

Board Meeting Handout
Codification Improvements to Topic 326, Financial Instruments—Credit Losses
June 5, 2019

Meeting Purpose

1. The purpose of this decision-making Board meeting is to discuss proposed Codification improvements to the amendments in FASB Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The meeting will include a discussion of the following:
 - (a) Issue 1—Negative Allowances on Purchased Financial Assets with Credit Deterioration (PCD)
 - (b) Issue 2—Negative Allowances on Available-for-Sale (AFS) Debt Securities
 - (c) Issue 3—Miscellaneous Technical Improvements Related to Update 2016-13.
2. The Board also will discuss the transition and effective date requirements, the cost-benefit analysis, and permission to proceed with drafting a proposed Accounting Standards Update for vote by written ballot.

Questions for the Board

Issue 1—Negative Allowances on PCD Assets

1. Does the Board want to permit the use of negative allowances on PCD assets?
2. If the Board permits the use of negative allowances on PCD assets, should the amount of negative allowances recorded be subject to a cap? If so, at what amount should negative allowances be capped?

Issue 2—Negative Allowances on AFS Securities

3. Does the Board want to permit an entity to record a negative allowance for credit losses on AFS debt securities?
4. If so, does the Board want to limit the amount of a negative allowance that an entity may record?

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

Issue 3—Miscellaneous Technical Improvements

5. Does the Board agree with the staff's recommendations for the proposed clarifications and corrections?

Transition, Effective Date, Cost-Benefit Analysis and Comment Period

6. Does the Board agree with the staff's recommendations for the effective date, transition method, and transition disclosures for the proposed amendments?

7. Has the Board received sufficient information and analysis to make an informed decision on the perceived costs of the changes? If not, what other information or analysis is needed?

8. Does the Board think that the benefits justify the costs? If so, does the Board authorize the staff to proceed to a proposed Accounting Standards Update for vote by written ballot?

9. What comment period does the Board select for the amendments in the proposed Update?

Background

3. In Accounting Standards Update No. 2019-04, *Codifications Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, the Board amended the guidance in Topic 326 to require entities to consider recoveries when estimating expected credit losses on financial assets. Those amendments also clarify that recoverable amounts should be included in the estimate of expected credit losses and are limited to the aggregate amount of previous or expected writeoffs of the financial asset.

Issue 1: Negative Allowances on PCD Assets

4. Before the issuance of Update 2019-04, stakeholders submitted comment letters on the proposed Accounting Standards Update, *Codification Improvements—Financial Instruments*, requesting clarification about whether the Board's decisions about negative allowances also would apply to PCD assets. In response to comment letter feedback, the staff performed additional outreach and research on permitting negative allowances for PCD assets. All stakeholders included in the outreach supported providing entities with the ability to record negative allowances for PCD assets. However, those stakeholders expressed mixed views on limiting, or capping, the amount of negative allowances for PCD assets.

5. The staff has proposed the following alternatives to clarify the applicability of negative allowances for PCD assets:
 - (a) **Alternative A:** Permit Negative Allowances on PCD Assets to the Amount of Unpaid Principal Balance
 - (b) **Alternative B:** Limit Negative Allowances on PCD Assets to the Purchase Price
 - (c) **Alternative C:** Limit Negative Allowances on PCD Assets to its Amortized Cost Basis.

Issue 2: Negative Allowances on AFS Debt Securities

6. The proposed Update on Codification improvements to financial instruments included a question about the applicability of negative allowances to AFS debt securities. In addition to the feedback received during the comment letter process, the staff performed additional research and outreach on this question.
7. Most outreach participants supported allowing entities to record a negative allowance on AFS debt securities that have incurred a previous writeoff. Some stakeholders noted that they would expect writeoffs of AFS debt securities to be rare and that recording a negative allowance on those securities may be difficult because AFS debt securities must be evaluated individually for impairment.
8. The staff has proposed the following alternatives to clarify the applicability of negative allowances for AFS debt securities:
 - (a) **Alternative A:** Permit Negative Allowances for AFS Debt Securities
 - (b) **Alternative B:** Retain Existing Guidance That Prohibits Negative Allowances on AFS Debt Securities.

Issue 3: Miscellaneous Technical Improvements

9. The staff has identified other miscellaneous technical improvements raised by stakeholders on the following topics:
 - (a) **Transition Relief for Troubled Debt Restructurings:** Stakeholders requested that the Board codify its previous decision to permit entities to calculate a prepayment-adjusted effective interest rate for troubled debt restructurings existing as of the date of adoption of Topic 326 based on the prepayment assumptions as of the adoption date rather than the restructuring date.

- (b) **Disclosures Related to Accrued Interest Receivables:** Stakeholders requested relief from including accrued interest receivables in amortized cost basis disclosures from Topic 320, if accrued interest is accounted for separately from the other components of the amortized cost basis.
- (c) **Collateral Maintenance Practical Expedient:** Stakeholders requested that the Board clarify the scope and methodology of estimating credit losses for financial assets that apply the collateral maintenance practical expedient.
- (d) **Cross-reference to Subtopic 326-20 in Subtopic 805-20:** Stakeholders suggested removing references to superseded guidance.

Transition and Effective Date

10. The staff plans to include a question in the Exposure Draft about the appropriate effective date and transition requirements for these issues. For the Board's consideration, the staff notes that Accounting Standards Update No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, provided the following effective date and transition requirements:
 - (a) For entities that have not adopted the amendments in Update 2016-13, the effective dates and transition requirements for the amendments in Update 2019-04 are the same as the effective dates and transition requirements for Update 2016-13.
 - (b) For entities that have adopted the amendments in Update 2016-13, the amendments in Update 2019-04 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted in any interim period as long as the entity has adopted the amendments in Update 2016-13. The amendments in Update 2019-04 should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date an entity adopted the amendments in Update 2016-13.