
**Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
National Credit Union Administration
Office of Thrift Supervision**

December 15, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
Post Office Box 5116
Norwalk, Connecticut 06856-5116

RE: File Reference No. 1880-100 – Proposed Accounting Standards Update, *Clarifications to Accounting for Troubled Debt Restructurings by Creditors*

Dear Sir:

We are pleased to provide comments on behalf of the staffs of the five federal financial institution regulatory agencies (the agencies) on the proposed Accounting Standards Update (ASU), *Clarifications to Accounting for Troubled Debt Restructurings by Creditors*. We appreciate the efforts of the Financial Accounting Standards Board (FASB) to address diversity in practice related to the identification and reporting of troubled debt restructurings (TDR).

The agencies support the ASU's clarifications that the application by creditors of TDR accounting literature intended for debtors is inappropriate and that an insignificant delay in cash flows, as referenced in Accounting Standards Codification (ASC) paragraph 310-10-35-17, does not preclude the application of TDR guidance. Similarly, we concur with the clarifications that temporary or permanent increases in contractual interest rates do not preclude a modification from being a TDR and with the application of TDR guidance when payment default is probable in the foreseeable future.

However, we are concerned that the ASU's proposed clarification regarding a borrower's inability to obtain similar financing at a market rate of interest may be interpreted in a manner that would result in many modifications, extensions, and renewals of loans in this situation being mischaracterized as TDRs without also assessing whether the borrower is experiencing financial difficulties. Accordingly, the agencies believe that, as written, the proposed guidance on the consequences of a borrower's inability to obtain similar financing would reduce the decision usefulness of the accounting for, and disclosure of, TDRs in financial statements and regulatory reports as further explained below.

We have also provided comments related to the transition requirements and other technical matters.

Interest Rates and Credit Availability

The agencies presume that the proposed ASU would not change the criteria required for a modification to be characterized as a TDR; namely, that the borrower is experiencing financial difficulties and a concession has been granted by the creditor. Determining whether these criteria have been met can

involve a significant amount of judgment and requires a consideration of all of the facts and circumstances surrounding the modification.¹ Accordingly, the agencies believe it is inappropriate to automatically conclude that a modification is a TDR when a borrower does not have access to funds at a market rate for debt with similar risk characteristics as the restructured debt.

However, as the proposed ASU is currently drafted, it is not clear how the availability of credit at a market rate plays a role in determining whether the renewal, extension, or other modification of a loan is a TDR. Under proposed paragraph 310-40-15-8A, a borrower's inability to access funds at a market rate for debt with similar risk could in and of itself mean that a restructuring of the borrower's debt should be considered a TDR. Recently, some otherwise creditworthy borrowers have found it difficult to obtain or renew credit and a "market rate" was often not readily determinable, if credit was available at all. Although these borrowers were not experiencing financial difficulties, current market conditions adversely affected their access to credit.

In contrast, the proposed ASU provides in paragraph 310-40-55-10A(f) that the inability of a borrower to obtain outside financing is one of several indicators that the creditor should consider in determining whether the borrower is experiencing financial difficulties at the time of a loan modification. Evaluating a loan modification under these conditions requires the exercise of judgment and a thorough analysis of the borrower's specific facts and circumstances to determine whether the borrower is experiencing financial difficulties as well as whether the creditor has granted a concession. Sole reliance on a lack of access to credit to trigger a TDR conclusion without considering current credit conditions and the borrower's situation, as proposed in paragraph 310-40-15-8A, increases the risk that loan modifications may be evaluated differently as market conditions change.

Because of this apparent drafting conflict within the ASU, we do not believe the FASB will fully achieve its goal of clarifying the accounting for TDRs. Therefore, the agencies urge the FASB to modify proposed paragraph 310-40-15-8A so that a restructuring is not automatically a TDR simply because a debtor does not have access to funds at a market rate for debt with similar risk characteristics as the restructured note. We recommend that paragraph 310-40-15-8A be revised as follows (new text is provided in bold and deleted text is struck out):

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 a below market rate and should be considered a troubled debt restructuring~~ **this is an indicator that the creditor should consider when determining whether a concession has been granted.**

Concessions Other Than Interest Rates

ASU paragraph 310-40-15-8B explains that a temporary or permanent increase in the contractual interest rate as part of a loan modification does not preclude the modification from being considered a TDR. The agencies suggest this should also be true for temporary or permanent changes to debt service requirements

¹ As explained in guidance on commercial real estate workout programs issued by the agencies in October 2009, "The determination of whether a restructured loan is a TDR requires consideration of all of the facts and circumstances surrounding the modification. No single factor, by itself, is determinative of whether a restructuring is a TDR. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean that the borrower is experiencing financial difficulties. Accordingly, lenders and examiners should use judgment in evaluating whether a modification is a TDR." (See page 11 of the Policy Statement on Prudent Commercial Real Estate Loan Workouts at <http://www.occ.treas.gov/news-issuances/bulletins/2009/bulletin-2009-128a.pdf>.)

associated with a loan modification, including changes in the loan term or principal amortization requirements. The agencies recommend revising this language to address any temporary or permanent concession, rather than focusing solely on a temporary or permanent change in the contractual interest rate.

Insignificant Delay in Cash Flows

As stated above, the agencies support the clarification provided in ASU paragraph 310-40-55-10C. The notion that a modification involving an insignificant delay in cash flows can be considered a TDR is consistent with our view. However, the concept of an “insignificant delay” may not be well understood by all entities. The agencies recommend the FASB include additional language in this proposed paragraph to add context and more clearly explain what is meant by an insignificant delay without providing a specific, bright-line measurement. For example, the first sentence of this paragraph could be restated as follows (new text is in bold):

A restructuring that results in an insignificant delay in contractual cash flows, **such as a temporary payment deferral or short-term extension or renewal**, may still be considered a troubled debt restructuring. **That is, the insignificant delay should be considered along with the other terms and conditions of a restructuring to determine whether a troubled debt restructuring exists.**

In many instances, loans with temporary payment deferrals or short-term extensions or renewals are underwritten with a stated interest rate that is lower than the current market rate for new debt with similar risk characteristics. The agencies also encourage the FASB to consider whether it would be meaningful for institutions to continue to treat these temporary or short-term restructurings as TDRs for disclosure and impairment measurement purposes for the entire remaining life of the loan, particularly if the loan reverts to its original terms, the borrower has demonstrated performance in accordance with the original terms after reversion, and continued performance is expected based on a current evaluation of the borrower’s condition.

Proposed Transition Requirements and Disclosures

The agencies request that the FASB carefully analyze the operational burden and cost associated with the retrospective application of the guidance in the proposal for TDR disclosures. We have concerns that institutions, particularly those that are small, will not have adequate access to prior information sufficient to determine whether prior modifications should have been considered TDRs had the clarifications been in effect at the time of the modification. Therefore, it would be beneficial to provide for prospective application of the proposed guidance for both disclosure and impairment measurement purposes. If prospective application for both disclosures and measurement were implemented, the FASB may be able to accelerate the effective date of the guidance.

If the FASB requires entities to retrospectively apply the proposed guidance for disclosure of TDRs, it is not clear how the proposed guidance will be incorporated into paragraphs 310-10-50-33 and 310-10-50-34 of Accounting Standards Update 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The agencies appreciate the FASB’s recent efforts to add a project to its agenda to consider changing the effective date for TDR disclosures required by ASU 2010-20 to coincide with the effective date of the proposed ASU to avoid the risk of subsequent changes to those disclosures pending the issuance of final clarifications to the accounting for TDRs. Nevertheless, institutions may still be challenged to explain how newly identified TDRs were incorporated into prior period allowance for loan and lease losses calculations and how that inclusion resulted in appropriate allowance balances in prior periods. There may also be limited quantitative and qualitative data available

for these prior period modifications to provide meaningful information by portfolio segment and class of financing receivable to financial statement users. The agencies are concerned that providing incomplete information will make the disclosures less transparent and institutions may incur unnecessary costs in their attempt to comply with these disclosure requirements.

Other Technical Clarifications

There is an apparent inconsistency between the scopes of ASC paragraphs 310-40-35-2 and 310-10-35-13 with respect to loans held for sale accounted for at the lower of cost or fair value. ASC paragraph 310-40-35-2 states that a “creditor shall account for a troubled debt restructuring...as prescribed in the following paragraphs. [These p]aragraphs ... do not apply to a receivable that the creditor is accounting for at market value in accordance with specialized industry practice.” Therefore, TDR accounting by a creditor would apply to loans held for sale that are carried at the lower of cost or fair value. In contrast, ASC paragraph 310-10-35-13 explains “this guidance applies to all loans ... except the following: ... b. Loans that are measured at fair value or at the lower of cost or fair value.” We encourage the FASB to use the opportunity created by this proposed update to resolve this apparent inconsistency by clarifying that loans held for sale that meet the definition of a TDR are subject to TDR disclosure requirements even though they are not subject to the impairment measurement requirements in ASC paragraph 310-10-35-13.

The agencies also encourage the FASB to review the use of the term “market value” in ASC paragraph 310-40-35-2 and consider changing this term to “fair value” to ensure consistent application of fair value guidance.

The agencies appreciate your consideration of our comments. We would be pleased to discuss our views on the proposed update with you further.

Sincerely,

Randall J. Black
Acting Chief Accountant
Office of the Comptroller of the Currency

Arthur W. Lindo
Senior Associate Director and Chief Accountant
Board of Governors of the Federal Reserve System

Robert F. Storch
Chief Accountant
Federal Deposit Insurance Corporation

Melinda Love
Director, Office of Examination and Insurance
National Credit Union Administration

Jeffrey J. Geer
Chief Accountant
Office of Thrift Supervision