January 31, 2019

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

Re: Proposed Accounting Standards Update, Codification Improvements — Financial Instruments (File Reference No. 2018-300)

Dear Ms. Cosper:

Cavalry Investments Holdings, LLC appreciates the opportunity to comment on the Proposed Accounting Standards Update (ASU), Codification Improvements - Financial Instruments (the Proposal) issued by the Financial Accounting Standards Board (FASB or Board) on November 19, 2018.

We are in strong support of the FASB’s efforts in conjunction with its Credit Losses Transition Resource Group (TRG), to promptly address key interpretive issues so preparers can implement ASU 2016-13, Financial Instruments – Credit Losses, in a practical manner. We support the proposed principle that an entity should be permitted to record a “negative allowance” for the inclusion of estimated recoveries in arriving at the “net amount expected to be collected” on the financial assets within the scope of the Standard.

In the Appendix, we have also included (a) background information on our industry, and (b) a discussion of the challenges we encountered in trying to apply ASU 2016-13.

Once again, thank you for the opportunity to comment on the Proposal.

Sincerely,

Tim Oetjen  
Controller
Appendix

Background on our Industry

Our primary business is the purchase, collection and management of portfolios defaulted consumer receivables. The accounts we acquire are primarily the unpaid, unsecured obligations of individuals owed to credit grantors, which include banks and other types of consumer, retail, and other largely unsecured lending arrangements. We purchase these discounted receivables generally from banks and other financial institutions as larger portfolios of individual accounts or where the customer is involved in a bankruptcy proceeding and make collections through our operations. The price at which we acquire portfolios is based on our estimate of future recovery cash flows, with consideration given to the age of the portfolio, geographic distribution, our historical experience with a certain asset type or credit grantor and other similar factors.

Practical Challenges in Applying ASU 2016-13 Without the Clarifications in the Proposal

The aggregation criteria and practical expedient guidance in ASC 310-30 allow us to utilize quarterly pools as the unit of account to set initial yield, recognize income and measure impairment. We prepare reasonable and supportable forecasts under ASC 310-30 that meet the stated requirements of ASC 326-20 for purposes of estimating an allowance. To be clear, our operational focus, for the twenty plus years we have been in business, is the pool unit of account. We measure and report to our investors based on the pool unit of account. We use analytical tools and extensive data sets of historic information to forecast expected cash flows at the portfolio level. The forecasts leverage the risk diversification that is achieved when forecasting on a pool basis versus an individual basis. In estimating expected credit losses and recoveries of a pool, it is the collective data that best forecasts how the pool will be expected to perform. On a historical basis a substantial majority of the individual accounts in our portfolios have not provided any recoveries due to their deeply distressed nature. For these reasons, it would be ineffective to develop expected cash flows at any level lower than the individual portfolio.

We believe the requirement to allocate the initial allowance measured at the PCD pool level to individual loans would lead us to establish an amortized cost basis at the individual account that would not be representative of the economics measured at the pool level. Each individual loan would continue to be deemed “uncollectible” and require full write-off under the Standard and banking regulatory guidance, which would result in zero assets recorded on the balance sheet. As a result, we believe that bringing the unit of account to the loan level for purchases of portfolios of low credit quality, defaulted, well past-due receivables has required the need to incorporate the “recovery” guidance provided by the proposed amendments such that the balance sheet appropriately reflects the “assets” that we acquire as “uncollectible” at the time of purchase. We believe expected future recoveries of amounts written off, or expected to be written off, at the individual loan level should be included in the calculation of the allowance. Accordingly, we believe the use of a negative allowance provides a reasonable and appropriate way to achieve the Standard’s objective of having the balance sheet reflect the net amount expected to be collected.
We ask that in its re-deliberations, the FASB acknowledge that this Proposal may have the ultimate effect of presenting a pool-level “negative CECL allowance” on a portfolio of purchased PCD loans that individually have had their amortized cost balance charged-off shortly after purchase. In the absence of specific acknowledgement by the FASB or FASB staff to this point, we believe some may require our industry participants to seek clarifying interpretation through other authoritative regulatory agencies.