FINANCIAL ACCOUNTING STANDARDS BOARD

Public Roundtable Meeting to Discuss Implementation of Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

Thursday, May 20, 2021
9am – 12:00pm EDT

Financial Accounting Standards Board
Virtual Meeting via Zoom

AGENDA

Purpose

To listen to stakeholders' views and to further enhance the Board's understanding of the issues raised or alternatives proposed.

	Topics for Discussion
9:00 a.m.	Welcome and Introduction
9:05 a.m.	Topic 1: CECL Implementation and Summary of Post-Implementation Review (PIR)
10:05 a.m.	Topic 2: Purchased Financial Assets with Credit Deterioration (PCD) and Non-PCD
11:00 a.m.	Break
11:10 a.m.	Topic 3: Troubled Debt Restructurings (TDRs) By Creditors
11:55 p.m.	Closing Remarks

TOPICS FOR DISCUSSION

Topic 1: CECL Implementation

Summary of PIR Feedback

1. The staff performed outreach with 117 stakeholders, including both buy-side and sell-side analysts (covering both private and public banks ranging in size from small-cap and mid-cap public banks to the largest global public banks), preparers that have adopted Accounting Standards Update No. 2016-13*, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* and those that have not yet adopted the Update, regulators, academics, and advisory committees.

2. The feedback included below represents a summary of the feedback received from multiple stakeholders through February 2021.

Summary of Investor Feedback From the December 2020 Board Meeting

3. Overall, buy-side and sell-side analysts that responded to the staff's request for outreach indicated that they generally support the additional information provided under CECL as compared with the previous incurred loss model. Most of those respondents indicated that the additional information provided on earnings calls and in SEC filings as a result of the adoption was helpful in performing analyses and in discussing financial results with management of those entities. Buy-side analysts generally did not indicate whether they thought CECL was an improvement.

4. Analysts acknowledged that they generally understood the purpose of CECL and recognizing a Day-1 allowance. Some analysts indicated that they view the standard as particularly useful in the current economic environment because banks increased their reserves for expected credit losses more quickly than they would have done under the incurred loss model. However, analysts are still learning how CECL affects reserves and the timing of charge offs.

5. The following represent key comments provided by sell-side and buy-side analysts:

   a. *Disclosure Criticism:* Analysts acknowledged that CECL provided them with more information than under the incurred loss model but expressed frustration with the current disclosures and noted that they were disappointed with the quality of the information provided because it lacked consistency across different institutions and did not always provide the desired level of detail.

b. *Disclosure Recommendations:* The staff and Board members asked those analysts if they had recommendations on changes to improve the disclosure information being provided or if new disclosures were needed. Analysts suggested several new or revised disclosures that they perceive would enhance the decision usefulness of the information provided.

c. *PCD Financial Assets:* Some analysts were critical of purchase accounting as it relates to establishing an allowance for purchased financial assets that do not qualify for PCD accounting treatment. Those analysts noted that the allowance for credit losses is being double counted and also that they were challenged in understanding what purchases qualify for PCD accounting treatment.

Preparer Feedback

Financial Institutions That Adopted CECL in 2020

6. Overall, financial institutions that adopted CECL indicated that they were well prepared to adopt the standard at the beginning of 2020. At the onset of the COVID-19 pandemic, financial institutions indicated that it was very challenging to incorporate the quickly evolving macroeconomic environment into their models so close to the end of Q1 2020.

7. The following items represent key comments related to cost of adoption, complexity or modeling challenges, and comparability and disclosures across banks:

a. *Costs:* Some of these institutions noted that the costs of adoption were greater than they anticipated because of data cleaning and storing costs, vendor costs to implement software and/or build models to reflect expected credit losses and validate those models, costs to obtain macroeconomic forecast data, and costs of educating employees about the new standard.

b. *Complexity/Modeling Challenges:* Several institutions noted that the rollout of CECL in 2020 has led to numerous questions from investors, specifically on macroeconomic assumptions, reasonable and supportable forecast periods, reversion methods and durations, and charge off and/or reserve release timing. In addition, some institutions noted that using a qualitative overlay is necessary because of the inherent limitations in quantitative modeling. For example, certain governmental actions are unprecedented (examples include level of assistance provided to borrowers and automatic payment deferrals) and there is no historical data that can be used to model these actions; therefore, a qualitative adjustment is needed. They stated that the qualitative overlay was a component of the CECL reserve. However, some institutions noted that there is an assumption or belief among investors that the allowance is primarily driven by a quantitative model only. This divergence between investors' expectations and institutions' measurement processes has created additional questions from investors. In addition, a few institutions indicated that they find the non-PCD accounting treatment to be unintuitive and complex.

c. *Comparability/Disclosures:* Some institutions noted that they were spending time to review and analyze peer disclosures to determine what is the benchmark of information being provided to users and to determine if they should be enhancing their disclosures. The principles-based measurement model and disclosure requirements make comparability difficult for institutions comparing themselves to peers/competitors. A few institutions also noted that more information could be provided on loan modifications, in lieu of the existing TDR designation. Those institutions noted that TDR designation and disclosure may no longer be meaningful because it overlaps with certain disclosure requirements of Topic 326, Financial Instruments—Credit Losses.

Nonfinancial Institutions That Adopted CECL in 2020

8. Overall, nonfinancial institutions that adopted CECL indicated that they were well prepared to adopt the standard at the beginning of 2020, similar to financial institutions. Nonfinancial institutions generally did not experience a major effect on their allowance levels after adopting CECL, especially when compared with their overall company size. Nonfinancial institutions noted that they spent a lot of time and internal resources to implement CECL to those financial assets that are included within the scope of the standard; however, external costs were low because most institutions built upon their existing practices. Because some nonfinancial institutions already have adopted the standard, they supported retaining the requirement to apply CECL to trade receivables and other assets, while others indicated that a scope exception for smaller entities may be helpful because they may not have the capacity to implement the standard.

Financial Institutions That Have Not Adopted CECL

9. Overall, most financial institutions that have not yet adopted CECL noted that they were continuing with their plans to implement the standard by 2023. A few of those institutions noted that they have put a hold on CECL implementation plans to deal with more pressing matters related to COVID-19 or have decided to pause their implementation plans following the 2019 CECL deferral for nonpublic business entities, which includes credit unions. Those institutions that have paused their implementation timelines indicated that they expected to resume implementation plans in 2021. The outreach conducted to date with non-adopters was limited and the staff will continue to perform outreach with financial institutions that have not adopted CECL to monitor their progress toward implementation.

10. For those institutions that were continuing with their implementation plans, they generally provided similar feedback, including the following:

a. Most are using or plan to utilize an outside vendor to help determine their allowances for credit losses. One institution indicated that it was planning on using the weighted-average remaining maturity (WARM) method for calculating its allowance, while another institution was comparing the WARM method to a third-party vendor to determine if the result was substantially consistent.

b. Most noted that gathering historical data and performing data cleanup was challenging but that they expected to have the necessary data and information to adopt the standard. A few institutions noted challenges in developing qualitative overlays considering forward-looking information to apply to their models.

c. Those institutions generally acknowledged that they were not considered small in comparison with other credit unions or community banks and noted that they have the necessary resources for adoption. However, they expressed some concern that small institutions may struggle to adopt the standard. One smaller institution acknowledged that it thought the WARM example was helpful, but more information or examples could be provided to help institutions determine which inputs to incorporate into their reasonable and supportable forecasts. Credit unions and community banks indicated that a simplified approach to developing a reserve under CECL would be very helpful to ease the implementation burden on smaller financial institutions.

Other Feedback Received

11. The staff received feedback from other stakeholders, including the following:

a. *Academics:* The staff and certain Board members participated in an academic roundtable on CECL with professors and doctoral students. Participants indicated that they are still in the early stages of performing an academic review of the standard and they do not anticipate having findings to share with the FASB until more data is available to properly assess the effects of implementation. Participants were generally interested in how the adoption of the CECL standard affected behavior of financial institutions (that is, whether Day-1 allowances would reduce risk taking) and how investors and regulators reacted to the reserves established under the CECL model. The staff also participated in a webinar to describe opportunities for academic research related to CECL.

b. *Prudential Regulators:* On September 15, 2020, the U.S. Department of Treasury released the congressionally mandated study (as required by the Consolidated Appropriations Act for Fiscal Year 2020) on the need, if any, for changes to regulatory capital requirements necessitated by CECL. The study did not provide a definitive assessment of the effect of CECL on financial institutions' regulatory capital, considering the state of CECL implementation across financial institutions and current market conditions. However, the U.S. Department of Treasury made a number of recommendations, including that the FASB should further study CECL's anticipated benefits, expand its efforts to consult and coordinate with the prudential regulators to understand regulatory capital effects of CECL on financial institutions, explore the costs and benefits of aligning the timing of recognition of fees associated with financial assets with credit losses on those assets, and examine the applicability of CECL to smaller lenders.

c. *Financial Accounting Standards Advisory Council (FASAC):* At the September 24, 2020 FASAC meeting, the staff and Board met with the Council to discuss the costs and benefits of CECL, specifically related to trade receivables. FASAC members stated that because CECL has a relatively insignificant effect on the allowance for credit losses related to trade receivables, Council members discussed whether CECL should be amended to either exclude trade receivables or to provide an option for entities to not apply the guidance to trade receivables. Council members expressed mixed views. Some Council members supported an option to not apply the guidance to trade receivables. Others supported retaining the existing guidance because it has been implemented by many entities and may be similar to prior practices and they had concerns about having different accounting guidance for trade receivables and other receivables.

Questions for Discussion
1. For those organizations who have adopted CECL in 2020, what implementation observations can you share? 2. For those practitioners who have completed calendar-year end audits for those organizations who adopted CECL in 2020, what observations can you share? 3. For those organizations who have not yet adopted CECL, what implementation observations can you share? Where are you in your implementation process? 4. For investors, what observations did you have when reviewing financial statements and disclosures for those entities who adopted CECL in 2020? Did you find the disclosures of entities that adopted CECL in 2020 decision useful? Are there any disclosures needed for your analyses that are currently not provided?

Topic 2: PCD and Non-PCD

Relevant Guidance

12. *Plain English (Nonauthoritative) Summary of Relevant Guidance For PCD Financial Assets:* If the purchase of a financial asset through a business combination or asset acquisition qualifies for PCD accounting, an entity must recognize an allowance for credit losses on the balance sheet (that is, a credit journal entry) and a corresponding increase to the amortized cost basis of the financial asset(s) (that is, a debit journal entry) without recognizing a provision expense at the acquisition date. Any remaining noncredit premium or discount would be recognized over time as an adjustment to yield following the effective interest rate method. In subsequent reporting periods, any changes in the allowance for credit losses would be recognized as a charge or credit to the provision expense. To qualify for PCD accounting treatment, the purchased financial assets must have more-than-insignificant deterioration in credit quality since origination.

13. *Plain English (Nonauthoritative) Summary of Relevant Guidance for Non-PCD Financial Assets:* For those purchased financial assets that do not qualify for PCD accounting (non-PCD), an entity would recognize the purchased financial assets at their fair value at the acquisition date, as well as an allowance for credit losses on the balance sheet and a corresponding provision expense on the income statement. In subsequent reporting periods, any changes in the allowance for credit losses would be recognized as a charge or credit to the provision expense.

14. The difference between PCD and non-PCD accounting is the recognition of the Day-1 provision expense for non-PCD assets versus the Day-1 adjustment to yield for PCD financial assets.

15. Relevant authoritative guidance includes the following:

> **310-10-35-53B** When recognizing interest income on purchased financial assets with credit deterioration within the scope of Topic 326, an entity shall not recognize as interest income the discount embedded in the purchase price that is attributable to the acquirer's assessment of expected credit losses at the date of acquisition. The entity shall accrete or amortize as interest income the non-credit-related discount or premium of a purchased financial asset with credit deterioration in accordance with existing applicable guidance in Section 310-20-35 or 325-40-35.
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> **310-10-35-53C** Recognition of income on purchased financial assets with credit deterioration is dependent on having a reasonable expectation about the amount expected to be collected. Subsequent to purchase, this Subtopic does not prohibit placing financial assets on nonaccrual status, including use of the cost recovery method or cash basis method of income recognition, when appropriate. For example, if the timing of either a sale of the financial asset into the secondary market or a sale of collateral in essentially the same condition as received upon foreclosure is indeterminate, the creditor likely does not have the information necessary to reasonably estimate cash flows expected and shall cease recognizing income on the financial asset. However, the ability to place a financial asset on nonaccrual shall not be used to circumvent recognition of a credit loss. If the financial asset is acquired primarily for the rewards of ownership of the underlying collateral, accrual of income is inappropriate. Such rewards of ownership would include use of the collateral in operations of the entity or improving the collateral for resale. Consistent with paragraph 310-20-35-18, interest income shall not be recognized to the extent that the net investment in the financial asset would increase to an amount greater than the payoff amount.

326-20-30-13 An entity shall record the allowance for credit losses for **purchased financial assets with credit deterioration** in accordance with paragraphs 326-20-30-2 through 30-10 and 326-20-30-12. An entity shall add the allowance for credit losses at the date of acquisition to the purchase price to determine the initial **amortized cost basis** for purchased financial assets with credit deterioration. Any noncredit discount or premium resulting from acquiring a pool of purchased financial assets with credit deterioration shall be allocated to each individual asset. At the acquisition date, the initial allowance for credit losses determined on a collective basis shall be allocated to individual assets to appropriately allocate any noncredit discount or premium.

805-20-30-4A For acquired financial assets that are not **purchased financial assets with credit deterioration,** the acquirer shall record the purchased financial assets at the acquisition-date fair value. Additionally, for these financial assets within the scope of Topic 326, an allowance shall be recorded with a corresponding charge to credit loss expense as of the reporting date.

805-20-30-4B For assets accounted for as purchased financial assets with credit deterioration (which includes beneficial interests that meet the criteria in paragraph 325-40-30-1A), an acquirer shall recognize an allowance in accordance with Topic 326 with a corresponding increase to the amortized cost basis of the financial asset(s) as of the acquisition date.

Examples

16. The following examples are for illustrative purposes only and not intended to be authoritative. Examples 1 and 2 depict non-PCD and PCD accounting using the same fact pattern to highlight how the different accounting models affect the balance sheet and income statement.

Example 1: Non-PCD Accounting

17. For purposes of an illustration, assume that an entity acquires a pool of loans through a business combination with the following characteristics at 1/1/20X0:

Purchase Price	$900,000
Par Amount	$1,000,000
Purchase Discount	($100,000)
Stated Coupon	5.00%
Purchase Yield	7.47%
Remaining Term	5 years
Initial Estimate of Allowance for Credit Losses	$60,000

18. The entity determines that these loans should be classified as non-PCD at the acquisition date and records the following entries to recognize the pool of loans and to establish the allowance for credit losses in accordance with paragraph 805-20-30-4A:

Loans Receivable Dr.	$1,000,000	
Cash Cr.		$900,000
Discount Cr.		$100,000
Provision Expense Dr.	$60,000	
Allowance for Credit Losses Cr.		$60,000

19. This results in the entity recognizing a provision expense of $60,000 when it acquires this pool of loans. Because the entity is purchasing this pool of loans at a discount, an estimate of credit losses is already incorporated into the purchase discount. In other words, this pool of loans has a purchase yield (7.47%) that is higher than the stated coupon rate (5.00%) to compensate the entity for (a) incremental changes in credit risk that is not incorporated into the stated coupon rate and (b) difference in noncredit factors such as market interest rates. However, because this pool of loans are classified as non-PCD, the purchase yield is not bifurcated between its credit and noncredit components, but instead the entire purchase discount is recognized into income over the remaining life of the pool of loans as an adjustment to yield.

20. In the period of the acquisition, an immediate income statement effect is recognized. In addition, the entity will recognize higher interest income over the remaining life of these loans. The table below illustrates the income statement effect, assuming there are no changes in expected credit losses:

	20X0	20X1	20X2	20X3	20X4	Total
Interest Income (Effective Yield = 7.47%)	67,227	68,514	69,897	71,383	72,980	**350,000**
Provision Expense	(60,000)					**(60,000)**
Net Income	7,227	68,514	69,897	71,383	72,980	**290,000**

Example 2: PCD Accounting

21. In contrast, assume that the entity determines that the same pool of loans meets the definition of an PCD at the date of acquisition. Under the PCD accounting model, an entity is required to apply the gross-up methodology at acquisition (that is, the allowance for credit losses is added to the purchase price to determine the initial amortized cost basis for the acquired loans).

22. As noted in the example above, the pool of loans is purchased at a discount. Therefore, at the acquisition date the entity must first bifurcate the allowance for credit losses from the purchase discount, as follows:

Purchase Discount ($100,000) = **Allowance for Credit Losses** ($60,000) + **Noncredit Discount** ($40,000)

23. Once the entity determines the gross-up amount, it would record the following entry to recognize the pool of loans at the acquisition date:

Loans Receivable Dr.	$1,000,000	
Cash Cr.		$900,000
Allowance for Credit Losses Cr.		$60,000
Noncredit Discount Cr.		$40,000

24. Unlike non-PCD accounting, there is no immediate income statement effect for the allowance for credit losses. Instead, the entity reduces the purchase yield for the remaining life of this pool of loans for the initial expected credit loss amount. Any future changes in the estimate of credit losses will not affect the effective yield, but rather would be recognized immediately as a provision expense or credit.

	20X0	20X1	20X2	20X3	20X4	Total
Interest Income (Effective Yield = 5.95%)	57,103	57,526	57,973	58,448	58,950	**290,000**
Provision Expense	-					**-**
Net Income	57,103	57,526	57,973	58,448	58,950	**290,000**

Issue Background and Feedback

25. At the December 2, 2020 Board meeting, the Board asked the staff to perform additional research and outreach on the accounting for non-PCD assets and return at a future date to consider if additional standard setting is required. Based on the direction from the Board, the staff performed additional outreach and received the following feedback from stakeholders regarding the application of the non-PCD guidance to purchased financial assets:

   a. Entities are required to recognize a provision expense at the acquisition date when acquiring financial assets, even though the acquisition price includes credit risk.

   b. The purchase yield is overstated because it includes expected credit losses.

   c. Determining which purchased financial assets qualify for PCD accounting is based on entity-specific judgments, which leads to diversity in practice and confusion for preparers and users.

Potential Alternative

26. In discussions with stakeholders after the Board meeting on December 2, 2020, most stakeholders suggested an approach under which the PCD accounting model would be expanded to include all purchased loans and debt securities classified as held to maturity (HTM). Under this approach:

   a. Entities would apply the PCD accounting model to all acquired loans and HTM debt securities at acquisition, regardless of whether any deterioration in credit since origination existed.

b. There would be no income statement effect resulting from the recognition of the allowance for credit losses on the date of acquisition.

c. Loans or HTM debt securities acquired immediately following their origination dates would apply the PCD accounting model (that is, there will be no element of seasoning). The staff received feedback that some element of seasoning may be relevant, but it could be challenging to establish guidance related to the appropriate seasoning period and stakeholders did not support an arbitrary seasoning period.

d. Loans or HTM debt securities acquired with no deterioration in credit since origination would be recorded at an amount above par (see Example 3).

e. All other purchased financial assets would continue applying the more-than-insignificant threshold when determining if purchased financial assets qualify for PCD accounting.

f. No new disclosures would be considered, but rather entities would continue to be subject to the PCD reconciliation disclosures and required to disclose any unamortized premiums or discounts on the financial statements for a larger population of purchased financial assets.

27. The following example highlights how this alternative would be applied when purchasing financial assets close to origination and the purchase price for the pool of loans is at par and there is no deterioration in credit since origination. For purposes of this illustration, assume that an entity acquires a pool of loans at par through a business combination with the following characteristics at 1/1/20X0:

Example 3: PCD Expansion to All Purchased Loans

Purchase Price	$1,000,000
Par Amount	$1,000,000
Stated Coupon	5.00%
Remaining Term	5 years
Initial Estimate of Allowance for Credit Losses	$60,000

28. Because the pool of loans is purchased at par, the allowance for credit losses results in a noncredit premium, as follows:

Purchase Discount/Premium	=	Allowance for Credit Losses	+	Noncredit Premium
$0		($60,000)		$60,000

29. The entity would record the following entry to recognize the pool of loans:

Loans Receivable Dr.	$1,000,000	
Noncredit Premium Dr.	$60,000	
Cash Cr.		$1,000,000
Allowance for Credit Losses Cr.		$60,000

30. In this acquisition, the noncredit premium represents the deferred provision expense on this pool of loans. The noncredit premium is recognized as an adjustment to yield and is reported in the income statement as an adjustment to interest income. Any changes to the allowance for credit losses will be recognized immediately as an increase or decrease in the provision expense. The effect of deferring the provision expense would result in a reduced yield, that is, the entity's yield would be reduced from 5.00% to 3.66%. This is illustrated in the table below (assuming that there are no changes to expected credit losses over the remining term of these loans):

	20X0	20X1	20X2	20X3	20X4	Total
Interest Income (Effective Yield = 3.66%)	38,848	38,439	38,016	37,576	37,121	**190,000**
Provision Expense	-					**-**
Net Income	38,848	38,439	38,016	37,576	37,121	**190,000**

Questions for Discussion

Preparers, Practitioners, and Regulators

1. What are your views on the current accounting guidance for PCD and non-PCD accounting?

2. Should all purchased loans (except for those classified as held for sale [HFS]) and debt securities classified as HTM apply the PCD accounting model?

3. What considerations should the Board be aware of if it expands PCD accounting to all purchased loans (except for those classified as HFS) and HTM debt securities? For example:

    a. Loans subsequently placed on nonaccrual status
    b. Expected recoveries and negative allowances
    c. Freestanding insurance contracts
    d. Callable HTM debt securities acquired at a premium

4. Do you believe that expanding PCD accounting to all purchased loans (except for those classified as HFS) and HTM debt securities would be operable and cost-beneficial?

5. For entities that have not adopted CECL what effect, if any, would expanding PCD accounting to all purchased loans (except for those classified as HFS) and HTM debt securities have on your implementation plans and timeline?

Investors

6. How would expanding PCD accounting to all purchased loans (except for those classified as HFS) and HTM debt securities affect your interest income analyses, if at all?

7. What, if any, incremental information would be needed to perform your analysis for purchased loans (except for those classified as HFS) and HTM debt securities for which the initial estimate of expected credit losses is deferred and recognized to interest income overtime?

All Participants

8. Are there any other alternatives to PCD and non-PCD accounting that should be considered, such as the scope of assets included or excluded from PCD accounting?

Topic 3: TDRs by Creditors

Relevant Guidance

31. *Plain English (Nonauthoritative) Summary of Relevant Guidance:* This issuance of the CECL standard did not change the guidance on how entities determine and measure the effect of a TDR. If a loan modification is made for a borrower experiencing financial difficulty and the modification represents a concession that the creditor otherwise would not have considered (for example, the effective interest rate of the new loan is not at a market rate), the modification should be accounted for as a TDR. Concessions granted in a TDR reflect the creditor's effort to recover its initial loan and, therefore, are treated as a continuation of the original loan whereby the effective interest rate continues to be based on the original effective interest rate. The effect of the concession is recorded as an adjustment to the allowance for credit losses. If a loan modification is not a TDR, an entity is required to evaluate if the modification represents a continuation of the existing loan or an extinguishment of the existing loan and creation of a new loan. The effective interest rate utilized, and treatment of deferred fees and costs is affected by the conclusion reached in this evaluation. See Appendix A for an illustration of the analysis considered.

32. Relevant authoritative guidance includes the following:

> **310-40-15-5** A restructuring of a debt constitutes a troubled debt restructuring for purposes of this Subtopic if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider.
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> **310-40-15-6** That concession is granted by the creditor in an attempt to protect as much of its investment as possible. That concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court; for example, either of the following circumstances might occur:
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> a. A creditor may restructure the terms of a debt to alleviate the burden of the debtor's near-term cash requirements, and many troubled debt restructurings involve modifying terms to reduce or defer cash payments required of the debtor in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor.
> b. The creditor may accept cash, other assets, or an equity interest in the debtor in satisfaction of the debt though the value received is less than the amount of the debt because the creditor concludes that step will maximize recovery of its investment. Although troubled debt that is fully satisfied by foreclosure, repossession, or other transfer of assets or by grant of equity securities by the debtor is, in a technical sense, not restructured, that kind of event is included in the term troubled debt restructuring in this Subtopic.
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> **310-40-15-7** Whatever the form of concession granted by the creditor to the debtor in a troubled debt restructuring, the creditor's objective is to make the best of a difficult situation. That is, the creditor expects to obtain more cash or other value from the debtor, or to increase the probability of receipt, by granting the concession than by not granting it.
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> **310-40-15-8** In general, a debtor that can obtain funds from sources other than the existing creditor at market interest rates at or near those for nontroubled debt is not involved in a troubled debt restructuring. A debtor in a troubled debt restructuring can obtain funds from

sources other than the existing creditor in the troubled debt restructuring, if at all, only at effective interest rates (based on market prices) so high that it cannot afford to pay them.

310-40-15-9 A troubled debt restructuring may include, but is not necessarily limited to, one or a combination of the following:

a. Transfer from the debtor to the creditor of receivables from third parties, real estate, or other assets to satisfy fully or partially a debt (including a transfer resulting from foreclosure or repossession)
b. Issuance or other granting of an equity interest to the creditor by the debtor to satisfy fully or partially a debt unless the equity interest is granted pursuant to existing terms for converting the debt into an equity interest
c. Modification of terms of a debt, such as one or a combination of any of the following:
    1. Reduction (absolute or contingent) of the stated interest rate for the remaining original life of the debt
    2. Extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk
    3. Reduction (absolute or contingent) of the face amount or maturity amount of the debt as stated in the instrument or other agreement
    4. Reduction (absolute or contingent) of accrued interest.

310-40-15-10 The guidance in this Subtopic shall be applied to all troubled debt restructurings including those consummated under reorganization, arrangement, or other provisions of the Federal Bankruptcy Act or other federal statutes related thereto.

310-40-15-11 For purposes of this Subtopic, none of the following are considered troubled debt restructurings:

a. Lease modifications (for guidance, see Topic 842)
b. Changes in employment-related agreements, for example, pension plans and deferred compensation contracts
c. Unless they involve an agreement between debtor and creditor to restructure, either of the following:
    1. Debtors' failures to pay trade accounts according to their terms
    2. Creditors' delays in taking legal action to collect overdue amounts of interest and principal.

326-20-30-4A As an accounting policy election for each class of financing receivable or major security type, an entity may adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments. However, if the asset is restructured in a troubled debt restructuring, the effective interest rate used to discount expected cash flows shall not be adjusted because of subsequent changes in expected timing of cash flows.

326-20-30-6 An entity shall estimate expected credit losses over the contractual term of the financial asset(s) when using the methods in accordance with paragraph 326-20-30-5. An entity shall consider prepayments as a separate input in the method or prepayments may be embedded in the credit loss information in accordance with paragraph 326-20-30-5. An entity shall consider estimated prepayments in the future principal and interest cash flows when utilizing a method in accordance with paragraph 326-20-30-4. An entity shall not extend the contractual term for expected extensions, renewals, and modifications unless either of the following applies:

a. The entity has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring with the borrower.
b. The extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

Issue Background and Feedback

33. At the December 2, 2020 Board meeting, the Board asked the staff to perform additional research and outreach on the accounting and disclosure of TDRs by creditors and return at a future date to consider if additional standard setting is required. Based on the direction from the Board, the staff performed additional research and outreach and received the following feedback:

    a. Stakeholders who adopted CECL in 2020 indicated that they believe the accounting for TDRs does not provide decision-useful information. Certain stakeholders commented that during 2020, analysts were focused on loan modifications more holistically, which suggests that TDR information is no longer necessary for entities that have adopted CECL.

    b. Other stakeholders suggested that the allowance for credit losses under the CECL guidance captures the effect of most concessions and the TDR guidance is duplicative and unnecessary.

    c. Some stakeholders also noted that, in most cases, the effect of the concession would result in reduced interest income being recognized over time.

Potential Alternative

34. Stakeholders who participated in outreach after the December 2, 2020 Board meeting generally supported eliminating the existing TDR accounting guidance for entities who have adopted CECL. Under this alternative:

    a. Entities would apply the existing loan modification guidance instead of evaluating modifications for TDRs. Entities would have to determine if a loan modification results in a continuation or extinguishment of the loan by applying the guidance in paragraphs 310-20-35-9 through 35-11. If the loan modification is accounted for as a continuation after applying the loan modification guidance, the entity would continue amortizing any remaining deferred fees and costs and carry forward the effective interest rate applied before the modification. If the loan modification is accounted for as an extinguishment, the entity would treat the loan as if it underwrote a new loan and write off any unamortized deferred fees or costs and establish a new effective interest rate based on the terms of the loan.

    b. The Board did not specify what methodology should be applied in computing the allowance for credit losses under Topic 326. If entities are not applying a discounted cash flow method when calculating the allowance for credit losses, certain concessions such as an interest rate concession will not be included in the measurement of expected credit losses. Instead, entities would have to consider the guidance in paragraphs 310-10-35-53C and 310-20-35-18 that prohibits entities from recognizing interest income to the extent that the net investment in the financial asset would increase to an amount greater than the payoff amount.

c. The following are the currently required TDR related disclosures. Under the proposed alternative, TDR measurement guidance would be eliminated, but the following disclosures would be retained as part of a broader set of disclosures related to loan modifications:

i. By class of financing receivable, qualitative and quantitative information about how loans were modified and the financial effects of modifications

ii. By portfolio segment, qualitative information about how modifications are factored into the determination of the allowance for credit losses

iii. For each loan that was modified in the past 12-month period, by class of financing receivable, qualitative and quantitative information about the defaulted loans, including the types of loans that defaulted and the amount of the default

iv. By portfolio segment, qualitative information about how those defaults are factored into the determination of the allowance for credit losses.

Questions for Discussion

Preparers, Practitioners, and Regulators

1. What are your views on the current accounting for TDRs for creditors under CECL?

2. Do you believe that the potential alternative would be operable and cost-beneficial? Are there any consequences and challenges to applying the modification accounting guidance? Are there any changes to modification guidance that would need to be made to make the alternative cost-beneficial?

Investors

3. Do you believe that identifying a loan as a TDR provides decision-useful information when compared with modifications that do not result in TDR accounting? If the Board eliminated TDR accounting, what (if any) additional disclosures would provide you with decision-useful information?

All Participants

4. Are there other alternatives that should be considered if you believe that the current accounting for TDRs does not provide decision-useful information?

Appendix A: Loan Modification Flowchart

A1. The following flowchart provides an illustrative view of the modification guidance that is currently required in paragraphs 310-20-35-9 through 35-12.