

Acquisition Accounting under CECL

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Speakers



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Today's Discussion Points

- » Overall changes to acquisition accounting due to CECL
- » What is PCD?
- » Transitioning from pre- to post-CECL
- » Potential impact beyond the debits and credits
- » Q&A

Overall Changes to Acquisition Accounting

- » Moving from Purchase Credit Impaired (PCI) to Purchase Credit Deteriorated (PCD) model
- » Impact to non-PCD acquisitions could impact the economics of a deal
 - No longer able to utilize a purchase discount to offset some of the allowance; full allowance must be included in final amortized cost
- » Best shown in a simplified example:
 - Bank acquires a single, non-PCD loan for \$70 (par value = \$100 and purchase discount = \$30)
 - CECL allowance on Day 1 is \$7 = $(70 \times .1)$ (Am Cost * Loss Rate)

Current Accounting		Accounting under CECL	
Loan	\$ 100	Loan	\$ 100
Cash	70	Provision Exp	7
Discount	30	Cash	70
→ Carrying Value = \$70		Discount	30
→ Am Cost = \$70		Allowance	7
		→ Carrying Value = \$63	
		→ Am Cost = \$70	

Acquired non-PCDs

No Changes are Expected from FASB

Under CECL model

- » Double counting of expected credit losses exists (FV and Day 1 Allowance through income)
- » Yield includes amortization of both credit and non-credit discount

What is PCD?

» PCD → Purchase Credit Deteriorated (PCD) assets

- » At acquisition experienced a more-than-insignificant deterioration in credit quality since origination
- » Replaces the former Purchase Credit Impaired (PCI) accounting which required evidence of deterioration

» Applies to all assets within the CECL scope as well as AFS debt securities

» Accounting for PCD assets:

- Allowance is determined in a similar manner as an originated or purchased performing asset
- No provision on Day 1. Instead, AM Cost = FV (price) + Allowance
- When non-DCF method is used, estimate loss on the basis of UPB

Day 1	Example	Day 2
Dr Asset 100 Cr Discount 20 Cr Allowance 10 Cr Cash 70 Am Cost: \$80 Carrying Value: \$70	Par Amount: \$100 Purchase Price: \$70 Loss Rate: .1 ECL: \$10 (100 * .1)	Apply relevant credit loss models dependent on the asset classification Accrete the non-credit discount to income using the Effective Interest Rate (EIR)

PCD vs PCI

What is scoped in

PCD

- » Can qualify individually or in groups (but non-credit discount/premium has to be allocated individually)
- » Indicators:
 - See PCI indicators **plus**
 - Relative indicators at acquisition date:
 - › Change in risk rating
 - › Change in FICO score

PCI

- » Has to qualify individually
- » Indicators:
 - Impaired
 - Non-accrual
 - Past Due
 - Bankruptcy/Foreclosure

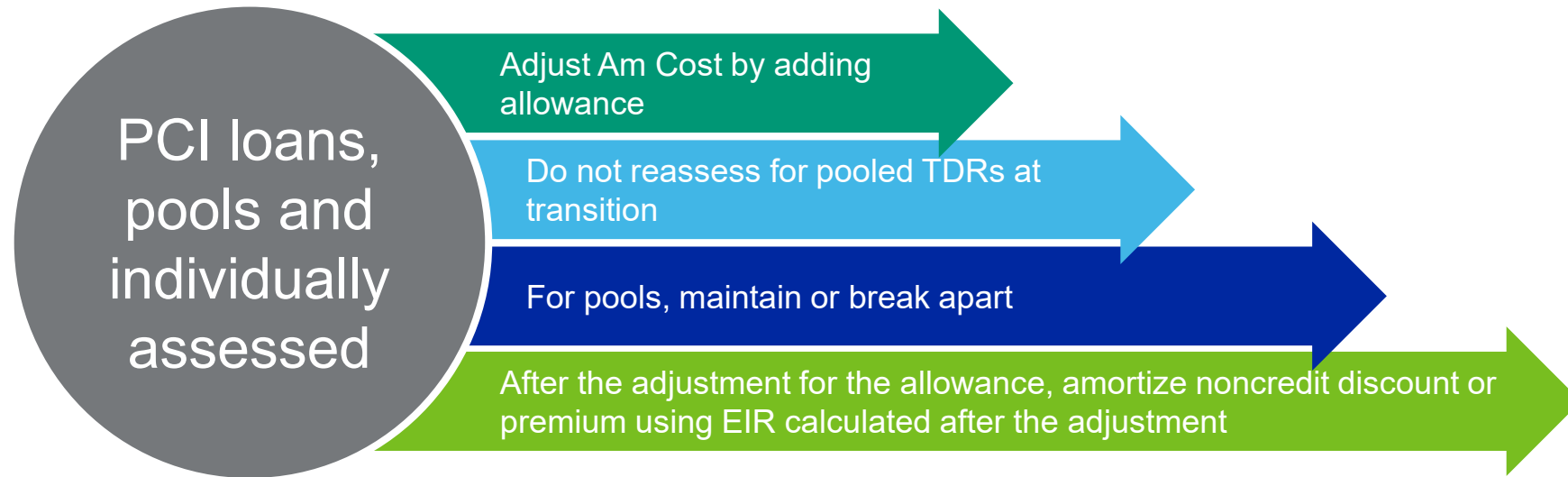
PCDs

No Changes are Expected from FASB

CECL model application

- » Follows the same model as originated except:
 - › Income recognition (may be inappropriate to accrete to contractual)
 - › Day 1 Am Cost = FV + Allowance
 - › When using method that does not project future P&I cash flows, use UPB to calculate the allowance
 - › When using DCF, discount rate equates purchase price with PV of ECF

Guidance for PCI to PCD Transition



- » Transition PCI to PCD (beneficial assets not included) in accordance with CECL
 - Follow the same steps as directed for a newly acquired PCD asset
 - Do not need to revisit PCI determination (i.e. PCI assets as of CECL transition become the initial PCD population)
- » Applies to all assets within the CECL scope as well as AFS debt securities

Transition Example

» PCI to PCD transition example:

» PCI Asset Details

Loan Principal Balance - \$300

Recorded Investment - \$210

ALLL (represents change in expected cash flows from Day 1) - \$100

Contra Loan (AKA Credit Mark) - \$90 = (\$300-\$210)

ACL (represents lifetime credit loss estimate at transition) - \$150

» PCD Transition

» Day 1 –

- 1) Reclassify the current ALLL to the ACL account.

Dr ALLL	\$100		
		Cr ACL	\$100

- 2) Reduce the Credit Mark by the ACL additional balance.

Dr Contra Loan	\$50 (= \$150 ACL - \$100 ALLL)		
		Cr ACL	\$50

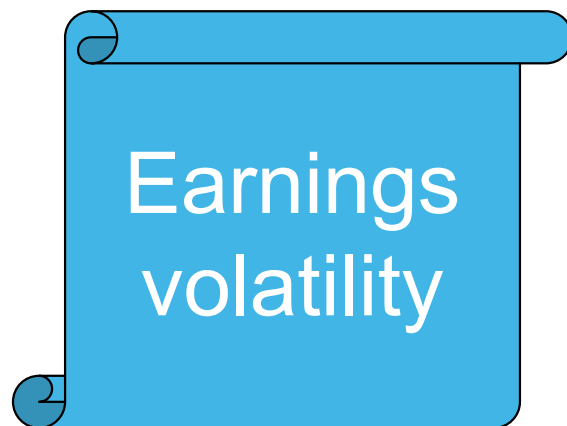
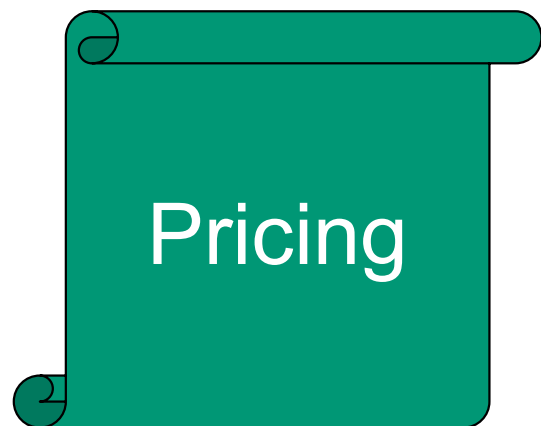
- 3) Reclassify the remaining credit mark as a non-credit related discount

Dr Contra Loan	\$40 (= \$90 Credit Mark - \$50 from entry 1)		
		Cr Non-Credit Discount	\$40

» Day 2 - Amortize the non-credit discount into income using an EIR method

Anticipated Impacts

What are some of the possible impacts to acquisitions due to CECL?





Questions & Answers

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