Southeast Bankers Outreach Forum

Emerging Accounting Topics

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FEDERAL RESERVE BANK *of* ATLANTA

TOPICS

- FASB Proposal – Accounting for Credit Losses
- Private Company Council (PCC)
- Transfer of mortgage loans to OREO
- Subsequent Restructuring of a TDR

FASB: ACCOUNTING FOR CREDIT LOSSES

Background

- **G20 requested in April 2009 that standard setters "strengthen accounting recognition of loan-loss provisions..."**

- **Weaknesses identified in the current standard**
  - Delayed recognition of credit losses due to "probable" and "incurred" thresholds
  - Inability to consider forward-looking information
  - Use of multiple models

FASB: ACCOUNTING FOR CREDIT LOSSES

Goals

- **Broaden the information set considered**
  - Internally and externally available information
  - Past events, current conditions, and <u>reasonable and supportable assumptions</u> about the future
  - Quantitative and qualitative factors specific to borrowers and the economic environment, including underwriting standards
- **Replace numerous impairment models with one**
  - Applicable to almost all debt instruments not carried at fair value through net income
- **Result in earlier recognition of losses**
  - Through Current Expected Credit Loss (CECL) model

FASB: ACCOUNTING FOR CREDIT LOSSES

The Current Expected Credit Loss (CECL) Model

- Recognizes an allowance for credit losses on the basis of the current estimate of contractual cash flows not expected to be collected

- Extends the time horizon over which “expectations” are to be formed (life of loan)

- Requires a fundamental change in the data required to estimate the allowance

- Allows firms to leverage current risk monitoring systems and techniques in the implementation of the model

FASB CECL MODEL

- ❑ **Expected losses**
  - Eliminates the probable initial recognition threshold
  - Earlier recognition

- ❑ **Single impairment model**
  - Available-for-Sale Debt Securities are excluded

- ❑ **More forward looking**
  - Consideration of past events and current conditions
  - Consideration of reasonable and supportable assumptions about the future

FASB CECL MODEL

❑ Overall supervisory view is positive

- Supportive of efforts to improve the accounting for credit losses
- Consistent with other reforms prompted by the financial crisis, including enhancements to regulatory capital requirements

❑ Specific issues under consideration

- Transition impact
- Implementation challenges
- Supervisory approach

PRIVATE COMPANY COUNCIL (PCC)

The Private Company Council (PCC) has two principal responsibilities:

- **Based on criteria established by PCC and FASB, the PCC will review and propose alternatives within U.S. GAAP to address the needs of users of private company financial statements.**
- **The PCC also serves as the primary advisory body to the FASB on the appropriate treatment for private companies for items under active consideration on the FASB's technical agenda.**

PRIVATE COMPANY COUNCIL (PCC)

- **Call Report and Y-9C**
  - **Will PCC standards be allowed for regulatory reporting?**

RECLASSIFICATION OF RESIDENTIAL REAL ESTATE COLLATERALIZED MORTGAGE LOANS UPON FORECLOSURE

- **Other Real Estate Owned**
  - **ASU 2014-04 was issued in the first quarter 2014**
  - **Addresses diversity in practice for reclassifying a loan receivable to Other Real Estate Owned (OREO)**
  - **Defines when physical possession occurs for residential real estate collateral underlying a consumer mortgage loan.**

RECLASSIFICATION OF RESIDENTIAL REAL ESTATE COLLATERALIZED MORTGAGE LOANS UPON FORECLOSURE

- **Clarifies physical possession is considered to have occurred and a loan receivable would be reclassified to OREO upon:**
  - The creditor obtaining legal title to residential real estate property through foreclosure even if the borrower has redemption rights or
  - Completion of a deed-in-lieu of foreclosure or similar legal agreement under which the borrower conveys all interest in the residential real estate property to the creditor to satisfy the loan
  - The new standard is effective for fiscal years beginning after December 15, 2014 and early adoption is permitted.
  - Therefore, financial institutions could early adopt the standard as of March 31, 2014.

ACCOUNTING FOR SUBSEQUENT RESTRUCTURINGS OF A TDR

- Background
- Varying interpretations under GAAP
- Regulatory Guidance

Questions?