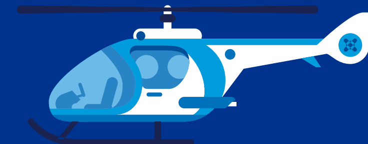

Defining Issues®

FASB changes premium amortization period for certain callable debt securities

March 31, 2017

KPMG reports on ASU 2017-08[1], which shortens the premium amortization period for purchased non-contingently callable debt securities.

Applicability

Companies that hold certain non-contingently callable debt securities, whose amortized cost basis is at a premium to the amount repayable by the issuer at the earliest call date.

Key facts and impacts

The ASU specifies that the premium amortization period ends at the earliest call date, rather than the contractual maturity date, for purchased non-contingently callable debt securities. Shortening the amortization period is generally expected to more closely align the interest income recognition with the expectations incorporated in the market pricing on the underlying securities.

The shorter amortization period means that interest income would generally be lower in the periods before the earliest call date and higher thereafter (if the security is not called) compared to current US GAAP. The premium is amortized to the contractual maturity date under current US GAAP.

Because the premium will be amortized to the earliest call date, the holder will not recognize a loss in earnings for the unamortized premium when the call is exercised.

Investment companies will be required to apply the guidance in the ASU, although they are not required to apply other aspects of the guidance on nonrefundable fees and costs.[2]

The ASU does not change the discount amortization period for purchased debt securities. The discount continues to be amortized to the contractual maturity date.

[1] ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities; issued March 30, 2017

[2] ASC Subtopic 310-20, Nonrefundable Fees and Other Costs

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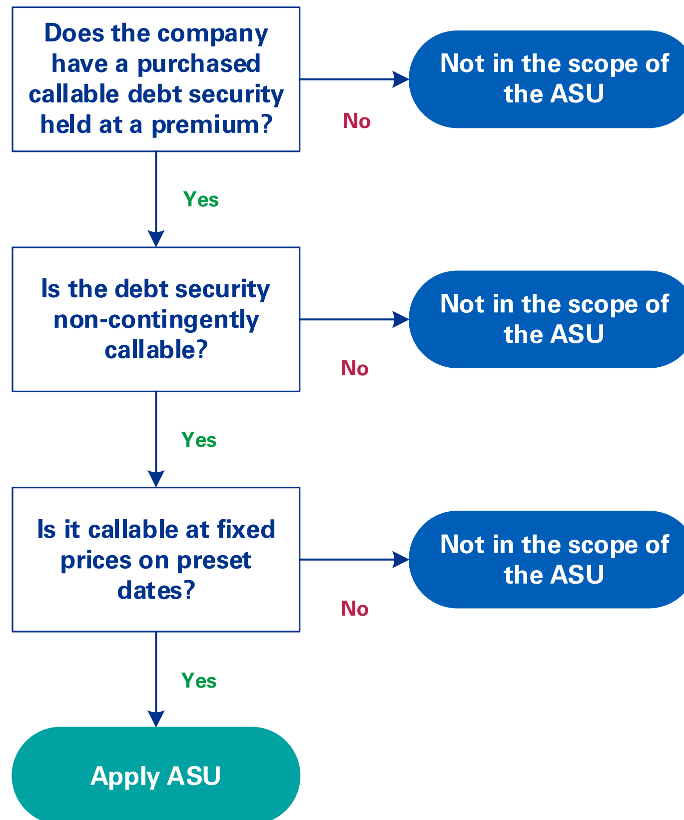
Scope

The flowchart shows which debt securities, including those held by an investment company, fall within the scope of the ASU.



KPMG observation

The Board stated that the ASU would be difficult to operationalize if the scope included debt securities with call features in which the call date or call price were not known in advance. Therefore, the Board decided that the ASU should apply to only debt securities that have explicit, non-contingent call features that specify fixed prices and preset call dates.

Premium amortization

The ASU applies to all premiums on debt securities regardless of how the premiums were generated (e.g. purchase premiums, deferred acquisition costs and cumulative fair value hedge adjustments).

The ASU requires the:

- premium to be amortized to the earliest call date; and
- effective yield to be reset using the payment terms of the debt security if the call option is not exercised at the earliest call date.

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Example
Company purchases a $100 par debt security for $105 on January 1, 20X4. The debt is callable on January 1, 20X6 for $103; matures on January 1, 20X9 for $100; and does not contain contingent call features. Company amortizes the debt security from $105 to $103 between the purchase date and January 1, 20X6 (the earliest call date). If the debt security is not called at that date, Company amortizes the remaining $3 premium through the contractual maturity on January 1, 20X9.

Effective dates and transition

	Public business entities	All other entities
Annual periods – Fiscal years beginning after	December 15, 2018	December 15, 2019
Interim periods – Fiscal years beginning after	December 15, 2018	December 15, 2020
Early adoption allowed?	Yes, including adoption in an interim period. If a company adopts in an interim period, it should compute and reflect the cumulative effect as of the beginning of the fiscal year that includes the interim period.	
Transition approach	Modified retrospective basis with a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. In the period of adoption, a company will need to disclose the change in accounting principle.	

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KPMG's Financial Reporting View

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