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December 22, 2021

Ms. Hillary Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

**RE: Proposed Accounting Standards Update, *Financial Instruments – Credit Losses (Topic 326) – Troubled Debt Restructurings and Vintage Disclosures* (File Reference No. 2021-006)**

Dear Ms. Salo:

We appreciate the opportunity to comment on the proposed ASU, *Financial Instruments – Credit Losses (Topic 326) – Troubled Debt Restructurings and Vintage Disclosures*.

We support the Board's decision to eliminate the recognition and measurement guidance in Subtopic 310-40 for troubled debt restructurings (TDRs) by creditors. We also support the Board's efforts to enhance the disclosure requirements for creditors.

To prevent diversity in practice as a result of the Board's decision to eliminate the requirement for an entity that had a TDR to use the original effective interest rate when estimating the allowance for credit losses, we recommend that the Board provide explicit guidance about the appropriate rate. We believe an entity that estimates the allowance for credit losses using a discounted cash flow approach should use the effective interest rate determined using the financial asset's contractual terms following the modification (not the original contractual terms), even if the borrower is experiencing financial difficulty. We discuss this recommendation further in Appendix A.

Appendix B provides our responses to selected questions for respondents.

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If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Kimber Bascom at kbascom@kpmg.com or Mark Northan at mnorthan@kpmg.com.

Sincerely,

KPMG LLP

KPMG LLP

## Appendix A – Recommendations

### Clarify the guidance on the effective interest rate

With the Board's decision to eliminate the requirement for an entity that had a TDR to use the original effective interest rate when estimating the allowance for credit losses (ASC 310-40-35-12 and 326-20-30-4A), we believe the question of how the effective interest rate should be determined when estimating the allowance for credit losses using a discounted cash flow approach will be frequently asked and therefore explicit guidance on the topic would be useful.

We recommend that the Board clarify that an entity estimating the allowance for credit losses using a discounted cash flow approach as described in ASC 326-20-30-4 should use the effective interest rate determined using the financial asset's contractual terms following the modification (not the original contractual terms). This would have the practical effect of eliminating the portion of the allowance specifically related to interest rate concessions and payment deferrals and would, therefore, provide consistency and comparability between entities applying a discounted cash flow method and entities that determine the allowance for credit losses using other methods.

Our recommendation would also ensure that the effective interest rate used in estimating the allowance for credit losses would be determined similarly for all modifications for all borrowers, and would, therefore, eliminate any need for the Board to develop effective interest rate guidance that is specific to modifications involving borrowers that are experiencing financial difficulty. Under Subtopic 326-20, when an asset modification is not a TDR, we believe the asset's effective interest rate is updated to reflect changes in both the asset's contractual terms (i.e. changes in the amount and timing of contractual principal and interest) and its amortized cost basis (i.e. changes in principal and in deferred fees and costs). Our view about the application of Subtopic 326-20 is consistent with the guidance for updating the effective interest rate in Subtopic 310-20. Our recommendation would result in the effective interest rate for modifications previously classified as TDRs being determined in a manner similar to all other loans.

In paragraph BC22 of the proposed ASU, the Board states that when a discounted cash flow approach is applied "the effect of those concessions…would continue to be recognized." This statement implies that the Board believes the effective interest rate used in applying ASC 326-20-30-4 for certain modifications should be determined based on the instrument's original contractual terms, which appears to be at odds with our recommendation. If the Board believes the effective interest rate should be based on the instrument's original contractual terms, we believe the guidance in ASC 326-20-30-4 should be amended to establish this requirement and clarify the scope of modifications to which it would apply (e.g. modifications of receivables to borrowers experiencing financial difficulty).

## Appendix B – Responses to Selected Questions for Respondents

### Issue #1: Troubled Debt Restructurings by Creditors

**Questions 1 and 3:**

*Should the designation of and accounting for TDRs by creditors be eliminated? That is, do the benefits of designating and accounting for certain loan modifications as TDRs and providing specific disclosures about those modifications justify the costs of providing that information? Please explain why or why not.*

*Would the amendments in this proposed Update result in financial reporting outcomes that are appropriate and meaningful for users of financial statements? That is, would the proposed amendments related to recognition and measurement changes on loan modifications produce meaningful information absent designation of certain modifications as TDRs? Is application of the modification guidance to loans previously accounted for as TDRs appropriate, or should the Board consider amending that guidance such that TDRs are more or less likely to be accounted for as new loans? Please explain why or why not.*

We believe the designation of and accounting for TDRs by creditors should be eliminated because the associated costs outweigh the benefits. We support the Board's objective to improve clarity, consistency and comparability of the disclosures by requiring creditors to disclose additional information related to modifications of receivables made to debtors experiencing financial difficulty. We encourage the Board to consider feedback from users about the benefits of the specific disclosures in the proposed ASU and from preparers about the related costs.

**Question 5:**

*Are there any additional disclosures or enhancements to the proposed disclosures needed to understand the effect of modifications made by creditors? If so, please explain why and how that information would be used and for what purpose. Please provide specific examples of what calculations would be done and when that information would influence investment and capital allocation decisions.*

In addition to disclosing the changes to contractual terms, we recommend disclosures that would enable investors to better understand the financial statement effect of modifications made to borrowers experiencing financial difficulty, specifically:

- The disclosures should be enhanced to enable users to better understand the financial statement effect of modifications when a loan is modified in more than one way (e.g. the modification includes an interest rate concession and principal forgiveness). The illustrative disclosures in the proposed ASU do not provide sufficient information for a reader to understand the total amortized cost balance of loans modified for each modification type (interest rate deferral, payment extension and principal forgiveness) because the entity would not be required to disclose the extent to which each of these modification types was used. For example, a reader would not be able to determine the total amortized cost of loans modified with an interest rate concession. Without this information, it would be difficult for users to understand the impact of those modifications on the financial statements (e.g. the impact on interest income).
- The illustrative disclosures proposed in paragraph 310-10-55-12A do not provide enough information to understand how interest income was impacted (or would be impacted) by the term extension modifications. For example, it is not clear whether, under the modified terms, interest would be charged during the term extension period or whether, and to what extent, the effective interest rates of the loans were otherwise adversely impacted by the modifications.

Proposed paragraph 310-10-50-42 would require additional disclosures about financing receivables that had a payment default during the period. Because different entities may have different policies for determining when a receivable has had a payment default (e.g. when a loan is 90, 120, or 180 days past due), we believe the Board should consider requiring disclosure of an entity's policy for determining when a payment default has occurred.

**Question 6:**

*Do you foresee any operability or auditing concerns in providing the disclosures in the proposed amendments? Please describe the nature and magnitude of costs and any operability or auditing concerns, differentiating between one-time costs and recurring costs.*

We do not have concerns about the auditability of the proposed disclosures. We believe preparers are best positioned to comment on the potential operational challenges of developing the processes and related internal controls over financial reporting for these disclosures. If an entity has appropriately developed these processes and controls, we do not believe there would be incremental auditing challenges.

**Question 7:**

*Are there certain assets within the scope of Topic 326 that if modified with a borrower experiencing financial difficulty should not be required to provide the information required by the disclosures in the proposed amendments? Are there certain modification types that should not be included in the disclosures in the proposed amendments? Please explain why or why not.*

We believe the proposed disclosures about modifications of receivables made to debtors experiencing financial difficulty would be most meaningful for financing receivables that arise from lending relationships and less meaningful for receivables that are a by-product of other activities (such as revenue transactions with customers or reinsurance activities).

**Question 8:**

*Are the proposed transition methods appropriate? Please explain why or why not.*

We believe entities should prospectively apply the proposed amendments, with the exception of changes to the allowance for credit losses as a result of the elimination of the recognition and measurement guidance for TDRs.

While the proposed ASU provides entities with the option to apply the changes in the allowance for credit losses prospectively or using a modified retrospective transition, we believe that the prospective option should either be 1) removed or 2) replaced with an option to irrevocably elect to continue to measure the allowance for credit losses for loans modified in a TDR before adoption using a discounted cash flow approach that incorporates the loan's effective interest rate before the TDR modification (effectively allowing an entity to continue to apply the measurement guidance in superseded Subtopic 310-40). We believe that the latter option may be consistent with the Board's intent based on paragraph BC38 in the proposed ASU.

Removing or replacing the prospective transition option for the allowance for credit losses will have the practical effect of requiring any accounting changes arising from the adoption of the ASU to be treated as a change in accounting principle associated with the adoption of new accounting guidance, as opposed to providing entities with an option to recognize those changes as either a change in accounting principle or prospectively in earnings as a change in estimate.

**Issue #2: Vintage Disclosures – Gross Writeoffs**

**Questions 12 and 14:**

*Do you foresee any operability or auditing concerns or constraints in complying with the proposed amendments in paragraph 326-20-50-6? Please describe the nature and magnitude of costs and any operability or auditing concerns about providing this information, differentiating between one-time costs and recurring costs.*

*In developing these proposed amendments, the Board considered, but decided not to require, gross recoveries by year of origination. If the Board decided to consider requiring gross recovery information, please describe the nature and magnitude of costs and any operability or auditing concerns about providing that information, differentiating between one-time costs and recurring costs. For financial statement users, is gross recovery information by year of origination necessary and, if so, how you would use that information?*

We do not have concerns about the auditability of the proposed amendments in paragraph 326-20-50-6, nor are we aware of constraints that would limit our ability to audit the proposed disclosures. Further, we do not have concerns about the auditability of gross recoveries by year of origination if the Board decides to consider requiring that information. We believe preparers are best positioned to comment on the potential operational challenges and the nature and magnitude of costs of developing the processes and related internal controls over financial reporting for these disclosures. If an entity has appropriately developed these processes and controls, we do not believe there would be incremental auditing challenges.