July 29, 2019

Via Electronic Mail

Mr. Russell Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the above-referenced proposal and supports the efforts of the Financial Accounting Standards Board (FASB or the Board) to provide improvements to ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (Topic 326).

As the Board is aware, the implementation of the Current Expected Credit Loss (CECL) methodology and the adoption of Topic 326 constitute a significant and ongoing effort. They affect lending and investing balances, as well as the allowance for loan and lease losses account, which for financial institutions are among the largest assets and estimates on the balance sheets. As such, implementation of this standard has a broad impact not only on financial reporting, but also on risk management of lending and investing activities, which will require significant enhancements to systems, modelling capabilities, data sourcing and data management.

Accordingly, we are appreciative of the Board's efforts to provide clarification of various interpretational issues posed by Topic 326. We are supportive of the amendments proposed in Issues 2 through 5 of the proposal and believe that these amendments result in an overall improvement to Topic 326. We also believe that additional clarifications are needed regarding the accounting for purchased

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

credit deteriorated (PCD) assets given the amendments in Issue 1 of the proposal, as more fully described using a credit card example below.

PCD guidance in Topic 326 mandates application of the "gross up" approach, whereby the allowance for credit losses at acquisition is added to the purchase price to determine the initial amortized cost basis. Likewise, the initial noncredit discount or premium is determined at acquisition as the difference between the unpaid principal balance (UPB) and amortized cost.

Regulatory writeoff policies require a full charge-off of open-ended unsecured consumer loans, including credit cards, that become 180 days past due. The PCD gross up approach, when applied to the acquisition of loans that were fully charged off by the seller prior to being sold, present accounting and reporting issues for the acquirer. In particular, it is not clear whether the negative allowance should be limited by the amount of the unamortized credit discount. The resolution of this issue could affect the timing of income recognition.

We believe that when PCD loans are written off, the negative allowance created should not be reduced by the amount of the unamortized noncredit discount, unless and until the amount of the negative allowance exceeds the amount of prior writeoffs. This approach is illustrated in Example 1 in the Appendix.

In this regard, we find the second sentence of paragraph 326-20-30-13A in the proposal to be unclear. Some have interpreted this sentence to mean that when PCD loans are written off, the amount of the negative allowance created subsequent to writeoff should be limited by the amount of the unamortized noncredit discount. This would ignore the amount of prior writeoffs and the net amount expected to be collected, in most cases. This approach is illustrated in Example 2 of the Appendix.

We believe the first approach is superior as it is consistent with the accounting for non-PCD loans, whereas the second approach is not. In line with the Board's stated objectives, we believe that, aside from the required initial day one grossup, the model for PCD and non-PCD loans should be consistent, as there is no theoretical support for a different model. Accordingly, we believe that Example 1 is the appropriate approach, in which expected recoveries are recognized as an offset to the allowance subsequent to writeoff.

Furthermore, the first approach is consistent with the accounting for loans that are transferred from the Held for Investment to the Held for Sale (HFS) category. Specifically, in accordance with ASC 310-20-30-3, the unamortized premium is considered part of the recorded investment in the loan. The loan's recorded investment is compared with its fair value to determine the amount of the writeoff, any difference is recorded as a credit loss, and the loan is written down by that amount, resulting in a new cost basis at the time of the transfer to HFS.[2]

Additionally, if the FASB introduces a separate model, as in Example 2, this could result in the need to implement loan level tracking, adjustments to recovery forecasts, and changes to collections systems, none of which were expected or planned for as part of the standard implementation.

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[2] See, for example, the guidance in Office of the Comptroller of the Currency, *Bank Accounting Advisory Series*, August 2018, Topic 2E, Question 8, available at https://www.occ.treas.gov/news-issuances/news-releases/2018/nr-occ-2018-78.html.

If the Board agrees with our interpretation, we recommend that the second sentence of paragraph 326-20-30-13A be stricken, 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 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.~~

In addition, we believe that the FASB should add an example to the final ASU to illustrate this application of the accounting guidance.

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The Bank Policy Institute appreciates the opportunity to comment on the proposal. If you have any questions regarding our suggestions or comments, please contact the undersigned by phone at 646-736-3958 or by email at David.Wagner@bpi.com.

Respectfully submitted,

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cc: Mr. Shayne Kuhaneck
Financial Accounting Standards Board

Mr. Sagar Teotia
Securities and Exchange Commission

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Appendix

Accounting for PCD Loans
Application to Acquisition of Regulatory Written Off Credit Card Loans
Examples

Assume the following for an acquired portfolio of 180+ day past due loans for the examples below:

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

Example 1: Discount Recognized Against Provision at Writeoff (Recommended Approach)

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

	Debit	Credit
UPB	100	
Cash		20
Allowance		75
Noncredit discount		5

2. Entry just before writeoff (to ensure allowance is sufficient to write off loan):

	Debit	Credit
Provision	20	
Allowance		20

3. Entry to write off loan to zero basis:

	Debit	Credit
Allowance	95	
Noncredit discount	5	
UPB		100

4. Establish negative allowance for amounts expected to be collected
(does not exceed amortized cost of $95 written off):

	Debit	Credit
Allowance	25	
Provision (expected recoveries)*		25

*Alternatively an entity could make a policy election to credit
Net Interest Revenue instead of Provision to establish the negative allowance

Income Statement Impact	
Provision Expense	$ 20
Expected Recoveries	($25)
Net Provision Benefit:	($5)

5. Entry when cash is collected (assume cash collected is equal to initial expectation):

Cash	25	
Allowance		25

Recoveries	($25)
Allowance Change	$25
Net Provision Impact:	$0

Example 2: Negative Allowance from Grossup Limited by Discount

1. Entry at acquisition (amortized cost of $95):

UPB	100	
Cash		20
Allowance		75
Noncredit discount		5

2. Entry just before writeoff (ensures allowance is adequate to fully write off loan):

Provision	20	
Allowance		20

3. Entry to write off loan to zero basis:

Allowance	95	
Noncredit discount	5	
UPB		100

Income Statement Impact	
Provision Expense	$20
Expected Recoveries	($20)
Net Provision Impact:	$0

4. Entry to establish negative allowance for amount expected to be collected, less initial noncredit discount:

Allowance	20	
Provision (portion of expected recoveries)		20

5. Entry when cash is collected (assume cash collected is equal to initial expectation):

Cash	25	
Allowance		20
Income*		5

Recoveries	$25
Allowance Change	$20
Net Provision Benefit:	($5)

*Alternatively an entity could elect to record the excess cash collected as Net Interest Revenue