

### FASB STANDARD ON ALLOWANCE FOR CREDIT LOSSES (IMPAIRMENT)

In June 2016, FASB issued a new standard on accounting for loan losses and losses on held-to-maturity (HTM) debt securities. The FASB standard (nicknamed the Current Expected Credit Loss Impairment Model – “CECL”) requires banks to record credit losses at origination, based on a so-called “life of loan loss” expectation. CECL requires forecasting all future losses, a process that adds to the complexity and lowers the reliability of this highly judgmental area of accounting. The standard will be effective in 2020 for SEC registrants and 2021 for all others.

FASB’s CECL standard may increase the ALLL, though many factors will determine the impact for each bank. Changes in expectations of future economic conditions play a large role in CECL and can significantly affect the credit loss estimate. While OCC estimates made in 2012 indicated 30% to 50% increases, more recent projections performed by KBW were far lower.

Long-term forecasts of future credit losses are inherently imprecise and will likely necessitate additional regulatory capital buffers on top of the new Basel III additions. Investors will need to be educated on new mismatches of income to expenses, as well as of credit losses (which are recorded at origination) to credit metrics, such as delinquencies (reported on a current basis).

The biggest challenge in the long run is the operational impact. Costly new systems and processes to track loan performance may need to be purchased or developed for banks of all sizes. While banking regulators insist the sophistication of a bank’s CECL processes should be consistent with the sophistication of its operations, significant procedural challenges will, nevertheless, be faced both in implementation and on an ongoing basis. ABA’s discussion paper *CECL Challenges: the Life of Loan Concept* details several of these challenges.

The industry position has been consistent since CECL was first proposed:

1. CECL should be amended – Banks should record an estimate of all losses that can be estimated with reasonable confidence. Instead, CECL requires a forecast of the future that decreases confidence in ALLL estimates.
2. The standard must be workable for banks of all sizes. To this end, ABA sponsored a private day-long workshop in February 2016 with banking agencies, FASB, bankers, and auditors to help ensure such expectations are understood.
3. Banking agencies should revisit Basel III rules to ensure consistency with CECL, primarily related to Tier 2 capital. As significant increases in credit loss estimates may be required, reconsideration of the regulatory capital rules is also required.

With the standard now issued, ABA will be providing training to its members through webinars, workshops, discussion papers, and the formation of peer groups. ABA will monitor implementation progress throughout the industry through the peer groups to determine whether FASB needs to provide extra time in implementation or any changes or clarification in its guidance. Engagement with the regulators related to capital will occur within the next several months.