December 23, 2021

Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2021-006

Dear Ms. Salo:

The Financial Reporting Executive Committee (FinREC) and the Depository Institutions Expert Panel (Expert Panel) of the American Institute of Certified Public Accountants are pleased to offer feedback on FASB Proposed Accounting Standards Update (ASU), "*Financial Instruments—Credit Losses (Topic 326) - Troubled Debt Restructurings and Vintage Disclosures*."

We support the Board's objective to help entities with the implementation of FASB Topic 326 and agree with the proposal, but recommend a clarification related to transition and changes on insignificant delays.

Transition

In the proposed FASB ASU, par. 326-10-65-5c states:

> "The following represents the transition and effective date information related to Accounting Standards Update No. 2022-XX, Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures.
>
> c. An entity shall apply prospectively the pending content that links to this paragraph.
>
> 2. For the elimination of recognition and measurement guidance on troubled debt restructurings for creditors in Subtopic 310-40, an entity may elect to apply a modified retrospective transition by means of a cumulative-effect adjustment to the opening retained earnings as of the beginning of the first reporting period in which the pending content that links to this paragraph is effective for any change in the allowance for credit losses that had been recorded for loans modified or reasonably expected to be modified in a troubled debt restructuring before the adoption of the pending content that links to this paragraph."

We agree with the transition provisions as we interpret them. If an entity elects the modified retrospective approach, we interpret the transition guidance to:

- Not permit or require an entity to re-evaluate whether past modifications would have resulted in the creation of new loans or re-evaluate the treatment of fees and costs.

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- If the entity was using a discounted cash flow approach for TDRs before transition, the entity is permitted, but not required to continue to apply a discounted cash flow methodology in accordance with FASB ASC 326-20-30-4. If an entity elects to continue to follow a discounted cash flow approach, the entity would:
  - change the discount rate used to calculate the estimate of credit losses to the effective interest rate of the loan at the date of transition and
  - use the term *effective interest rate* for discount purposes as defined in the FASB Master Glossary, as follows:

    > "The rate of return implicit in the financial asset, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset. For purchased financial assets with credit deterioration, however, to decouple interest income from credit loss recognition, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at the date of acquisition."

- As a result, the amortized cost basis of the former TDR is expected to be unchanged; only the discount rate used in the calculation of credit losses changes from the original effective interest rate (i.e., based on the original contractual rate in the pre-restructured agreement, not the rate specified in the restructured agreement) to the effective interest rate (i.e., based on the rate specified in the restructured agreement) at the transition date.

We understand that other interpretations of this transition provision may be reasonable. Therefore, we believe further clarification would be helpful in the Basis for Conclusions.

<u>Insignificant Delay</u>

The guidance currently in FASB ASC 310-40-15-18 states:

> If the debt has been previously restructured, an entity shall consider the cumulative effect of the past restructurings when determining whether a delay in payment resulting from the most recent restructuring is insignificant.

This guidance is relevant for purposes of determining whether a current restructuring of debt with a borrower that is experiencing difficulty might be considered a concession and therefore would be a TDR. While the Proposed FASB ASU would eliminate the recognition and measurement of TDR's, it also has incremental disclosures relating to modifications of receivables to a debtor that is experiencing financial difficulty. Proposed FASB ASC 310-10-50-44 states, in part:

> "In the case of a restructuring that results in only a delay in payment that is insignificant, an entity may elect not to include the modification made to receivables for debtors experiencing financial difficulty in the disclosure requirements in paragraphs 310-10-50-36 and 310-10-50-40 through 50-42…."

The proposed FASB ASU moves the guidance currently in FASB ASC 310-40-15-18 to FASB ASC 310-10-50-45, so the guidance is still relevant for purposes of determining whether certain receivables modifications may be excluded from the disclosures upon adoption of the Proposed FASB ASU.

We believe the board should consider whether the requirement to aggregate the cumulative effect of all past restructurings during the life of a loan is decision useful information, especially in the current environment where many lenders provided borrowers with payment holidays during the pandemic. If the current guidance is not amended, any future payment delays in the remaining life of the loan that may have otherwise been considered insignificant would not be able to elect to exclude those modifications from the disclosures. An additional example would be in the context of a 30-year residential mortgage, a borrower may live in an area that experiences natural disasters that are spaced many years apart. Even absent the pandemic, providing insignificant payment delays many years ago may preclude an entity from electing to exclude a current modification with similar insignificant payment delay from the disclosures.

We suggest that a one-year threshold that is similar to the one in the guidance for modifications of debt in FASB ASC 470-50-40-12(f) should be incorporated into both FASB ASC 310-40-15-18 and FASB ASC 310-10-50-44. If FASB ASC 310-40 is superseded by the Proposed FASB ASU, the current guidance in FASB ASC Subtopic 310-20 would be applicable for all loan modifications. FASB ASC 310-20-35-11 makes specific reference to FASB ASC 470 for purposes of determining whether a modification of a debt instrument shall be considered more than minor. FASB ASC 310-20-35-11 states (emphasis added):

> "A modification of a debt instrument shall be considered more than minor under the preceding paragraph if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. If the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10 percent, a creditor shall evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification. **The guidance in Topic 470 shall be used to calculate the present value of the cash flows for purposes of applying the 10 percent test**."

FASB ASC Subtopic 470-50 provides guidance that a borrower would evaluate in determining whether the modification of its debt was substantial enough to conclude that the original debt is extinguished and replaced by newly issued debt. FASB ASC 470-50-40-10 provides that "[i]f the terms of a debt instrument are changed or modified and the cash flow effect on a present value basis is less than 10 percent, the debt instruments are not considered to be substantially different…" FASB ASC 470-50-40-12 provides detailed guidance on calculating the present value of cash flows for purposes of applying the 10 percent cash flow test described in FASB ASC 470-50-40-10. FASB ASC 470-50-40-12(f) states:

> "If within a year of the current transaction the debt has been exchanged or modified without being deemed to be substantially different, then the debt terms that existed a year ago shall

be used to determine whether the current exchange or modification is substantially different."

We believe a similar threshold should be applied in evaluating whether a delay in payment is insignificant. In other words, we believe proposed FASB ASC 310-10-50-44 should be modified as follows (marked to show changes):

> "If the debt has been ~~previously~~ restructured within a year of the current transaction, an entity shall consider the cumulative effect of the ~~past~~ restructurings that occurred within a year of each other when determining whether a delay in payment resulting from the most recent restructuring is insignificant."

We believe that the changes should also be made to FASB ASC 310-40-15-18, in addition to proposed FASB ASC 310-10-50-44 above, because we believe entities that have not yet adopted FASB ASU 2016-13 should be provided relief from the recognition and measurement of TDRs for insignificant delays in payment that occur between the date of adoption of the proposed FASB ASU and the date of adoption of FASB ASU 2016-13. We believe those entities should be provided the option to early adopt any changes to FASB ASC 310-40-15-18 prior to them adopting FASB ASU 2016-13.

Members of FinREC, the Expert Panel and AICPA staff would be pleased to discuss this comment at your convenience.

Sincerely,

Angela J. Newell
Chair
Financial Reporting Executive Committee

Linda Bergen
Chair
Depository Institutions Expert Panel