Financial Accounting Standard Board
Credit Losses Proposal
File Reference No. 2012-260

As the CFO of a medium sized Credit Union, I have huge concerns about the Credit Losses Proposal that FASB has put forward. It seems to me that, we, the community-oriented financial institutions seem to take the brunt of the punishment and regulation again and again for the sins committed by our larger (and more politically powerful) brethren; the large national banks. We had little or no part in triggering the economic collapse of a few years ago, yet we have been lumped in with those who did to the point where I can soon see where we smaller FIs become both regulated and, in this case, “accounted” out of business.

I most strenuously object to the inclusion of Credit Unions in your proposed rule for the following reasons:

1) The structure of Credit Unions is unique among financial institutions. Credit unions are member- owned, not-for-profit financial cooperatives that operate for the purpose of promoting thrift, providing credit, and providing other financial services at competitive rates. In addition, credit unions are unique from other financial institutions in that their enabling statute, the Federal Credit Union Act, limits net worth to retained earnings only. Further, this statutory limitation restricts the ability of the National Credit Union Administration (NCUA)—the prudential regulator of federally chartered credit unions and insurer of most state and all federally chartered credit unions—to adjust its regulations in response to changes in accounting standards, as is possible for other federal financial regulators.

2) The proposal would require credit unions to provide information that is not relevant to the primary users of credit unions’ financial statements, who are the NCUA and state credit union regulators. The financial statement users of a credit union are so very different from those of a bank, including both public and private. We, as you know, do not have public shareholders.

3) FASB’s stated intent behind issuing the proposed changes is that the current impairment methodology does not allow for the timely recognition of credit losses. I do not agree with this. I also do not believe the proposed approach would have been effective at preventing the extent of credit losses experienced over the past several years. This is because I do not believe it is possible to accurately predict the extent and timing of the credit events that led to such widespread losses within the financial sector. You are, in my opinion, asking us to replace a historical rolling average calculation for determining the Allowance for Loan Loss (adjusted by Qualitative & Environmental factors) with essentially a Crystal Ball approach. You will take what is already a very subjective calculation and make it almost nearly completely subjective. Had this proposal been in effect prior to 2006-2008, I do not for one minute believe that it would have made one bit of difference in the eventual outcome of the meltdown. And it would certainly have made no difference to credit unions and their member-owners.

Potential Impact of Proposal on Credit Unions
1) The proposal would require credit unions to recognize on the balance sheet, current loss expectations in the Allowance for Loan and Lease Losses (ALLL). Thus, upon becoming effective, the proposed changes would cause an immediate and drastic increase to the ALLL of credit unions that have financial assets and liabilities within the (broad) scope of the proposal. This increase, is expected to double or even triple current ALLLs, which will result directly in a reduction in many credit unions’ retained earnings.
This is wrong for Credit Unions and wrong for our members as it is ridiculous to think that we will suddenly overnight have 2 to 3 times more risk on our balance sheet. You will be by the stroke of a pen be robbing our members of millions of dollars in Member Equity that would otherwise be used to pay higher deposit dividends, lower loan rates and/or fees, and allow for expansion and growth in our communities. I can only describe this impact in terms of legalized robbery or robbery by slight of hand. (See your Equity.... Now you don't)

2) Further, a decrease in earnings can lead to a reduced capital ratio, which can trigger prompt corrective action (PCA) implications for numerous credit unions that currently do not have PCA concerns.

3) The proposed current expected credit loss (CECL) approach has the potential to lead to quarterly adjustments in expected loss projections, possibly resulting in more volatility in provision expense and earnings.

4) Another possible result of the proposal is that reporting entities could take large one-time charges at first signs of distress in their loan portfolios, and then look for opportunities to smooth earnings volatility over time through reserve releases or reverse provisions.

5) One result of the proposal that is certain is that it will require credit unions to expend extensive financial and technical resources to even begin to comply with the changes proposed. The costs of any such expenditures will be borne by credit unions' member-owners. And these expenses are both burdensome and unnecessary. In fact, a complete waste of our members money. The proposal attempts to address the problems of a few financial institutions—albeit some extremely large financial institutions—that misled or simply did not understand the credit quality of complex CMOs and MBSs by proposing far-reaching changes that will severely impact all financial institutions, including credit unions that did not cause the financial crisis.

6) Unfortunately, the proposed changes could ultimately result in the consolidation of credit unions that are unable to comply with these changes. Such a result would not only affect the members of those credit unions directly involved, but would affect the larger financial services marketplace by reducing consumer financial options.

Challenges / Impediments to Effectively Implementing / Complying with the Changes as Proposed

1) The proposed CECL model effectively requires entities to predict/forecast the extent and timing of future losses. Predicting such losses with any degree of accuracy will be extremely challenging, even for an entity with adequate data sets and modeling capability. Further, attempting to predict credit loss for the life of a loan will inherently be affected by the subjectivity of and assumptions made by the reporting entity.

2) In regard to the data necessary to conduct such modeling, even the largest financial institutions have indicated that they do not have adequate information on this data and that it will take years (some estimating four to five years) to obtain. Further, since smaller financial institutions will require even more time to obtain such data, these institutions will default to relying on their larger counterparts peer information, which will have a lag of at least six to nine months. In addition, even once smaller institutions obtain adequate data, it will take another three to four years for these institutions to become comfortable with the required modeling.

3) The proposed CECL model is inconsistent with the accounting principle of matching, which states that expenses should be recorded in the same period as the revenues that relate to those expenses. The proposal is inconsistent since it requires expected future loan losses to be recorded immediately. In addition to its impact on the reporting entity, this inconsistency will likely cause challenges/trepidation within the audit community.
FASB Proposal is Incongruent with IASB Proposal
1) While FASB maintains its intention to achieve a convergence of standards with the International Accounting Standards Board (IASB), including on credit losses, it is unclear how this will occur since the IASB’s and FASB’s credit losses proposals are so very different.

2) Unlike the FASB proposal, which does not include a trigger for recognizing certain losses, the IASB proposal provides that an entity would only recognize a portion of expected credit losses until a specific recognition trigger has been met. The IASB’s credit losses model utilizes the following two-bucket approach:

a. 12-month expected credit loss (Bucket 1): Only requires a full expected loss recognition when there is a significant increase in credit risk since origination or acquisition.

b. Lifetime expected credit loss (Bucket 2): For all other assets, credit losses are recorded based on the probability of a default occurring in the next twelve months.

3) There is concern among some within the accounting industry, that the CECL model has the potential of driving U.S. entities to report asset values more conservatively than their international counterparts applying the IASB’s proposed credit loss standard.

Suggestions to Improve the Proposal
1) I believe it would be inappropriate to apply the proposed changes to credit unions, based on their unique structure as private, not-for-profit, cooperatively owned, financial institutions. As noted above, the primary user of a credit union’s financial statements is its regulator, which is not likely to benefit from the proposed changes since it already has a well-developed understanding of the operations of the credit unions it regulates.

2) I urge FASB to work closely with the federal financial regulatory agencies throughout the remainder of the standard-setting process, and we encourage such collaboration to continue, particularly with NCUA in light of the unique structure of credit unions.

3) I ask FASB to consider a credit impairment approach that is more in-line with the proposed IASB model, particularly the aspect of the IASB’s model that uses a twelve-month forecast period.

4) I ask FASB to clarify what is meant by the term “lifetime expected losses,” which is used throughout the proposal but not explicitly defined.

5) If FASB moves forward with this or a variation of this proposal, it is crucial that there be an adequate phase-in/transition period for credit unions. Further, we urge FASB to delay the effective date of a final credit losses standard by at least three years for non-public reporting entities, including credit unions.

In closing let me say that I have worked in the Credit Union industry since 1983 when I started as an Examiner for the State of Texas. Over that time I have seen Credit Unions (one of the few good and decent industries left in the world) repeatedly battered by lawmakers, regulators, and industry rule makers. We get painted with the same brush as the Wall Street greedsters and the giant corporate banks who put profit above all else (especially and including basic morality). This is not right and must stop.

I realize that I may sound a little overheated and, in fact, I am. This proposal makes no sense for Credit Unions for the reasons that I have noted above. Please do the right thing and leave us out of it. I cannot ever in my career remember being so angry about a proposal and feeling so powerless to do anything about it. So, you are getting this letter full of my reasoned opinions and a whole lot of passion.
Sincerely,

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