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August 28, 2023

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

RE: Proposed Accounting Standards Update, *Financial Instruments – Credit Losses (Topic 326) – Purchased Financial Assets* (File Reference No. 2023-ED400)

Dear Ms. Salo:

We appreciate the opportunity to comment on the proposed ASU, *Financial Instruments – Credit Losses (Topic 326) – Purchased Financial Assets* (the Proposed ASU).

We support the Board's objective to expand the use of the accounting model for purchased credit deteriorated assets (i.e., the gross-up approach) to all purchased financial assets. We believe the gross-up approach provides better financial reporting information than the current model for non-purchased credit deteriorated financial assets. Although there is an impact on comparability when two accounting models exist for economically similar transactions (i.e. purchased versus originated financial assets), we believe this drawback is outweighed by the benefit of removing the Day 1 credit loss expense that applies to non-credit deteriorated purchased financial assets under current GAAP.

Appendix A provides our responses to questions for respondents.

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If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Mark Northan at mnorthan@kpmg.com or Kimber Bascom at kbascom@kpmg.com.

Sincerely,

KPMG LLP

KPMG LLP

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Appendix A – Responses to Questions for Respondents

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 the Board's proposal to expand the population of acquired financial assets accounted for under the gross-up approach. However, we believe there are a few areas where the Board should consider changing the scope of the Proposed ASU. Our scope recommendations, as well as alternatives to changing the scope, are as follows.

<u>AFS debt securities</u>[1]

The Board should consider retaining the gross-up approach for impaired AFS debt securities. Alternatively, the Board should consider other approaches, described below, that would either:

- prevent the subsequent recognition of interest income related to amounts the entity does not expect to collect; or
- ensure that a credit loss and related allowance is recognized when the amortized cost of the debt security is increased to amounts greater than the entity expects to collect.

If impaired AFS debt securities are excluded from the gross-up approach, their initial amortized cost will be their purchase price. Current GAAP requires the difference between the amortized cost and amounts contractually due to be recognized in income using the interest method. Therefore, if an entity acquires an impaired AFS debt security at a discount, it will amortize the difference between the purchase price and the contractual amount due into interest income regardless of whether it expects to collect all amounts contractually due.

To prevent the recognition of interest income in the scenario described above, the Board should consider retaining the gross-up approach in current Topic 326 for AFS debt securities when those securities are credit impaired at acquisition. Alternatively, the Board could consider either 1) including these securities within the scope of Subtopic 325-40, which would result in interest income recognition based on the cash flows an entity expects to collect (as opposed to the contractual amounts due), or 2) requiring nonaccrual accounting, as described in paragraph 310-10-35-53C, when these securities are acquired.

If the Board chooses to exclude these securities from the gross-up approach and permit entities to accrete the purchase discount such that the amortized cost increases to an amount greater than an entity expects to collect, the Board should consider adding a specific triggering event to paragraph 326-30-55-1 to 55-4 that would require the entity to consider the need for an allowance for credit losses. The addition of a triggering event would be necessary in this scenario because

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[1] For purposes of this response, references to AFS debt securities exclude AFS debt securities in the scope of Subtopic 325-40.

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there is no specific triggering event in paragraphs 326-30-55-1 to 55-4 that would require the entity to consider the need for an allowance for credit losses as a result of the amortization of the purchase discount.

Forward contracts to purchase financial assets[2]

The Board should consider clarifying that Day 1 credit loss expense should not be recognized for fixed-price forward contracts to acquire financial assets that are seasoned at the date the forward contract is entered into. Given that the Proposed ASU provides that credit loss expense should not be recognized upon the acquisition of seasoned financial assets, we believe that credit loss expense should similarly not be recognized at the inception of a fixed-price forward contract to acquire seasoned financial assets.

To accomplish this objective, the Board could consider either of two alternative approaches.

The first alternative would include these contracts within the scope of the Proposed ASU. Under this approach, a liability for off-balance sheet credit exposure would be recognized by applying the gross-up approach at the inception of the forward contract through an adjustment to the initial carrying amount of the forward contract. Upon exercise of the forward contract, the carrying amount of the forward contract would be added to the purchase price to establish the initial amortized cost basis of the purchased financial assets. Similarly, the liability for off-balance sheet credit exposure would become the allowance for expected credit losses. The primary benefit of this approach is that it establishes a reserve for credit losses at the date that the entity first becomes exposed to the credit risk of the underlying assets.

A second alternative would clarify that no liability for off-balance sheet credit exposure would be recognized for these forward contracts. The rationale for this view is that, while the entity is exposed to credit *risk*, it is not exposed to potential credit loss *expense* over the forward contract period because, when the contract is exercised, the entity will recognize the underlying financial assets using the gross-up method. As a result, any credit deterioration during the forward contract period will increase the adjustment to the amortized cost basis of the acquired assets as opposed to leading to the recognition of financial statement loss or expense. Under this view, absent exposure to potential financial statement loss or expense, there is no need for a liability for off-balance sheet credit exposure related to these contracts.

Contract assets

The Board should consider excluding contract assets from the scope of acquired financial assets that apply the gross-up approach because the Proposed ASU would result in measurement of contract assets acquired in a business combination at amounts inconsistent with Topic 606. Instead, entities should continue to recognize contract assets acquired in a business combination under Topic 606 as if they had originated the acquired contracts, consistent with the objective of ASU 2021-08.[3] Given this approach for recognizing contract assets, a similar approach should be

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[2] For purposes of this response, references to forward contracts to purchase financial assets exclude contracts within the scope of Topic 815.

[3] Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

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applied for recognizing the allowance for credit losses. That is, the estimate for expected credit losses for contract assets acquired in a business combination should be initially measured under Topic 326 as if the acquirer had originated the contract asset. To accomplish this objective, the offsetting entry to the recognition of an allowance for credit losses associated with contract assets acquired in a business combination would be reflected as an adjustment to goodwill instead of the initial carrying amount of the contract asset(s).

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.

As discussed in our cover letter, there is an impact on comparability when two accounting models exist for economically similar transactions (i.e. purchased versus originated financial assets). We believe this drawback is outweighed by the benefit of removing the Day 1 credit loss expense that applies to non-credit deteriorated purchased financial assets under current GAAP. In addition, the Proposed ASU has the potential to reduce or eliminate diversity in practice with respect to the scope of purchased credit deteriorated financial assets.

We believe investors are best positioned to provide input on whether the proposed amendments would improve the decision usefulness of financial information, including whether additional disclosures would be useful.

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.

The Proposed ASU requires the gross-up approach to be applied at the individual asset level. In the case of revolving arrangements, such as credit cards, when the borrower continues to have revolving privileges, application of the gross-up approach would generally result in the receivables existing at the date of acquisition being recognized at a premium. To amortize this premium, entities would be required to account for receivables existing at the date of acquisition separate from amounts drawn subsequent to acquisition.

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The Board should consider whether the benefit of separately tracking these amounts outweighs the cost to preparers. It seems possible to provide substantially equivalent financial statement information without such a requirement. For example, the Board could provide a practical expedient under which entities recognize the adjustment to the amortized cost as a pool level adjustment versus an adjustment to the amortized cost of the individual assets in the pool. This pool level adjustment would be a unit of account separate from the individual assets in the pool (akin, in this respect, to the basis adjustment in an active portfolio layer method hedge under ASU 2022-01[4]). The pool level adjustment could be amortized to interest income on a systematic and rational basis over the weighted average expected life of the acquired receivables estimated by the entity as of the acquisition date.

Ultimately, we believe preparers are best positioned to comment on the potential operational challenges of developing the processes and related internal controls over financial reporting in applying the gross-up approach. If an entity has appropriately developed these processes and controls, we do not believe there would be incremental auditing challenges.

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.

We believe the Board should consider clarifying whether an entity using a method other than a discounted cash flow method (i.e. an undiscounted method) that initially estimates expected credit losses for purchased financial assets based on the unpaid principal balance, as required by the Proposed ASU, would be permitted to subsequently measure expected credit losses based on the amortized cost of the financial assets, consistent with the estimate of expected credit losses for originated assets.

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 generally agree with the proposed seasoning criteria. However, we believe that the seasoning criteria should be applied at the individual asset level, as opposed to a group level. This will ensure that purchased financial assets acquired in an asset acquisition are accounted for consistently as seasoned or not seasoned regardless of whether they are acquired individually or with a group of financial assets.

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[4] Derivatives and Hedging (Topic 815): Fair Value Hedging – Portfolio Layer Method

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If the Board decides that the seasoning criteria should be applied at a group level, we believe it should clarify the following items.

- Whether the 'group of financial assets' in paragraph 326-20-30-15(b)(1) refers to all financial assets in a given transaction or whether the financial assets acquired in a given transaction would (or could) be subdivided into smaller groups for purposes of applying the criteria.
- What measure should be used to determine whether substantially all of the financial assets in the group are seasoned. For example, the Board could consider clarifying that the assessment should be based on the:
  - number of loans acquired,
  - unpaid principal balance of the loans acquired, or
  - fair value of the loans acquired.

In addition, we recommend that the Board consider limiting the circumstances in which the acquirer is considered to have been involved with the origination of the financial assets to circumstances in which the acquirer had, through a contractual agreement, an economic exposure to the financial assets that began during the first 90 days after the assets were originated and extended through the date of acquisition. Limiting the circumstances in this manner eliminates the potential for noneconomic factors (such as the ability to influence the originator's underwriting standards) to influence the assessment and, because it is limited to the existence of contractual agreements, will make it easier for entities to design related processes and internal controls over financial reporting.

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 believe financial statement users are best positioned to provide input on the usefulness of information provided by different transition alternatives and preparers are best positioned to comment on the related implementation costs.

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 believe preparers are best positioned to comment on the time needed to implement the Proposed ASU. We are not aware of factors specific to entities other than public business entities that would warrant a different implementation period.

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