Interpretation of the Emerging Accounting Issues Working Group

INT 02-03: Accounting for the Impact of the Terrorist Attacks of September 11th on Commercial Mortgage Loans

GUIDANCE DETERMINED TO BE NO LONGER RELEVANT

INT 02-03 Dates Discussed

December 10, 2001; March 18, 2002

INT 02-03 References

SSAP No. 36—Troubled Debt Restructuring (SSAP No. 36)
SSAP No. 37—Mortgage Loans (SSAP No. 37)

INT 02-03 Issue

1. The terrorist attacks of September 11, 2001, resulted in a tremendous loss of life and property. Secondarily, those events interrupted the business activities of many entities and disrupted the U.S. economy at many levels. The economic uncertainty that the attacks have interjected into the real estate market has caused a great deal of uncertainty, at least temporarily, in appraisals of certain types of real estate, including, but not limited to, office building, hotels, and retail. This temporary economic disruption warrants consideration for temporary relief from specific requirements of statutory accounting related to troubled debt restructuring, in particular, the recognition of a permanent impairment at the time of a non-market driven modification of loan terms.

2. Paragraph 2 of SSAP No. 36 defines a troubled debt restructuring as a debt restructuring whereby the creditor, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise grant. Many troubled debt restructurings involve the temporary or permanent modifications of terms to reduce or defer the cash payments required of the debtor in the near term in an attempt to temporarily help the debtor improve its financial condition, so that the debtor will eventually be able to pay the creditor. Per paragraph 10 of SSAP No. 36, mortgage debt with modified terms is accounted for at the fair value of the collateral, as determined by acceptable appraisal methodologies. If the fair value of the loan is less than the recorded investment (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established equal to the fair value, with the difference being recorded as a permanent impairment or a realized loss in the statement of operations.

3. One example of an industry that has incurred a temporary setback is the hotel industry, due to the severe, but hopefully, temporary disruption in both personal and corporate travel. The uncertainty of the long-term impact of the unprecedented events of September 11th on hotels has made it extremely difficult for insurance companies to obtain current appraisals at reasonable long-term investment values for mortgage loans collateralized by hotel properties. Additionally, the current valuation difficulties in the real estate market and the current accounting ramifications of loan modifications may encourage companies to make non-economic decisions because of the permanent nature of the losses under SSAP No. 36. For example, companies might consider allowing a borrower to default under the contractual terms of a mortgage loan, because the impairment could be considered temporary under *SSAP No. 37—Mortgage Loans*, instead of restructuring the terms of the loan to maximize debt recovery and recording a realized loss or a permanent write-down under SSAP No. 36.

4. The accounting issue is, in light of the terrorist attacks of September 11, 2001, and their negative impact on commercial mortgage loans, would be appropriate for reporting entities to be granted a limited waiver of the permanent write-down requirements of paragraph 10 of SSAP No. 36?

5. Under the limited waiver that is being proposed, a commercial mortgage loan with restructured terms shall still be accounted for at the fair value of the underlying collateral. The difference between the fair value of the loan and the recorded investment in the mortgage loan shall be recognized as an impairment by creating a valuation allowance with a corresponding charge to unrealized loss. For reporting entities required to maintain an Asset Valuation Reserve (AVR), the unrealized gain or loss on impairments shall be included in the calculation of the AVR. If some or all the impairment is considered to be "other than temporary", a direct write down shall be recognized as a realized loss, and a new cost basis will be established. This new cost basis shall not be changed for subsequent recoveries in value. The limited waiver would be effective for reporting periods commencing December 31, 2001, and would end December 31, 2002.

INT 02-03 Discussion

6. The working group reached a consensus that it would not be appropriate for reporting entities to be granted a limited waiver of the other than temporary impairment requirement stipulated in paragraph 10 of SSAP No. 36. Although the events of September 11 have interrupted the business activities of many entities and disrupted the U.S. economy at many levels, it would be very difficult to separate and quantify the effects of September 11 versus the general downturn in the economy. The working group felt the requested waiver was too broad and inconsistent with the impairment guidelines for other types of invested assets.

INT 02-03 Status

7. No further discussion is planned.

