FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: January 17, 2014
Comments Due: April 30, 2014

Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)

Classification of Certain Government-Guaranteed Residential Mortgage Loans upon Foreclosure

a consensus of the FASB Emerging Issues Task Force

This Exposure Draft of a proposed Accounting Standards Update of Topic 310 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. EITF-13F

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by April 30, 2014. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. EITF-13F
- Sending written comments to "Technical Director, File Reference No. EITF-13F, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Proposed Accounting Standards Update

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Comment Deadline: April 30, 2014

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Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Under certain government-sponsored loan guarantee programs, qualifying creditors can extend residential mortgage loans to borrowers with a guarantee that the creditor will be paid by the government if the borrower defaults. The most common government-sponsored program in the United States that provides a full guarantee of certain residential mortgage loans is the guarantee offered by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD).

U.S. generally accepted accounting principles on troubled debt restructurings provide guidance for situations in which a creditor obtains a debtor's assets in satisfaction of the receivable, including receipt of assets through foreclosure, but does not provide guidance specific to the classification or the measurement of foreclosed loans that are government guaranteed.

Currently, there is diversity in practice related to classification by creditors of government-guaranteed residential mortgage loans entitling a creditor to the full unpaid principal balance of the loan (fully-government-guaranteed residential mortgage loans), including those with an FHA guarantee, upon foreclosure. Some creditors reclassify those loans to real estate as with other foreclosed loans that do not have guarantees; others reclassify the loans to other receivables. The objective of this proposed Update is to reduce that diversity by addressing the classification of foreclosed residential mortgage loans held by creditors that are fully guaranteed under certain government programs. Greater consistency in classification of such guaranteed loans upon foreclosure is expected to provide more decision-useful information about a creditor's foreclosed residential mortgage loans that are expected to be recovered through government guarantees.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect creditors that extend certain fully-government-guaranteed residential mortgage loans, including those guaranteed by the FHA.

What Are the Main Provisions?

The amendments in this proposed Update would require that a residential mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the loan has both of the following characteristics:

a. The loan has a government guarantee that is not separable from the loan before foreclosure entitling the creditor to the full unpaid principal balance of the loan.
b. At the time of foreclosure, the creditor has the intent to make a claim on the guarantee and the ability to recover the full unpaid principal balance of the loan through the guarantee.

Upon foreclosure, the separate other receivable would be measured based on the current amount of the loan balance expected to be recovered under the guarantee.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Current U.S. GAAP provides guidance for situations in which a creditor obtains a debtor's assets in satisfaction of the receivable, including receipt of assets through foreclosure, but does not provide guidance specific to the classification of foreclosed loans that are fully-government-guaranteed. Current U.S. GAAP also does not provide guidance on determining the unit of account; that is, whether a single asset should be recognized or whether two separate assets should be recognized (real estate and a guarantee receivable). In practice, most creditors derecognize the loan and recognize a single asset. Some creditors recognize a nonfinancial asset (other real estate owned), while others recognize a financial asset (typically a guarantee receivable). Regardless of the classification of the asset, measurement of the asset in practice generally represents the amount recoverable under the guarantee. The amendments in this proposed Update would reduce diversity in practice by providing guidance on the classification and measurement of fully-government-guaranteed residential mortgage loans upon foreclosure.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied using the same transition method selected by the reporting entity for application of FASB Accounting Standards Update No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. If under

Update 2014-04 a reporting entity elects a modified retrospective basis of application by means of a cumulative-effect adjustment as of the beginning of the annual reporting period in which the guidance is effective, that method also would be applied to the guidance in this proposed Update. Under that method of transition, any reclassification to a separate other receivable at the date of adoption would be reflected as of the beginning of the current annual period presented. Prior periods would not be adjusted. If under Update 2014-04 a reporting entity elects a prospective transition method, that method also would be applied in adopting this proposed guidance for all foreclosures on government-guaranteed residential mortgage loans occurring after the effective date. Early adoption would be permitted. The effective date will be determined after the Task Force considers stakeholder feedback on the proposed Update.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not contain any guidance specific to the classification of foreclosed residential mortgage loans that are guaranteed by a government loan program.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree with limiting the scope of the guidance in the proposed Update to government-guaranteed residential mortgage loans for which the government guarantee is not separable from the loan and the creditor has the intent and ability to recover the full unpaid principal balance of the loan upon foreclosure? If not, please explain why and discuss the types of guaranteed mortgage loans that also should be addressed.

Question 2: Do you agree that a guaranteed residential mortgage loan within the scope of this proposed Update should be reclassified from loans to other receivables upon foreclosure (foreclosure as determined by paragraph 310-40-40-6)? If not, please explain why.

Question 3: The proposed amendments require a single unit of account to be recognized as other receivables upon foreclosure of loans within the scope of the proposed Update. The Task Force decided not to require disclosure of the amount expected to be recovered under the guarantee and the fair value less cost to sell of the real estate for such foreclosed loans. Would it be decision-useful for an entity to provide recurring disclosure of both the amount expected to be received under the government guarantee and the fair value less cost to sell of the foreclosed residential real estate? If yes, please explain why.

Question 4: Do you agree that the proposed amendments should be applied using the same method of transition applied for Update 2014-04, that is, either under the modified retrospective transition method (requiring a cumulative-effect adjustment as of the beginning of the annual reporting period in which the guidance is effective) or under the prospective transition method? If not, please explain why.

Question 5: Do you agree that the proposed amendments should apply to both public entities and nonpublic entities? If not, please explain why.

Question 6: Do you agree that an entity should be permitted to early adopt the proposed amendments?

Question 7: The Private Company Decision-Making Framework states that, generally, amendments should be effective one year after the first annual period for which public companies are required to adopt them and for interim periods thereafter. Should nonpublic entities have one additional year for implementation? Please explain why or why not.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 310-10

2. Add paragraph 310-10-40-1A and its related heading, with a link to transition paragraph 310-40-65-3, as follows:

Receivables—Overall

Derecognition

<u>**> Classification and Measurement of Certain Government-Guaranteed Residential Mortgage Loans upon Foreclosure**</u>

<u>**310-10-40-1A** For guidance on classification and measurement of certain government-guaranteed residential mortgage loans upon foreclosure by a creditor, see paragraphs 310-40-40-7A through 40-7B.</u>

Amendments to Subtopic 310-40

3. Add paragraphs 310-40-40-7A through 40-7B and their related heading, with a link to transition paragraph 310-40-65-3, as follows:

Receivables—Troubled Debt Restructurings by Creditors

Derecognition

> **Foreclosure**

> > Classification and Measurement of Certain Government-Guaranteed Residential Mortgage Loans upon Foreclosure

310-40-40-7A A guaranteed residential mortgage loan receivable shall be derecognized and a separate other receivable shall be recognized upon foreclosure, as determined by paragraphs 310-40-40-6 and 310-40-55-10A, if the loan has both of the following characteristics:

a. The loan has a government guarantee that is not separable from the loan before foreclosure entitling the creditor to the full unpaid principal balance of the loan.
b. At the time of foreclosure (as determined by paragraph 310-40-40-6), the creditor has the intent to make a claim on the guarantee and the ability to recover through the guarantee.

310-40-40-7B Upon foreclosure, the separate other receivable shall be measured based on the current amount of the loan balance expected to be recovered under the guarantee.

4. Add paragraph 310-40-65-3 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2014-XX, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Residential Mortgage Loans upon Foreclosure*

310-40-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-XX, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Residential Mortgage Loans upon Foreclosure:*

a. The pending content that links to this paragraph shall be effective for fiscal years and interim periods within those years beginning after [date to be inserted after exposure].
b. An entity shall apply the pending content that links to this paragraph using the same method of transition elected for application of Accounting Standards Update No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure,* in transition paragraph 310-40-65-2*:*
    1. If under Update 2014-04 a reporting entity elected a prospective transition method, the reporting entity also shall apply that method to the pending content that links to this paragraph. Any reclassification to a separate other receivable shall follow the guidance in the pending content that links to this paragraph for all foreclosures of certain government-guaranteed residential mortgage loans that occur after the date of adoption.

2. If under Update 2014-04 a reporting entity elected a modified retrospective transition method by means of a cumulative-effect adjustment as of the beginning of the annual reporting period for which that guidance is effective, the reporting entity also shall apply that method to the pending content that links to this paragraph. Any reclassification to a separate other receivable at the date of adoption shall be reflected as of the beginning of the current year presented.

c. Earlier adoption of the pending content that links to this paragraph is permitted.
d. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Under certain government-sponsored loan guarantee programs, qualifying creditors can extend residential mortgage loans to borrowers with a guarantee that the creditor will be paid by the government if the borrower defaults. The most common government-sponsored program in the United States that provides a full guarantee of certain residential mortgage loans is the guarantee offered by the FHA of the U.S. Department of HUD, which guarantees the mortgages on single-family and multifamily homes of low-income and first-time home buyers.

BC3. U.S. GAAP on troubled debt restructurings provides guidance for situations in which a creditor obtains a debtor's assets in satisfaction of the receivable, including receipt of assets through foreclosure, but does not provide guidance specific to the classification or the measurement of foreclosed loans that are government guaranteed. Recently, the Board issued Update 2014-04, which provides guidance on the timing of reclassification of residential mortgage loans to other real estate owned in the statement of financial position. That Update is intended to address diversity in practice across creditors related to the timing of reclassification of loans to foreclosed residential real estate but does not address specifically government-guaranteed residential mortgage loans.

BC4. Currently, there also is diversity in practice related to classification by creditors of fully-government-guaranteed residential mortgage loans, including those with an FHA guarantee, upon foreclosure. Some creditors reclassify those loans to real estate consistent with other loans without guarantees, while others reclassify the loans to other receivables. The objective of this proposed Update is to reduce diversity by addressing the classification of foreclosed residential mortgage loans held by creditors that are fully guaranteed under certain government programs. Greater consistency in classification of such guaranteed loans upon foreclosure is expected to provide more decision-useful information about a creditor's foreclosed residential mortgage loans that are expected to be recovered through government guarantees.

BC5. Government-guaranteed mortgage loans in the scope of this proposed Update are mortgages that represent a subset of residential mortgage loans in the scope of Update 2014-04. Loans in the scope of this proposed Update are extended by approved creditors, and those loans must meet certain requirements established by government programs in order to qualify. Currently, the most common government loan guarantee program in the United States is offered by the FHA.

Scope

BC6. The Task Force reached a consensus-for-exposure that the guidance in this proposed Update would apply to residential mortgage loans for which (a) there is a government guarantee that is not separable from the loan entitling the creditor to recover the full unpaid principal balance of the loan and (b) at the time of foreclosure the creditor has the intent and ability to recover under the guarantee. The Task Force determined that the scope of the proposed guidance should be based on the characteristics of the loan and the guarantee rather than on the particular features of a specific government program, since those programs can change over time.

BC7. The Task Force observed that this proposed Update would predominantly affect mortgage loans fully guaranteed by the FHA. The Task Force understands that most of the diversity in practice relates to the classification for FHA-guaranteed loans. Therefore, the Task Force noted that it was not necessary to consider other variations in loan guarantees available to creditors and that the scope of this proposed guidance should be limited to government programs with full guarantees. Additionally, the Task Force determined that the creditor at the time of foreclosure should have the intent and ability to recover under the guarantee on the basis that the accounting should be determined based on the economic substance (that the creditor will recover under the guarantee) rather than on the mere existence of the guarantee. A creditor would be considered to have the ability to recover under the guarantee at the time of foreclosure if the creditor determines that it has maintained compliance with the conditions and procedures required by the guarantee program. The Task Force decided that without such intent and ability, reporting entities should not be subject to the provisions of this proposed Update even if there is a guarantee on the loan, but that they should be subject to the provision of Update 2014-04.

Classification of Fully-Government-Guaranteed Residential Mortgage Loans upon Foreclosure

BC8. The Task Force reached a consensus-for-exposure that a creditor would reclassify a government-guaranteed residential mortgage loan for which the creditor has the intent and ability to recover the full unpaid principal balance of the loan to a separate receivable at the time of foreclosure. The Task Force determined that receivable classification was most appropriate upon foreclosure of loans within the scope of the proposed Update because the creditor has a guarantee which entitles it to make a claim for cash rather than selling the real estate. The Task Force considered several alternatives for classification. The Task Force considered whether upon foreclosure a creditor should separately recognize foreclosed real estate (for example, other real estate owned) measured at the fair value of the real estate less costs to sell in accordance with Subtopic 310-40 and a separate guarantee receivable measured as the difference between the carrying value of the real estate and the amount recoverable under the guarantee. The Task Force also considered whether the loan should be reclassified to other real estate owned as a single unit of account and measured based on the amount expected to be recovered under the guarantee.

BC9. The Task Force determined that, upon foreclosure, if the creditor does not intend to recover on the loan through sale of the real estate, and has the intent and ability to recover the full principal balance under the guarantee, it has no exposure to the value of the real estate collateralizing the loan and, therefore, the value of the real estate does not affect the amount the creditor expects to recover through the guarantee. The Task Force acknowledged that the creditor receives title to the real estate but noted that it is acting in a manner similar to an agent for the guarantor. Therefore, the Task Force decided that real estate presentation and accounting would not be appropriate. Furthermore, the Task Force noted that because the loan would not have been extended without the guarantee and the creditor intends to make a claim on the guarantee, the guarantee and the loan (and after foreclosure the guarantee and the real estate) should be recognized as a single unit of account both before and after foreclosure occurs.

BC10. The Task Force also considered whether the loan should not be reclassified (that is, whether it should remain classified as a loan) from the time of foreclosure until the guarantee claim is paid. The Task Force concluded that the asset held by the creditor no longer represents a loan because upon foreclosure the counterparty has changed from the original borrower to the guarantor. At the point of foreclosure, the creditor can no longer look to the borrower to recover on the loan but instead will look to the guarantee claim to recover on the loan. Accordingly, the Task Force decided that the loan would be reclassified to a separate receivable apart from loans at the time of foreclosure.

Disclosures

BC11. The Task Force considered whether entities should be required to disclose the full amount expected to be received under the guarantee and the fair value less cost to sell of the property collateralizing the government-guaranteed loans. The Task Force decided that such recurring disclosures would not be required because the creditor is not exposed to the changes in the fair value of the real estate collateralizing the loans. Therefore, the Task Force believes that the disclosures would not be decision-useful. The Task Force also noted that this disclosure requirement would be inconsistent with the basis for the decision to require reclassification of the foreclosed loan to a receivable rather than to real estate.

Transition and Effective Date

BC12. The Task Force reached a consensus-for-exposure that the amendments in this proposed Update would be applied using the same transition method elected by a reporting entity that applies Update 2014-04. Update 2014-04 permits an entity to select (a) a modified retrospective transition method by means of a cumulative-effect adjustment as of the beginning of the annual reporting period for which the guidance is effective or (b) a prospective transition method.

BC13. The Task Force also considered whether a full retrospective transition method of application should be required. A full retrospective transition method generally achieves the greatest consistency of reported information across reporting periods. However, in this case, the Task Force observed that because the loans addressed in this proposed Update represent a subset of the loans addressed by Update 2014-04, applying this guidance to periods before the period that Update 2014-04 is applied could result in reclassification of certain foreclosed real estate that should not have been initially reclassified out of loans. Therefore, the Task Force concluded that aligning the transition methods for this proposed Update and Update 2014-04 would achieve greater consistency in reported information and would reduce complexity in the initial application of this proposed Update.

BC14. The Task Force will determine the effective date after it considers stakeholder feedback on the proposed Update including feedback on the effective date for nonpublic entities based on the Private Company Decision-Making Framework. That framework states that based on private company resource limitations and the learning cycle, generally the amendments in an FASB Accounting Standards Update should be effective for private entities one year after the first annual period in which public companies are required to adopt them and for interim periods thereafter.

BC15. The Task Force also decided that early adoption would be permitted but acknowledged that the timing of adoption would not necessarily align with Update 2014-04.

Benefits and Costs

BC16. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC17. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update because the proposed amendments primarily relate to classification and therefore do not require significant judgments with respect to recognition and measurement. The proposed amendments would provide the benefit of improving application of U.S. GAAP by resolving diversity in practice in classifying and measuring foreclosed loans in the scope of this proposed Update.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). We welcome comments on these proposed changes to the UGT at ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the UGT will be made available for public comment at www.fasb.org and finalized as part of the annual release process.