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Congress Shows That It CARES About Accounting Rules for Banks and Credit Unions

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This *Heads Up* was updated to reflect the April 3, 2020, statement by SEC Chief Accountant Sagar Teotia on actions being taken by the SEC in response to coronavirus disease 2019 (COVID-19).

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which provides relief from certain accounting and financial reporting requirements under U.S. GAAP. The passage of the CARES Act has already triggered actions by the SEC, and the FASB may take certain steps as well. Below are some thoughts related to those activities in connection with certain provisions of the CARES Act.

Deferral of CECL

Section 4014 of the CARES Act offers optional temporary relief from applying the FASB's current expected credit losses standard[1] ("CECL") only for the following qualifying entities:

- Insured depository institutions,[2] as defined in Section 3 of the Federal Deposit Insurance Act.
- Credit unions regulated by the National Credit Union Administration.

[1] FASB Accounting Standards Update (ASU) No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.
[2] The CARES Act states that the relief applies to an insured depository institution, bank holding company, or any affiliate thereof.

Qualifying entities are not required to comply with CECL during the period beginning on the date of enactment and ending on the earlier of the following:

- The termination date of the national emergency declared by President Trump under the National Emergencies Act on March 13, 2020, related to the outbreak of COVID-19.
- December 31, 2020.

Connecting the Dots

On April 3, 2020, SEC Chief Accountant Sagar Teotia issued a statement regarding actions the SEC has been taking in response to COVID-19. He indicated that for those entities that are eligible to apply the provision of the CARES Act related to the deferral of CECL, an election to apply that provision would be in accordance with GAAP.

In addition, on the basis of discussions with the SEC staff, we understand that the SEC would object to the application of the CARES Act's provisions by an entity that is not eligible to apply them. In other words, the optional deferral of CECL under Section 4014 of the CARES Act is limited to insured depository institutions and credit unions.

It is also our understanding that if an insured depository institution or credit union intends to elect to defer CECL under Section 4014 of the CARES Act, the entity must make that election before its first filing of financial statements with the SEC that include the reporting period that contains the effective date of the CARES Act (March 27, 2020). In addition, the entity should not apply CECL to any of its filings for that reporting period. For example, a qualifying entity with a December 31 year-end may elect to defer CECL under the CARES Act's provisions in its 10-Q filing for the quarter ending March 31, 2020. As a result, the entity would not have adopted CECL as of January 1, 2020.

Further, we understand that an entity that elects to defer CECL under the CARES Act's provisions would be required to adopt CECL on the date the deferral expires under the CARES Act. Accordingly, an entity would not have the ability to elect to defer CECL and then subsequently elect to adopt CECL before the date the deferral expires under the CARES Act. The entity's application of CECL should be retrospective to the beginning of the fiscal year of adoption. For example, if an end to the national emergency is declared on September 1, 2020, an entity with a December 31 year-end would adopt CECL in the third quarter and apply it retrospectively as of January 1, 2020.

Note that in the agenda for its April 8, 2020, public Board meeting, the FASB indicates that it intends to discuss, among other topics, requests for the deferral of the effective dates of significant standards that are not yet effective for certain or all entities. We do not know whether the Board will specifically acknowledge the CARES Act's limited deferral of CECL, but entities should monitor the FASB's Web site for further developments.

Relief From Troubled Debt Restructurings

Section 4013 of the CARES Act provides temporary relief from the accounting and reporting requirements for troubled debt restructurings regarding certain loan modifications related to COVID-19 that are offered by "financial institutions."[3]

Specifically, the CARES Act provides that a financial institution may elect to suspend (1) the requirements under U.S. GAAP for certain loan modifications that would otherwise be

[3] A financial institution is not a defined term in the CARES Act or GAAP. Entities may need to discuss whether they are within the scope of Section 4013 with their legal counsel.

categorized as a troubled debt restructuring and (2) any determination that such loan modifications would be considered a troubled debt restructuring, including the related impairment for accounting purposes. The modifications that would qualify for this exception include any modification involving a loan that was not more than 30 days past due as of December 31, 2019, that occurs during the "applicable period,"[4] including any of the following:

- A forbearance arrangement.
- An interest rate modification.
- A repayment plan.
- Any other similar arrangement that defers or delays the payment of principal or interest.

The exception does not apply to any adverse impact on the credit of a borrower that is not related to the COVID-19 pandemic.

Connecting the Dots

On March 22, 2019, a group of banking agencies[5] released an interagency statement[6] that offers some practical expedients for modifications that occur in response to the COVID-19 pandemic. The expedients require a lender to conclude that a borrower is not experiencing financial difficulty if either (1) short-term (e.g., six months) modifications are made, such as payment deferrals, fee waivers, extensions of repayment terms, or other delays in payment that are insignificant related to loans in which the borrower is less than 30 days past due on its contractual payments at the time a modification program is implemented or (2) the modification or deferral program is mandated by the federal government or a state government (e.g., a state program that requires all institutions within that state to suspend mortgage payments for a specified period).

For a loan modification to be considered a troubled debt restructuring in accordance with ASC 310-40,[7] **both** of the following conditions must be met:

- The borrower is experiencing financial difficulty.
- The creditor has granted a concession (except for an insignificant delay in payment).

Accordingly, any loan modification that meets a practical expedient described above would not be considered a troubled debt restructuring because the borrower is not experiencing financial difficulty. However, if a loan modification does not meet the conditions for a practical expedient, the modification is not necessarily a troubled debt restructuring. The creditor must evaluate whether, under ASC 310-40, the borrower is experiencing financial difficulty and whether a concession, other than an insignificant delay in payment, has been made. Note that in the discussion above on short-term modifications, we are not interpreting the meaning of an insignificant delay in payment; ASC 310-40 provides guidance on determining whether a delay in payment is insignificant. Further, the FASB issued a statement on March 22, 2020, noting that the interagency statement "was developed in consultation with the staff of the FASB who concur with this approach."

[4] The applicable period for loan modifications means the period beginning on March 1, 2020, and ending on the earlier of (1) December 30, 2020, or (2) the date that is 60 days after the termination date of the national emergency declared by President Trump under the National Emergencies Act on March 13, 2020, related to the outbreak of COVID-19.

[5] The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and the State Banking Regulators.

[6] Interagency Statement on Loan Modifications by Financial Institutions Working With Customers Affected by the Coronavirus.

[7] FASB Accounting Standards Codification (ASC) Subtopic 310-40, *Receivables: Troubled Debt Restructurings by Creditors*.

The CARES Act and the interagency statement overlap in many areas, but they are not consistent. For example, the interagency statement requires an evaluation of whether the borrower is less than 30 days past due at the time a modification program is implemented, as opposed to the CARES Act, under which that determination is made as of December 31, 2019. In addition, the CARES Act allows interest rate modifications to occur on the loans, whereas the interagency statement only provides relief for modifications associated with the timing of payments (e.g., deferrals).

In his April 3, 2020, statement, Mr. Teotia indicated that for those financial institutions that are eligible to apply the provision of the CARES Act related to the modification of loans, an election to apply that provision would be in accordance with GAAP.

In addition, the SEC staff continues to collaborate with the FASB staff, the AICPA, banking regulators, and other stakeholders on some of the related implementation questions, including the relationship between the CARES Act and the interagency statement. The agenda for the FASB's April 8, 2020, public Board meeting indicates that the Board intends to discuss responses to pervasive questions on urgent accounting issues and notes that "[t]he FASB will help its stakeholders interpret guidance related to priority issues, including troubled debt restructurings and lease modifications." As in the case of the optional deferral of CECL discussed above, entities should monitor any guidance issued by the SEC or FASB.

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