

Allowance for Credit Losses Disclosures

Maine Bankers Association
Financial Management Committee
May 26, 2011

Topics

- Requirements of ASU 2010-20
Receivables (Topic 310), *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*
- Sample Disclosure

ASU 2010-20 Purpose

This Update is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses.

ASU 2010-20 Objective

- To provide disclosures that facilitate financial statement user's evaluation of:
 - Nature of the credit risk inherent in the entity's portfolio
 - How that risk is analyzed and assessed in arriving at the allowance for credit losses
 - The changes and reasons for those changes in the allowance for credit losses
 - Requires disaggregation of existing disclosures and requires new disclosures related to credit quality information, credit risk exposure and accounting policies

ASU 2010-20 Scope

- Applies to all entities, both public and nonpublic that have financing receivables
- Excludes:
 - Short term receivables
 - Receivables or loans measured at FV or LOCOM
 - Debt securities
 - Unconditional promises to give

ASU 2010-20

Effective date and transition

- Public companies
 - Disclosure required as of the end of the reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010 (already implemented for calendar year companies)
 - Disclosure required about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010 (1st quarter for 2011 calendar year companies)
- Nonpublic companies
 - All of the amendments are effective for first annual reporting period ending on or after December 15, 2011
- Transition
 - Encourages but does not require comparative disclosures for earlier reporting periods in the initial period of adoption

ASU 2010-20 Definitions

Term	Definition
Class of Financing Receivable	Classes of financing receivables generally are a disaggregation of portfolio segment
Credit Quality Indicator	A statistic about the credit quality of financing receivables
Portfolio Segment	The level at which an entity develops and documents a systematic methodology to determine its allowance for credit losses
Recorded Investment	<ul style="list-style-type: none">• Unpaid principal balance plus or minus deferred fees/costs (FAS 91)• Purchased loans – balance plus or minus premium/discounts• Unpaid principal balance net of partial charge-off (general ledger balance)

ASU 2010-10

Categories of New Disclosures

Category	Portfolio Segment	Class
Nonaccrual and Past Due Loans		✓
Allowance for Credit Losses	✓	
Impaired Loans (Individually Evaluated)		✓
Credit Quality Information		✓
Modifications	✓	✓

ASU 2010-20

Determining Portfolio Segments

- ASC 310-10-55-21 provides the following examples of portfolio segments
 - Type of financing receivable
 - Industry sector of the borrower
 - Risk rate
- The determination of the portfolio segment will require judgment and should be based on the level at which the allowance for credit losses is calculated and monitored

ASU 2010-20

Determining Portfolio Segment

- ASU 310-10-55-7 shows portfolio segments as consisting of the following:
 - Commercial
 - Commercial Real Estate
 - Consumer
 - Residential
 - Finance leases
 - Unallocated

ASU 2010-20

Determining Classes

- ASC 310-10-55-16 provides the following process to determine the classes of financing receivables
 - 1st – segregate receivables on the basis of the model under which they were initially recorded
 - 2nd - using the portfolio segment as the starting point, determine classes based on the level that the entity uses when assessing and monitoring the risk and performances of the portfolio for various types of receivables, considering the risk characteristic of the receivable *
- * determination would be expected to be consistent with the information provided to the entity's key management personnel

ASU 2010-10

Determining Class

- ASU 310-10-55-17 further indicates that in determining the appropriate level of its internal reporting to use as a basis for disclosure, an entity should consider the level of detail needed by a user to understand the risk inherent in the entity's receivable.
- It goes on to provide factors to consider in determining the disaggregation of portfolio segments into classes

ASU 2010-10

Determining Class

Factor	Considerations
Categorization of borrower	<ul style="list-style-type: none">•Commercial•Consumer•Related party
Type of financing receivable	<ul style="list-style-type: none">•Mortgage•Credit Card•Interest-only•Finance leases
Industry sector	<ul style="list-style-type: none">•Real estate•Mining
Type of collateral	<ul style="list-style-type: none">•Residential property•Commercial property•Government-guaranteed•Uncollateralized
Geographic distribution	<ul style="list-style-type: none">•Domestic•International
Credit risk concentrations	<ul style="list-style-type: none">•ASC 825-10-55 provides guidance

ASU 2010-20

Nonaccrual and Past Due – By Class

Old Requirement	ASU 2010-20	Comment
<p>Accounting policies for financing receivables:</p> <ul style="list-style-type: none">•Placing on nonaccrual•Recording payments received•Resuming accrual of interest•Charging off uncollectible•Determining past due or delinquency status	<p>Same disclosures required by class except that the disclosure of the accounting policy for charging off uncollectible receivables is required by portfolio segment</p>	<p>Many banks already disclose certain policies by loan type; the ASU will require more detailed disclosure by class</p> <p>Guide 3 requires disclosure of the policy for placing a loan on nonaccrual but only by domestic and foreign</p> <p>SEC staff previously requested disclosure of charge -off and nonaccrual policies by loan type (CFO letter)</p>

ASU 2010-20

Nonaccrual and Past Due – By Class

Old Requirement	ASU 2010-20	Comment
Recorded investment in receivables on nonaccrual status	Now required by class	Guide 3 requires disaggregation between domestic and foreign
Recorded investment in receivables past due by 90 days or more and still accruing	Now required by class	Guide 3 requires disaggregation between domestic and foreign
N/A	An entity shall provide, by class , an analysis of the age of the recorded investment in loans at the end of each reporting period that are past due, as determined by the entity's policy	ASU does not define when a loan is considered past due/delinquent or prescribe aging categories Existing policies on past due status should not change

ASU 2010-20

Allowance for Losses – by Portfolio Segment

Old Requirement	ASU 2010-20	Comment
N/A	<p>Accounting policies regarding the credit loss allowance methodology by portfolio segment:</p> <ul style="list-style-type: none">•Description of factors that influenced management’s judgment including historical losses and existing economic conditions•Discussion of risk characteristics relevant to each portfolio segment•Identification of any changes from prior periods and rationale	<p>Institutions generally disclose this information in the notes; however, changes to the disclosure will be required to meet the requirement to disclose such matters by portfolio segment</p> <p>SEC staff previously requested disclosure of various items when an entity changed its allowance methodology</p>

ASU 2010-20

Allowance for Losses – by Portfolio Segment

Old Requirement	ASU 2010-20	Comment
Roll forward of total allowance for credit losses	<p>Roll forward is required by portfolio segment</p> <p>Additional disclosures:</p> <ul style="list-style-type: none">•Qualitative effects of changes in allowance methodology on current period provision•Amount of significant purchases of loans•Amount of significant loan sales and/or reclassifications to HFS•Balance in ALLL disaggregated on basis of impairment method	<p>Guide 3 requires disclosure of loan amounts, charge-offs/recoveries and ending allowance balances disaggregated by major loan type and domestic vs foreign</p> <p>Guide 3 does not require a roll forward of the allowance by type</p>

ASU 2010-20

Allowance for Losses – by Portfolio Segment

Old Requirement	ASU 2010-20	Comment
Recorded investment in financing receivables	Recorded investment in financing receivables by portfolio segment and disaggregated on the basis and method of impairment method	Guide 3 currently requires disclosure of the amounts of loans by specified categories
Disclosure requirements in ASC 450-20-50-3 when no accrual is made for a loss contingency because either the loss is not probable or not reasonably estimable	Clarifies that the disclosures in ASC 450-20-50-3 through 50-6 do not apply to loss contingencies arising from an entity's estimation of its allowance for credit losses	Not a significant impact

ASU 2010-20 Impaired Loans – By Class

Old Requirement	ASU 2010-20	Comment
<p>For individually-evaluated loans:</p> <ol style="list-style-type: none"> 1. The recorded investment in impaired loans 2. The amount of the recorded investment for which there is an allowance and the amount of the allowance 3. The amount of the recorded investment for which there is not an allowance 	<p>Same disclosures required by class</p> <p>Additionally, the following disclosures are also required by class;</p> <ol style="list-style-type: none"> 1. The accounting for impaired loans 2. The amount of impaired loans 3. The total unpaid principal balance of impaired loans 	<p>Disaggregation by class and disclosure of the unpaid principal balance of impaired loans is similar to what is currently required by regulatory reporting</p>

ASU 2010-20 Impaired Loans – By Class

Old Requirement	ASU 2010-20	Comment
<p>For individually-evaluated impaired loans:</p> <ol style="list-style-type: none"> 1. Accounting policy for recognizing interest income, including how cash receipts are recorded 2. The average recorded investment 3. The related interest income recognized when the loans were impaired 4. The amount of interest income recognized on the cash basis 	<p>Same disclosure required by class</p> <p>Additionally, the following disclosures are also required by class:</p> <ol style="list-style-type: none"> 1. The entity’s policy for determining which loans it assesses for impairment on an individual basis 2. The factors considered in determining that the loan is impaired 	<p>Consistent with prior guidance:</p> <ol style="list-style-type: none"> 1. No guidance is provided on how a creditor calculates the average recorded investment in impaired loans 2. The change in present value of an impaired loan due to passage of time can be recorded as bad debts or interest income

ASU 2010-20

Credit Quality Information – By Class

- The following end of reporting period disclosure of qualitative and quantitative credit quality information is required **by class**
 - A description of the credit quality indicator
 - The recorded investment in loans by credit quality indicator
 - The date or range of dates in which the credit quality indicator was updated
 - How internal risk ratings relate to the likelihood of loss
- The disclosures do not apply to loans measured at FV or LOCOM or debt securities, but do apply to loans collectively evaluated for impairment, leases, credit card receivables and acquired credit-impaired loans

ASU 2010-20

Credit Quality Information – By Class

- ASC 310-10-55-19 provides the following examples of disaggregation by credit quality indicator:
 - Consumer credit risk scores
 - Credit-rating-agency ratios
 - Internal credit risk grades
 - Loan-to-value ratios
 - Collateral
 - Collections experience
 - Other internal metrics
- Judgment should be used to determine credit quality indicators for each class of loans, considering how the entity monitors loans and uses information in determining the allowance for credit losses

Historical Loss Period Considerations

- Examples of historical loss period basis include:
 - The average life of the loans in the segment
 - The average period from origination to default or charge-off
 - Levels of and trends in past due/delinquencies and impaired loans
 - Levels of and trends in charge-offs and recoveries
 - Effects of any changes in underwriting standards or other changes in lending policies, procedures, and practices
 - Experience and ability of lending management and other relevant lending staff.

Disclosure of Economic Factors by Segment

- Financial risk factors of the borrower including company cash flow, leverage ratios, liquidity and profitability
- Industry specific risks including industry sales data, concentration risks, environmental factors and industry-specific laws
- National and local economic factors including unemployment rates, occupancy rates, foreclosure rates, industrial production and GDP

Methodology Changes Disclosure

- All changes to methodology must be disclosed
- Changes include the following:
 - Changing historical loss period for segment or class
 - Adding or removing a risk factor such as unemployment rates or other economic factors used in the allowance credit loss calculation
 - Reclassifying a class of loans to their own segment due to changes in risk factors

Implementation Considerations

- Design/format the allowance for credit loss calculation to be easily utilized in preparing the disclosures.
- As part of your allowance for credit loss policy, management must define what constitutes a methodology change.
- Develop a method to identify changes in the methodology, as an entity is required to disclose changes in the methodology caused by management modifying one or more variables used in the calculation.

Implementation Considerations

- Develop a method to track all impaired loans including TDRs by segment to ease disclosure efforts.
- Develop a method to track any acquired loans by segment and specifically identify those with deteriorated credit quality.
- Be sure to maintain adequate supporting records as this information needs to be audited.
- Good documentation will lead to efficient re-creation efforts each year or interim period.

Sample Disclosure

People's United Financial, Inc. and Subsidiaries

Questions?

Tracy Harding, CPA | Principal

d/f: 207.991.5114

www.berrydunn.com

Todd J. Desjardins, CPA, CFE | Senior Manager

d/f: 207.541.2381

www.berrydunn.com