December 19, 2018

Ms. Susan Cosper, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2018-300

Ms. Cosper:

Hilltop Holdings, Inc. appreciates the opportunity to respond to the FASB’s invitation to comment on the Proposed Accounting Standards Update Codification Improvements - Financial Instruments (the Proposed Update).

**About Us**
Hilltop Holdings Inc. is a financial holding company based in Dallas, Texas with $13.4 billion in assets as of September 30, 2018. Our primary line of business is providing business and consumer retail banking services through PlainsCapital Bank at locations throughout Texas. We also provide financial products and services through our broker-dealer, mortgage origination, and insurance subsidiaries.

**Background**
Current GAAP for purchased credit impaired (PCI) loans allows for loans to be accounted for individually or in pools at acquisition (ASC 310-30). Often after acquisition, a collateral dependent loan within a pool of similar loans will be subject to a partial charge-off down to the appraised value of the collateral, less estimated selling costs. At the same time, there would be a corresponding charge-off against the discount of the entire pool. Subsequently, if the value of the property were to increase, current GAAP does not permit the partial charge-off to be reversed. Instead, the gross book value of the pool (before discount) would be maintained at a value lower than the amount originally recorded. Additionally, any payments collected subsequent to the charge-off would further reduce the gross book value of the pool.

**Comments**
Our comments relate to Question 9 of the Proposed Update:

Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a
periodic basis and additional changes may be postponed to a subsequent Codification improvement project.

The transition paragraph for purchased financial assets with credit deterioration (PCD) is as follows:

326-10-65-1(d)
An entity shall apply prospectively the pending content that links to this paragraph for purchased financial assets with credit deterioration to financial assets for which Subtopic 310-30 was previously applied. The prospective application will result in an adjustment to the amortized cost basis of the financial asset to reflect the addition of the allowance for credit losses at the date of adoption. An entity shall not reassess whether recognized financial assets meet the criteria of a purchased financial asset with credit deterioration as of the date of adoption. An entity may elect to maintain pools of loans accounted for under Subtopic 310-30 at adoption. An entity shall not reassess whether modifications to individual acquired financial assets accounted for in pools are troubled debt restructurings as of the date of adoption. The noncredit discount or premium, after the adjustment for the allowance for credit losses, shall be accreted to interest income using the interest method based on the effective interest rate determined after the adjustment for credit losses at the adoption date. The same transition requirements should be applied to beneficial interests for which Subtopic 310-30 was applied previously or for which there is a significant difference between the contractual cash flows and expected cash flows at the date of recognition.

It appears as though the adjustment described above, the transitional gross-up, should be performed for all PCD loans:

326-20-30-14
If an entity estimates expected credit losses using a method other than the discounted cash flow method, the entity shall measure expected credit losses on the basis of the unpaid principal balance (face value) of the financial asset(s).

We believe the Proposed ASU needs to further clarify how the allowance for expected losses should be determined for PCI loans that become PCD loans on the transition date. For example, the gross-up in amortized cost basis may result in a sharp increase in yields that reflects no economic substance.

Example
A PCI loan had a partial charge-off down to appraised value subsequent to acquisition.

Assumptions
- Remaining life of loan is 145 months as of January 1, 2020
- Contractual rate on loan is 3.75%
- There is no CECL allowance as of January 1, 2020

**Carrying amount as of December 31, 2019**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unpaid principal balance (UPB)</td>
<td>$1,315,000</td>
</tr>
<tr>
<td>Prior partial charge-offs</td>
<td>(277,000)</td>
</tr>
<tr>
<td>Gross book value</td>
<td>$1,038,000</td>
</tr>
<tr>
<td>Discount</td>
<td>(588,000)</td>
</tr>
<tr>
<td>Carrying amount of loan</td>
<td>450,000</td>
</tr>
</tbody>
</table>
NRV as of December 31, 2019

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appraised value (as of January, 2018)</td>
<td>$1,650,000</td>
</tr>
<tr>
<td>Estimated selling &amp; disposal costs</td>
<td>(165,000)</td>
</tr>
<tr>
<td>NRV of collateral</td>
<td>$1,485,000</td>
</tr>
</tbody>
</table>

Measuring NRV of collateral vs. UPB

PCD gross-up journal entry at January 1, 2020:

Dr. Book value 865,000
Cr. Non-credit discount 865,000

To gross-up amortized cost basis by the difference between UPB and book value (1,315-450=865). This non-credit discount will be accreted over the remaining life of the loan, 145 months. CECL will be measured based on UPB going forward.

Book value at January 1, 2020

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>UPB</td>
<td>$1,315,000</td>
</tr>
<tr>
<td>Non-credit discount</td>
<td>(865,000)</td>
</tr>
<tr>
<td>Carrying amount of loan</td>
<td>450,000</td>
</tr>
</tbody>
</table>

Observations

- The carrying amount of the loan has remained $450,000, but after the gross-up there is an accretable discount of $865,000.
- The discount is non-credit
- The effective yield with the gross-up is 29.21%.
- While the measurement basis for PCD loans is UPB and the measurement for non-PCD loans is amortized cost basis, disclosures are all based on amortized cost. In this example, the allowance is measured based on UPB of $1,315,000, but only $450,000 would be disclosed in the table.

Conclusion

Many financial institutions hold significant pools of PCI loans with the following characteristics:

1. The pool is deeply or fully discounted.
2. The remaining ASC 310-30 discount is mostly or all non-credit.
3. When carry value of the pool is zero, the Cost Recovery Method is applied.

The result is an extremely high yield on individual loans in the pool after the transitional gross-up. We would recommend that loans with these characteristics remain fully discounted and subject to the Cost Recovery Method, but not subject to the transitional gross-up.

Thank you for this opportunity to present our comments. If you have any questions, please contact Mike Brown or Rick Martin.

Respectfully,

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