The AICPA's Financial Reporting Executive Committee (FinREC) is requesting your feedback on a proposed enhancive update to the AICPA Accounting Guide *Brokers and Dealers in Securities*. This note is related to the implementation of FASB ASC Topic 326 *Financial Instruments — Credit Losses*.

This proposed update includes

- **New section "Current Expected Credit Losses (CECL) in Note 2 "Significant Accounting Policies" in the notes to consolidated financial statements (chapter 6)**
- **Updated Note 9 in the notes to consolidated financial statements (chapter 6)**
- **New considerations for SEC-registered broker-dealers as they develop an accounting policy footnote related to FASB ASC Topic 326 – "Financial Instruments – Credit Losses" (chapter 5).**

Interested parties are encouraged to submit their informal feedback on this illustrative draft note to Irina Portnoy (Irina.Portnoy@aicpa-cima.com) by July 17, 2021.

To be included in Exhibit 6-8 (Chapter 6 of the guide, existing Note 2 *Significant Accounting Policies*, immediately after *Cash and Cash Equivalents* of Notes to Consolidated Financial Statements)

Current Expected Credit Losses (CECL)

The Company accounts for estimated credit losses[1] on financial assets measured at an amortized cost basis and certain off-balance sheet credit exposures in accordance with FASB ASC 326-20, *Financial Instruments – Credit Losses*. FASB ASC 326-20 requires the Company to estimate expected credit losses over the life of its financial assets and certain off-balance sheet exposures as of the reporting date based on relevant information about past events, current conditions, and reasonable and supportable forecasts.

The Company records the estimate of expected credit losses as an allowance for credit losses. For financial assets measured at an amortized cost basis the allowance for credit losses is reported as a valuation account on the balance sheet that adjusts the asset's amortized cost basis.

[1] Individual facts and circumstances could differ based on activities of a SEC registered broker-dealer. This example contemplates this hypothetical broker-dealer's facts and circumstances and does not reflect all disclosures required in FASB ASC 326 under accounting principles generally accepted in the United States of America. FASB ASC 326 is effective for most public business entities that are SEC filers, which include SEC-registered broker-dealers. Readers should refer to the "Financial Instruments – Credit Losses" section of chapter 5 of this guide for more information. Broker-dealers should consider all relevant disclosure requirements in FASB ASC 326-20-50, based on facts and circumstances, including credit quality information, allowance for credit losses (including the Company's method for developing its allowance for credit losses), including rollforwards of the allowance for credit losses by portfolio segment and major security type, past due and non-accrual status receivables, etc.
Broker-dealers should also consider accrued interest receivables in its estimate of expected credit losses under FASB ASC 326-20 baring certain accounting policy elections.

Changes in the allowance for credit losses are reported in Credit Loss expense.[2]

Financial assets measured at amortized cost basis that are eligible for the collateral maintenance practical expedient. Many of the Company's financial assets measured at amortized cost basis are eligible for the collateral maintenance practical expedient as described in FASB ASC 326-20-35-6. The practical expedient may be elected for contracts when the counterparty is contractually obligated to continue to fully replenish the collateral to meet the requirements of the contract and the Company reasonably expects the counterparty to continue to replenish the collateral. The Company elects to use the practical expedient when eligible. The Company determines if it is eligible for the collateral maintenance provision practical expedient, considers the credit quality of these assets, and the related need for an allowance for credit losses, based on several factors, including: 1) the daily revaluation of the underlying collateral used to secure the customer's borrowings and collateral, 2) the customer's continuing ability to meet additional collateral requests based on decreases in the market value of the collateral, and 3) its right to sell the securities collateralizing the borrowings, if additional collateral requests are not met by the customer or the amounts borrowed are not returned on demand. Under the collateral maintenance provision practical expedient, the Company compares the amortized cost basis with the fair value of collateral at the reporting date. When the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset and the Company reasonably expects the counterparty to continue to replenish the collateral as necessary to meet the requirements of the contract, the practical expedient permits the Company to consider that the expectation of nonpayment of the amortized cost basis is zero. When the fair value of the collateral is less than the amortized cost basis of the financial assets, and the Company reasonably expects the counterparty to continue to replenish the collateral as necessary to meet the requirements of the contract, the Company establishes an allowance for 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 assets.

Financial assets measured at amortized cost basis that are not eligible for the collateral maintenance practical expedient. For financial assets measured at amortized cost basis that are not eligible for the collateral maintenance practical expedient (and any unsecured amounts for instruments applying the practical expedient), the Company estimates expected credit losses over the life of the financial assets as of the reporting date based on relevant information about past events, current conditions, and reasonable and supportable forecasts.

Certain off-balance sheet credit exposures. The Company estimates credit losses on certain off-balance sheet credit exposures over the contractual period of a present obligation to extend credit, unless that obligation is unconditionally cancellable by the Company. The Company provides letters of credit and other guarantees primarily to enable clients to enhance their credit standing and complete transactions. Other than the estimation of the probability of funding on such arrangements, the allowance for credit losses is estimated in a manner similar to the methodology used for funded credit exposures and as such, the Company estimates expected credit losses over the life of the instruments as of the reporting date based on relevant information about past events, current conditions, and reasonable and supportable forecasts.

---

[2] FASB ASC 326-20-30-1 and 326-20-35-1 require that the establishment of, or subsequent adjustment to, the allowance for credit loss be reported as a credit loss expense or reversal of credit loss expense, therefore the Company should consider the materiality of the exposure when determining the financial statement line item for any amounts to be reported in.

For off-balance sheet credit exposures, the allowance for credit losses is reported as a liability. Changes in the allowance for credit losses are reported in Credit Loss expense.

Receivables from Customers. The Company's receivables from its brokerage customers include margin loans and accrued interest on these loans. Margin loans represent credit extended to customers to finance their purchases of securities by borrowing against securities they own and are fully collateralized by these securities in customer accounts. Collateral is maintained at required levels at all times. The borrowers of a margin loan are contractually required to continually adjust the amount of the collateral as its fair value changes. The Company subjects the borrowers to an internal qualification process and an interview to align investing objectives, and monitors customer activity. The Company applies the practical expedient based on collateral maintenance provisions in estimating an allowance for credit losses for margin loans. [3]

Securities borrowed. Securities borrowed transactions require the Company to deliver cash to the lender in exchange for securities. Interest on such transactions is accrued and is included in the consolidated statement of financial condition in receivables from and payables to broker-dealers and clearing organizations. The market value of securities borrowed is monitored, with additional collateral obtained to ensure full collateralization. The Company applies the practical expedient based on collateral maintenance provisions in estimating an allowance for credit losses for securities borrowed receivables. The Company has established policies and procedures for mitigating credit risk on securities borrowed transactions, including reviewing and establishing limits for credit exposure, maintaining collateral, and continually assessing the creditworthiness of counterparties. The Company minimizes credit risk associated with these activities by daily monitoring collateral values and requiring additional collateral to be deposited with the Company as permitted under contractual provisions. [4]

Receivables from broker-dealers and Clearing Organizations. The Company's receivables from broker-dealers and clearing organizations include amounts receivable from unsettled trades, including amounts related to futures and options on futures contracts executed on behalf of customers, amounts receivable for securities failed to deliver, accrued interest receivables and cash deposits. A portion of the Company's trades and contracts are cleared through a clearing organization and settled daily between the clearing organization and the Company. Because of this daily settlement, the amount of unsettled credit exposures is limited to the amount owed the Company for a very short period of time. The Company continually reviews the credit quality of its counterparties.[5]

---

[3] The Company should consider all the disclosure requirements in FASB ASC 326-20-50, including credit quality information, allowance for credit losses (including the Company's method for developing its allowance for credit losses), including rollforwards of the allowance for credit losses by portfolio segment and major security type, past due and non-accrual status receivables, etc. The Company should also consider accrued interest receivables in its computation of credit losses under ASC 326-20.

[4] The Company should consider all the disclosure requirements in FASB ASC 326-20-50, including credit quality information, allowance for credit losses (including the Company's method for developing its allowance for credit losses), including rollforwards of the allowance for credit losses by portfolio segment and major security type, past due and non-accrual status receivables, etc. The Company should also consider accrued interest receivables in its computation of credit losses under ASC 326-20.

[5] The Company should consider all the disclosure requirements in FASB ASC 326-20-50, including credit quality information, allowance for credit losses (including the Company's method for developing its allowance for credit

losses), including rollforwards of the allowance for credit losses by portfolio segment and major security type, past due and non-accrual status receivables, etc. The Company should also consider accrued interest receivables in its computation of credit losses under ASC 326-20.

To be included in Exhibit 6-8 (Chapter 6 of the guide, existing Note 9 that breaks out the $40M balance of customer receivables into $9M of fails, $8M of commissions receivable and $22M of Margin loans)

9. Receivable From and Payable to Customers[6]

When determining the estimate of the expected credit losses for amounts receivable for securities failed to deliver and margin loans, the Company considers its actual historical collection experience, the length of time the receivable has been outstanding and the credit quality of its counterparties. The Company continually reviews these credit quality indicators. All receivables for securities failed to deliver were originated in the current year. All receivables for securities failed to deliver and margin loans were current as of December 31, 20X1. There were no changes in the factors that influenced management's accounting policies or their current estimate of credit losses. There were no significant write offs. As a result, the expected credit losses as of December 31, 20X1 were immaterial

[6] The Company should consider all the disclosure requirements in FASB ASC 326-20-50, including credit quality information, allowance for credit losses (including the Company's method for developing its allowance for credit losses), including rollforwards of the allowance for credit losses by portfolio segment and major security type, past due and non-accrual status receivables, etc. The Company should also consider accrued interest receivables in its computation of credit losses under ASC 326-20.

To be included in Chapter 5 of the guide immediately after paragraph 5.70

Financial Instruments – Credit Losses[7]

Expected credit losses on financial assets measured at an amortized cost basis and certain off-balance sheet credit exposures are estimated in accordance with FASB ASC 326-20, *Financial Instruments – Credit Losses – Measured at Amortized Cost.* FASB ASC 326-20 requires expected credit losses to be estimated over the life of financial assets and certain off-balance sheet exposures based on relevant information about past events, current conditions, and reasonable and supportable forecasts of future economic conditions and events. The estimate of expected credit losses is established at the inception date in accordance with FASB ASC 326-20-30-1 and is recorded as an allowance for credit losses at the reporting date. This allowance is a valuation account on the balance sheet that adjusts the asset's amortized cost basis as described in FASB ASC 326-20-30-1. As a result, the financial statements would generally reflect the net amount expected to be collected. The establishment of the allowance for credit losses is reported as a credit loss expense on the statement of operations. Increases to the allowance would be charged to credit loss expense (with reversals for declines in credit losses as reversals of credit loss expense)[8].

Financial assets measured at amortized cost basis that are eligible for the collateral maintenance provision practical expedient.

Broker-dealers enter into a variety of transactions where the financial asset is measured at amortized cost and may be eligible for the collateral maintenance provision practical expedient. These financial assets may include, for example, securities borrowed and securities purchased under agreements to resell and receivables from customers.

For these types of collateralized transactions the market value of the collateral is continuously monitored, with additional collateral obtained to ensure appropriate levels of collateral are maintained. Broker-dealers establish policies and procedures for mitigating credit risk on collateralized transactions, including reviewing and establishing limits for credit exposure, maintaining collateral, and continually assessing the creditworthiness of counterparties; credit risk associated with these activities is minimized by daily monitoring of collateral values and requiring additional collateral to be deposited as permitted under contractual provisions.

These financial assets are generally eligible for the collateral maintenance provision practical expedient as described in FASB ASC 326-20-35-6. The practical expedient may be elected for contracts when the counterparty is contractually obligated to continue to fully replenish the

---

[7] Broker-dealers should consider all relevant disclosure requirements in FASB ASC 326-20-50, based on facts and circumstances, including credit quality information, allowance for credit losses (including the Company's method for developing its allowance for credit losses), including rollforwards of the allowance for credit losses by portfolio segment and major security type, past due and non-accrual status receivables, etc.
Broker-dealers should also consider accrued interest receivables in its computation of credit losses under FASB ASC 326-20.

[8] FASB ASC 326-20-30-1 and 326-20-35-1 require that the establishment of, or subsequent adjustment to, the allowance for credit loss be reported as a credit loss expense or reversal of credit loss expense; therefore, the broker-dealer should consider the materiality of the exposure when determining the financial statement line item for any amounts to be reported in.

collateral to meet the requirements of the contract and it is reasonably expected that the counterparty will continue to replenish the collateral.

A broker-dealer should determine if it is eligible to elect the collateral maintenance provision practical expedient considering the credit quality of these assets, and the related need for an allowance for credit losses, based on several factors, including: 1) the daily revaluation of the underlying collateral used to secure the customer's borrowings and collateral, 2) the customer's continuing ability to meet additional collateral requests based on decreases in the market value of the collateral, and 3) its right to sell the securities collateralizing the borrowings, if additional collateral requests are not met by the customer or the amounts borrowed are not returned on demand. Under the collateral maintenance provision practical expedient, the amortized cost basis is compared with the fair value of collateral at the reporting date. When the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset, and it is reasonably expected that the counterparty will continue to replenish the collateral as necessary to meet the requirements of the contract, the practical expedient permits that the expectation of nonpayment of the amortized cost basis to be zero. When the fair value of the collateral is less than the amortized cost basis of the financial assets, and it is reasonably expected that the counterparty will continue to replenish the collateral as necessary to meet the requirements of the contract, an allowance for credit losses is established for the unsecured amount of the amortized cost basis, if any. 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 assets.

Financial assets measured at amortized cost basis that are not eligible for the collateral maintenance provision practical expedient.

For financial assets measured at amortized cost that are not eligible for the collateral maintenance provision practical expedient (and any unsecured amounts for instruments applying the practical expedient), expected credit losses are estimated over the life of the financial assets as of the reporting date based on relevant information about past events, current conditions, and reasonable and supportable forecasts of future economic conditions and events.

Broker-dealers enter into a variety of transactions where the financial asset is measured at amortized cost and are not eligible for the collateral maintenance provision practical expedient, including, but not limited to, revenue generating activities, such as underwriting securities, mergers and acquisitions fees, asset management fees and other commission generating activities that generate receivables from customers, brokers, dealers and clearing organizations. In addition, some broker-dealers enter into loans to employees and may account for accrued interest receivables in a manner that requires separate consideration.

The amount of credit exposures arising from receivables from broker-dealers and clearing organizations is often limited because of the daily settlement that takes place. The amount owed to the broker-dealer often is for a very short period of time which can help reduce the risk of nonperformance.

Certain broker-dealers grant loans to employees in conjunction with programs established to recruit and retain employees. These loans are often contingent on the employees' continued employment with the broker-dealer, amortize over a contractual service period and generally require repayment if employees leave during a contractual service period. An allowance for credit loss is estimated by considering credit quality indicators and the recoverability of outstanding loan balances from employees that have or may leave the broker-dealer. An employee loan is placed on non-accrual status when, based on current information, it is no longer probable that the scheduled payments of principal and interest would be collected when due according to the contractual terms of the underlying loan agreement. The amortized cost basis of the employee loan is written-off against the allowance for credit losses when the amount is deemed to be uncollectible[9].

Certain off-balance sheet credit exposures.
Credit losses on certain off-balance sheet credit exposures are estimated over the contractual period of a present obligation to extend credit, unless that obligation is unconditionally cancellable by the issuer in accordance with FASB ASC 326-20-30-11.

Certain broker-dealers may provide letters of credit and other financial guarantees primarily to enable clients to enhance their credit standing and complete transactions. Other than the estimation of the probability of funding on such arrangements, the allowance for credit losses is estimated in a manner similar to the methodology used for funded credit exposures not eligible for the collateral maintenance provision practical expedient. Expected credit losses are estimated over the life of the instruments at the reporting date based on relevant information about past events, current conditions, and reasonable and supportable forecasts.

For off-balance sheet credit exposures, the allowance for credit losses is reported as a liability. Changes in the allowance for credit losses are reported in credit loss expense.

[9] Disclosures around modifications, renewals, or extensions, as well as the year of origination, related to any loans should be included. Additionally, if an entity discloses internal risk ratings, they should provide qualitative information on how those internal risk ratings relate to the likelihood of loss.