



**BB&T Corporation**

January 28, 2019

200 West Second Street  
P.O. Box 1250  
Winston-Salem, NC 27102

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

**Re: Agenda Request – Accounting for acquired financial assets that do not meet the definition of purchased financial assets with credit deterioration**

Dear Ms. Cospers:

BB&T Corporation (“BB&T” or “we”) appreciates the opportunity to submit an agenda request to the Financial Accounting Standards Board (“Board”) to reevaluate the accounting for acquired financial assets that do not meet the Topic 326 Financial Instruments—Credit Losses (“Topic 326” or “standard”) definition of purchased financial assets with credit deterioration (“PCD”).

As more fully described in this letter, we believe that the standard as written does not result in the application of the same accounting model to non-PCD assets, as compared to originated financial assets, which is contrary to the Board’s stated intent and may result in non-PCD accounting that is confusing and lacks transparency to financial statement preparers and users.

Also, as more fully described herein, we believe that credit risk may be reliably isolated for acquired financial assets, the incremental cost of doing so would be negligible, and that the credit mark on non-PCD assets would not be insignificant when applied to a large portfolio of non-PCD assets acquired in a business combination.

In light of these impacts, we urge the Board to consider (or reconsider) certain alternative approaches that we believe would better achieve the Board’s objective of accounting equivalency between non-PCD acquired and originated financial assets.

**Issue**

In the context of financial assets acquired in a business combination, and accounted for under the requirements of Subtopic 805-10 subsequent to the standard’s effective date, the accounting described below and illustrated in Exhibit A results in a net carrying amount of non-PCD financial assets that is less than fair value on a post-acquisition basis, and at a lower carrying amount relative to fair value than PCD financial assets.

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More significant to the objective of equivalency for non-PCD and originated financial assets, this accounting also results in an entity carrying non-PCD financial assets at less than the net amount expected to be collected. This result is inconsistent with paragraph 326-20-30-1 and therefore the accounting for originated financial assets. The non-PCD credit mark is also amortized to income, when it is expected to be needed for charge-offs at a later date, resulting in an above market yield on the financial assets (please refer to Exhibit A), and in contrast to the Board's observation in BC85, a situation in which an entity accretes to an amount that it does not expect to collect resulting in artificially inflated yields.

We believe the above results will be confusing to financial statement preparers and users, as non-PCD financial assets will reflect a "double counting" of expected credit losses on a post-acquisition basis, with the negative impact of this double counting reflected in earnings in the period of the acquisition. In contrast, this double counting phenomenon will not occur with PCD financial assets. While the negative impact to earnings will gradually be "recaptured" through interest income accretion over the life of the acquired non-PCD financial assets, such an approach is counterintuitive and unnecessarily penalizes equity to some degree from acquisition date through the reporting period in which expected losses are ultimately realized in comparison to both acquired non-PCD and originated financial assets.

While it appears likely that a larger population of financial assets will be classified as PCD as compared to the definition of purchased credit impaired ("PCI") under current guidance, we anticipate that the population of PCD financial assets will not be meaningfully larger than PCI in a benign economic environment. As a result, the broadening of the definition of PCD in comparison to PCI does not fully address this issue, and the extent to which it addresses the issue is largely dependent on the economic environment in place or expected in the period of acquisition.

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## **Background**

Subtopic 326-20 requires the recognition of an allowance for credit losses (“ACL”), and related provision expense, in the period of acquisition for non-PCD assets. This contrasts with PCD financial assets, where the ACL is added to the purchase price (i.e., fair value) in determining the amortized cost basis pursuant to paragraph 326-20-30-13.

Subtopic 326-20 defines PCD as acquired individual or groups of financial assets with similar risk characteristics that, as of the acquisition date, have experienced a more-than-insignificant deterioration in credit quality since origination.

Paragraph 326-20-30-15 requires an entity to account for non-PCD financial assets in a manner consistent with originated financial assets. This includes paragraph 326-20-30-5, which among other requirements specifies that when an entity expects to accrete a discount into interest income, the discount should not offset the entity’s expectation of credit losses when applying a non-discounted cash flow (“DCF”) method.

We acknowledge the Board previously objected to the application of the gross-up method for financial assets purchased at or near par when there has not been a more-than-insignificant increase in credit risk because those assets should apply the same model as originated financial assets. We further acknowledge the Board’s objections related to extending the gross-up approach to all purchased financial assets, which we summarize as follows:

- Insignificant credit risk may be difficult to reliably isolate from other discounts reflected in the purchase price, and the effort required to isolate such credit risk would not justify the incremental costs; and
- The impact of such an approach would have an insignificant impact on accretion.

We have provided our perspective on these previously stated objections related to extending the gross-up approach to all purchased assets as follows:

*Expected Credit Losses on Non-PCD Assets are Readily Identifiable; the Incremental Cost to Identify the Credit Mark on Non-PCD Assets would be Negligible*

The fair value of financial assets in a business combination is typically estimated using a DCF method under the income approach pursuant to the requirements of Topic 820. The DCF method includes estimated principal defaults in the amount and timing of future cash flows. As a result, the fair value of non-PCD financial assets determined using a DCF method includes a credit mark, which may be reliably measured and distinguished from the other components (i.e., interest rates and liquidity) within the DCF model. Since this information is readily available, we do not believe that such disaggregation would result in significant incremental costs.

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*The Aggregate Impact of Credit Mark Accretion on Non-PCD Assets could be Significant*

The credit mark related to a non-PCD asset may be insignificant on an individual financial asset basis, but could be significant when evaluated in the aggregate. Please refer to Exhibit A for an illustrative example that, among other things, demonstrates this concept. The fair value mark (inclusive of the credit mark) for non-PCD financial assets is accounted for as a discount recorded as of the acquisition date and subsequently accreted to income over the life of the acquired financial assets. As noted above, this accretion will result in the recognition of an above-market yield on the underlying non-PCD assets.

**Proposed Alternative Solutions**

We believe the most transparent and conceptually sound alternative would be to recognize the credit mark on non-PCD financial assets as an addition to the purchase price (i.e., fair value) in determining the amortized cost (i.e., apply an approach consistent with that used for PCD assets.) Such an approach more closely aligns with the balance sheet accounting for originated financial assets for which the ACL is recognized upon origination (i.e., financial assets net of credit mark approximate the net amount expected to be collected – please refer to Exhibit A).

A second alternative would be to forgo amortization of the non-PCD credit component of the fair value mark and not establish an ACL on the balance sheet for financial assets acquired in a business combination at fair value determined by a DCF method. While preferable to the existing requirement, investors will require visibility related to the non-PCD mark, necessitating the inclusion of this information in earnings releases and other disclosures. Also the non-PCD credit mark would need to be relieved as credit losses are realized, necessitating operational complexity.

A third alternative would be to establish the unamortized non-PCD credit mark as an eligible off-set to expected credit losses under paragraph 326-20-30-5 (i.e. expected credit losses exceeding the unamortized non-PCD mark would be recognized in the ACL). This avoids carrying the financial assets at less than the net amount expected to be collected; however, it still results in a gross-up of both interest income and credit losses to the extent of amortization prior to expected charge-off.

**Conclusion**

As described above, non-PCD accounting applied in the context of a business combination results in an initial post-acquisition carrying amount that is less than the net amount expected to be collected with an accompanying future gross-up of interest income by the amount of expected (and actual) credit losses. While all three of the alternatives described in this letter would equate the “day 1” carrying amount net of ACL to

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originated financial assets, we believe the most transparent and conceptually sound alternative is to recognize the credit mark component of the fair value mark determined by DCF method for non-PCD financial assets acquired in a business combination in the same manner as PCD financial assets.

We appreciate the Board's consideration of this issue and would welcome the opportunity to discuss and/or provide further clarification on any of the matters included in this letter. Should you have further questions, please do not hesitate to contact me at 336 (733-2737).

Sincerely,

A handwritten signature in black ink, appearing to read "Jay Cochrane". The signature is fluid and cursive, with the first name "Jay" being more prominent.

Jay Cochrane  
Senior Accounting Policy Director  
336-733-2737

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Page 6**Exhibit A – Illustrative Example**Assumptions

- \$10 billion of non-PCD loans acquired, 5 year remaining life
- Contractual and market interest are 5%. No interest rate or other non-credit marks are required.
- Constant default rate of 0.25%/year – applied at end of year
- Non-PCD loan fair value is \$9.953 billion
- Expected defaults total \$52 million

Contractual Cash Flow (in millions)

	<u>BOP</u>	<u>Interest</u>	<u>Cash</u>	<u>Defaults</u>	<u>EOP</u>
Year 1	\$ 10,000	\$ 500	\$ (2,310)		\$ 8,190
Year 2	8,190	410	(2,310)		6,290
Year 3	6,290	315	(2,310)		4,295
Year 4	4,295	215	(2,310)		2,200
Year 5	2,200	110	(2,310)		-
		\$ 1,549	\$ (11,549)	\$ -	

Modeled Cash Flow (in millions)

	<u>BOP</u>	<u>Interest</u>	<u>Cash</u>	<u>Defaults</u>	<u>EOP</u>
Year 1	\$ 10,000	\$ 500	\$ (2,310)	\$ (20)	\$ 8,170
Year 2	8,170	408	(2,304)	(16)	6,259
Year 3	6,259	313	(2,298)	(11)	4,263
Year 4	4,263	213	(2,292)	(5)	2,178
Year 5	2,178	109	(2,287)	-	0
		\$ 1,543	\$ (11,491)	\$ (52)	
Fair Value	\$ 9,953				

If the assumptions are perfect and actual results match the modeled amounts, then a \$52 million ACL must be established in the period of acquisition. The following table summarizes the expected accretion of marks:

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Page 7Expected Subtopic 310-20 Recognition (*in millions*)

	BOP	Interest	Cash	Defaults	EOP	Rate
Year 1	\$ 9,953	\$ 515	\$ (2,310)	\$ (20)	\$ 8,137	5.2%
Year 2	8,137	421	(2,304)	(16)	6,238	5.2%
Year 3	6,238	323	(2,298)	(11)	4,252	5.2%
Year 4	4,252	220	(2,292)	(5)	2,174	5.2%
Year 5	2,174	112	(2,287)	-	(0)	5.2%
		\$ 1,591	\$ (11,491)	\$ (52)		

Note that by amortizing the credit mark, the required interest rate is 5.2%, which is higher than the market rate of 5.0%. The following table summarizes the balances and entries for the life of the loan contracts:

*In millions*

	BOP Balance Sheet				Debit (Credit)				
	UPB	FV Mark	Loans	ACL	Cash	Loan	Mar	Int Inc	ACL
Yr1	\$ 10,000	\$ (47)	\$ 9,953	\$ (52)	\$ 2,310	\$ (1,830)	\$ 15	\$ (515)	20
Yr2	8,170	(33)	8,137	(32)	2,304	(1,911)	12	(421)	16
Yr3	6,259	(20)	6,238	(16)	2,298	(1,996)	10	(323)	11
Yr4	4,263	(10)	4,252	(5)	2,292	(2,085)	7	(220)	5
Yr5	2,178	(4)	2,174	-	2,287	(2,178)	4	(112)	-
Yr6	-	-	-	-	\$ 11,491	\$ (10,000)	\$ 47	\$ (1,591)	\$ 52

## Period of acquisition "day 1" balance sheet summary:

Fair value	\$ 9,953	
Net amount expected to be collected	9,948	Equivalent to origination and PCD accounting models
Carrying amount less ACL	9,900	Carried below net amount expected to be collected

Note that the carrying amount less ACL for non-PCD of \$9.900 billion is below the net amount expected to be collected of \$9.948 billion by \$48 million on a post-acquisition basis, which is also the expected gross-up of interest income and credit losses over the contractual life of acquired non-PCD loans. In contrast, both originated and acquired PCD loans are carried, net of ACL, at the net amount expected to be collected. In this example, each of the non-PCD accounting alternatives recommended in this letter would similarly equate the initial post-acquisition carrying amount less ACL to the same net amount expected to be collected as originated and PCD financial assets.