Q&A Section 2130

Loan Restructurings Resulting in Periods With Reduced Payments

Creditors may restructure loans in response to COVID-19 that result in restructurings that are not troubled debt restructurings and include periods of reduced payments, including payment deferrals, fee waivers, extension of repayment terms, or delays in payment. The following question and answer addresses the recognition of interest income on such loans following the restructuring, provided the restructuring is not accounted for as a new loan.

.41 Determination of the Effective Interest Rate

Inquiry—If a creditor restructures a loan due to COVID-19 to include a period of reduced payments, and the restructuring is neither a troubled debt restructuring (TDR), nor required to be accounted for as a new loan, how should a creditor recognize interest income on the restructured loan?[1]

Reply—FASB *Accounting Standards Codification* (ASC) 310-20, *Receivables—Nonrefundable Fees and Other Costs*, requires creditors to recognize interest income on loans[2] in accordance with the interest method. For loans other than those with no scheduled payment terms or revolving lines of credit, the objective of the interest method is to arrive at periodic interest income at a constant effective interest rate (EIR) on the net investment in the receivable. That is, for such loans the EIR is the rate that equates the amortized cost basis of the loan[3] to the loan's future contractual payments.

When a loan is restructured by a creditor, and the restructured loan is neither a TDR nor required to be accounted for as a new loan, a creditor should determine a new EIR in accordance with the interest method, as described in FASB ASC 310-20.

[1] The guidance in this question and answer is not applicable to the accounting by borrowers and should not be applied by borrowers by analogy.

[2] For loans classified as held-for-sale, creditors should consider the guidance in FASB *Accounting Standards Codification* (ASC) 948-310-25-3.

[3] For entities that have adopted FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, for purchased financial assets with credit deterioration, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at the date of acquisition.

For restructured loans that include a period with reduced payments (including temporary payment holidays), the application of the interest method may result in a creditor's net investment in a loan increasing above the amount at which the borrower could settle the obligation. For loans structured at origination with increasing interest rates, FASB ASC 310-20-35-18(a) prohibits the recognition of interest income that would result in a creditor's net investment in a loan increasing above the amount at which the borrower could settle the obligation. Prepayment penalties are considered in determining the amount at which the borrower could settle the obligation only to the extent that such penalties are imposed throughout the loan term.

At its [April 8, 2020 board meeting](), FASB staff discussed a fact pattern in which a loan was restructured in response to COVID-19, that restructuring was neither a TDR nor accounted for as a new loan, and the restructured terms included a period with a reduced payments. FASB staff noted that, for such a restructuring, creditors may elect to apply or not apply the guidance in FASB ASC 310-20-35-18(a) to loans that have a period with reduced payments following a restructuring. In the fact pattern discussed by FASB staff, the loan did not have any unamortized discounts or premiums and, as a result, the application of the guidance in FASB ASC 310-20-35-18(a) would result in recognizing interest at the contractual rate in effect during the period of reduced payments. However, for loans with unamortized discounts, interest income would be recognized at the EIR determined upon restructuring, subject to the cap in FASB ASC 310-20-35-18(a). AICPA staff believes that the election regarding whether to apply or not apply FASB ASC 310-20-35-18(a) to restructured loans with periods of reduced payments is an entity-wide accounting policy election.

If a creditor elects to not apply the guidance in FASB ASC 310-20-35-18(a) to its restructured loans, the EIR on the restructured loan would be the rate that equates the new contractual cash flows over the restructured contractual term with the amortized cost basis of the loan at the restructuring date.

If a creditor elects to apply the guidance in FASB ASC 310-20-35-18(a) to its restructured loans, the EIR on the restructured loan would be the rate that equates the new contractual cash flows over the restructured contractual term with the amortized cost basis of the loan at the restructuring date. However, the amount recognized in interest income is limited to the amount that would not cause a creditor's net investment in the loan to exceed the amount for which the borrower could settle the obligation. The limitation on interest income described in FASB ASC 310-20-35-18(a) is illustrated in Example 6 in paragraphs 35–37 of FASB ASC 310-20-55. At the end of the period of reduced payments, the creditor would determine a new EIR that equates the remaining contractual cash flows to the amortized cost basis of the loan.

While not specifically addressed by this question and answer (Q&A), whichever policy a creditor elects, creditors that have elected to estimate prepayments in accordance with paragraphs 26–32 of FASB ASC 310-20-35 should consider the impact of that guidance on their determination of the EIR.

Additionally, while also not specifically addressed by this Q&A, whichever policy a creditor elects, creditors should apply appropriate accounting policies regarding the recognition of interest income to restructured loans in the scope of this Q&A when concerns about the realization of loan principal or interest on a restructured loan exist.