FASB FINANCIAL ACCOUNTING STANDARDS BOARD

**Board Meeting Handout**

**Leases**

**December 2, 2020**

## Meeting Purpose

1. As part of its Post-Implementation Review (PIR) process, the Board has provided resources to monitor and assist stakeholders with their implementation of Topic 842, Leases, since the issuance of Accounting Standards Update No. 2016-02, *Leases (Topic 842).* The FASB staff has proactively engaged with stakeholders in both formal and informal settings to solicit feedback. Specifically, meetings have been held with FASB advisory groups, regulators, users of financial statements, public accounting firms, the AICPA's Technical Issues Committee, industry groups, and individual public and private preparers. The FASB staff also actively monitors agenda requests and technical inquiries for pervasive implementation or ongoing application issues. Additionally, as part of the ongoing PIR process, the FASB hosted a public Leases Roundtable in September 2020. Across two sessions, participants shared their views on several broad topics related to Topic 842.

2. As part of the PIR process, the staff plans to continue to monitor and assist stakeholders with the implementation and application of Topic 842, particularly for nonpublic entities that have yet to adopt the Topic. In the first quarter of 2021, the staff will continue to gather information from stakeholders about the costs of implementing and applying Topic 842.

3. At its December 2, 2020 Board meeting, the staff will provide the Board with a summary of feedback received to date. The discussion will begin with feedback from outreach recently conducted with financial statement users. That outreach was performed primarily to understand whether lease assets and lease liabilities reported under Topic 842 and the related disclosures provide decision-useful information and, if so, how that information is being used in analyses. Next, the staff will present broader stakeholder feedback from outreach performed with a wide array of stakeholders (including the September 2020 public roundtables).

| Questions for the Board |
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| 1. What are the Board's preliminary observations about the results of user outreach performed to date?<br><br>2. What are the Board's preliminary observations about the issues summarized by the staff?<br><br>3. Does the Board request that the staff perform additional outreach and research on any of those issues?<br><br>4. Are there any specific next steps that the Board requests? |

FINANCIAL ACCOUNTING STANDARDS BOARD

**Board Meeting Handout**

**Post-Implementation Review of Topic 326, Financial Instruments—Credit Losses**

**December 2, 2020**

## Meeting Purpose

1. The purpose of this Board meeting is to provide a summary of the feedback received in Stage 1: Post-Issuance Date Implementation Monitoring and Stage 2: Post-Effective Date Evaluation of Costs and Benefits in the Post Implementation Review (PIR) process as it relates to Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (referred to as CECL herein), and to determine if the Board would like to direct the staff to perform additional research and outreach on certain issues raised by stakeholders who participated in Stage 1 and Stage 2 of the Post-Implementation Review.

| **Questions for the Board** |
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| 1. Does the Board have any questions or comments on the feedback received to date as part of the PIR process?<br><br>2. Does the Board want to direct the staff to perform additional outreach and research on any of the following topics related to Update 2016-13?<br>a. Issue 1: Accounting for Assets That Do Not Qualify as Purchased Financial Assets with Credit Deterioration (Non-PCD Financial Assets)<br>b. Issue 2: Accounting for Troubled Debt Restructurings by Creditors<br>c. Issue 3: Amending the Scope of Financial Assets Included in Update 2016-13<br>d. Issue 4: Enhancing Disclosures for Update 2016-13<br><br>3. Are there any other issues that the Board would like the staff to further research? |

## Summary of PIR Feedback

2. The staff performed outreach with 117 stakeholders, including both buy-side and sell-side analysts (covering both private and public banks ranging in size from small-cap and mid-cap public banks to the largest global public banks), preparers that have adopted Update 2016-13 and those that have not yet adopted the Update, regulators, academics and advisory committees.

3. The feedback included below represents a summary of the feedback received from multiple stakeholders through November 20, 2020. The staff will continue to perform outreach and inform the Board of additional feedback received.

**Analysts Feedback**

4. Overall, analysts that responded to the staff's request for outreach indicated that they generally support the additional information provided under CECL as compared to the previous incurred loss model. Most of those respondents indicated that the additional information provided on earnings calls and in SEC filings as a result of the adoption was helpful in performing analyses and in discussing financial results with management of those entities. It should be noted that buy-side analysts generally did not indicate whether they thought CECL was an improvement, and those who commented on whether CECL was an improvement offered mixed feedback.

5. Analysts acknowledged that they generally understood the purpose of CECL and recognizing a Day-1 allowance. Some analysts indicated that they view the standard as particularly useful in the current economic environment because banks increased their reserves for expected credit losses more quickly than they would have done under the incurred loss model. However, analysts are still learning how CECL affects reserves and the timing of charge offs.

6. The following represent key comments provided by sell-side and buy-side analysts:

    a. *Disclosure Criticism:* Analysts acknowledged that CECL provided them with more information than under the incurred loss model, but expressed frustration with the current disclosures and noted that they were disappointed with the quality of the information provided because it lacked consistency across different institutions and did not always provide the desired level of detail.

    b. *Disclosure Recommendations:* The staff and Board members asked those analysts if they had recommendations on changes to improve the disclosure information being provided or if new disclosures were needed. Analysts suggested several new or revised disclosures that they perceive would enhance the decision-usefulness of the information provided.

c. *PCD Financial Assets:* Some analysts were critical of purchase accounting because it relates to establishing an allowance for purchased financial assets that do not qualify for PCD accounting treatment. Those analysts noted that the allowance for credit losses is being double counted and also that they were challenged in understanding what purchases qualify for PCD accounting treatment.

*d. Other Feedback:*

i. Several analysts noted that they compare bank allowances with disclosures for regulatory capital purposes based on the Comprehensive Capital Analysis and Review (CCAR) and/or the Dodd-Frank Act Stress Tests (DFAST) to discern some sort of benchmark across financial institutions.

ii. Several analysts commented that they did not like how credit reserves are subject to volatile economic forecasts that ultimately have large effects on reserves. A few of those analysts indicated that there appears to be an overreliance on external third-party provider information used in measuring the allowance.

iii. Some analysts expressed their view that all financial institutions (regardless of size) should be subject to the same allowance for credit losses guidance.

iv. A few analysts noted that CECL is procyclical.

**Preparer Feedback**

***Financial Institutions That Adopted CECL in 2020***

7. Overall, financial institutions that adopted CECL indicated that they were well prepared to adopt the standard at the beginning of 2020. At the onset of the COVID-19 pandemic, financial institutions indicated that it was very challenging to incorporate the quickly evolving macroeconomic environment into their models so close to the end of Q1.

8. The following items represent key comment themes related to cost of adoption, complexity or modeling challenges, and comparability and disclosures across banks:

a. *Costs:* Some of these institutions noted that the costs of adoption were greater than they anticipated because of data cleaning and storing costs, vendor costs to implement software and/or build models to reflect expected credit losses and validate those models, costs to obtain macroeconomic forecast data, and costs of educating employees about the new standard.

b. *Complexity/Modeling Challenges:* Several institutions noted that the rollout of CECL in 2020 has led to numerous questions from investors, specifically on macroeconomic assumptions, reasonable and supportable forecast periods, reversion methods and durations, and charge off and/or reserve release timing. In addition, some institutions noted that using a qualitative overlay is necessary because of the inherent limitations in quantitative modeling. For example, certain governmental actions are unprecedented (e.g., level of assistance provided to borrowers, automatic payment deferrals) and there is no historical data that can be used to model these actions; therefore, a qualitative adjustment is needed. They stated that the qualitative overlay was a component of the CECL reserve. However, some institutions noted that there is an assumption or belief among investors that the allowance is primarily driven by a quantitative model only. This divergence between investors' expectations and institutions' measurement processes has created additional questions from investors. In addition, a few institutions indicated that they find the non-PCD accounting treatment to be unintuitive and complex.

c. *Comparability/Disclosures:* Some institutions noted that they were spending time to review and analyze peer disclosures to determine what is the benchmark of information being provided to users and to determine if they should be enhancing their disclosures. The principles-based measurement model and disclosure requirements make comparability difficult for institutions comparing themselves to peers/competitors. A few institutions also noted that more information could be provided on loan modifications, in lieu of the existing troubled debt restructuring designation. Those institutions noted that troubled debt restructuring designation and disclosure may no longer be meaningful because it overlaps with certain disclosure requirements of Topic 326.

*d. Other Feedback:*

i. Some preparers noted that the adoption of the CECL standard has exacerbated volatility in earnings.

ii. A few preparers commented that the Day-1 loss that is recognized under the CECL model is inconsistent with the economic characteristics of lending. Those individuals further noted that, as a result, the pricing, availability, and structure of lending may change due to the adoption of the standard.

iii. A few preparers stated that a model that captures expected losses over a limited-life model or a model that captures some longer term expected losses in other comprehensive income would be more consistent with the economic characteristics of lending and, therefore, would be more appropriate.

### *Nonfinancial Institutions That Adopted CECL in 2020*

9. Overall, nonfinancial institutions that adopted CECL indicated that they were well prepared to adopt the standard at the beginning of 2020, similar to financial institutions. Nonfinancial institutions generally did not experience a major effect on their allowance levels after adopting CECL, especially when compared with their overall company size. Nonfinancial institutions noted that they spent a lot of time and internal resources to implement CECL to those financial assets that are included within the scope of the standard; however, external costs were low because most institutions built upon their existing practices. Because some nonfinancial institutions already have adopted the standard, they supported retaining the requirement to apply CECL to trade receivables and other assets, while others indicated that a scope exception for smaller entities may be helpful because they may not have the capacity to implement the standard.

## Financial Institutions That Have Not Adopted CECL

10. Overall, most financial institutions that have not yet adopted the CECL standard noted that they were continuing with their plans to implement the standard by 2023. A few of those institutions noted that they have put CECL implementation plans aside for now to (a) deal with more pressing matters related to COVID-19 or (b) decided to pause their implementation plans following the 2019 CECL deferral for nonpublic business entities, which includes credit unions. Those institutions that have paused their implementation timelines indicated that they did expect to resume implementation plans in 2021. The outreach conducted to date with non-adopters was limited and the staff will continue to perform outreach with financial institutions that have not adopted CECL to monitor their progress toward implementation.

11. For those institutions that were continuing with their implementation plans, they generally provided similar feedback, including the following:

    a. Most are using or plan to utilize an outside vendor to help determine their allowances for credit losses. One institution indicated that it was planning on using the weighted-average remaining maturity (WARM) method for calculating its allowance, while another institution was comparing the WARM method to determine if its calculation was close to a third-party vendor.

    b. Most noted that gathering historical data and performing data cleanup was challenging but that they expected to have the necessary data and information to adopt the standard. A few institutions noted challenges in developing qualitative overlays considering forward-looking information to apply to their models.

    c. These institutions generally acknowledged that they were not considered small in comparison with other credit unions or community banks and noted that they have the necessary resources for adoption. However, they expressed some concern that small institutions may struggle to adopt the standard. One smaller institution acknowledged that it thought the WARM example was helpful, but more information or examples could be provided to help institutions determine which inputs to incorporate into their reasonable and supportable forecasts. Credit unions and community banks indicated that a simplified approach to developing a reserve under CECL would be very helpful to ease the implementation burden on smaller financial institutions.

**Other Feedback Received**

12. The staff received feedback from other stakeholders, including the following:

    a. *Academics:* The staff and certain Board members participated in an academic roundtable on CECL with professors and doctoral students. Participants indicated that they are still in the early stages of performing an academic review of the standard and they do not anticipate having findings to share with the FASB until more data is available to properly assess the effects of implementation. Participants were generally interested in how the adoption of the CECL standard affected behavior of financial institutions (that is, whether Day-1 allowances would reduce risk taking) and how investors and regulators reacted to the reserves established under the CECL model.

    b. *Prudential Regulators:* In early 2020, one prudential regulator reached out to the staff to indicate that it received early feedback that the WARM method may still be too complex for institutions, in particular, those financial institutions with less than $500 million in total assets. On September 15, 2020, the U.S. Department of Treasury released the congressionally mandated study (as required by the Consolidated Appropriations Act for Fiscal Year 2020) on the need, if any, for changes to regulatory capital requirements necessitated by CECL. The study did not provide a definitive assessment of the effect of CECL on financial institutions' regulatory capital, considering the state of CECL implementation across financial institutions and current market conditions. However, the U.S. Department of Treasury made a number of recommendations including that the FASB should further study CECL's anticipated benefits, expand its efforts to consult and coordinate with the prudential regulators to understand regulatory capital effects of CECL on financial institutions, explore the costs and benefits of aligning the timing of recognition of fees associated with financial assets with credit losses on those assets, and examine the applicability of CECL to smaller lenders.

    c. *Financial Accounting Standards Advisory Council (FASAC):* At the September 24, 2020 FASAC meeting, the staff and Board met with the Council to discuss the costs and benefits of CECL, specifically related to trade receivables. FASAC members stated that because CECL has a relatively insignificant effect on the allowance for credit losses related to trade receivables, Council members discussed whether CECL should be amended to either exclude trade receivables or to provide an option for entities to not apply the guidance to trade receivables. Council members expressed mixed views. Some Council members supported an option to not apply the guidance to trade receivables. Others supported retaining the existing guidance because (i) it has been implemented by many entities and may be similar to prior practices and (ii) they had concerns about having different accounting guidance for trade receivables and other receivables.

## Identification of Issues

13. Through the direct and indirect feedback received from stakeholders during the initial PIR, the following areas were identified into which the Board could consider making certain targeted improvements to address stakeholders' concerns:

    a. Issue 1: Accounting for non-PCD financial assets

    b. Issue 2: Accounting for troubled debt restructurings by creditors

    c. Issue 3: Amending the scope of financial assets included in Update 2016-13

    d. Issue 4: Enhancing disclosures for Update 2016-13.