Division of
Risk Management Supervision

Kansas City Region
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Troubled Debt Restructuring
Accounting Update

Presented by
Julia Kuhn
Regional Accountant
Kansas City Region FDIC

Presentation Information

- Presentation: http://www.fdic.gov/news/conferences/kc_region/2011-10-26.pdf
- Questions at the end via the telephone and email
- Email address for questions: kcconferencecall@fdic.gov

Agenda

- Troubled Debt Restructuring
  - Applicable Accounting Standards
  - Other Guidance
  - Identification
  - Impairment Measurement
  - Ongoing Accounting
  - Regulatory Reporting

TDR-Applicable Accounting Standards

- Applicable Accounting Standards
  - ASC 310-40 (FAS 15) *Receivables, Troubled Debt Restructurings by Creditors*
  - ASC 310-10 (FAS 114) *Receivables-Overall-Subsequent Measurement*
  - ASU 2011-22 *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*

TDR- Other Guidance

- Call Report-
  - Glossary: Troubled Debt Restructurings
- Call Report Supplemental Instructions
  - Quarterly beginning September 2010
- Policy Statement on Prudent Commercial Real Estate Loan Workouts (10/09)
  - Attachment 1 examples of TDR evaluations

TDR-Identification

- A restructuring constitutes a “troubled debt restructuring” if:
  - Borrower experiencing financial difficulties *and,*
  - For economic or legal reasons, a creditor grants a concession to a debtor that it would not otherwise consider.
- Risk Management Strategy
  - Creditor wants to maximize collection/recovery
  - Creditor expects that by granting concessions this will increase receipts by matching with borrower’s ability.
- Not all modifications are TDRs

TDR-Identification

- What types of transactions may be TDRs?
  - A transfer from the borrower to the bank (including via foreclosure or repossession) of real estate or other assets,
  - A modification of the loan terms, or
  - A combination of the above
- A modification of terms includes
  - Reduction of the contractual (stated) interest rate
  - Extension of the maturity date at a contractual interest rate lower than the current rate for new debt with similar risk
  - Reduction of the face amount of debt, i.e., forgiveness of a portion of principal
  - Reduction (forgiveness) of accrued interest

TDR-Identification

- Is a modification of terms a troubled debt restructuring?
  - Is the debtor experiencing financial difficulty?
    - NO – Not a troubled debt restructuring
    - YES – Go to next question
  - Has the creditor granted a concession?
    - NO – Not a troubled debt restructuring
    - YES – Modification is a troubled debt restructuring
  - Even if a loan is current, a modification of terms would be a troubled debt restructuring if the preceding conditions are met

TDR-Identification

Determining Whether the Borrower is Experiencing Financial Difficulty

- Default on any debt
- Probable default if foreseeable future without modification
- Bankruptcy
- Going concern
- Unable to service debt (current/future cashflow)
- Credit availability

Determining Whether Concession has been Granted

- Effective borrowing rate of restructure
- Compared to prior debt

(Forgiveness of principal or interest would be included)

http://www.occ.gov/static/publications/BAAS.pdf

TDR-Identification

- Borrowing Rate at Restructure
  - A current market interest rate is an interest rate greater than or equal to the rate the creditor was willing to accept at the time of the restructuring for a new loan with comparable risk
  - A restructured loan does not yield a market interest rate simply because the rate charged under the restructuring agreement has not been reduced

TDR-Identification

ASU 2011-02-Goal Consistency in Identification

- 1. A creditor may have granted a concession if the borrower is otherwise unable to access funds at a market rate for debt with similar risk characteristics as the restructured debt.
- 2. A temporary or permanent increase in the contractual interest rate as a result of a restructuring does not preclude the restructuring from being considered a concession.
- 3. An insignificant delay in payment resulting from a restructuring is not a concession.
- 4. Creditors are prohibited from using the borrower’s effective interest rate test in ASC 470-60 to evaluate whether a restructuring constitutes a TDR.

TDR-Impairment Measurement

Impairment Measurement

- Creditor’s accounting for a troubled debt restructuring involving a modification of terms on a loan held for investment
  - The loan usually is in the ASC 310(FAS 114) but if not would be within this scope at modification
  - ASC 310 applies even if the loan – such as a 1-4 family residential mortgage – would not otherwise fall within the scope of ASC 310 because it would be part of a “large group of smaller-balance homogeneous loans that are collectively evaluated for impairment”

TDR-Impairment Measurement

- Items to consider:
  - Determine if the restructured loan is collateral dependent or not
  - A loan is collateral dependent if repayment is expected to be provided solely by the sale or operation of the underlying collateral

TDR-Impairment Measurement

- If not collateral dependent; measure impairment based on the present value of expected future cash flows discounted at loan’s effective interest rate
  - Estimates of expected future cash flows should be creditor’s best estimate based on reasonable and supportable assumptions and projections
  - Best estimate is not normally the contractual cash flows under the modified terms
  - Default and Prepayment projections should be appropriate for similar impaired loans
  - Effective interest rate is the original effective interest rate on the loan-not TDR rate

TDR-Impairment Measurement

- For a loan with a starter rate, original effective interest rate would be a blend of the starter rate and the fully indexed rate at the time of the modification (even if the modification occurs before the interest rate resets)

TDR-Impairment Measurement

- Examples:
  - Extending Maturity with no Change in Interest Rates
  - Interest Only for a time Period then Revert to Scheduled Payments

TDR-Impairment Measurement

- If a TDR loan is collateral dependent, measure impairment based on fair value of the collateral
  - If repayment is dependent on sale of collateral reduce the fair value by estimated costs to sell
  - If repayment is dependent on operation of collateral, do not reduce fair value by estimated costs to sell
  - Costs to sell are "incremental direct costs to transact a sale," including "broker commissions, legal and title transfer fees, and closing costs"

TDR-Impairment Measurement

- Fair Value should be estimated in keeping with ASC 820, Fair Value Measurements
  - "Fair Value" is defined as "the price that would be received to sell an asset…in an orderly transaction between market participants at the measurement date, " i.e., not a forced liquidation or distress sale
  - Fair Value should reflect the current condition of a property, not the potential value of the property at some future date.

TDR-Impairment Measurement

What is impaired amount?

- ASC 310-Impaired Loan Guidance the amount that the recorded amount of loan exceeds
  - PV of expected cash flows (not collateral dependent)
  - Fair Value of Collateral (if collateral dependent)
  - Recorded Investment-face amount adjusted for unamortized loan fees/costs or premium/discount less any charge-offs, plus accrued interest

TDR-Ongoing Accounting

- TDR loans will need to have collectability of the loan reviewed quarterly and any portion of the loan deemed uncollectible should be charged off
  - A loan that is not collateral dependent AND the modification was limited to an interest rate concession would not generally be expected to charge the loan to the present value at the time of restructuring-but maintain a reserve allowance
  - If debt is forgiven at the time of restructuring then a charge-off should be taken

TDR-Ongoing Accounting

- Should a TDR loan be placed on nonaccrual?
  - Most loans that are TDRs were impaired and likely on NA prior to restructuring
    - If on NA status follow Call Report guidance for returning a loan to NA
      - Reasonable Assurance of repayment under modified terms
      - Demonstrated repayment for six months on modified terms

TDR Regulatory Accounting

- Call Report instructions do not require retail loans (1-4 family residential mortgages and consumer loans) to be placed in nonaccrual status when they become 90 days past due
  - Instructions say that "such loans should be subject to other alternative methods of evaluation to assure that the bank's net income is not materially overstated"
  - If retail loan was current before under going a TDR and monthly payments under modified terms are not significantly different than under previous terms, and continued repayment performance is expected, placement in nonaccrual status would not be required

TDR Regulatory Accounting

- The loan must be reported as a TDR until it is paid off or otherwise settled reporting is as follows:
  - RC-C, part I, Memo item 1, if it is in compliance with its modified terms
  - RC-N, Memo item 1, if it is not in compliance with its modified terms
  - Sole exception: A TDR that yields a market interest rate (see slide 10) at the time of restructuring and is in compliance with its modified terms need not be reported as a TDR in Schedule RC-C, part I Memo item 1, in calendar years after the year of the restructuring
    - This may occur if the modification included a reduction in principal or uses an A/B note structure

TDR Regulatory Accounting

- Call Report TDR revisions effective in March 2011
  - Schedule RC-C, part I, Memo item 1, and Schedule RC-N, Memo item 1, were revised to collect a more detailed breakdown of TDRs by loan category
    - Before 2011, in each Memo item TDRs were reported separately for 1-4 family residential mortgages and all other loans (excluding consumer loans
    - Now, separate reporting of TDRs for several real estate loan categories, commercial and industrial loans, and all other loans (including consumer loans), with disclosure of loan categories that are significant components of all other loans

Questions

Thank You

- Contacts
  - Julia Kuhn 816-234-8071

    Regional Accountant