August 28, 2023

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

**RE: File Reference No. 2023-ED400**

Dear Ms. Salo:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Proposed Accounting Standards Update, *Financial Instruments—Credit Losses (Topic 326): Purchased Financial Assets*.

Consistent with feedback shared with the Board during the development of the current expected credit loss model, we believe that requiring full recognition of expected losses in earnings upon origination or purchase of assets does not reflect the economics of market-based lending or investing transactions. We continue to believe the presence of credit risk that was inherently included in the transaction price for a financial instrument should not give rise to a day-one loss.

Also, we acknowledge the complexity that investors and other constituents have noted with the current model in which purchased financial assets are treated differently depending on whether the asset has experienced an other-than-insignificant deterioration in credit. In addition, given the degree of judgement involved in determining whether a financial asset is considered purchased credit deteriorated (PCD), we also note diversity in its application. We believe some changes to the current PCD model would provide more consistency, reduce complexity in the accounting model for certain purchased assets, and reduce instances when entities record day-one losses, which are inconsistent with the economics of the transaction.

We generally believe that the accounting for business combinations and asset acquisitions should be aligned. We note that accounting for economically similar transactions differently generally adds complexity and can decrease transparency in financial reporting. The proposed model would treat certain acquired assets differently from originated assets and would create further differences between the accounting for assets acquired in a business combination versus an asset acquisition. While much focus has been placed on the differences in initial recognition of the assets and whether there is a day-one credit loss recorded in earnings, we believe that subsequent measurement issues are equally as important and perhaps less understood by users, and merit further consideration by the Board.

The "gross-up" accounting model for PCD assets was designed to be applied to assets that have experienced credit deterioration. As a result, there are elements of the PCD model (other than the day one gross-up) that are different from the accounting model applied to financial assets that have not experienced credit deterioration. This includes differences in nonaccrual and recovery guidance, as well as in how credit losses are measured on a collective basis (e.g., amortized cost versus unpaid principal

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balance). We believe these differences should be eliminated if the Board proceeds with different models for purchased and originated financial assets. When credit losses will be measured on a collective (pool) basis because similar risk characteristics exist, we believe it is important that the credit loss model, including subsequent measurement, is the same for the assets within that pool. We also believe the proposed "seasoning" criteria for distinguishing between acquired and "in substance originated" assets lack clarity and would be operationally challenging to implement.

With regard to adoption, we believe that an entity should be permitted, but not required, to adopt the proposed standard on a modified retrospective basis. We understand that adopting the standard on a modified retrospective basis will be costly and operationally challenging for some reporting entities and therefore, we support providing an option for prospective adoption. The proposal would be a significant change to the existing accounting model and its adoption would likely require extensive updates and changes to existing credit loss models, accounting systems, and controls. This may require preparers to incur significant costs, and we encourage the Board to consider those costs in its cost benefit analysis.

The appendix contains our detailed responses to the Questions for Respondents and additional suggestions for clarification on certain issues for the Board's consideration.

* * * * *

We would be pleased to discuss our comments or answer any specific questions. Please contact Thomas Barbieri at thomas.barbieri@pwc.com or Chip Currie at frederick.currie@pwc.com regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

**Appendix**

**Question 1: The amendments in this proposed Update would expand the population of acquired financial assets accounted for under the gross-up approach, which currently applies only to PCD assets. Should certain classes of financial assets or specific transactions be included (for example, AFS debt securities) or excluded (for example, credit cards or similar revolving credit arrangements)? Please explain why or why not.**

We support removing AFS debt securities from the gross-up approach. The acquisition of AFS debt securities does not create a day-one credit loss as the impairment model in ASC 326-30 is different from the model in ASC 326-20. However, we believe the Board should develop guidance for the recognition of income on AFS securities purchased at a discount due to credit deterioration. One of the original reasons for the adjustment to the amortized cost basis of the asset under the PCD model was to ensure that an appropriate amount of interest income was recorded on assets purchased at a discount due to credit deterioration. The amortized cost basis adjustment component of the PCD model eliminates the portion of the purchase discount due to estimated credit losses. After adoption of ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*, for AFS debt securities that are not beneficial interests subject to ASC 325-40, the interest income guidance requires accretion of a discount based on the contractual amounts owed on the security. Applying this model to AFS securities purchased at a discount due to credit deterioration may result in recording interest income that is not expected to be collected, which we do not believe is useful for investors.

We recommend that the purchased financial asset (PFA) model not apply to any instrument subject to ASC 325-40, including beneficial interests classified as held-to-maturity. The interaction of a gross up model with a model based on expected cash flows has proven to be unnecessarily complex.

There are complexities in applying a gross-up approach to credit cards with revolving privileges and other similar arrangements. We understand that these complexities were part of the reason that credit cards with revolving privileges were excluded from the scope of ASC 310-30. As discussed in Question 3, we believe that some practical expedients could aid application of a gross-up model to these arrangements.

We believe the Board should consider whether a similar gross-up model could be applied to off-balance-sheet items such as forward contracts to purchase financial assets or loan commitments. We note that both acquisitions of portfolios of assets and business combinations frequently involve such instruments that may become funded loans shortly after the acquisition. In addition, acquisitions of loan facilities in which a portion has been funded and a portion remains unfunded are not uncommon, and creating different accounting models for the portion of the arrangement that is funded versus unfunded as of the acquisition date is not intuitive.

We do not believe that a gross-up approach should be applied to assets that are subject to an exception from the Topic 805 fair value measurement approach. This would include contract assets, sales-type and direct financing lease receivables, and certain indemnification assets. As these instruments are not recorded at fair value, there is no “double counting” of credit risk in their initial and day-one measurements. For these instruments that are acquired when there are credit-related concerns with the counterparty, the gross-up approach will exacerbate the difference between the assets’ amortized cost bases and their fair values.

**Question 2: Would the proposed amendments enhance comparability and improve the decision usefulness of financial information? Are there specific disclosures related to these proposed amendments that would be useful to investors? Please explain why or why not.**

Although the proposal is a step towards eliminating the recognition of day-one losses, which does not faithfully represent the economics of lending and investing transactions, we also believe that accounting for economically similar transactions differently will add complexity and may decrease comparability in financial reporting.

We generally believe that the accounting for business combinations and asset acquisitions should be aligned. The proposed model would treat certain acquired assets differently from originated assets and would create further differences in the accounting treatment for assets acquired in a business combination versus an asset acquisition. We see little conceptual difference between loans acquired in a business combination and other acquired loans as they are generally recorded at fair value upon acquisition, and even originated loans are originated at amounts that approximate fair value. Much of the complexity in the proposed guidance comes from the Board's decision to treat originated and acquired assets differently. However, given the Board's intent to create different accounting models for acquired and originated assets, and the potential for financial assets purchased through asset acquisitions to be economically similar to originated financial assets, we understand the need to have additional criteria for asset acquisitions to be treated as purchased financial assets. We also note the proposed guidance in ASC 326-20-30-15(b)(1) requires an acquiror to determine the accounting for an individual asset acquired in a group of assets (that is not deemed a business) to be based on the characteristics of other assets in the group. Thus, the accounting for similar assets could be different depending on what other items were acquired with it.

As discussed in our response to Question 4, under the proposal we would expect more similarities in risk characteristics between originated assets and those applying a gross-up model than under the current guidance because the gross-up model will be applied to a broader population of assets. To facilitate comparability and usefulness to investors, we believe that differences in the accounting models between originated assets and those applying a gross-up model should be eliminated if the gross-up model will be applied to assets that have not experienced credit deterioration.

**Question 3: Do you foresee operability or auditing concerns in applying the gross-up approach to certain classes of financial assets (for example, credit cards or other revolving arrangements), certain types of transactions (for example, business combinations, asset acquisitions, or the consolidation of a VIE that is not a business), or certain classes of financial assets in specific transactions (for example, credit cards or other revolving arrangements in an asset acquisition)? Please describe the nature of those concerns and the magnitude of associated costs, differentiating between one-time costs and recurring costs.**

**Are there practical expedients or implementation guidance that would mitigate your concerns? Are there practical expedients or implementation guidance that would enhance comparability? For any proposed practical expedients suggested, please explain your reasoning.**

There are a complexities in applying the PFA accounting model to credit cards and other revolving lines of credit. We understand these complexities result from a number of issues, including the fact that individual draws on a revolving line of credit lose their identity and become part of a larger receivable balance. The issues raised with amortizing a basis adjustment on a revolving product are similar to those discussed at the Credit Losses Transition Resource Group regarding estimating the "life" of a credit card. In addition, because individual draws become part of a larger balance, it is important that there are no differences in the accounting models for purchased and originated balances.

We propose a practical expedient whereby any adjustment to the amortized cost basis of revolving instruments similar to credit cards subject to the gross-up model would not be allocated to individual assets but instead be maintained at a portfolio level. This adjustment would be amortized into interest income on a straight-line basis over the life used to determine the initial estimate of credit losses. This would be similar to how amounts traditionally considered as basis adjustments to individual assets are now considered in portfolio layer method hedges under ASC 815, *Derivatives and Hedging*. Also, ASC 310-20 provides similar guidance for amortizing certain credit card fees without association to individual loan balances.

We understand the proposal would not permit a gross-up model to be applied to off-balance sheet items, but we believe the Board should consider applying the gross up model to off-balance sheet items. We believe that this could alleviate the complexity in the accounting for acquired arrangements that include both a funded and unfunded element as well as the accounting for draws made after acquisition.

**Question 4: There are no proposed amendments to the gross-up approach as it is currently applied to PCD assets; rather, there are proposed amendments that would expand the population of financial assets that apply the gross-up approach at acquisition. Do you agree that no amendments are needed to the existing gross-up approach? Please explain why or why not.**

Under the proposal, we would expect more similarities in risk characteristics between originated assets and those applying a gross-up model than under the current guidance because the gross-up model will be applied to a broader population of assets. The gross-up accounting model was originally designed to be applied to assets that have experienced credit deterioration. As a result, there are elements of this model (other than the day one gross-up) that are different from the accounting model applied to other assets. We believe these differences should be eliminated if the gross-up model will be applied to assets that have not experienced credit deterioration. For credit losses to be measured on a collective (pool) basis when similar risk characteristics exist, we believe it is important that the credit loss model, including subsequent measurement, be the same for the assets within that pool.

*Nonaccrual*

ASC 310-10-35-53C has specific guidance on recognition of interest income. It states: "Recognition of income on purchased financial assets with credit deterioration is dependent on having a reasonable expectation about the amount expected to be collected." This guidance was carried forward by ASU 2016-13 (with some amendments) from ASC 310-30-35-3. We understand that this guidance is designed to acknowledge that acquirors of assets that have experienced credit deterioration are expecting to earn a return on their investment, but they may not expect to collect all of the contractual cash flows. In these instances, original contractual cash flows are not as relevant in the investing decision. In contrast, nonaccrual of interest on other assets is generally based on whether there are concerns the creditor will receive contractual cash flows. As proposed, the guidance would create a difference when an asset is placed on nonaccrual status depending on whether it was deemed a PFA or not.

Nonaccrual guidance is an integral part of the accounting model for credit losses and may impact an entity's calculation of credit losses. For example, to exclude accrued interest from estimating credit losses under ASC 326-20, an entity must write off accrued interest receivable balances in a timely manner. We believe the nonaccrual guidance should be the same for all assets within a pool if the allowance for credit loss is calculated at a pool level. Therefore, we propose that the nonaccrual guidance currently applied to PCD assets be applied only to assets acquired that have experienced significant credit deterioration.

*Recoveries*

ASC 326-20-30-13A provides specific guidance on the application of recoveries guidance to PCD assets. It addresses a potential issue noted in purchases of distressed financial assets regarding whether the application of the write-off and recoveries guidance could accelerate the recognition of income. The application of this limitation on recoveries is complex.

Estimating recoveries is an integral part of measuring the allowance for credit losses and recoveries are frequently estimated at a pool level. We believe that this guidance should be the same for all assets within a pool if the allowance for credit loss is calculated at a pool level. We believe that the Board should require the application of ASC 326-20-30-13A only when the assets acquired have experienced significant credit deterioration and clarify its application in those situations. The current guidance and example do not provide sufficient guidance on the application of the requirement that "expected recoveries shall not include any amounts that result in the acceleration of the noncredit discount."

*Basis from which the allowance is calculated*

For assets not subject to the PCD model, ASC 326-20 provides that the allowance for credit losses is the company's expected credit losses of the amortized cost basis of the financial asset. However, for assets treated as PCD, ASC 326-20-30-14 requires the allowance to be based on the unpaid principal balance of the financial asset when an entity uses a methodology other than a discounted cash flow approach. We understand this guidance was included for PCD assets to avoid potential circularity in the estimation of credit losses if the allowance was based on the amortized cost basis of the asset, but the allowance also impacted the amortized cost basis of the asset.

The basis on which an allowance is calculated is an integral part of measuring the allowance for credit losses. We believe that this guidance should be the same for all assets within a pool if the allowance for credit loss is calculated at a pool level. Given the circularity that would result in basing a gross-up model on amortized cost basis, it would seem the only way to converge the guidance would be to amend the CECL model for originated assets such that it is based on unpaid principal balance, as opposed to amortized cost basis. While we recognize that this would be a significant change to the conceptual basis of ASC 326-20 and would likely require a number of amendments to the current guidance, we believe that such consistency is important as the Board seeks to expand the application of the gross-up model to assets that are economically similar to originated assets.

*Freestanding insurance contracts*

In March 2020, the Board discussed the accounting model for certain freestanding purchased insurance contracts covering credit losses on financial instruments subject to ASC 326-20. While acknowledging that other views would also be appropriate, the Board and staff noted that it would be appropriate for an insurance recovery asset to be recognized at the time of recording expected credit losses or, in other words, to apply a mirror image accounting model. Insurance contracts covering assets applying the PCD model were excluded from those discussions. We believe the Board should consider how a mirror image accounting model could be applied when the underlying assets are accounted for under a gross-up model. This could result in the application of a gross-up model to the insurance contract that would generally be an off-balance sheet contract otherwise. As noted above, we support extending the PFA model to certain off-balance sheet exposures.

*Charge-off guidance*

As noted, the PCD model was originally designed to be applied to assets that had experienced credit deterioration. One of the original goals of the PCD model and the adjustment to the amortized cost basis of the asset was to ensure that an appropriate amount of interest income was recorded on assets purchased at a discount due to credit deterioration. The amortized cost basis adjustment component of the PCD model eliminates the portion of the purchase discount due to estimated credit losses. If an entity acquires a distressed asset and applies the gross-up model, the subsequent application of write-off guidance may result in the adjustment to the amortized cost basis recorded at acquisition to be written off. Assuming the Board intends for entities to recognize interest income on these assets, we believe the Board should consider providing additional guidance on interest income if the amortized cost basis of the asset does not include the day-one gross up as a result of a write off.

As noted in our responses above, we believe the Board should consider whether there should be specific accounting guidance (e.g., interest income, nonaccrual, and recoveries) for assets that have experienced significant credit deterioration. While we understand that this would result in there still being two different models for acquired assets, these differences would be relatively limited, address issues historically noted for these types of assets, and be appropriate given the special nature of assets that have experienced significant credit deterioration.

**Question 5: Do you agree with the proposed seasoning criteria in paragraph 326-20-30-15 and 30-16? If not, please explain why or why not and describe any potential alternatives for the Board's consideration.**

We understand the Board intends the proposed seasoning criteria to distinguish assets that are "in substance originated" from other acquired assets as originated and acquired assets will follow different accounting models under the proposed guidance.

We support not requiring an assessment at an individual asset level for business combinations. For asset acquisitions, the proposed guidance would require an assessment at a group level to determine whether substantially all of the assets acquired would meet the criteria to be considered PFA for any of the assets to be considered PFA. By requiring an assessment at a group level, the substantially all criteria could result in similar loans being accounted for differently depending on the nature of other assets acquired contemporaneously. We believe this adds unnecessary complexity for users of financial statements.

It is also unclear how the substantially all test is performed. For example, is the assessment based on number of loans, unpaid principal amount, amortized cost, or some other factor? It is similarly unclear how a group should be constructed. Should it be based on assets acquired contemporaneously or within a specified time period? Would the group have any level of disaggregation? The proposed definition of purchased financial assets references "acquired groups of financial assets with similar risk characteristics," but the guidance does not seem to contemplate similarity in risk characteristics.

Notwithstanding the questions above, we do not agree with the current proposal that an acquired asset could not be treated as PFA unless substantially all of the acquired assets meet the requirements. We believe this is inconsistent with an intent to have more assets accounted for under a gross-up model. We believe that the guidance should generally require an individual asset assessment, but as a practical expedient, also permit all assets subject to ASC 326-20 acquired to be treated as PFA if based on the fair value of the assets, substantially all of the acquired assets would meet the requirements to be treated as PFA.

The proposed guidance seems to indicate that if an entity is deemed the originator of an asset, that asset would never be considered a purchased financial asset if it were subsequently repurchased, unless it were acquired in a business combination. We believe this could create significant operational challenges as preparers may not retain records of assets they originated subsequent to selling them. When a purchased financial asset is deemed an in-substance origination, it is unclear whether the entity that legally originated the assets, as well as that which purchased the assets, would be deemed the originator. Prohibiting an originator from ever applying the PFA model may result in unintended consequences. For example, if an asset is originated and sold, the transferor may be required or elect to repurchase that asset following a contingent event (e.g., a representation and warranty issue or a call upon default). In these situations, the repurchase may result in a loss recorded in earnings as a result of the requirements to recognize an asset at fair value under ASC 860, *Transfers and Servicing,* and an additional loss to be recognized through the application of ASC 326-20 as the asset could not be considered a PFA.

It is also unclear how loan modifications may impact the analysis under the proposed guidance. For example, if a loan is sold and then modified before it is repurchased, would that modified loan would be ineligible to be treated as a PFA? If a loan were purchased and treated as PFA, but modified such that it were accounted for as a new loan, would it now be considered originated? Transition from a loan treated as PFA to a loan considered originated would seem to result in the recording of a loss upon modification.

The proposed guidance in ASC 326-20-30-16 is also unclear and could result in difficult judgments and diversity in practice. For example, if an institution makes it known that it stands ready to purchase newly-originated loans with specified criteria at fair value, loan originators may extend loans with those characteristics, knowing that there is a market to sell those loans. In these situations, it is unclear if the institution with a stand-ready offer should be deemed to be involved in the origination of that asset. It is also unclear if the existence of any of these factors would render a purchased asset ineligible to apply the PFA model, or if more than one of these criteria are needed and if so, how to weigh the criteria. The proposed criteria also lack clarity on whether fixed price or variable price forward purchase commitments should be analyzed differently.

We generally believe that having economic exposure to an asset for a period of 90 days is an operable and reasonable criterion for determining when the legal originator of an asset has been exposed to substantive risk. Similarly, we believe the guidance should provide a period of time after which an asset is sold when it would be deemed a purchased financial asset if subsequently re-acquired.

We are unclear as to the Board's intent with the proposed guidance in ASC 326-20-30-15(b)(2), which requires revolving arrangements to be assessed "in a manner consistent with an entity's policy for measuring credit losses on similar financial assets." Specifically, is this guidance meant to apply only to arrangements in which the lender has the ability to terminate undrawn exposures, and how are policies designed to estimate the remaining life to be applied to estimating when it was originated?

**Question 6: Do you agree with the modified retrospective transition guidance in this proposed Update? Should early adoption be permitted? Please explain why or why not.**

We do not agree with the proposal to require adoption on a modified retrospective basis and believe that preparers should have the option to adopt the guidance prospectively. We believe that early adoption should be permitted.

Since the adoption of ASU 2016-13, many entities have acquired significant amounts of assets in scope of the proposed guidance, including held-to-maturity debt securities. We understand that it would be a significant operational burden for preparers to identity all assets purchased since adoption of ASU 2016-13, evaluate whether those assets would have met the requirements to be considered purchased financial assets, and revise the accounting applied at the acquisition date and subsequently.

In addition, we believe the Board should eliminate some of the existing differences between the general CECL and gross-up models. Changes made to the application of the accounting models would significantly increase the level of difficulty in a retrospective adoption. If the Board finalizes a standard in which the allowance for loan losses at the date of adoption is impacted (for example, if changes are made to the existing CECL model), we believe these changes should be reflected as a cumulative effect of a change in accounting principal in retained earnings. We encourage the Board to obtain additional information from users of financial statements to determine if some of the information that would be obtained in a retrospective adoption (e.g., day-one credit losses recorded in large acquisitions/business combinations) is already readily available.

We also share a number of observations about the proposed modified retrospective transition that we recommend clarifying.

- ASC 326-10-65-6(d) states that the guidance should be adopted retrospectively "to all periods presented in the financial statements," but BC30 indicates it would be applied as of the "beginning of the first reporting period that an entity adopted Update 2016-13." We understand the Board's intent was to have entities adopt this proposal as of the date it adopted ASU 2016-13, and the impact of this adoption would be reported as a cumulative effect adjustment in the earliest period presented. If that is the case, we recommend that ASC 326-10-65-6(d) be edited to reflect that intent.

- In the transition provisions of ASU 2016-13, an entity did not re-assess which assets would be considered PCD. Instead, at transition, only assets that were accounted for under the previous guidance in ASC 310-30 were deemed to be considered PCD and no other assets were re-evaluated. In addition, certain other accommodations were made to transition from ASC 310-30 to the model introduced by ASU 2016-13. Assuming the Board did not intend to change the original transition provisions of ASU 2016-13, we understand that certain AFS debt securities would be considered PFA following the adoption of this guidance. However, the proposed amendments remove all guidance regarding the gross-up model for AFS debt securities (ASC 326-20). As a result, there could be certain investments accounted for under a balance sheet gross-up model not supported by the GAAP applicable to those instruments. If the Board's intent is to retain the original transition provisions of ASU 2016-13, we recommend that some of the guidance on AFS debt securities in ASC 326-20 also be retained, but only be applicable to investments owned as of the adoption date of ASU 2016-13.

**Question 7: How much time would be needed to implement the proposed amendments? Is additional time needed for entities other than public business entities? Please explain your response.**

We defer to preparers regarding the time needed to implement the proposed amendments. Our discussions with preparers suggest that adoption of these amendments would likely require significant effort and result in significant costs.