FASB

FASB | IASB Education Meeting

September 29, 2023

Current Expected Credit Losses (CECL)

Purchased Financial Assets

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Purchased Financial Assets: PIR Feedback

- After the issuance of Accounting Standards Update 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, the Board received feedback that:
  - The accounting for acquired financial assets is complex
  - The understandability and decision-usefulness of the information is questionable
- Throughout its PIR process the Board received mixed feedback about the treatment of expected credit losses for purchased credit deteriorated (PCD) and non-PCD financial assets:
  - Non-PCD assets are initially recognized with a “double count” of credit losses
  - Interest income recognized on non-PCD assets blends credit amounts embedded in the purchase price
- Investors also raised concern about inconsistent application of the criteria to determine whether acquired financial assets are classified as PCD

Background – Non-PCD and PCD Model Overview

		Non-PCD Model	PCD Model
Credit deterioration since origination		Less than insignificant (≈ originated)	More-than-insignificant
Expected credit losses—at acquisition		Day-1 credit loss expense (income statement)	Adjustment to purchase price (“gross-up” on balance sheet)
Expected credit losses—subsequent changes		Credit loss expense	Credit loss expense
Financial Reporting impact—Dr. (Cr.)			
Acquisition date (Purchase accounting)	Asset (par)	1,000,000	1,000,000
	Fair value mark (credit + rate discount)	(150,000)	(150,000)
	Purchase price	**850,000**	**850,000**
	Allowance for credit losses (gross-up)	—	95,000
	Initial amortized cost basis	**850,000**	**945,000**
Day-1 (Outside purchase accounting)	Provision for credit losses	95,000	—
	Allowance for credit losses	(95,000)	(95,000)
	Balance sheet amount, net	**755,000**	**850,000**

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Purchased Financial Assets

Is the acquired asset within the scope of Topic 326?

- Includes assets acquired in business combinations and asset acquisitions
- Includes lessor’s net investment in sales-type and direct financing leases and contract assets
- Includes credits cards, HELOCs, and other revolving arrangements

Yes

Is the acquired asset *seasoned*?

- Assets **acquired in a business combination presumed seasoned**
- Assets **acquired within 90 days of origination presumed <u>not</u> seasoned**
- Assets **acquired after 90 days of origination**—seasoning **depends on acquirer’s involvement** with the asset prior to acquisition

Yes

PFA Accounting

Acquired financial assets <u>not</u> seasoned are “In substance originated”

- Proposed ASU issued on June 27, 2023 with a 60-day comment period
- Purchased with Credit Deterioration (PCD) amended to *Purchased Financial Assets (PFA)*

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Preliminary Comment Letter Feedback

- Most respondents generally support the proposal because it simplifies and streamlines the accounting for all purchased financial assets
- Those respondents who did not support the proposal expressed concern that it would drive greater inconsistency in the accounting for purchased financial assets compared to originated financial assets
- Some respondents asked the Board to consider whether PFA-specific recognition and measurement guidance related to triggering nonaccrual status, recognizing recoveries, and using the unpaid principal balance to determine the allowance should be amended
- Respondents provided mixed feedback on whether AFS debt securities and assets not accounted for at fair value in a business combination (i.e., contract assets and sales-type and direct financing lease receivables) should be accounted for using the PCD gross-up approach
- Most respondents asked the Board to address operational complexity associated with applying the PCD gross-up approach to credit cards by either:
  - Scoping out credit cards and other similar arrangements with active revolving privileges
  - Allowing the application of practical expedients that would permit PFA accounting on a portfolio basis
- Most respondents asked the Board to clarify the seasoning criteria, and some asked to allow application of the criteria at the individual asset level rather than at the portfolio level
- Few stakeholders supported retrospective application back to the date of CECL adoption; instead, most supported prospective application from the date of adoption