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Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2019-710
Re: Proposed Accounting Standards Update, *Codification Improvements to Topic 326, Financial Instruments — Credit Losses*

Dear Mr. Kuhaneck:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Codification Improvements to Topic 326, Financial Instruments — Credit Losses*.

We support the Board's efforts to clarify or address certain aspects of the guidance in ASU 2016-13.[1]

The appendix contains our responses to the proposed ASU's questions for respondents.

We would be happy to share additional perspectives and suggestions with the Board and FASB staff on the matters discussed in our comment letter.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Jon Howard at (203) 761-3235 or Ashley Carpenter at (203) 761-3197.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Jon Howard

Ashley Carpenter

[1] ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*.

Appendix
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents

Question 1: Should other changes be made that are directly or indirectly related to amendments in this proposed Update? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.

Under ASC 310-30, entities evaluated purchased financial assets for evidence of credit deterioration at acquisition and recorded those assets at their initial fair value. For financial assets acquired with evidence of credit deterioration (i.e., purchased credit-impaired (PCI) assets), the excess of the financial asset's contractually required payments as of the acquisition date over all cash flows expected to be collected would not be accreted into interest income (i.e., a nonaccretable yield). If an entity had a reasonable expectation about the timing and amount of cash flows expected to be collected on a pool of similar loans, the remaining amount would be accreted into interest income over the remaining life (i.e., an accretable yield).

After the acquisition (i.e., starting on day 2), increases in expected cash flows over those expected as of the acquisition date would be recognized prospectively as interest income over the remaining life. The present value of any decreases in expected cash flows resulting directly from a change in the contractual interest rate would be recognized prospectively as a reduction of the accretable yield. The decreases in expected cash flows that were not a result of a change in the contractual interest rate would be recognized as an impairment. Although ASC 310-30-35-3 states that ASC 310-30 does not prohibit an entity from placing loans on nonaccrual status, historical practice was to not apply traditional nonaccrual policies to PCI assets under ASC 310-30 because the unit of account was a pool of loans, and the entity could generally assert a reasonable expectation of timing and amount of cash flows.

ASU 2016-13 eliminated the separate model in ASC 310-30 for PCI assets and instead established a day 1 accounting model for purchased credit deteriorated (PCD) assets. However, even though an entity determines the allowance for credit losses at a pool level, it allocates that allowance on day 1 to the individual assets within the pool when it determines the day 1 "gross up" and subsequent accounting for interest income.

ASC 326 prescribes that for subsequent accounting for PCD assets purposes, entities should apply (1) ASC 326-20 (the current expected credit loss (CECL) model) for instruments measured at amortized cost and (2) ASC 326-30 (the available-for sale (AFS) model) for debt securities classified as AFS. The guidance in ASC 326-20 would require entities to apply write-off and nonaccrual guidance on an individual asset basis. Our understanding is that this will most likely result in either the application of nonaccrual accounting for interest income or the immediate write-off of PCD assets (owing in part to certain regulatory guidance with the elimination of the pool accounting under ASC 310-30) or both.

As discussed in our response to Question 4, the proposed amendments would permit a negative allowance for PCD assets. If PCD assets follow the subsequent accounting model in ASC 326-20, this could result in either day 1 gain or in entities' recognizing interest income on a cost recovery basis. We believe that this is inconsistent with the Board's intention and recommend that the Board conduct further standard setting to address this.

Question 2: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

We are not aware of any special consideration for nonpublic entities with respect to the proposed amendments.

Question 3: Should an entity be permitted to record a negative allowance (basis recovery) when measuring the allowance for credit losses for purchased financial assets with credit deterioration?

Yes. We believe that an entity should be permitted to record a negative allowance (basis recovery) when measuring the allowance for credit losses for purchased financial assets with credit deterioration.

Question 4: Should a negative allowance (basis recovery) for PCD assets be limited to the amortized cost basis previously written off and expected to be written off by the entity? If not, please explain why and what changes should be made instead.

The proposed ASC 326-20-30-13A states:

> The allowance for credit losses for purchased financial assets with credit deterioration shall include expected recoveries of the amortized cost basis previously written off and expected to be written off and shall not exceed the aggregate of amounts previously written off and **expected to be written off**. An entity shall not include **recoveries** or expected recoveries of the unamortized noncredit discount or premium in the allowance for credit losses. [Emphasis added]

Paragraph BC8 of the proposed ASU states, in part, that the Board believes that the negative allowance for PCD assets should be limited to the amortized cost basis previously written off because "not limiting negative allowances to its amortized cost basis may lead to the premature recognition of interest income (that is, this noncredit discount) on the basis of projections of recoveries." We do not agree that a negative allowance should exist for those amounts expected to be written off in the future. We recommend that the Board remove the reference to those amounts expected to be written off. Further, if it was the Board's intention to not allow entities to accelerate the recognition of the accretable yield (i.e., recognize a day 1 gain), the proposed amendments will not accomplish this objective because the expected recoveries would include the day 1 purchase price plus any incremental cash flows expected to be collected. If an entity applies a model other than a discounted cash flow model in determining its allowance for credit losses, the ability to recognize recoveries in an amount up to the amortized cost basis (which includes the day 1 gross up) written off and expected to be written off would result in the acceleration of the accretable yield (although the accretable yield would be classified as provision for credit losses as opposed to interest income). As noted in our response to Question 1, if an entity is faced with the alternatives of either going on nonaccrual accounting with a cost recovery model or accelerating the accretable yield, the entity may choose to recognize the income on day 1.

Further, the last sentence of proposed ASC 326-20-30-13A states that "recoveries or expected recoveries" of the unamortized premium should not be included in the allowance for credit losses. As worded, this sentence would imply that an entity would continue to recognize a discount or premium even after the amortized cost basis of the PCD asset is fully recovered because of the use of the term "recoveries" in addition to "expected recoveries." In the case of a premium, this would delay the recognition of losses.

Finally, paragraph 3 and paragraph BC9 of the proposed ASU both state that negative allowances should be limited to expected recoveries of amounts previously written off "and expected to be written off." We do not believe that an estimated recovery of an amount that has not yet been written off should result in a negative allowance. We recommend that the Board remove the phrase "and expected to be written off."

Question 5: Should the recognition of a negative allowance (basis recovery) be extended to available-for-sale (AFS) debt securities? Please explain why and what changes, if any, should be made instead.

Yes. We believe that the recognition of a negative allowance should be extended to AFS debt securities because we don't think that the Board has provided a compelling reason for the lack of consistency between AFS securities and assets carried at amortized cost. We also do not understand the basis for the comment in paragraph BC11 of the proposed ASU that "the Board believes that writeoffs of an AFS debt security should occur infrequently upon adopting the amendments in Update 2016-13 because credit losses will be presented as an allowance." Although such a write-off may occur less frequently, we do not believe that this would necessarily mean that it would be infrequent. We also believe that the same argument could be made for held-to-maturity securities. Therefore, we believe that the Board should extend recognition of a negative allowance to the AFS debt model in a manner consistent with the CECL model.

Question 6: Should an entity be permitted to adjust the effective interest rate on existing TDRs using prepayment assumptions on the date of adoption of Topic 326 rather than the prepayment assumptions in effect immediately before the restructuring? If not, please explain why and what changes, if any, should be made instead.

We agree that an entity should be permitted to adjust the effective interest rate on existing troubled debt restructurings (TDRs) by using prepayment assumptions on the date of adoption of ASC 326 rather than the prepayment assumptions in effect immediately before the restructuring.

Question 7: Will the proposed amendment to permit an election of a practical expedient to disclose the total amount of accrued interest receivables separately from other components of amortized cost basis for certain disclosure requirements simplify and reduce operational concerns when implementing the guidance in Update 2016-13?

Yes. We believe that the proposed amendment to permit an election of a practical expedient to disclose the total amount of accrued interest receivables separately from other components of amortized cost basis for certain disclosure requirements will simplify and reduce operational concerns when an entity is implementing the guidance in ASU 2016-13.

Question 8: Do you support the proposed amendments to clarify the application of the collateral maintenance practical expedient in accordance with paragraph 326-20-35-6? If not, please explain why and what changes, if any, should be made instead.

Yes. We support the proposed amendments to clarify the application of the collateral maintenance practical expedient in accordance with ASC 326-20-35-6. However, we believe that the collateral maintenance practical expedient should be further clarified to reduce potential inconsistencies when entities apply the practical expedient.

The proposed amendments clarify that an entity should reasonably expect the borrower to continually replenish the collateral securing the financial asset(s) in accordance with the contractual terms of the financial asset to apply the practical expedient as follows (amended language is underlined):

> For certain financial assets, the borrower may be contractually required to continually adjust the amount of the collateral securing the financial asset(s) as a result of fair value changes in the collateral. In those situations, if an entity reasonably expects the borrower to continue to replenish the collateral to meet the requirements of the contract, an entity may use, as a practical expedient, a method that compares the amortized cost basis with the fair value of collateral at the reporting date to measure the estimate of expected credit losses. An entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset and the entity reasonably expects the borrower to continue to replenish the collateral as necessary to meet the requirements of the contract. If the fair value of the collateral at the reporting date is less than the amortized cost basis of the financial asset, an entity shall estimate expected credit losses for the unsecured amount of the amortized cost basis. The allowance for credit losses on the financial asset is limited to the difference between the fair value of the collateral at the reporting date and the amortized cost basis of the financial asset.

We recommend that the Board further amend the above guidance to separately state the following key points:

1. The borrower has a contractual requirement to continually replenish the amount of the collateral so that the fair value of the collateral is equal to or exceeds a contractual threshold for collateral sufficiency by reference to the amortized cost basis of the financial asset.
2. The entity reasonably expects the borrower to comply with the contractual requirement to continually replenish the amount of the collateral.
3. If items (1) and (2) are true, the entity should estimate expected credit losses for the unsecured amount of the amortized cost basis of the financial asset. If the fair value of the collateral is equal to or greater than the amortized cost basis of the financial asset, the entity may determine that the expectation of nonpayment of the amortized cost basis is zero.

We believe that there may be confusion because the evaluation of whether the entity expects the borrower to continue to replenish the collateral is mentioned in the second sentence and again in the third sentence (i.e., the first example, in which an entity may conclude that there is a zero credit loss), but the last scenario in the paragraph does not include a reference to this evaluation.

Further, we believe that the proposed ASU's Basis for Conclusions should align with the proposed amendments. For example, paragraph BC17 suggests that for the practical expedient to apply, it must be probable that the borrower will be able to continually replenish the collateral "such that the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset." However, the proposed amendments state only that an entity may be contractually required to replenish collateral if the fair value of the collateral changes, but it is not necessary for the fair value of the collateral to be equal to or to exceed the amortized cost basis of the financial asset.

Question 9: Will the proposed effective dates provide sufficient time for entities to implement the proposed amendments? If not, please explain why and how much time would be needed to adopt the proposed amendments.

Yes. We believe that the proposed effective dates provide sufficient time for entities to implement the proposed amendments.

Question 10: Do you support the proposed transition method and transition disclosures when adopting the proposed amendments? If not, please explain why and what transition method and disclosure changes should be required instead.

Yes. We support the proposed transition method and transition disclosures when entities are adopting the proposed amendments.