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Technical Director
Financial Accounting Standards Board
801 Main Avenue
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2023-ED400 – *Proposed Accounting Standard Update, Financial Instruments – Credit Losses (Topic 326)*

The Financial Reporting Executive Committee (FinREC) and the Depository Institutions Expert Panel, both of the American Institute for Certified Public Accountants (AICPA), appreciates the opportunity to comment on FASB's Proposed Accounting Standards Update, "Financial Instruments – Credit Losses (Topic 326)" ("ED").

Overall, there is diversity among the members regarding the benefits of the proposal – in particular, of the proposed expansion of the gross-up approach. Those in favor of the proposal generally support how it reduces the prevalence of the "double count" issue, creates one model for substantially all acquired financial assets, and reduces instances where interest income is recognized on amounts not expected to be collected as of the acquisition date. Those not in favor of the proposal hold one or both of the following concerns: a) the proposal does not achieve the objective of establishing a single approach for all purchased financial assets, thereby failing to entirely eliminate the "double count" issue and comparability issues due to the use of two accounting models; or b) the benefits do not outweigh the costs of implementation – especially with respect to the application of the gross-up approach to credit cards and other revolving arrangements.

While the members are split in their support for the ED, we recommend the following issues be addressed if a final standard is to be issued:

- Scope – the ED would expand the number of credit card and other revolving arrangements subject to the gross-up approach. This outcome would compound tremendous operational complexities in applying the gross-up approach to credit card receivables and other revolving credit agreements.
- Seasoning – the ED would require entities to classify financial assets acquired in an asset acquisition as either in-substance originations or purchases based on both a quantitative and qualitative seasoning assessment. We believe the quantitative and qualitative criteria would create significant operational complexities. Further, the proposed requirement to assess seasoning at a portfolio level could reduce the number of assets subject to the gross-up approach, which seems contrary to the Board's objective.

- Transition – the ED would require entities to apply its provisions using a modified retrospective approach. We believe the cost to do so, however, could be significant, particularly for companies with material acquisitions of financial assets in the scope of the proposal. In addition to cost constraints, in some cases it may be impractical to apply a modified retrospective approach when changes in loan systems have resulted in the inability to access asset-specific historical detail needed.

An explanation of each of these issues in more detail, including recommendations as to how each issue could be addressed, follows.

Scope

The final standard should either: a) exclude credit card receivables, other revolving arrangements (for example, home equity lines of credit), and trade accounts receivable entirely from the scope of the gross-up approach or b) permit companies to use a practical expedient under which the initial adjustment to the amortized cost basis recognized under the gross-up approach is accounted for as a separate unit of account.

In addition, we recommend as a practical expedient, an exclusion for purchased financial assets measured at amortized cost for which the day-one recognition of expected credit losses through the provision and its amortization through interest income would not result in substantially different net income from recognition over its contractual or expected life. For example, a preparer should be able to make an accounting policy election to exclude non-PCD assets that have short or no contractual lives such as trade receivables under one-year. Some of the more significant operational complexities that arise in the application of the gross-up approach to revolving-type financial assets include:

- *The proposed quantitative seasoning assessment would require an institution to determine the age of revolver receivables as of the acquisition date:*
    - Complexity of determining the origination year of a revolver did not previously pass Cost/Benefit Analysis in CECL - In the November 1, 2018, FASB TRG for Credit Losses Memo No 16 acknowledges the complexity of determining the origination year for revolvers such as credit card, as the timing of underwriting decisions may not align with the borrower's drawdown of funds.
        - This acknowledged complexity led the Board to exclude these arrangements from providing by-year vintage details of credit quality indicators for these arrangements, choosing instead to disclose these assets in a single column.
    - A lack of a uniform approach to estimating the remaining life of a revolver will lead to diverse application of PFA for revolvers.
        - In its October 4, 2017, Board meeting, the Board "effectively permit[ted] any combination of payment allocation methodologies…and payment amount determination methods", citing the consistency of this conclusion with the amendments of

    - FASB ASC 2016-13, which allow various approaches to be used in CECL.
    - BC50 of FASB ASC 326 acknowledges that by not prescribing one methodology for estimating credit losses, different outcomes for expected credit losses are expected. However, the Exposure Draft takes the diversity of practice of CECL measurement and applies those diverse outcomes to the determination of scope.

- *The Exposure Draft does not specifically address the multiple units of accounts for revolvers, which creates complexity for preparers of financial statements:*

    - FASB ASC 326 generally acknowledges multiple units of account for an individual revolving account relationship (the account relationship and specific receivables generated by that relationship). As stated in TRG for Credit Losses Memo No 5 - Determining the Estimated Life of a Credit Card relationship, "Credit card vintages are viewed as relating to the age of the account relationship and not to specific receivables generated by that relationship. Furthermore, the life of a revolving credit card receivable within an actively used account is not clear because quite often the balance of an actively used credit card account is never reduced to zero."
    - For revolving lending arrangements, estimates of credit loss under CECL are based on the receivables generated by the relationship as of the measurement date, rather than by the credit risk of the account relationship, since unfunded amounts are generally unconditionally cancelable by the lender and therefore do not constitute a present obligation.
    - Since the exposure draft is an amendment of CECL, and the unit of account questions for revolvers are not otherwise addressed, the expectation is that the application of the exposure draft would be on the specific receivables generated by the account relationship as of the acquisition date. As a result:
        - A singular credit card relationship would have both acquired balances accounted for under the PFA accounting model and originated balances for subsequent draws after the acquisition date. Furthermore, PFA would have specific, non-credit-related premium or discount that originated assets would not. While these outcomes are consistent with the unit of account expectations of CECL, they are far more complex than the application issues thus far in CECL, as servicing systems do not currently have the capability to maintain this bifurcated model.
        - Under CECL, all receivables outstanding as of each measurement date are in the scope of a credit loss estimate. Under the PFA approach of the exposure draft, the bifurcation of acquired and originated receivables would need to be maintained for as long as the acquired balances continue to be legal obligations.
        - Due to regulatory charge off requirements, recoveries on credit card receivables are a significant component of expected cash flows for revolvers. The requirements of the PFA exposure draft would require the maintenance of the bifurcation of acquired receivables, unamortized discounts of acquired balances, and originated balances for revolvers after charge-off. Recovery collections systems do not

have the technological capability to account for unamortized accounting discounts and any attempt to account for this activity would require significant operational investment.

- At its November 7, 2018, meeting, the Board reaffirmed its prior decision from the August 29, 2018, meeting to require the inclusion of recoveries in determining the allowance, and that negative allowance balances are permitted. With the expansion of PFA contemplated in this exposure draft, an institution's allowance models would need to ensure that unamortized discounts are monitored such that an institution's recoveries are "capped" by the amount of unamortized purchase discounts on PFA assets, as opposed to those acquired assets that are not seasoned and thus not in the scope of the PFA model.

Under the proposal, the volume of credit card receivables and other revolving-type financial assets that would be subject to the gross-up approach and the related operational complexities would increase significantly. We believe the costs of applying the gross-up approach to these assets would outweigh the benefits.

If the Board chooses not to exclude these assets from the scope of the gross-up approach, we recommend the final standard provide practical expedients to permit companies to account for the initial adjustment to the amortized cost basis recognized as a result of the gross-up approach for these types of assets as a separate unit of account.

For example, existing guidance is not clear on the unit of account to be used for a revolving arrangement with both drawn and undrawn components as the seasoned requirement would be met at acquisition date, but subsequent draws would be treated as an origination. As such, diversity exists as to whether the Day 1 allowance for credit losses should be allocated and recognized. The operational complexities that led the FASB to exclude these types of assets from the PCI model are still present in this standard. Expanding the gross-up approach to these types of assets presents significant operational complexities. As previously mentioned, in prior standard-setting efforts, the Board decided to exclude these types of financial assets due to said complexities.

In addition, we continue to believe the negative allowance (on existing PCD loans and on all acquired assets under the Proposed Update) should be limited to ensure the recognition of the negative allowance does not result in acceleration of the non-credit discount into earnings (i.e., recovery limits). Currently, when determining the allowance for credit losses for loans, there are instances where it is possible to have a negative allowance as a result of required write-offs (due to regulatory charge-off triggers for certain consumer loans) and expected recoveries. These recoveries are estimated by preparers at a pool level for consumer loans and this unit of account discrepancy with the PCD model and the proposed Update should be addressed as generally it is not possible to estimate recoveries at the individual consumer loan account level today. Therefore, the final standard should clarify that the limitation on recoveries should be applied at the pool level (that is, the level at which the allowance is estimated for loans with similar risk characteristics) and not at a lower level.

The suggestion that entities apply a reasonable approach for these instruments could result in lack of comparability in practice without specific guidance on the unit of account and amortization of the day-one allowance. If sufficient practical expedients aren't implemented to address the significant operational concerns, we recommend the Board scope out credit cards, and other revolving credit arrangements. Specifically, if credit cards and other arrangements with revolving privileges are not scoped out, then provide for practical expedients as follows:

1. Provide for a pool level adjustment at the date of acquisition, which would not be revisited subsequently and separate the acquired amount from subsequent draws
2. For determining seasoning, use the date when the account was opened (instead of when acquired)
3. Determine the limit of expected recoveries to amounts previously written off at the same unit of account as the estimation of recoveries (i.e., pool level)

Seasoning Criteria

The proposed seasoning criteria would create significant operational complexities outweighing the benefits. Additionally, the accompanying pooling guidance produces counterintuitive results given the Board's stated goal of "requiring] the application of [a] single accounting approach to all acquired financial assets…."

Our primary concerns with the proposed seasoning criteria are as follows:

- *Pooling guidance* – The final standard should clarify how "substantially all" is determined and the Board's intention, including whether the measure of "substantially all" is based on the financial asset pool's fair value of unpaid principal balance, loan count, or some other metric and whether the implementation is considered an overall requirement or a practical expedient. Absent this clarification, a single approach might not be applied to all acquired assets, and comparability might decline as a result. For example, if a company acquires a pool of financial assets in an acquisition and 15% of the assets in the pool are originated within 90 days of the acquisition and thus are not seasoned, we understand the proposal would require all the assets in the pool to be accounted for as in-substance originations even though 85% of the assets meets the 90-day seasoning criterion to be considered purchased. FinREC wants to ensure the Board is aware of this potential result in the event it was not their intention. Further, if the same pool of assets was acquired in two separate transactions—with the same overall number of loans within 90 days of origination being acquired in one transaction and the remainder in another—one pool will be accounted for as purchased and the other accounted for as originated. We recommend the final standard not require a pool-level assessment of the seasoning criterion; rather it should be considered a practical expedient under the standard rather than a requirement

  If the Board decides to keep the approach as proposed, the final standard should also clarify how "substantially all" is to be determined. For example, the final standard should clarify whether the measure of "substantially all" is based on the fair value of the financial assets, their unpaid principal balance, loan count, or some other metric.

- *Revolving-type financial assets* – it is unclear how the proposed seasoning guidance would apply to these types of assets. Specifically, the proposal does not explain whether the seasoning determination of an acquired financial asset with revolving features should be applied solely to the funded portion of a revolving credit arrangement or to both the funded and future potential funded amounts under the arrangement. In addition, there could be operational challenges in gathering data elements to determine funding dates. Absent a scope out of revolving arrangements, we recommend application of the seasoning criteria be limited to the funded portion and utilize a relationship origination date in lieu of a funding date.

- *Securities* – the proposed seasoning criteria would account for acquired held-to-maturity (HTM) securities as in-substance originated assets if acquired within 90 days of issuance. In that context, we recommend the acquisition of HTM securities be scoped out of the proposed seasoning criteria. Conceptually, it is difficult to understand how the acquirer of a security would be considered an originator or why the time by which an acquirer purchases a security would affect how the allowance for credit losses should be recognized for such assets.

  If the Board chooses not to exclude HTM securities from the scope of the seasoning criteria, we recommend the final standard address transfers of securities into HTM from AFS, at which point the securities would become subject to this guidance. First, clarify whether entities would apply the gross-up accounting as of the transfer date (as opposed to the original purchase date of the security.) Second, clarify whether (and if so, how) the calculation of unrealized gains/losses is impacted for purposes of disclosure for HTM securities given the disclosure is based on amortized cost. .

  We also recommend the final standard clarify how the seasoning guidance would apply to acquired securities that are issued by an unconsolidated entity of which the acquirer is the sponsor. For example, it is not clear whether the guidance would view the sponsor of the issuing entity as the originator or what should be considered in determining whether the sponsor is the deemed originator.

- *Acquisition of previously originated financial assets* – the proposed seasoning criteria would preclude originators of financial assets from ever applying the gross-up approach to subsequently acquired assets that they originated, even if the acquisition occurs more than 90 days after the acquirer's most recent exposure to the risks and rewards of ownership. We observe this new limitation is stricter than what is required by existing GAAP – that is, under existing GAAP, originators can apply the gross-up approach to subsequently acquired assets that they originated if the assets have experienced more than insignificant credit deterioration since origination. Because this requirement would narrow application of the gross-up approach, we recommend the final standard allow originators to account for acquired financial assets that they originated under the gross-up approach if acquired more than 90 days after the acquirer's most recent exposure to the risks and rewards of ownership.

- *Involvement with origination* – the proposed qualitative assessment of whether the acquirer has "involvement with the origination of [an] asset" is operationally complex. We recommend the assessment of whether an acquirer is involved in the origination of an acquired financial asset be limited to instances where the acquirer is exposed to substantially all the risks and rewards of ownership during the first 90 days after origination. For example, if an entity enters into an agreement to purchase financial assets from the originator at a fixed price during the first 90 days after origination – even if the purchase date occurs outside of that 90-day period – the acquirer would be considered to have exposure to the risks and rewards of ownership.

Transition Guidance

We recommend the final standard permit a prospective transition approach. We believe the users of the financial statements have previously evaluated financial assets acquired prior to the transition date of the proposed ASU, determined their own valuations, and find little benefit in any retrospective application of the standard. Further, the cost to preparers – in terms of both financial and human resources – of applying the standard under a modified retrospective approach could be significant, and would not outweigh the benefits, especially for companies with material acquisitions of financial assets since their adoption of FASB ASU 2016-13. Among other things, companies may need to recalculate the transition adjustment from the adoption of FASB ASU 2016-13, identify all acquired financial assets since the adoption of FASB ASU 2016-13, determine appropriate pools to apply the seasoning criteria, assess the effect of any changes on prior purchase accounting, and recalculate (for all quarters since adoption of FASB ASU 2016-13) the provision for credit losses, allowance for credit losses, loans, charge-offs, non-performing assets, net interest margin, and any related effects on capital metrics and requirements. Also of concern are scenarios in which the loan systems of acquired entities have been decommissioned in favor of acquiror loan and securities systems such that the asset-level detail, necessary to accurately restate each of the aforementioned elements for all prior periods, is no longer available.

Use of a prospective transition approach would be significantly less costly. We observe that standard-setting activities affecting business combinations generally employ a prospective transition approach (for example, FASB ASU 2021-08), in part, to minimize the costs of adoption.

Effective Date (Question 7)

If the Board changes the transition provisions of the final standard to prospective adoption, we believe companies would need at least one year from the date of issuance to adopt the standard. Given the significant increase in assets accounted for under the gross-up approach, companies will need adequate time to recalibrate credit loss models, especially those whose historical loss rates currently are based on amortized cost and would need to be adjusted to be based on unpaid principal balance. If the Board proceeds with a modified retrospective adoption approach, we believe companies will need at least two years from the date of issuance to adopt the standard. In either case, we recommend non-public business entities (PBEs) be extended an additional year to learn from the adoption experiences of PBEs.

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We thank the Board for its consideration and would welcome the opportunity to further discuss this matter with Board members and their staff.

Sincerely,

Mark Crowley, Chair
Financial Reporting Executive Committee

Dom Giuffrida, Chair
Depository Institution Expert Panel