FASB/IASB Joint Accounting Proposal

Background

The Financial Accounting Standards Board and the International Accounting Standards Board are jointly proposing new standards for accounting of ALLL and Other Than Temporary Impairment of debt securities (OTTI) called the Current Expected Credit Loss model ("CECL"). The proposal is intended to address the overstatement of assets caused by delayed recognition of credit losses under existing standards, which recognize a credit loss that is probable or has already incurred. The CECL model, which applies to loans, debt securities, lease receivables, loan commitments, and other receivables, requires banks to impair existing financial assets on the basis of current estimates of contractual cash flows not expected to be collected. Estimates would be based on past events, current conditions, and forecasts.

The CECL model focuses on recording "life of loan" ("LOL") losses as of loan origination, which would require banks to make forecasts far beyond their capability. Because CECL is unrelated to how banks manage credit losses, it would require significant changes to the systems that banks currently use to estimate credit losses. As a result, bankers would be producing estimates that are unreliable to users of financial disclosures and also inconsistent with current regulatory standards.

The required recording of LOL losses up front is troubling as bankers do not originate loans believing that they will default. Instead, bankers manage credit portfolios, including expected portfolio losses, by adjusting underwriting, pricing, and volume on a going-forward basis. The CECL model would also require reference to historical loss experience that inevitably over-weights the anomalous financial crisis beginning in 2008, thus heavily skewing the ALLL. The OCC estimates that the ALLL will be 15% - 50% higher industry wide under the new standard.

Comment Letters Needed

Bankers are requested to send comments to FASB urging it to continue working with bankers, investors, regulators, and auditors to improve the proposal. Among the comments you might offer are:

- the CECL should exclude debt securities, as their accounting is already covered by the existing OTTI standard and does not improve it;

- the CECL will require overhaul of existing estimation systems, and thus significant costs to develop and apply new policies and procedures;

- the CECL will result in unreliable and volatile loss estimates beyond the foreseeable future.

Attached are draft comments prepared by the American Bankers Association for your use. Letters are to be sent to FASB, attention to Russell G. Golden at director@FASB.org. Please include in your letter your bank's relevant information and choose among the sample paragraphs those concerns that apply to your bank. It is important that you write a letter that is specific to your bank rather than adopt any paragraph "as is." Here is the link to the latest version of FASB's proposal for your reference. If this proposal affects your bank, your voice is important.