MEMO# 30660

March 31, 2017

FASB Requires Amortization of Premium to Earliest Call Date for Callable Debt Securities

[30660]

March 31, 2017 TO: ICI Members SUBJECTS: Fund Accounting & Financial Reporting RE: FASB Requires Amortization of Premium to Earliest Call Date for Callable Debt Securities

The Financial Accounting Standards Board recently released an accounting standards update that shortens the amortization period for callable debt securities purchased at a premium.[1] Specifically, the amendments require premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities purchased at a discount. Any discount continues to be amortized to maturity.

According to the ASU, entities generally amortize the premium as an adjustment to yield over the contractual life of the instrument. As a result, upon the exercise of a call on a callable debt security purchased at a premium, the unamortized premium is recognized as a loss. The FASB has also determined that there is diversity in practice as to the amortization period for callable debt securities.

According to the ASU, the amendments provide more useful information to investors because they align the amortization period of premiums and discounts to expectations incorporated in market pricing on securities. In most cases, market participants price securities to the call date when the coupon is above current market rates and price securities to maturity when the coupon is below market rates in anticipation that the borrower act in its economic best interest. As a result, the amendments more closely align interest income recorded on callable debt securities purchased at a premium with market expectations.

Investment Companies

The exposure draft amends ASC paragraph 310-20-35-33 to indicate that premiums on purchased callable debt securities must be amortized to the earliest call date. After the earliest call date, if the call option is not exercised, the effective yield should be reset using the payment terms required by the security. Securities that have explicit, noncontingent call features that are callable at fixed prices and on preset dates are within the scope of the amendments.

Commenters on the proposal expressed concern that the amendments to ASC paragraph

946-320-35-20 were overly broad in that they would apply the entirety of the guidance within Subtopic 310-20 to investment companies. The ASU addresses this concern by removing the reference to Subtopic 310-20 and clarifying that investment companies should amortize premiums on purchased callable debt securities that have explicit, noncontingent call features that are callable at fixed prices on preset dates consistent with the guidance in paragraph 310-20-35-33.

Effective Date and Transition Guidance

The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Reporting entities should apply the amendments on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. In the period of adoption the reporting entity should provide disclosures about a change in accounting principle.

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endnotes

[1] The accounting standards update, *Premium Amortization on Purchased Callable Debt Securities*, No. 2017-08 (March 30, 2017) is available on the FASB website.