FASB FINANCIAL ACCOUNTING STANDARDS BOARD

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MEMO

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Project	**Transition Resource Group for Credit Losses**
Project Stage	**Post-Issuance**
Issue(s)	**Accounting for Troubled Debt Restructurings**

Memo Purpose

1. Some stakeholders informed the staff that there is a lack of clarity on the accounting for troubled debt restructurings (TDRs) when assessing credit losses under the amendments in Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

2. This memo summarizes the implementation questions and provides staff analyses of those issues. The staff will seek input from members of the Transition Resource Group for Credit Losses (TRG) on these implementation questions.

Question for the TRG Members
1. Which view do the TRG members agree with?

Issue Background

Accounting for TDRs

3. The amendments in Update 2016-13:

   (a) Retain the concept of a TDR

(b) Do not change the criteria used to determine whether a modification of a financial asset constitutes a TDR

(c) Continue to require a TDR to be accounted for as a continuation of the original financial asset when identified.

4. Under current GAAP, if a creditor determines, on the basis of current information and events, that it is probable it will be unable to collect all amounts due according to the contractual terms, an individual loan is deemed impaired. Once a loan is deemed impaired, the creditor is required to measure the individually impaired loan using the present value of expected future cash flows discounted at the loan's effective interest rate, assuming the creditor does not apply one of two available practical expedients (that is, the loan's observable market price or the fair value of the loan's collateral if collateral dependent). Impaired loans are sometimes restructured, and at that time the creditor is required to assess whether the restructure is a TDR.

5. For certain loans (for example, large groups of smaller balance homogeneous loans) that are collectively evaluated for impairment, creditors are exempt from identifying individual loans as impaired, and, therefore, an individual loan's status as impaired is determined at the time of restructuring. Consequently, all TDRs are considered impaired loans under current GAAP.

6. The amendments in Update 2016-13 eliminated the concept of an individually impaired loan that was previously codified in paragraph 310-10-35-16 because that concept is no longer relevant under the amendments. The concept of an individually impaired loan under current GAAP relies on general concepts codified in paragraph 310-10-35-4 that will be superseded by the amendments in Update 2016-13 when they become effective. Specifically, paragraph 310-10-35-4(b) states the following:

> Losses shall not be recognized before it is **probable that they have been incurred**, even though it may be probable based on past experience that losses will be incurred in the future. It is inappropriate to consider possible or expected future trends that may lead to additional losses. Recognition of losses shall not be deferred to periods after the period in which the losses have been incurred. [Emphasis added.]

7. The elimination of the individually impaired loan concept under the amendments in Update 2016-13 further necessitated the elimination of specific impaired loan measurement guidance provided in Subtopic 310-10, *Receivables—Overall,* because all measurement guidance for expected credit losses of financial assets recorded at amortized cost is provided for under the amendments, which allow various measurement methodologies. This is illustrated by paragraph 326-20-30-3, which states:

> The allowance for credit losses may be determined using various methods. For example, an entity may use discounted cash flow methods, loss-rate methods, roll-rate methods, probability-of-default methods, or methods that

utilize an aging schedule. An entity is not required to utilize a discounted cash flow method to estimate expected credit losses. Similarly, an entity is not required to reconcile the estimation technique it uses with a discounted cash flow method.

8. The amendments in Update 2016-13 do not change the concept that a TDR is a continuation of the original loan. The amendments focus on conforming the guidance by eliminating references to the individually impaired loan concept and directing the reader to the new amendments for purposes of overall credit loss measurement. Revised paragraphs 310-40-35-10 and 310-40-35-12 state the following:

> **310-40-35-10** A loan restructured in a troubled debt restructuring shall not be accounted for as a new loan because a troubled debt restructuring is part of a creditor's ongoing effort to recover its investment in the original loan. Topic 326 provides guidance on measuring credit losses on financial assets and requires credit losses to be recorded through an allowance for credit loss account, including concessions given to the borrower upon a troubled debt restructuring.
>
> **310-40-35-12** The effective interest rate for a loan restructured in a troubled debt restructuring is based on the original contractual rate, not the rate specified in the restructuring agreement. As indicated in paragraph 310-40-35-10, a troubled debt restructuring does not result in a new loan but rather represents part of a creditor's ongoing effort to recover its investment in the original loan. Therefore, the interest rate used to discount expected future cash flows on a restructured loan shall be the same interest rate used to discount expected future cash flows on the original loan.

9. Additionally, the Board did not intend to require a specific methodology for measuring TDRs. This is evidenced by the discussion in paragraph BC105 of Update 2016-13, which states, in part:

> Separately, the Board rejected an approach that would have required expected credit losses on troubled debt restructurings to always be measured by using a discounted cash flow method on an individual basis because such a requirement would be inconsistent with the ability to estimate expected credit losses using approaches other than a discounted cash flow method for assets measured at amortized cost. This decision allows entities to assess credit risk on troubled debt restructurings individually, or in a pool using other expected credit loss methods such as loss rates….

Issue Description

10. Paragraph 326-20-30-6 states:

> 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 it has a reasonable expectation at the reporting date that it will execute a troubled debt restructuring with the borrower.** [Emphasis added.]

11. The addition of paragraph 326-20-30-6 (in particular, the last sentence) coupled with the elimination of the concept of an individually impaired loan as discussed above, has caused stakeholders to question the accounting for TDRs within the amendments in Update 2016-13. The primary issue underlying stakeholder questions is:

    (a) Should entities forecast all types of reasonably expected future TDRs on a portfolio basis and include the effect of those reasonably expected TDRs in the calculation of expected credit losses?

Stakeholder Feedback

12. Stakeholders' questions tend to focus on the Board's intent of the last sentence in paragraph 326-20-30-6. The interpretation of the last sentence in that paragraph could have a significant effect on the allowance for credit losses. Some stakeholders note that the last sentence was only intended to extend the credit loss measurement period in cases in which credit losses are expected to occur after the stated contractual maturity of a financial asset when a potential TDR is specifically identified, while others said that the Board intended to communicate a broader principle that requires forecasting future TDRs before they can be specifically identified.

13. If it is the Board's intent to forecast future TDRs that affect the contractual term before they are specifically identified, the assessment of a reasonable expectation of executing a TDR would be performed on a portfolio basis. When assessed on a portfolio basis, an entity may be able to reasonably predict a specific level, or percentage, of TDRs that will occur in the future. Stakeholders expect this approach would result in accelerated recognition of the effect of future TDRs as compared with when the assessment is made on an individual financial asset basis because entities would generally not be able to reasonably expect individual TDRs until the borrower is experiencing financial difficulty.

14. For TDRs that do not affect the contractual life of an asset, stakeholders note that there are several factors that may already be incorporated in historical loss information or otherwise considered in an entity's allowance estimation methodology, which include the following:

    (a) Loss rates may be lower because TDRs would be expected to reduce losses.

    (b) The value of certain concessions may be reflected in historical loss amounts.

Stakeholders have raised the question of whether entities need to consider such effects of reasonably expected TDRs when estimating losses over the contractual term based on historical loss information, adjusted for current conditions and reasonable and supportable forecasts.

15. Finally, some stakeholders have expressed concerns over the potential unintended consequences of concluding that reasonably expected TDRs should be forecast on a portfolio basis and including the effects of those future TDRs in the calculation of expected credit losses. Specifically, some suggest that it would not be appropriate to calculate the allowance for credit losses on any portfolio of financial assets using a method other than discounted cash flows because future TDRs could include interest rate concessions that can only be properly captured through a discounted cash flow approach. Moreover, if a method such as a loss-rate approach is utilized, these stakeholders argue it would need to be supplemented with an overlay based on discounted cash flows (or another method that reasonably approximates a discounted cash flow method).

16. The staff's discussions and outreach have identified two views for the TRG to consider:

    (a) View A: Entities should include the effect of reasonably expected TDRs that do not extend the contractual term in their estimate of credit losses (for example, interest rate concessions). Entities also should forecast reasonably expected TDRs that extend the contractual term on a portfolio basis and include the effect of those reasonably expected TDRs in the calculation of expected credit losses.

    (b) View B: Entities should include the effect of reasonably expected TDRs that do not extend the contractual term in their estimate of credit losses (for example, interest rate concessions). Entities should extend the term over which they are measuring credit losses when a TDR is reasonably expected at an individual financial asset level (that is, the loan for which a TDR is expected can be specifically identified) and include the effect of that reasonably expected TDR in the calculation of expected credit losses.

17. Supporters of View A note that the projection of future TDRs on a portfolio basis is consistent with the objective of the amendments in Update 2016-13 in that it is a forward-looking approach and it will ensure that recognition of expected credit losses will not be deferred because the loss is expected to occur after the stated maturity of the financial asset. They add there would be no reasonable basis to project future TDRs on an individual financial asset that would delay recognition of credit losses until just before the execution of a restructuring; therefore, these stakeholders argue that an individual financial asset approach would not appear to meet the objective of paragraph 326-20-30-6. They said that most entities will have sufficient historical information on TDRs, which, along with current conditions and reasonable and supportable forecasts, will enable them to reasonably project a certain level (or percentage) of TDRs within a specific portfolio. However, while predicting a level of future TDRs is possible, in absence of specific modification programs, it is acknowledged that it will be difficult for entities to predict the nature and therefore effect of future modifications for some portfolios.

18. Supporters of View B note that the projection of future TDRs should be performed on an individual financial asset basis, which is consistent with the statement in paragraph 326-20-30-6 on executing a troubled debt restructuring with "the borrower." These stakeholders add that the objective of paragraph 326-20-30-6 is to limit the estimation of credit losses to the contractual term except in limited situations (that is, when an expected TDR can be specifically identified) to avoid requiring a "life of relationship" estimate. If the contractual term is extended on the basis of portfolio-level forecasts of TDRs, these stakeholders note that the estimate of credit losses would be one step closer to a "life of relationship" approach, which the Board was trying to avoid.

19. Supporters of View B also note that an individual financial asset approach is consistent with the guidance in paragraph 326-20-55-33 for removing specific financial assets from a larger pool. That is, once there is sufficient information to conclude that an individual borrower is experiencing financial difficulties and to reasonably determine the nature of the modification, the individual financial asset may be removed from the larger pool and evaluated separately. View B supporters also said that if TDRs must be forecasted on a portfolio basis, there may be no need to remove the financial assets from the larger portfolio when the modification occurs because the credit risk effect of such modifications would already be captured in the allowance for credit losses for the larger portfolio. Alternatively, the portfolio approach may suggest that certain financial assets within the larger portfolio should have been separately evaluated from inception but there would be no reasonable basis to identify the specific financial assets within the larger portfolio that will be modified.

Staff Analysis

20. The staff thinks that an entity should consider in the estimate of credit losses all reasonably expected TDRs that do not extend the contractual term. While the language in paragraph 326-20-30-6 establishes the circumstances in which an entity may consider extensions to the contractual term of a financial asset, the language was not intended to limit the types of TDRs an entity should consider when calculating expected losses. The staff thinks that the effect of these types of TDRs would need to be considered to comply with paragraphs 326-20-30-7 through 30-9, which require entities to consider available information that is relevant to assessing the collectability of cash flows. Additionally, it is clear in paragraph 310-40-35-10 that a creditor should consider all concessions as part of the application of Topic 326 when calculating expected credit losses. Paragraph 310-40-35-10 states the following:

> A loan restructured in a troubled debt restructuring shall not be accounted for as a new loan because a troubled debt restructuring is part of a creditor's ongoing effort to recover its investment in the original loan. Topic 326 provides guidance on measuring credit losses on financial assets and requires credit losses to be recorded through an allowance for credit loss account, **including concessions given to the borrower upon a troubled debt restructuring.** [Emphasis added.]

21. The staff acknowledges that for some portfolios the consideration of TDRs may be embedded in historical loss information and therefore the explicit consideration of TDRs that do not extend the contractual term may be a distinction without a difference for purposes of recognizing expected credit losses. For example, when evaluating a credit card portfolio that does not employ a nonaccrual policy, historical loss rates will likely already capture losses because of TDRs. However, a TDR assessment may or may not have a significant effect on an entity's process for other portfolios. For example, when evaluating an auto loan portfolio an entity may not regularly employ the use of TDRs as a loss mitigating strategy since the underlying collateral can easily be repossessed, and, therefore, reasonably expected TDRs may have little effect. Alternatively, for a mortgage portfolio an entity may have historically, for a specific period of time for specific reasons, extensively used TDRs as a loss mitigating strategy and therefore would need to determine if it plans to continue to use such a strategy given reasonable and supportable forecasts.

22. Additionally, some stakeholders have questioned the meaning of the term *reasonable expectation*. Specifically, stakeholders have questioned whether the Board intended for the term to be interpreted in the same manner as "reasonable and supportable." While the staff acknowledges that there is no formal definition of "reasonable expectation" contained within the amendments in Update 2016-13, the staff would expect entities to apply the same level of judgment that is applied for forward-looking information for reasonable and supportable forecasts.

23. Regarding the consideration of TDRs that extend the contractual term, the staff acknowledges the different points of view on the intent of the last sentence in paragraph 326-20-30-6. In the staff's view, the primary question is whether potential TDRs must be specifically identified to be "reasonably expected." Under View A, the contractual term can be extended without specifically identifying TDRs, which would result in earlier recognition of loss but would introduce more complexity and may result in an approach that is closer to a "life of relationship." Under View B, the term would only be extended when a TDR can be specifically identified, which would result in later recognition of credit losses relative to View A but would better portray estimated credit losses over the prescribed measurement period, which is the contractual term. The staff notes that both views may be consistent with the overall intent of the amendments in Update 2016-13.

24. View A is consistent with the forward-looking aspect of the amendments and is based on a collective evaluation when similar risk characteristics exist, which is a fundamental requirement of the amendments. Moreover, the staff understands that there is a concern by some stakeholders that View B appears to reintroduce a threshold for recognizing losses similar to that which was eliminated as part of superseding the concept of an individually impaired loan as discussed in paragraphs 6 and 7 above. This issue becomes particularly acute in the context of short-term commercial loans that continuously renew and in some instances result in TDRs in the future. Some would consider waiting until an individual borrower experiences financial difficulty before recognizing an amount associated with a TDR

to be inconsistent with the requirements of the amendments when history would suggest that a portion of a portfolio could potentially experience TDR activity resulting in additional losses. Others would argue that specific identification is consistent with TDR accounting and that any threshold has been removed because contractual terms are extended and expected losses are measured when a TDR is reasonably expected as opposed to when it is executed.

25. View B is consistent with the objective of limiting the estimate of credit losses to the contractual term except in limited cases, thereby avoiding a "life of relationship" measurement approach. View B maintains a key component of the amendments in Update 2016-13, which is that a contractual term is a substantive negotiated feature of the contract that exists for the benefit of both the lender and borrower. The contractual term provides the lender the ability to demand repayment and the borrower with the ability to pay off amounts owed and decide whether to obtain financing from another source. When an individual loan is reasonably expected to become a TDR, the contractual term of that loan becomes less relevant because the lender is likely to offer a concession to maximize recovery of the original amount lent. However, if forecasted TDRs within a pool of assets cannot be specifically identified it is difficult to conceptually justify altering the contractual term.

26. View B highlights that the unit of account for a TDR is the individual loan because restructurings occur with specific borrowers. Consequently, TDR accounting reflects the concession that has been granted to a specific borrower. Therefore, by extension, if the accounting for a TDR is performed at the individual loan level when executed, a reasonable expectation of the restructuring also would be performed at the individual loan level.

27. The staff notes that View A could be considered inconsistent with other areas where loss estimates are limited because of the contractual term (that is, the exposure period). For example, unconditionally cancellable obligations to extend credit essentially have no contractual term for the unfunded amount because the entity does not have a present obligation to extend credit. The Board determined that if there is no present obligation to extend credit, there can be no contractual term, and, therefore, no allowance may be recorded even though some entities may assert they will experience losses on these exposures. View A highlights this inconsistency because historical TDR experience would extend the contractual term, but historical information on unconditionally cancellable obligations would not extend the contractual term. The staff thinks that if View A is allowed, the extension of the contractual term should not be analogized to any other situations outside of reasonably expected TDRs (that is, TDRs are actively used as a loss mitigating strategy) and the term *reasonably expected* should be applied in the same manner as "reasonable and supportable."

28. The staff notes that some arguments put forth against projecting TDRs on a portfolio basis have tended to focus on specific "knock-on effects" that may be created by this interpretation. The staff would like to address each of these "knock-on effects" in the following discussion.

29. First, some stakeholders suggest that forecasting reasonably expected TDRs on a portfolio basis would be inconsistent with paragraph 326-20-55-33, which states the following:

> An entity may estimate expected credit losses for some financial assets on a collective (pool) basis and may estimate expected credit losses for other assets on an individual basis when similar risk characteristics do not exist. As a result, the method used to estimate expected credit losses for a financial asset may change over time. **For example, a pool of homogeneous loans may initially use a loss-rate method, but certain individual loans no longer may have similar risk characteristics because of credit deterioration.** When a financial asset no longer shares similar risk characteristics with the original pool of financial assets, an entity should evaluate that financial asset to determine whether it shares risk characteristics similar to other pools of loans. Expected credit losses of that financial asset should be measured individually if there are no similar risk characteristics with other loans. A discounted cash flow approach is one method to estimate expected credit losses of individual loans, but it is not a required method. Paragraphs 326-20-55-34 through 55-36 illustrate those concepts. [Emphasis added.]

30. The staff thinks forecasting reasonably expected TDRs on a portfolio basis can be considered an acceptable approach consistent with the guidance highlighted in paragraph 29 above because it could be viewed as similar to forecasting any future reasonable and supportable loss on a collective basis. Forecasting reasonably expected TDRs may be viewed different from the specific identification of a TDR at the individual loan level, which could be consistent with the guidance for all other losses. For example, an entity may have a pool of loans with similar risk characteristics for which it uses historical information, adjusted for current conditions, and reasonable and supportable forecasts to calculate expected losses. Additionally, the entity also may have historical information that would suggest that a percentage of the portfolio results in restructuring activities that would meet the definition of a TDR. In considering this additional information for TDRs, the entity should consider making an adjustment to the overall expected loss calculation to recognize the effect of the reasonably expected TDRs. Once credit deterioration is identified at the specific loan level, at that point an evaluation may conclude that the individual loan does not exhibit the same risk characteristics as the remaining pool of loans and thus the loan would be either individually accounted for or pooled together with other loans of similar credit quality. It is also likely that at the same time restructuring activities take place that could meet the definition of a TDR, and when identified, the loan losses at the pool level would be adjusted to reflect the specific identification in much the same way an adjustment would be made if the loan were not a TDR but exhibited different risk characteristics.

31. While the previous paragraph provides an example of a pool of loans whereby individual loans are identified as TDRs, the staff acknowledges this identification also could happen for a group of loans,

particularly if the creditor has established programs whereby groups of borrowers are restructured together.

32. Finally, some stakeholders note that an interpretation that requires forecasting all types of reasonably expected TDRs on a portfolio basis will ultimately require entities to use a discounted cash flow model for calculating expected credit losses for all portfolios. Those stakeholders add that when a discounted cash flow method is utilized, the estimate of expected credit losses explicitly considers the present value of principal and interest cash flows that are not expected to be collected whereas other methods do not. When other methods are utilized, the historical charge-off information used as the starting point for estimating credit losses does not explicitly capture the time value of money and only "lost" interest cash flows that have been accrued into the carrying amount of the financial asset are captured as losses. Consequently, the interest cash flows captured in the loss information are affected by an entity's nonaccrual accounting policy. For example, if an entity ceases to accrue interest at a set number of days past due, the charged-off amounts may only include uncollected interest cash flows for the days before the nonaccrual period.[1] In absence of an alteration of the method used to calculate expected credit losses for these types of modifications, there would be no specific effect on the allowance for credit losses.

33. The staff notes (as highlighted in paragraph 7 above) that the amendments in Update 2016-13 do not require the use of or reconciliation to a discounted cash flow methodology. Additionally, and as noted in paragraph 9 above, the basis for conclusions in Update 2016-13 emphasizes the decisions codified in the amendments by highlighting that the Board concluded that specifying a methodology for TDRs would be "inconsistent with the ability to estimate expected credit losses using approaches other than a discounted cash flow method for assets measured at amortized cost" and the "decision allows entities to assess credit risk on troubled debt restructurings individually, or in a pool using other expected credit loss methods such as loss rates."

34. The staff acknowledges that to date it is not aware of a new methodology that has been developed beyond a discounted cash flow method to *explicitly* capture future interest amounts that have been given up as part of an interest rate concession (that is, for those TDRs that have been executed). However, the staff does not think it was the Board's intent to explicitly and precisely capture an interest rate concession as part of the estimate for expected credit losses when forecasting reasonably expected TDRs. The staff thinks that the Board understands that the precision of any estimation will be based on the way in which TDR loss history has been captured. That is, TDR loss data has likely been captured through charge-off data or by directly affecting the loss rate that may be lower because of

[1] Alternatively, if the entity's policy is to reverse the accrued interest from recognized interest income, the charge-off amounts will not include any accrued interest.

TDR activity. Additionally, different methodologies may be applied over time that may be indirectly affected by nonaccrual policies or choices of practical expedients.

35. The staff bases the above rationale on the fact that the amendments in Update 2016-13 purposefully allow for flexibility with an expectation that there will be differences in estimates from entity to entity depending upon several factors. This is evidenced by paragraph BC50 in the Update, which states the following:

> The Board acknowledges that any approach to estimating the collectibility of financial assets is subjective. The Board has permitted entities to estimate expected credit losses using various methods because the Board believes entities manage credit risk differently and should have flexibility to best report their expectations. The Board recognizes that different methods may result in a range of acceptable outcomes. Given the subjective nature of this estimate and certain fact patterns, one methodology's consideration of time value may have a more direct impact on the estimate of expected credit losses than other methods. Some entities may be able to forecast over the entire estimated life of an asset, while other entities may forecast over a shorter period. The complexity of the portfolio, size of the entity, access to information, and management of the portfolio may result in approaches with varying degrees of sophistication. Because entities may have different levels of sophistication, the Board did not prescribe one type of methodology for measuring expected credit losses for financial assets measured at amortized cost. The Board concluded that different outcomes for expected credit losses due to these and other factors are acceptable under the amendments in this Update. Furthermore, using terms such as *reasonable* and *supportable* does not imply a single conclusion or methodology upon which an entity must base its estimate. Different parties using different methodologies do not make a particular estimate unreasonable. While the range of reasonable outcomes is not unlimited, the Board concluded that it is rare that there will only be one acceptable choice in estimating credit losses. Estimates of credit losses may not precisely predict actual future events and, therefore, subsequent events may not be indicative of the reasonableness of those estimates.

36. Moreover, with respect to the discounted cash flow method, the Board stated the following in paragraph BC61:

> The Board observed that upon origination the amortized cost basis of a financial asset is equal to principal and interest cash flows discounted at the original effective interest rate. As a result, the amortized cost amount implicitly reflects the time value of money. The amendments in this Update do not require that a discounted cash flow model be used that explicitly considers the time value of money. An entity should have the flexibility to utilize estimation techniques that are practical and relevant to its circumstance. For example, an entity may develop loss statistics on the basis of the amortized cost amount

> written off and use those loss statistics to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Methods that indirectly consider the time value of money may include loss-rate methods, rollrate methods, probability-of-default methods, and an aging schedule using loss factors. Although there may be a range of acceptable outcomes between the various models based on assumptions utilized, the Board decided that methods using amortized cost information are acceptable because the amortized cost basis of a financial asset implicitly reflects the time value of money.

37. Consequently, the staff does not think the Board intended to explicitly or precisely capture interest rate concessions for reasonably expected TDRs in the same manner as a discounted cash flow method. Rather, the Board would like entities to consider reasonably expected TDRs in the calculation of expected credit losses. For example, an entity might consider the following questions when evaluating TDRs (not considered all-inclusive):
    (a) Do the loss rates used to calculate expected credit losses already contain TDR concessions embedded within the loss history?
    (b) Does the entity have a program for restructuring groups of small homogeneous loans, and do those programs contain loss history that would be useful for projecting future concessions?
    (c) For particular products that typically renew on a short-term basis, would history suggest that a portion of the portfolio will be restructured through TDRs?
    (d) Does the entity reasonably expect to use TDRs that may have been used historically for specific reasons over specific periods as a loss mitigating strategy over the reasonable and supportable forecast period?

Staff Recommendation

38. The staff does not object to either view but prefers View B and would like to obtain feedback from the TRG members. While the staff thinks that either view may be consistent with the overall intent of the amendments in Update 2016-13, the staff thinks that View A may result in the estimate being over a longer time horizon, which may add more complexity and subjectivity to the estimate, particularly when it applies to performing loan pools. Additionally, the staff thinks that TDR accounting applies an identification process to a specific financial asset that is not a portfolio assessment but, rather, a loan-by-loan assessment. Therefore, the staff thinks that to reasonably expect a TDR, the same process should apply. That process of identification of expected TDRs will allow for earlier recognition of expected losses when compared with actual execution. If View A is allowed, the extension of the contractual term should not be analogized to any other situations outside of reasonably expected TDRs and the term *reasonably expected* should be applied in the same manner as "reasonable and supportable." The staff thinks that View B would be more operable and more consistent with other areas

such as unconditionally cancellable obligations but acknowledges that this view may result in potentially lower reserves under the amendments in Update 2016-13 when compared with the current measurement of incurred losses for certain product types (in particular, short-term commercial loans continuously renewed).

39. Additionally, the application of View A may involve additional cost and complexity compared with View B. Under View A, the collection and analysis of historical TDR data and the incorporation of this analysis into each period's estimate would represent another layer of the allowance estimate that would not be necessary under View B. Under View B, entities could likely leverage their current TDR identification processes to determine when individual assets are reasonably expected to be TDRs that extend the contractual term.