FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: February 6, 2019
Comments Due: March 8, 2019

Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 326 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. 2019-100, 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 March 8, 2019. 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. 2019-100
- Sending a letter to "Technical Director, File Reference No. 2019-100, 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

Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses

February 6, 2019

Comment Deadline: March 8, 2019

CONTENTS

Page Numbers

Summary and Questions for Respondents

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

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* which 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 Update 2016-13 added Topic 326, Financial Instruments—Credit Losses, and made several consequential amendments to the Codification. Update 2016-13 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.

Since the issuance of Update 2016-13, the Board has assisted stakeholders in the implementation of the amendments formally through the activities of the Credit Losses Transition Resource Group (TRG) and informally through other implementation assistance activities. Through this assistance, the Board has identified certain areas that require clarification and improvement.

The FASB received several agenda request letters requesting that the Board consider amending the transition guidance for Update 2016-13. The entities that submitted the agenda request letters noted that certain financial statement preparers have begun (or are planning) to elect the fair value option on newly originated or purchased financial assets, although those entities have historically measured similar financial assets at amortized cost basis. Without the proposed targeted transition relief provided by the amendments in this proposed Update, those entities noted that they would be required to maintain dual measurement methodologies that may result in noncomparable financial statement information for users.

The amendments in this proposed Update would address those stakeholders' concerns by providing an option to irrevocably elect the fair value option for certain financial assets previously measured at amortized cost basis. For some entities, the targeted transition relief would increase comparability of financial statement information by providing an option to align measurement methodologies for similar financial assets. Furthermore, the targeted transition relief also may reduce the costs for some entities to comply with the amendments in Update 2016-13 while still providing financial statement users with decision-useful information.

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

The amendments in this proposed Update amend the transition guidance of Topic 326 and would apply to all reporting entities within the scope of that Topic.

What Are the Main Provisions?

The amendments in this proposed Update would provide entities that have instruments within the scope of Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, except for held-to-maturity debt securities, with an option to irrevocably elect the fair value option in Subtopic 825-10, Financial Instruments—Overall, applied on an instrument-by-instrument basis for eligible instruments, upon adoption of Topic 326. An entity that elects the fair value option would subsequently apply the guidance in Subtopics 820-10, Fair Value Measurement—Overall, and 825-10.

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 would provide targeted transition relief that is intended to increase comparability of financial statement information for some entities that otherwise would have measured similar financial instruments using different measurement methodologies. The proposed amendments also would decrease costs for some financial statement preparers while providing financial statement users with decision-useful information. The proposed amendments would accomplish those objectives by providing entities with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, that are within the scope of Subtopic 326-20, except for held-to-maturity debt securities, upon adoption.

When Would the Amendments Be Effective?

For entities that have not yet adopted the amendments in Update 2016-13 as of the issuance date of a final Update of these proposed amendments, the effective date and transition methodology would align with that 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 the amendments in this proposed Update 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.

Question 1: Do you agree with the amendments in this proposed Update to provide entities with an option to irrevocably elect the fair value option in Subtopic 825-10 for eligible instruments that are within the scope of Subtopic 326-20, except for held-to-maturity debt securities, upon adoption? If not, please explain your reasoning.

Question 2: Do you agree with the proposed amendment that would require that the irrevocable election of the fair value option be applied on an instrument-by-instrument basis? If not, please explain your reasoning and provide an alternative.

Question 3: For entities that have not adopted Topic 326, should the effective date and transition requirements of the proposed amendments align with the effective date and transition requirements of the amendments in Update 2016-13? If not, please explain your reasoning and provide an alternative.

Question 4: For entities that have early adopted Topic 326, what should be the effective date and transition requirements for the proposed amendments?

Question 5: Would additional disclosures be needed for the proposed amendments, beyond the disclosure requirements in Topic 250, Accounting Changes and Error Corrections, and Subtopics 820-10 and 825-10?

Question 6: Do you support the Board's decision not to provide entities with an option to discontinue fair value measurements for financial assets measured at fair value through net income and instead apply the measurement guidance in Subtopic 326-20? If not, please explain your reasoning about why the measurement guidance in Subtopic 326-20 is preferable for the types of financial assets for which an entity would elect to discontinue fair value measurements.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraph 3. 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~~.

2. 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 provide targeted transition relief upon the adoption of the amendments in Update 2016-13, in response to several agenda request letters submitted by various financial statement users and preparers. The proposed amendments provide entities with the option to irrevocably elect the fair value option for eligible instruments that are within the scope of Subtopic 326-20, Financial Instruments—Credit Losses—Measured at Amortized Cost, upon adopting Topic 326.

Amendments to Subtopic 326-10

3. Amend paragraph 326-10-65-1 and its related heading, with a link to transition paragraph 326-10-65-2, and add paragraph 326-10-65-2 and its related heading, as follows:

Financial Instruments—Credit Losses—Overall

Transition and Open Effective Date Information

> Transition Related to Accounting Standards ~~Update~~ <u>Updates</u> No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*<u>, and No. 201X-XX, *Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses*</u>

326-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments:*

i. An entity may irrevocably elect the fair value option in accordance with Subtopic 825-10 for financial instruments within the scope of Subtopic 326-20, except for those financial assets in paragraph 326-20-15-2(a)(2), that also are eligible items in Subtopic 825-10.

> Transition Related to Accounting Standards Update No. 201X-XX, *Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses*

326-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 201X-XX, *Targeted Transition Relief for Topic 326, Financial Instruments—Credit Losses:*

a. An entity that has not yet adopted the pending content that links to paragraph 326-10-65-1 shall apply the pending content that links to this paragraph in accordance with the effective date and transition paragraph 326-10-65-1(a) and (c), respectively.
b. [For entities that have adopted the pending content that links to paragraph 326-10-65-1, the Board will determine the effective date and transition of this proposed Update after it considers stakeholders' feedback.]
c. For items measured at **fair value** in accordance with paragraph 326-10-65-1(i), the difference between the carrying amount and the fair value shall be included in the cumulative-effect adjustment in paragraph 326-10-65-1(c). Those differences may include, but are not limited to:
   1. Unamortized deferred costs, fees, premiums, and discounts
   2. Valuation allowances (for example, allowance for loan losses)
   3. Accrued interest, which may be reported as part of the fair value of the eligible item.

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.

Background Information

BC2. On June 16, 2016, the Board issued Update 2016-13, which 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 that Update added Topic 326 and made several consequential amendments to the Codification. That 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.

BC3. Since the issuance of Update 2016-13, the Board has assisted stakeholders in the implementation of the amendments in that Update. Through this assistance, the Board has identified certain areas that require clarification and correction. The Board also has considered and responded to agenda request letters submitted by stakeholders, including those requesting targeted transition relief upon adopting the amendments in Update 2016-13.

Benefits and Costs

BC4. The amendments in this proposed Update would provide entities with the option to irrevocably elect the fair value option for eligible instruments that are within the scope of Subtopic 326-20, except for held-to-maturity debt securities, upon adopting Topic 326. The proposed amendments would not change any of the principles described in the amendments in Update 2016-13 or Subtopic 825-10. The amendments for targeted transition relief in this proposed Update would provide entities with an additional election date upon adoption of Topic 326 to elect the fair value option in accordance with Subtopic 825-10.

BC5. Subtopic 825-10 provides entities with the option to elect the fair value option on certain election dates on an instrument-by-instrument basis, with certain exceptions in paragraph 825-10-25-7. Because the proposed targeted transition relief would be applied in a consistent manner with Subtopic 825-10 on an instrument-by-instrument basis, the Board anticipates that entities will be able to utilize existing systems and processes to adopt the amendments in this proposed Update without incurring significant operational costs. Furthermore, electing the fair value option is not required, and any additional costs would apply only to those entities that elect to use the targeted transition relief.

BC6. The Board believes that the amendments in this proposed Update would benefit financial statement users by increasing comparability of financial statement information for entities that have elected the fair value option for certain financial instruments that are newly purchased or originated. As a result of their election of the fair value option, those entities would measure similar financial assets using different measurement methodologies. Absent these proposed amendments, an entity would have been required to measure previously originated or purchased financial assets within the scope of the amendments in Update 2016-13 at amortized cost basis. For those entities that have elected the fair value option for newly originated or purchased financial assets, the proposed amendments would allow the use of fair value measurements for those previously originated or purchased financial assets, resulting in a consistent measurement methodology for those financial assets.

Basis for Conclusions

BC7. After the issuance of Update 2016-13, several stakeholders submitted agenda request letters asking that the Board consider providing targeted transition relief upon the adoption of the amendments in Update 2016-13. Those stakeholders requested an option to elect the fair value option in accordance with Subtopic 825-10 for eligible instruments that are within the scope of Subtopic 326-20, except for held-to-maturity debt securities, upon adoption of Topic 326.

BC8. Several of those stakeholders represent financial statement users and preparers in the auto-financing industry, including institutions that may extend credit to borrowers with limited or impaired credit histories. They noted that certain financial statement preparers have begun (or are planning) to elect the fair value option on newly originated or purchased financial assets, although those entities historically have measured their financial assets at amortized cost basis. Those entities noted that without the proposed targeted transition relief provided through the amendments in this proposed Update, their election of the fair value option would have resulted in the need to maintain dual measurement methodologies by measuring previously originated or purchased financial assets at amortized cost basis in accordance with Topic 326, while measuring newly originated or purchased financial assets at fair value through net income in accordance with Subtopic 825-10. Furthermore, several investors also noted that a dual measurement model would not provide financial statement users with decision-useful information. They noted that dual measurement methodologies would result in noncomparative financial statement information.

BC9. The Board also received an agenda request letter from an industry trade group that supported the proposed targeted transition relief. Those stakeholders noted that the targeted transition relief would provide cost savings for some financial statement preparers by allowing them to utilize their existing systems and processes for measuring financial assets at fair value.

BC10. In response to stakeholders' requests, the Board decided to provide entities with an irrevocable option to elect the fair value option in accordance with Subtopic 825-10 for eligible instruments that are within the scope of Subtopic 326-20, except for held-to-maturity debt securities, upon adoption of Topic 326. The Board decided that the proposed amendments in this Update would provide certain financial statement preparers with targeted transition relief upon adopting the amendments in Update 2016-13 while providing financial statement users with decision-useful information.

BC11. The Board observed that the amendments in this proposed Update would allow some entities to elect the fair value option to achieve a single measurement methodology for similar types of financial assets. As a result, the proposed amendments would provide increased comparability for financial statement users who may have had difficulty analyzing financial statement information that includes dual measurement methodologies for similar types of assets. The Board also noted that the proposed amendments would lessen the costs associated with adopting Topic 326 for some entities.

BC12. During deliberations, the Board considered whether the unit of account for which entities must apply the proposed transition relief should be on an instrument-by-instrument basis or at the class of financing receivable, as defined in the Master Glossary. The Board decided to provide the election on an instrument-by-instrument basis because this unit of account would be more operable and understandable for entities electing the targeted transition relief because an instrument-by-instrument election aligns with the current requirements in Subtopic 825-10. Furthermore, an instrument-by-instrument election provides entities with flexibility to more precisely align their risk management strategies with their measurement methodologies.

BC13. The Board understands some stakeholders' concerns about potential selection bias if the fair value option were granted on an instrument-by-instrument basis. However, the Board believes that any potential selection bias would be limited by the transition requirements of the amendments in this proposed Update, which would require any fair value adjustments to be recorded as a cumulative-effect adjustment to opening retained earnings. Potential selection bias also would be curtailed by the irrevocable nature of the fair value option, which prohibits entities from subsequently discontinuing fair value measurement for financial instruments that had previously elected the fair value option.

BC14. The Board also understands that an election on an instrument-by-instrument basis may result in similar financial assets having different measurement methodologies, potentially resulting in noncomparability. However, existing guidance in Subtopic 825-10 currently allows for similar outcomes because entities can measure similar financial instruments using different measurement methodologies by electing to use the fair value option (at certain election dates) for certain assets and not others. The Board believes that this concern is mitigated by the disclosure objectives in Subtopic 825-10, which require entities to disclose information to allow for comparisons when an entity selects different measurement methodologies for similar assets. The Board also included a question (Question 5) in this proposed Update if additional disclosures would be needed to provide adequate transparency for financial statement users.

BC15. The industry trade group also requested that the Board consider providing an option to discontinue fair value measurements for financial assets measured at fair value in accordance with Subtopic 825-10 that otherwise would be within the scope of Subtopic 326-20. The trade group noted that because of significant systems redesigns, some of its members would prefer to apply the expected credit losses methodology in Topic 326 for certain financial instruments measured at fair value.

BC16. The Board decided not to provide entities with the option to discontinue fair value measurements upon the adoption of Topic 326 because of the irrevocable nature of the fair value option election and the potential selection bias of using hindsight in discontinuing fair value measurements. In determining this, the Board also considered that entities that have historically elected the fair value option already have the ability to continue to elect the fair value option on similar financial assets originated or purchased in future periods. As a result, those entities currently have the ability to elect the fair value option to use a single measurement methodology for similar financial assets. Consequentially, the Board believes that the requirement to use a dual measurement methodology would result from an entity's future decision rather than adopting Topic 326. Therefore, the Board questioned whether the scope of the proposed targeted transition relief relating to the adoption of Topic 326 should include the option to discontinue fair value measurements. The Board believes that the reasons presented by stakeholders for discontinuing the fair value option did not overcome those concerns. Instead, the Board decided to include Question 6 in this proposed Update to gain further insights about why the expected credit loss methodology is preferable to fair value measurements for the types of financial assets for which an entity would elect to discontinue fair value measurements.

Scope

BC17. The amendments in this proposed Update would provide targeted transition relief upon the adoption of Topic 326. The Board decided that the proposed amendments would apply to financial assets within the scope of Subtopic 326-20, except for held-to-maturity debt securities, that also are eligible items for the fair value option election in accordance with Subtopic 825-10. In determining the scope, the Board considered the nature of the narrow-scope targeted transition relief project and the specific request from stakeholders in the auto-financing industry to address comparability concerns related to an entity's loan portfolio upon transition to Topic 326. The Board also considered the potential transition complexities and subsequent questions that could arise from broadening the scope of the targeted transition relief to include held-to-maturity debt securities. On the basis of those factors, the Board decided to exclude held-to-maturity debt securities from the scope of the proposed Update.

BC18. The Board decided to limit the scope further to financial assets that are eligible for the fair value option in Subtopic 825-10. For example, an entity could not elect the fair value option for a net investment in a lease because this type of financial asset is not an eligible item for the fair value option in accordance with paragraph 825-10-15-5.

Effective Date and Transition

BC19. The Board decided that the effective date and transition requirements for the amendments in this proposed Update should align with the effective date and transition requirements in Update 2016-13 for entities that have not yet adopted the amendments in Update 2016-13. The Board decided to include a question (Question 4) in this proposed Update about the appropriate effective date and transition requirements for entities that have adopted the amendments in Update 2016-13 before the issuance date of a final Update of these proposed amendments.

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.