

# Financial Instruments — FASB Continues Redeliberations Related to Credit Impairment

**November 12, 2015** — At its meeting yesterday, the FASB continued redeliberating its project on the credit impairment of financial instruments. Specifically, the Board discussed (1) troubled debt restructurings (TDRs), (2) available-for-sale (AFS) debt securities, and (3) feedback received on its confidential external review (i.e., “fatal flaw”) draft. In addition, the Board discussed the effective date and early adoption of the final standard.

## Troubled Debt Restructurings

The Board previously decided that when a TDR occurs, an entity would be required to adjust the cost basis of the modified asset so that the effective interest rate (EIR) on the modified asset continues to be the original EIR, given the new series of contractual cash flows. However, feedback received on this decision indicated that the cost-basis adjustment was operationally burdensome and would result in significant costs. As a result, the Board tentatively decided that credit losses for TDRs should be measured under the expected credit loss model without a cost-basis adjustment.

## Available-for-Sale Debt Securities

Regarding AFS debt securities, the Board tentatively decided that:

- Credit losses recognized on an AFS debt security should be limited to the difference between the security’s amortized cost and its fair value.
- When determining whether an other-than-temporary impairment (OTTI) exists for an AFS debt security, an entity is permitted but not required to consider the historical and implied volatility of the security’s fair value.
- When determining whether an OTTI exists, if an entity does not intend to sell the debt security, the entity must consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of the security’s amortized cost basis. This decision is consistent with existing U.S. GAAP.

## Fatal-Flaw Feedback Received

The FASB staff discussed the feedback received on the fatal-flaw draft and noted that most of the comments can be addressed through the drafting process and do not need to be redeliberated by the Board. The fatal flaws noted in the feedback were related to beneficial interests, using the contractual term versus weighted-average life, collective evaluation requirements, the practical expedient for collateral-dependent financial assets, situations that result in zero expected credit losses, loans held for sale, off-balance-sheet commitments to extend credit, reinsurance receivables, discounts and premiums, and reasonable and supportable forecasts. The Board agreed with the staff’s approach to address comments on these topics in drafting the final standard.

## Effective Date and Early Adoption

The Board tentatively decided that:

1. For public business entities that meet the definition of an SEC filer<sup>1</sup> in U.S. GAAP, the final standard will be effective for fiscal years beginning after December 15, 2018, including interim periods therein.
2. For public business entities that do not meet the definition of an SEC filer in U.S. GAAP, the final standard will be effective for fiscal years beginning after December 15, 2019, including interim periods therein.
3. For all other entities, the final standard will be effective for fiscal years beginning after December 15, 2019, and interim periods therein beginning after December 15, 2020.

The Board also tentatively decided that public business entities that meet the definition of an SEC filer in U.S. GAAP will not be permitted to early adopt the final standard. All other entities will be permitted to early adopt the final standard but not before the effective date for SEC filers.

## Next Steps

The FASB plans to discuss purchased financial assets with credit deterioration at its November 23, 2015, meeting on the basis of the comments received on the fatal-flaw draft. The FASB staff will continue to assess and present to the Board any additional sweep issues that may result from further analysis of the feedback received on the fatal-flaw draft or issues identified during the drafting of the final standard. The Board is expected to issue the final standard in the first quarter of 2016.

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<sup>1</sup> The Codification Master Glossary defines an SEC filer as follows:

An entity that is required to file or furnish its financial statements with either of the following:

- a. The Securities and Exchange Commission (SEC)
- b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

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