

December 8, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via email: director@fasb.org

File Reference: No. 1880-100 *Clarifications to Accounting for Troubled Debt Restructurings by Creditors*

Dear Technical Director:

The American Bankers Association (ABA) appreciates the opportunity to comment on the exposure draft *Clarifications to Accounting for Troubled Debt Restructurings by Creditors* (ED). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

ABA understands the concerns with the identification and reporting of troubled debt restructurings (TDRs). Considering the economic climate we have faced over the past four years, ABA agrees that better transparency regarding loan modification activity is necessary for a financial statement user to understand the performance of assets held by financial institutions that contain credit risk. ABA's analysis of the ED, therefore, is made in light of two very important projects of the FASB:

- The recently issued Accounting Standards Update 2010-20 *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20)
- The outstanding Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (AFI ED)

ASU 2010-20 requires comprehensive credit-related information to be disclosed on loans and receivables, including the volume and performance of loan modifications that qualify as TDRs. In addition to TDR activity, ASU 2010-20 requires information on credit ratings, loans individually considered impaired, nonaccrual loans and past due loans.

The AFI ED proposes comprehensive changes to the concept of impairment, including the removal of traditional triggers used to identify impairment. Further, during the comment period for the AFI ED, FASB has heard from investors of their skepticism of market values related to loans. Ironically, the ED proposes to put greater emphasis on the current standard's market-based trigger in order to identify a

TDR. The required analysis of the “market” trigger in the current TDR accounting process provides the biggest hurdle in providing effective, consistent, and understandable application of the TDR standard, and the proposed guidance does little to alleviate the problem.

Practices regarding TDRs have evolved over many years through discussions with both auditors and regulators. It appears that the ED attempts to eliminate various “bright lines” that have developed to streamline the processes to identify and document TDRs. As a result, the proposals in the ED will require drastic operational changes for banks, which may mean that banks will need to elect to report all loan modifications as TDRs. Further, even if banks are able to eventually implement the proposed requirements, the resulting information will add little, if any, value to financial statement users’ efforts to analyze the credit risks in a bank’s lending portfolio.

The TDR concept is losing relevance; ABA recommends better loan modification disclosures without a market-based assessment.

Accounting for TDRs is not a concept that exists in International Financial Reporting Standards and also is not addressed within the AFI ED. Therefore, we question why FASB must address TDRs at this time. From a practical perspective, however, commercial loans that are subject to a TDR have, in the vast majority of cases, been individually identified as impaired (and subject to the “FAS 114” allowance methodology), and many are already reported as nonaccrual loans. Thus, the impact of the proposed changes on the allowance for loan and lease losses, as well as interest accruals, should be insignificant. With this in mind, considering the additional credit-related disclosures required in ASU 2010-20, the current movement toward a “triggerless” concept of impairment, as well as the demonstrated investor skepticism of market values, we believe the current definition of a TDR is becoming virtually irrelevant to the investor. Investors will have extensive credit-related information, so it is unnecessary (and confusing) to provide activity that is largely based on a market-related trigger.

As a result, ABA recommends a two-step approach to improve transparency:

- Prior to implementation of ASU 2010-20, eliminate the requirements for the TDR disclosures contained therein. Instead, require disclosure of specific loan modification activity, whether defined as a TDR or not, such as payment extensions (see below regarding our concern for “insignificant delays”) or reductions of principal balance. This activity can be disaggregated by the credit quality of the loan. For example, disaggregation could be broken out by investment grade, by delinquency status, or by whether the loan is criticized or not.

In determining which loan modification activity to include for disclosure, we caution FASB that a requirement to merely report all loan modification activity may have significant, and often unmanageable, internal control implications unless the activity is sufficiently defined. Such a requirement would also be of questionable informational value. The following are “every day” loan modification examples that would not normally be relevant to the financial statement user and would merely add “noise” to the disclosures. This activity can also be very difficult to track for disclosure purposes.

- A customer asks for an increase in their credit card line.
 - A customer asks the lender to waive a late fee on their mortgage loan.
 - A commercial borrower asks to release a third party guarantor in exchange for additional collateral (or conversely, asks to release collateral if a third party guarantee is provided).
 - A borrower with a seasonal business model (agriculture loans, for example) requests a short and temporary timing delay.
- If the concept of a TDR is still considered necessary, simplify the definition of a TDR to eliminate the concept of “market rate”. ABA recommends that a TDR be defined as a loan modification that either:
 - Reduces the outstanding principal balance owed, or
 - Reduces the effective interest rate of the loan, without being sufficiently compensated with additional cash, collateral, guarantees, or other features that reduce credit risk.

Implementation of this recommendation, in conjunction with ASU 2010-20, will better provide relevant loan modification information. The loan modification process will now be evaluated based on commonly understandable terms and focus on the credit risk that actually exists. This process is also implementable by banking institutions in a cost-effective manner. Our recommendation is based on the following problems with the proposals in the ED:

- Determining a “market rate” is difficult, if not impossible, in any cost-beneficial manner.
- Transition to comply with the proposed guidance will be unmanageable – often, the bank will not have maintained the appropriate historical data to adequately evaluate these situations under the new criteria – and likely result in virtually all loan modifications to be considered TDRs without improving transparency.

Determining a “market rate” is difficult, if not impossible, in any cost-beneficial manner.

The main difficulty in the current TDR standards is the difficulty in determining a “market rate” in assessing whether a concession has been granted by the creditor. Just as the market (or fair) values of most loans are normally hard to determine, market rates are equally as elusive. For example, because of complexities related to specialized terms, collateral and personal guarantees applied to loans, it is very difficult to determine a “market” interest rate on most loans. Even if you can find a bank to quote an interest rate on a new loan, it is unlikely that it would quote a rate that applies to borrowers with less than prime credit rating. As the FASB has heard from comments on the financial instruments project, banks do not manage their customer relationships on a market value basis, which makes determining a market rate both difficult to do and unreliable. Banks manage the customer relationship to preserve the cash flows that are contractually due. As a result, market rate information is often not a primary factor in structuring loan modifications.

The “market rate” trigger is particularly problematic because of the proposed addition of paragraph 310-40-15-8A, which indicates that if a borrower does not have access to a market rate for debt with similar characteristics, the modification is considered a TDR, presumably whether or not the borrower is in financial difficulty. In the present economic environment, it has not been unusual for local credit markets to freeze, virtually shutting out the availability of many different kinds of credit vehicles, whether they are new or modified. Practically speaking, this one aspect of the proposal will, by itself, likely cause almost all commercial loan modifications to be TDRs in any part of the economic cycle. Therefore, we recommend that this addition be deleted.

A further difficulty in applying the “market rate” trigger is that many TDRs, though eventually re-performing, must be reported and accounted for as TDRs for the remaining life of the loan. This is due to the difficulty in determining whether the loan has resumed paying at a market rate. For modifications that involve temporary rate adjustments, these loans are often perpetually presumed to be “less than market”, though the borrower has returned to paying off according to the original terms of the note. Our recommendation above, which redefines the TDR as a modification that reduces the effective rate of the loan (without being sufficiently compensated with additional cash, collateral, guarantees, or other features that reduce credit risk), alleviates the difficulty in determining whether a TDR has been cured or not.

Transition to comply with the proposed guidance will be unmanageable and likely result in virtually all loan modifications being considered TDRs.

The proposal to retrospectively disclose loan modifications as TDRs under the new guidance will, for all practical purposes, cause most banks, to be conservative, to consider all loan modifications during the effective reporting period to be TDRs. This is because the data will not normally exist to determine the then-market rate, if one was available at the time. If it does exist, the time and funds required to evaluate each modification will be significant.

Going forward, ABA believes the required detailed processes – processes in the credit and the accounting areas of the organization – will place significant, and often unmanageable, burdens on banks to implement systems to evaluate loan modifications. A process to effectively determine legitimate market rates does not exist. If this proposal is to be required, it should only be done prospectively and should allow a minimum of one year for implementation from the date the rule becomes final.

More guidance is needed regarding insignificant delays in cash flows.

In contrast to effectively eliminating the position that an insignificant delay in cash flows does not result in a TDR, we recommend that guidance around the term “insignificant delay” be provided. The use of three months as a guideline for certain loans in the banking industry is generally understood and trial periods of this length are common. These trial periods, when the borrower has “passed” the trial, produce successful permanent loan workouts far more frequently than other modifications. These trial periods will likely be unable to continue if these are considered TDRs and this designation will not accurately reflect the ongoing quality of the credit resulting from these successful trials.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me if you would like to discuss our views.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael L. Gullette". The signature is written in a cursive, flowing style.

Michael L. Gullette