Capital One Financial Corp
1680 Capital One Drive
McLean, VA 22102

July 29, 2019

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

Via email: director@fasb.org

RE: Proposed Accounting Standards Update, Codification Improvements to Topic 326, Financial Instruments—Credit Losses

File Reference No. 2019-710

Dear Mr. Kuhaneck:

Capital One Financial Corporation ("Capital One")[1] appreciates the Board's continued responsiveness to implementation concerns raised by stakeholders and the opportunity to provide comments on the Exposure Draft, *Proposed Accounting Standards Update, Codification Improvements to Topic 326, Financial Instruments—Credit Losses* ("the Exposure Draft"). We support the Board's efforts to make improvements to Accounting Standards Update ("ASU") No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* and ask that you please consider the comments and suggestions we have provided below.

Issue 1: Negative Allowances for Purchased Financial Assets with Credit Deterioration

<u>General</u>

We agree with the Board's decision to clarify that an entity should include expected recoveries in the allowance for credit losses for purchased financial assets with credit deterioration ("PCD assets") within the scope of Subtopic 326-20. We also acknowledge the Board's intent to limit expected recoveries included in the allowance for PCD assets to the aggregate of amounts previously charged off and expected to be charged off. Further, we believe the amendments proposed by the Board are intended to keep an entity from recognizing interest income on

[1] Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A., and Capital One Bank (USA), N.A., had $255.1 billion in deposits and $373.2 billion in total assets as of March 31, 2019. Capital One, N.A. has branches located primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia, and the District of Columbia. A Fortune 500 company headquartered in McLean, Virginia, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

amounts it expects to receive in excess of the amortized cost basis of a loan prior to actually receiving such amounts, which is consistent with the requirements for non-PCD assets.

Our understanding of the FASB's intent and proposed amendments is that an entity would be allowed to record a contra allowance up to the amortized cost basis (as defined for PCD assets in ASC 326-20-30-13) charged off. Further, an entity would not be permitted to recognize interest income until it receives recoveries in excess of the amortized cost basis charged off. We have provided a simple example in the Appendix below that demonstrates the application of this guidance. Provided our understanding is correct, we believe we could timely implement the accounting required for PCD assets as of January 1, 2020, as the incremental systematic and operational considerations are manageable and consistent with our implementation efforts to date. However, if our interpretation of the proposed guidance is inconsistent with its intent, we would have significant systematic and operational hurdles affecting our ability to timely implement Topic 326[2], as the amendments in the Exposure Draft would create new accounting requirements for PCD assets that conflict with the Board's intent expressed in BC85 of ASU 2016-13 (for purchased and originated assets to follow the same model, to the extent possible). If the Board intends to create separate accounting requirements for PCD assets, we believe stakeholders would have additional interpretative questions and strongly encourage the FASB to conduct further research to ensure that the benefits of having separate requirements exceed the related operational costs.

Notwithstanding the above, we encourage the Board to consider revising the proposed amendments for clarity. As currently proposed, the amendments suggest the limitation on expected recoveries allowed to be included in the allowance applies to the allowance itself. Further, because the amortized cost basis for PCD assets is net of any non-credit discounts, we believe the proposed amendments could be simplified in order to avoid redundancy, misinterpretation and/or inconsistent application while still meeting the Board's objective of limiting the negative allowance on PCD assets to their amortized cost basis. Therefore, we encourage the Board to consider revising the proposed amendments as follows:

> **326-20-30-13A** 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~~ Expected recoveries included in the allowance for credit losses shall not exceed the aggregate of amounts of amortized cost basis 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~~.

Accounting for acquisitions of loans that meet the acquirer's requirements for charge-off

[2] For example, accounting that would require limiting the negative allowance to the purchase price would necessitate loan level tracking and manual intervention to recoveries forecasts and collections systems.

The guidance for PCD assets in ASU 2016-13 and the amendments in the Exposure Draft do not directly address the accounting for acquisitions of loans that, at the time of acquisition, meet the acquiring entity's requirements for charge-off (which we believe would qualify as PCD assets) and for which the acquiring entity expects recoveries[3]. Absent any specific guidance requiring a different treatment, we believe the acquiring entity would record the full unpaid principal balance, allowance and noncredit discount (to establish the amortized cost basis necessary to be able to record a contra allowance) and then immediately charge off the unpaid principal balance and noncredit discount. Further, we believe the acquiring entity should separately disclose the resulting charge-offs and recovery expectations from acquired PCD and non-PCD assets when disclosing charge-off metrics and allowance rollforwards. This would allow financial statement users to easily identify such amounts (which they might want to separately evaluate).

Similar to the above for other PCD assets, provided our understanding is correct, we believe we could timely implement (as of January 1, 2020) the accounting required for PCD assets that, at the time of acquisition, meet the entity's requirements for charge-off. However, if our interpretation of the proposed guidance is inconsistent with its intent, we would have significant systematic and operational hurdles affecting our ability to timely implement Topic 326 and strongly encourage the FASB to conduct further research to ensure that the benefits of having separate requirements for PCD assets exceed the related operational costs.

Effective Dates

We agree with the effective dates proposed by the Board in the Exposure Draft. However, if our interpretations noted above are inconsistent with the Board's intent, we strongly encourage the Board to conduct further research and to consider delaying the effective dates of ASU 2016-13 to ensure entities have time to implement the requirements for PCD assets.

Sincerely,

/s/ Timothy Golden

Timothy Golden
SVP, Controller and Principal Accounting Officer
Capital One Financial Corporation

[3] This scenario could arise, for example, when an entity acquires credit card loans that, at the time of acquisition, meet regulatory requirements for full charge-off.

Appendix

The following simple example illustrates our understanding of the accounting required for PCD assets in accordance with the Exposure Draft:

Modeling Approach:	Non-DCF
Acquired UPB[4]:	$100
Purchase Price:	$20
Expected Cash Collection:	$25

Entry at acquisition (amortized cost basis of $95 per ASC 326-20-30-13):

UPB	100	
Noncredit discount		5
Allowance		75
Cash		20

Entries at charge-off[5] (entity would report a charge-off of the $95 amortized cost basis and creation of a negative allowance of $25 to reflect expected recoveries):

Allowance	75	
Noncredit discount	5	
Provision	20	
UPB		100

Allowance	25	
Provision		25

Allowance roll-forward:

Beginning Balance	0
Initial Allowance for PCD Assets	75
Charge-Offs	(95)
Provision	(5)
Ending Balance	(25)

Entry when cash collected (assuming collections equal initial expectation):

Cash	25	
Allowance		25

[4] Unpaid Principal Balance ("UPB")
[5] The acquired loans in this example are credit card loans requiring full charge-off in accordance with regulatory requirements for open-end retail loans.