FASB *Flash* Report

No. 2010-06

To	**All Assurance Professionals**	Date	**June 4, 2010**
Re	**FASB Accounting Standards Update (ASU) No. 2010-18, Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset**	From	**National Assurance**

The FASB recently issued ASU 2010-18 (EITF Issue 09-I) to address the diversity in practice regarding the accounting for a loan receivable that is a part of an acquired pool of loans and is modified in a manner that meets the criteria for a troubled debt restructuring (TDR). ASU 2010-18 is applicable to any entity that acquires loans that are in the scope of Subtopic 310-30, that accounts for some or all of those loans within pools, and that subsequently modifies one or more of those loans after acquisition. The issue is whether the loan should be removed from or retained in the pool when it is modified. This issue is particularly relevant to financial institutions and other entities that have been acquiring a high volume of credit-impaired loans accounted for in pools and have modified individual loans in these pools.

This ASU amends the guidance in Topic 310-30[1] and is effective for modifications occurring in the first interim or annual period ending on or after July 15, 2010. The amendments should be applied prospectively and early adoption is permitted. Upon initial adoption, an entity may make a one-time election to terminate pool accounting on a pool-by-pool basis. This election does not preclude an entity from applying pool accounting to subsequent loan acquisitions, provided the criteria in ASC 310-30-15-6 are met.

Unit of Account – Pooled Loans: Topic 310-30 provides guidance on accounting for acquired loans (1) with evidence of a deterioration in credit quality since origination and (2) for which it is probable, at acquisition, that all contractually required payments will not be received. Current GAAP allows loans acquired in the same fiscal quarter (other than debt securities) with common risk characteristics (e.g., similar credit risk or risk ratings and one or more predominant risk characteristics) to be accounted for in the aggregate as a pool. Upon establishment of the pool, the pool becomes the unit of account. Once a pool is established, individual loans should not be removed from the pool unless the entity sells, forecloses, or otherwise receives assets in satisfaction of the loan or the loan is written off (ASC 310-30-40-1).

Current Practice for Modification of Individual Loan that is Part of an Acquired Pool: Two approaches have been applied in practice to acquired pooled loans when a single loan is modified and the modification constitutes a TDR.[2] One approach removes the individual loan from the pool

[1] FASB ASC 310-30, *Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality*

[2] A restructuring of a debt constitutes a troubled debt restructuring if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider (ASC 310-40-15-5).

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and impairment[3] of that specific loan is measured and recognized by crediting the allowance for loan losses.[4] Under an alternative approach, the individual modified loan remains in the pool and the entire pool is evaluated for impairment.

New Guidance: According to ASU 2010-18, modifications of loans that are within the scope of Subtopic 310-30 and are accounted for as part of a pool should not be removed from the pool even if the modification of those loans would otherwise be considered a TDR. According to the Task Force, a TDR is the continuation of a prior loan, not the creation of a new loan. Consequently, in accordance with ASU 310-30, the integrity of the pool as assembled should be maintained. However, an entity will continue to be required to consider whether the pool of assets in which the loan is included is impaired if expected cash flows of the pool change.

In practice, the ASU may commonly apply to pools of commercial and real estate construction loans purchased by financial institutions acquiring failed depositories or for loans purchased from financial institution regulators. The guidance in ASU 2010-18 does not apply to individual acquired loans in the scope of Subtopic 310-30 (i.e., loans that are not aggregated and accounted for within pools) – these individual loans will continue to follow the troubled debt restructuring requirements in Subtopic 310-40.[5] The guidance also does not apply to smaller-balance homogenous loans that are collectively evaluated for impairment such as purchased residential mortgage loans and credit card receivables, as discussed in ASC 310-10-35-13. When the modification of such a loan represents a troubled debt restructuring, it is treated accordingly under ASC 310-40-35-9.

In the period of adoption, an entity is required to provide the disclosures for a change in accounting principle (ASC 250-10-50-1 through 50-3). The amendments in the ASU do not require additional disclosures for modified loans that continue to be accounted for as a pool under Subtopic 310-30. Such disclosures will be addressed as part of the Board's project on credit loss disclosures.

All final FASB guidance can be accessed on the FASB website at www.fasb.org, located under the *Standards* tab, *Standards Issued in 2010*.

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[3] ASC 310-40-35-9 indicates "Usually, a loan whose terms are modified in a troubled debt restructuring already will have been identified as impaired" because it is considered probable that the creditor will be unable to collect all amounts due according to the terms of the loan agreement.

[4] ASC 310-10-35-22 requires that the impaired loan value be measured based on one of the following methods:

- Present value of expected cash flows discounted at the effective interest rate of the loan; or
- The observable market price of the loan; or
- If the loan is collateral dependent, the fair value of the collateral.

The amount of the impairment is the difference between the value of the loan as calculated by one of the methods above less the net carrying amount of the investment in the loan.

[5] FASB ASC 310-40, *Receivables–Troubled Debt Restructurings by Creditors*