The Association of
Accountants and
Financial Professionals
in Business

via email
To: director@fasb.org

September 11, 2023

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

RE: File Reference No. 2023-ED400, Exposure Draft, Financial Instruments—Credit Losses (Topic 326): Purchased Financial Assets

Dear Ms. Salo:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update, *Financial Instruments—Credit Losses (Topic 326): Purchased Financial Assets* (Proposed Update).

The IMA is a global association representing over 140,000 accountants and finance team professionals. Our members work inside organizations of diverse sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

We generally agree with the proposal to eliminate the credit deterioration criterion that currently limits the use of the "gross-up" approach to purchased financial assets with credit deterioration (PCD) assets. As a general matter, the Committee opposed recording a day one provision for credit losses for originated and acquired financial assets when ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

(CECL) was adopted. We find that many of the arguments that were raised in opposition to that accounting model are further amplified when a day one provision for credit losses is recorded for acquired financial assets. In addition, the Committee supports the enhanced comparability within purchased financial assets and decreased complexity that the Proposed Update would produce, if adopted. That said, we believe there are certain aspects of the exposure document that need to be adjusted and/or clarified to ensure operability of the Proposed Update and reduce costs of implementation. Our comments on the Proposed Update are included herein.

Scope:

1. In Substance Originations

   The Committee has mixed views on the use of a bright-line threshold to determine if loans should be accounted for as a purchased financial asset. In general, the Committee discussed two views:

   a) A subset of the Committee is supportive of a bright-line threshold in determining if an acquired loan is seasoned and therefore could possibly be accounted for as a purchased financial asset (subject to the assessment of the factors in proposed paragraph 16 of ASC 326-20-30). This subset notes that loans that are acquired by banks shortly after origination are generally acquired through an established correspondent-lending relationship where there is a continual transfer of loans (shortly after their origination) to the lender that will manage the financial assets. To the buyer, these acquisitions function as, and are economically similar to, loan originations. Therefore, these acquisitions are disclosed in the acquiring financial institutions' loan origination statistics (a key metric for most banks and similar financial institutions). Absent the establishment of a bright line, entities will incur ongoing costs related to processes and procedures needed to assess qualitative factors in determining if the acquisitions are purchases or originations. This subset of the Committee also believes the 90-day bright line will not change current practice for banks and similar financial institutions. This subset believes that the criteria for evaluating whether a loan acquired more than 90 days after its origination is a purchase or an origination are reasonable.

   b) A subset of the Committee believes the determination as to whether an acquired loan should be considered seasoned and treated as a purchased financial asset should be solely based on the qualitative criteria in proposed paragraph 16 of ASC 326-20-30 (adjusted for the suggested amendments discussed below), regardless of the period since origination. For example, this subset believes that a subprime auto loan that is acquired by a finance company within 90 days of origination from a dealer through a competitive bid process against other finance companies should be treated as a purchased financial asset. In these transactions, the dealer uses a standardized loan contract that is acceptable to all the finance companies the dealers engage to sell their loans and does not have an agreement by the

finance company to buy the loan prior to its origination. Because of liquidity constraints, the dealer sells its loans as soon as practical after the origination. Accordingly, under the Proposed Update, the finance companies that acquire those loans would treat them as originated loans even though they did not play a role in the dealer's decision to extend credit to the borrower and competed against other finance companies to acquire the loans. This subset of the Committee disagrees with this result.

While this subset of the Committee generally agrees with the proposed criteria in paragraph 16, it believes the Board should expand the criteria to include certain conditions that were included in the consensus on EITF Issue No. 92-10, *Loan Acquisitions Involving Table Funding Arrangements*. In that issue, the EITF addressed whether the acquisition of a loan by a mortgage banking enterprise providing the funding needed at the closing of a loan arranged by an independent mortgage broker or correspondent firm should be treated by the mortgage banking enterprise as an origination or a purchase. The criteria this subset of the Committee thinks should be added to the Proposed Update include the following:

- Whether the originator sells loans to more than one purchaser or sells primarily to the acquirer[1].
- The process for selling the loans (e.g., an auction).
- Whether the originator is an independent third party and not affiliated with the acquirer.

Proponents of this view also recommend eliminating the portion of the condition in proposed paragraph 16(d) of ASC 326-20-30 relating to funding arrangements. As noted above, the EITF addressed how table funding arrangements affected the determination of whether a mortgage banking enterprise was an originator or a purchaser in 1992. The fact that the mortgage banking enterprise funded the loan at closing did not automatically result in concluding that the mortgage banking enterprise was the originator.

2. Ability to Influence the Originators Underwriting Standards

We are unsure how the guidance in the Proposed Update would be applied by a purchaser that, prior to origination, indicates its willingness to purchase financial assets that meet specified criteria. Does specifying the criteria that a financial asset is required to meet provide the purchaser with the "ability to influence the originator's underwriting standards" (proposed paragraph 16(b) of ASC 326-20-30) such that, even if the purchaser acquires the financial asset more than 90 days after the origination date, the purchaser would be deemed the in-substance originator? If so, that result ignores the fact that the originator independently decided to adopt origination standards that allow it to sell financial assets to third parties who are prepared to purchase financial assets meeting specified conditions. The originator was also under no

[1] This criterion was in EITF 92-10. This subset of the Committee believes that this criterion should be considered when there is a table funding arrangement as it is more believable that you are a purchaser and not an originator if the actual originator is in the business of originating and selling to many purchasers.

obligation to sell the financial asset upon origination. It also ignores the risk taken by the originator that by the time it has originated sufficient financial assets some of the financial assets it originated may not satisfy the conditions for purchase. If the Board believes that a purchaser providing asset-specific criteria that must be met for it to purchase financial assets gives that purchaser the "ability to influence the originator's underwriting standards," it should clarify that in the final standard including illustrative examples of scenarios that would and would not meet this criterion.

3. Unit of Account—In Substance Origination Scoping

Paragraph 326-20-30-15(b)-1 of the Proposed Update requires that substantially all the individual financial assets in a group of financial assets that were (1) acquired in an asset acquisition or (ii) recognized through the consolidation of a variable interest entity be seasoned for the entire group of financial assets to be within the scope of the purchased financial asset model. The use of the "substantially all" threshold establishes scoping criteria that are based on the dominant characteristics of the pool, rather than determining the scoping based on the characteristics of each individual loan. We believe that this approach will add significant operational complexity and cost to the implementation of the Proposed Update as existing accounting systems are not designed to aggregate information for acquired pools. However, we acknowledge that a company's individual facts and circumstances may vary. Therefore, we recommend that the FASB requires that the scoping decisions be based on the individual characteristics of each loan and provide a practical expedient that allows for the use of the "substantially all" criteria.

4. Revolving Credit Arrangements

a) Evaluating Seasoning:

We support the alignment of assessing the seasoning criteria for line-of-credit or other revolving arrangements in a manner consistent with the entity's policy for measuring expected credit losses on similar financial assets. However, we believe additional consideration should be given to acquisitions of credit card portfolios and the types of borrowers within the acquired credit card receivables. Specifically, a portfolio of credit cards will typically contain two types of borrowers, which are commonly referred to as transactors and revolvers. Transactor borrowers continually and routinely pay their balance in full each month. As credit cards are unconditionally cancellable by the lender, transactor balances are estimated to have a less than one-month life and have zero or de minimis amount of related allowance for credit losses. Revolver borrowers carry a recurring balance and have a related allowance for credit losses. For purposes of estimating the allowance for credit losses to the revolver borrowers, entities apply various payment allocation methodologies, such as "first-in-first-out," to determine the average outstanding life of a credit card receivable balance. To the extent that the FASB retains the "substantially all" criteria for determining seasoning, we believe the FASB should clarify that such guidance

should be applied separately to transactor and revolver balances when a portfolio of credit card receivables is acquired. Otherwise, the resulting conclusion of whether an acquired credit card portfolio is in-scope of the PFA model may not align with the characteristics of the acquired portfolio.

For example, assume an entity acquires a credit card portfolio with the following characteristics:

Credit Card Receivables:	**% of Portfolio:**	**Weighted Average Life (months)***
Transactors	20%	Less than 1
Revolvers	80%	22

*Based on the entity's "first-in-first-out" approach in determining the life of credit card receivables for measuring expected credit losses.

If the transactor and revolver credit card receivables are assessed together under the seasoning criteria, the full portfolio would not meet the "substantially all" criteria for being considered seasoned as more than 10% of the portfolio would have a life of less than 30 days and the acquisition in total would be treated as an origination.

If the transactors and revolvers are assessed separately under the seasoning criteria, the credit card receivables specific to the revolvers would be considered seasoned as they would have a weighted average life of 22 months and meet the criteria to be treated as purchased financial assets. Under this approach, the transactors would not be considered seasoned and accounted for as originations.

To the extent that the FASB retains the "substantially all" criteria, we believe the FASB should clarify that transactor balances and revolver balances should be evaluated separately for determining whether the "substantially all" criteria has been met and the pool is considered seasoned. This could be achieved either in the text or via an example that is specific to credit cards.

b) *Unit of Account*:

The gross up that is required under the Proposed Update would only apply to seasoned revolving credit balances on the date of acquisition. The Proposed Update requires subsequent units of account to be tracked separately and accounted for as new originations.

Creating two units of account within the same lending arrangement with distinct basis-adjustments that must be tracked separately would create significant complexity for the credit card industry. Additionally, the cost of the changes that would be required to implement this approach would be significant. Finally, the Board's proposed approach is inconsistent with the unit of account guidance in paragraph 7 of ASC 825-10-25 for such arrangements. Thus, we suggest that the FASB allow for a practical expedient that would apply to revolving credit arrangements. The practical expedient should be similar to the

one that was established in ASC 310-20 for credit card portfolios where fees and origination costs on receivables are amortized at the pool level, rather than the loan level, generally on a straight-line basis.

5. AFS Debt Securities

The scope of the Proposed Update excludes corporate debt securities that are acquired at a significant discount due to credit concerns if they are classified as available for sale (AFS). We are concerned that this outcome will result in inappropriate income recognition for such securities.

As an example, assume that a corporation purchases a distressed corporate debt security with a par value of $100 for $50 for which expected cash flows are estimated at $80. The security's initial cost basis is $50. Because the fair value equals the cost basis, there is no initial allowance for credit losses on the debt security. If the security is not within the scope of the Proposed Update, the discount of $50 will be accreted into income (which includes amounts which the purchaser does not expect to collect) over the remaining life of the debt security. We do not believe this outcome is appropriate absent an improvement in the cash flows that were expected at acquisition as the purchaser did not expect to collect those cash flows. To address this issue, the FASB should either include these securities in the acquisition accounting model or issue separate income recognition guidance for this fact pattern.

6. Purchases of Debt Securities Classified as Held-to-Maturity

The Committee considered the application of the seasoning criteria to securities classified as held-to-maturity by the investor. As a general matter, the Committee does not believe that an investor in either a beneficial interest or a corporate debt security should apply the seasoning criteria unless the investor is the underwriter of the issuance on a firmly committed basis. The Committee believes that the investor should always be considered a purchaser and not an originator. In reaching this conclusion, we considered the nature of the investor's involvement in the issuance. An investor does not negotiate the terms of the debt instrument with the issuer or the securitization trust. The terms of the debt instrument are the product of negotiation between the issuer and the underwriters and investors decide whether to purchase those debt securities. To treat the investor as an originator for purposes of applying the guidance in ASU 326 would be inconsistent with the investor's role in the issuance.

In making this recommendation, we also considered the need for implementation guidance related to beneficial interests that complicate the evaluation of seasoning. For example, should the seasoning of a beneficial interest be based on the issue date of the interest or the origination date of the pool of assets backing the beneficial interest? To the extent that seasoning is based on the underlying assets, there may be practical limitations on the information that is available to make that determination. Further, having to obtain this data to conclude whether the investor in the beneficial interest should be treated as the originator would add significant operational complexity.

7. Repurchases Under Representation and Warranty Provisions

We think that there may be an inherent flaw in the overall model that can result in a “double counting” of losses when the originator sells a mortgage loan and retains a contingent obligation to repurchase a loan when certain credit related criteria are met. Specifically, the Committee believes that the Board should clarify whether the repurchase of a loan by the originator under a representation and warranty provision and similar contingent obligations are within the scope of the Proposed Update.

As an example, if a lender originates a loan and then sells it to a buyer, the seller generally makes representation and warranty assertions in the sales agreement. If those assertions are not correct, the buyer can put those loans back to the seller at an amount that makes the buyer whole, e.g., the principal amount of the loan. As most loans that are put back to the seller are not performing in accordance with their original contractual terms, the repurchases of these loans are currently subject to the PCD model. If the loans are not within the scope of the Proposed Update, they would be treated as originated loans because the party that is acquiring the loan is the originator of the loan. We do not believe that this outcome is appropriate as it will result in the repurchaser double counting their expected credit losses.

Following is an illustration of this accounting.

	Amount
Unpaid principal balance	$100
Expected credit losses at the time of repurchase	$12
Fair value at time of repurchase	$88
Repurchase price	$100

After loans are sold, originators record a contingent liability for the expected credit losses that relate to representation and warranty violations. The following entry illustrates the establishment of this obligation in this example.

Entry A:		
Representation and warranty expense	$12	
Representation and warranty liability		$12

While the transferor continues to remeasure the liability for changes in expected credit losses, for purposes of this example, assume there is no change in expected credit losses from the sale date to the repurchase date.

If the loan is treated as an originated loan on the repurchase date and recorded at fair value ($88), the following entries would be recorded.

Entry B1:		
Representation and warranty liability (release)	$12	
Loans	$100	
Discount		$12
Cash		$100
Provision for credit losses*	$12	
Allowance for credit losses		$12

*We are assuming that there were no changes in estimated credit losses from the initial sale of the loans through the date of the repurchase by the originator. We are also assuming that the impact of the discount on the measurement of the allowance is de minimis.

As a result of treating the loan as originated on the repurchase date, the credit expense related to the representation and warranty assertions is recognized twice (first in Entry A and then again in Entry B1). In addition, interest income is overstated.

If the acquisition is treated as a purchased financial asset and recorded at fair value, the following entries would be recorded.

Entry B2:		
Representation and warranty liability	$12	
Loans	$100	
Allowance for credit losses		$12
Cash		$100

We believe the B2 entries better reflect the substance of the transaction. Therefore, we recommend that the Board amend the final standard to specify that the repurchase of loans by the originator pursuant to a representation and warranty claim is within the scope of the Proposed Update.

8. Contract Assets Acquired in a Business Combination

   We agree with including guidance on contract assets acquired in a business combination in the final standard for purchased financial assets (even though contract assets are not financial assets). However, since contract assets are not measured at fair value in a business combination, we believe the allowance for credit losses measured under ASC 326 should not be added to the carrying amount of the contract asset. Rather we believe any needed adjustments to the acquiree's allowance for credit losses should be recorded as an adjustment of goodwill. This would be consistent with the objective of ASU No. 2021-08.

Income Statement Presentation:

We agree with most of the Board members that the gross income statement presentation that was proposed by the dissenting Board member would not be preferable. We agree that it is important to maintain credit loss expense as a single measurement of the change in credit quality for financial assets that are originated or acquired during the period reported. To add the amortization of the day one credit expense to that metric would make it more difficult to isolate the change in credit quality from period to period on loans originated and loans acquired. Thus, we do not support the dissenting member's recommendation.

Transition:

We do not agree with the mandatory modified retrospective transition guidance that is in the Proposed Update. We recommend that the Board adopt a prospective transition approach with the option for entities to adopt the guidance using a modified retrospective approach.

As a general matter, we believe that the cost of a modified retrospective approach will be high and would exceed the benefit of comparability in most circumstances. Specifically, a modified retrospective approach would require entities to restate the accounting for each loan that is impacted by this change in scope. The changes will impact the entire loan and held-to-maturity security life cycle as they will require changes to:1) the initial cost basis, 2) the amortization of basis adjustments into net interest income, 3) the allowance for expected credit losses, 4) the recognition of write-offs and recoveries and 5) the gain/loss recorded upon an event of foreclosure. This would be a significant level of effort for organizations that have a material change in the population that is subject to this guidance as existing systems do not support these types of changes. Thus, a unique work around (either manual or automated) would have to be constructed by entities to allow them to reprocess the financial results for their loan and security portfolios to ensure that the changes are made properly and in a controlled manner. In certain instances, legacy loan systems will have been retired after a business combination which further complicates the ability of entities to recreate the required information for a modified retrospective adoption.

There are also some practical limitations that need to be considered. Specifically, certain entities estimate prepayments when they amortize the cost basis in their mortgage loans and securities. To properly reflect the amortization in each prior period, an entity would have to restore the projection of expected prepayments that was applicable for each of the previous financial reporting periods presented to properly reflect the change in amortization for each period. This might require an entity to restore previous versions of their prepayment model to the extent that the model has been revised to incorporate updated data or changes in estimates. Such changes would require significant cost and effort.

Other Implementation Matters:

1. Allowance for Credit Losses:

   On the date of acquisition, the expected credit losses on the acquired pool of loans are required to be allocated to the loan level to determine the initial premium that needs to be recorded on each loan to reflect the gross up that is required under this accounting model. Although the FASB did not propose amendments to the existing guidance related to the day two estimation of the allowance and did not provide specific guidance for estimating credit losses on loans that meet the purchased financial asset accounting criteria, our discussions with others within the financial services industry has indicated that many were interpreting the Proposed Update to require a loan level approach for the day two measurement of the allowance for credit losses for those financial assets that were within the scope of this Proposed Update. If that is the Board's intent, it would significantly increase the operational complexity and cost of implementing the proposed model. We believe that the measurement of the allowance for day-two accounting should be estimated in a manner that is consistent with other acquired or originated loans that have similar risk characteristics. Consistent with CECL, this would allow each entity to determine if a loan level or pool level estimate is appropriate, given the facts and circumstances associated with each loan. We request the Board to clarify in the final standard that this remains an acceptable approach.

2. Forward Contracts that are Not Accounted for as Derivatives

   We believe that Board should clarify the application of the purchased financial assets model to forward contracts to avoid diversity in practice.

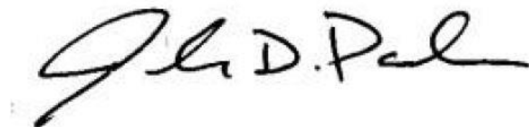
   ASC 326-20-30-11 indicates that an entity should record a liability and credit loss expense for credit losses on off-balance sheet credit exposures that are within the scope of ASC 326-20 and that are not unconditionally cancellable by the issuer. We are concerned that this guidance may be interpreted to require the recognition of day one losses when seasoned financial assets are acquired through an irrevocable forward contract that does not qualify for derivative accounting. However, if these seasoned financial assets were acquired without a forward contract, the financial assets would be recorded under the gross-up approach such that no day one losses would be recognized. We believe that the acquisition of financial assets that are seasoned at the inception of the forward contract should be under the same accounting model as acquisitions of seasoned financial assets that do not involve a forward contract. Therefore, the final standard should clarify that financial assets that are seasoned at the time the forward contract is executed should be recognized as a purchased financial asset when the parties perform under the forward contract.

   The Board should also clarify for these forward contracts whether the gross-up amount should be measured based on the expected credit losses of the underlying assets at the inception of the forward contract or at the termination of the forward contract when the entity acquires the financial assets. If expected credit losses are measured at the inception of the forward contract,

a liability for the off-balance sheet credit exposure should only be recognized in income to the extent that there are adverse changes in the amounts expected to be collected on the underlying financial assets from the inception of the forward contract. When the financial assets are acquired at the termination of the forward contract, the expected credit losses on the acquired loans at the acquisition date less the liability recognized for adverse changes in expected credit losses from the inception of the forward contract should be added to the purchase price to determine the initial amortized cost basis of the purchased financial assets. Alternatively, if the gross-up amount is measured based on expected credit losses at the termination of the forward contract when the underlying assets are acquired, no liability should be recognized throughout the forward contract and any changes in credit losses that occur during the commitment period should be included in the gross-up amount. We believe that diversity in practice exists today related to the accounting for forward contracts to acquire PCD assets and that this diversity will only increase upon the expansion of the gross-up approach.

We would be pleased to discuss our comments with the FASB or its staff at your convenience.

Sincerely,



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