Purchased Financial Assets (PFA)

FASB | IASB Education Meeting

October 11, 2024

FINANCIAL ACCOUNTING STANDARDS BOARD GOVERNMENTAL ACCOUNTING STANDARDS BOARD FINANCIAL ACCOUNTING FOUNDATION

Background

Current Expected Credit Losses (CECL)

- Requires an entity to measure an allowance for credit losses (ACL) for amounts not expected to be collected over the contractual life of a financial asset
  - CECL eliminates legacy guidance requiring recognition of credit losses when “incurred” and “probable”
  - The ACL estimate must be developed by considering information about past events, current conditions and reasonable and supportable forecasts
  - ACL is recognized as a valuation allowance against amortized cost basis; the net carrying amount at any reporting period equals the amount expected to be collected
  - No single methodology is required; CECL is intended to be flexible and scalable
- The scope of CECL is the same for origination and acquisition transactions
  - The ACL is recognized differently if the asset is *purchased with credit deterioration,* or “PCD”
  - PCD assets are those financial assets having experienced a “more-than-insignificant deterioration of credit quality since origination”– based on an assessment by the acquirer

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Purchased Financial Assets with Credit Deterioration (PCD)

- Assets acquired in a business combination or an asset acquisition are recognized at fair value and an ACL must be estimated for any financial assets subject to CECL
  - Recognition of the ACL at acquisition different for PCD vs. Non-PCD

	Purchased with Credit Deterioration	Purchased without Credit Deterioration
Initial ACL	Established through an offsetting debit entry to “gross-up” the initial purchase price, no income statement recognition, no effect on the purchase price allocation (goodwill)	Established through a charge to credit loss expense in the income statement for the period during which the acquisition was recognized
Amortized Cost Basis	Equal to the sum of the purchase price and the initial ACL	Equal to the purchase price
Interest Income	Recognized using the effective interest rate (EIR) determined by excluding the initial ACL from the purchase price	Recognized using the effective interest rate (EIR) determined from the purchase price

- The Board anticipated PCD would be an improvement to the purchased credit impaired (PCI) accounting required by U.S. GAAP prior to CECL (under SOP 03-3)
  - Most assets expected to qualify for PCD as “more-than-insignificant deterioration of credit” was intended to be a *lower* threshold than “credit impaired”
  - The EIR under PCD is fixed at origination; a simplification from the yield under the PCI model, which could be remeasured

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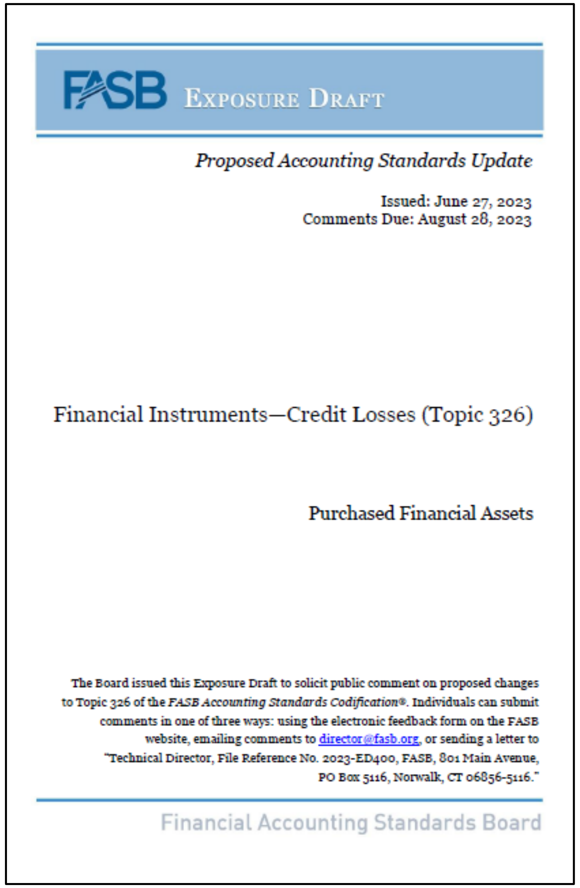
Technical Agenda Project: Purchased Financial Assets (PFA)

Purchased Financial Assets (PFA)


FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: June 27, 2023
Comments Due: August 28, 2023

Financial Instruments—Credit Losses (Topic 326)

Purchased Financial Assets

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 326 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2023-ED400, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Feedback

- In feedback that has been provided to the Board through CECL PIR and since the issuance of the standard, investors and preparers expressed their concerns related to comparability and complexity associated with:

1) PCD vs. Non-PCD
2) Non-PCD "double count"
3) "More-than-insignificant deterioration of credit"
4) Non-PCD interest income

Proposed Update—Purchased Financial Assets

Background

- Project added to the Board's technical agenda in July 2021 in consideration of PIR feedback
- Objective: improve the purchase accounting for financial assets primarily by requiring application of a single accounting model
- Exposure Draft issued on June 27, 2023

Proposed Update Feedback

- General support for the Board's intent
- Widely distributed mixed views on the application of proposed amendments to specific fact patterns
- Operability issues related to certain asset types
- Stakeholders did not support the proposed transition approach

Proposed Amendments

- Eliminate the credit deterioration assessment at acquisition
- Apply the PCD gross-up approach to all financial assets that:
  - Are acquired in a business combination
  - Qualify as "seasoned"
- Establish seasoning criteria
  - Qualitative and quantitative
  - Assessed by acquirer at acquisition

Next Steps

- The Board begin redeliberations at its February 28, 2024, meeting
- The Board was asked to affirm or modify the direction of the project (e.g., the project's scope and objective) after consideration of feedback submitted on the proposed Update
- The Board affirmed the direction of the project to expand the scope of assets that apply gross-up approach and harmonize the acquisition accounting models for financial assets
  - As a result, the Board will consider certain application issues identified by comment letter feedback
  - The Board will consider whether to modify the proposed scope of the gross-up approach for certain asset classes the present unique operational complexity
  - The Board will consider whether to modify recognition and measurement principles of the gross-up approach for specific fact patterns or transactions