

November 5, 2018

Via Electronic Mail

Russell G. Golden  
Chairman, FASB  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856

**RE: Measurement of Credit Losses on Financial Instruments**

Dear Chairman Golden,

As institutions progress in their activities to implement Accounting Standards Update 2016-13 (the “CECL” Accounting Standard), concerns are being identified, both through their preliminary testing and through feedback received from investors and regulators. Specifically, recent letters from the Bank Policy Institute (“BPI”) and the American Bankers Association and 51 state banking associations, escalate some of these concerns and requests that the Financial Stability Oversight Council engage with the Financial Accounting Standards Board (“FASB”) and banking regulators (“the Agencies”) to delay CECL’s implementation timeline and conduct a comprehensive quantitative impact study to review the systematic and economic risks posed by CECL<sup>1</sup>. The BPI letter indicates the unintended consequences could potentially be mitigated by excluding a portion of CECL reserves from being charged against income and Common Equity Tier 1 capital.

We are proposing an approach (“the Proposal”) that would retain the CECL methodology’s intent of establishing an allowance for the lifetime of an asset on the balance sheet, but recognize the provision for credit losses in three parts: (1) for non-impaired financial assets, loss expectations within the first year would be recorded to provision for losses in the income statement with (2) loss expectations beyond the first year recorded to Accumulated Other Comprehensive Income (“AOCI”) and (3) for impaired financial assets, lifetime expected credit losses would be recognized entirely in earnings.

We believe the Proposal would better align CECL with the “matching principle”, the definition of an expense per FASB Concepts Statement No. 6, international filers under IFRS 9<sup>2</sup>, and economics of lending, while still providing financial statement users with decision-useful information. Additionally, the Proposal retains the flexibility of the CECL standard and is not prescriptive of modeling methodologies. Therefore, consideration of any possible practical expedients in the future that establish an institution’s best estimate of lifetime losses would not conflict with, or diminish, the benefits of the Proposal.

---

<sup>1</sup>An October 24, 2018 letter from Senator Thom Tillis to the chairman of the Agencies and FASB raised similar concerns as the BPI letter, asking for a robust analysis of CECL’s long-term economic impacts, as well as a serious consideration given to modifying the current implementation timeline.

<sup>2</sup>International Financial Reporting Standards (“IFRS”)

While the Proposal has been designed to make CECL's impact more transparent in financial reporting for the benefit of regulators and investors, it does not address the inherent challenge associated with accurately forecasting changes in macro-economic conditions. Specifically, CECL requires institutions to predict economic conditions (and loan losses) over a "reasonable and supportable" period. Many recent studies have demonstrated the challenges associated with forecasting the timing and magnitude of changes in the economic cycle. As a result, it appears reasonable to conclude that institutions will be required to adjust their estimates of lifetime credit loss very close to the onset of an economic downturn, and these changes will be amplified by CECL's life-of-loan credit loss requirement. These factors will result in CECL's impact on capital being significantly more procyclical than the current accounting model and thus functioning contrary to its intended purpose by exacerbating, rather than limiting, the effect of an economic downturn.

The Proposal could be leveraged by the Agencies to reduce the effect on capital thereby avoiding the unintended consequences of additional capital cost passed on to consumers and small businesses through higher pricing, reduced loan tenors, and less access to credit for already underserved borrowers. Further, a delay in the implementation of CECL to complete a comprehensive quantitative impact study of CECL's impacts on lending and regulatory capital would ensure the Proposal appropriately addresses CECL's flaws and adverse systemic and economic effects.

For advanced approaches institutions, CECL's impact under the current capital regime could be mitigated by excluding loss expectations recorded in AOCI from minimum capital requirements. Losses in the first year would continue to flow through earnings and be immediately reflected in Common Equity Tier 1 capital, while losses beyond the first year and recorded in AOCI would be easily identified in financial statements and regulatory reporting through well governed and controlled processes. The Proposal would address inherent capital redundancy concerns if the Agencies amend the capital rules to include an adjustment for CECL's component of losses included in AOCI.

For non-advanced approaches institutions, the capital effects of the Proposal will be similar for product types with loss emergence periods less than or equal to 12 months; however, the Proposal could be accretive to capital for certain financial assets (with loss emergence periods greater than 12 months) as losses beyond the first year would be recorded in AOCI. The Agencies should ensure CECL remains capital neutral regardless of whether the FASB implements this Proposal, and we would expect the Agencies to consider differences in the capital treatment for advanced and non-advanced approaches institutions in any capital proposal.

Many of these stakeholders are concerned that the long-term assumptions used in CECL forecasts will mask changes in current credit quality and could therefore impact safety and soundness, as well as the prospects for dividends. Investors are also concerned of the potential exacerbating impact that increased procyclicality will have on capital management. As the potential increase to the cost of capital will be reflected in the cost and availability of credit, regulators could use this framework to minimize disruption to consumers as they consider a long-term regulatory capital framework that sufficiently harmonizes the impacts of both Basel 3

requirements and CECL. We welcome the opportunity to discuss the Proposal with you. As we believe this issue is of significant concern, we believe a delay in the current CECL effective dates may be necessary to consider this Proposal, or any others, before implementation.

Sincerely,

Ally Financial Inc.  
American Financial Services Association  
BB&T Corporation  
Capital One Financial Corporation  
CIT Group Inc.  
Citizens Financial Group, Inc.  
Comerica Incorporated  
Discover Financial Services, Inc.  
Fifth Third Bancorp  
First Horizon National Corporation  
Huntington Bancshares Incorporated  
KeyCorp  
M&T Bank Corporation  
OneMain Holdings, Inc.  
PNC Financial Services Group, Inc.  
Regions Financial Corporation  
SunTrust Banks, Inc.  
Synchrony Financial  
Synovus Financial Corporation  
U.S. Bancorp  
Zions Bancorporation

CC: Office of Chief Accountants, SEC, Federal Reserve, OCC, and FDIC

## **Executive Summary**

This whitepaper was prepared by representatives of large and mid-sized financial institutions in the U.S. (“Industry Participants” or “we”).<sup>1</sup> It provides the Industry Participants’ proposal for how the Financial Accounting Standards Board (“FASB”) could amend ASC Topic 326, *Financial Instruments—Credit Losses* (“ASC 326”) to better align the income statement presentation of the current expected credit loss (“CECL”) model with the economics of lending transactions, set a framework to reduce the procyclicality of provisioning under CECL, enhance transparency and comparability, and limit the competitive disadvantage as compared to International Financial Reporting Standards filers (“the Proposal”).

The requirement under ASC 326 to recognize the entire change in lifetime expected credit losses within current period earnings (i.e., current period net income) has caused stakeholders to raise significant concerns related to procyclicality, comparability amongst peers, transparency, and competitive disadvantages for U.S. financial institutions compared to international financial institutions. As institutions have had time to study the impacts of CECL and better understand the challenges of creating life-of-loan credit loss estimates, it has become clear that the amount of detailed judgment and the related variation in views of future events will drive a lack of comparability of loss measurement. ASC 326

---

<sup>1</sup> Institutions supporting this whitepaper include Ally Financial Inc., American Financial Services Association, BB&T Corporation, Capital One Financial Corporation, CIT Group Inc., Citizens Financial Group, Inc., Comerica Incorporated, Discover Financial Services, Inc., Fifth Third Bancorp, First Horizon National Corporation, Huntington Bancshares Incorporated, KeyCorp, M&T Bank Corporation, OneMain Holdings, Inc., PNC Financial Services Group, Inc., Regions Financial Corporation, SunTrust Banks, Inc., Synchrony Financial, Synovus Financial Corporation, U.S. Bancorp, and Zions Bancorporation.

produces a financial performance measure that Industry Participants believe to be a less faithful representation of the economics of lending, and the financial reporting impacts of CECL to institutions making long dated loans will be disproportionately adverse relative to the impacts to institutions with product sets having shorter tenors. Industry Participants believe the unintended impacts of ASC 326 related to these concerns can be avoided through the adoption of the Proposal.

Under the Proposal, for performing financial assets, the amount recognized in earnings for credit losses would be limited to the next 12 months of expected credit losses. The remaining provision for periods beyond the next 12 months would be included in other comprehensive income (“OCI”). For impaired assets within the scope of ASC 326, lifetime expected credit losses would be recognized entirely in earnings. From a balance sheet perspective, the Proposal maintains the lifetime loss estimate established in ASC 326. The use of OCI to defer income statement recognition until underlying transactions have been realized enables the balance sheet to accurately reflect potential lifetime loss exposure, which is consistent with items identified and reported in OCI today and adheres to established income statement recognition concepts.<sup>2</sup>

The primary objective of CECL, to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments at each reporting date, would not change with adoption of the Proposal. Instead, the Proposal attempts to leverage the primary features of CECL (e.g., incorporating forward-looking

---

<sup>2</sup> FASB Concepts Statement No. 6, Elements of Financial Statements

information, estimates of expected credit losses over the contractual term of the underlying financial assets), while reflecting a more accurate depiction of the economics of lending transactions in the income statement (credit losses are typically experienced well after origination, clustered in economic downturns, and are offset by interest income from performing loans). The Proposal would provide financial statement users with enhanced visibility into an entity's expected credit losses and more appropriately align the income statement recognition of credit losses with the FASB's concept statement related to recognition and measurement in an entity's financial statements.

November 5, 2018

## **Background**

1. CECL was issued in June 2016 to replace the existing ‘incurred loss’ framework with a new model requiring immediate recognition of credit losses expected over the contractual life of the underlying financial instrument. The allowance for credit losses under CECL considers historical information, current information and reasonable and supportable forecasts.
2. The global financial crisis of 2007-2009 underscored perceived deficiencies in the incurred loss model that delayed recognition of credit losses on loans with its ‘probable’ threshold, resulting in a build of allowance on the balance sheet during the crisis that was considered by some to be “too little, too late.” The delayed recognition of credit losses was cited by the Financial Crisis Advisory Group (FCAG) as a weakness in generally accepted accounting principles (“GAAP”). With CECL, the ‘probable’ threshold and the ‘incurred’ concept were removed and consideration of forward looking information was included for credit loss measurement.
3. The primary objective of FASB’s project that led to the issuance of CECL was to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments at each reporting date. The Proposal does not change this. Instead, the Proposal attempts to supplement the objective of CECL (e.g., use of forward-looking information, estimates of expected credit losses over the contractual term of the underlying financial assets), by providing a more accurate depiction of the economics of lending transactions in the income statement.
4. Financial assets are not priced assuming credit losses will occur immediately. Rather, they are priced to reflect the risk of credit loss that occurs over time, which is more than offset

by the respective income. Charge-offs are experienced well after origination, are clustered in economic downturns and are offset by interest income from performing loans. The Proposal would provide financial statement users with enhanced visibility into an entity's expected credit losses, while at the same time ensure that the income statement recognition of credit losses is more appropriately aligned with the FASB's concept statement related to recognition and measurement in an entity's financial statements.

## **Unintended Impacts from CECL**

### ***Impact of CECL on Procyclicality***

5. One of the benefits cited by the FASB to both investors and other users of financial statements was that CECL would result in more timely reporting of credit losses.<sup>3</sup> Research has been performed after the issuance of CECL to specifically examine this premise. Namely, the research addressed whether CECL reduces the procyclicality of credit loss recognition by building and releasing allowances earlier in the cycle than the incurred loss model. As noted by the Financial Stability Forum, "addressing procyclicality is an integral part of strengthening the macroprudential or systemic orientation of regulatory and supervisory frameworks. A macroprudential orientation focuses policy on avoiding damage to the financial system as a whole with an eye to the impact on the real economy."<sup>4</sup> For this whitepaper, reserves are procyclical when they are overstated at the trough (the downturn) of a cycle and understated at the peak of a cycle. CECL reserves will be more procyclical than the current incurred loss framework from peak to trough.

---

<sup>3</sup> Financial Accounting Standards Board (FASB) publication: "Understanding Costs and Benefits – ASU: Credit Losses (Topic 326)," June 16, 2016

<sup>4</sup> Financial Stability Forum publication: "Report of the Financial Stability Forum on Addressing Procyclicality in the Financial System," April 2, 2009



6. According to research by The Bank Policy Institute (“BPI”, formerly the Clearing House), had CECL been implemented prior to the global financial crisis, loss provisioning would have been “highly procyclical” and likely would have “exacerbated the impact of the 2007-2009 financial crisis.” BPI noted that macroeconomic models and forecasters are “...generally unable to predict turning points. Most of the time, the models predict that economic conditions in the future will be similar to the present while gradually reverting to the mean.”<sup>5</sup> This is especially relevant because, due to intentions to minimize management bias (and, thus, earnings management concerns), companies will likely generally rely on such forecasters for their future macroeconomic assumptions used within their CECL estimates.
7. BPI also noted that forecast errors are generally small prior to a recession but rise significantly when a recession starts. For example, utilizing macroeconomic models, the forecast error for the unemployment rate was determined to be 0.1 percent using an 8-quarter forecast ending in Q4 2007 but 3.75 percent ending in Q4 2009.<sup>6</sup> This is critical, as CECL credit loss expectations will be highly sensitive to forecasts of economic indicators. Similarly, in a Staff working paper of the Federal Reserve Board (“FRB”), it was noted that there are many challenges associated with forecasting, including changes in the structure of the macroeconomic environment, forecaster bias and measurement of input data. The FRB Staff indicated that “the December 2008 forecasts of the December 2009 unemployment rate ranged from under 5 percent to almost 10 percent.”<sup>7</sup> As noted by the

---

<sup>5</sup> The ClearingHouse Staff Workpaper 2018-3: “*Current Expected Credit Loss: A Top Down Approach*”

<sup>6</sup> The ClearingHouse Staff Workpaper 2018-3: “*Current Expected Credit Loss: A Top Down Approach*”

<sup>7</sup> Chae, Sarah, Robert F. Sarama, Cindy M. Vojtech, and James Wang (2018). “The Impact of the Current Expected Credit Loss Standard (CECL) on the Timing and Comparability of Reserves,” Finance and Economics Discussion Series 2018-020.

American Bankers Association (“ABA”), unemployment forecasts by the Federal Reserve Bank of St. Louis (“FRBSL”) did not sufficiently recognize the extent of the eventual increase in unemployment in its forecasts until late in 2009. However, subsequent FRBSL forecasts then overshot both the severity and the length of the economic decline. Essentially, CECL estimates relying on such forecasts would have resulted in inappropriately higher reserves during the financial crisis than those recognized with incurred loss accounting and would have maintained those high reserves longer, even as the economy was stabilizing.

8. Additional research highlights the procyclical nature of CECL with respect to credit loss provisioning. Forward looking impairment methods, such as CECL or International Financial Reporting Standards (“IFRS”) 9, imply larger allowances and sharper response to the arrival of average economic recessions than the existing incurred loss model. Further, the results correlate to the degree turning points in the economic cycle imply bigger or smaller surprises relative to those anticipated by institutions. According to one analysis, “if banks fail to anticipate turning points well in advance or to adopt additional precautions during good times, the more forward-looking provisioning methods may paradoxically mean that banks experience more sudden falls in regulatory capital right at the beginning of contractionary phases of the business cycle,”<sup>8</sup> which would amplify the procyclicality currently observed in the incurred loss model.
9. The Staff of the FRB also analyzed the procyclicality of CECL and concluded that provisions are generally less procyclical compared to the incurred loss model, “to the extent that risk managers have a capacity, even somewhat limited, to predict near-future

---

<sup>8</sup> Abad, Jorge, and Javier Suarez (2018), “The Procyclicality of Expected Credit Loss Provisions”

macroeconomic trends.”<sup>9</sup> As indicated by BPI and ABA, however, the assumption that macroeconomic forecasters can predict even short-term trends, especially the ability to predict the timing and/or magnitude of the onset of an economic downturn (or an upturn), is not supported by empirical forecast data.

*Impact of CECL on Comparability Amongst Peers and Transparency*

10. The FASB believes that CECL will provide greater transparency about the extent of expected credit losses on financial assets held at the reporting date and will improve a user’s ability to understand changes in expected credit losses that have taken place during the period.<sup>10</sup>
11. Fundamentally, CECL attempts to improve transparency and comparability by introducing a single measurement objective for all in-scope financial assets, expanding disclosure requirements of credit quality indicators and expanding disclosure requirements related to allowance techniques and drivers.
12. However, there are aspects of CECL that will amplify transparency shortcomings and hinder comparability amongst peers. The wide range of possible economic forecast assumptions and resulting impact on credit risk measurement within individual portfolios will create significant differences in performance between institutions. Based on participant input to date, the “reasonable and supportable” forecast period could also vary considerably across the industry, making comparisons, especially in times of economic

---

<sup>9</sup> Chae, Sarah, Robert F. Sarama, Cindy M. Vojtech, and James Wang (2018). “The Impact of the Current Expected Credit Loss Standard (CECL) on the Timing and Comparability of Reserves,” Finance and Economics Discussion Series 2018-020.

<sup>10</sup> Financial Accounting Standards Board (FASB) publication: “Understanding Costs and Benefits – ASU: Credit Losses (Topic 326),” June 16, 2016

stress, more difficult. Said differently, two institutions with identical portfolios applying identical modeling techniques and identical macro-economic forecasts can report non-comparable provisions due to the relative portions of lifetime losses that those institutions project will occur outside of the “reasonable and supportable” forecast period (i.e., the speed at which different institutions will build or release reserves could be significantly different). Likewise, institutions will implement different models (e.g., discounted cash flows, loss rate, vintage year, etc.) and approaches for CECL. As a result, expected credit loss estimates will differ, sometimes significantly, across entities as well as potentially between portfolios within each entity.<sup>11</sup> As institutions with similar asset classes may make different judgments about the future performance of their portfolios, readers of financial statements will be forced to reconcile the differences in management judgment to fully understand the comparability of financial results. This problem will be particularly acute for portfolios of long dated assets where the estimated loss recognized at origination will change through time with changes in economic assumptions and never align the provision expense with the economics of the long term loan, economics which require the institution to realize the benefits of fees and interest income as the borrower performs against the obligation over a period of time.

13. The Staff of the FRB acknowledges that CECL could create issues related to the comparability of provisions between institutions and across time. They noted that under the incurred loss model, higher provisioning levels correspond directly to increased charge-offs and market participants rely on disclosed provisioning and allowance data to assess

---

<sup>11</sup> The RMA Journal, “Credit Loss Estimates Used in IFRS 9 Vary Widely, Says Benchmarking Study”, May 2018. The study, conducted in Q4 2017, found that credit loss estimates vary greatly across institutions modeling the same hypothetical portfolio with a common macroeconomic forecast.

underlying portfolio risk. With the adoption of CECL, they note “by incorporating somewhat opaque, bank-specific idiosyncratic modeling decisions, the tight link between allowance and actual losses may be relaxed. Market participants could face difficulty in disentangling the degree to which variation in the ALLL is driven by modeling assumptions as opposed to differences in underlying risk.”<sup>12</sup> As this occurs, institutions are likely to turn to non-GAAP measures to enable the readers of financial statements to understand the differences between financial and economic performance.

*Competitive Disadvantage of CECL vs IFRS 9*

14. One of the key differences between CECL and IFRS 9 is in financial assets that require a lifetime estimate of expected credit losses. IFRS 9 Stage 1 assets, which on average constitute 90 percent of loan portfolios,<sup>13</sup> only require an estimate of expected credit losses resulting from default events that are possible within the next 12 months weighted by the probability of default occurring. As a result, US institutions under CECL will hold a higher allowance and recognize higher Day-1 provision expense for the majority of their financial assets than international institutions under IFRS 9. For longer duration assets and in times of stress or deteriorating economic conditions, the difference between CECL reserves and IFRS 9 reserves would be more prominent.

---

<sup>12</sup> Chae, Sarah, Robert F. Sarama, Cindy M. Vojtech, and James Wang (2018). “The Impact of the Current Expected Credit Loss Standard (CECL) on the Timing and Comparability of Reserves,” Finance and Economics Discussion Series 2018-020.

<sup>13</sup> Deloitte, “Capital and the Allowance for Credit Losses”, 2018.

Operational Costs to Smaller Organizations

15. CECL's requirement of lifetime credit loss measurement with forecasts of the future, along with expanded disclosures, requires significant operational changes at all institutions no matter the size. While not explicitly required in the standard, the management and retention of disparate loan level data for a wide variety of credit characteristics and events, are practical necessities for audit purposes and to provide credible credit risk analysis on an ongoing basis. The additional maintenance, analysis, and governance of such data is significant.
16. The costs of CECL compliance is perhaps greater than previously anticipated at the time CECL was issued, evidenced by recent agency calls for community banks to consider data warehousing, use of third-party data, and disclaimers on the ease of "non-complex" estimation methods. However, assuming that non-complex processes can be deployed to forecast charge-offs over the next twelve months, the Proposal should not significantly increase the relative cost of CECL compliance for most organizations.

**The Proposal**

Loss Recognition

17. Consistent with the measurement objectives of CECL, the Proposal would require that lifetime expected credit losses be recorded on the balance sheet as a valuation allowance deducted from the amortized cost of financial assets that are within the scope of the standard. However, for performing financial assets, the amount recognized in the provision for credit losses would be limited to the next 12 months of expected credit losses, with the remaining provision for periods beyond the next 12 months included in OCI. The expected

credit losses related to impaired financial assets (per ASC 326-20-35-4&5) would be recognized entirely in earnings.<sup>14</sup> The allowance build or release recognized in the provision for credit losses would be the change in reserves for the next 12 months of expected credit losses for performing financial assets combined with the change in lifetime allowance for impaired financial assets, while the allowance build or release related to periods beyond the next 12 months of expected credit losses for performing financial assets will be recognized in OCI. Operationally, a simple book and reverse accounting process could be applied to appropriately reflect the change in the reserves from the 12 months of performing financial assets and lifetime loss from impaired financial assets in the provision for credit losses and the change in reserves from periods beyond the next 12 months of expected credit losses in OCI (no need to track transfers between categories).

18. Identifying the next 12 months of expected credit losses will result in additional implementation effort; however, the portfolio, size of the entity, access to information, and management of the portfolio may result in approaches with varying degrees of sophistication. For example, the next 12 months of expected credit losses could simply be derived as the previous or forecasted 12 months of gross charge-offs and gross recoveries (potentially qualitatively adjusted for economic outlook and/or portfolio changes). A more sophisticated approach would be to separate the next 12 months of expected credit losses from the CECL expected loss curve. For both examples, the next 12 months of expected credit losses represents a subset of total CECL losses. Further, the Proposal doesn't alter

---

<sup>14</sup> The Proposal retains the guidance in ASU 2016-13 related to purchased financial assets with credit deterioration ("PCD") assets and available for sale debt securities. PCD assets may be impaired, but by definition do not have to be impaired.

CECL's flexibility for institutions to best report their expectations of credit loss using different methods and therefore should not be a barrier.

19. A financial asset is considered impaired when, based on current information and events, a creditor determines that it is probable that it will not be able to collect all amounts due from a borrower in accordance with the original contractual terms. This would largely align with the legacy definition of impaired assets (including TDRs, nonaccrual loans, and collateral-dependent assets where foreclosure is probable). The retention of the 'probable' threshold would be for distinguishing between non-impaired and impaired financial assets and not affect the measurement of impairment. Additionally, the threshold for classifying assets as impaired is higher than the threshold used in IFRS 9 for Stage 2 classification<sup>15</sup> and therefore the use of the impaired assets definition should not introduce volatility or procyclicality relative to IFRS 9.<sup>16</sup> We believe that the retention of the impaired loan classification will be significantly less complex to implement than IFRS 9 staging as it is already embedded in current operational processes. In addition, the provision will appropriately reflect lifetime losses on impaired loans (consistent with current treatment). Further, for this whitepaper, performing assets (for which provision for credit losses would be limited to the next 12 months of expected credit losses) are financial assets not classified as impaired.

---

<sup>15</sup> IFRS 9 threshold for Stage 2 classification is assets with a significant increase in credit risk since initial recognition with a rebuttable presumption that credit risk has increased significantly since initial recognition no later than when contractual payments are more than 30 days past due.

<sup>16</sup> EY Applying IFRS December 2014 - Impairment of Financial Instruments under IFRS 9 - "This will give rise to what has been referred to as a 'cliff effect' i.e., the significant increase in loss allowance that represents the difference between the portion that was recognized previously and the lifetime ECLs."



Conceptual Basis for 12 Months

20. Identification of the next 12 months of expected losses would reintroduce a timing component to the CECL model; however, recognition of the next 12 months of expected losses in the provision for credit losses for performing financial assets better aligns income statement recognition with the FASB accounting concepts for recognition and measurement in the financial statements (the “matching principle”). Specifically, FASB Concepts Statement 5 describes earnings as “...a measure of performance for a period and to the extent feasible excludes items that are extraneous to that period—items that belong primarily to other periods” and requires the recognition of an expense or loss when “...it becomes evident that previously recognized future economic benefits of an asset have been reduced or eliminated, or that a liability has been incurred or increased, without associated economic benefits”. The Proposal aligns these concepts requiring losses to be recognized once it becomes evident that “previously recognized future economic benefits” have been eliminated or reduced by reporting the next 12 months of losses in provision expense. Losses expected beyond the next 12 months would be reported in OCI because they may not directly relate to the reduction or elimination of previously recognized future economic benefits of an asset (i.e., Day-1 loss recognition). The Proposal also better aligns with the matching principle and the definition of an expense in FASB Concepts Statement 6<sup>17</sup> along with addressing the concern that CECL is inconsistent with this definition.<sup>18</sup>

---

<sup>17</sup> FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements – “Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity’s ongoing major or central operations”

<sup>18</sup> ASU 2016-13 Dissenting View – CECL inconsistent with the definition of an expense in in FASB Concepts Statement No. 6

21. Use of a 12-month threshold exists elsewhere in GAAP, implying the difference between current and future activity and risk. The current and non-current designations for balance sheet line items use a 12-month threshold which aligns with CECL's emphasized importance of the balance sheet presentation of a lifetime loss reserve.<sup>19</sup> Additionally, GAAP requires disclosure of the amount of gains or losses reported in OCI related to cash flow hedges expected to be reclassified into earnings within the next 12 months, indicating the usefulness of the next 12 months of income statement activity to financial statement users.<sup>20</sup> Further, 12 months is used as the threshold in evaluating whether an entity constitutes a going concern<sup>21</sup> and will be used for the classification of leases as short- or long-term under ASC 842.<sup>22</sup>

22. The Comptrollers Handbook<sup>23</sup> defines an adequate allowance as no less than the sum of the following items:

- a. "(1) For loans and leases classified substandard or doubtful, whether analyzed and provided for individually or as part of pools, all estimated credit losses over the remaining effective lives of these loans.
- b. (2) For components of the loan and lease portfolio that are not classified, all estimated credit losses over the upcoming 12 months."

The handbook further states "...the ability to estimate credit losses on specific loans and categories of loans improves over time as substantive information accumulates regarding the factors affecting repayment prospects". Though this regulatory guidance is in reference

---

<sup>19</sup> ASC 210-10-45-3 (Balance Sheet), 470-10-45-10 (Debt), and 740-10-45-11 (Income Taxes)

<sup>20</sup> ASC 815 Derivatives and Hedging

<sup>21</sup> ASC 205-40-20 – "within one year after the date that the financial statements are issued"

<sup>22</sup> ASC 842-20-25-2, 842-20-25-3, and the glossary

<sup>23</sup> Comptroller's Handbook: Allowance for Loan and Lease Losses – May 2012

to the incurred loss model, it aligns with the income statement recognition portion of the Proposal and the recognition of expected losses beyond the next 12 months for performing financial assets in OCI along with balance sheet presentation of lifetime losses achieves the objectives of CECL.

23. Finally, recognition of the next 12 months of expected losses in the provision for credit losses for performing financial assets is based on the fact that many institutions generally consider coverage of one year's losses an appropriate benchmark for most pools of loans because the probable loss on any given pool should ordinarily become apparent in that time frame.<sup>24</sup>

#### Conceptual Basis for OCI

24. For performing financial assets, the provision for credit losses beyond the next 12 months would be included in OCI. OCI is defined as "Revenues, expenses, gains, and losses that under GAAP are included in comprehensive income but excluded from net income".<sup>25</sup> FAS 130 – *Reporting Comprehensive Income* identifies that "Although the Board generally followed the all-inclusive income concept, occasionally it made specific exceptions to that concept by requiring that certain changes in assets and liabilities not be reported in a statement that reports results of operations for the period in which they are recognized but instead be included in balances within a separate component of equity in a statement of financial position".<sup>26</sup> The exceptions are the items identified and reported in OCI today.

Existing OCI items share certain characteristics with the Proposal, such as:

---

<sup>24</sup> OCC 2006-47 - Interagency Policy Statement on the Allowance for Loan and Lease Losses

<sup>25</sup> ASC 220-10-20 – Income Statement - Reporting Comprehensive Income - Glossary

<sup>26</sup> SFAS 130 – Reporting Comprehensive Income – Introduction – Paragraph 3

- a. unrealized holding gains and losses on available for sale debt securities<sup>27</sup> deferred in OCI and subsequently reclassified into earnings when the securities are sold;
- b. the effective portion of unrealized gains/losses deferred in OCI that are designated and qualify as cash flow hedges<sup>28</sup> and subsequently reclassified into earnings concurrently with the recognition of the underlying forecasted transaction;
- c. foreign currency translation adjustments<sup>29</sup> deferred in OCI and subsequently reclassified to earnings when the investment is sold or when permanent reinvestment is no longer asserted; and
- d. defined benefit plans<sup>30</sup> prior service costs and certain gains or losses deferred in OCI and subsequently recognized in earnings during the periods those future benefits relate.<sup>31</sup>

These OCI items defer income statement recognition until underlying transactions have been realized while presenting certain valuation adjustments on the balance sheet prior to recognition in the income statement, thereby accurately reflecting potential exposure on the balance sheet while adhering to consistent income statement recognition concepts.<sup>32</sup> CECL's balance sheet expected loss viewpoint coupled with the Proposal, would align with the exceptions to the all-inclusive income concept applied to the aforementioned OCI items.

25. The Proposal results in amounts being reclassified out of OCI and into income statement provision when the credit losses for performing financial assets are included in the next 12

---

<sup>27</sup> ASC 326-30-35-2

<sup>28</sup> ASC 815-20-35-1(c)

<sup>29</sup> ASC 830-20-35-3(a)

<sup>30</sup> ASC 715-30-35-4

<sup>31</sup> FASB Summary of Statement No.158 "...results in financial reporting that is more understandable by eliminating the need for a reconciliation in the notes to financial statements".

<sup>32</sup> FASB Concepts Statement No. 6, Elements of Financial Statements

months. The Proposal eliminates the complexity with amortizing amounts from OCI and does not retain the loss emergence period (along with the inherent difficulties with identifying the timing of loss events) included in previously proposed alternative CECL models utilizing OCI.

### Disclosures

26. The roll-forward of the allowance for credit losses<sup>33</sup> would be amended to include the current period amount recorded in OCI (for credit losses related to periods beyond the next 12 months). Additionally, the requirement to provide information regarding the circumstances that caused changes to the allowance for credit losses, thereby affecting the credit loss expense (or reversal) for the period,<sup>34</sup> would be expanded to include information regarding the effect on OCI.

### Transition

27. Upon adoption, any increase or decrease in the allowance related to the next 12 months of expected credit losses for performing financial assets combined with lifetime losses on impaired financial assets would require a cumulative-effect adjustment to opening retained earnings in the statement of financial position as of the date of adoption (i.e., a modified retrospective approach consistent with the transition approach outlined in ASU 2016-13). For expected losses beyond the next 12 months, the increase in the allowance would be included in OCI to reflect the portion of losses that are not yet realized (similar to OCI items described above under “Conceptual Basis for OCI”).

---

<sup>33</sup> ASC 326-20-50-13

<sup>34</sup> ASC 326-20-50-10(c)

## **Proposal Benefits**

### *Mitigating Unintended Impacts of CECL*

28. The Proposal would enhance the comparability of the provision for credit losses amongst peers as the income statement would reflect expected credit losses over a consistently applied 12-month period for performing financial assets, thus eliminating differences related to inconsistent application of reasonable and supportable periods and mitigating income statement differences due to dissimilar loss forecast models and macroeconomic forecasting. Though variability from modeling choices and economic views will be present in the next 12 months of expected credit losses for performing financial assets, the extent will be far less than for lifetime reserves for financial assets (particularly for periods beyond the next 12 months included in OCI).<sup>35</sup> As provision estimates would be more comparable, institutions would be less inclined to utilize CECL-related non-GAAP measures to explain operating results to readers of financial statements because of differences in management judgment and long term views on the economic environment. However, because the allowance measure would continue to reflect the life of loan loss, the risk associated with the portfolio would still be available to readers in the financial statements.
29. The use of a 12-month threshold for reporting expected losses in the provision for credit losses would also enhance transparency for financial statement users by isolating near-term loss expectations (provision) while still providing a view of expected losses beyond 12 months (OCI). The transparency would be further enhanced by the level of consistency and

---

<sup>35</sup> The RMA Journal, “Credit Loss Estimates Used in IFRS 9 Vary Widely, Says Benchmarking Study”, May 2018.

comparability between entities for 12 months of losses reported in the provision for credit losses, providing financial statement users decision-useful information and a more complete view of credit risk, when combined with the balance sheet lifetime loss reserves and incremental CECL disclosures.

30. The Proposal sets a reporting framework the federal banking agencies (collectively, the "Agencies") could use to assess and recalibrate regulatory capital requirements for CECL requirements. The Agencies could consider minimizing the unintended effects of CECL by excluding from regulatory capital the portion of allowances that gets presented in OCI or by assessing these amounts in an alternative manner to ensure CECL remains capital neutral.

31. We recognize that the 12-month threshold could result in less provision for financial assets with a loss emergence period greater than 1 year under the existing incurred loss approach. Though the magnitude is not easily quantifiable due to differences in modeling techniques and loss emergence periods under the existing incurred loss model, there are some mitigating factors to consider. The Proposal includes a lifetime loss estimate for impaired financial assets that would not result in less provision relative to the loss emergence period and financial assets tend to show signs of deterioration well after the actual loss event has been incurred. Overall, we believe that near-term loss expectations (provision) and expected loss beyond 12 months (OCI) combined with the enhanced disclosures required by ASC 326 would provide a more complete view of credit losses.

32. Additionally, the Proposal would more closely align the provision for credit losses between domestic filers under CECL and international filers under IFRS 9. The inclusion of 12 months of expected losses in provision for credit losses in current period earnings for

performing financial assets would align with the significant percentage of accounts (approximately 90%) classified as Stage 1 assets under IFRS 9. Additionally, the inclusion of lifetime loss estimates in current period earnings for impaired financial assets would more closely align with assets classified as Stage 2 or 3 under IFRS 9. This would increase income statement comparability with international filers and limit the potential for competitive disadvantages.

*Additional Enhancements to Meet CECL Objectives*

33. The enhancement to include the provision for credit losses related to periods beyond the next 12 months in OCI would not impact existing OCI accounting guidance<sup>36</sup> which focuses on presentation. The identification of OCI items is not centrally defined, but is determined separately by each of the respective areas within the accounting literature. Therefore, only the CECL standard would need to be updated to identify the item as an element of OCI.
34. The inclusion of 12 months of expected credit losses in the income statement would align with existing benchmarks and early warning indicators currently used by many entities in managing the allowance for credit losses. This would allow certain existing processes and procedures to continue under CECL. For example, back testing could continue to be used to help ensure that the provision for credit losses included in current period earnings is appropriate. The requirement to provision all expected credit losses for a financial asset at the point of origination or acquisition undermines the ability to validate adequacy in a

---

<sup>36</sup> ASC 220 – Income Statement - Reporting Comprehensive Income



reasonable time frame, as the provision is not related to near-term loss confirmations, but rather expected losses over the financial asset's contractual life.

35. The better alignment with lending economics discussed above can be verified through business strategies which would no longer be incentivized under CECL. Specifically, due to the delayed recognition of net profits, CECL would incentivize entities to limit contractual maturity dates (resulting in lower provision compared to longer maturities) and/or increase prices for their products to offset the negative economic return (net present value) impacts of recognizing lifetime expected credit losses upon origination of financial assets. Limiting the income statement impact to the next 12 months of expected credit losses would alleviate the potential for such impacts that could otherwise occur after adoption of CECL.

*Retention of the CECL Measurement Objective*

36. The Proposal retains CECL's single measurement objective for assets measured at amortized cost. The CECL allowance will reflect an entity's current estimate of lifetime expected credit losses and consider a broad range of reasonable and supportable information. Further, financial assets will be presented on the balance sheet at the net amount expected to be collected by the entity. Specifically, the Proposal does not require amendments to the language within ASC 326 related to initial measurement, subsequent measurement, or other presentation matters<sup>37</sup> (other than language referring to net income, credit loss expense, earnings, or provision for expected credit losses<sup>38</sup>). Accordingly, the

---

<sup>37</sup> ASC 326-20-30-1 through 45-4

<sup>38</sup> ASC 326-20-30-1 and 11, 35-1, 3 and 9, and 45-3 and 4

FASB's overall objective to provide financial statement users with more decision-useful information about expected credit losses will be met.

37. Some institutions have expended significant time and monetary resources in their ongoing efforts to prepare for the implementation of CECL and measurement of expected credit losses. By retaining the measurement principles of CECL, the Proposal does not invalidate those efforts and use of resources. Rather, institutions will continue to further those efforts in moving toward the FASB's balance sheet measurement objective and related requirements of the original standard.

*No Conflicts with TRG Decisions to Date*

38. Prior to the issuance of the CECL standard in June 2016, the FASB established a Transition Resource Group ("the TRG") to inform the FASB of implementation issues (identified through stakeholder outreach) in order to help the Board determine what actions (if any) will be needed to address such issues. Through three post-standard issuance meetings with the TRG to date, the Board has responded to several implementation questions, made several tentative decisions related to implementation, and shown support for several recommendations made by TRG members (some of which are expected to result in future amendments to the CECL standard). The issues addressed in such meetings have primarily related to the measurement of the CECL allowance and balance sheet presentation requirements. As the Proposal retains the measurement principles and balance sheet presentation requirements of CECL, it does not conflict with the responses provided, tentative decisions made, or recommendations related to such issues during the TRG meetings.