July 29, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 51165
Norwalk, CT 06856-5116

Reference: Proposed Accounting Standards Update, Codification Improvements to Topic 326, Financial Instruments – Credit Losses (File Reference No. 2019-710)

Dear Mr. Kuhaneck:

Encore Capital Group, Inc. appreciates the opportunity to comment on the proposed ASU Codification Improvements to Topic 326, Financial Instruments – Credit Losses ("Proposed ASU"). We are a specialty finance company providing debt recovery solutions for consumers across a broad range of financial assets. We purchase portfolios of unsecured defaulted receivables at deep discounts to face value and manage them by working with individual consumers as they repay their obligations and work toward financial recovery.

Based on the nature of our business operations, our comments are limited to the questions relevant to Issue 1 identified in the Proposed ASU. We support the Board’s efforts to respond to stakeholder concerns associated with implementing the new credit loss standard. We generally believe the proposed amendments, including establishing the amortized cost basis as the cap for negative allowances should address concerns raised during the FASB Staff’s outreach in April 2019, and would help preparers implement Topic 326.

As further discussed below, we recommend that preparers be given additional time to implement the amendments to the provisions regarding negative allowances on purchased financial assets with credit deterioration ("PCD Assets"). We also recommend that the FASB add an agenda item to delay mandatory implementation of the provisions of Topic 326 applicable to PCD Assets in their entirety until the effective date of the amendment with respect to negative allowances. We believe expanding the concept of negative allowances to written off PCD assets may affect many preparers (not just those within our specific industry niche), and that a single transition from existing accounting for assets purchased with credit impairment ("PCI Assets") to the new PCD model incorporating negative allowances is preferable.

Our recommendations and responses to selected Questions for Respondents are included in the Appendix to this letter. We appreciate your previous outreach and responsiveness to the concerns raised by our industry regarding the implementation of Topic 326 and would be pleased to discuss our comments with the Board or its staff at your convenience.

Sincerely,

Ann Gill
Chief Accounting Officer, Controller

Jonathan Clark
Chief Financial Officer
APPENDIX

General Questions

Question 1: Should other changes be made that are directly or indirectly related to amendments in this proposed Update? 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.

As further discussed in our response to Question 9, we believe additional time to implement the negative allowance concept for PCD Assets is warranted. We further believe that the Board should consider deferring the mandatory adoption date provisions of Topic 326 related to PCD Assets to the effective date of the amendments in the Proposed ASU and allow existing accounting under ASC 310-30 to continue until that time. This would allow a single transition from accounting for PCI Assets to the improved accounting model for PCD Assets incorporating negative allowances for written off assets. Because Topic 326 requires that the unit of account for PCD Assets be the individual asset, rather than pools of assets, we believe many preparers will need to change their existing write-off policies, and as a result may conclude that all or portions of existing pools of existing PCI Assets currently considered collectible may qualify for write-off.

Delaying the effective date of only the amendment would effectively result in preparers having to transition to two new accounting models, first to PCD accounting without the benefit of negative allowances for a short period of time, and then to the amended requirements incorporating PCD accounting. The alternative would be early adoption of the amendments, which would negate the positive benefits of any delay to the effective date of the amendments. As further discussed in our response to Question 9, we believe implementing the proposed amendments in such a short time or transitioning twice to two methods of accounting for recoveries of written off PCD Assets would present operational challenges, and increase the costs of implementation relative to the benefits to the users of financial statements.

To be clear, we are not suggesting a delay to the overall effective date of Topic 326, as we support the Board’s overall objective of incorporating lifetime losses and forecasts of future expected conditions into the accounting for credit losses. However, we believe incorporating negative allowances into PCD accounting is a significant change that, if approved, would be introduced just months before Topic 326 becomes effective for public business entities who are SEC filers.

Issue 1: Negative Allowance for Purchased Financial Assets with Credit Deterioration

Question 3: Should an entity be permitted to record a negative allowance (basis recovery) when measuring the allowance for credit losses for purchased financial assets with credit deterioration?

Yes, we believe entities should be permitted to record negative allowances when measuring the allowance for credit losses on PCD Assets. This would provide consistency between the accounting for write-offs of PCD Assets with write-offs of other assets previously carried at amortized cost.
**Question 4:**
*Should a negative allowance (basis recovery) for PCD assets be limited to the amortized cost basis previously written off and expected to be written off by the entity? If not, please explain why and what changes should be made instead.*

We support the Board’s objective of limiting the negative allowance for PCD Assets to the amortized cost basis previously written off and expected to be recovered, as it provides consistency between the accounting for PCD Assets with other assets previously carried at amortized cost. We understand that the Board considered capping negative allowances to the purchase price of PCD Assets. We strongly agree with the Board’s reasons for rejecting this view as stated in paragraph BC10 of the Proposed ASU. Also, capping negative allowances to the purchase price would create lack of comparability with other written off assets. It would also likely lead to accounting for recoveries in excess of the purchase price on a cash basis.

However, we believe the Board should consider providing additional clarity regarding whether recording a negative allowance at write-off could result in recognition of a provision reversal through the income statement. It is not clear whether the proposed wording of 326-20-30-13A fully captures the stated intent in paragraph BC8 of the Proposed ASU of preventing premature recognition of the noncredit discount based on projections of recoveries because the amortized cost basis of PCD Assets will exceed the purchase price.

If it is the Board’s intent not to permit premature recognition of the noncredit discount, we believe there are several ways the Board could achieve that intent without capping the negative allowance at the purchase price, including the following:

1) Explicitly clarify that an entity should not include expected recoveries of the noncredit discount in its initial estimate of the negative allowance.

2) Require that when the negative allowance is initially established for PCD assets it is limited to the lesser of the amortized cost basis written off, or the present value of the expected future cash flows, discounted at the rate originally applied when they were established as PCD Assets.

We do not express a preference for either of the methods above, and believe there may be other acceptable methods of achieving the Board’s intent without capping negative allowances at the purchase price. However, if the Board chooses the first approach above, we believe it should provide guidance on the subsequent accounting treatment for the noncredit discount. Otherwise, the negative allowance would effectively be capped at the purchase price, which is not consistent with the Board’s stated objective in paragraph BC10 of the Proposed ASU.

We acknowledge that the second method proposed above would require the use of a discounted cash flow approach for one component of the allowance for credit losses, while in general Topic 326 permits either a discounted cash flow approach or other approaches that do not incorporate discounting. However, the suggested approach does not preclude an entity from initially using a non-discounted method of estimating credit losses while the assets are accounted for as PCD Assets. Discounting would apply only when measuring the negative allowance upon write-off, and would be applied at the rate the entity computed when recording the initial PCD gross-up entry in order to avoid premature recognition of the noncredit discount through a reversal of provision for credit loss at write-off.
Question 9:
Will the proposed effective dates provide sufficient time for entities to implement the proposed amendments? If not, please explain why and how much time would be needed to adopt the proposed amendments.

We believe the proposed effective date of the date of adoption of Update 2016-13 may not provide public business entities that are U.S. Securities and Exchange Commission filers (“SEC Filers”) sufficient time to implement the proposed amendment. Those entities who have not already adopted Update 2016-13 will do so in fiscal years beginning after December 15, 2019. For many SEC Filers, including Encore Capital Group, Inc., that will be the fiscal year beginning January 1, 2020. Given the need to complete the Board’s re-deliberations and incorporate stakeholder feedback, a final amendment may be released just 4 months before Topic 326 becomes effective. That does not allow sufficient time for preparers to design and implement changes to information systems, financial reporting processes, and internal controls. As recently as April 2019, the Board’s stated position was to exclude PCD Assets from the negative allowance amendments adopted in ASU 2019-04 Codification Improvements to Topic 326 Financial Instruments Credit Losses, Topic 815 Derivatives, and Topic 825 Financial Instruments (“ASU 2019-04”). Therefore, many entities with portfolios that will become PCD Assets may not have designed their financial reporting processes to consider negative allowances on written off balances. As previously discussed, because the unit of account for PCD Assets will be the individual asset, rather than pools, as is common under existing accounting for PCI Assets, we believe that adoption of Topic 326 will result in many PCD Assets being assessed as individually uncollectible and subject to write-off.

Deferring the required adoption date for one year, to fiscal years beginning after December 15, 2020, should allow SEC Filers sufficient time to design and implement financial reporting processes and internal controls related to accounting for negative allowances on written off PCD Assets. As noted above in our response to Question 1, we also believe the Board should consider deferring the provisions of Topic 326 applicable to PCD Assets to the required adoption date of the amendments in this Proposed ASU. This would enable entities with a significant number of PCD Assets expected to be written off as individually uncollectible sufficient time to adopt the improved accounting in the Proposed ASU, while avoiding a first transition as of January 1, 2020 and a second transition at a later date. Lack of a deferral to the provisions of Topic 326 related to PCD Assets would negate many of the benefits of a deferral of the effective date of the Proposed ASU.