Troubled Debt Restructurings

Financial Reporting Application & Accounting
Abby Wegner, Director of Financial Reporting
Sheila Earp, Senior Financial Reporting Analyst
Joel Erickson, Financial Reporting Analyst
May 14, 2014

Agenda

- Troubled Debt Restructuring (TDR) Basics
- TDR Reporting
- TDR Accounting
- Overview of TDR Application
- It’s Complicated – TDR Examples
Troubled Debt Restructuring (TDR) Basics

What is a Troubled Debt Restructuring?

• A troubled debt restructuring is when both of the following criteria are met:
  – The debtor is experiencing financial difficulties
  – A concession is granted that the creditor would not otherwise consider

• Identifying financial difficulties (includes, but may not be limited to):
  – The debtor is currently in payment default on any of its debt
  – It is probable the debtor would be in payment default in the foreseeable future without modification
  – The debtor has declared or is in the process of bankruptcy
  – Substantial doubt exists as to whether the debtor will continue as a going concern

Troubled Debt Restructuring (TDR) Basics

What is a Troubled Debt Restructuring?

• Identifying a concession:
  – A creditor does not expect to collect all amounts due, including interest accrued at the original contract rate
  – If payment is primarily dependent on collateral, the value of the collateral should be used to determine if the principal will be paid
  – Adequacy of cross collateralization for multiple loans needs to be evaluated
  – Interest rate reduction to the point that the debtor would be unable to obtain the same terms and rate from a different lender
  – If the institution would not make a loan to a new borrower with the same credit risk utilizing the same terms as the restructured loan
  – The institution should consider the cumulative effect of all changes to the loan when determining whether a delay in payment is significant
**Troubled Debt Restructuring (TDR) Basics**

**What is a Troubled Debt Restructuring?**

- A concession may not exist:
  - If the borrower has provided more compensation (additional collateral, for example) than the creditor has granted in modifying the terms
  - If there is an increase in interest rate; however, this in and of itself does not preclude a concession if the rate granted does not meet the criteria of a market rate
  - If a delay in payment is considered insignificant
    - Payments subject to the delay is insignificant relative to the unpaid principal or collateral value of the debt and will result in an insignificant shortfall in the contractual amount due
    - The delay in timing of the restructured payment period is insignificant relative to any one of the following:
      - The frequency of payments due under the debt
      - The debt’s original contractual maturity
      - The debt’s original expected duration

---

**TDR Reporting**

**What are the required disclosures?**

ASC 310-10-50-33 For each period for which a statement of income is presented, an entity shall disclose the following about troubled debt restructurings of financing receivables that occurred during the period:

- By class of financing receivable, qualitative and quantitative information, including both of the following:
  - How the financing receivables were modified
  - The financial effects of the modifications

**How the financing receivables were modified**

- Prior to the new TDR Application, there was very limited systematic ability to capture this data point
- Beginning in 2014, model disclosures for the AgriBank District Associations include:
  - "The primary types of modification typically includes [extension of maturity, interest rate reduction below market, or forgiveness of principal]."

**The financial effects of the modifications**

- Disclosed as the ‘pre-modification’ investment in the loan and the ‘post-modification’ investment in the loan
TDR Reporting
What are the required disclosures?

ASC 310-10-50-33 For each period for which a statement of income is presented, an entity shall disclose the following about troubled debt restructurings of financing receivables that occurred during the period:
• By portfolio segment, qualitative information about how such modifications are factored into the determination of the allowance for credit losses.

Model disclosures for the AgriBank District Associations include:
• “Loans classified as troubled debt restructurings are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.”
• On an annual basis, allowance for loan losses are disclosed by FCA Loan Type

TDR Reporting
What are the required disclosures?

ASC 310-10-50-34 For each period for which a statement of income is presented, an entity shall disclose the following for financing receivables modified as troubled debt restructurings within the previous 12 months and for which there was a payment default during the period:
• By class of financing receivable, qualitative and quantitative information about those defaulted financing receivables, including both of the following:
  • The types of financing receivables that defaulted
  • The amount of financing receivables that defaulted.

Model disclosures for the AgriBank District include:
• On a quarterly basis, subsequent defaults are disclosed by FCA Loan Type
**TDR Reporting**

*What are the required disclosures?*

**ASC 310-10-50-34** For each period for which a statement of income is presented, an entity shall disclose the following for financing receivables modified as troubled debt restructurings within the previous 12 months and for which there was a payment default during the period:

- By portfolio segment, qualitative information about how such defaults are factored into the determination of the allowance for credit losses.

**Model disclosures for the AgriBank District Associations include:**

- “Loans classified as troubled debt restructurings are considered risk loans. All risk loans are analyzed within our allowance for loan losses. We record a specific allowance to reduce the carrying amount of the restructured loan to the lower of book value or net realizable value of collateral.”
- Defaults on a TDR are typically evaluated in a similar manner with all risk loans; therefore, no additional disclosure is included specific to this default occurrence
- On an annual basis, allowance for loan losses are disclosed by FCA Loan Type

---

**TDR Reporting**

*What are the required disclosures?*

**ASC 310-40-50-1** As of the date of each balance sheet presented, a creditor shall disclose, either in the body of the financial statements or in the accompanying notes, the amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructurings.

- **Loan coded as a TDR with an Unfunded Balance**: DISCLOSE
- **Available commitment on a CIF with a TDR**: DISCLOSE
- **Loan NOT coded as a TDR with an Unfunded Balance, but CIF has a TDR**: DISCLOSE

- For loans that are part of a restructure, but have $0 215 (nonaccrual/book value balance) it is important to still code these appropriately as TDRs, otherwise the logic may not capture the appropriate commitments related to the CIF
TDR Accounting

Management Controls – Preparing for an Audit

- TDR control(s) are in scope for Sarbanes-Oxley testing

- Typically, one KEY control is sufficient to address the reporting risk

- While the Non-KEY control is not required, it is important to ensure a process exists whereby AgriBank Financial Reporting is made aware of late changes to TDR classifications

- Control should address the following risk:
  - Loans are not properly classified and reported as a Troubled Debt Restructuring

Recommended KEY* control description:
- [Monthly/Weekly/Daily], the [position with requisite knowledge to evaluate] reviews and completes a TDR evaluation form for all loans meeting pre-established criteria to determine whether the loan qualifies for TDR reporting.

- [Quarterly/Monthly/Weekly], the [position with requisite knowledge to evaluate] reviews a report listing all potential TDRs and ensures a TDR evaluation form was completed for each loan meeting pre-established criteria to validate whether the loan qualifies for TDR reporting.

*either or substantially similar is acceptable

Recommended Non-KEY control (or best practice) description:
- A loan identified as a TDR is keyed with a restructure code of a ‘1’ (formally restructured with deferral) or ‘2’ (formally restructured without deferral) to ensure proper reporting. If quarter reporting cutoff (last day of the quarter) is passed, a request for an override is submitted to AgriBank Financial Reporting for material TDRs.
**TDR Accounting**

**Management Controls – Preparing for an Audit**

- Population Request: Provide all loans evaluated for TDRs
  - This should be the same population used for management’s controls testing
  - Not all loans meeting this criteria are TDRs; however, all loans that meet the population criteria, should be evaluated to determine whether a concession was granted and, thus, the loan should be coded as a TDR
    - PwC will expect a TDR Assessment form has been completed for all loans meeting the pre-determined criteria

---

**TDR Accounting**

**Management Controls – Preparing for an Audit**

- Best practice is to determine a population as follows:

  - Identify borrowers with financial difficulties
  - Identify loans for which terms were modified outside the normal course of business that may be considered a concession
  - All loans with a PD of 11 or Greater AND PD of 10 and has at least one instance of over 30 days delinquent
  - Transaction Codes:
    - Q800 – Billing Amt Change (> $500)
    - 9000 – Int Rate Change (exclude stated rate)
    - 9010 – Base Rate Change
    - 9200 – Maturity Date Change
    - BP00 – Principal Due Changed to -0- due to a deferment or principal
    - 0500 – Interest Adj (> $500 or < -$500)

- Population for TDR assessments

---

*This criteria continues to be vetted; significant updates will be communicated to all Association stakeholders as necessary*
TDR Accounting  
Preparation for an Audit

- Documenting Management’s Position
- Ensure consistent application in theory and approach across analyses
- For complex, grey situations, documentation should include, but may not be limited to:

<table>
<thead>
<tr>
<th>FACTS</th>
<th>CIRCUMSTANCES</th>
</tr>
</thead>
<tbody>
<tr>
<td>- How many loans involved?</td>
<td>- Collateral – did it change and why?</td>
</tr>
<tr>
<td>- What is the delinquency history for the borrower?</td>
<td>- Set-aside notes – due to bankruptcy or other agreement with borrower?</td>
</tr>
<tr>
<td>- What was modified?</td>
<td>- Likelihood of receiving set-aside notes</td>
</tr>
<tr>
<td>- Term extension relative to original maturity</td>
<td></td>
</tr>
<tr>
<td>- Are there ongoing legal proceedings?</td>
<td></td>
</tr>
</tbody>
</table>

- How many samples need to be tested to sufficiently document the control is working properly?
  - Regardless of the frequency stated in the KEY control description, the actual number of instances tested is contingent on the population (or projected population) of loans evaluated for TDR reporting during the year.

- **Example Facts:**
  - At 6/30, 25 loans were captured in the pre-determined population; of which 4 were determined to be TDRs. Last year, 100 loans were captured in the pre-determined population; of which 10 were determined to be TDRs.
Sample size is determined by frequency and risk related to the control as well as management judgment. The sample size should be trued-up for the appropriate population size throughout the year. 

### Example Sample Determination:

- As TDRs are not necessarily regular occurrences one of two approaches could be taken to determine the appropriate sample size:
  - 25 loans in the population at 6/30, estimates approximately 50 loans in the population by 12/31. 50 Instances is approximately weekly – a total sample size of 15 over the course of the year.*
  - 100 loans in the population for last year, use this as an estimate for the current year expected population. Use the higher frequency (daily) as a starting point – a total sample size of 40 over the course of the year.*

<table>
<thead>
<tr>
<th>Number of Instances of Control Event</th>
<th>Sample Size*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annually (1 time per year)</td>
<td>1</td>
</tr>
<tr>
<td>Quarterly (4 times per year)</td>
<td>2</td>
</tr>
<tr>
<td>Monthly (12 times per year)</td>
<td>2 - 5</td>
</tr>
<tr>
<td>Weekly (52 times per year)</td>
<td>5 - 15</td>
</tr>
<tr>
<td>Daily (250 times per year)</td>
<td>20 - 40</td>
</tr>
<tr>
<td>Multiple times per day (&gt;365 times per year)</td>
<td>25 - 60</td>
</tr>
</tbody>
</table>

*Sample size is determined by frequency and risk related to the control as well as management judgment. The sample size should be trued-up for the appropriate population size throughout the year.

---

**TDR Accounting**

**Preparing for an Audit**

### Capturing Pre & Post Modification Investment

- The recorded investment of the loan is the face amount of the receivable increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, and acquisition costs and may also reflect a previous direct charge-off.
- Calculation is consistent with ‘Volume’ for all other Financial Reporting purposes
- 215 Balance accounts for Late Charges
TDR Accounting
Capturing Pre & Post Modification Investment

- When should a charge-off be considered in determining the Pre and Post modification investment?
  - The pre modification investment should not be modified for a charge-off taken prior to the troubled debt restructuring
  - A charge-off OR compromise taken as part of the restructuring should be shown as a reduction in the investment

- Was a principal or interest concession granted that resulted in a compromise?
  - YES: Include as a reduction in Post modification investment in the loan. Documentation regarding management’s decision is highly recommended.
  - NO: Was a balance determined to not be collectible; although not yet formally compromised to the borrower due to timing or other factors?
    - YES: An in substance forgiveness has not occurred; no charge-off recorded
    - NO: Include as a reduction in Post modification investment in the loan. Documentation regarding management’s decision is highly recommended.

- How should fees collected/charged upon restructuring be accounted?
  - Fees received in connection with a modification of terms of a troubled debt restructuring should be recorded as a reduction of the recorded investment in the loan. (ASC 310-20-35-12)
  - In practice across the District, fees charged in a troubled debt restructuring have been capitalized to the recorded investment in the loan; however, a process change is underway that would capture fees of this nature as deferred income; therefore, reducing the recorded investment in the loan
  - Typically, these fees are not considered material individually or in aggregate for troubled debt restructurings
  - This guidance is limited to instances of a TDR – the accounting is different for typical refinancing arrangements or minor modifications
TDR Accounting
Capturing Pre & Post Modification Investment

• How should costs incurred upon restructuring be accounted?
  – Legal fees and other direct costs incurred by a creditor to effect a troubled debt restructuring should be included in expense when incurred. (ASC 310-40-25)

Overview of TDR Application
Basics of the Application Functionality

Logging into the TDR Application

• Option 1:
  – Go to the AgriBank District Connect site and click on “Information Systems”
  – Select “Financial Reporting” in the center of the page
  – Log-in using your mainframe log-in information

• Option 2:
  – Copy the following URL into your browser
  – Save it to “Favorites” folder
  – Log-in using your mainframe log-in information

• Access needs to be granted from your local ISG department
Overview of TDR Application

Basics of the Application Functionality

Primary Purposes of the Application

- ‘Link’ loans as the pre restructured loan(s) and the post restructured loan(s)
- Update the pre and post modification investment amounts within days of when the loan is changed to a ‘1’ or ‘2’ restructure code
- Ability to search all TDRs effective since April 1, 2013
- Reduce reliance on data provided by AgriBank Financial Reporting
- Through data in the Application, update Hyperion District Reporting to efficiently disclose:
  - The financial effects of the modifications
  - Loans defaulted subsequent to the modification date
  - Commitments to borrowers whose loans have been modified in a TDR
  - Foregone interest on restructured loans (System/District Reporting Only)

- Ability to query ‘Unassigned Loans’
  - Enhances association’s ability to monitor the TDRs and accurately record the pre and post modification investment immediately after a restructuring event

- Ability to clear errors in the amortization table calculating foregone interest through overrides
  - Key fields required to replicate the amortization table include:
    - Next payment date must be AFTER the restructure date
    - Term must be > 0 months
    - Interest Rate must be > 0.0%

- Detailed list of TDRs in the application
  - Search functionality available by date range
  - Search on current year-to-date range will yield detail of data to be reported in current reporting period
Overview of TDR Application

Frequently Asked Questions

• I participated in the webcasts in 2013, but I don’t remember how to use the TDR Application – is there a training available?
  – Yes, AgriBank Financial Reporting can set-up a time to train individually
  – Typically this works best with a recently restructured loan example
  – Our busiest reporting periods are the first three days of each month or the first three weeks of the quarter reporting month – if possible, it is preferred to avoid these times

• Is there a best practice to monitor my TDRs in the application?
  – Yes, best practice is to link the restructured loans the day after they are changed to a ‘1’ or a ‘2’ in CornerStone – overrides can be posted the day after the linking is created
  – If this is not possible, we recommend reviewing and updating any overrides necessary, at a minimum, on a weekly or monthly basis (depending on volume)
  – Cut-off for reporting occurs on the last day of the quarter – at this point reporting cannot be changed without AgriBank Financial Reporting intervention

It’s Complicated – TDR Examples

Real-life Example 1

FACTS

• Assume financial difficulties factor has been met
• Investment in the loan at the time of restructure (including default charges) $100,000
• Default charges of $1,000 were forgiven
• No other terms of the loan were modified
It’s Complicated – TDR Examples

**Real-life Example 1**

- Is the modification a TDR?
  
  **NO** Forgiveness of late charges may be considered in many circumstances and this, in and of itself, does not meet the definition of a concession ‘the creditor would not otherwise consider’.

- Using just the facts provided, what is the pre and post modification investment?
  
  Not applicable – restructuring event does not meet the definition of a TDR

---

It’s Complicated – TDR Examples

**Real-life Example 2**

**FACTS**

- Assume financial difficulties factor has been met

- Investment in the loan at the time of restructure $300,000

- Loan was modified into two loans:
  
  - Loan A – $200,000
    - Interest is below market
    - NRV of Collateral – $200,000

  - Loan B – $100,000
    - Interest is below market
    - NRV of Collateral – $0
    - Agreement with borrower if terms on Loan A are met (payments current for three years); Loan B will be forgiven
    - At the time of restructure, Credit believes this loan is uncollectible
It’s Complicated – TDR Examples

Real-life Example 2

- Is the modification a TDR?
  YES A concession was granted by providing loans below the market rate of interest.

- Using just the facts provided, what is the pre and post modification investment?

<table>
<thead>
<tr>
<th>PRE MODIFICATION</th>
<th>POST MODIFICATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>$300,000</td>
<td>$200,000*</td>
</tr>
</tbody>
</table>

*If the charge-off occurred as part of the restructuring, it is likely an in substance forgiveness of debt and is appropriate to show the financial effects of the modification as a reduction in principal.

It’s Complicated – TDR Examples

Real-life Example 3

FACTS

- Assume financial difficulties factor has been met
- Dairy farmer with an intermediate term loan; original maturity of two years
- One year into the loan, the creditor agreed to defer monthly payments for six months
- Investment in the loan at the time of restructure $100,000
- NRV of the collateral – $150,000
- The borrower agreed to sell some livestock, machinery, and grain and apply the proceeds to the creditor’s debt. The payments deferred amount to approximately 25% of the outstanding balance of the term notes
- There was no change to the interest rates, no principal or interest was forgiven and there were no changes to the term note maturity dates
It’s Complicated – TDR Examples

Real-life Example 3

• Is the modification a TDR?

NO While the argument could be made that this is not insignificant, interest continues to accrue at the contractual rate and no debt has been forgiven. Since the loans are expected to be paid in full (either via payment or via the acquisition of sufficient collateral), no concession has been granted and the deferral is not considered a TDR. As such, the delay in payment is considered insignificant.

• Using just the facts provided, what is the pre and post modification investment?

Not applicable – restructuring event does not meet the definition of a TDR

It’s Complicated – TDR Examples

Real-life Example 4

FACTS

• Assume financial difficulties factor has been met
• Farmer with a real estate loan; original maturity of 30 years
• Five years into the loan, the creditor agreed to extend the maturity an additional ten years; therefore, reducing the required monthly payments
• Investment in the loan at the time of restructure $400,000
• NRV of the collateral – $450,000
• There was no change to the interest rates, no principal or interest was forgiven.
It’s Complicated – TDR Examples

Real-life Example 4

• Is the modification a TDR?

IT DEPENDS If the interest rate (while unchanged) continues to represent a market rate of interest (i.e.: if the institution would make a loan to a new borrower with the same credit risk utilizing the same terms as the restructured loan), the delay in payment is considered insignificant. The loan continues to accrue interest at a market rate, no debt has been forgiven, and the collateral is sufficient should foreclosure be necessary, the debt is expected to be paid in full.

If the interest rate no longer represents a market rate of interest, a concession has been granted.

• Using just the facts provided, what is the pre and post modification investment?

<table>
<thead>
<tr>
<th>PRE MODIFICATION*</th>
<th>POST MODIFICATION*</th>
</tr>
</thead>
<tbody>
<tr>
<td>$400,000</td>
<td>$400,000</td>
</tr>
</tbody>
</table>

*If the interest rate is below market

For questions or comments, please contact:
Abby Wegner at abby.wegner@agribank.com or 651-282-8732
Sheila Earp at sheila.earp@agribank.com or 651-282-8737
Joel Erickson at joel.erickson@agribank.com or 651-282-8604
Kerri Hansen at kerri.b.hansen@us.pwc.com or 612-596-6363

System Guidance can be located on AgriBank District Connect Document Library ➔ Category Controller / Financial Reporting ➔ Troubled_Debt_Restruct_Guide