FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: November 19, 2018
Comments Due: December 19, 2018

Codification Improvements—Financial Instruments

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 326, Topic 815, and Subtopic 825-10 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2018-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

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

The Board invites comments on all matters in this Exposure Draft until December 19, 2018. 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 comments to director@fasb.org, File Reference No. 2018-300
- Sending a letter to "Technical Director, File Reference No. 2018-300, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

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. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Codification Improvements—Financial Instruments

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

Over the last several years, the Board has issued the following Accounting Standards Updates related to financial instruments:

1. Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*
2. Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*
3. Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.

Since the issuance of each Update, the Board has assisted stakeholders in the implementation of the amendments within those Updates. Through this assistance, the Board has identified certain areas that require clarification and correction.

The Board has an ongoing project on its agenda for improving the Codification or correcting its unintended application. The items addressed in that project generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. The amendments in this proposed Update are similar to those items. However, the Board decided to issue a separate Update for improvements to Updates 2016-01, 2016-13, and 2017-12 to increase stakeholders' awareness of the amendments and to expedite the improvements.

The Board issued Update 2016-01 in January 2016. The amendments in that Update retained the current framework for accounting for financial instruments in generally accepted accounting principles (GAAP) but made targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. In addition to making amendments to Topic 825, Financial Instruments, the amendments in+ the Update added Topic 321, Investments—Equity Securities, and made several consequential amendments to the Codification.

The Board issued Update 2016-13 in June 2016. The amendments in that Update introduced the expected credit losses methodology for the measurement of credit losses on financial assets measured at amortized cost basis, replacing the previous incurred loss methodology. The amendments in the Update added Topic 326, Financial Instruments—Credit Losses, and made several consequential amendments to the Codification. The Update also modified the accounting for available-for-sale debt securities, which must be individually assessed for credit losses when fair value is less than the amortized cost basis, in accordance with Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities.

The Board issued Update 2017-12 in August 2017. The amendments in that Update made targeted improvements to the hedge accounting model with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in that Update made certain targeted improvements to simplify the application of hedge accounting guidance in current GAAP on the basis of the feedback received from preparers, auditors, users, and other stakeholders.

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

The amendments in this proposed Update would affect a variety of Topics in the Codification. A chart identifying the Topics (Subtopics), paragraphs, and the nature of the amendment being proposed is provided in the Amendments to the *FASB Accounting Standards Codification®* section.

The amendments in this proposed Update would apply to all reporting entities within the scope of the affected accounting guidance.

What Are the Main Provisions?

Topic 1: Codification Improvements Resulting from the June 11, 2018 Credit Losses Transition Resource Group (TRG) Meeting

The amendments to Topic 326 and other Topics in this proposed Update include items related to the amendments in Update 2016-13 discussed at the June 2018 Credit Losses TRG meeting. The proposed amendments clarify or address stakeholders' specific issues about certain aspects of the amendments in Update 2016-13 as described in the table below.

Area for Improvement	Summary of Proposed Amendments
Issue 1A: Accrued Interest The guidance in Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, contains	The proposed amendments to Topic 326 would allow an entity to:

specific guidance on the measurement, presentation, and disclosure of financial assets measured at amortized cost basis. Because the definition of *amortized cost basis* in the Codification includes accrued interest, the guidance in Subtopic 326-20 also applies to the accrued interest amounts included as part of the amortized cost of a related financial asset. Applying the guidance in Subtopic 326-20 to accrued interest as part of the amortized cost basis of a related financial asset potentially imposes unintended costs to implement Update 2016-13. The guidance in paragraph 326-20-35-8 requires that writeoffs of financial assets measured at amortized cost basis be deducted from the allowance for credit losses when the financial assets are deemed uncollectible. Because accrued interest is included in the definition of *amortized cost basis,* an entity would be required to write off accrued interest amounts through the allowance for credit losses. The application of the writeoff guidance in paragraph 326-20-35-8 to accrued interest potentially imposes unintended costs to implement Update 2016-13.	a. Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets and net investments in leases. b. Make an accounting policy election to present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets and net investments in leases on the balance sheet. If the accrued interest receivable balances and the related allowance for credit losses are not presented as a separate line item on the balance sheet, an entity would disclose the amount of accrued interest receivable balances and the related allowance for credit losses and where the balance is presented. c. Elect a practical expedient to separately disclose the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements in Subtopic 326-20. d. Make an accounting policy election to write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses. e. Make an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollectible accrued interest

	receivable balance in a timely manner.
Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities Subtopics 310-10, Receivables—Overall, and 948-310, Financial Services—Mortgage Banking—Receivables, provide guidance on how an entity should account for loans with various classifications. While a significant portion of that guidance was superseded by Update 2016-13, stakeholders questioned how to account for the allowance for credit losses or valuation allowance when transferring loans between classifications (that is, held-for-investment and held-for-sale classifications). Subtopic 320-10, Investments—Debt Securities—Overall, provides guidance on how an entity should account for transfers of debt securities between categories. Stakeholders questioned how to account for the allowance for credit losses or valuation allowance when transferring debt securities between the available-for-sale category and the held-to-maturity category.	The proposed amendments would require an entity to reverse any allowance for credit losses or valuation allowance previously measured on a loan or debt security, transfer the loan or debt security to the new classification or category, and apply the applicable measurement guidance in accordance with the new classification or category.
Issue 1C: Recoveries The guidance in paragraph 326-20-35-8 states that recoveries of financial assets and trade receivables previously written off should be recorded when received. Without proper clarification, stakeholders noted that this guidance could be interpreted to prohibit the inclusion of recoveries in the estimation of expected credit losses on financial assets measured at amortized cost	The proposed amendments would clarify that an entity should include recoveries when estimating the allowance for credit losses. The proposed amendments would clarify that recoverable amounts included in the valuation account should not exceed the aggregate of amounts previously written off and

basis. Furthermore, stakeholders questioned how an entity should account for an amount expected to be collected greater than the amortized cost basis.	expected to be written off by the entity. In addition, for collateral-dependent financial assets, the proposed amendments clarify that an allowance for credit losses, that is added to the amortized cost basis of the financial asset(s), should not exceed amounts previously written off.

Topic 2: Codification Improvements to Update 2016-13

The amendments to Topic 326 and other Topics in this proposed Update include items related to the amendments in Update 2016-13 brought to the Board's attention by stakeholders. The proposed amendments clarify certain aspects of the amendments in Update 2016-13 as described in the table below.

Area for Improvement	**Summary of Proposed Amendments**
Issue 2A: Conforming Amendment to Subtopic 310-40 Stakeholders noted that the cross-reference to paragraph 326-20-35-2 in Example 2 in Subtopic 310-40, Receivables—Troubled Debt Restructurings by Creditors, is incorrect. The illustration describes an entity that determines that foreclosure is probable on a collateral-dependent loan. Therefore, stakeholders asked whether the cross-reference should instead link to paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.	The proposed amendment would clarify the illustration by removing the incorrect cross-reference to paragraph 326-20-35-2 and replacing it with the correct cross-reference to paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.
Issue 2B: Conforming Amendment to Subtopic 323-10 Stakeholders noted that the guidance on equity method losses in paragraph	The proposed amendment would

323-10-35-26 was not amended in Update 2016-13. Specifically, the guidance describes the allocation of equity method losses when an investor has other investments, such as loans and debt securities, in the equity method investee. Stakeholders asked whether the guidance should refer an entity to Topic 326 for the subsequent measurement of those loans and debt securities.	clarify the equity method losses allocation guidance in paragraph 323-10-35-26 by adding cross-references to Subtopics 326-20 and 326-30 for the subsequent measurement of loans and available-for-sale debt securities, respectively.
Issue 2C: Clarification That Reinsurance Recoverables Are within the Scope of Subtopic 326-20 Stakeholders asked whether reinsurance recoverables measured on a net present value basis in accordance with Topic 944, Financial Services—Insurance, are within the scope of Subtopic 326-20. As written, the scope could be interpreted to exclude those recoverables because they are not measured at amortized cost basis.	The proposed amendment would clarify the Board's intent to include all reinsurance recoverables within the scope of Topic 944 within the scope of Subtopic 326-20, regardless of the measurement basis of those recoverables.
Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments Stakeholders asked whether the prohibition of using projections of future economic environments in estimating expected future cash flows and determining the effective interest rate to discount expected cash flow for variable-rate financial instruments was consistent with the Board's intent. As written, an entity that chooses to use a discounted cash flow method to determine expected credit losses on a variable-rate financial instrument is precluded from forecasting changes in the variable rate for the purposes of estimating expected cash flows and determining the effective interest rate	The proposed amendments would clarify the Board's intent to provide flexibility in determining the allowance for credit losses by removing the prohibition of using projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable-rate financial instruments. The proposed amendments would clarify that an entity should use the same projections or expectations of future interest rate environments in estimating expected cash flows and in determining the effective interest

with which to discount those cash flows.	rate used to discount those expected cash flows.
Issue 2E: Consideration of Prepayments in Determining the Effective Interest Rate Stakeholders asked whether an entity may adjust the effective interest rate used to discount expected cash flows in a discounted cash flow method for the entity's expectations of prepayments on financial assets. Stakeholders noted that expected prepayments are required to be considered in estimating expected cash flows. However, they noted that without incorporating those expected prepayments into determining the effective interest rate, the discounted cash flow calculation fails to appropriately isolate credit risk in the determination of an allowance for credit losses.	 The proposed amendments would permit an entity to make an accounting policy election to adjust the effective interest rate used to discount expected future cash flows for expected prepayments on financial assets within the scope of Subtopic 326-20 and on available-for-sale debt securities within the scope of Subtopic 326-30 to appropriately isolate credit risk in determining the allowance for credit losses. The proposed amendments also would clarify that an entity should not adjust the effective interest rate used to discount expected cash flows for subsequent changes in expected prepayments if the financial asset is restructured in a troubled debt restructuring.
Issue 2F: Consideration of Estimated Costs to Sell When Foreclosure Is Probable Stakeholders asked whether an entity is required to consider estimated costs to sell the collateral when using the fair value of the collateral to estimate expected credit losses on a financial asset because foreclosure is probable in accordance with paragraph 326-20-35-4. Stakeholders noted that the collateral-dependent financial asset practical expedient in paragraph 326-20-35-5 requires that an entity consider estimated costs to sell if repayment or satisfaction of the asset depends on the sale of the collateral.	 The proposed amendment would clarify the guidance in paragraph 326-20-35-4 by specifically requiring that an entity consider the estimated costs to sell if it intends to sell rather than operate the collateral when the entity determines that foreclosure on a financial asset is probable.

Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

The amendments to Topic 815 in this proposed Update include items related to Update 2017-12 and other hedge accounting items brought to the Board's attention by stakeholders. The amendments clarify certain aspects of Topic 815 as described in the table below.

Area for Improvement	Summary of Proposed Amendments
Issue 3A: Partial-Term Fair Value Hedges of Interest Rate Risk	
Stakeholders asked whether the ability to measure the hedged item in a partial-term fair value hedge using its assumed maturity date applies only to interest rate risk or whether the hedged item in a partial-term fair value hedge of both interest rate risk and foreign exchange risk also can be measured using the assumed partial-term maturity date. Additionally, stakeholders asked whether multiple partial-term fair value hedging relationships of a single financial instrument can be outstanding at the same time.	An entity may designate and measure the change in fair value of a hedged item attributable to both interest rate risk and foreign exchange risk in a partial-term fair value hedge. The proposed amendment also would clarify that one or more separately designated partial-term fair value hedging relationships of a single financial instrument can be outstanding at the same time.
Issue 3B: Amortization of Fair Value Hedge Basis Adjustments	
Because the amendments in Update 2017-12 added paragraph 815-25-35-9A, stakeholders asked whether the amortization of a fair value hedge basis adjustment is required for outstanding fair value hedging relationships. Stakeholders also asked for clarification of the amortization period to be used when amortizing the basis adjustment in a partial-term fair value hedging	The proposed amendment would clarify that an entity may, but is not required to, begin to amortize a fair value hedge basis adjustment before the fair value hedging relationship is discontinued. It also would clarify that if an entity elects to amortize the basis adjustment during an outstanding partial-term hedge, that basis adjustment should be fully amortized on or before the hedged item's assumed maturity date in accordance

relationship.	with paragraph 815-25-35-13B.
Issue 3C: Disclosure of Fair Value Hedge Basis Adjustments Stakeholders asked for clarification of the fair value hedge basis adjustment amounts required to be disclosed in accordance with paragraph 815-10-50-4EE. Specifically, stakeholders asked whether hedged available-for-sale debt securities should be disclosed at amortized cost or fair value and whether basis adjustments related to foreign exchange risk should be disclosed.	The proposed amendment would clarify that available-for-sale debt securities should be disclosed at their amortized cost and that fair value hedge basis adjustments related to foreign exchange risk should be excluded from the disclosures required by paragraph 815-10-50-4EE.
Issue 3D: Consideration of the Hedged Contractually Specified Interest Rate under the Hypothetical Derivative Method As a result of the amendment to paragraph 815-30-35-26 in Update 2017-12, stakeholders asked whether an entity should consider the contractually specified interest rate designated in the hedging relationship when applying the hypothetical derivative method.	The proposed amendment would clarify that an entity should consider the contractually specified interest rate being hedged when applying the hypothetical derivative method.
Issue 3E: Scope for Not-for-Profit Entities Stakeholders asked whether a not-for-profit entity that does not separately report earnings may elect the amortization approach for amounts excluded from the assessment of effectiveness under fair value hedge accounting. Stakeholders also asked whether the scope of Topic 815 in paragraph 815-10-15-1 was complete for entities that do not report earnings separately.	The proposed amendment would clarify that a not-for-profit entity that does not separately report earnings may not elect the amortization approach for amounts excluded from the assessment of effectiveness for fair value hedging relationships. The proposed amendment also would update the cross-references in paragraph 815-10-15-1 to further clarify the scope of Topic 815 for entities that do not report earnings separately.

Issue 3F: Hedge Accounting Provisions Applicable to Certain Private Companies and Not-for-Profit Entities	
Stakeholders asked when is a private company that is not a financial institution as described in paragraph 942-320-50-1 required to document the analysis supporting a last-of-layer hedge designation. Stakeholders also asked whether the same timing relief related to subsequent quarterly hedge effectiveness assessment provided to certain private companies in paragraph 815-20-25-142 may be applied to hedging relationships of not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market).	The proposed amendment would clarify that a private company that is not a financial institution as described in paragraph 942-320-50-1 should document the analysis supporting a last-of-layer hedge designation concurrently with hedge inception. The proposed amendment also would clarify that not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) should be provided with the same subsequent quarterly hedge effectiveness assessment timing relief provided to certain private companies in paragraph 815-20-25-142.
Issue 3G: Application of a First-Payments-Received Cash Flow Hedging Technique to Overall Cash Flows on a Group of Variable Interest Payments	
The amendments in Update 2017-12 removed the implementation guidance and illustration demonstrating the application of the first-payments-received cash flow hedging technique to overall cash flows on a group of variable interest payments. Consequently, stakeholders asked whether those deletions indicate that such a technique no longer is permitted.	The proposed amendment would clarify that the application of the first-payments-received cash flow hedging technique to overall cash flows on a group of variable interest payments continues to be permitted.

Issue 3H: Update 2017-12 Transition Guidance	
Paragraph 815-20-65-3(e)(1) indicates that transition adjustments to amend the measurement methodology of the hedged item in a fair value hedge of interest rate risk should be made as of the date of adoption of Update 2017-12.	The proposed amendment to paragraph 815-20-65-3(e)(1) would clarify that transition adjustments to amend the measurement methodology of the hedged item in a fair value hedge of interest rate risk should be made as of the date of initial application of Update 2017-12. The date of initial application differs from the date of adoption if an entity adopts Update 2017-12 in an interim period.
Stakeholders asked questions about the three transition requirements included in Update 2017-12. The questions are as follows:	The proposed amendments would clarify the following:
1. Whether other rebalancing approaches beyond dedesignating a portion of the hedged item are allowed for fair value hedging relationships of interest rate risk when an entity modifies the measurement methodology used for the hedged item from total contractual coupon cash flows to the benchmark rate component of the contractual coupon cash flows.	1. An entity may rebalance its fair value hedging relationships of interest rate risk when it modifies the measurement methodology used for the hedged item from total contractual coupon cash flows to the benchmark rate component of the contractual coupon cash flows by any combination of increasing or decreasing the designated notional of the hedging instrument or increasing or decreasing the designated proportion of the hedged item. However, the entity may not add new hedged items or hedging instruments to the hedging relationship.
2. Whether an entity may transition from a quantitative method of hedge effectiveness assessment to a method comparing the	2. An entity may transition from a quantitative method of hedge effectiveness assessment to a method comparing the hedging

hedging relationship's critical terms in accordance with paragraphs 815-20-25-84 through 25-85 or paragraph 815-20-25-129 without dedesignating the existing hedging relationship.	relationship's critical terms in accordance with paragraphs 815-20-25-84 through 25-85 or paragraphs 815-20-25-129 through 25-129A without dedesignating the existing hedging relationship if the guidance within those paragraphs is met.
3. Whether the reclassification of a debt security from held-to-maturity to available-for-sale in accordance with paragraph 815-20-65-3(e)(7): a. Calls into question an entity's assertion to hold to maturity those debt securities that continue to be classified as held-to-maturity. b. Whether a reclassified debt security is required to be designated in a last-of-layer hedging relationship. c. Whether an entity is prohibited from selling the security after reclassification.	3. A debt security reclassified from held-to-maturity to available-for-sale in accordance with paragraph 815-20-65-3(e)(7): a. Would not call into question an entity's assertion to hold to maturity those debt securities that continue to be classified as held-to-maturity. b. Is not required to be designated in a last-of-layer hedging relationship. c. May be sold by an entity after reclassification.

Topic 4: Codification Improvements to Update 2016-01

The amendments to Topic 321 and other Topics in this proposed Update relate to the amendments in Update 2016-01 brought to the Board's attention by stakeholders. The amendments clarify certain aspects of the amendments in Update 2016-01 as described in the table below.

Area for Improvement	Summary of Proposed Amendments
Issue 4A: Scope Clarifications for Subtopics 320-10 and 321-10	
Stakeholders noted that health and welfare plans accounted for in accordance with Topic 965, Plan Accounting, Health and Welfare	The proposed amendments would clarify the scope of Subtopics 320-10 and 321-10 by specifically naming health and welfare plans accounted

Benefit Plans, are not within the scope of either Subtopic 320-10 or Subtopic 321-10. However, stakeholders noted that the guidance does not specifically name health and welfare plans in the paragraphs that limit the scope of those Subtopics.	for in accordance with Topic 965 in the paragraphs limiting the scope of those Subtopics.
Issue 4B: Held-to-Maturity Debt Securities Fair Value Disclosures Stakeholders noted that the disclosure requirements in paragraph 320-10-50-5 require that all entities disclose the fair value of held-to-maturity debt securities measured at amortized cost basis. Those stakeholders noted that it was the Board's intent to eliminate the fair value disclosure requirements for financial instruments measured at amortized cost basis for entities other than public business entities.	The proposed amendment to paragraph 320-10-50-5 would clarify the Board's intent to exempt entities other than public business entities from fair value disclosure requirements for financial instruments not measured at fair value on the balance sheet.
Issue 4C: Applicability of Topic 820 to the Measurement Alternative Stakeholders asked the Board to clarify the subsequent measurement of equity securities without readily determinable fair values accounted for under the measurement alternative and when an entity would be required to adhere to the principles of Topic 820, Fair Value Measurement. Specifically, stakeholders asked whether an entity is required to remeasure an equity security without readily determinable fair value accounted for under the measurement alternative at fair value in accordance with Topic 820 when the entity identifies an orderly transaction with an observable price change for the identical investment of the same issuer. Furthermore, stakeholders	The proposed amendment would clarify the guidance in paragraph 321-10-35-2 and the measurement alternative by specifically requiring that an entity remeasure an equity security without readily determinable fair value at fair value when an orderly transaction is identified for an identical or similar investment of the same issuer in accordance with Topic 820. That is, the proposed amendment clarifies that the measurement alternative is a nonrecurring fair value measurement. Additionally, the proposed amendments would clarify that an entity should adhere to the applicable disclosure requirements in Topic 820 for a nonrecurring fair value

asked whether entities are required to adhere to the disclosure requirements of Topic 820 for subsequent remeasurements of equity securities without readily determinable fair values measured in accordance with the measurement alternative.	measurement.
Issue 4D: Remeasurement of Equity Securities at Historical Exchange Rates Stakeholders noted that the guidance in paragraph 830-10-45-18, which requires that certain accounts be remeasured at historical exchange rates, was not amended in the amendments in Update 2016-01. Specifically, the stakeholders stated that equity securities are no longer carried at cost but, instead, are measured at fair value with changes in fair value recognized in net income each period. However, the stakeholders asked whether equity securities without readily determinable fair values measured in accordance with the measurement alternative should continue to be remeasured at historical exchange rates.	The proposed amendments would clarify that the only equity securities required to follow paragraph 830-10-45-18 and remeasure at historical exchange rates are those equity securities without readily determinable fair values accounted for under the measurement alternative in accordance with paragraph 321-10-35-2. In addition, the proposed amendments would clarify that the rate to be used should be the historical exchange rate as of the acquisition date or the most recent date on which the equity security was adjusted to fair value in accordance with paragraphs 321-10-35-2 through 35-3, if applicable.

Topic 5: Codification Improvements Resulting from the November 1, 2018 Credit Losses TRG Meeting

The proposed amendments to Topic 326 and other Topics in this proposed Update include items related to the amendments in Update 2016-13 discussed at the November 1, 2018 Credit Losses TRG meeting. The proposed amendments clarify or address stakeholders' specific issues about certain aspects of the amendments in Update 2016-13 as described in the table below.

Area for Improvement	Summary of Proposed Amendments
Issue 5A: Vintage Disclosures—Line-of-Credit Arrangements Converted to Term Loans Stakeholders asked how an entity should disclose line-of-credit arrangements that convert to term loans within the vintage disclosure table.	The proposed amendments would require that an entity present the amortized cost basis of line-of-credit arrangements that are converted to term loans within each credit quality indicator in the origination year that corresponds with the period in which the most recent credit decision after original credit decision was made by the entity. However, line-of-credit arrangements that are converted to term loans without an additional credit decision after the original credit decision or through a troubled debt restructuring will be presented in a separate column as illustrated in Example 15.
Issue 5B: Contractual Extensions and Renewals Stakeholders asked whether an entity should consider contractual extension or renewal options in determining the contractual term of a financial asset. Stakeholders stated that the guidance in paragraph 326-20-30-6 appears to preclude an entity from considering those contractual extension or renewal options.	The proposed amendments would clarify that an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

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

The amendments in this proposed Update represent changes to clarify, correct errors in, or improve the Codification. The proposed amendments would make the Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications.

When Would the Amendments Be Effective?

Topics 1, 2, and 5: Codification Improvements to Update 2016-13

For entities that have not yet adopted the amendments in Update 2016-13 as of the issuance date of a final Update, the effective dates and transition requirements for the proposed amendments related to Update 2016-13 would be the same as the effective dates and transition requirements in Update 2016-13.

For entities that have adopted the amendments in Update 2016-13 as of the issuance date of a final Update of these proposed amendments, the Board will determine the effective date and transition requirements for those proposed amendments after it considers stakeholders' feedback on this proposed Update.

Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

For entities that have not yet adopted the amendments in Update 2017-12 as of the issuance date of a final Update of these proposed amendments, the effective dates and transition requirements for the proposed amendments to Topic 815 would be the same as the effective dates and transition requirements in Update 2017-12.

For entities that have adopted the amendments in Update 2017-12 as of the issuance date of a final Update of these proposed amendments, the effective date would be as of the earlier of the beginning of the first quarterly period (if applicable) or first annual period after the issuance date of the final Update. For those entities, early adoption would be permitted, including adoption on any date on or after the issuance of a final Update.

Transition Requirements

Entities that have already adopted the amendments in Update 2017-12 as of the issuance date of a final Update of these proposed amendments would be able to elect either to retrospectively apply all the proposed amendments as of the date the entity adopted Update 2017-12 or to prospectively apply all amendments as of the date of adoption of the amendments in this proposed Update with the following exceptions:

1. Entities that elect to rebalance fair value hedge relationships upon adoption of the amendments in this proposed Update would be required to reflect any adjustments for existing hedges as of the date of adoption of the amendments in Update 2017-12 on the date of initial application of Update 2017-12.
2. Entities that did not reclassify debt securities from held-to-maturity to available-for-sale upon adoption of Update 2017-12 and elect to reclassify debt securities upon adoption of the proposed amendments in this Update would be required to reflect the reclassification as of the date of adoption of the amendments in this Update. Entities that reclassified debt securities from held-to-maturity to available-for-sale upon adoption of Update 2017-12 would not be permitted to make any additional reclassifications.

Topic 4: Codification Improvements to Update 2016-01

For entities that have not yet adopted the amendments in Update 2016-01 as of the issuance date of a final Update of these proposed amendments, the effective dates and transition requirements for the proposed amendments related to Update 2016-01 would be the same as the effective dates and transition requirements in Update 2016-01.

For entities that have adopted the amendments in Update 2016-01 as of the issuance date of a final Update of these proposed amendments, the Board will determine the effective date and transition requirements for these proposed amendments after it considers stakeholders' feedback on this proposed Update.

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.

Topic 1: Codification Improvements Resulting from the June 11, 2018 Credit Losses TRG Meeting

Issue 1A: Accrued Interest

Question 1: Will the amendments in this proposed Update to (a) measure expected credit losses on accrued interest separately from other components of amortized cost basis, (b) make an accounting policy election to present accrued interest amounts separately from the related loan balance, and (c) elect a practical expedient to separately disclose the total amount of accrued interest included in amortized cost basis as a single balance to meet certain disclosure requirements simplify and reduce operational concerns when implementing the guidance in Update 2016-13 related to accrued interest? If not, please explain why you disagree and what changes should be made instead.

Question 2: Do you support the separate accounting policy elections that would allow an entity to choose to (a) write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses and (b) elect not to measure an allowance for credit losses on accrued interest if the entity writes off uncollectible accrued interest amounts in a timely manner? If not, please explain why you disagree and what changes should be made instead.

Question 3: If you agree with the policy election not to measure an allowance for credit losses on accrued interest if the entity reverses or writes off uncollectible accrued interest amounts in a timely manner, what period would you consider to be timely?

Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities

Question 4: Are the proposed amendments related to the transfer of loans and debt securities between classifications or categories operable? If not, please explain why you disagree and what changes should be made instead.

Issue 1C: Recoveries

Question 5: Do the proposed amendments clarify that recoveries are inputs that should be considered when measuring the allowance for credit losses? If not, please explain why you disagree and what changes should be made instead.

Question 6: Do the proposed amendments clarify that an entity may record a negative allowance when measuring the allowance for credit losses using the fair value of the underlying collateral in accordance with paragraphs 326-20-35-4 through 35-5?

Question 7: Should an entity be permitted to record a negative allowance when measuring the allowance for credit losses on available-for-sale debt securities? If yes, why?

Topic 2: Codification Improvements to Update 2016-13

Question 8: Do the proposed amendments clarify the guidance in Update 2016-13? If not, please explain which proposed amendment(s) you disagree with and why.

Question 9: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.

Question 10: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

Question 11: Should an entity be required to use a prepayment-adjusted effective interest rate if it uses projections of interest rate environments in estimating expected cash flows, including expected prepayments and defaults?

Question 12: How much time would be needed to implement the proposed amendments for an entity that has already adopted Update 2016-13 before these proposed amendments are finalized? What transition method and transition disclosures should be required when adopting these proposed amendments and why?

Question 13: Should the effective date and transition requirements for the amendments in this proposed Update align with that of Update 2016-13 for entities that have not yet adopted Update 2016-13 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?

Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

Question 14: Do the proposed amendments clarify the guidance in Topic 815? If not, please explain which proposed amendment(s) you disagree with and why.

Question 15: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the proposed

Codification improvements related to (a) the change in hedged risk guidance for cash flow hedges discussed at the March 28, 2018 Board meeting and (b) use of the word *prepayable* in the shortcut method guidance discussed at the February 14, 2018 Board meeting will be included in a future proposed Update.

Question 16: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

Question 17: Should partial-term fair value hedging be expanded to all risks eligible for hedge accounting?

Question 18: Do you agree with the specific considerations for transition and the effective date for the proposed amendments to Topic 815? Please explain why or why not.

Question 19: Should the proposed amendments to Topic 815 be effective as of the earlier of the beginning of the first quarterly period (if applicable) or the first annual period after the issuance date of a final Update? Would this provide entities with sufficient time to implement these amendments?

Topic 4: Codification Improvements to Update 2016-01

Question 20: Do the proposed amendments clarify the guidance in Update 2016-01? If not, please explain which proposed amendment(s) you disagree with and why.

Question 21: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.

Question 22: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

Question 23: How much time would be needed to implement the proposed amendments for an entity that has already adopted Update 2016-01 before these proposed amendments are finalized? What transition method and transition disclosures should be required when adopting the proposed amendments and why?

Question 24: Should the effective date and transition requirements for the proposed amendments align with that of Update 2016-01 for entities that have not yet adopted Update 2016-01 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?

Topic 5: Codification Improvements Resulting from the November 1, 2018 Credit Losses TRG Meeting

Question 25: Do the proposed amendments clarify how an entity should present line-of-credit arrangements that convert to term loans within the vintage disclosure table requirement in paragraph 326-20-50-6? If not, please explain which proposed amendment(s) you disagree with and why.

Question 26: Do the proposed amendments clarify how an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity? If not, please explain which proposed amendment(s) you disagree with and why.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Area for Improvement	Related Paragraphs
Issue 1A: Accrued Interest	4 and 5
Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities	6–10
Issue 1C: Recoveries	11 and 13
Issue 2A: Conforming Amendment to Subtopic 310-40	14 and 15
Issue 2B: Conforming Amendment to Subtopic 323-10	16 and 17
Issue 2C: Clarification That Reinsurance Recoverables Are within the Scope of Subtopic 326-20	18 and 19
Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments	20–22
Issue 2E: Consideration of Prepayments in Determining the Effective Interest Rate	23–25
Issue 2F: Consideration of Estimated Costs to Sell When Foreclosure Is Probable	26 and 27
Issue 3A: Partial-Term Fair Value Hedges of Interest Rate Risk	28–30
Issue 3B: Amortization of Fair Value Hedge Basis Adjustments	31 and 32
Issue 3C: Disclosure of Fair Value Hedge Basis Adjustments	33 and 34

Area for Improvement	Related Paragraphs
Issue 3D: Consideration of the Hedged Contractually Specified Interest Rate under the Hypothetical Derivative Method	35 and 36
Issue 3E: Scope for Not-for-Profit Entities	37–39
Issue 3F: Hedge Accounting Provisions Applicable to Certain Private Companies and Not-for-Profit Entities	40 and 41
Issue 3G: Application of a First-Payments-Received Cash Flow Hedging Technique to Overall Cash Flows on a Group of Variable Interest Payments	42 and 43
Issue 3H: Update 2017-12 Transition Guidance	44–46
Issue 4A: Scope Clarifications for Subtopics 320-10 and 321-10	47–49
Issue 4B: Held-to-Maturity Debt Securities Fair Value Disclosures	50 and 51
Issue 4C: Applicability of Topic 820 to the Measurement Alternative	52 and 53
Issue 4D: Remeasurement of Equity Securities at Historical Exchange Rates	54 and 55
Issue 5A: Vintage Disclosures—Line-of-Credit Arrangements Converted to Term Loans	57 and 58
Issue 5B: Contractual Extensions and Renewals	59 and 60

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–60. 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~~.

Topic 1: Codification Improvements Resulting from the June 11, 2018 Credit Losses Transition Resource Group (TRG) Meeting

3. Since the issuance of Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* the staff has been working with stakeholders by responding to inquiries and seeking feedback, both through the formal Credit Losses TRG and informally through other communications with stakeholders. The following proposed amendments in this section reflect the Board's tentative decisions to clarify the guidance in the amendments in Update 2016-13 resulting from the June 11, 2018 Credit Losses TRG meeting. The proposed amendments relate to the following three issues raised by stakeholders during the implementation of the amendments in Update 2016-13 and discussed at that meeting: accounting for accrued interest, accounting for transfers of loans and debt securities between classifications or categories, and considering expected recoveries in the estimate of expected credit losses.

Issue 1A: Accrued Interest

4. The proposed amendments related to accrued interest receivables would provide an entity with the ability to make accounting policy elections and apply practical expedients to operationalize the amendments in Update 2016-13. Under the proposed amendments, an entity would be allowed to:

a. Make an accounting policy election not to measure an allowance for credit losses on accrued interest receivables if the entity writes off the uncollectible accrued interest receivables in a timely manner
b. Make an accounting policy election to write off accrued interest receivables by either reversing interest income or adjusting the allowance for credit losses (if applicable)
c. Measure an allowance on accrued interest receivables separate from the allowance related to the unpaid principal balance and other components of amortized cost basis that is required only when an entity does not write off the applicable interest receivables in a timely manner
d. Make an accounting policy election to present the accrued interest receivables separate from the related financial asset balance on the balance sheet, with additional disclosure requirements
e. Apply a practical expedient to exclude accrued interest receivables from the amortized cost basis of certain disclosures.

Amendments to Subtopic 326-20

5. Amend paragraph 326-20-30-5 and add paragraphs 326-20-30-5A, 326-20-35-8A, 326-20-45-5, and 326-20-50-3A through 50-3B, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

326-20-30-5 If an entity estimates expected credit losses using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. For example, if an entity uses a loss-rate method, the numerator would include the expected credit losses of the amortized cost basis (that is, amounts that are not expected to be collected in cash or other consideration, or recognized in income). In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses. An entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the following components of the amortized cost basis, including ~~both~~ <u>all</u> of the following:

a. Amortized cost basis, excluding <u>applicable accrued interest,</u> premiums, discounts (including net deferred fees and costs), foreign exchange, and fair value hedge accounting adjustments (that is, the face amount or unpaid principal balance)
b. Premiums or discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments.
<u>c. Applicable accrued interest. See paragraph 326-20-30-5A for guidance on excluding accrued interest from the calculation of the allowance for credit losses.</u>

<u>**326-20-30-5A** An entity may make an accounting policy election, at the class of financing receivable or the major security-type level, not to measure an allowance for credit losses for accrued interest receivables if the entity writes off the applicable accrued interest receivable balance in a timely manner. This accounting policy election should be considered separately from the accounting policy election in paragraph 326-20-35-8A.</u>

Subsequent Measurement

> Writeoffs and Recoveries of Financial Assets

326-20-35-8A An entity may make an accounting policy election, at the class of financing receivable or the major security-type level, to write off accrued interest receivables by reversing interest income or recognizing credit loss expense, or a combination of both. This accounting policy election should be considered separately from the accounting policy election in paragraph 326-20-30-5A.

Other Presentation Matters

326-20-45-5 For financial assets measured at amortized cost and net investments in leases within the scope of this Subtopic, an entity may elect to separately present on the statement of financial position or within another statement of financial position line item the entire accrued interest receivable balance net of the allowance for credit losses (if any) if the entity meets the disclosure requirements in paragraph 326-20-50-3A.

Disclosure

326-20-50-3A An entity that chooses to present the accrued interest receivable balance within another statement of financial position line item as described in paragraph 326-20-45-5 shall disclose the total amount of accrued interest presented separately from the amortized cost basis and shall disclose in which line item on the balance sheet that amount is presented. An entity also shall disclose the amount of the allowance for credit losses measured on the applicable accrued interest, if any.

326-20-50-3B As a practical expedient, an entity may exclude the applicable accrued interest that is included in the amortized cost basis of financing receivables for the purposes of the disclosure requirements in paragraphs 326-20-50-4 through 50-22. If an entity elects this practical expedient, it shall disclose the total amount of accrued interest excluded from the disclosed amortized cost basis.

Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities

6. The proposed amendments related to transfers between classifications or categories for loans and debt securities would provide an entity with guidance on how to account for the allowance for credit losses or the valuation allowance when transferring loans and debt securities. Under the proposed amendments, an entity would (a) reverse in earnings the valuation allowance or allowance for credit losses recorded under the previous classification or category at the transfer date, (b)

transfer the loan or debt security to the new classification or category at amortized cost basis (adjusted for any previous writeoffs and remaining unrealized gains or losses, if applicable), and (c) measure the allowance for credit losses or the valuation allowance in accordance with the guidance applicable to the new classification or category.

Amendments to Subtopic 310-10

7. Amend paragraphs 310-10-35-47 through 35-48 and the related heading and 310-10-45-2 and its related heading and add paragraphs 310-10-35-47A and 310-10-35-48A through 35-48B and their related heading, with a link to transition paragraph 326-10-65-1, as follows:

Receivables—Overall

Subsequent Measurement

> Subsequent Measurement of Specific Types of Receivables

> > Nonmortgage Loans and Trade Receivables Not Held for Sale

310-10-35-47 ~~Loans and trade~~ Trade receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff shall be reported in the balance sheet at **amortized cost basis** ~~outstanding principal adjusted for any writeoffs, the allowance for credit losses, any deferred fees or costs on originated loans, and any unamortized premiums or discounts on purchased loans~~. (Discounts offered as a result of the pricing of a sale or a product or service may be termed sales discounts. This Subsection does not address these discounts.) See Subtopic 326-20 for guidance on the measurement of credit losses for financial instruments measured at amortized cost basis.

310-10-35-47A Nonmortgage loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff shall be reported in the balance sheet at their amortized cost basis. See Subtopic 326-20 for guidance on the measurement of credit losses for financial instruments measured at amortized cost basis. See Topic 948 for guidance on mortgage loans classified as held-for-long-term-investment.

> > Nonmortgage Loans Held for Sale

310-10-35-48 Nonmortgage loans held for sale shall be reported at the lower of **{remove glossary link}amortized cost basis{remove glossary link}** or fair value. The amount by which amortized cost basis exceeds fair value shall be accounted for as a valuation allowance. Changes in the valuation allowance shall be included in the determination of net income of the period in which the change occurs. This paragraph applies only to nonmortgage loans. See Topic 948 for guidance related to mortgage loans classified as held for sale.

> > Transfers of Nonmortgage Loans between Classifications

310-10-35-48A For a nonmortgage loan that is transferred into the held-for-sale classification from the nonmortgage loan not-held-for-sale classification, an entity shall reverse in earnings any allowance for credit losses previously recorded on the nonmortgage loan not held for sale at the transfer date. An entity shall then reclassify and transfer the nonmortgage loan into the held-for-sale classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses). An entity shall then determine if a valuation allowance is necessary by following the guidance in Subtopic 310-10.

310-10-35-48B For a nonmortgage loan that is transferred into the not-held-for-sale classification from the nonmortgage loans held-for-sale classification, an entity shall reverse in earnings any valuation allowance previously recorded on the nonmortgage loan held for sale at the transfer date. An entity shall then reclassify and transfer the nonmortgage loan into the not-held-for-sale classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any valuation allowance). An entity shall then determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-20.

Other Presentation Matters

> Nonmortgage Loans or Trade Receivables

310-10-45-2 Nonmortgage loans ~~Loans~~ or trade receivables may be presented on the balance sheet as aggregate amounts. However, such receivables held for sale shall be a separate balance sheet category. Major categories of nonmortgage loans or trade receivables shall be presented separately either in the balance sheet or in the notes to ~~the~~ financial statements. An entity shall present the amounts reversed or established for the valuation allowance and the allowance for credit losses, as applicable, related to the transfer of nonmortgage loans (see paragraphs 310-10-35-48A through 35-48B) on a gross basis on the income statement or in the notes to financial statements.

Amendments to Subtopic 320-10

8. Amend paragraphs 320-10-35-10 and 320-10-55-25, add paragraphs 320-10-35-10A through 35-10B and 320-10-45-8B and supersede paragraphs 320-10-35-15 through 35-16, with a link to transition paragraph 326-10-65-1, as follows:

Investments—Debt Securities—Overall

Subsequent Measurement

> Reassessment of Classification

> > Transfers of Securities Between Categories

320-10-35-10 With the exception of debt security transfers in paragraphs 320-10-35-10A through 35-10B, the ~~The~~ transfer of a security between categories of investments shall be accounted for at fair value. At the date of the transfer, the security's unrealized **holding gain or loss** shall be accounted for as follows:

a. For a security transferred from the trading category, the unrealized holding gain or loss at the date of the transfer will have already been recognized in earnings and shall not be reversed.
b. For a security transferred into the trading category, the portion of the unrealized holding gain or loss at the date of the transfer that has not been previously recognized in earnings shall be recognized in earnings immediately.
c. Paragraph superseded by Accounting Standards Update No. 201X-XX.~~For a debt security transferred into the available-for-sale category from the held-to-maturity category, the unrealized holding gain or loss at the date of the transfer shall be reported in other comprehensive income.~~
d. Paragraph superseded by Accounting Standards Update No. 201X-XX.~~For a debt security transferred into the held-to-maturity category from the available-for-sale category, the unrealized holding gain or loss at the date of the transfer shall continue to be reported in a separate component of shareholders' equity, such as accumulated other comprehensive income, but shall be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. The amortization of an unrealized holding gain or loss reported in equity will offset or mitigate the effect on interest income of the amortization of the premium or discount (discussed in the following sentence) for that held-to-maturity security. For a debt security transferred into the held-to-maturity category, the use of fair value may create a premium or discount that, under amortized cost accounting, shall be amortized thereafter as an adjustment of yield pursuant to Subtopic 310-20.~~

320-10-35-10A For a debt security that is transferred into the available-for-sale category from the held-to-maturity category, an entity shall:

a. Reverse in earnings any allowance for credit losses previously recorded on the held-to-maturity debt security at the transfer date

b. Reclassify and transfer the debt security to the available-for-sale category at its **amortized cost basis** (which is reduced by any previous writeoffs but excludes any allowance for credit losses)
c. Determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-30
d. Report in other comprehensive income any unrealized gain or loss on the available-for-sale debt security at the date of transfer, excluding the amount recorded in the allowance for credit losses
e. Consider whether the transfer of a debt security from the held-to-maturity category to the available-for-sale category calls into question the entity's intent and ability to hold securities that remain in the held-to-maturity category to maturity in accordance with paragraphs 320-10-35-8 through 35-9.

320-10-35-10B For a debt security that is transferred into the held-to-maturity category from the available-for-sale category, an entity shall:

a. Reverse in earnings any allowance for credit losses previously recorded on the available-for-sale debt security at the transfer date
b. Reclassify and transfer the debt security to the available-for-sale category at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses) plus or minus the amount of any remaining unrealized holding gain or loss reported in accumulated other comprehensive income
c. Evaluate the debt security for an allowance for credit losses by following the guidance in Subtopic 326-20
d. Continue to report the unrealized holding gain or loss at the date of the transfer in a separate component of shareholders' equity, such as accumulated other comprehensive income, but that gain or loss shall be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. The amortization of an unrealized holding gain or loss reported in equity will offset or mitigate the effect on interest income of the amortization of the premium or discount (discussed in the following sentence) for that held-to-maturity security. For a debt security transferred into the held-to-maturity category, using fair value may create a premium or discount that, under amortized cost accounting, shall be amortized thereafter as an adjustment of yield in accordance with Subtopic 310-20 on receivables—nonrefundable fees and other costs.

320-10-35-15 Paragraph superseded by Accounting Standards Update No. 201X-XX.~~When a security is transferred from held-to-maturity to available-for-sale, the security's~~ ~~**amortized cost basis**~~ ~~carries over to the available-for-sale category for all of the following purposes:~~

~~a. The subsequent amortization of the historical premium or discount~~

b. ~~The comparisons of fair value and amortized cost for the purpose of determining unrealized holding gains and losses under paragraph 320-10-35-1~~
c. ~~The required disclosures of amortized cost.~~

320-10-35-16 Paragraph superseded by Accounting Standards Update No. 201X-XX.~~When a security is transferred from available-for-sale to held-to-maturity, the difference between the par value of the security and its fair value at the date of transfer is amortized as a yield adjustment in accordance with Subtopic 310-20. That fair value amount, adjusted for subsequent amortization, becomes the security's amortized cost basis for the disclosures required by paragraphs 320-10-50-2 through 50-3, 320-10-50-5, and 320-10-50-10.~~

Other Presentation Matters

> Income Statement Classification

320-10-45-8B An entity shall present the amounts reversed or established for the allowance for credit losses related to the transfer of debt securities between categories (see paragraphs 320-10-35-10A through 35-10B) on a gross basis on the income statement or in the notes to financial statements, if applicable.

Implementation Guidance and Illustrations

> Illustrations

> > Example 4: Transfer from Available-for-Sale to Held-to-Maturity

320-10-55-25 For illustrative purposes, amortization of the premium and the unrealized holding gain was computed on a straight-line basis. Premiums and discounts on debt securities should be amortized pursuant to Subtopic 310-20. Paragraph 320-10-35-10B ~~320-10-35-10(d)~~ requires that the unrealized **holding gain or loss** at the date of transfer be amortized in a manner consistent with any premium or discount. The Cumulative Effect on Interest Income column represents the difference between the amortization of the premium and the unrealized holding gain over the life of the security, and does not reflect any coupon interest received.

Amendments to Subtopic 326-20

9. Amend paragraph 326-20-35-7, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Subsequent Measurement

> Loans Subsequently Identified for Sale

326-20-35-7 Once a decision has been made to sell **loans** not currently classified as held for sale, those loans shall be transferred into the held-for-sale classification. See paragraph 310-10-35-48A for guidance on transfers of nonmortgage loans between classifications and see Topic 948 for guidance on transfers of mortgage loans between classifications. The application of the writeoff guidance in paragraph 326-20-35-8 may result in a portion of the amortized cost basis being written off before the loan has been transferred to the held-for-sale classification.~~ Upon transfer, an entity shall measure a valuation allowance equal to the amount by which the **amortized cost basis** (which is reduced by any previous writeoffs but excludes the allowance for credit losses) exceeds the **fair value**. This paragraph applies to both mortgage and nonmortgage loans.~~

Amendments to Subtopic 948-310

10. Amend paragraphs 948-310-30-4 and 948-310-35-5A and add paragraphs 948-310-35-2A and 948-310-45-2, with a link to transition paragraph 326-10-65-1, as follows:

Financial Services—Mortgage Banking—Receivables

Initial Measurement

> Loans Held as Long-Term Investments

948-310-30-4 A mortgage loan ~~transferred to a~~ classified as long-term-investment ~~classification~~ shall be measured ~~upon transfer~~ at ~~the lower of~~ amortized cost basis ~~or fair value on the transfer date~~. See Subtopic 326-20 for guidance on the measurement of credit losses for financial assets measured at amortized cost basis.

Subsequent Measurement

> Loans Held for Sale

948-310-35-2A For a mortgage loan that is transferred into the held-for-sale classification from the held-for-long-term-investment classification, an entity shall reverse in earnings any allowance for credit losses previously recorded on the mortgage loan held-for-long-term investment at the transfer date. An entity shall then reclassify and transfer the mortgage loan into the held-for-sale classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses). An entity shall then determine if a valuation allowance is necessary by following the applicable guidance in this Subtopic.

> Loans Held as Long-Term Investments

948-310-35-5A For a mortgage loan that is transferred into the held-for-long-term-investment classification from the mortgage loans held-for-sale classification, an entity shall reverse any valuation allowance previously recorded on the mortgage loan held for sale at the transfer date. An entity shall then reclassify and transfer the mortgage loan into the held-for-long-term-investment classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any valuation allowance). An entity shall then determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-20. ~~See Subtopic 326-20 for guidance on the measurement of credit losses for financial instruments measured at amortized cost basis.~~

Other Presentation Matters

948-310-45-2 An entity shall present the amounts reversed or established for the valuation allowance and the allowance for credit losses, as applicable, related to the transfer of a mortgage loan between classifications (see paragraphs 948-310-35-2A and 948-310-35-5A) on a gross basis on the income statement or in the notes to financial statements.

Issue 1C: Recoveries

11. The proposed amendments would clarify that an entity should consider expected recoveries when measuring the allowance for credit losses by superseding the guidance in paragraphs 326-20-35-8 through 35-9 that may have precluded an entity from considering recoveries when estimating expected credit losses on financial assets measured at amortized cost basis. Additionally, the proposed amendments would clarify that recoverable amounts included in the valuation account that are an adjustment to the amortized cost basis should not exceed the aggregate of amounts previously written off and expected to be written off by the entity.

Amendments to Subtopic 326-20

12. Amend paragraphs 326-20-30-1, 326-20-35-4 through 35-5, 326-20-35-8, 326-20-50-13, and 326-20-55-52 and supersede paragraph 326-20-35-9, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

326-20-30-1 The allowance for credit losses is a valuation account that is deducted from<u>, or added to,</u> the **amortized cost basis** of the **financial asset(s)** to present the net amount expected to be collected on the financial asset. <u>Recoverable amounts included in the valuation account shall not exceed the aggregate of amounts previously written off and expected to be written off by the entity.</u> At the reporting date, an entity shall record an allowance for credit losses on financial assets within the scope of this Subtopic. An entity shall report in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s).

Subsequent Measurement

> Financial Assets Secured by Collateral

> > Collateral-Dependent Financial Assets

[Note: Paragraph 326-20-35-4 also is amended in Issue 2F.]

326-20-35-4 Regardless of the initial measurement method, an entity shall measure expected credit losses based on the **fair value** of the collateral<u> at the reporting date,</u> when the entity determines that foreclosure is probable. When an entity determines that foreclosure is probable, the entity shall remeasure the **financial asset** at the fair value of the collateral <u>at the reporting date </u>so that the reporting of a credit loss is not delayed until actual foreclosure. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses.<u> An allowance for credit losses, that is added to the amortized cost basis of the financial asset(s), shall not exceed amounts previously written off.</u>

326-20-35-5 An entity may use, as a practical expedient, the fair value of the collateral at the reporting date when recording the net carrying amount of the asset and determining the allowance for credit losses for a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date (collateral-dependent financial asset). If an entity uses the practical expedient on a collateral-dependent financial asset and repayment or satisfaction of the asset depends on the sale of the collateral, the fair value of the collateral shall be adjusted for estimated costs to sell (on a discounted basis). However, the entity shall not incorporate in the net carrying amount of the financial asset the estimated costs to sell the collateral if repayment or satisfaction of the financial asset depends only on the operation, rather than on the sale, of the collateral. ~~For a collateral-dependent financial asset, an entity may expect credit losses of zero when~~ When the fair value (less costs to sell, if applicable) of the collateral at the reporting date ~~is equal to or~~ exceeds the **amortized cost basis** of the financial ~~asset~~ asset, an entity shall adjust the allowance for credit losses to present the net amount expected to be collected on the financial asset to equal to the fair value (less costs to sell, if applicable) of the collateral. An allowance for credit losses, that is added to the amortized cost basis of the financial asset(s), shall not exceed amounts previously written off. If the fair value of the collateral is less than the amortized cost basis of the financial asset for which the practical expedient has been elected, an entity shall recognize an allowance for credit losses on the collateral-dependent financial asset, which is measured as the difference between the fair value of the collateral, less costs to sell (if applicable), at the reporting date and the amortized cost basis of the financial asset. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses.

> Writeoffs and Recoveries of Financial Assets

326-20-35-8 Writeoffs of **financial assets**, which may be full or partial writeoffs, shall be deducted from the allowance. The writeoffs shall be recorded in the period in which the financial asset(s) are deemed uncollectible. ~~Recoveries of financial assets and trade receivables previously written off shall be recorded when received.~~

326-20-35-9 Paragraph superseded by Accounting Standards Update No. 201X-XX.~~Practices differ between entities as some industries typically credit recoveries directly to earnings while financial institutions typically credit the allowance for credit losses for recoveries. The combination of this practice and the practice of frequently reviewing the appropriateness of the allowance for credit losses results in the same credit to earnings in an indirect manner.~~

Disclosure

> > Rollforward of the Allowance for Credit Losses

326-20-50-13 Furthermore, to enable a financial statement user to understand the activity in the allowance for credit losses for each period, an entity shall separately provide by **portfolio segment** and major security type the quantitative disclosures of the activity in the allowance for credit losses for **financial assets** within the scope of this Subtopic, including all of the following:

a. The beginning balance in the allowance for credit losses
b. Current-period provision for expected credit losses
c. The initial allowance for credit losses recognized on financial assets accounted for as **purchased financial assets with credit deterioration** (including beneficial interests that meet the criteria in paragraph 325-40-30-1A), if applicable
d. Writeoffs charged against the allowance
e. Recoveries <u>collected</u> ~~of amounts previously written off, if applicable~~
f. The ending balance in the allowance for credit losses.

Implementation Guidance and Illustrations

> Illustrations

> > Example 9: Recognizing Writeoffs and Recoveries

326-20-55-52 Bank K currently evaluates its loan to Entity L on an individual basis because Entity L is 90 days past due on its loan payments and the loan no longer exhibits similar risk characteristics with other loans in the portfolio. At the end of December 31, 20X3, the amortized cost basis for Entity L’s loan is $500,000 with an allowance for credit losses of $375,000. During the first quarter of 20X4, Entity L issues a press release stating that it is filing for bankruptcy. Bank K determines that the $500,000 loan made to Entity L is uncollectible<u>, and Bank K has no information that supports an expectation of a future recovery in accordance with paragraph 326-20-30-7</u>. Bank K measures a full credit loss on the loan to Entity L and writes off its entire loan balance in accordance with paragraph 326-20-35-8, as follows:

[The remainder of this paragraph is not shown here because it is unchanged.]

Amendments to Subtopic 326-30

13. Amend paragraph 326-30-35-13, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Available-for-Sale Debt Securities

Subsequent Measurement

> Accounting for Debt Securities after a Credit Impairment

326-30-35-12 An entity shall reassess the credit losses each reporting period when there is an allowance for credit losses. An entity shall record subsequent changes in the allowance for credit losses on available-for-sale debt securities with a corresponding adjustment recorded in the credit loss expense on **available-for-sale debt securities**. An entity shall not reverse a previously recorded allowance for credit losses to an amount below zero.

326-30-35-13 An entity shall recognize writeoffs and recoveries of available-for-sale debt securities in accordance with paragraphs <u>326-20-30-1 and </u>326-20-35-8 ~~through 35-9~~.

Topic 2: Codification Improvements to Update 2016-13

Issue 2A: Conforming Amendment to Subtopic 310-40

14. The proposed amendment would clarify paragraph 310-40-55-14 by removing the incorrect cross-reference to paragraph 326-20-35-2 and, instead, properly cross-referencing paragraphs 326-20-35-4 through 35-5, which require that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.

Amendments to Subtopic 310-40

15. Amend paragraph 310-40-55-14, with a link to transition paragraph 326-10-65-1, as follows:

Receivables—Troubled Debt Restructuring by Creditors

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Fair Value Less Cost to Sell Less Than the Seller's Net Receivable

310-40-55-14 On March 31, 20X3, the lender estimates expected credit losses using the fair value of the collateral in accordance with paragraphs 326-20-35-4 through 35-5 ~~paragraph 326-20-35-2~~. Accordingly, the lender should record an allowance for credit losses in the cumulative amount of $29,000 ($19,000 incremental amount plus $10,000 recorded previously) measured as the difference between the amortized cost basis ($100,000) and the fair value less cost to sell ($71,000). Upon foreclosure on May 1, 20X3, the application of paragraph 310-40-40-5 results in the measurement of a new cost basis (also $71,000) for long-lived assets received in full satisfaction of a receivable.

Issue 2B: Conforming Amendment to Subtopic 323-10

16. The proposed amendment to paragraph 323-10-35-26 would clarify the guidance by including references to both Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, and Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities, to require the subsequent measurement of credit losses on financial assets after the guidance on equity method losses is applied.

Amendments to Subtopic 323-10

17. Amend paragraph 323-10-35-26, with a link to transition paragraph 326-10-65-1, as follows:

Investments—Equity Method and Joint Ventures—Overall

Subsequent Measurement

> Equity Method Losses

> > Investee Losses If the Investor Has Other Investments in the Investee

323-10-35-26 If the investor has other investments in the investee (including, but not limited to, preferred stock, debt securities, and loans to the investee) that are within the scope of Subtopic 310-10, 320-10, or 321-10, the investor should perform all of the following steps to determine the amount of equity method loss to report at the end of a period:

a. Apply this Subtopic to determine the maximum amount of equity method losses.
b. Determine whether the adjusted basis of the other investment(s) in the investee is positive, and do the following:

1. If the adjusted basis is positive, the adjusted basis of the other investments shall be adjusted for the amount of the equity method loss based on the investments' seniority. Paragraph 320-10-35-3 explains that, for investments accounted for in accordance with Subtopic 320-10, this adjusted basis becomes the debt security's basis from which subsequent changes in fair value are measured. Paragraph 321-10-35-5 explains that for investments accounted for in accordance with Subtopic 321-10, this adjusted basis becomes the equity security's basis from which subsequent changes in fair value are measured.
2. If the adjusted basis reaches zero, equity method losses shall cease being reported; however, the investor shall continue to track the amount of unreported equity method losses for purposes of applying paragraph 323-10-35-20. If one of the other investments is sold at a time when its carrying value exceeds its adjusted basis, the difference between the cost basis of that other investment and its adjusted basis at the time of sale represents equity method losses that were originally applied to that other investment but effectively reversed upon its sale. Accordingly, that excess represents unreported equity method losses that shall continue to be tracked before future equity method income can be reported. Example 4 (see paragraph 323-10-55-30) illustrates the application of (b)(2).

c. After applying this Subtopic, apply Subtopics 310-10, 320-10, ~~and~~ 321-10, 326-20, and 326-30 to the adjusted basis of the other investments in the investee, as applicable.
d. Apply appropriate generally accepted accounting principles (GAAP) to other investments that are not within the scope of ~~Subtopics~~ Subtopic 310-10, 320-10,~~ or~~ 321-10, 326-20, or 326-30.

Example 4 (see paragraph 323-10-55-30) illustrates the application of this guidance.

Issue 2C: Clarification That Reinsurance Recoverables Are within the Scope of Subtopic 326-20

18. The proposed amendments would clarify that reinsurance recoverables that result from insurance transactions that are within the scope of Topic 944, Financial Services—Insurance, are within the scope of Subtopic 326-20 even if those reinsurance recoverables are measured on a net present value basis in accordance with Topic 944.

Amendments to Subtopic 326-20

19. Amend paragraphs 326-20-05-1 and 326-20-15-2, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Overview and Background

326-20-05-1 This Subtopic provides guidance on how an entity should measure expected credit losses on financial instruments measured at amortized cost and on leases, off-balance-sheet credit exposures, and reinsurance recoverables.

Scope and Scope Exceptions

> Instruments

326-20-15-2 The guidance in this Subtopic applies to the following items:

a. Financial assets measured at amortized cost basis, including the following:
   1. **Financing receivables**
   2. Held-to-maturity **debt securities**
   3. Receivables that result from revenue transactions within the scope of Topic 605 on revenue recognition, Topic 606 on revenue from contracts with customers, and Topic 610 on other income
   4. Subparagraph superseded by Accounting Standards Update No. 201X-XX.~~**Reinsurance recoverables** that result from insurance transactions within the scope of Topic 944 on insurance~~
   5. Receivables that relate to repurchase agreements and securities lending agreements within the scope of Topic 860

b. Net investments in leases recognized by a lessor in accordance with Topic 842 on leases

c. Off-balance-sheet credit exposures not accounted for as insurance. Off-balance-sheet credit exposure refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815 on derivatives and hedging.

d. **Reinsurance recoverables** that result from insurance transactions within the scope of Topic 944 on insurance.

Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments

20. The proposed amendments would clarify the Board's intent for how an entity should determine the effective interest rate and estimated expected future cash flows by removing the prohibition in the guidance and requiring that the projections used for determining the effective interest rate also be used in determining the estimated expected future cash flows.

Amendments to Subtopic 326-20

21. Amend paragraph 326-20-30-4, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

326-20-30-4 If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's **effective interest rate**. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows. If the financial asset's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset's effective interest rate (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset. ~~Projections of~~ An entity is not required to project changes in the factor ~~shall not be made~~ for purposes of ~~determining the effective interest rate or~~ estimating expected future cash flows. If the entity projects changes in the factor for purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. Subtopic 310-20 on receivables—nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

Amendments to Subtopic 326-30

22. Amend paragraph 326-30-35-11, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Available-for-Sale Debt Securities

Subsequent Measurement

> Impairment of Individual Available-for-Sale Securities

> > Identifying and Accounting for Impairment

> > > Impairment in Earnings and Other Comprehensive Income

326-30-35-11 If the security's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that security's effective interest rate (used to discount expected cash flows as described in paragraph 326-30-35-7) may be calculated based on the factor as it changes over the life of the security or may be fixed at the rate in effect at the date an entity determines that the security has a credit loss as determined in accordance with paragraphs 326-30-35-1 through 35-2. The entity's choice shall be applied consistently for all securities whose contractual interest rate varies based on subsequent changes in an independent factor. ~~Projections of~~ <u>An entity is not required to project</u> changes in the factor ~~shall not be made~~ for purposes of ~~determining the effective interest rate or~~ estimating expected future cash flows.<u> If the entity projects changes in the factor for purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. Subtopic 310-20 on receivables—nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.</u>

Issue 2E: Consideration of Prepayments in Determining the Effective Interest Rate

23. The proposed amendment to add paragraph 326-20-30-4A would permit an entity to make an accounting policy election to adjust the effective interest rate used to discount expected cash flows of a financial asset in accordance with paragraph 326-20-30-4 for the consideration of timing of expected prepayments. Additionally, the proposed amendment to add paragraph 326-30-35-7A would permit an entity to make an accounting policy election to adjust the effective

interest rate used to discount expected cash flows of a debt security classified as available-for-sale in accordance with Subtopic 326-30.

Amendments to Subtopic 326-20

24. Add paragraph 326-20-30-4A, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

<u>**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 should not be adjusted because of subsequent changes in expected timing of cash flows.</u>

Amendments to Subtopic 326-30

25. Add paragraph 326-30-35-7A, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Available-for-Sale Debt Securities

Subsequent Measurement

> Impairment of Individual Available-for-Sale Securities

> > Identifying and Accounting for Impairment

> > > Impairment in Earnings and Other Comprehensive Income

<u>**326-30-35-7A** As an accounting policy election for each major security type of debt securities classified as available-for-sale securities, an entity may adjust the</u>

effective interest rate used to discount expected cash flows to consider the timing (and changes in the timing) of expected cash flows resulting from expected prepayments.

Issue 2F: Consideration of Estimated Costs to Sell When Foreclosure Is Probable

26. The proposed amendment would clarify the guidance and align the measurement of credit losses using fair value when foreclosure is probable and when an entity elects the collateral-dependent practical expedient by adding a requirement to adjust the fair value of the collateral for estimated costs to sell in paragraph 326-20-35-4.

Amendments to Subtopic 326-20

27. Amend paragraph 326-20-35-4, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Subsequent Measurement

> Financial Assets Secured by Collateral

> > Collateral-Dependent Financial Assets

[Note: Paragraph 326-20-35-4 also is amended in Issue 1C.]

326-20-35-4 Regardless of the initial measurement method, an entity shall measure expected credit losses based on the **fair value** of the collateral when the entity determines that foreclosure is probable. The entity shall adjust the fair value of the collateral for the estimated costs to sell (on a discounted basis) if it intends to sell rather than operate the collateral. When an entity determines that foreclosure is probable, the entity shall remeasure the **financial asset** at the fair value of the collateral (less costs to sell, if applicable) so that the reporting of a credit loss is not delayed until actual foreclosure. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses.

Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

Issue 3A: Partial-Term Fair Value Hedges of Interest Rate Risk

28. The proposed amendments would clarify that an entity may designate and measure the change in fair value of a hedged item attributable to both interest rate risk and foreign exchange risk in a partial-term fair value hedge. The proposed amendments also would clarify that one or more separately designated partial-term fair value hedging relationships of a single financial instrument can be outstanding at the same time.

Amendments to Subtopic 815-20

29. Amend paragraph 815-20-25-12, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Eligibility of Hedged Items and Transactions

> > Hedged Item Criteria Applicable to Fair Value Hedges Only

815-20-25-12 An asset or a liability is eligible for designation as a hedged item in a fair value hedge if all of the following additional criteria are met:

a. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment.
b. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof), in which circumstance:
    1. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities shall share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio shall be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk. See the discussion beginning in paragraph 815-20-55-14 for related

implementation guidance. An entity may use different stratification criteria for the purposes of impairment testing and for the purposes of grouping similar assets to be designated as a hedged portfolio in a fair value hedge.

2. If the hedged item is a specific portion of an asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities), the hedged item is one of the following:
    i. A percentage of the entire asset or liability (or of the entire portfolio). An entity shall not express the hedged item as multiple percentages of a recognized asset or liability and then retroactively determine the hedged item based on an independent matrix of those multiple percentages and the actual scenario that occurred during the period for which hedge effectiveness is being assessed.
    ii. One or more selected contractual cash flows, including one or more individual interest payments during a selected portion of the term of a debt instrument (such as the portion of the asset or liability representing the present value of the interest payments in any consecutive two years of a four-year debt instrument). Paragraph 815-25-35-13B discusses the measurement of the hedged item in hedges of **interest rate risk** <u>or of both interest rate risk and **foreign exchange risk**</u>.
    iii. A put option or call option (including an interest rate cap or price cap or an interest rate floor or price floor) embedded in an existing asset or liability that is not an embedded derivative accounted for separately pursuant to paragraph 815-15-25-1.
    iv. The residual value in a lessor's net investment in a direct financing or sales-type lease.

c. The hedged item presents an exposure to changes in fair value attributable to the hedged risk that could affect reported earnings. The reference to affecting reported earnings does not apply to an entity that does not report earnings as a separate caption in a statement of financial performance, such as a not-for-profit entity (NFP), as discussed in paragraphs 815-30-15-2 through 15-3.

d. If the hedged item is all or a portion of a debt security (or a portfolio of similar debt securities) that is classified as held to maturity in accordance with Topic 320, the designated risk being hedged is the risk of changes in its fair value attributable to **credit risk**, **{remove glossary link}foreign exchange risk{remove glossary link}**, or both. If the hedged item is an option component of a held-to-maturity security that permits its prepayment, the designated risk being hedged is the risk of changes in the entire fair value of that option component. If the hedged item is other than an option component of a held-to-maturity security that permits its prepayment, the designated hedged risk also shall not be the risk of changes in its overall fair value.

e. If the hedged item is a nonfinancial asset or liability (other than a recognized loan servicing right or a nonfinancial firm commitment with financial components), the designated risk being hedged is the risk of changes in the fair value of the entire hedged asset or liability (reflecting its actual location if a physical asset). That is, the price risk of a similar asset in a different location or of a major ingredient shall not be the hedged risk. Thus, in hedging the exposure to changes in the fair value of gasoline, an entity may not designate the risk of changes in the price of crude oil as the risk being hedged for purposes of determining effectiveness of the fair value hedge of gasoline.
f. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is any of the following:
    1. The risk of changes in the overall fair value of the entire hedged item
    2. The risk of changes in its fair value attributable to changes in the designated benchmark interest rate (referred to as interest rate risk)
    3. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates (referred to as foreign exchange risk)
    4. The risk of changes in its fair value attributable to both of the following (referred to as credit risk):
        i. Changes in the obligor's creditworthiness
        ii. Changes in the spread over the benchmark interest rate with respect to the hedged item's credit sector at inception of the hedge.
    5. If the risk designated as being hedged is not the risk in paragraph 815-20-25-12(f)(1), two or more of the other risks (interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.
g. The item is not otherwise specifically ineligible for designation (see paragraph 815-20-25-43).

Amendments to Subtopic 815-25

30. Amend paragraphs 815-25-35-13B and its related heading and 815-25-55-99, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Fair Value Hedges

Subsequent Measurement

> Changes in Fair Value of Hedged Item

> > Changes Involving Interest Rate Risk

> > > Partial-Term Hedges of Interest Rate Risk or of both Interest Rate Risk and Foreign Exchange Risk

815-25-35-13B For a fair value hedge of interest rate risk in which the hedged item is designated as selected contractual cash flows in accordance with paragraph 815-20-25-12(b)(2)(ii), an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. The assumed maturity of the hedged item occurs on the date in which the last hedged cash flow is due and payable. An entity may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument. For example, an entity may have 2 outstanding hedging relationships for consecutive interest cash flows in Years 1–3 and consecutive interest cash flows in Years 5–7 of a 10-year debt instrument. The guidance in this paragraph also may be applied to a fair value hedge of both interest rate risk and foreign exchange risk.

Implementation Guidance and Illustrations

> Illustrations

> > Example 15: Fair Value Hedge of Interest Rate Risk Using the Partial-Term Approach

815-25-55-99 Although this Example illustrates the hedged item as the first two years of interest payments associated with an existing debt instrument, paragraph 815-20-25-12(b)(2)(ii) permits one interest payment or any consecutive interest payments associated with an existing debt instrument to be designated as the hedged item. An entity also may have one or more separately designated partial-term hedging relationships outstanding at the same time for the same debt instrument. For example, an entity may have 2 outstanding hedging relationships for consecutive interest cash flows in Years 1 and 2 and consecutive interest cash flows in Years 4 and 5 of the 5-year debt instrument.

Issue 3B: Amortization of Fair Value Hedge Basis Adjustments

31. The proposed amendments would clarify that an entity may, but is not required to, begin to amortize a fair value hedge basis adjustment before the fair value hedging relationship is discontinued. It also would clarify that if an entity elects to amortize the basis adjustment during an outstanding partial-term hedge, that basis adjustment should be fully amortized on or before the hedged item's assumed maturity date in accordance with paragraph 815-25-35-13B.

Amendments to Subtopic 815-25

32. Amend paragraph 815-25-35-9A, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Fair Value Hedges

Subsequent Measurement

> Changes in Fair Value of Hedged Item

815-25-35-9 An adjustment of the carrying amount of a hedged interest-bearing **financial instrument** shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

815-25-35-9A ~~For an outstanding hedging relationship, any amortization of adjustments to the carrying amount of the hedged item shall be performed assuming that the amortization period is the remaining life of the hedging relationship.~~ <u>If, as permitted by paragraph 815-25-35-9, an entity amortizes the adjustment to the carrying amount of the hedged item in an outstanding partial-term hedge of interest rate risk (or of interest rate risk and foreign exchange risk), that adjustment shall be fully amortized on or before the hedged item's assumed maturity date in accordance with paragraph 815-25-35-13B.</u> For a discontinued hedging relationship, all remaining adjustments to the carrying amount of the hedged item shall be amortized over a period that is consistent with the amortization of other discounts or premiums associated with the hedged item in accordance with other Topics (for example, Subtopic 310-20 on receivables—nonrefundable fees and other costs).

Issue 3C: Disclosure of Fair Value Hedge Basis Adjustments

33. The amendment would clarify that an entity should disclose available-for-sale debt securities at their amortized cost and that fair value hedge basis adjustments related to foreign exchange risk should be excluded from the disclosures required by paragraph 815-10-50-4EE.

Amendments to Subtopic 815-10

34. Amend paragraph 815-10-50-4EE, with a link to transition paragraph 815-20-65-5, as follows:

Derivative and Hedging—Overall

Disclosure

> Overall Quantitative Disclosures

815-10-50-4EE An entity shall disclose in tabular format the following for items designated and qualifying as hedged items in fair value hedges:

a. The carrying amount of hedged assets and liabilities recognized in the statement of financial position. For an available-for-sale debt security, the amount disclosed is the amortized cost basis.
b. The cumulative amount of fair value hedging adjustments to hedged assets and liabilities included in the carrying amount of the hedged assets and liabilities recognized in the statement of financial position
c. The line item in the statement of financial position that includes the hedged assets and liabilities
d. The cumulative amount of fair value hedging adjustments remaining for any hedged assets and liabilities for which hedge accounting has been discontinued.

The disclosures required by (b) and (d) shall exclude cumulative basis adjustments related to foreign exchange risk.

Issue 3D: Consideration of the Hedged Contractually Specified Interest Rate under the Hypothetical Derivative Method

35. The proposed amendment would clarify that an entity should consider the contractually specified interest rate being hedged when applying the hypothetical derivative method.

Amendments to Subtopic 815-30

36. Amend paragraph 815-30-35-26, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Cash Flow Hedges

Subsequent Measurement

> Subsequent Recognition and Measurement of Gains and Losses on Hedging Instrument

> > Assessing Hedge Effectiveness in Certain Cash Flow Hedges Involving Interest Rate Risk When Effectiveness Is Assessed on a Quantitative Basis

> > > Hypothetical-Derivative Method

815-30-35-26 Essentially, the hypothetical derivative would need to satisfy all of the applicable conditions in paragraphs 815-20-25-104 and 815-20-25-106 necessary to qualify for use of the shortcut method except ~~the criterion in paragraph 815-20-25-106(g) and~~ the criterion in paragraph 815-20-25-104(e). Thus, the hypothetical interest rate swap would be expected to perfectly offset the hedged cash flows. Because the requirements of paragraph 815-20-25-104(e) were developed with an emphasis on fair value hedging relationships, they do not fit the more general principle that the hypothetical derivative in a cash flow hedging relationship should be expected to perfectly offset the hedged cash flows.

Issue 3E: Scope for Not-for-Profit Entities

37. The proposed amendment would clarify that a not-for-profit entity that does not separately report earnings is not permitted to elect the amortization approach for amounts excluded from the assessment of effectiveness under fair value hedge accounting. The proposed amendment also would update the cross-references in paragraph 815-10-15-1 to further clarify the scope of Topic 815, Derivatives and Hedging, for entities that do not report earnings separately.

Amendments to Subtopic 815-10

38. Amend paragraph 815-10-15-1, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Overall

Scope and Scope Exceptions

General

> Entities

815-10-15-1 This Subtopic applies to all entities. Some entities, such as not-for-profit entities (NFPs) and defined benefit pension plans, do not report earnings as a separate caption in a statement of financial performance. The application of this Subtopic to those entities is set forth in paragraphs 815-10-35-3<u>, 815-20-15-1,</u> ~~and~~ 815-25-35-19<u>, and 815-30-15-3</u>.

Amendments to Subtopic 815-20

39. Amend paragraphs 815-20-15-1 and 815-20-25-12, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Hedging—General

Scope and Scope Exceptions

> Entities

815-20-15-1 The guidance in this Subtopic applies to all ~~entities.~~ <u>entities, with the following exceptions:</u>

- <u>a.</u> <u>Entities that do not report earnings separately are not permitted to use cash flow hedge accounting as described in this Subtopic or Subtopic 815-30 on cash flow hedges.</u>
- <u>b.</u> <u>Entities that do not report earnings separately are not permitted to elect the amortization approach for amounts excluded from the assessment of effectiveness under fair value hedge accounting in accordance with paragraphs 815-20-25-83A and 815-25-35-1(a).</u>

Recognition

> Eligibility of Hedged Items and Transactions

> > Hedged Item Criteria Applicable to Fair Value Hedges Only

815-20-25-12 An asset or a liability is eligible for designation as a hedged item in a fair value hedge if all of the following additional criteria are met:

- a. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment.
- b. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof), in which circumstance:
    1. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities shall share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio shall be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk. See the discussion beginning in paragraph 815-20-55-14 for related

implementation guidance. An entity may use different stratification criteria for the purposes of impairment testing and for the purposes of grouping similar assets to be designated as a hedged portfolio in a fair value hedge.

2. If the hedged item is a specific portion of an asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities), the hedged item is one of the following:
   i. A percentage of the entire asset or liability (or of the entire portfolio). An entity shall not express the hedged item as multiple percentages of a recognized asset or liability and then retroactively determine the hedged item based on an independent matrix of those multiple percentages and the actual scenario that occurred during the period for which hedge effectiveness is being assessed.
   ii. One or more selected contractual cash flows, including one or more individual interest payments during a selected portion of the term of a debt instrument (such as the portion of the asset or liability representing the present value of the interest payments in any consecutive two years of a four-year debt instrument). Paragraph 815-25-35-13B discusses the measurement of the hedged item in hedges of **interest rate risk**.
   iii. A put option or call option (including an interest rate cap or price cap or an interest rate floor or price floor) embedded in an existing asset or liability that is not an embedded derivative accounted for separately pursuant to paragraph 815-15-25-1.
   iv. The residual value in a lessor's net investment in a direct financing or sales-type lease.

c. The hedged item presents an exposure to changes in fair value attributable to the hedged risk that could affect reported earnings. The reference to affecting reported earnings does not apply to an entity that does not report earnings as a separate caption in a statement of financial performance, such as a not-for-profit entity (NFP), in accordance with paragraph 815-20-15-1 ~~as discussed in paragraphs 815-30-15-2 through 15-3~~.

d. If the hedged item is all or a portion of a debt security (or a portfolio of similar debt securities) that is classified as held to maturity in accordance with Topic 320, the designated risk being hedged is the risk of changes in its fair value attributable to **credit risk**, **foreign exchange risk**, or both. If the hedged item is an option component of a held-to-maturity security that permits its prepayment, the designated risk being hedged is the risk of changes in the entire fair value of that option component. If the hedged item is other than an option component of a held-to-maturity security that permits its prepayment, the designated hedged risk also shall not be the risk of changes in its overall fair value.

e. If the hedged item is a nonfinancial asset or liability (other than a recognized loan servicing right or a nonfinancial firm commitment with financial components), the designated risk being hedged is the risk of changes in the fair value of the entire hedged asset or liability (reflecting its actual location if a physical asset). That is, the price risk of a similar asset in a different location or of a major ingredient shall not be the hedged risk. Thus, in hedging the exposure to changes in the fair value of gasoline, an entity may not designate the risk of changes in the price of crude oil as the risk being hedged for purposes of determining effectiveness of the fair value hedge of gasoline.
f. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is any of the following:
    1. The risk of changes in the overall fair value of the entire hedged item
    2. The risk of changes in its fair value attributable to changes in the designated benchmark interest rate (referred to as interest rate risk)
    3. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates (referred to as foreign exchange risk)
    4. The risk of changes in its fair value attributable to both of the following (referred to as credit risk):
        i. Changes in the obligor's creditworthiness
        ii. Changes in the spread over the benchmark interest rate with respect to the hedged item's credit sector at inception of the hedge.
    5. If the risk designated as being hedged is not the risk in paragraph 815-20-25-12(f)(1), two or more of the other risks (interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.
g. The item is not otherwise specifically ineligible for designation (see paragraph 815-20-25-43).

Issue 3F: Hedge Accounting Provisions Applicable to Certain Private Companies and Not-for-Profit Entities

40. The proposed amendment would clarify that a private company that is not a financial institution as described in paragraph 942-320-50-1 should document the analysis supporting a last-of-layer designation concurrently with hedge inception. The proposed amendment also would clarify that not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) should be provided with the same subsequent quarterly hedge effectiveness assessment timing relief provided to certain private companies in paragraph 815-20-25-142.

Amendments to Subtopic 815-20

41. Amend paragraphs 815-20-25-139 and 815-20-25-143, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Hedge Accounting Provisions Applicable to Certain Private Companies

> > Timing of Hedge Documentation for Certain Private Companies If Simplified Hedge Accounting Approach Is Not Applied

> > > Concurrent Hedge Documentation

815-20-25-139 Concurrent with hedge inception, a **private company** that is not a financial institution as described in paragraph 942-320-50-1 shall document the following:

a. The hedging relationship in accordance with paragraph 815-20-25-3(b)(1)
b. The hedging instrument in accordance with paragraph 815-20-25-3(b)(2)(i)
c. The hedged item in accordance with paragraph 815-20-25-3(b)(2)(ii), including (if applicable) firm commitments or the analysis supporting a last-of-layer designation in paragraph 815-20-25-3(c), or forecasted transactions in paragraph 815-20-25-3(d) ~~815-20-25-3(c) or (d)~~
d. The nature of the risk being hedged in accordance with paragraph 815-20-25-3(b)(2)(iii).

> Hedge Accounting Provisions Applicable to Certain Not-for-Profit Entities

815-20-25-143 Not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) may apply the guidance on the timing of hedge documentation and hedge effectiveness assessments in paragraphs 815-20-25-139 through 25-142. Specifically, those entities shall document the items listed in paragraph 815-20-25-139 concurrent with hedge inception, but they may perform and document the items listed in paragraph 815-20-25-140 and perform the required subsequent quarterly hedge effectiveness assessments in accordance with paragraph 815-20-25-142 within the time periods discussed in paragraph 815-20-25-142.

Issue 3G: Application of a First-Payments-Received Cash Flow Hedging Technique to Overall Cash Flows on a Group of Variable Interest Payments

42. The proposed amendment would clarify that the application of the first-payments-received cash flow hedging technique to overall cash flows on a group of variable interest payments continues to be permitted under Topic 815.

Amendments to Subtopic 815-20

43. Add paragraph 815-20-55-33G, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Hedging—General

Implementation Guidance and Illustrations

> Implementation Guidance

> > Eligibility of Hedged Items

> > > Hedged Items in Cash Flow Hedges Only

> > > > First-Payments-Received Technique in Hedging Variable Interest Payments on a Group of Loans

815-20-55-33G <u>Under the first-payments-received technique, an entity also may designate the risk of overall changes in the hedged cash flows, which includes the risk of decreases in cash flows attributable to credit default. The use of the first-payments-received technique in those circumstances is permitted by this Subtopic as an exception even though that technique excludes the variable interest payments that are contractually due but not paid by the debtor from being hedged transactions, thereby excluding some of the risk of decreases in interest payment inflows attributable to credit default. This implementation guidance on applying the first-payments-received technique to overall changes in cash flows for interest-bearing financial assets should not be applied by analogy to other circumstances.</u>

Issue 3H: Update 2017-12 Transition Guidance

44. The proposed amendments would clarify the following:

a. If an entity changes its measurement methodology for the hedged item in a fair value hedge of interest rate risk in accordance with paragraph 815-20-65-3(e)(1), transition adjustments should be made as of the date of initial application of the amendments in Update 2017-12. The date of initial application differs from the date of adoption if an entity adopts the amendments in Update 2017-12 in an interim period.

b. An entity may rebalance its fair value hedging relationships of interest rate risk when it modifies the measurement methodology used for the hedged item from total contractual coupon cash flows to the benchmark rate component of the contractual coupon cash flows by any combination of increasing or decreasing the designated notional of the hedging instrument or increasing or decreasing the designated proportion of the hedged item. However, the entity may not add new hedged items or hedging instruments to the hedging relationship.
c. The entity may transition from a quantitative method of hedge effectiveness assessment to a method comparing the hedging relationship's critical terms in accordance with paragraphs 815-20-25-84 through 25-85 or paragraphs 815-20-25-129 through 25-129A without dedesignating the existing hedging relationship if the guidance within those paragraphs is met.
d. A debt security reclassified from held-to-maturity to available-for-sale in accordance with paragraph 815-20-65-3(e)(7):
    1. Would not call into question the entity's assertion to hold to maturity those debt securities that continue to be classified as held-to-maturity
    2. Is not required to be designated in a last-of-layer hedging relationship
    3. Is not prohibited from being sold after reclassification.

Amendments to Subtopic 815-20

45. Amend paragraph 815-20-65-3, with a link to transition paragraph 815-20-65-5, as follows:

Derivatives and Hedging—Hedging—General

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

815-20-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities:*

a. For **public business entities,** the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.
b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.
c. Early adoption, including adoption in an interim period, of the pending content that links to this paragraph is permitted. If an entity early adopts the pending content that links to this paragraph in an interim period, any adjustments shall be reflected as of the beginning of the fiscal year that includes that interim period (that is, the initial application date).
d. For **cash flow hedges** and net investment hedges existing (that is, the hedging instrument has not expired, been sold, terminated, or exercised or the entity has not removed the designation of the hedging relationship) as of the date of adoption, an entity shall apply the pending content that links to this paragraph related to the elimination of the separate measurement of ineffectiveness by means of a cumulative-effect adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
e. An entity may elect any of the following items upon adoption of the pending content that links to this paragraph:
    1. For a **fair value hedge** of **interest rate risk** existing as of the date of adoption, an entity may modify the measurement methodology for a hedged item in accordance with either paragraph 815-20-25-6B or paragraph 815-25-35-13 without dedesignation of the hedging relationship. The cumulative basis adjustment carried forward shall be adjusted to an amount that reflects what the cumulative basis adjustment would have been at the initial application date ~~of adoption~~ had the modified measurement methodology been used in all past periods in which the hedging relationship was outstanding. When making this election, the benchmark rate component of the contractual coupon cash flows shall be determined as of the hedging relationship's original inception date. The cumulative effect of applying this election shall be recognized as an adjustment to the basis adjustment of the hedged item recognized on the balance sheet with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
    2. For the fair value hedges of interest rate risk for which an entity modifies the measurement methodology for the hedged item based on the benchmark rate component of the contractual coupon cash flows in accordance with (1) above, an entity may elect to ~~dedesignate a portion of the hedged item and reclassify the basis adjustment associated with the portion of the hedged item dedesignated~~ rebalance the hedging relationship through any of the following approaches, including any combination thereof:

i. <u>Increasing the designated notional amount of the hedging instrument</u>
ii. <u>Decreasing the designated notional amount of the hedging instrument</u>
iii. <u>Increasing the designated proportion of the hedged item</u>
iv. <u>Decreasing the designated proportion of the hedged item.</u>

<u>An entity may not add a new hedging instrument or hedged item to an existing hedging relationship. If an entity applies the guidance in (iii) or (iv) above, the cumulative effect of changing the designated proportion of the hedged item shall be recognized as an adjustment to the basis adjustment of the hedged item recognized on the balance sheet with a corresponding adjustment</u> to the opening balance of retained earnings as of the initial application date.

3. For fair value hedges existing as of the date of adoption in which foreign exchange risk is the hedged risk or one of the hedged risks and a currency swap is the hedging instrument, an entity may, without dedesignation, modify its hedge documentation to exclude the cross-currency basis spread component of the currency swap from the assessment of hedge effectiveness and recognize the excluded component through an amortization approach. The cumulative effect of applying this election shall be recognized as an adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
4. For hedges existing as of the date of adoption that exclude a portion of the hedging instrument from the assessment of effectiveness, an entity may modify the recognition model for the excluded component from a mark-to-market approach to an amortization approach without dedesignation of the hedging relationship. The cumulative effect of applying this election shall be recognized as an adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
5. An entity may modify documentation without dedesignating an existing hedging relationship to specify the following:
   i. For hedging relationships that currently use a quantitative method to assess effectiveness, that subsequent prospective and retrospective effectiveness assessments shall be performed qualitatively in accordance with paragraph 815-20-25-3(b)(2)(iv)(03)
   ii. For hedging relationships that currently use the shortcut method to assess effectiveness, the quantitative method that would be used to perform assessments of effectiveness in accordance with paragraph 815-20-25-117A if the entity determines at a later date that use of the shortcut method was not or no longer is appropriate.

iii. For cash flow hedging relationships in which an entity currently uses a quantitative method to assess effectiveness, that the critical terms of the hedging instrument and the hedged item match if the criteria in paragraphs 815-20-25-84 through 25-85 or paragraphs 815-20-25-129 through 25-129A are met and that subsequent prospective and retrospective effectiveness assessments shall be performed in accordance with paragraphs 815-20-35-9 through 35-12 or in accordance with paragraphs 815-20-25-126 through 25-129A and paragraphs 815-30-35-33 through 35-34.

6. For cash flow hedges existing as of the date of adoption in which the hedged risk is designated as the variability in total cash flows that meet the requirements to designate as the hedged risk the variability in cash flows attributable to changes in a **contractually specified component** or a contractually specified interest rate, an entity may:
   i. Modify the hedging relationship, without dedesignation, to specify the hedged risk is the variability in the contractually specified component or contractually specified interest rate
   ii. Create the terms of the instrument used to estimate changes in value of the hedged risk (either under the hypothetical derivative method or another acceptable method in Subtopic 815-30) in the assessment of effectiveness on the basis of market data as of the inception of the hedging relationship
   iii. Consider any ineffectiveness previously recognized on the hedging relationship as part of the transition adjustment in accordance with (d) above.

7. An entity may reclassify a debt security from held-to-maturity to available-for-sale if the debt security is eligible to be hedged under the last-of-layer method in accordance with paragraph 815-20-25-12A. Any unrealized gain or loss at the date of the transfer shall be recorded in accumulated other comprehensive income in accordance with paragraph 320-10-35-10(c). That reclassification, in and of itself, would not result in any of the following:
   i. Call into question the entity's assertion at the most recent reporting date that it had the intent and ability to hold to maturity those debt securities that continue to be classified as held-to-maturity
   ii. Require the entity to designate the reclassified security in a hedging relationship under the last-of-layer method
   iii. Restrict the entity from selling the reclassified security.

f. For private companies that are not financial institutions as described in paragraph 942-320-50-1 and **not-for-profit entities** (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market), the elections in (e) above shall be determined before the next interim (if applicable) or annual **financial statements are available to be issued.**

g. For all other entities, the elections in (e) above shall be determined before the first quarterly effectiveness assessment date after the date of adoption.
h. For fair value hedges existing as of the date of adoption in which the hedged item is a tax-exempt **financial instrument**, the hedged risk may be modified to interest rate risk related to the **Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate**. The modification shall be considered a dedesignation and immediate redesignation of the hedging relationship. In this situation, the cumulative basis adjustment of the hedged item from the dedesignated hedging relationship shall be amortized to earnings on a level-yield basis over a period of time based on the applicable requirements in other Topics.
i. An entity is not required to apply the guidance in paragraph 815-20-25-81 when comparing hedging relationships executed before and after the date of adoption of the pending content that links to this paragraph for any of the following:
    1. Hedging relationships executed before the date of adoption assessed under the shortcut method for which hedge documentation was not amended as permitted by (e)(5)(ii) above, and hedging relationships executed after the date of adoption assessed under the shortcut method in accordance with paragraphs 815-20-25-117A through 25-117D
    2. Hedging relationships executed before the date of adoption for which the hedged risk was not amended to a contractually specified component or a contractually specified interest rate as permitted by (e)(6) above, and hedging relationships executed after the date of adoption for which the hedged risk is the variability in cash flows attributable to changes in a contractually specified component or a contractually specified interest rate
    3. Hedging relationships executed before the date of adoption for which the recognition of excluded components was not amended to an amortization approach as permitted by (e)(4) above, and hedging relationships executed after the date of adoption for which an amortization approach is elected in accordance with paragraph 815-20-25-83A.
j. On a prospective basis only for existing hedging relationships on the date of adoption (in all interim periods and fiscal years ending after the date of adoption), an entity shall:
    1. Present the entire change in the fair value of the hedging instrument in the same income statement line item as the earnings effect of the hedged item when the hedged item affects earnings (with the exception of amounts excluded from the assessment of hedge effectiveness in a net investment hedge) in accordance with paragraphs 815-20-45-1A and 815-20-45-1C

        2. Disclose the items in the pending content that links to this paragraph in Subtopic 815-10.
    k. An entity shall provide the following disclosures within Topic 250 on accounting changes and error corrections:
        1. The nature of and reason for the change in accounting principle
        2. The cumulative effect of the change on the opening balance of each affected component of equity or net assets in the statement of financial position as of the date of adoption
        3. The disclosures in (1) through (2) above in each interim and annual financial statement period in the fiscal year of adoption.

46. Add paragraph 815-20-65-5 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 201X-XX, *Codification Improvements—Financial Instruments*

815-20-65-5 The following represents the transition and effective date information related to Accounting Standards Update No. 201X-XX, *Codification Improvements—Financial Instruments*:

a. For an entity that has adopted the amendments in Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* before the issuance date of Update 201X-XX, the pending content that links to this paragraph shall be effective at the beginning of the earlier of an entity's first quarterly reporting period (if applicable) and first annual reporting period after the date of issuance of Update 201X-XX. Early adoption is permitted on any date on or after the issuance of Update 201X-XX. See (c), (d), and (e) below for additional transition guidance for entities that have adopted the amendments in Update 2017-12 before the issuance date of Update 201X-XX.
b. For an entity that has not adopted the amendments in Update 2017-12 before the issuance date of Update 201X-XX, the pending content that links to this paragraph shall be effective as of the date the entity adopts the amendments in Update 2017-12 in accordance with paragraph 815-20-65-3. The pending content that links to this paragraph shall be adopted at the same time that the amendments in Update 2017-12 are adopted.
c. For an entity that has adopted the amendments in Update 2017-12 before the issuance date of Update 201X-XX, that entity shall elect to reflect all of the pending content that links to this paragraph either on a prospective basis or on a retrospective basis as of the date of adoption of the amendments in Update 2017-12 in accordance with paragraph 815-20-65-3, with the following exceptions:
    1. An entity that elects fair value hedge rebalancing in accordance with paragraph 815-20-65-3(e)(2) shall reflect any adjustments for existing hedges as of the date of adoption of the amendments in

Update 2017-12 on the date of initial application of the amendments in Update 2017-12 in accordance with paragraph 815-20-65-3.

2. An entity may reclassify a debt security from held-to-maturity to available-for-sale if the debt security is eligible to be hedged under the last-of-layer guidance in accordance with paragraph 815-20-25-12A upon adoption of the pending content that links to this paragraph only if the entity did not reclassify one or more debt securities from held-to-maturity to available-for-sale upon adoption of the amendments in Update 2017-12. If the entity did not reclassify any debt securities from held-to-maturity to available-for-sale upon adoption of the amendments in Update 2017-12 and elects to reclassify securities in accordance with paragraph 815-20-65-3(e)(7) upon adoption of the pending content that links to this paragraph, it shall make that reclassification as of the date of adoption of the pending content that links to this paragraph in accordance with (a) above. Any unrealized gain or loss at the date of the reclassification shall be recorded in accumulated other comprehensive income in accordance with paragraph 320-10-35-10(c).

d. For an entity that has adopted the amendments in Update 2017-12 before the issuance date of Update 201X-XX and reflects the amendments on a prospective basis in accordance with (c) above, the adjustment resulting from the amendment in paragraph 815-25-35-9A to a partial-term fair value hedge relationship's amortization shall be accounted for as a change in estimate in accordance with paragraph 250-10-45-17.

e. For an entity that has adopted the amendments in Update 2017-12 before the issuance date of Update 201X-XX and reflects the amendments on a retrospective basis in accordance with (c) above, new hedging relationships may be retrospectively designated between the date of adoption of the amendments in Update 2017-12 and the effective date of Update 201X-XX in accordance with (a) above for existing eligible hedging instruments and existing eligible hedged items or existing eligible forecasted transactions related to the amendments in paragraph 815-20-25-12(b)(2)(ii), 815-30-35-26, or 815-20-55-33G.

Topic 4: Codification Improvements to Update 2016-01

Issue 4A: Scope Clarifications for Subtopics 320-10 and 321-10

47. The proposed amendments would clarify the guidance in paragraphs 320-10-15-3 and 321-10-15-3, including adding health and welfare plans to the list of entities for which Topic 320, Investments—Debt Securities, does not apply.

Amendments to Subtopic 320-10

48. Amend paragraph 320-10-15-3, with a link to transition paragraph 825-10-65-2, as follows:

Investments—Debt Securities—Overall

Scope and Scope Exceptions

> Entities

320-10-15-3 The guidance in this Topic does not apply to the following entities:

a. Entities in certain specialized industries. Entities whose specialized accounting practices include accounting for substantially all investments in **debt securities** at fair value, with changes in value recognized in earnings (income) or in the change in net assets. Examples of those entities are:
   1. Brokers and dealers in securities (Topic 940)
   2. Defined benefit pension, ~~pension and~~ other postretirement, and health and welfare plans (Topics 960, 962, and 965)
   3. Investment companies (Topic 946).

Amendments to Subtopic 321-10

49. Amend paragraph 321-10-15-3, with a link to transition paragraph 825-10-65-2, as follows:

Investments—Equity Securities—Overall

Scope and Scope Exceptions

> Entities

321-10-15-3 The guidance in this Topic does not apply to entities in certain specialized industries whose specialized accounting practices include accounting for substantially all investments at fair value, with changes in value recognized in earnings (income) or in the change in net assets. Examples of those entities are:

a. Brokers and dealers in securities (Topic 940)
b. Defined benefit pension, ~~pension and~~ other postretirement, and health and welfare plans (Topics 960, 962, and 965)
c. Investment companies (Topic 946).

Issue 4B: Held-to-Maturity Debt Securities Fair Value Disclosures

50. The Board intended to eliminate all fair value disclosures for entities other than public business entities through the amendments in this proposed Update. The proposed amendments would clarify the guidance in paragraph 320-10-50-5 by eliminating the requirement for entities other than public business entities to disclose aggregate fair value of held-to-maturity debt securities.

Amendments to Subtopic 320-10

51. Amend paragraph 320-10-50-5 and its related pending content and add paragraph 320-10-50-5A, with a link to transition paragraph 825-10-65-2, as follows:

Investments—Debt Securities—Overall

Disclosure

> Securities Classified as Held to Maturity

320-10-50-5 ~~For securities classified as held to maturity, all~~ <u>All</u> reporting entities shall disclose ~~all of~~ the following<u> for securities classified as held-to-maturity</u> by major security type as of each date for which a statement of financial position is presented:

- a. Amortized cost basis
- aa. <u>Subparagraph superseded by Accounting Standards Update No. 201X-XX.</u>~~Aggregate fair value~~
- b. <u>Subparagraph superseded by Accounting Standards Update No. 201X-XX.</u>~~Gross unrecognized holding gains~~
- c. <u>Subparagraph superseded by Accounting Standards Update No. 201X-XX.</u>~~Gross unrecognized holding losses~~
- d. Net carrying amount
- dd. Total other-than-temporary impairment recognized in accumulated other comprehensive income
- e. Gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities
- f. Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented. (Maturity information may be combined in appropriate groupings. In complying with this requirement, financial institutions [see paragraph 942-320-50-1] shall disclose the fair value and the net carrying

amount (if different from fair value) of debt securities on the basis of at least the following four maturity groupings:

1. Within one year
2. After one year through five years
3. After 5 years through 10 years
4. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.)

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2020* | **Transition Guidance:** 326-10-65-1

320-10-50-5 ~~For securities classified as held to maturity, all~~ All reporting entities shall disclose ~~all of~~ the following for securities classified as held-to-maturity by major security type as of each date for which a statement of financial position is presented:

a. Amortized cost basis

aa. Subparagraph superseded by Accounting Standards Update No. 201X-XX.~~Aggregate fair value~~

aaa. Total allowance for credit losses

b. Subparagraph superseded by Accounting Standards Update No. 201X-XX.~~Gross unrecognized holding gains~~

c. Subparagraph superseded by Accounting Standards Update No. 201X-XX.~~Gross unrecognized holding losses~~

d. Net carrying amount

dd. Subparagraph superseded by Accounting Standards Update 2016-13.

e. Gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities

f. Information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented. (Maturity information may be combined in appropriate groupings. In complying with this requirement, financial institutions [see paragraph 942-320-50-1] shall disclose the fair value and the net carrying amount (if different from fair value) of debt securities on the basis of at least the following four maturity groupings:

1. Within one year
2. After one year through five years
3. After 5 years through 10 years
4. After 10 years.

Securities not due at a single maturity date, such as mortgage-backed securities, may be disclosed separately rather than allocated over several maturity groupings; if allocated, the basis for allocation also shall be disclosed.)

320-10-50-5A Public business entities shall disclose the following information for securities classified as held-to-maturity, by major security type, as of each date for which a statement of financial position is presented:

a. Aggregate fair value
b. Gross unrecognized holding gains
c. Gross unrecognized holding losses.

Issue 4C: Applicability of Topic 820 to the Measurement Alternative

52. The Board intended to require a nonrecurring fair value measurement in accordance with Topic 820, Fair Value Measurement, upon the occurrence and identification of any remeasurement events described in Topic 321 for equity securities without readily determinable fair values accounted for under the measurement alternative. Without proper clarification, the guidance in Topic 321 for the remeasurement of equity securities without readily determinable fair values accounted for under the measurement alternative could be interpreted to require different measurement bases depending on the specific remeasurement event that occurs. The proposed amendments would clarify that all adjustments made under the measurement alternative upon the identified remeasurement events should be accounted for in accordance with Topic 820.

Amendment to Subtopic 321-10

53. Amend paragraph 321-10-35-2 and add paragraph 321-10-50-2B, with a link to transition paragraph 825-10-65-2, as follows:

Investments—Equity Securities—Overall

Subsequent Measurement

> Equity Securities without Readily Determinable Fair Values

321-10-35-2 An entity may elect to measure an equity security without a **readily determinable fair value** that does not qualify for the practical expedient to estimate fair value in accordance with paragraph 820-10-35-59 at its cost minus impairment, if ~~any,~~ any. If an entity identifies ~~plus or minus changes resulting from~~ observable price changes in **orderly transactions** for the identical or a similar investment of the same ~~issuer~~ issuer, it shall measure the equity security at fair value as of the date that the observable transaction occurred. An election to measure an equity security in accordance with this paragraph shall be made for each investment separately. Once an entity elects to measure an equity security in accordance with this paragraph, the entity shall continue to apply the measurement guidance in this paragraph until the investment does not qualify to be measured in accordance with this paragraph (for example, if the investment has a readily determinable fair value or becomes eligible for the practical expedient to estimate fair value in accordance with paragraph 820-10-35-59). The entity shall reassess at each reporting period whether the equity investment without a readily determinable fair value qualifies to be measured in accordance with this paragraph. If an entity measures an equity security in accordance with this paragraph (and the security continues to qualify for measurement in accordance with this paragraph), the entity may subsequently elect to measure the equity security at fair value. If an entity subsequently elects to measure an equity security at fair value, the entity shall measure all identical or similar investments of the same issuer, including future purchases of identical or similar investments of the same issuer, at fair value. The election to measure those securities at fair value shall be irrevocable. Any resulting gains or losses on the securities for which that election is made shall be recorded in earnings at the time of the election.

Disclosures

321-10-50-2B To the extent that the disclosure requirements in this Subtopic achieve the fair value disclosure requirements described in Section 820-10-50 on disclosing fair value measurement, an entity need not duplicate the related fair value disclosure.

Issue 4D: Remeasurement of Equity Securities at Historical Exchange Rates

54. The proposed amendments would clarify that the only equity securities required to follow paragraph 830-10-45-18, which requires that those accounts be remeasured at historical exchange rates, are those equity securities without readily determinable fair values accounted for under the measurement alternative in accordance with paragraph 321-10-35-2. The proposed amendments also would clarify that only debt securities intended to be held to maturity are required to follow paragraph 830-10-45-18.

Amendments to Subtopic 830-10

55. Amend paragraph 830-10-45-18, with a link to transition paragraph 825-10-65-2, as follows:

Foreign Currency Matters—Overall

Other Presentation Matters

> Remeasurement of the Books of Record Into the Functional Currency

> > Accounts to Be Remeasured Using Historical Exchange Rates

830-10-45-18 All of the following are common nonmonetary balance sheet items and related revenue, expense, gain, and loss accounts that shall be remeasured using historical rates to produce the same result in terms of the functional currency that would have occurred if those items had been initially recorded in the functional currency:

a. ~~Marketable securities carried at cost, including:~~ Equity securities without readily determinable fair values accounted for under paragraph 321-10-35-2. The historical rate to be used should be the exchange rate as of the acquisition date or the most recent date on which the equity security was adjusted to fair value in accordance with paragraphs 321-10-35-2 through 35-3, if applicable.
   1. Subparagraph superseded by Accounting Standards Update No. 201X-XX.~~Equity securities~~
   2. Subparagraph superseded by Accounting Standards Update No. 201X-XX.~~Debt securities not intended to be held until maturity.~~

b. Inventories carried at cost
c. Prepaid expenses such as insurance, advertising, and rent
d. Property, plant, and equipment
e. Accumulated depreciation on property, plant, and equipment
f. Patents, trademarks, licenses, and formulas
g. Goodwill
h. Other intangible assets
i. Deferred charges and credits, except policy acquisition costs for life insurance companies
j. Deferred income
k. Common stock
l. Preferred stock carried at issuance price
m. Revenues and expenses related to nonmonetary items, for example:
   1. Cost of goods sold
   2. Depreciation of property, plant, and equipment
   3. Amortization of intangible items such as patents, licenses, and so forth
   4. Amortization of deferred charges or credits except policy acquisition costs for life insurance entities.

Topic 5: Codification Improvements Resulting from the November 1, 2018 Credit Losses TRG Meeting

56. Since the issuance of Update 2016-13, the staff has been working with stakeholders by responding to inquiries and seeking feedback, both through the formal Credit Losses TRG and informally through other communications with stakeholders. The following proposed amendments in this section reflect the Board's tentative decisions to clarify the guidance in the amendments in Update 2016-13 resulting from the November 1, 2018 Credit Losses TRG meeting. The proposed amendments relate to the following two issues raised by stakeholders during the implementation of Update 2016-13 and discussed at that meeting: (a) vintage disclosure requirements related to line-of-credit arrangements that convert to term loans and (b) considering contractual extensions and renewals in determining the contractual term of a financial asset.

Issue 5A: Vintage Disclosures—Line-of-Credit Arrangements Converted to Term Loans

57. The proposed amendments would require an entity to present the amortized cost basis of line-of-credit arrangements that are converted to term loans within each credit quality indicator in the origination year that corresponds with the period in which an entity made its most recent credit decision after the original credit decision. However, line-of-credit arrangements that are converted to a term loan without an additional credit decision after an entity made its original credit decision or through a troubled debt restructuring would be presented in a separate column, as illustrated in Example 15.

Amendments to Subtopic 326-20

58. Add paragraph 326-20-50-6A and amend paragraph 326-20-55-79, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Disclosure

> Credit Quality Information

326-20-50-6A For the purpose of the disclosure requirement in paragraph 326-20-50-6, an entity shall present the amortized cost basis of line-of-credit arrangements that are converted to term loans within each credit quality indicator in the

<u>origination year that corresponds with the period in which the entity made its most recent credit decision after the original credit decision. For amounts of line-of-credit arrangements that are converted to term loans without an additional credit decision after an entity made its original credit decision or that are converted to term loans because of a troubled debt restructuring, the entity shall disclose the amortized cost basis in a separate column (see Example 15). An entity shall disclose each reporting period, by class of financing receivable or major security type, the amount of line-of-credit arrangements that are converted to term loans each reporting period.</u>

Implementation Guidance and Illustrations

> Illustrations

> > Example 15: Disclosing Credit Quality Indicators of Financing Receivables by Amortized Cost Basis

326-20-55-79 The following Example illustrates the presentation of credit quality disclosures for a financial institution with a narrow range of loan products offered to local customers—both consumer and commercial. Depending on the size and complexity of an entity's portfolio of financing receivables, the entity may present disclosures that are more or less detailed than the following Example. An entity may choose other methods of determining the class of financing receivable and may determine different credit quality indicators that reflect how credit risk is monitored. Some entities may have more than one credit quality indicator for certain classes of financing receivables.

	Term Loans Amortized Cost Basis by Origination Year								
As of December 31, 20X5	20X5	20X4	20X3	20X2	20X1	Prior	Revolving Loans Amortized Cost Basis	Revolving Loans Converted to Term Loans Amortized Cost Basis	Total
Residential mortgage:									
Risk rating:									
1–2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3–4 internal grade	-	-	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-	-	-
Total residential mortgage loans	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Residential mortgage loans:									
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Consumer:									
Risk rating:									
1–2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3–4 internal grade	-	-	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-	-	-
Total consumer	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Consumer loans:									
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial business:									
Risk rating:									
1–2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3–4 internal grade	-	-	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-	-	-
Total commercial business	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial business loans:									
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial mortgage:									
Risk rating:									
1–2 internal grade	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3–4 internal grade	-	-	-	-	-	-	-	-	-
5 internal grade	-	-	-	-	-	-	-	-	-
6 internal grade	-	-	-	-	-	-	-	-	-
7 internal grade	-	-	-	-	-	-	-	-	-
Total commercial mortgage	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Commercial mortgage loans:									
Current-period gross writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Current-period recoveries	-	-	-	-	-	-	-	-	-
Current-period net writeoffs	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -

Issue 5B: Contractual Extensions and Renewals

59. The proposed amendments would clarify that an entity should consider extension or renewal options (excluding those that are accounted for as a derivative in Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

Amendments to Subtopic 326-20

60. Amend paragraph 326-20-30-6, with a link to transition paragraph 326-10-65-1, as follows:

Financial Instruments—Credit Losses—Measured at Amortized Cost

Initial Measurement

> Developing an Estimate of Expected Credit Losses

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: ~~unless it has a reasonable expectation at the reporting date that it will execute a **troubled debt restructuring** with the borrower.~~

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. In determining the contractual term, the entity shall evaluate the likelihood that the contractual extension or renewal option will be exercised.

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

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

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

BC2. The following paragraphs are organized by issue and further segmented by subissues within each issue. This organization mirrors the organization in the Amendments to the *FASB Accounting Standards Codification*® section.

Background Information

BC3. Over the last several years, the Board has issued the following Accounting Standards Updates related to financial instruments:

a. Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*
b. Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*
c. Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.*

BC4. Since the issuance of each Update, the Board has assisted stakeholders in the implementation of the amendments within those Updates. Through this assistance, the Board has identified certain areas that require clarification and correction.

BC5. The Board has an ongoing project on its agenda for improving the Codification or correcting its unintended application. The items addressed in that project generally are not expected to have a significant effect on current accounting practice or to create a significant administrative cost for most entities. The amendments in this proposed Update are similar to those items. However, the Board decided to issue a separate Update for improvements related to Updates 2016-01, 2016-13, and 2017-12 to increase stakeholders' awareness of the amendments and to expedite the improvements.

BC6. The Board issued Update 2016-01 in January 2016. The amendments in that Update retained the current framework for accounting for financial instruments in GAAP but made targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. In addition to amending Topic 825, Financial Instruments, the amendments in the Update added Topic 321, Investments—Equity Securities, and made several consequential amendments to the Codification.

BC7. The Board issued Update 2016-13 in June 2016. The amendments in that Update introduced the expected credit losses methodology for the measurement of credit losses on financial assets measured at amortized cost basis, replacing the previous incurred loss methodology. The amendments in the Update added Topic 326, Financial Instruments—Credit Losses, and made several consequential amendments to the Codification. The Update also modified the accounting for available-for-sale debt securities, which must be individually assessed for credit losses when fair value is less than the amortized cost basis, in accordance with Subtopic 326-30, Financial Instruments—Credit Losses—Available-for-Sale Debt Securities.

BC8. The Board issued Update 2017-12 in August 2017. The amendments in that Update made targeted improvements to the hedge accounting model with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in that Update made certain targeted improvements to simplify the application of hedge accounting guidance in current GAAP on the basis of the feedback received from preparers, auditors, users, and other stakeholders.

BC9. The amendments in this proposed Update include items brought to the Board's attention by stakeholders. The proposed amendments would clarify, correct, and improve the guidance related to the amendments in Updates 2016-01, 2016-13, and 2017-12. Therefore, the Board does not anticipate that entities would incur significant costs because of the proposed amendments. The proposed amendments should provide the benefit of improving consistent application of GAAP by clarifying existing and pending guidance within GAAP.

Basis for Conclusions

Topic 1: Codification Improvements Resulting from the June 11, 2018 Credit Losses Transition Resources Group (TRG) Meeting

Issue 1A: Accrued Interest

BC10. Update 2016-13 defines *amortized cost basis* as the amount at which a financing receivable or investment is originated or acquired, adjusted for applicable accrued interest, accretion, or amortization of premium, discount, and net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments.

BC11. Stakeholders indicated that including *applicable accrued interest* in the definition of *amortized cost basis* would be operably burdensome and costly to implement. Those stakeholders noted that many financial reporting systems, which are separate from loan systems that track individual loan details, do not track accrued interest amounts on an individual loan basis, which is necessary to (a) measure expected credit losses on a pool basis, (b) implement presentation requirements, and (c) prepare certain disclosures. Stakeholders asked whether including accrued interest in the definition of *amortized cost basis* was appropriate.

BC12. The Board clarified that the original intent in defining *amortized cost basis* was for financial assets held at amortized cost basis to represent the net amount expected to be collected. Therefore, contractual interest that has been earned but not yet received on the financial asset must be included in the amortized cost basis, which is reduced by the allowance for credit losses to reflect the net amount expected to be collected on the balance sheet.

BC13. However, the Board also clarified that it was not its intent to impose significant system and operational changes because of the change in definition. Therefore, the proposed amendments in this Update would:

a. Allow an entity to perform an assessment of collectibility and determine the allowance for credit losses for accrued interest separately from the associated financial asset and other components of amortized cost basis. The Board acknowledged that an entity would still be required to apply the guidance in paragraph 326-20-30-2, which requires an entity to measure expected credit losses on a collective (pool) basis when similar risk characteristics exist when measuring the allowance for credit losses for accrued interest.
b. Allow an entity to make an accounting policy election to separately present on the statement of financial position the accrued interest receivable balance net of the allowance for credit losses or to present the accrued interest receivable balance net of the allowance for credit losses within another statement of financial position line item if the entity discloses the accrued interest receivable balance, the applicable allowance for credit losses related to the accrued interest receivable balance, and the line item in which the accrued interest receivable balance is included.
c. Allow an entity to separately disclose the total amount of accrued interest as a single balance in certain disclosure requirements within Topic 326.

BC14. Stakeholders also noted that a conflict exists between current nonaccrual practices and the writeoff guidance in paragraph 326-20-35-8 regarding accrued interest. Stakeholders noted that the writeoff guidance would require the reversal of accrued interest through the allowance for credit losses, whereas certain policies currently used in practice would allow the reversal of accrued interest through interest income.

BC15. The Board clarified that it was not its intent to change existing practice with regards to the reversal or writeoff of uncollectible accrued interest. As a result, the Board clarified that an entity may make an accounting policy election at the class of financing receivable or the major security type level to write off accrued interest by either reversing interest income or adjusting the allowance for credit losses. The Board understands that the amendments in Update 2016-13 and the amendments in this proposed Update apply to all types of entities, including regulated and nonregulated entities. The Board expects that entities that currently do not have an accounting policy in place would be able to develop a policy without incurring significant costs.

BC16. Separate from the accounting policy election to write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses, the Board clarified that an entity may make an accounting policy election at the class of financing receivable or the major security type level to exclude accrued interest from the calculation of expected credit losses if the entity writes off the applicable accrued interest receivable balance in a timely manner. The Board understands that requiring an entity to record an allowance for credit losses on accrued interest balances only to have it reverse or write off those balances would create an unnecessary burden. However, the Board did not want an entity to record accrued interest balances without recording an allowance for credit losses if it does not write off uncollectible accrued interest balances in a timely manner. Therefore, an entity that does not have or develop an accounting policy to write off accrued interest amounts in a timely manner would be required to calculate an allowance for credit losses on those balances, subject to the guidance in Topic 326.

Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities

BC17. The amendments in Update 2016-13 made numerous changes to the accounting for loans and debt securities, including the introduction of the expected credit losses methodology, which replaced the incurred loss methodology and the other-than-temporary impairment assessment methodology. In addition, the amendments made only limited changes to account for transfers of loans that are subsequently identified for sale.

BC18. Measurement guidance in Subtopic 948-310, Financial Services—Mortgage Banking—Receivables, requires that mortgage loans held for sale be reported at the lower of amortized cost basis or fair value at the balance sheet date. The amount by which amortized cost basis exceeds fair value should be accounted for as a valuation allowance, and changes in the valuation allowance should be included in the determination of net income of the period in which the change occurs. In addition, Subtopic 948-310 requires that mortgage loans transferred to loans held as long-term investment be measured upon transfer at the lower of amortized cost basis and fair value on the transfer date. Subsequently, an entity with loans held as long-term investments is required to measure the allowance for credit losses by following guidance in Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost.

BC19. Subtopic 310-10, Receivables—Overall, provides guidance on how an entity should account for loans not held for sale and nonmortgage loans held for sale.

a. Loans not held for sale that management has the intent and ability to hold for the foreseeable future or until maturity or payoff should be reported in the balance sheet at the outstanding principal adjusted for any writeoffs, the allowance for credit losses, any deferred fees or costs on originated loans, and any unamortized premiums or discounts on the purchased loans.
b. Nonmortgage loans held for sale should be reported at the lower of amortized cost basis and fair value.

BC20. Subtopic 320-10, Investments—Debt and Equity Securities—Overall, describes the measurement of investments in debt securities classified as held-to-maturity. Investments in debt securities classified as held-to-maturity are measured at amortized cost, and an entity is required to measure an allowance for credit losses for held-to-maturity debt securities by following the guidance in Subtopic 326-20.

BC21. Subtopic 326-30 requires that for individual debt securities classified as available-for-sale, an entity should determine whether a decline in fair value below the amortized cost basis has resulted from credit losses or other factors. An entity should record an impairment for credit losses through an allowance for credit losses. However, the allowance is limited by the amount that the fair value is less than the amortized cost basis. Impairment that has not been recorded through an allowance for credit losses is recorded through other comprehensive income, net of applicable taxes. The fair value floor and other requirements of Subtopic 326-30 may cause differences in the measurement of an allowance for credit losses on available-for-sale and held-to-maturity debt securities.

BC22. Subtopic 320-10 requires that when a debt security is transferred into the held-to-maturity category from the available-for-sale category, any unrealized holding gain or loss at the date of the transfer should continue to be reported as a separate component of shareholder’s equity, such as accumulated other comprehensive income, but should be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. That is, the unrealized gain or loss should be amortized as an adjustment of yield by following the interest method in accordance with Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs. Additionally, Subtopic 320-10 requires that when a debt security is transferred into the available-for-sale category from the held-to-maturity category, the unrealized holding gain or loss at the date of the transfer should be reported in other comprehensive income.

BC23. Stakeholders noted that the guidance in Update 2016-13 would lead to an entity double counting credit losses when transferring a loan or debt security between classifications or categories. Stakeholders noted that the amendments in Update 2016-13 require an entity with (a) loans classified as held-for-long-term-investment or not-held-for-sale or (b) debt securities classified as held-to-maturity to calculate and record the expected credit loss for the related financial asset on day one even if that risk is remote. The issue of double counting credit losses arises when an entity records an allowance for credit losses or a valuation allowance related to a loan classified as held-for-sale or a debt security classified as available-for-sale and subsequently decides to transfer the loan or debt security to a long-term hold position because the entity would be required to transfer the loan or debt security at the lower of amortized cost basis and fair value. Therefore, upon transfer of a loan or debt security to a long-term hold position, an entity that previously recorded an allowance for credit losses or a valuation allowance that may already have considered credit losses would have to measure an allowance for credit losses in accordance with Subtopic 326-20, even if that risk is remote.

BC24. To address stakeholders' concerns about double counting the allowance for credit losses, the Board clarified that when transferring a loan or debt security between classifications or categories, an entity should reverse in earnings any valuation allowance or allowance for credit losses that is recorded at the time the entity transfers a loan or debt security. The Board clarified that an entity should then reclassify and transfer the loan or debt security to the new classification or category at its amortized cost basis (which is reduced by any previous writeoffs but excludes any valuation allowance or allowance for credit losses), adjusted for any remaining unrealized holding gain or loss in accumulated other comprehensive income, if applicable. Finally, the Board clarified that an entity should then measure a valuation allowance or allowance for credit losses on the loan or debt security following the guidance applicable to the new classification or category.

BC25. To be consistent with the logic of existing presentation requirements, the Board clarified that an entity should present the amounts reversed or established for the allowance for credit losses related to the transfer of loan and debt security between classifications or categories on a gross basis through the income statement or the notes to the financial statements, if applicable.

Issue 1C: Recoveries

BC26. The amendments in Update 2016-13 require that writeoffs of financial assets, which may be full or partial writeoffs, should be deducted from the allowance. The writeoffs should be recorded in the period in which the financial asset or assets are deemed uncollectible. The guidance further states that recoveries of financial assets and trade receivables previously written off should be recorded when received.

BC27. Stakeholders noted that there was diversity in views on whether cash flows from expected recoveries of a financial asset that had been written off, or may be written off in the future, should be included in the calculation of expected credit losses. Stakeholders stated that paragraph 326-20-30-1 implies that recoveries of financial assets should be included in the net amount expected to be collected and, therefore, by extension, included in the allowance calculation for credit losses. However, stakeholders noted that paragraph 326-20-35-8 states that recoveries on written off assets should be recorded when received. Stakeholders noted that they are uncertain whether an entity is required to include expected recoveries when measuring the allowance for credit losses on an individual or pool of financial assets.

BC28. The Board clarified that an entity should consider recoveries when measuring the allowance for credit losses on either an individual basis or a pool basis. The Board noted that when considering recoveries, an entity should follow the guidance in Subtopic 326-20, which states that when developing an estimate of expected credit losses on financial asset(s), an entity should consider available information relevant to assessing the collectibility of cash flows. This information may include internal information, external information, or a combination of both relating to past events, current conditions, and reasonable and supportable forecasts.

BC29. In deciding to clarify that an entity should consider recoveries when measuring the allowance for credit losses, the Board considered the deliberations that led to the finalization of Update 2016-13.

a. First, the Board concluded that the measurement of credit losses should be based on an entity's expectations about the collectibility of financial assets held at the reporting date.
b. Second, the Board concluded that an entity's expectations about the collectibility of a financial asset should consider available information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that inform the entity about the estimated collectibility of the asset.
c. Third, the Board considered retaining an initial recognition threshold (such as probable) for recording credit losses. The Board concluded, however, that the methodology for recording credit losses should not be based on a notion of "incurred" losses because that notion would interfere with the timely measurement of changes in expected credit losses and the reporting of credit losses. Removing the probable threshold would result in a more timely measurement of expected credit losses because losses can be expected *before* they are probable. The exception to this requirement relates to the two instances that allow an entity to measure the allowance for credit losses by using the fair value of the underlying collateral at the reporting date. Those two instances include situations in which foreclosure is probable or for a collateral-dependent loan for which the borrower is experiencing financial difficulty.

BC30. The Board considered numerous alternatives in defining the scope of recoveries that could be considered as an input into determining the allowance for credit losses. The Board decided that it would be inconsistent with its original intent to provide flexibility if the Board were to specifically define one input. Therefore, the Board decided not to specifically define the scope of recoveries that could be included in determining the allowance for credit losses. The majority of stakeholders stated that the Board should not define what is considered a recovery because the guidance in Update 2016-13 is clear that recoveries must be considered when measuring the allowance for credit losses and defining a single input would be inconsistent with the intent of the guidance to provide flexibility in measuring the allowance for credit losses. In contrast, some stakeholders stated that the Board should consider defining recoveries so that (a) entities apply the guidance consistently and (b) to provide rigor around recovery types.

BC31. In addition, the Board understood that in certain circumstances, in particular when measuring the allowance for credit losses on an individual financial asset, an entity may estimate that it will collect cash flows that are greater than the current amortized cost basis. The Board decided that recoverable amounts included in the valuation account should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. For collateral-dependent financial assets, when the fair value (less costs to sell, if applicable) of the collateral at the reporting date exceeds the amortized cost basis of the financial asset, an entity should add an allowance for credit losses to the amortized cost basis and that allowance for credit losses should not exceed amounts previously written off.

Topic 2: Codification Improvements to Update 2016-13

BC32. Issues 2A and 2B represent conforming amendments to the guidance related to amendments in Update 2016-13. The reasons for making those conforming amendments are sufficiently explained in the Summary and Amendments to the *FASB Accounting Standards Codification®* sections. Therefore, there are no formal basis for conclusions sections for those issues.

Issue 2C: Clarification That Reinsurance Recoverables Are within the Scope of Subtopic 326-20

BC33. The scope of Subtopic 326-20 includes financial assets measured on an amortized cost basis. Paragraph 326-20-15-2 provides a list of specific financial assets that are measured on an amortized cost basis and are within the scope of Subtopic 326-20, which includes reinsurance recoverables that result from insurance transactions within the scope of Topic 944, Financial Services—Insurance. Topic 944 requires that reinsurance recoverables be recognized in a manner consistent with the liabilities (including estimated amounts for claims incurred but not reported and future policy benefits) relating to the underlying reinsurance contracts. Assumptions used in estimating reinsurance recoverables should be consistent with those used in estimating the related liabilities. Stakeholders noted that, without proper clarification, a reader could interpret that reinsurance recoverables are excluded from the scope of Subtopic 326-20 because those amounts are not measured on an amortized cost basis. The Board clarified that it intended to include within the scope of Subtopic 326-20 all reinsurance recoverables measured in accordance with Topic 944 and thereby require an entity to measure an allowance for credit losses on those reinsurance recoverables in accordance with Subtopic 326-20. Therefore, the proposed amendments would clarify that reinsurance recoverables are within the scope of Subtopic 326-20.

Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments

BC34. The guidance in paragraph 326-20-30-4 permits an entity to use a discounted cash flow method when determining the allowance for credit losses for financial assets measured at amortized cost basis. The guidance was retained, amended, and moved from Topic 310, Receivables, to Topic 326 through the amendments in Update 2016-13. The guidance in this paragraph specifically addresses the measurement of variable-rate financial assets on which an entity chooses to measure credit losses using a discounted cash flow method. Specifically, the guidance requires an entity to calculate the financial asset's effective interest rate used to discount expected cash flows on the basis of the variable factor as it changes over the life of the financial asset. Furthermore, the guidance prohibits an entity from incorporating projections of changes in the variable factor for determining both the effective interest rate and the estimate of expected future cash flows.

BC35. During the implementation process for Update 2016-13, stakeholders questioned whether prohibiting projections of future economic environments in estimating expected cash flows and determining the effective interest rate used to discount expected cash flows for variable-rate financial assets was consistent with the Board's intent. The Board acknowledged that the prohibition carried forward from existing guidance was inconsistent with its intent in providing entities with the flexibility to determine the allowance for credit losses. The Board noted that some entities may have more sophisticated methodologies that allow them to project the interest rate environment and more accurately reflect expected credit losses. The Board saw no reason to prohibit entities from measuring a more accurate estimate of credit losses and reflecting that estimate in the allowance for credit losses.

BC36. Therefore, the Board decided to permit, but not require, an entity to use projections of future interest rate environments in determining those expected future cash flows and in determining the effective interest rate for discounting expected future cash flows, provided that the expectations or projections are determined in a manner that is consistent with Topic 326's requirements.

Specifically, the Board believes that the reasonable and supportable forecast period over which an entity chooses to project the contractual variable interest rate should be consistent for the purposes of estimating future cash flows and for determining the effective interest rate.

BC37. In addition, the Board acknowledged that the issue also exists for available-for-sale debt securities for which an entity must use a discounted cash flow method to estimate expected credit losses in accordance with Subtopic 326-30. That is, the guidance in paragraph 326-30-35-11 prohibits an entity from incorporating projections of changes in the variable factor for purposes of determining expected future cash flows or determining the effective interest rate. For the same reasons as the amendments to Subtopic 326-20 for this issue, the Board decided to permit, but not require, an entity to use projections of future interest rate environments in determining the expected future cash flows and in determining the effective interest rate when calculating the allowance for credit losses on an available-for-sale debt security.

Issue 2E: Consideration of Prepayments in Determining the Effective Interest Rate

BC38. The guidance in paragraph 326-20-30-4 permits an entity to use a discounted cash flow method in determining the allowance for credit losses on financial assets and requires that an entity use the effective interest rate to discount the expected future cash flows when using a discounted cash flow method. *Effective interest rate* is defined in the Codification as the rate of return implicit in the financial asset and is used for interest income recognition purposes. In most cases, the effective interest rate is not adjusted for expected prepayments on the financial asset. However, paragraph 326-20-30-6 requires an entity to consider expected prepayments in the future principal and interest cash flows when utilizing a discounted cash flow method.

BC39. During the implementation process for Update 2016-13, stakeholders questioned whether it would be appropriate to adjust the effective interest rate to consider expected prepayments on the financial asset because those expected prepayments must be considered in the estimate of expected future cash flows. The misalignment between the timing of cash flows due to expected prepayments in estimating the expected future cash flows and in determining the effective interest rate used to discount those future cash flows results in a measurement of an allowance that is inconsistent with the expected credit losses on the financial asset. That is, the measurement fails to appropriately isolate credit risk in determining an allowance for credit losses.

BC40. The staff discussed the issue with the Credit Losses TRG in June 2017 and supported the view that an entity may, as an accounting policy election, adjust the effective interest rate used to discount expected future cash flows in accordance with paragraph 326-20-30-4 for the expectation of prepayments on the financial asset. The accounting policy election would be made by class of financing receivable and by major security type. However, the use of a prepayment-adjusted effective interest rate is not required and would not affect the effective interest rate used to recognize interest income in accordance with Topic 310. The permission to make an accounting policy election that allows an entity to determine a more accurate and faithful representation of expected credit losses on an entity's financial assets is consistent with the Board's intent in providing flexibility and judgment in the expected credit losses methodology introduced through the amendments in Update 2016-13. Therefore, the proposed amendment to add paragraph 326-20-35-4A would clarify the guidance by permitting an entity to make an accounting policy election to adjust the effective interest rate for the consideration of timing of expected prepayments.

BC41. In addition, the Board acknowledges that the issue also exists for available-for-sale debt securities for which an entity must use a discounted cash flow method to estimate credit losses in accordance with Subtopic 326-30. Therefore, the proposed amendment to add paragraph 326-30-35-7A would clarify the guidance by permitting an entity to make an accounting policy election to adjust the effective interest rate for the consideration of timing of prepayments in estimating credit losses on available-for-sale debt securities. The accounting policy election would be applied at the major security type level.

BC42. Finally, the Board discussed the relationship between an entity's electing to use a prepayment-adjusted effective interest rate and an entity's using projected interest rate environments in estimating expected cash flows and determining the effective interest rate for variable rate financial instruments. The Board decided to include a question in this proposed Update to ask whether an entity should be required to use a prepayment-adjusted effective interest rate if that entity uses projections of interest rate environments in estimating expected cash flows, including expected prepayments and defaults.

Issue 2F: Consideration of Estimated Costs to Sell When Foreclosure Is Probable

BC43. The guidance in paragraph 326-20-35-4 requires an entity to use the fair value of the collateral to determine the allowance for credit losses when foreclosure is probable. The guidance in paragraph 326-20-35-5 permits an entity, as a practical expedient, to use the fair value of the collateral in determining the allowance for credit losses on a collateral-dependent financial asset. The guidance describes a collateral-dependent financial asset as a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date. The guidance in paragraph 326-20-35-5 requires an entity to consider the estimated costs to sell (on a discounted basis) if the repayment or satisfaction of the financial asset depends on the sale of the collateral for collateral-dependent financial assets. Both requirements in paragraphs 326-20-35-4 through 35-5 were carried forward from Subtopic 310-10, which stated that if the fair value of collateral was used to measure impairment of a collateral-dependent loan and repayment or satisfaction of a loan depends on the sale of the collateral, an entity should adjust the fair value to consider estimated costs to sell (on a discounted basis).

BC44. The Board did not intend to change the requirement in existing GAAP to consider estimated costs to sell when using the fair value of the collateral to determine the allowance for credit losses. However, without clarification, paragraph 326-20-35-4 may be interpreted to not require, or to even prohibit, the consideration of estimated costs to sell when foreclosure is probable. Therefore, the proposed amendment would clarify in paragraph 326-20-35-4 that an entity would be required to adjust the fair value of the collateral for estimated costs to sell (on a discounted basis).

Transition and Effective Date for Codification Improvements to Update 2016-13

BC45. The proposed amendments included in Topics 1 and 2 amend or relate to the guidance in Update 2016-13. For entities that have not adopted Update 2016-13 as of the issuance date of a final Update of these proposed amendments, the Board decided to align the effective dates and transition requirements of these proposed amendments with the effective dates and transition requirements of Update 2016-13. For entities that have adopted Update 2016-13 as of the issuance date of a final Update of these proposed amendments, the Board will determine the effective date and transition requirements for these proposed amendments after it considers stakeholders' feedback on this proposed Update.

Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

Issue 3A: Partial-Term Fair Value Hedges of Interest Rate Risk

BC46. For a fair value hedge of interest rate risk, paragraph 815-25-35-13B, added by the amendments in Update 2017-12, allows an entity to measure the change in the fair value of the hedged item using an assumed term that begins when the hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. Stakeholders asked whether the ability to measure the hedged item in a partial-term fair value hedge using its assumed maturity date only applies to interest rate risk or whether the hedged item in a partial-term fair value hedge of both interest rate risk and foreign exchange risk also can be measured using the assumed partial-term maturity date. Stakeholders noted that for full-term fair value hedges, both interest rate risk and foreign exchange risk may be designated as the hedged risks.

BC47. The Board decided that partial-term fair value hedging guidance should be aligned with that of full-term fair value hedging guidance by allowing both interest rate risk and foreign exchange risk to be designated. However, the Board is requesting feedback on this proposed Update to determine whether partial-term fair value hedging should be extended to all risks that can be hedged in Topic 815, Derivatives and Hedging.

BC48. The amendments in Update 2017-12 added partial-term fair value hedging to Topic 815, which resulted in stakeholders raising the question of whether one or more separately designated partial-term fair value hedges of a single financial instrument can be outstanding at the same time. For example, stakeholders inquired whether an entity could have hedges of consecutive interest cash flows in Years 1–3 and Years 5–7 of a 10-year debt instrument outstanding at the same time. The Board decided that permitting multiple outstanding partial-term fair value hedging relationships of a single financial instrument further aligns the flexibility already existing for cash flow hedging strategies with fair value hedging strategies. The Board's decision is consistent with the basis for conclusions in Update 2017-12 in which the Board decided that there should be equitable treatment for partial-term fair value and cash flow hedges.

Issue 3B: Amortization of Fair Value Hedge Basis Adjustments

BC49. The amendments in Update 2017-12 added paragraph 815-25-35-9A to indicate the amortization periods to be used when amortizing fair value hedge basis adjustments. Before the issuance of Update 2017-12, the amortization period always related to the full term of the financial instrument. Because the guidance added in the amendments in Update 2017-12 permits partial-term fair value hedging, the primary purpose of paragraph 815-25-35-9A is to indicate the period over which to amortize the basis adjustments for outstanding and discontinued partial-term fair value hedges. After the addition of paragraph 815-25-35-9A, stakeholders asked whether the wording of that paragraph indicates that an entity is required to amortize fair value hedge basis adjustments for outstanding hedging relationships. Stakeholders also asked if the amortization period in a partial-term hedge may be the term over which the partial-term was originally designated or an earlier term if an entity intended to discontinue the hedging relationship.

BC50. The Board did not intend to alter the existing guidance in paragraph 815-25-35-9 by adding paragraph 815-25-35-9A. Accordingly, the Board affirmed that an entity may begin amortization of a fair value hedge basis adjustment before the hedging relationship is discontinued, but an entity is not required to begin amortization until the hedging relationship is discontinued. Additionally, the Board decided to clarify that if an entity elects to amortize the basis adjustment on an outstanding partial-term fair value hedge, that basis adjustment should be fully amortized on or before the hedged item's assumed maturity date, which is documented at hedge inception in accordance with paragraph 815-25-35-13B.

Issue 3C: Disclosure of Fair Value Hedge Basis Adjustments

BC51. Paragraph 815-10-50-4EE, added by the amendments in Update 2017-12, introduces new tabular disclosures for fair value hedges. Specifically, it requires disclosing the carrying amount of hedged assets and liabilities recognized on the balance sheet and the cumulative amount of fair value hedge basis adjustments included in those carrying amounts. Stakeholders asked the Board whether available-for-sale debt securities designated as hedged items in fair value hedges should be disclosed at amortized cost or fair value. Stakeholders also asked if basis adjustments resulting from fair value hedges of foreign currency risk should be included in the tabular disclosures required by paragraph 815-10-50-4EE.

BC52. When an available-for-sale debt security is designed as the hedged item in a fair value hedge, its basis adjustment is calculated on the basis of the instrument’s amortized cost. Accordingly, the Board decided that the amortized cost of the hedged available-for-sale debt security should be included in the disclosures required by paragraph 815-10-50-4EE. The Board concluded that disclosing the amortized cost of an available-for-sale debt security in relation to its fair value hedge basis adjustment assists users in understanding the changes in the fair value of the available-for-sale debt security attributable to the hedged risk. This decision also aligns available-for-sale disclosures with those of other fair value hedges of interest rate risk that compare amortized cost with fair value hedge basis adjustments. The Board believes that this alignment is appropriate because the earnings effect of an available-for-sale debt security is similar to that of an instrument held at amortized cost (that is, the change in fair value is not immediately recognized in earnings).

BC53. The Board intended for the disclosures in paragraph 815-10-50-4EE to provide users with information to evaluate the amount, timing, and uncertainty of future cash flows associated with hedged assets or liabilities. The basis adjustment disclosures provide users with additional information about fair value hedge basis adjustments that will *not* affect future cash flows. For example, interest rate risk basis adjustments will revert to zero at the end of the hedging relationship if the hedging relationship is not discontinued before maturity. Unlike interest rate risk basis adjustments, foreign exchange risk basis adjustments indicate changes to cash flows that are not expected to revert to zero over the life of the hedging relationship. Moreover, foreign exchange risk basis adjustments are required to be recognized in accordance with Topic 830 regardless of whether hedge accounting is applied to the hedged item. Accordingly, the Board concluded that foreign exchange risk basis adjustments should be excluded from the disclosure requirements of paragraph 815-10-50-4EE because they do not provide incremental information on balance sheet adjustments resulting from hedge accounting that are not expected to affect future cash flows.

Issue 3D: Consideration of the Hedged Contractually Specified Interest Rate under the Hypothetical Derivative Method

BC54. Paragraph 815-30-35-26, as amended in Update 2017-12, describes how an entity should assess hedge effectiveness for certain cash flow hedges of interest rate risk under the hypothetical derivative method. That paragraph, as amended, appears to require that the hypothetical derivative used in the quantitative effectiveness assessment satisfy all the conditions that would have to be met to apply shortcut method accounting except that the index on which the variable leg of the hypothetical swap is based does not have to match the designated contractually specified interest rate (described in paragraph 815-20-25-106(g) under the shortcut method). However, the Board intended to incorporate contractually specified interest rate hedging into the hypothetical derivative method. Consequently, the proposed amendment to paragraph 815-30-35-26 would indicate that an entity should consider the contractually specified interest rate designated in the hedging relationship when applying the hypothetical derivative method.

Issue 3E: Scope for Not-for-Profit Entities

BC55. Paragraph 815-20-25-83A, added by the amendments in Update 2017-12, permits an entity to amortize the initial value of a component excluded from the assessment of hedge effectiveness. This guidance applies to both fair value hedging relationships and cash flow hedging relationships. Under this amortization approach, the difference between the change in fair value of the excluded component and the amounts amortized in earnings is recognized in other comprehensive income. To recognize amounts in other comprehensive income, an entity must separately report earnings. Thus, the Board decided to limit the scope of the guidance on amortizing excluded components to only entities that separately report earnings. Accordingly, under the proposed amendment, entities that do not separately report earnings, including most not-for-profit entities, cannot elect to amortize an excluded component in a fair value hedge. These are the same entities that under existing GAAP cannot apply cash flow hedge accounting because they do not separately report earnings.

BC56. Additionally, stakeholders asked whether the scope of Topic 815 described in paragraph 815-10-15-1 should be amended to include cross-references to paragraph 815-20-15-1 related to the scope of hedge accounting and paragraph 815-30-15-3, which indicates that not-for-profit health care entities seeking to apply the guidance in Subtopic 815-30 on cash flow hedge accounting should see Subtopic 954-815, Health Care Entities—Derivatives and Hedging. The Board agreed that those cross-references should be added for completeness.

Issue 3F: Hedge Accounting Provisions Applicable to Certain Private Companies and Not-for-Profit Entities

BC57. The guidance added in the amendments in Update 2017-12 provides relief relative to the timing of when a private company that is not a financial institution that also is not applying the simplified hedge accounting approach (as described in paragraphs 815-20-25-133 through 25-138) is required to document certain components of a designated hedging relationship. Stakeholders inquired about the timing of when an entity applying the guidance in paragraphs 815-20-25-139 through 25-140 must prepare the documentation that supports its assertion that the designated last of layer in a last-of-layer hedge is anticipated to be outstanding at the hedged item's assumed maturity date (that is, the last-of-layer hedging assertion described in paragraph 815-20-25-3(c)(2)).

BC58. The Board decided that these private companies should document the analysis supporting their last-of-layer designation concurrently with hedge inception. The Board notes that even with the timing relief provided by the amendments in Update 2017-12, an entity is still required to document the characteristics of the hedge that allow the hedged item to be identified at hedge inception. The amendments in Update 2017-12 only defer documentation requirements for items related to hedge effectiveness assessment.

BC59. The Board believes that performing the analysis to support a last-of-layer assertion is an inherent step in identifying the last of layer as the hedged item. Because these private companies are required to document the hedged item at hedge inception in accordance with paragraph 815-20-25-139(c), the Board decided that the timing of the last-of-layer analysis also should coincide with hedge inception.

BC60. Stakeholders also asked whether the same timing relief related to subsequent quarterly hedge effectiveness assessment provided to certain private companies in paragraph 815-20-25-142 may be applied to hedging relationships of not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market).

BC61. It was the Board's intent to provide certain private companies and not-for-profit entities with the same documentation and hedge effectiveness assessment relief. Accordingly, the proposed amendment would align the timing relief for subsequent hedge effectiveness assessment already provided to certain private companies to certain not-for-profit entities.

Issue 3G: Application of a First-Payments-Received Cash Flow Hedging Technique to Overall Cash Flows on a Group of Variable Interest Payments

BC62. The amendments in Update 2017-12 removed the implementation guidance in paragraphs 815-20-55-33A through 55-33F and the illustration in paragraphs 815-20-55-226 through 55-229 demonstrating the application of the first-payments-received cash flow hedging technique to overall cash flows on a group of variable interest payments. Consequently, stakeholders asked if those deletions indicate that such a technique no longer is permitted. Stakeholders commented that there may be certain circumstances in which an entity would still want to designate overall cash flows as the hedged risk under a first-payments-received technique.

BC63. In removing the implementation guidance and illustration of the first-payments-received cash flow hedging technique, the Board did not intend to prohibit hedging overall cash flows under that technique. The amendments in Topic 815 introduced contractually specified interest rate hedging into Topic 815. By introducing that concept, the Board believed that entities no longer would seek to hedge overall cash flows because entities no longer would be limited to hedging only benchmark interest rate risk.

BC64. The Board believes that prohibiting an entity from designating overall cash flows as the hedged risk in a hedge using the first-payments-received technique is inconsistent with the guidance for cash flow hedges of interest rate risk not under the first-payments-received technique. When a first-payments-received technique is not used, an entity may designate total cash flows as the hedged risk in accordance with paragraph 815-20-25-15(j)(1). Accordingly, the Board decided to clarify that hedging overall cash flows using such a technique continues to be permitted.

BC65. However, the Board wanted to emphasize that designating the variability in overall cash flows under the first-payments-received technique is an exception because it does not consider cash flows contractually due but not received from the debtor as hedged cash flows. Thus, the technique when applied to overall cash flows excludes some of the risk of decreases in interest payment inflows related to credit default. That exception guidance does not apply to an interest rate risk hedge when the variability in a contractually specific interest rate is designated as the hedged risk in accordance with paragraph 815-20-25-15(j)(2) because an entity does not consider cash flow changes resulting from changes in the credit quality of the underlying assets. The guidance related to the exception of hedging the variability in overall cash flows under the first-payments-received technique, which was superseded by the amendments in Update 2017-12 along with all references to the first-payments-received technique when hedging overall cash flows, was added to proposed paragraph 815-20-55-33G because the Board believes that the exception is still relevant.

Issue 3H: Update 2017-12 Transition Guidance

BC66. Stakeholders asked the Board to clarify three issues encountered when applying the transition guidance in Update 2017-12. Specifically, stakeholders raised questions on hedge rebalancing, transition from a quantitative method of assessing hedge effectiveness to a critical-terms-match method, and reclassifying prepayable debt securities from the held-to-maturity category to the available-for-sale category.

BC67. In relation to hedge rebalancing, the transition guidance in Update 2017-12 allows an entity to rebalance fair value hedges of interest rate risk in transition when switching from calculating the change in the fair value of the hedged item attributable to interest rate risk from total coupon cash flows to benchmark rate coupon cash flows. Under previous GAAP, an entity often created imbalanced hedge ratios between the notionals of the hedging instrument and hedged item to reduce the hedge ineffectiveness related to having to use the total coupon cash flows in calculating the change in the fair value of the hedged item attributable to interest rate risk.

BC68. To accomplish the rebalancing of affected hedging relationships in transition, paragraph 815-20-65-3(e)(2) specifically permits the partial dedesignation of the hedged item, with the excess basis adjustment associated with the portion of the hedged item dedesignated recorded to opening retained earnings. In feedback received since the issuance of Update 2017-12, stakeholders indicated that there are other strategies that could be employed to rebalance the affected fair value hedging relationships in transition, including any combination of increasing or decreasing the notionals of the hedged item or hedging instrument included in the hedging relationship.

BC69. In redeliberations leading to the issuance of Update 2017-12, partial dedesignation of the hedged item was the only fact pattern presented for the Board's consideration as a possible rebalancing strategy. It was only after issuance that entities noted that any combination of increasing or decreasing the notionals of the hedged item or hedging instrument could be used to achieve the desired rebalancing result. The Board decided that there is no conceptual reason for disallowing any particular rebalancing technique in transition as long as an entity does not designate any new hedging instruments or hedged items because that would constitute a change in the critical terms of the hedging relationship and require full dedesignation.

BC70. Also, with respect to transition guidance, stakeholders asked the Board to clarify whether an entity may transition from a quantitative method of hedge effectiveness assessment to a method comparing the hedging relationship's critical terms in accordance with paragraphs 815-20-25-84 through 25-85 or paragraphs 815-20-25-129 through 25-129A without dedesignating the existing hedging relationship if the guidance within those paragraphs is met. Stakeholders requested this clarification because some entities that were unable to apply a critical-terms-match method before adopting the amendments in Update 2017-12 are seeking to change to a critical-terms-match method in transition. Those entities now can apply a critical-terms-match method because of the guidance added in Update 2017-12 in paragraphs 815-20-25-84A and 815-20-25-129A that allows entities to assume that the timing of the hedged transactions and maturity of the derivative match if the forecasted transactions occur and the derivative matures in the same 31-day period or fiscal month.

BC71. Moreover, stakeholders communicated that the inability to transition existing hedges that qualify for a critical-terms-match method may have unintended consequences because of the guidance in paragraph 815-20-25-81 that requires an entity to assess similar hedging relationships in a similar manner, meaning the same assessment method. Therefore, if an entity does not modify the documentation at transition to assess those hedging relationships using a critical-terms-match method and, instead, continues to use the original quantitative method or a subsequent qualitative assessment approach (discussed in paragraphs 815-20-35-2A through 35-2F), the guidance could be interpreted to preclude an entity from using a critical-terms-match method to assess effectiveness in newly designated hedging relationships that are similar to those existing hedging relationships.

BC72. The Board believes that providing transition relief would be consistent with the relief provided in the amendments in Update 2017-12 for the transition from a quantitative method of assessing hedge effectiveness to a qualitative method (paragraph 815-20-65-3(e)(5)(i)). Because the critical-terms-match methods were amended in Update 2017-12 to allow more hedging relationships to qualify for those approaches, requiring dedesignation of existing hedging relationships in transition to a critical-terms-match method would seem to impose a barrier to achieving the desired simplification objective. Furthermore, by providing this relief, an entity would not be precluded from applying a critical-terms-match method to similar hedges that are newly designated after adoption of Update 2017-12.

BC73. Regarding transition, stakeholders raised questions about reclassifying debt securities from the held-to-maturity category to the available-for-sale category in accordance with paragraph 815-20-65-3(e)(7). Specifically, stakeholders asked whether executing such a reclassification would call into question an entity's assertion to hold to maturity those debt securities that continue to be classified as held-to-maturity. Stakeholders also asked whether the reclassified debt security is required to be designated in a last-of-layer hedging relationship and whether the entity is prohibited from selling the debt security after reclassification.

BC74. The Board's intent in allowing the reclassification of securities from held-to-maturity to available-for-sale in transition was to accommodate the adoption of newly allowed hedging strategies introduced by Update 2017-12. Accordingly, the Board did not intend for this reclassification to call into question an entity's assertion at the most recent previous reporting date that it had the intent and ability to hold to maturity those debt securities that continue to be classified as held-to-maturity.

BC75. Because calling into question an entity's held-to-maturity assertion would discourage reclassification, it most likely would result in the entity only designating qualifying debt securities already classified as available-for-sale in a last-of-layer hedge. Additionally, the entity may have classified additional securities as available-for-sale as opposed to held-to-maturity if the last-of-layer hedging strategy were permitted when the entity acquired the securities. The Board decided that this outcome would contradict the objective of the amendments in Update 2017-12 of more closely aligning hedge accounting to risk management strategies. Therefore, the amendment in this proposed Update would clarify that an entity's previous held-to-maturity assertion is not tainted by reclassifying debt securities in transition in accordance with paragraph 815-20-65-3(e)(7).

BC76. The Board also decided to clarify that an entity is not required to designate reclassified debt securities in a last-of-layer hedge. Because hedge accounting always is elective, such a requirement would not be meaningful because an entity would be able to dedesignate the hedging relationship immediately after designating it. If the Board required the reclassified debt securities to be hedged for a certain period after reclassification, the guidance would run the risk of conflicting with an entity's risk management strategies, which would counteract a primary objective of the amendments in Update 2017-12 of more closely aligning hedge accounting with an entity's risk management activities. Therefore, the amendment in this proposed Update would clarify that an entity is not required to hedge reclassified debt securities after reclassification.

BC77. In a similar vein, the Board also decided that the sale of the reclassified debt securities should not be prohibited. Prohibiting the sale of those securities would fundamentally change the nature of the available-for-sale categorization by requiring the security to be recorded at its fair value on the balance sheet without the corresponding potential to realize any gain or loss upon sale. Furthermore, prohibiting the sale of reclassified securities would require separate tracking of the individual reclassified securities which could be operably burdensome. Consequently, the proposed Update would clarify that debt securities reclassified in transition in accordance with paragraph 815-20-65-3(e)(7) carry no incremental restrictions barring their sale after reclassification.

Transition and Effective Date for Codification Improvements to Update 2017-12

BC78. The majority of the proposed Codification improvements to Topic 815 amend the guidance in Update 2017-12. Accordingly, for entities that have not adopted Update 2017-12 as of the issuance date of a final Update of the amendments in this proposed Update, the Board decided to align the effective date and transition provisions of the proposed amendments with that of Update 2017-12.

BC79. For entities that have adopted Update 2017-12 as of the issuance date of a final Update of the amendments in this proposed Update, the Board decided that the effective date of the proposed amendments should be approximately three months after the issuance of a final Update, which would provide entities with sufficient time to review and implement the resulting changes. However, the Board included in this proposed Update a question for respondents to determine if more time is needed. Because these proposed amendments are meant to clarify existing guidance and not change the Board's intent for particular decisions in Update 2017-12, the Board believes that entities will not incur significant costs to implement the proposed amendments. Early adoption also would be permitted on any day on or after the issuance of a final Update.

BC80. To allow entities flexibility in transition, the Board decided that entities that have already adopted Update 2017-12 may elect the transition provisions to apply to all the proposed amendments either retrospectively to the date of adoption of Update 2017-12 or prospectively as of the effective date of a final Update of these amendments with two exceptions discussed in paragraph 815-20-65-5(c)(1) through (2).

BC81. Paragraph 815-20-65-5(c)(1) indicates that an entity that elects to rebalance a fair value hedging relationship using a technique that the Board permitted in paragraph 815-20-65-3(e)(2) should reflect the adjustment related to hedges existing as of the date of adoption of Update 2017-12 on the date of initial application of Update 2017-12. If the transition provision for this proposed amendment is not aligned to that of Update 2017-12, then changes in the interest rate environment from the date of adoption of Update 2017-12 to the date of adoption of this proposed amendment may affect amounts rebalanced in the fair value hedging relationship. Accordingly, the Board decided to require hedge rebalancing under the proposed amendment to be applied under the same transition requirements applicable to the initial adoption of Update 2017-12.

BC82. Paragraph 815-20-65-5(c)(2) indicates that entities that did not reclassify one or more debt securities from held-to-maturity to available-for-sale in transition upon adoption of Update 2017-12 may make that reclassification as of the effective date of the proposed amendments. However, entities that adopted Update 2017-12 and reclassified assets from held-to-maturity to available-for-sale upon adoption may not make a second reclassification when the proposed amendments are issued as final.

BC83. The Board decided that entities that reclassified debt securities from held-to-maturity to available-for-sale were able to distinguish between the transition provisions of Update 2017-12 and the held-to-maturity assertions of GAAP. The Board believes that entities should have only one chance in transition to reclassify debt securities from held-to-maturity to available-for-sale (that is, either upon adoption of the amendments in Update 2017-12 or upon adoption of the proposed amendments in the final Update). Consequently, the Board decided to prohibit entities from reclassifying debt securities from held-to-maturity to available-for-sale for a second time.

BC84. The Board added the proposed amendments in paragraph 815-20-65-5(e) that would allow retrospective designation of certain hedging relationships between the date of adoption of Update 2017-12 and the effective date of these proposed amendments for hedging instruments, hedged items, or forecasted transactions that existed between those two dates if all other requirements for hedge accounting are met. The retrospective designation only applies to the amendments related to designating both interest rate risk and foreign exchange risk in a partial-term fair value hedge, determining the hypothetical derivative using a contractually specified interest rate, and designating the variability in total cash flows in a first-payments-received cash flow hedging technique. For example, if between the date of adoption of Update 2017-12 and the effective date of a final Update of these amendments, an entity entered into a derivative instrument that it did not designate as the hedging instrument in a cash flow hedge because it determined the hypothetical derivative on the basis of the guidance in paragraph 815-30-35-26 as issued in Update 2017-12, it would be able to retroactively designate that derivative as a hedging instrument in a cash flow hedge using the proposed amended guidance in paragraph 815-30-35-26 if all other criteria for cash flow hedging are met. The Board believes that this approach should be permitted to allow all entities to apply the strategies that were intended to be allowed by the amendments in Update 2017-12.

BC85. In applying retrospective application of the proposed amendments, the Board considered whether that retrospective application should be as of the date of adoption of Update 2017-12 or the date of initial application of Update 2017-12. Those dates do not differ if an entity adopted Update 2017-12 at the beginning of a fiscal year. If an entity adopted those amendments in an interim period, for example, at the beginning of an entity's fourth quarter, the date of adoption of Update 2017-12 is the beginning of the entity's fourth quarter. However, in accordance with paragraph 815-20-65-3, the entity had to adjust prior reporting periods for existing hedges as of the date of adoption of Update 2017-12 back to the beginning of its fiscal year (the date of initial application of Update 2017-12). In applying the final Update of the proposed amendments retrospectively, the Board believes that those proposed amendments should be applied to the date of adoption of Update 2017-12 because the proposed amendments mainly relate to hedge accounting strategies or documentation relief that was added or amended by Update 2017-12 with one exception discussed in paragraph BC86. Entities should not be allowed to apply those new strategies before the date of adoption of Update 2017-12. For example, if an entity adopted Update 2017-12 at the beginning of the fourth quarter of its fiscal year and also entered into a cross-currency swap in the second quarter of that fiscal year, it should not be allowed to retroactively designate that swap as a hedging instrument in a partial-term fair value hedge of both interest rate risk and foreign exchange risk in the second quarter because that type of hedging strategy was not permitted in that period.

However, under the proposed amendments, the entity would be allowed to make that designation in the fourth quarter after it adopted Update 2017-12 if all other requirements for fair value hedge accounting are met.

BC86. The Board also observed that if an entity chooses to rebalance fair value hedging relationships in accordance with the proposed amended transition guidance in paragraphs 815-20-65-3(e)(2) and 815-20-65-5(c)(1), it would record those transition adjustments as if they were made upon adoption of Update 2017-12. This would require an entity that adopted Update 2017-12 in an interim period to adjust the balance of opening retained earnings for existing hedges as of the date of adoption of Update 2017-12 on the date of initial application of Update 2017-12.

Topic 4: Codification Improvements to Update 2016-01

Issue 4A: Scope Clarifications for Subtopics 320-10 and 321-10

BC87. Issue 4A represents a scope clarification to the guidance related to amendments in Update 2016-01. The reasons for making that scope clarification are sufficiently explained in the Summary and Amendments to the *FASB Accounting Standards Codification®* sections. Therefore, there is no formal basis for conclusions section for that issue.

Issue 4B: Held-to-Maturity Debt Securities Fair Value Disclosures

BC88. The disclosure requirements in paragraph 320-10-50-5 state that all reporting entities must disclose the aggregate fair value of debt securities classified as held-to-maturity by major security type. Held-to-maturity debt securities are measured at amortized cost under Topic 320 and subsequently measured for credit losses under Subtopic 326-20. The amendments in Update 2016-01 to paragraph 825-10-50-2A exempt entities other than public business entities from the fair value disclosure requirements for financial assets and liabilities measured at amortized cost basis.

BC89. Stakeholders noted that the requirement for entities other than public business entities to disclose the fair value of held-to-maturity securities in Topic 320 contradicted the Board’s decision to exempt entities other than public business entities from those disclosure requirements through the amendments in Update 2016-01.

BC90. The Board intended to eliminate all fair value disclosures for financial assets measured at amortized cost basis for entities other than public business entities through the amendments in Update 2016-01. The amendments in this proposed Update would clarify the guidance in paragraph 320-10-50-5 by eliminating the requirement for entities other than public business entities to disclose the aggregate fair value of held-to-maturity debt securities, as well as any gross unrecognized holding gains or losses on those debt securities.

Issue 4C: Applicability of Topic 820 to the Measurement Alternative

BC91. The guidance in paragraph 321-10-35-2 provides an entity with an election to measure equity securities without readily determinable fair value at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment in the same issuer. The guidance in paragraph 321-10-35-3 that applies to an entity that has elected the measurement alternative in paragraph 321-10-35-2 for equity securities without readily determinable fair values specifically requires that an entity remeasure those equity securities at fair value when a qualitative assessment indicates that the investment is impaired. Additionally, the guidance in paragraph 321-10-55-9 provides implementation guidance about the remeasurement of an equity security without readily determinable fair value upon an observable price change in an orderly transaction of a similar investment of the same issuer. Specifically, this guidance states that the adjustments to the carrying value of the equity security without readily determinable fair value should reflect the fair value of the security at the date that the observable transaction for the similar security took place.

BC92. During the implementation process of Update 2016-01, which added Topic 321, Investments—Equity Securities, stakeholders questioned whether an entity is required to remeasure equity securities without readily determinable fair value accounted for under the measurement alternative at fair value in accordance with Topic 820, Fair Value Measurement, when an entity identifies an orderly transaction of the identical investment of the same issuer.

BC93. The Board believed that, in most cases, the observable price change in an orderly transaction of the identical investment of the same issuer would generally represent the fair value change in that investment. The Board intended a consistent remeasurement at fair value for investments accounted for under the measurement alternative upon identifying (a) an orderly transaction of the identical investment of the same issuer, (b) an orderly transaction of a similar investment of the same issuer, and (c) impairment. Therefore, the Board intended to require a nonrecurring fair value measurement in accordance with Topic 820 upon the occurrence and identification of any remeasurement event described in Topic 321 for equity securities without readily determinable fair value accounted for under the measurement alternative.

BC94. Without proper clarification, the guidance in Topic 321 for the remeasurement of equity securities without readily determinable fair value accounted for under the measurement alternative could be interpreted to require different measurement bases depending on the specific remeasurement event that occurs. The proposed amendments would clarify that all adjustments made under the measurement alternative upon the identified remeasurement event should be accounted for in accordance with Topic 820. Accordingly, an entity would be required to apply the disclosure requirements for nonrecurring fair value measurements in Topic 820 when remeasuring equity securities without readily determinable fair values. However, the proposed amendments would clarify that an entity need not provide duplicate fair value disclosures if the disclosure requirements in Topic 321 achieve the disclosure requirements of Topic 820.

Issue 4D: Remeasurement of Equity Securities at Historical Exchange Rates

BC95. The guidance in paragraph 830-10-45-18 relates to applying historical exchange rates for remeasuring certain accounts on the balance sheet. This guidance applied to marketable equity securities carried at cost in previous GAAP. The amendments in Update 2016-01 require all equity securities to be measured at fair value each reporting period with changes in the fair value recognized in earnings. However, those amendments provide a measurement alternative to perform a nonrecurring fair value measurement for equity securities without readily determinable fair values. The Board acknowledged that foreign-currency-denominated equity securities accounted for under the measurement alternative are subject to remeasurement at historical exchange rates in accordance with paragraph 830-10-45-18. However, because all other equity securities are measured at fair value each reporting period, those securities should not be subjected to the guidance in paragraph 830-10-45-18.

BC96. The proposed amendments clarify that the only equity securities required to follow paragraph 830-10-45-18, which requires those accounts to be remeasured at historical exchange rates, are those equity securities without readily determinable fair values accounted for under the measurement alternative in accordance with paragraph 321-10-35-2. In addition, the proposed amendments would clarify that the rate to be used should be the historical exchange rate as of the acquisition date or the most recent date on which the equity security was adjusted to fair value in accordance with paragraphs 321-10-35-2 through 35-3, if applicable.

Transition and Effective Date for Codification Improvements to Update 2016-01

BC97. The proposed amendments in Topic 4 amend or relate to the guidance in Update 2016-01. For entities that have not adopted Update 2016-01 as of the issuance date of a final Update of these proposed amendments, the Board decided to align the effective date and transition provisions of the proposed amendments with that of Update 2016-01. For entities that have adopted Update 2016-01 as of the issuance date of a final Update of the proposed amendments, the Board will determine the effective date and transition requirements for these proposed amendments after it considers stakeholders' feedback on this proposed Update.

Topic 5: Codification Improvements Resulting from the November 1, 2018 Credit Losses TRG Meeting

Issue 5A: Vintage Disclosures—Line-of-Credit Arrangements Converted to Term Loans

BC98. During implementation of Update 2016-13, stakeholders asked how an entity should disclose line-of-credit arrangements that convert to term loans within the vintage disclosure table. The staff discussed this issue with the Credit Losses TRG at its November 1, 2018 meeting and solicited feedback from those stakeholders.

BC99. The Board considered several alternatives that were discussed at the Credit Losses TRG meeting on how to disclose the amortized cost basis of line-of-credit arrangements that are converted to term loans in the vintage disclosures, including the following:

a. The line-of-credit arrangements converted to term loans should remain in the line-of-credit arrangements total.
b. The line-of-credit arrangements converted to term loans should be disclosed in the origination year that corresponds with the start date of the term loan (that is, the conversion date).
c. The line-of-credit arrangements converted to term loans should be disclosed in the origination year that corresponds with the origination date of the original revolving credit arrangement.
d. An entity should make and disclose an accounting policy election by class of financing receivable.
e. The line-of-credit arrangements converted to term loans should be disclosed in the origination year that corresponds with the lender's most recent credit decision.
f. The line-of-credit arrangements converted to term loans should be disclosed in a column separate from the line-of-credit arrangements column but should not be disclosed by origination year.

BC100. The Board ultimately developed an approach that would not be operationally burdensome for financial statement preparers, while retaining the utility of the disclosure requirements for financial statement users. The Board concluded that an entity should present line-of-credit arrangements that are converted to term loans by origination year that corresponds with the period in which an entity made its most recent credit decision after the original credit decision. However, if the line-of-credit arrangement converted to a term loan without an additional credit decision after the original credit decision, or through a troubled debt restructuring, the converted line-of-credit arrangement should be presented in a separate column. The Board decided that coupled with disclosures explaining the amount of line-of-credit arrangements that were converted to term loans by class of financing receivable or major security type each reporting period, the disclosure requirements will provide financial statement users with transparent information about changes to the nature of the line-of-credit arrangement.

Issue 5B: Contractual Extensions and Renewals

BC101. During implementation of Update 2016-13, stakeholders asked whether an entity should consider contractual extension or renewal options in determining the contractual term. Stakeholders stated that the guidance in paragraph 326-20-30-6 appears to preclude an entity from considering those contractual extension or renewal options, although the lender would not be able to prevent the borrower from exercising the option and, therefore, would be exposed to credit risk.

BC102. At the November Credit Losses TRG meeting, the staff provided an analysis on the question raised and solicited additional feedback from stakeholders. Overall, stakeholders stated that an entity should consider those contractual extension or renewal options that are in the control of the borrower in determining the contractual term. Stakeholders discussed various methods on considering those contractual extension options. Under one alternative, an entity would perform a probability assessment of (a) whether the contingent event that makes the option exercisable will occur, if applicable, and (b) whether the borrower will exercise the option. Under another alternative discussed, an entity would assume that all of the contractual extension or renewal options will be exercised; subsequently, the entity would consider expected prepayments to determine whether the contractual term should be shortened.

BC103. The Board concluded that an entity should be required to consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity. In determining the contractual term, an entity should consider the likelihood that the contractual extension or renewal option will be exercised. The Board considered an alternative that would have required that an entity consider only unilateral contractual extension or renewal options within the control of the borrower that are included in the original or modified contract when determining the contractual term of the financial asset(s). However, the Board rejected that alternative because it would have resulted in a difference in how an entity evaluates its off-balance-sheet credit exposures and how an entity determines the contractual term of a financial asset or assets. The Board concluded that as long as the extension or renewal option was included in the original or modified contract, and the option does not meet the definition of a derivative, then an entity should evaluate the effect that extension or renewal option has on the entity’s credit exposure.

BC104. Additionally, the Board acknowledged that various methods are available to entities on how to consider those contractual extension or renewal options in determining the contractual term. However, the Board decided that it would be inappropriate to prescribe one specific method for determining the contractual term, consistent with the overall flexibility provided in determining the allowance for credit losses.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed improvements to the Taxonomy through Proposed Taxonomy Improvements provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the Taxonomy will be finalized as part of the annual release process.