincerely,

/s/ Grant Thornton LLP