FASB FINANCIAL ACCOUNTING STANDARDS BOARD

# Public Roundtable Meeting to Discuss a Proposal Submitted by a Group of Banks to Consider an Alternative Approach to Presenting Expected Credit Losses on the Income Statement and Whether Gross Writeoffs and Gross Recoveries Should be Presented in the Credit Quality Disclosures

***Financial Instruments—Credit Losses (Topic 326)***
***Measurement of Credit Losses on Financial Instruments***

**January 28, 2019**
**8:30 a.m.–2:00 p.m.**

**Financial Accounting Standards Board**
**401 Merritt 7**
**Norwalk, Connecticut**

## AGENDA

**Purpose:** To listen to stakeholder views and to further develop the Board's understanding of the alternative proposed or issues raised.

**Agenda**

A. Introductions of Roundtable Participants
B. Introductory Remarks by FASB Staff and Board Members
C. Opening Comments from Roundtable Participants
D. Topic 1 – Open Discussion of the Submission
   1. Overview of the Submission – Participants who Signed the Letter
   2. Open Discussion on the Submission – All Participants
E. Topic 2 – Credit Quality Disclosure Requirements
   1. Overview of Issue Raised and Summary of TRG Discussion – FASB Staff
   2. Open Discussion on Credit Quality Disclosures – All Participants

### Background

1. In October 2008, as part of a joint approach to dealing with the reporting issues arising from the global financial crisis, the FASB and the IASB created the Financial Crisis Advisory Group (FCAG). FCAG considered how improvements in financial reporting could enhance investors' confidence in financial markets. In its report issued on July 28, 2009, FCAG identified delayed recognition of losses associated with loans (and other financial instruments) and the complexity of multiple impairment approaches as primary weaknesses in accounting standards and application of those standards. FCAG recommended exploring alternatives to the incurred loss model that would use more forward-looking information because the incurred loss model delays recognition of credit losses until it is probable a loss has been incurred.
2. In May 2010, the FASB issued the proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815), which included proposals on classification and measurement, credit impairment, and hedge accounting. With regards to credit impairment, the Board's objective was to ensure that the allowance balance reflected all estimated credit losses for the remaining life of a financial instrument. To accomplish that objective, the FASB proposed that an entity should measure credit impairment when the entity does not expect to collect all contractual amounts due. The credit loss would not need to be considered "probable" to be recorded under the proposed Update. For purposes of measuring credit impairment, the proposed Update would have required that an entity assume that the economic conditions existing at the reporting date would remain unchanged for the remaining life of the financial assets. Furthermore, the FASB proposed that interest income should be recognized based on applying the effective interest rate to the amortized cost basis net of any allowance for credit losses.
3. The Board performed extensive outreach with stakeholders to obtain feedback on the May 2010 Exposure draft including public comment letters, investor questionnaires, field visits with preparers, in-person meetings, and public roundtable meetings. The feedback provided highlighted the following:
   a. Respondents agreed with recording the entire credit loss in the period estimated.

b. Superseding the probable threshold for recognizing credit losses was widely supported.

c. While most stakeholders supported the objective of a single impairment model, some asserted that the proposed Update retained three different impairment models (that is, one for pools, one for individual assets, and one for purchased assets).

d. Stakeholders expressed concern about the requirement to assume the economic conditions would remain unchanged at the reporting date.

e. Stakeholders opposed requiring interest income to be recognized based on applying the effective interest rate to the amortized cost basis net of any allowance for credit losses, preferring instead to maintain the approach in current GAAP.

f. Respondents stated that the primary issue is delayed recognition of impairment losses in net income as opposed to the interest recognition model.

4. In redeliberating their original impairment proposals, both the FASB and IASB developed a model for impairment accounting that was a variant of their original proposals. In January 2011, the FASB and IASB jointly issued a Supplementary Document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Impairment*. This proposal would more commonly be referred to as the "good book and bad book" accounting model for determining credit losses.

5. The FASB received more than 200 comment letters in response to the good book and bad book proposal and both the FASB and IASB performed extensive outreach with preparers, regulators, auditors, users and other interested parties. The outreach program included commentary from more than 1,000 stakeholders, representing more than 100 different organizations. The feedback provided highlighted the following:

   a. U.S. preparers and auditors supported the development of an impairment model that would address the "too little, too late" concern.

   b. Respondents indicated that the condition for when to transfer an asset between the good book and bad book needed to be further refined for the proposed amendments to be operable. Some suggested that a bright line be established to promote consistency.

   c. Preparers and auditors noted that without stronger definitions of the important terms, the model would not be operable, auditable or understandable, and comparability would not be achieved.

   d. Respondents stated that the concept of "foreseeable future period" was vague and could lead to counterintuitive results.

   e. Nonfinancial institutions stated that they do not manage their financial assets in the same way as financial institutions, and, therefore, found the good book and bad book proposal unfamiliar and inconsistent with their current practices.

   f. Preparers noted that the greatest exposure to losses exists as the loan is originated and credit risk is reduced over the life of the loan and that the allowance balance should follow a similar pattern. Those stakeholders argued that the objective of linking the pricing of the asset to the measurement of credit loss would not reconcile to the objectives of the "too little, too late" concern.

6. Leveraging the feedback received from June 2011 through July 2012, the FASB and the IASB jointly developed a three-bucket impairment model. While developing application guidance for the three-bucket model, the Board received requests to clarify a number of principles in the model, including:

   a. The Bucket 1 measurement objective.

   b. The criteria to follow when transferring financial assets between each Bucket.

   c. Stakeholders viewed the proposed transfer criteria as reintroducing an incurred loss recognition threshold for a full lifetime loss estimate.

7. From April 2012 through July 2012, the FASB staff and individual Board members held detailed working sessions with stakeholders (including users, preparers, auditors, and regulators) to address application issues through additional clarifying guidance. Despite those efforts, stakeholders continued to express concerns about whether the three-bucket impairment model was operable, auditable, and understandable.

   a. The most significant operability concerns related to the use of two different measurement objectives—a portion of total expected losses for some assets and a full measurement approach for assets that have exhibited significant deterioration since origination or acquisition.

b. Concern about ambiguity of the criteria for determining which measurement objective to utilize.

c. Concern about the potential for earnings management relating to the timing of the transfers between measurement objectives.

d. Concern about potential "cliff effects" of moving from an approach that measures a portion of total expected losses for some assets to a full measurement approach, and vice versa.

e. Stakeholders stated that the three-bucket model would result in inconsistent application and would not provide users with comparable or transparent results.

f. Users expressed concern about interpreting any model that utilizes two different measurement objectives to arrive at the allowance for credit losses on the balance sheet.

8. As a result of the pervasive feedback from U.S. stakeholders about the good book and bad book and three-bucket model, in July 2012, the Board decided to revisit some previous tentative decisions on the impairment project, primarily relating to the use of two different measurement objectives. In doing so, the Board developed the current expected credit loss (CECL) model that retained certain concepts from the jointly developed credit loss model that were sound, while at the same time avoiding other concepts that U.S. stakeholders considered complex, inoperable, or otherwise problematic. The Board exposed this single measurement objective model for public comment in December 2012 with the issuance of its proposed Accounting Standards Update, Financial Instruments—Credit Losses (Subtopic 825-15).

9. The FASB Board received significant input on the December 2012 Exposure Draft through comment letters and through direct outreach with numerous preparers, auditor, and users of financial statements. In addition, the Board held various roundtables with preparers, investors, and regulators to discuss the Exposure Draft. The Board considered the feedback from stakeholders during its redeliberations at public meetings held in 2013, 2014, 2015, and 2016.

a. The Board observed that investors and other users strongly preferred a model that records the full amount of expected credit losses. Investors stated that they saw no point in recognizing different amounts of expected credit losses on the basis of whether default events are expected within a specific time frame.

b. Investors also disagreed with the idea of using any other type of trigger for determining the amount of expected credit losses recognized, which they asserted would add another layer of subjectively into an already subjective estimate.

c. Preparers participating in field visits and outreach sessions indicated that past, current, and reasonable and supportable forecasts should be used to develop the loss estimate to make the measured of expected credit losses operable.

d. To be responsive to concerns raised by community banks and credit unions, the Board held a public meeting with representatives of community banks and credit unions, bank industry groups, regulators, and auditors to discuss the concerns about the proposed Update and the expected costs of implementation.

**Overview of CECL Outreach Activities**

10. The FASB currently has robust, transparent and inclusive processes in place to develop high-quality accounting standards. Central to these is consideration of the views of a broad array of stakeholders. This has been, and continues to be, the case with regard to CECL's development and implementation. As part of the FASB's due process we routinely conduct outreach activities with interested stakeholders. The FASB's outreach included stakeholders representing large and small financial institutions, public and private companies, large and small practitioners, investors, other users of financial statements, and regulators. The FASB devoted a significant amount of time and resources to ensure that it considered and benefited from views from a broad array of stakeholders during its deliberations. The FASB sought to objectively consider all stakeholder views and used this extensive feedback to, where appropriate, revise the standard–with the goal of minimizing costs for preparers and improving the usefulness of financial instrument reporting for financial statement investors and other users. The following table summarizes the outreach conducted by the FASB through deliberations and during implementation of the CECL standard.

| Documents Issued for Public Comment | Outreach |
|---|---|
| **2010 Exposure Draft** | • Received over 2,800 comment letters.<br>• Conducted 8 field visits with banking institutions of various sizes, nonfinancial entities, and an insurance company.<br>• Received feedback from 120 investors and other users of financial statements<br>• Held 5 public roundtable meetings with more than 65 participants, including users, preparers, regulators, auditors, and others representing various perspectives |
| **2011 Joint Supplementary Document (Good Book and Bad Book)** | • Received more than 200 comment letters.<br>• Conducted outreach with preparers, regulators, auditors, users and other interested parties – that amounts to meeting with more than 1,000 stakeholders, representing more than 100 different organizations.<br>• Detailed working sessions with stakeholders including users, preparers, auditors, and regulators to discuss application guidance for the three-bucket approach. |
| **2012 Exposure Draft** | • Received more than 360 comment letters.<br>• Obtained feedback from more than 70 analysts and investors.<br>• Conducted 17 field visits with preparers including multinational and domestic, financial and nonfinancial, and public and private institutions.<br>• Held various roundtables with preparers, investors, and regulators to discuss the 2012 Exposure Draft.<br>• Conducted outreach with 265 preparers in the form of comment letters, phone calls, and roundtables. |

11. Outreach doesn’t end when a standard is issued. On CECL, the FASB has continued our outreach through education and dialogue as well as through the formation of the Credit Losses Transition Resource Group (TRG). We continue to meet with the U.S. Securities and Exchange Commission (SEC), Public Company Accounting Oversight Board (PCAOB), and banking regulators to ensure that preparers have a smooth and timely adoption. Additionally, we have

been working with banking regulators to develop educational initiatives to inform all financial institutions (especially community banks and credit unions) about the new model's flexibility and scalability, as well as how they can leverage their existing processes.

12. At the FASB, continuous improvement is the foundation of our process. It means ensuring that standards provide investors with better information at the right time. It means educating stakeholders and making clear "what we meant" when we issue a standard to reduce uncertainty around it. And it means continually communicating with stakeholders throughout the process to better understand the costs of a standard–which helps us make better decisions. When we do that, we believe all of our stakeholders' benefit.

13. Our collaboration with regulators on educational initiatives is also intended to directly address other misunderstandings of CECL, for example, allaying concerns that the model requires community banks and credit unions to hire outside consultants to help them procure necessary data. Earlier this month, we issued a question and answer document that addresses particular issues related to the weighted average remaining maturity (WARM) method for estimating the allowance for credit losses as required by CECL. In the question-and-answer document, the FASB staff agrees that the WARM method is one of many methods that could be used to estimate an allowance for credit losses for less complex financial asset pools. The staff also provides examples of how it could be used.

14. An important aspect of our educational efforts involves the Credit Losses TRG, which comprises representatives from large and small financial institutions, auditors, and other affected stakeholders. We formed the Credit Losses TRG to solicit, analyze, and discuss implementation issues that arise. The Credit Losses TRG brings potential implementation issues to our attention, which has helped us determine what, if any, actions (such as additional educational efforts or further clarifications of the guidance) may be needed. The following table summarizes the TRG activities and outreach conducted by the FASB staff in preparation for TRG meetings:

| TRG Meetings | Outreach |
|---|---|
| **September 2015**<br><br>**April 1, 2016** | Held two TRG meetings before the standard was issued to educate the Board on operational concerns before the standard was issued. |
| **June 12, 2017**<br><br>**June 11, 2018**<br><br>**November 1, 2018** | Held three TRG meetings post-issuance to discuss implementation issues that have arisen as well as educating stakeholders broadly about the new standard. |

## Alternatives Considered

15. The following table highlights some of the alternatives considered by the FASB when deliberating and redeliberating which accounting model should be used to measure credit losses on financial instruments. The table does not include the following alternatives:

a. Fair Valuing Loans and other Financial Assets
b. Gross Up Model (similar to PCD accounting)

| | No Forward-looking Information | | Forward-looking Information | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Existing GAAP** | **Yield Adjustment 2010** | **Good Book, Bad Book 2011** | **3-Bucket Model 2011** | **"Gross-Up" Model (OCI) 2013** | **Truncated Model 2013** | **CECL 2012 - 2016** | **Proposed Alternate Model 2018** |
| **Objective** | Objective unclear – mixed measurement model | ACL reflects all estimated CL for remaining life of financial instrument | Objective unclear – mixed measurement model | Objective unclear – mixed measurement model | Present net amount expected to be collected | Present net amt expected to be collected (less than lifetime) | Present net amount expected to be collected | Present net amount expected to be collected |
| **Income Statement Recognition** | General reserve<br><br>Impairment – DCF or FV of the collateral | All contractual amts that entity does not expect to collect; Interest income based on ACB net of ALLL. | Good Book – Higher of TPA or CL in foreseeable future (min. 12 months)<br><br>Bad Book – Full ECL | B1 – Lifetime ECL for loss events in next 12 months<br>B2 – Lifetime ECLs (pool)<br>B3 – Lifetime ECLs (individual) | Amortization over loss emergence period + True Ups | Current expected credit losses (not lifetime) | Current expected credit losses lifetime reserve | General reserve up to<br>(1) 12 months<br>(2) Reasonable & supportable<br>(3) LEP<br><br>Impairment - Lifetime ECLs |
| **OCI** | N/A | N/A | N/A | N/A | ECL | N/A | N/A | B/S – P&L = OCI (Plug) |
| **Recognition Thresholds** | General reserve – probable for (1) impairment & (2) reasonably estimated<br><br>Impaired – probable that will not collect all amts due (using current conditions) | Expected CL (No thresholds) | Good Book – TPA until credit risk mgt objective changes<br><br>Bad Book – Expected CL | B1 – TPA until credit deteriorates<br>B2/3 – Expected CL (B3 - FASB/IASB: Pool evaluation)<br>(B3 - IFRS 9: Evidence of impairment) | Expected CL (No thresholds) | Expected CL (No thresholds) | Expected CL (No thresholds) | Assets are impaired when probable that will not collect all amts due |
| **Amt of Day 1 Loss in P&L** | General reserve | Lifetime ECLs | Good Book calculation only | B1 calculation only | Zero | Portion of lifetime ECLs | Lifetime ECLs | General reserve on non-impaired assets and lifetime ECLs on impaired assets |
| **Measurement Models** | Two | One | Two | Three | One | One | One | Two |
| **Unit of Account** | Pool/individual | Option for pool/individual | Only open pools considered | Pool or individual based on bucket | Not Considered | Not Considered | Pool if similar risk characteristics | Pool if similar risk characteristics |
| **Operational Concerns** | Probability Evaluation | No tracking | Tracking | Tracking | Tracking of True-Ups | Tracking new, existing loans | No tracking | Probability Evaluation, Tracking |

**Benefits and Costs (As shown in ASU 2016-13 Basis of Conclusion Paragraphs 2 – 13)**

16. BC2. Paragraph OB2 of FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting, Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information, states the following:

> The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [Footnote reference omitted.]

17. BC3. The objective of this Update, which is based on the objective of general purpose financial reporting, is to provide financial statement users with more decision-useful information about the expected credit losses on financial assets and other commitments to extend credit held by a reporting entity at each reporting date. Users criticized previous GAAP because the thresholds required to recognize credit losses delayed the recognition until the credit losses were probable, even if an entity may have had an expectation of a future loss. Diversity also existed in application of when the "probable" threshold had been reached. The combined effect of delayed recognition and diversity resulted in a misalignment between accounting standards and the market's perception of credit risk as evidenced by a significant disparity in market value as compared with book value of creditors, most evident in stressed economic environments. As a result, users supported an approach for the allowance for credit losses based on management's expectations of credit losses over the contractual life of the financial assets (considering the effect of prepayments) with an explanation of inputs and assumptions and changes in those inputs and assumptions from the prior reporting period. Also, recognizing the subjective nature of estimating credit losses, users supported additional disclosures that would facilitate users' assessment of management's initial credit loss estimate for newly originated loans as well as subsequent changes to those estimates.

18. BC4. In conjunction with the due process that led to the issuance of this Update, the Board conducted extensive outreach activities with users, preparers, and auditors of financial statements to obtain information about specific deficiencies in the previous GAAP accounting requirements for credit losses. Input was received both before the project was added to the Board's technical agenda and throughout the project.

19. BC5. The FASB's Rules of Procedure states that the mission of the FASB is to:

> Establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.

20. BC6. In fulfilling that mission, the Board follows certain precepts, including the issuing of standards only when the expected benefits of the resulting information justify the expected costs. The Board strives to determine that a standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

21. BC7. On the basis of extensive due process and significant input received from financial statement users and preparers, the Board concluded that the guidance in this Update will provide users of financial statements with more decision-useful information about the credit risk inherent in financial assets and the change in expected credit losses occurring during the period. The Board developed the amendments in this Update to provide users of financial statements with relevant information. The Board expects this updated guidance to accomplish the following:

    a. Result in an earlier measurement of credit losses

    b. Result in greater transparency about the extent of expected credit losses on financial assets held at the reporting date

    c. Improve a user's ability to understand the realizability of assets held at each reporting period

d. Improve a user's ability to understand changes in expected credit losses that have taken place during the period

e. Improve a user's ability to understand purchased financial assets with credit deterioration by enhancing the comparability of the reporting with that of originated assets, while also reducing the cost and complexity of accounting for those assets

f. Provide greater transparency to the user in assessing the credit quality indicators of a financial asset portfolio and changes in composition of the financial asset portfolio over time.

22. BC8. The Board recognizes that the amendments in this Update may require significant effort for many entities to gather the necessary data for estimating expected credit losses. The Board also recognizes that the guidance will require additional effort to review, audit, and examine financial statements. During the course of developing the amendments, the Board sought to minimize the cost of implementing the credit loss guidance and its complexity by developing an approach that:

a. Permits an entity to utilize its current internal credit-risk management approaches and systems as a framework for applying the new measurement objective

b. Does not include multiple measurement objectives that would have required different measures of credit losses depending on whether credit deterioration for financial assets has occurred for assets measured on an amortized cost basis

c. Does not prescribe specific estimation methods to be used in any specific circumstance but, rather, allows an entity to apply judgment to develop estimation methods that are appropriate, practical, and consistent with the principles of the guidance

d. Does not change the guidance for writing off uncollectible assets

e. Does not change interest income reporting for originated loans on the basis of feedback received that preparers manage and users seek separate reporting of credit risk and interest income separately

f. Requires an entity to consider forward-looking information rather than limiting consideration to current and past events, at the date of the statement of financial position

g. Allows an entity to revert to historical loss information, with a straightline or immediate reversion both being acceptable methods if the expected contractual term of financial assets goes beyond periods for which reasonable and supportable forecasts can be obtained

h. Makes targeted improvements to the impairment of available-for-sale debt securities, which was supported by both users and preparers

i. Provides transition relief for a prospective transition approach for assets for which the guidance in previous GAAP (Subtopic 310-30) had been applied and for assets for which an other-than-temporary impairment had been recognized before the effective date.

23. BC9. The Board understands that some stakeholders are of the view that a requirement to record the full estimate of expected losses may inhibit lending, particularly to less creditworthy borrowers or during an economically stressed environment. However, the amendments in this Update do not change the economics of lending. In other words, the same loss ultimately will be recorded, regardless of the accounting requirements. What changes is an accounting threshold for the recognition of credit losses, which affects only the timing of when to record credit losses, not the ultimate amount realized on the financial assets. The guidance on credit losses should provide information that is useful in making business and economic decisions, and that guidance on credit losses should provide information that faithfully reports the economics of a transaction, regardless of any perceived positive or negative impact of reporting that information in the financial statements (that is, "neutrality") has on business and policy decisions. This information will assist users in making their own decisions based on the financial information.

24. BC10. Some stakeholders may interpret Topic 326 as recognition guidance; however, Topic 326 is measurement guidance. The recognition event occurs when the financial asset is recognized on the statement of financial position through origination or purchase. Recognition is limited to assets and liabilities because the conceptual framework places primacy on those

accounts. Expenses and losses in the Conceptual Framework are secondary because they represent changes in balance sheet accounts. Therefore, an expense is a remeasurement of an asset after its recognition. The amendments in this Update provide guidance for the measurement of expected credit losses for recognized financial assets and off-balance-sheet commitments. Following the Conceptual Framework, the measurements of credit losses for recognized financial assets are reported in the income statement as an expense.

25. BC11. In this context, the Board observes that Topic 326 better aligns the accounting guidance with underwriting decisions because expected losses (rather than only incurred losses) generally are considered when underwriting a loan or other financial asset. The Board acknowledges that a growing business involving riskier credits could give rise to measurement of incremental credit losses in the period the loans were originated. However, the Board was concerned about the inconsistency of an accounting standard that measures only incurred losses, whereas the underwriting process considers the expectation of credit losses (that is, the economics of a transaction that are reflected in the underwriting are not reflected in an incurred loss accounting model). The Board concluded that it would have been inappropriate to defer credit losses that were expected by the entity, which would result in the recognition of overstated financial assets.

26. BC12. The Board considered feedback that the cost of implementation will not be known completely until all implementation issues are identified. Although the Board's entire due process procedures are designed to gather information about costs and benefits, the analysis of costs and benefits is unavoidably more qualitative than quantitative. The Board has created a Transition Resource Group (TRG) to assist with issues relating to circumstances that arise during implementation. The Board believes that the TRG will be in a position to monitor implementation efforts and provide support as needed. The Board has considered the role of the TRG when assessing costs and benefits. The Board also observes that the shortcomings of current GAAP create a need for users to derive their own estimates of expected credit losses. Therefore, the amendments in this Update will reduce costs for users. The Board acknowledges that some of those costs will shift to preparers but notes that the costs to the system as a whole should be reduced because management is in a position to make a more informed estimate based on information used in assessing collectibility and underwriting decisions. The Board made efforts to minimize the costs of compliance for preparers as noted in paragraph BC8.

27. BC13. Notwithstanding the potential additional costs described above, the Board concluded that the benefits of more timely measurement of expected credit losses justify the costs.

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[1]. 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[2], 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.

[1]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.
[2]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").[1] 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

[1] 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.[2]

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

[2] 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.[3] 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."[4] 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.

[3] Financial Accounting Standards Board (FASB) publication: "Understanding Costs and Benefits – ASU: Credit Losses (Topic 326)," June 16, 2016
[4] 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."[5] 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.[6] 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."[7] As noted by the

[5] The ClearingHouse Staff Workpaper 2018-3: "*Current Expected Credit Loss: A Top DownApproach*"
[6] The ClearingHouse Staff Workpaper 2018-3: "*Current Expected Credit Loss: A Top DownApproach*"
[7] 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,"[8] 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

[8] Abad, Jorge, and Javier Suarez (2018), "The Procyclicality of Expected Credit Loss Provisions"

macroeconomic trends."[9] 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.[10]
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

[9] 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.
[10] 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.[11] 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

[11] 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."[12] 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,[13] 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.

[12] 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.
[13] 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.[14] 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

[14] 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[15] and therefore the use of the impaired assets definition should not introduce volatility or procyclicality relative to IFRS 9.[16] 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.

[15] 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.

[16] 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[17] along with addressing the concern that CECL is inconsistent with this definition.[18]

[17] 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"

[18] 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. [19] 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.[20] Further, 12 months is used as the threshold in evaluating whether an entity constitutes a going concern[21] and will be used for the classification of leases as short- or long-term under ASC 842.[22]
22. The Comptrollers Handbook[23] 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

[19] ASC 210-10-45-3 (Balance Sheet), 470-10-45-10 (Debt), and 740-10-45-11 (Income Taxes)
[20] ASC 815 Derivatives and Hedging
[21] ASC 205-40-20 – "within one year after the date that the financial statements are issued"
[22] ASC 842-20-25-2, 842-20-25-3, and the glossary
[23] 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.[24]

*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".[25] 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".[26] The exceptions are the items identified and reported in OCI today. Existing OCI items share certain characteristics with the Proposal, such as:

[24] OCC 2006-47 - Interagency Policy Statement on the Allowance for Loan and Lease Losses
[25] ASC 220-10-20 – Income Statement - Reporting Comprehensive Income - Glossary
[26] SFAS 130 – Reporting Comprehensive Income – Introduction – Paragraph 3

a. unrealized holding gains and losses on available for sale debt securities[27] 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[28] and subsequently reclassified into earnings concurrently with the recognition of the underlying forecasted transaction;
c. foreign currency translation adjustments[29] 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[30] prior service costs and certain gains or losses deferred in OCI and subsequently recognized in earnings during the periods those future benefits relate.[31]

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.[32] 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

[27] ASC 326-30-35-2
[28] ASC 815-20-35-1(c)
[29] ASC 830-20-35-3(a)
[30] ASC 715-30-35-4
[31] 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".
[32] 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[33] 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,[34] 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").

[33] ASC 326-20-50-13
[34] 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). [35] 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

[35] 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[36] 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

[36] 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[37] (other than language referring to net income, credit loss expense, earnings, or provision for expected credit losses[38]). Accordingly, the

[37] ASC 326-20-30-1 through 45-4
[38] 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.

January 11, 2019

Mr. R. Harold Schroeder
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856

Dear Mr. Schroeder:

The undersigned banks and lending institutions ("banking group" or "we") are writing as a follow-up to a conversation that you had with representatives of BB&T Corporation ("BB&T") on December 4, 2018 related to potential modifications to the Current Expected Credit Loss ("CECL") accounting standard. During this conversation, you expressed an interest in gaining a better understanding of various bifurcation options that the banking group might consider, and how such approaches would be operationalized by the financial services industry.

Over the past month, we have devoted significant time and attention toward providing you and the Financial Accounting Standards Board ("FASB") staff with further insight related to these matters. We have summarized certain key observations related to this effort and other considerations as follows:

- CECL Alternative Whitepaper ("the whitepaper") – The banking group reaffirms its support for the CECL Alternative approach outlined in our letter to the FASB dated November 5, 2018. We continue to believe that this approach strikes the most reasonable balance between the objectives of the FASB, the needs of investors, and the concerns expressed by the financial services industry and other stakeholders. Specifically, we believe that:
    - Income statement provisions based on twelve months of expected net charge-offs, plus lifetime expected losses on specifically identified and impaired loans, represents an income statement measurement principle that will be widely understood and allow for comparability.
    - Any additional lifetime reserves recognized in Accumulated Other Comprehensive Income will provide decision useful information to investors and other stakeholders on the longer-term outlook on expected losses that could be meaningfully impacted by future changes in the economic environment.
    - Such an approach would be more consistent with the requirements of IFRS 9.

- Other CECL Alternatives – At the FASB's request, the banking group was asked to consider whether other CECL bifurcation approaches might represent viable alternatives. In the spirit of compromise, we indicated a willingness to consider variants to the CECL alternative outlined in the whitepaper. This flexibility should not be interpreted as a change in direction on our part, but rather a showing of good faith that we stand ready to work with the FASB to identify modifications to CECL that address stakeholder concerns.

- Comparative Evaluation of CECL Alternatives - After giving further consideration to several different CECL alternatives, we have concluded that each approach has distinct advantages and disadvantages, with varying impacts to CECL's stakeholders. The attachment entitled "Comparative Evaluation of CECL Alternative Approaches" provides the banking group's views on the "pros and cons" associated with each potential alternative bifurcation method. In FASB's December 4th conversation with BB&T, it was suggested that there may be a reasonable bifurcation approach that leverages some form of an incurred loss methodology. However, after evaluating the results summarized in the attached comparative evaluation we believe that it would be imprudent for this group to formally endorse any approach (other than what was described in our whitepaper) at this point in the process. Therefore, we reaffirm support for the CECL alternative approach as described in our letter to the FASB dated November 5, 2018.

As noted above, you also asked the banking group to provide further insight into how the varying bifurcation approaches would be operationalized. Given the limited time that we've had available to gather information, we were unable to gather feedback from all members of the banking group related to this topic. However, based on the feedback that we have received thus far, we have identified no insurmountable issues from an operability perspective. While any bifurcation approach would likely require additional testing and modifications to the CECL models currently under development, and certain other aspects of the allowance estimation process would require additional analysis (e.g., bifurcation of qualitative reserves), the banking group has not identified any significant operability concerns that would prevent the FASB from giving further consideration to any of the alternative approaches. We do believe that the one year (or other specified time period) bifurcation approach would be more operable than an incurred approach.

In addition to our thoughts on the proposal, we are aware of numerous requests for a delay in the implementation of CECL in order to provide the time necessary to complete a quantitative impact study, which should be designed to assess any unintended consequences that CECL may have on the broader U.S. economy and bank capital levels. We believe that such a delay would be a prudent course of action prior to moving forward with CECL implementation or any alternative proposals that you may consider.

Our banking group is committed to working with the FASB to further evaluate potential changes to CECL. We believe that the alternative approach outlined in our whitepaper represents the best path forward. Our proposal leverages certain fundamental CECL concepts, such as the ability to consider forward-looking information in establishing reserves, and provides investors with incremental, decision-useful information related to a financial institution's credit losses by incorporating a life-of-loan measure of expected credit losses on the balance sheet. However, our proposal also substantially addresses the industry's concerns related to procyclicality, comparability amongst peers, transparency, and competitive disadvantages for U.S. financial institutions compared to international financial institutions. Further, we believe that the whitepaper approach more appropriately reflects the economics of lending and could offer additional useful mechanisms for regulators to apply bank regulatory capital measures.

We believe that all of the potential alternatives warrant a comprehensive evaluation by the FASB. We stand ready to provide the FASB with support throughout the evaluation process, and are committed to working with the FASB to identify changes that will ultimately benefit all stakeholders.

Sincerely,

Ally Financial, Inc.
American Financial Services Association
BB&T Corporation
Capital One Financial Corporation
CIT Group Inc.
Citizens Financial Group, Inc.
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 Corporation
Synovus Financial Corporation
U.S. Bancorp
Zions Corporation

cc: Russell G. Golden, Chairman – FASB
James L. Kroeker – FASB Board Member
Christine Ann Botosan – FASB Board Member
Gary R. Buesser – FASB Board Member
Marsha L. Hunt – FASB Board Member
Susan M. Cosper – FASB Technical Director

**Attachment A – Comparative Evaluation of CECL Alternative Approaches**

| Alternative Approach | Pros | Cons |
|---|---|---|
| **12 months expected losses** | • Comparability<br>  ○ Domestic - use of a specified time horizon enhances comparability of results between reporting entities, regardless of business model.<br>  ○ International – aligns closely (but not perfectly) with the approach required by IFRS9.<br><br>• Volatility – short time horizon minimizes forecast-driven P&L volatility on non-impaired assets.<br><br>• Conceptual basis:<br>  ○ 12 month time period supported by guidance in the Comptroller's handbook.<br>  ○ Other GAAP requirements based on 12 months.<br><br>• Alignment with loss event – shorter time horizon, coupled with full recognition of expected losses on impaired assets, more closely aligns P&L presentation with underlying loss events, while at the same time avoiding recognition of highly uncertain future losses. | • Regulatory capital considerations – likely challenging to define portion of ALLL that would be eligible for capital relief (i.e., how would the regulators maintain capital neutrality without some measure of incurred losses to measure against.)<br><br>• Consistent with current CECL requirement could result in less credit losses running through the P&L compared to existing incurred loss approach for certain asset classes.<br><br>• Could be viewed as a "bright line." |
| | | |
| **Some other specified time period (e.g., 18 or 24 months)** | • Comparability – use of specified time horizon enhances comparability of results between reporting entities, regardless of business model.<br><br>• Longer specified time frame addresses optics of an approach that would result in less losses running through the P&L under the 12 month view.<br><br>• Alignment with loss event – shorter time horizon, coupled with full recognition of expected losses on impaired assets, more closely aligns P&L presentation with underlying loss events, while at the same time avoiding recognition of highly uncertain future losses. | • Conceptual basis – some other specified time period may be viewed as arbitrary.<br><br>• Could be viewed as a "bright line."<br><br>• Uneven application across business models – use of a longer specified time period could have a more significant impact on business models with shorter loss emergence periods. |

| Alternative Approach | Pros | Cons |
|---|---|---|
| **Reasonable and supportable (“R&S”)** | • Straight-forward change to CECL standard – leveraging existing definition of reasonable and supportable (“R&S”) period would streamline change from FASB’s perspective.<br><br>• Correlation to CECL models – leveraging a CECL-defined term may mitigate concerns regarding operationality of bifurcation approach. | • Comparability – definition of R&S period will vary amongst reporting entities.<br><br>• Incentive to minimize R&S period – could incentivize financial institutions to select a shorter R&S period. Therefore, could generate issues with application to Regulatory Capital.<br><br>• Conceptual basis – may be viewed as arbitrary.<br><br>• Changes to the R&S period would have a direct impact on reported earnings. |
| | | |
| **Incurred losses** | • Conceptual basis – use of incurred loss approach has a solid foundation from a conceptual perspective.<br><br>• Consistency – approach is most consistent with current P&L recognition of credit losses compared to the other alternatives.<br><br>• Business model differences – acknowledges that incurred losses could vary based on underlying business models (i.e., certain types of lending have shorter loss emergence periods than others.)<br><br>• Regulatory capital considerations – most straight-forward approach to align with regulatory capital requirements (i.e., incremental CECL reserves clearly identified for purposes of providing capital relief). | • Operationality – differing loss emergence periods by product type results in further complication of bifurcation approach. Therefore, could result in having to run 2 separate models.<br><br>• Volatility – longer time horizon could drive forecast-driven volatility on non-impaired assets.<br><br>• Comparability – results would not be as comparable as the specified time period alternatives (e.g., 12 months or some other specified timeframe) as the diversity that exists in the application of when the probable threshold has been reached would continue.<br><br>• In combination with CECL could be a convoluted concept<br><br>• Commercial incurred periods that are higher than CECL become nonsensical |

## Appendix C: FASB Transition Resource Group (TRG) Memo No. 14 (Excerpt)

***Disclaimer:*** *This paper has been prepared for discussion at a public meeting of the Transition Resource Group for Credit Losses. It does not purport to represent the views of any individual members of the Board or staff. Comments on the application of generally accepted accounting principles (GAAP) do not purport to set out acceptable or unacceptable application of GAAP. Stakeholders are strongly encouraged to listen to feedback about this staff paper from TRG members and Board members during the TRG meeting and to read the meeting summary, which will be prepared by the staff after the meeting.*

### Recent Technical Inquiries

6. Paragraphs 326-20-50-5 through 50-6 require public business entities to disclose in the footnotes to the financial statements the amortized cost basis of financial assets by class of financing receivable or major security type, credit quality indicator, and year of origination to meet the disclosure objective in paragraph 326-20-50-4. Paragraph 326-20-55-79 (Example 15) illustrates how an entity might meet the disclosure requirements in the implementation guidance. In addition to providing amortized cost basis by origination year, the illustration also provides a line item for gross writeoffs and recoveries for each origination year. A stakeholder asked whether gross writeoffs and recoveries are required to be included in the credit quality disclosure, similar to Example 15, because the requirement is not dictated by the guidance contained within paragraphs 326-20-50-5 through 50-6.

7. In reviewing the objectives of the credit quality disclosures (described in paragraph 326-20-50-4), the information in these disclosures should enable a financial statement user to "assess the quantitative and qualitative risks arising from the credit quality" of an entity's financial assets. The staff further recognizes the required disclosures are intended to help "users of the financial statements in understanding…management's estimate of expected credit losses…and changes in the estimate of expected credit losses that have taken place during the period," as described in paragraph BC106. The staff also notes that in accordance with paragraph 326-20-50-11, an entity is required to disclose "reasons for significant changes in the amounts of writeoffs by portfolio segment and major security type" to comply with the disclosure objective for the allowance for credit losses detailed in paragraph 326-20-50-10.

8. The staff believes that the Board intended to provide financial statement users with insight into management's estimates of the allowance for credit losses and how the individual components of the allowance (like writeoffs) are changing each reporting period. The staff notes that displaying gross writeoff and recovery information by vintage year allows financial statement users to better understand management's initial and revised expected loss estimates, the overall intent of the required disclosures. The staff also notes that gross writeoff and recovery information by vintage year enables financial statement users to track cyclical trends and create loss curves that can be compared to an entity's expected loss estimates. The staff believes that omitting the information needed to track management estimates in this way would significantly decrease the confirmatory value of the financial information provided in the vintage disclosure.

9. Based on the reasons listed above, the staff believes that gross writeoff and recovery information displayed by vintage year is critical to a financial statement user's understanding of the risks associated with an entity's financial assets. Given the Board's intentional inclusion of gross writeoff and recovery information in Example 15, the staff believes that the Board intended to include these amounts to comply with the disclosure requirements. Therefore, the staff believes that gross writeoffs and recoveries should be presented by origination year within the credit quality disclosures described in paragraphs 326-20-50-5 and 50-6.

10. The staff plans no further work on this issue.