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January 12, 2019

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

REFERENCE: Proposed Accounting Standards Update, *Codification Improvements – Financial Instruments* (File Reference No. 2018-300)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), *Codification Improvements - Financial Instruments* (the Proposal) issued by the Financial Accounting Standards Board (FASB or Board) on November 19, 2018.

We applaud the efforts of the Board, in conjunction with its Credit Losses Transition Resource Group (TRG), to promptly address key interpretive issues so preparers can implement ASU 2016-13, *Financial Instruments – Credit Losses*, in a practical manner. To this end, we support the amendments in the Proposal related to Issue 1C (Recoveries). Specifically, we believe the proposed amendment to remove the reference to recognition of recoveries only "when received," will result in recognition of all changes in expected cash flows during the period in which the change in estimate occurs. Furthermore, allowing the presentation of a "negative allowance" for estimated recoveries will result in an appropriate presentation on the balance sheet of the "net amount expected to be collected." The transparency of this information will provide users of our financial statements with better information about the realizability of amounts on our balance sheet, as well as insight into the operational and market conditions that affect the viability of our business to investors.

From a conceptual perspective, the TRG discussion around the topic of Recoveries reminded us of the FASB and IASB discussion (from 2008-2009) about the difference in (a) "expectations" at an aggregated pool level versus (b) the result of summing up individual "expectations" at a loan unit-of-account level. That is, in statistical terms, the statistical "mean" for a pool is not the same as the sum of the individual "modes" for each loan in the pool. We understand that the Board agreed with this conceptual difference, as was evidenced in (1) the variable consideration guidance in the Revenue Recognition standard[1] and (2) the difference in measurement guidance for the credit impairment allowances under ASC 326-20 (Current Expected Credit Loss (CECL), which is at a pool level or requires the estimate to reflect the "risk of loss") and ASC 326-30 (AFS impairment, which is at an individual unit of account level).

We highlight this conceptual difference between "expectations" at a pool level versus an individual asset level because it is the primary driver of why users of our financial statements will benefit from our application of the guidance in the Proposal that permits recognition of a "negative allowance" and will allow us to implement ASU 2016-13 in a manner consistent with the Standard's objective (having the balance sheet reflect the "net amount expected to be collected"). More specifically (and as we expand upon in the Appendix), when we purchase a pool of low credit quality, defaulted, well past-due receivables, we have no reasonable "expectation" of recovery at the individual loan level because our historical experience indicates a zero collection of the vast majority of individual loans (85% or higher). In addition, while we can predict the timing and amount of collections at the portfolio level based on statistical modeling and behaviors, we cannot predict with any degree of accuracy the amount and timing of expected collections at the individual loan level. When evaluated at the unit-of-account level, each loan will be individually deemed "uncollectible" and charged-off. However, when evaluated at the pool level, we have a reasonable and supportable "expectation" of recoveries. Therefore, in order to achieve the Standard's objective of having the balance sheet reflect the net amount expected to be collected, we believe that the use of a negative allowance is a practical way to bridge the difference between charge-off guidance (applied at the individual unit of account level) and CECL (applied at the pool level).

Having said that, we are always cognizant that "you can sometimes be considered wrong by others, even when you follow the letter of the guidance." With that in mind, we believe some may have a concern that the ultimate outcome of this Proposal, when applied to purchased portfolios of defaulted, well past due, low credit quality receivables could be perceived as having the effect of "side-stepping" the purchase credit deteriorated (PCD) guidance in ASU 2016-13. That is, some may not be convinced that the Board's intent is to permit the use of a "negative allowance" when the amortized cost basis of individual assets, inclusive of the PCD gross-up amount, has been charged-off (because the charge-off guidance is applied at the individual unit of account (receivable) level). We do believe that this outcome is consistent with the Board's intent and is a practical way for our industry to achieve the Standard's objective of having the balance sheet reflect the net amount expected to be collected. We ask that in its re-deliberations, the FASB acknowledge that this Proposal may have the ultimate effect of presenting a pool-level "negative CECL allowance" on a portfolio of purchased PCD loans that individually have had their amortized cost balance (inclusive of the "Day 1" PCD gross-up) charged-off shortly after purchase ("Day 2"). In the absence of specific acknowledgement by the FASB or FASB staff to this point, we believe some may require our industry participants to seek clarifying interpretation through other authoritative regulatory agencies. In the spirit of full transparency on this matter, we are including a step-by-step analysis of application of the guidance to our industry's basic fact pattern in the Appendix.

Our responses to the questions in the Proposal related to Issue 1C are set out in the Appendix to this letter. In the Appendix, we have also included (a) background information on our industry, (b) a discussion of the challenges we encountered in trying to apply ASU 2016-13, (c) an illustration of how we understand ASU 2016-13 would be applied assuming the Proposal is finalized, and (d) responses to certain questions in the Proposal.

We appreciate your willingness to meet with us in the past to help address our industry's issues with ASU 2016-13, and would be pleased to discuss our comments with the Board or its staff at your convenience.

Sincerely,

Ann Gill
Chief Accounting Officer, Controller

Jonathan Clark
Chief Financial Officer

APPENDIX

Background on our Industry

We are a specialty finance company providing debt recovery solutions for consumers across a broad range of financial assets. We purchase portfolios of unsecured defaulted consumer receivables at deep discounts to face value and manage them by working with individual consumers as they repay their obligations and work toward financial recovery. In doing so, our industry provides a vital service to the economy by helping credit distressed borrowers rebuild their credit history as well as their lives. We have been in business over 35 years, and therefore, have proprietary statistical data which enables us to predict the recoverability and default information for the portfolios which we purchase.

Each portfolio we purchase generally consists of a voluminous number of homogeneous receivables with similar credit risk. Although the dollar amounts of the receivables within a given portfolio may vary, these receivables are similar in that they are defaulted, well past-due loans which have already been determined uncollectible and charged-off by the originator.

Historically, we have been unable to collect an average of 85% or more of the individual receivables (this amount varies by portfolio and current trends may go as low as 70%). The amount of uncollectible individual receivables in a portfolio varies by portfolio but has never been less than 50% in any jurisdiction. The collections on the remaining receivables vary from partial to whole and from upfront payments to long-term payment plans. Although it is not evident at the date of purchase which individual accounts we will be able to collect on, using sophisticated probability models that are based on our historical experience, we are able to forecast cash collections on a portfolio basis. That is, despite not being able to predict *which* individual receivables in a portfolio we will collect on, we are able to forecast, with a high degree of confidence, the amounts that will be collected on a purchased portfolio basis (i.e., at the "deal level").

Practical Challenges in Applying ASU 2016-13 Without the Clarifications in the Proposal

Unlike many banks that found the accounting under ASC 310-30 unduly challenging, we were able to reasonably operationalize ASC 310-30. Under current guidance we have aggregated similar portfolios purchased within a quarter into "pool groups" and utilized the internal rate of return (IRR) of the pool groups in our initial calculation of yield. This aggregation to utilize the pool groups (i.e., aggregated similar portfolios purchased within a quarter) as the "unit of account" under ASC 310-30 served us well, because estimating expected cash flows at deal-level is how we manage the business. Initially, we believed that CECL would bring that unit of account to the portfolio level, which although more detailed would be manageable as we have the information on a portfolio level. However, bringing the unit of account to the loan level creates challenges for our industry to implement ASU 2016-13 in a manner that appears to achieve the Board's objective for the following reasons:

1. At the individual unit of account level, it would appear impossible for us to do anything other than conclude that each individual unit of account is "uncollectible" given the high likelihood of zero collection, and the inability to accurately identify the accounts that will generate cash flows, or the timing and amounts thereof at the individual unit of account level.

If we somehow were able to avoid the charge-off guidance, we would be arbitrarily assigning some portion of the purchase price (including the allocated PCD gross up) to individual receivables, which we know will not reflect our account-level collection experience. Because collectability is so uncertain at the individual account level, it is unclear whether it would be appropriate to amortize the non-credit discount in accordance with ASC 310-20, particularly after months or years without collections. If we were to apply a cost-recovery method of income recognition, then none of the non-credit discount assigned to our accounts with cash collections less than the allocated purchase price would ever be recognized as interest income (an important financial metric to our investors). Conversely, collections on many of the remaining receivables would likely exceed the allocated purchase price and non-credit discount, and the "excess" would be reflected as a reversal of the allowance. Therefore, our initial pool-level forecast could be accurate, yet we would underreport interest income and record a subsequent reversal to our allowance.

2. Further, from a pure operational perspective, we will have approximately 90,000,000 units of account under ASU 2016-13 (i.e., the individual receivable level) as compared to approximately 200 pool groups accounted for today under ASC 310-30. As a result, the prospect of seeing ASC 310-30 superseded and replaced with the purchased credit deteriorated (PCD) model in ASU 2016-13 has been concerning to our industry given these issues.

How ASU 2016-13 Would be Applied Given the Proposal

The changes in the Proposal provide our industry an avenue to implement ASU 2016-13. We believe that the proposed amendment to require presentation of a "negative allowance" provides for a practical accounting treatment that reflects the economics by having the balance sheet show the present value of the amount expected to be collected. On balance, we find the resulting treatment detailed below to be very consistent with ASC 310-30; the primary exception being that both favorable and unfavorable changes are recognized immediately under ASU 2016-13 (as would be amended by this Proposal), whereas favorable changes are amortized into income over time under ASC 310-30. We believe that this change is consistent with the Board's objective in ASU 2016-13.

In the interest of transparency and clarity, below we have detailed the step-by-step accounting that we understand would apply to an illustrative fact pattern for our industry, assuming the Proposal is finalized:

- **Assumptions** – On January 1, we pay $6M for a portfolio of approximately 10,000 individual defaulted receivables with a total unpaid principal balance (UPB) of $50M. Each of the receivables is over 180 days past due, qualifies as PCD, and has similar risk characteristics as of the date of acquisition. We estimate that we will collect $12M gross cash flows on the portfolio, over the course of approximately 20 years, though the primary receipts will occur in the first 10 years. The deal-level quarterly yield is approximately 10% (comparing the forecasted stream of expected cash flows with the purchase price).[2]

- **Step 1 (Day 1)** – We pay $6M in cash for the portfolio of receivables. We then estimate the allowance for credit losses (ACL) at the "deal level"[3] as the present value of expected credit losses (that is, contractual cash flows that we do not expect to collect) using an effective interest rate (EIR) that equates the purchase price ($6M) with the expected recoveries ($12M). [4] The resulting journal entry would be as follows:

Receivables (Amortized cost)	6
Cash	6
Receivables (Amortized cost)	44
Receivables (Allowance)	44

The balance sheet amounts that result from this step are as follows:

Receivables (Amortized cost)	50
Minus Receivables (Allowance)	(44)
Receivable carrying value (net)	6

- **Step 2 (Day 2)** – We evaluate each individual receivable to assess whether it is "uncollectible" under ASC 310-20-35-8 and as defined by our write-off policies. In addition to being over 180 days past due, our historical experience with similar receivables indicates that approximately 85% of individual receivables do not generate any cash flows, and our historical information spanning over 20 years does not enable us to reliably estimate cash flows for any specific individual receivable at the date of purchase. As such, while we know there is value at the portfolio level, on an individual asset basis we conclude that the receivable is uncollectible and charge-off the entire receivable in accordance with our charge-off policies for individual accounts. This treatment is consistent with the originating bank's prior accounting as well as Banking Regulatory guidance. The journal entry would be as follows:

Receivables (Allowance)	50
Receivables (Amortized cost)	50

The balance sheet amounts that result from Step 1 and Step 2 is a positive net carrying value, resulting from a zero-amortized cost basis and a negative (i.e., debit balance) allowance, as follows:

Receivables (Amortized cost)	0
Less: Negative Allowance	6
Carrying value (net)	6

- **Step 3 (During the Quarter)** – We engage in our normal business activities and collect cash on certain of the outstanding balances of $.9M (again, we cannot predict which of the individual receivables will ultimately prove collectible and which will not). The journal entry resulting from this activity is as follows:

Cash collections	0.9
Receivables (Allowance)	0.9

- **Step 4 (End of Quarter)** – We update our estimate of expected cash flows at the same "deal" level, using a DCF approach and the ACL discounting EIR established in Step 1. In this example, we also assume that the present value of expected future cash flows has increased by an additional 0.7 as a result of an increase in forecasted recoveries (i.e., there is a net benefit, or so-called "negative provision expense"). The journal entry resulting from this activity is shown below, effectively increasing the net carrying value, by recognizing "negative provision expense" and presenting as interest income the change in the negative allowance attributable to the time value of money:

Receivables (Allowance)	0.7
Provision benefit	0.7

Further, as permitted under the Standard, we elect to present separately the change in present value of the allowance that is attributable to the passage of time (consistent with ASC 326-20-45-3). The journal entry resulting from this activity is shown below, effectively reducing the "negative provision expense" previously recognized and presenting that instead as interest income in order to reflect the change in the negative allowance attributable to the time value of money:

Provision expense	0.6
Interest income (ACL)[5]	0.6

The resulting end of quarter balance sheet amounts would be as follows:

Receivables (Amortized cost)	0
Less: Negative Allowance	5.8
Receivable carrying value (net)	5.8

The resulting income statement activity for the quarter would reflect interest income (due to the discount unwind in the negative allowance), and "negative provision expense," as follows:

Interest income	0.6
Net Provision benefit	0.1
Total	0.7

<u>Responses to Certain Questions in the Proposal:</u>

Question 5: Do the proposed amendments clarify that recoveries are inputs that should be considered when measuring the allowance for credit losses? If not, please explain why you disagree and what changes should be made instead.

Yes. We believe the clarification in paragraph 326-20-30-1 appropriately clarifies that recoveries should be considered in developing the estimate of expected credit losses such that the balance sheet reflects the net amount expected to be collected on the financial asset (which we understand to be the primary intent of the standard). We believe that the Board could also consider an amendment to paragraph 326-20-30-4 to clarify the use of recoveries in a discounted cash flow technique. Regardless, we believe the clarification in paragraph 326-20-30-1 makes it sufficiently clear that the value of recoveries would be used in a discounted cash flow technique.

Question 6: Do the proposed amendments clarify that an entity may record a negative allowance when measuring the allowance for credit losses using the fair value of the underlying collateral in accordance with paragraphs 326-20-35-4 through 35-5?

We believe that the clarification in paragraph 326-20-30-1 (specifically, the added phrase "or added to") appropriately clarifies that an entity may record a negative allowance.

We do not read the proposed amendments to indicate that a negative allowance is only permissible when the assets are within the scope of the collateral-dependent financial asset guidance in paragraphs 35-4 and 35-5, nor do we understand such an interpretation to have been the TRG or the Board's intent, nor would we agree with such an interpretation. However, given how this question has been phrased by the FASB staff, we want to highlight that our industry fact pattern is one in which a negative allowance would be recorded despite not being within the scope of the collateral-dependent guidance (as illustrated earlier in this comment letter response). As such, if the Board intends that a negative allowance only be permissible when an asset is in the scope of the collateral dependent guidance, we believe that such an interpretation should be discussed, deliberated, and re-exposed under the due process procedures of the Board.

Further, as discussed in the introduction to our comment letter, we strenuously ask that in its re-deliberations, the FASB acknowledge that this Proposal may have the ultimate effect of presenting a pool-level "negative CECL allowance" on a portfolio of purchased PCD loans that individually have had their amortized cost balance (inclusive of the "Day 1" PCD gross-up) charged-off shortly after purchase ("Day 2"). In the absence of specific acknowledgement by the FASB or FASB staff to this point, we believe some may require our industry participants to seek clarifying interpretation through other authoritative regulatory agencies.

Question 7: Should an entity be permitted to record a negative allowance when measuring the allowance for credit losses on available-for-sale debt securities? If yes, why?

Yes. We believe that the approach for available-for-sale securities should be the same as that for loans, receivables, and held-to-maturity securities.

Question 13: Should the effective date and transition requirements for the amendments in this proposed Update align with that of Update 2016-13 for entities that have not yet

adopted Update 2016-13 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?

If the proposed amendments related to Issue 1C (Recoveries) are finalized, we should be able to implement ASU 2016-13 by the original effective date. If the proposed amendments are not finalized, we are not certain of our ability to adopt ASU 2016-13 by the effective date because there is no ability to allocate the purchase price down to an account level with a reasonable degree of accuracy necessary to produce financial results that are meaningful to a user of our financial statements.

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[1] Refer to the Basis for Conclusions paragraphs BC 195-202 in ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*.

[2] In theory, the individual receivables may legally have the right to earn a delinquent APR limited to the statutory usury rate, though in practice, such amounts are neither expected nor considered collectible, so even if attributed to the asset, they would be charged-off immediately.

[3] Estimation of the ACL at the deal level is consistent with the guidance in ASC 326-20-30-2 which requires estimation of the allowance on a collective (pool) basis when similar risk characteristics exist.

[4] Estimation of the EIR used for discounting the ACL in this manner is consistent with the guidance in ASC 326-20-30-14 which indicates the rate should be determined by equating the present value of the estimated future cash flows with the purchase price. Further, estimation of the ACL for PCD assets as the present value of expected credit losses, where credit losses are defined as contractual cash flows that we do not expect to collect, is consistent with the illustration in ASC 326-20-55-74. In this example, we would be comparing the present value of expected cash flows (i.e., $3M) with the contractual cash flow that is due ($50M, due currently). As noted previously, we have not attributed a delinquency or usury rate to the receivables because such amounts are neither expected nor considered collectible in practice. If we were to attribute those contractual cash flows to the assets, the indicated ACL would be lower, and that difference would be offset by a non-credit discount because the ACL-level EIR would differ from the delinquency/usury rate for the receivable. Even if such contractual cash flows were attributed to the receivables and a non-credit discount were recognized, such amounts would be irrelevant by virtue of the amortized cost basis being charged-off in Step 2. Additionally, in theory as part of Step 1, the purchase price and non-credit discount should be "pushed down" to the individual unit of account level, consistent with the guidance in ASC 326-20-30-13. However, this part of the Step becomes similarly irrelevant since such amounts are charged-off in Step 2. To be clear, attributing or not attributing delinquency or usury rates does not affect the ACL EIR determined in ASC 326-20-30-14, which is used in Step 4 to isolate the change in the ACL attributable to the time value of money.

[5] Approximated as 10% quarterly yield multiplied by the amount of the negative allowance ($6M) or approximately 0.6.