September 7, 2023

Submitted electronically to: director@fasb.org

Ms. Hillary Salo
Technical Director, FASB
801 Main Avenue
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2023-ED400, Financial Instruments – Credit Losses (Topic 326) – Purchased Financial Assets

Dear Ms. Salo,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Financial Accounting Standards Board's (the "Board") proposed Accounting Standard Update "*Financial Instruments – Credit Losses (Topic 326) – Purchased Financial Assets*" ("proposed Update").

I. EXECUTIVE SUMMARY

The origination and the acquisition of financial assets for investment and for resale is central to a global financial institution's business model. Our members recognize that the measurement of financial assets at amortized cost creates a complex financial reporting conundrum due to the interplay of the timing of recognition of interest income and expected credit losses. SIFMA also appreciates the Board's continued effort to achieve the right balance of comparable, relevant and decision-useful information for financial statement users. We, however, do not believe the proposed Update resolves this conundrum or represents an improvement to financial reporting over the existing requirements in the current expected credit loss (CECL) model. It may appear that the proposed Update resolves or reduces existing complexity for certain purchased financial assets acquired at fair value with significant non-credit discounts. However, it significantly reduces comparability between purchased and originated financial assets and the related timing and amount of recognized interest income and expected credit losses. SIFMA,

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

therefore, does not support the proposed Update as currently drafted for the reasons elaborated in this comment letter.

SIFMA's members adopted CECL, after significant implementation efforts and great cost in January 2020, the earliest effective date. This new expected credit loss model was immediately put to the test in a stress environment as a global pandemic hit, followed shortly after adoption by major geopolitical events. Supported by the feedback received through the post-implementation review process (PIR process), we believe CECL performed as intended, despite its known shortcomings, and investors were able to use the disclosed information to navigate in uncertain times. Further, SIFMA believes investors have come to understand the consequences of the CECL model, including the requirement to recognize lifetime expected credit losses in earnings as a portfolio grows. Nevertheless, the acquisition of a large portfolio of performing financial assets at fair value shines a spotlight on the initial recognition requirement (the "double count") that is not as evident in a static loan portfolio or a loan portfolio that grows organically through origination and over a longer time-period.

1) **<u>The proposed Update requires further examination and alignment with CECL:</u>**

   SIFMA believes that the proposed Update expansion of the gross-up approach, where initial lifetime expected credit losses determined at a portfolio level is recognized on the balance sheet rather than through earnings, to all purchased financial assets including to financial assets acquired at the same or substantially the same fair value as recognized by the originator (e.g., little to no credit discount embedded in the purchase price) lacks sufficient conceptual support within the broader foundation of the CECL model. Therefore, SIFMA believes the proposed Update reopens the long-standing debate on where to draw the line between initial measurement of financial assets held at amortized cost, the timing of recognition for estimated expected credit losses in a portfolio in relation to the timing and recognition of interest income and whether such expected credit losses should be presented as a component of interest income. These concepts were summarized in the basis for conclusions in ASU 2016-13, paragraphs BC 35 – BC 49 and paragraphs BC 84 – BC 93 and broadly settled with the issuance of CECL.

2) **<u>CECL is a single model for all financial assets measured at amortized cost:</u>**

   CECL requires **<u>all</u>** financial assets measured at amortized cost (<u>purchased</u> or <u>originated</u> and across all types of asset classes) to be initially and subsequently measured net of expected credit losses determined on a portfolio basis. The current accounting guidance for purchased assets with other than insignificant credit deterioration (PCD) is not a separate measurement basis or model for expected credit losses. Rather, it provides narrow scope guidance for the recognition of contractual cash flows not expected to be collected at a specific asset level for which the buyer is compensated through a discount to the purchase price. The proposed Update will needlessly create two separate initial and subsequent accounting models for the recognition and measurement of interest income and credit losses for economically equivalent risk positions (purchased vs originated).

3) **<u>Reconsideration of initial recognition through net income for all financial assets (aka the "Double Count"):</u>**

In lieu of the proposed Update, SIFMA strongly recommends that the Board develop a separate project to take a more deliberate and unifying approach and take the time we believe is necessary to redeliberate:

- Whether initial lifetime expected credit losses should be grossed-up on the balance sheet for all financial assets (originated and non-PCD).
- Where the gross-up should be classified (amortized cost basis or as a "negative allowance").
- The appropriate income statement classification (that is, as a component of interest income or as an offset to provision for credit losses).
- The timing for recognition of the reversal of the gross-up asset into the income statement (for example, straight-line, as the credit exposure is reduced or as estimated credit losses change or an alternative methodology).

If the Board disagrees and decides to move forward with the proposed Update, SIFMA has the following overall comments. A more detailed response to each of the Board's specific questions is provided in Section II of this letter.

- SIFMA strongly recommends that the Board move forward with a prospective transition approach for assets acquired after the date of adoption. The proposed modified retrospective transition approach for all assets acquired as of and since the adoption of CECL is not practical for global financial institutions and potentially not operational since it requires reconstructing interest income and the allowance and provision for credit losses for each period since CECL's initial adoption. We also do not believe it will provide decision useful information for financial statement users today as the historical adjustment would need to be recalculated from "stale" model inputs known to be inaccurate today.
- If the Board disagrees with SIFMA's recommendation of a prospective transition approach for acquired financial assets after the date of adoption, we request that the Board provide a fair value option election for any purchased financial assets affected by the adoption of the proposed Update with the effect of the election recognized in current earnings on the date of adoption. SIFMA also requests a one-time election upon transition to transfer HTM securities to AFS as we expect that substantially all HTM securities will be subject to the gross-up approach in the proposed Update. This one-time election would align with the election available at the adoption of CECL and provide a path to a more simplified transition for certain classes of purchased financial assets or certain single or portfolio assets that no longer exist on the date of adoption.
- SIFMA believes it is necessary to amend the presentation of the effects of the gross-up on the effective yield calculation for **non-PCD** assets. The expanded scope delinks the conceptual basis for adding the gross-up to the amortized cost basis to individual assets without "prepaid" credit losses observed through fair value in the

purchase price discount.[2] We believe an alternative balance sheet and income statement classification should be further deliberated for **non-PCD** assets. One alternative could be to recognize the gross-up for **non-PCD** assets as a negative allowance rather than adding it to the amortized cost basis and amortizing the gross-up asset against the provision rather than interest income, using a reasonable methodology.

- SIFMA proposes in our detailed comments below certain scope exclusions, specifically acquisitions of short-lived assets and revolving lines of credit to make the proposed Update more operable. If the Board disagrees with these scope exclusions, we propose certain practical expedients to reduce the operational complexity.
- SIFMA believes additional standard setting is required to apply the proposed Update to common financial assets, including revolving arrangements and HTM securities.

II. SIFMA RESPONSE TO QUESTIONS RAISED IN THE PROPOSED ASU

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.

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.

Combined Response for Questions 1 and 3:

SIFMA's members do not support the issuance of the proposed Update as currently drafted. However, if the Board decides to move forward with the proposed Update, we provide the following feedback:

[2] ASU 2016-13 BC88 - "... The Board struggled with applying a gross-up method for financial assets purchased at or near par when there generally has not been a more-than-insignificant increase in credit risk because those assets should apply the same model as originated financial assets. The Board felt it had to draw a line and placed weight on user feedback stating that increased comparability is achieved by grossing up the allowance when there has been a more-than-insignificant increase in credit risk."

Available-for-Sale (AFS) Securities:

Our members agree with the Board's decision to limit the gross-up approach to assets measured at amortized cost and to exclude AFS debt securities which are measured on the balance sheet at fair value. However, SIFMA recommends that the Board clarify that the day one effective yield for purchased AFS securities should not include cash flows that are not expected to be collected when determined at the individual security level. Our members follow the bank regulatory guidance for nonaccrual assets which includes this concept. However, we believe it would be helpful to clarify this point more generally to ensure that an impaired purchased security will not accrete cash flows not expected to be collected into interest income.

Scope Exclusions:

Insignificant or Zero Expected Credit losses

SIFMA recommends 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 would not be substantially different from recognition over its contractual or expected life. This concept should be expressed as a principle rather than a bright-line rule and include a requirement to disclose the accounting policy. For example, a preparer should be able to make an accounting policy election to exclude non-PCD assets that have very short or no contractual lives such as trade receivables and non-PCD assets for which expected credit losses are insignificant such as assets that qualify for the collateral maintenance practical expedient, for example, broker-dealer margin loans. Additionally, purchased financial assets where there is zero loss expectation should also be clearly stated as out of scope, such that they do not need to be reevaluated even if acquired more than 90 days after origination. We also recommend giving consideration to the application of charge-off policies by regulated banking entities and aligning with the practical expedients provided for in CECL for interest accruals. We believe the cost of implementing the proposed Update for such assets will far exceed any perceived benefit for financial statement users.

Revolving Lines of Credit

Our members also ask for a scope exclusion for any purchased revolving lines of credit. This would include corporate lines of credit, consumer and business credit cards, and home equity lines of credit. For these financial assets, the single unit of account includes by its nature, credit exposure that was originated by the seller (pre-acquisition receivable balance) and credit exposure that will be originated by the purchaser (post-acquisition drawdowns/funding). There are numerous application issues that will need to be worked through such as first identifying asset pools that are seasoned which will require a review of each acquired account. Then, each acquired "seasoned" credit card account will effectively need to be split in two, that is, between balances that are "purchased" (funded balance at acquisition) and "originated" (subsequent draws on the same account). New systems will need to be built to create a process for maintaining separate records solely for accounting purposes for each of these components of an individual account.

- The "gross-up" amount will need to be allocated to the component of a credit card account that is designated as seasoned and tracked separately.
- Subsequent draws (new origination) and paydowns/cash received will need an entirely new operational process for allocating between each component of a single account.

SIFMA does not believe solving for these operational issues at significant cost to preparers for lines of credit that are performing and revolving and generally acquired at a fair value that is equal to its originated value will provide more decision-useful information for financial statement users.

If the Board, however, disagrees and moves forward with the requirement to include revolving lines of credit in the scope of the proposed Update, SIFMA asks that the Board consider a practical expedient of separating the gross-up asset from the amortized cost basis of the individual acquired assets (eliminate the requirements under ASC 326-20-30-13 for revolving lines of credit) with a simplified method of amortizing the gross-up asset into interest income on a straight-line basis over a period of time that aligns with the guidance provided in ASC 310-20 on interest income recognition for lines of credit. Alternatively, the gross-up asset can be amortized into provision using a reasonable methodology. One alternative would be on a straight-line basis that aligns with the initial expected life used for calculating expected credit losses.

Held-to-Maturity (HTM) Securities:

SIFMA recommends broadly excluding non-PCD purchased securities that are classified as HTM and, therefore, held at amortized cost. Whereas loans are more frequently originated and held for investment at amortized cost by the originating entity, HTM securities are largely purchased by investors in the secondary market, and generally expected to meet the "seasoning" tests. We believe including HTM securities in the scope of the proposed Update will result in a reversion to pre-CECL financial reporting with separate credit loss models for securities versus loans. We would also like to highlight that the proposed Update does not address any of the practical issues that arise from a reclassification of a security from AFS to HTM. Under the existing guidance, a security is transferred at its amortized cost basis (which is reduced by any previous write-offs but excludes any allowance for credit losses) plus or minus the amount of any remaining unrealized holding gain or loss reported in accumulated other comprehensive income. It is unclear to us whether, after adoption of the proposed Update, an entity would be required to gross-up for the transferred security using calculated expected credit losses determined as of the transfer date or the purchase date. Further, under the current rules, when an AFS security is transferred to HTM at fair value, the amount in OCI is frozen and amortized into interest income. This amortization is offset by the accretion of the discount associated with the transfer, resulting in maintaining the original yield at acquisition. The proposed Update will create a new yield for a reclassified security as a result of the expected credit losses added to the amortized cost basis upon transition. Additionally, given the definition of amortized cost for an HTM security will be changed under the proposed Update, the Board would need to clarify how to perform the calculation of unrealized gains/losses for disclosure purposes.

Overall Operational considerations of this proposal:

In addition to the operational concerns of applying the proposed Update to the specific asset classes described above, SIFMA has significant overall concerns about the operational cost of implementing the proposed Update for all assets currently in scope of the CECL estimation processes. Our members developed numerous models to handle the CECL estimation process for each class of financial assets which were built appropriately for originated and non-PCD assets. Assets currently subjected to PCD accounting have generally been a very small subset of the overall lending book (both originated and purchased). As a result, rather than developing a systematic solution, many banks resorted to using manual spreadsheets to perform the calculations necessary for the operationally intensive requirements of the PCD model allocate the gross-up to the amortized cost basis of individual assets and the related effects of the subsequent amortization or otherwise avoided such operational complexity by electing the fair value option. If the PCD model is expanded to cover all purchased financial assets, these manual workarounds will no longer be acceptable. Numerous models will need to be redeveloped to address the expansion in scope. Redeveloped models must be tested and validated, which is a time-consuming and costly process.

The Board reflected on the past consideration of a similar proposal in paragraph BC6 of the proposed Update, noting *"...the Board considered extending the gross-up approach to all purchased financial assets. However, it determined that the benefits would not justify the incremental costs of attempting to accurately and reliably isolate and measure the credit component of the purchase price, specifically for financial assets recently originated or that have not experienced more-than-insignificant deterioration in credit quality since origination."* SIFMA does not believe anything has changed since the adoption of CECL in this cost/benefit analysis. Further, now that models have been developed and CECL fully implemented, that cost would likely be even higher than it would have been initially, given the need to redo processes, practices, and models to incorporate the gross up approach.

Examples of specific implementation considerations:

Unpaid Principal Balance vs. Amortized Cost:

The proposed Update requires a company to maintain two separate allowance models in perpetuity for acquired versus originated assets. Under the gross-up model required by the proposed Update, a portfolio-based allowance calculation is determined based upon the unpaid principal balance (UPB) of an asset. In contrast, the amortized cost basis is used to estimate allowance for originated financial assets. The proposed Update thus expands a fundamental inconsistency between originated and acquired assets. For many of our members, the expansion in scope under the proposed Update to all purchased financial assets will require significant adjustment to existing credit models and/or operational processes. Some of our members have based their CECL models on historical amortized cost information and would require re-work, testing, and validation to consume UPB and estimate expected credit losses for acquired financial assets in the scope of the proposed Update. Model validation took years as part of CECL implementation and would need to be repeated for the proposed Update at significant cost.

Negative Allowance limitations:

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. Negative allowance (on PCD loans today and on all acquired assets under the proposed Update) must be limited so that the recognition of the negative allowance does not result in acceleration of the loan-level, non-credit discount into earnings. Because recoveries are often tracked at a pool level for consumer loans (as evidenced by the recent deliberations related to charge-off vintage disclosures, which excluded recoveries because they could not be identified at the loan level), this aspect of the PCD model and the proposed Update must be addressed as generally it is not operationalized today. The significance of the negative allowance issue is expanded substantially under the proposed Update due to its broader scope.

Non-accrual considerations:

Assets considered PCD under CECL are subject to unique guidance for determining interest income recognition and nonaccrual determination. Namely, interest income on PCD assets is recognized to the extent the cash flows are "reasonably expected." In contrast, non-PCD assets are reported as nonaccrual with no interest income recognition when an entity does not expect to collect anything less than "all contractual cash flows." It's not clear how the "reasonably expected" threshold that will be broadly applicable to all purchased financial assets under the proposed Update will interact with required regulatory nonaccrual triggers.

Freestanding non-derivative credit enhancements

SIFMA believes it would be helpful for the Board to address the interaction of the accounting and timing of recognition of the benefit for purchased guarantees (i.e., freestanding, non-derivative credit enhancements) for purchased financial assets that recognize expected credit losses using the gross-up approach under either the PCD or non-PCD model. Some of the most material instances of purchased credit protection occur in business combinations or asset acquisitions.

In summary, SIFMA believes the implementation of the proposed Update will be as substantial as the adoption of CECL from an operational perspective.

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.

Response:

SIFMA does not support the Board's decision to expand the use of the gross-up approach to all purchased financial assets. In our view, this decision will decrease comparability and make the financial statements less decision useful.

The proposed Update will take a step backward in the improvements to financial reporting achieved at the adoption of CECL. The CECL model aligned the timing of credit loss recognition across all financial assets measured at amortized cost, whether originated or purchased. The broad scope of the proposed Update will create a separate model for measurement and recognition of expected credit losses for all purchased or acquired financial assets, a very significant subset of the population of assets currently in scope of the CECL model. This will cause financial statements to be less comparable in the timing of recognition for expected credit losses for purchased performing assets vs. an originated portfolio within the same class of financial assets, originated under the same economic conditions.

More notably, the proposed Update could potentially create a significant competitive advantage for investors that have a broader strategy of purchasing financial assets to be held at amortized cost over entities whose strategy is the origination of the economically equivalent financial assets solely due to the difference in timing for recognition of expected credit loss and its classification in the income statement.

SIFMA also would like to highlight that the value used for the calculation for expected credit losses is different under the PCD model. Because of the circular reference to the amortized cost basis, the PCD model requires the use of the unpaid principal balance as its base for measuring expected credit losses while currently expected credit losses for non-PCD and originated assets are calculated using the amortized cost basis. This distinction is conceptually sound in the divide between PCD and non-PCD assets but creates an unsupportable and illogical distinction between originated and non-PCD assets.

Additionally, under the current rules, the timing for recognition of a reporting entity's exposure to expected credit losses on off-balance sheet obligations is aligned for commitments to originate or purchase financial assets to be held at amortized cost. However, SIFMA believes the proposed Update applies only to recognized purchased financial assets creating a further divide in financial reporting between economically similar off-balance sheet credit exposures.

SIFMA would like to provide our perspective on the issues raised in the post implementation review process that the proposed Update is intended to address.

- ***PIR Issue #1: Non-PCD Accounting results in a double count of credit risk:***
  The broad scope of the proposed Update dilutes and confuses the conceptual basis on which the CECL model rests. SIFMA believes it was well understood throughout the CECL deliberation process that neither a newly originated asset nor an asset purchased at fair value that does not have other than insignificant deterioration in credit risk since origination will reflect an additional day one discount for expected credit losses determined at the portfolio level in its amortized cost basis or its fair value purchase price. An investor (originator or purchaser) is compensated for expected credit losses through contractual coupons and/or an original issue discount to its face ("par value"). Repricing to current rates (which is a combination of credit spreads and margin) is reflected in the purchase price premium or discount and recognized into interest income on an effective yield basis. For such purchased financial assets, there is no "double count" for expected losses when initially recognized at fair value through a purchase via an asset acquisition or business acquisition. Rather, just like originated financial assets under CECL, the timing for recognition of expected credit losses over the life of the asset is accelerated to initial recognition such that the purchased financial assets are initially measured at an amortized cost basis net of expected credit losses.

- ***PIR Issue #2: PCD and non-PCD are two different models, the purchase discount and day one fair value in non-PCD assets includes a discount for credit that affects interest income:***
  The existing guidance for purchased financial assets with other than insignificant credit deterioration (the "PCD" model) is not a "different" model from CECL. Rather it corrects for the day one discount embedded in the fair value of a purchased financial asset with other than insignificant credit deterioration determined at a loan level and aligns the measurement and timing of expected credit loss recognition going forward. The gross-up adjustment effectively removes the "prepaid" expected credit losses that were determined to be included in the fair value at initial recognition at an individual financial asset level. This adjustment ensures that there is no "double count" for expected credit loss recognition through the provision while simultaneously adjusting the effective yield to market so that

interest income for the purchased assets is comparable to that of financial assets originated at the time of the asset purchase.

In summary, SIFMA believes the narrow scope for application of the existing PCD accounting model is appropriate and provides effective implementation guidance which ensures that the recognition of interest income excludes contractual cash flows that are not expected to be collected at an individual asset level.

Alternative Proposal to address PIR feedback for purchased financial assets:

As an alternative approach to the proposed Update, SIFMA recommends that the Board clarify the unifying principle of the PCD model within the overall conceptual basis of CECL, provide additional guidance around the application of the PCD model to various fact patterns and provide a resolution to the conflicting implementation guidance. We believe this approach will be responsive to the feedback from investors that the divide between PCD and non-PCD was not being applied consistently and the criticism that there is a "double count" for purchased or acquired assets initially recognized at fair value that does not exist for originated assets.

SIFMA has the following specific recommendations for improvements to the existing PCD model to make it more understandable and operational:

1) More clearly articulate the PCD model narrow objective to correct for expected credit losses identified at the financial asset level that were "prepaid" (i.e., the investor is compensated) via a discount to the purchase price.

- The amortized cost basis used for interest income recognition is determined at the unit of account level; allocating credit losses determined on a collective basis to individual non-PCD assets is not appropriate.
- It would also be helpful to clarify that PCD assets generally exhibit risk characteristics that differ from non-PCD assets and therefore expected credit losses should be calculated separately.

2) In a business combination, assets acquired are reflected at fair value under ASC 805. This fair value is generally determined by the purchaser through a valuation process which allocates the purchase price across all assets acquired, many of which do not have readily observable fair values. Therefore, the judgments made as to whether acquired assets included a prepayment for expected credit losses determined at a loan level based on characteristics exhibited by individual loans or cohorts of loan in the initial fair value and the PCD/non-PCD classification should be consistent with the underlying valuation inputs/assumptions made by the acquirer. Market repricing for interest rates should be included in effective yield to align the interest income recognition for the purchased assets with assets that are originated during the same period. SIFMA believes these concepts should be clarified and disclosed as part of the significant judgments made for a significant acquisition.

3) The existing disclosures for PCD assets unintentionally implied that these purchased assets were expected to perform differently or more poorly than originated assets. Therefore, SIFMA recommends amending the existing disclosure requirements for acquired assets to require a disclosure that clarifies the intent and purpose for a day one gross-up adjustment. We also recommend adding an additional disclosure for non-PCD assets for the recognized non-credit discount if any, the initial effective yield for significant acquisitions and any significant inputs and factors to the day one fair value determination. We believe these disclosures are relevant only at the time of acquisition, should be applied only to significant acquisitions and should be provided in the context of describing accounting policies around interest income recognition rather than in connection with disclosures of expected credit losses.

4) SIFMA believes the guidance added to ASC 326-20-30-15 on considering a purchaser's involvement with the originated assets prior to acquisition is helpful if described as a concept rather than a rule and could be repurposed for implementation guidance as factors to consider when identifying non-PCD assets.

5) SIFMA believes it would be helpful if the Board provided additional implementation guidance to clarify that certain financial assets are presumed to be non-PCD if they are performing according to their contractual terms. For example, credit card accounts generally reprice to market on a regular basis and are generally unconditionally cancellable. Credit card accounts will generally trade at a premium related to the credit card relationship and the fair value of the related purchased funded receivables will not include a discount for expected credit losses unless there are accounts in the portfolio that are significantly past due/nonperforming.

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.

Response:

If the Board decides to move forward with the proposed Update as issued, SIFMA strongly supports amendments to the existing presentation in the balance sheet and the related classification in the income statement of the effect of the gross-up for non-PCD assets.

SIFMA believes that the gross-up approach is a solution that is conceptually consistent with CECL for assets purchased with credit deterioration determined at an individual financial asset level and operational given its narrow application. For such assets expected credit losses are determined to be "prepaid" and generally (but not always) reflected in a discount to the purchase price. ASC 310-20 requires discounts on performing financial assets to be accreted into interest income on an effective yield basis under a presumption that the discount relates to a market adjustment for the repricing of rates and or general credit risk rather than cash flows not expected to be collected. Accreting only "non-credit" discounts into interest income aligns the interest revenue recognition model for purchased and originated assets. The gross-up model solved the issue of recognizing expected credit losses estimated at initial recognition through the provision when such losses would not be realized because they were "paid for" in the purchase price.

However, for non-PCD assets where there is no significant "prepayment" for expected credit losses included in the fair value and observed through a discounted purchase price, a gross-up increasing the amortized cost basis will just create non-economic "noise." Under this approach, interest income will be artificially reduced to an effective yield that does not reflect its market yield and the provision will have artificial "gains" or reversals of losses never recognized as expectations of credit losses change over time. Further, there is no mechanism to subsequently adjust the premium or discount allocated to the amortized cost basis of a loan to allow for changes in the expected credit losses determined at the time of acquisition. For example, during the early days of the COVID pandemic, there were large builds in expected credit losses followed shortly by equally large decreases in expected credit losses. Pursuant to the proposed Update, acquisitions of financial assets in the early days would have exaggerated low yields that would persist over the life of the loan while the related change in expected credit loss estimate is entirely released into provision at a single point in time.

SIFMA also does not agree that the gross-up approach under the proposed Update has the effect of reducing interest income recognized on purchased financial assets to a "credit free rate" as argued by the dissenting Board member. Allocating a modeled number to a specific loan or security derived from the complex calculation of estimating expected credit losses under the CECL model determined on a portfolio level considering both quantitative and qualitative factors does not equate to specific credit risk of an individual asset. Rather, we believe the proposed Update will simply create a yield for the related assets that is disconnected from its economics.

If the Board decides to move forward with the proposed Update, SIFMA strongly recommends that the Board perform additional outreach on the most decision-useful classification of the "asset" created by this gross-up for non-PCD assets on the balance sheet and the related timing and classification into the income statement.

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.

Response:

No. SIFMA does not support a rules-based approach. We believe the PCD model should be limited to positions where there is an identifiable deterioration in expected credit losses that resulted in a discount to the purchase price or fair value of an acquired asset.

If the Board decides to move forward with the proposed Update, SIFMA recommends using a principle-based approach to describe the scope and remove the bright-line of a) a business combination as there is no inherent difference between financial assets acquired in a business combination with those acquired in an asset purchase, b) 90 days and c) the involvement in the origination process. SIFMA understands that these rules were intended to reduce complexity; however, in our view, this approach replaces the complexity of applying judgment with operational complexity and creates illogical outcomes.

- It is not clear how the rule should be applied in the circumstance where a company acquires financial assets through a business combination, for which the company was involved in the origination of the financial assets prior to the business combination.

- It is not clear whether there should be consideration for a significant passage of time since origination when applying the clause related to the involvement in the origination process, e.g., an asset originated by a reporting entity, sold and repurchased after a significant amount of time.

- It is not clear how to apply the clause on involvement in the origination process to transfers among entities under common control or otherwise affiliated.

- It is not clear how the 90-day rule should be applied to uncommitted or unconditionally cancellable revolving lines of credit given the origination process is on-going and the interest rates on these credit instruments generally reprice on a regular basis.

- It is not clear how to apply this rule to the purchase of financial assets that have terms that are less than 90 days, callable upon demand or facilities that extend automatically unless terminated by either party.

- It is not clear how to apply the seasoning test to purchased financial assets that were initially classified as held-for-sale and subsequently reclassified to held-for-investment.

- We believe there could be significant complexity and judgment involved in identifying a "Pool" for purposes of the "substantially all" test. For example, multiple lots of loans could be put up to bid at the same time by the same originator. The pools may be segmented by a methodology determined by the seller (geography, collateral, risk characteristics etc.) that may differ from how the acquirer would pool the same assets for internal risk management purposes. An acquirer could also be in the market buying similar assets from multiple sellers which would be committed on the same day or settled on the same day. It is unclear how a reporting company should identify the pool in these circumstances.

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.

Response:

No. SIFMA strongly objects to the transition guidance in the proposed Update for the following reasons.

Not Decision Useful:

- Changes to modeled estimates that require a forecast of future events are generally not conducive to a retrospective transition approach because the estimation process at a point in time in the past includes variables and inputs that are now currently known to be incorrect. This was acknowledged by the Board in the basis for conclusions, paragraph 115 of ASU 2016-13, stating "*retrospective transition methods require the use of data that is impracticable to apply in prior periods because the use of hindsight is necessary in making estimates of expected credit losses*." SIFMA does not agree that the estimate of expected credit losses determined at the time of acquisition of a portfolio or individual loan and recognized through the provision is the same that would be used for a gross-up approach which requires an allocation of the calculated expected loss to a loan level. We also highlighted elsewhere in this letter that the basis for the calculation will be different because the gross-up approach calculates expected credit losses off the unpaid principal balance.

- Transactional activities are one-time events that are analyzed by investors at the point of acquisition. SIFMA does not believe a retrospective application will improve comparability of the financial statements period over period because the proposed Update reduces comparability of balance sheet measurement for originated assets vs. purchased assets and the related timing of recognition of interest and expected credit losses. It will also create a significant divide in comparability of net interest income and net earnings between banks that mostly originate assets vs. banks that grow through acquisition.

- SIFMA is also concerned that the proposed transition approach will affect historically reported capital ratios for our members. The effect of the adoption of CECL was transitioned into capital over a three-year period.

Operational:

SIFMA members adopted CECL at the earliest effective date of January 2020 at a significant cost and effort. Our members generally do not track non-PCD loans or securities vs. those that are originated as the application of CECL is the same for on-going measurement. Therefore, finding all the financial assets in scope for this retrospective adjustment would be a significant challenge if not virtually impossible. Additionally, even if the scope was limited to significant acquisitions, it would require re-creating the effect of the gross-up through adjustments to financial asset balances, allowance, interest income and the provision, for each loan or security acquired (which could apply to many thousands of loans for global financial institutions across many individual loan acquisitions or portfolios). Tracing the history for each loan back in time is overly burdensome and we do not believe it will be supported by a cost benefit analysis. During this extended retrospective period, a loan could have matured, been sold, transferred to HFS, become "non-performing" and transferred to non-accrual, started accruing again, been restructured and determined to be a TDR and then remeasured in the adoption of ASU 2022-02. All these activities impact the restatement. We further note that the retrospective determination of the impact could be impossible for business combinations where acquiree systems have since been decommissioned in favor of the acquirer.

For these reasons, if the Board decides to move forward with the proposed Update, SIFMA strongly recommends a prospective transition approach for newly purchased or acquired assets.

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.

Response:

SIFMA believes the modified retrospective transition approach coupled with the broad scope of the proposed Update will be a significant and time-consuming operational burden to implement for all the reasons highlighted earlier in this letter. Therefore, the earliest our member firms would be able to implement the proposed amendments would be at least three years from the issuance of the final Update (aligning with the minimum amount of time needed to implement CECL). SIFMA asks that the Board conduct extensive outreach to better understand the required timeline for implementation, as three years may not be sufficient for certain preparers.

If the Board agrees with our Alternative Proposal to limit the amendments to a clarification of the conceptual basis for the existing PCD and non-PCD model and to provide additional implementation guidance with a prospective transition method through current earnings, SIFMA believes we can adopt the proposed Update within a year from the issuance date.

III CONCLUSION

Thank you for the opportunity to comment. Should you have any questions or require further information concerning any of the matters discussed in this letter, please do not hesitate to contact Dina Nussbaum, Chair of the FASB PFA Proposal Task Force, or the undersigned Timothy Bridges.

Regards,

Timothy Bridges
Chair, SIFMA Accounting Committee
Managing Director, Goldman Sachs & Co. LLC

CC: Dina Nussbaum
Chair, SIFMA FASB PFA Proposal Task Force
Goldman Sachs & Co. LLC

Kevin Zambrowicz
Deputy General Counsel (Institutional) & Managing Director, SIFMA