Friday, August 03, 2018

Volume 12, No. 150

ISSN 1935-9721

Today's News

FASB News

Banks Look to Lessen Credit Loss Standard's Effect on Regulatory Capital

Topic(s): FASB, GAAP, Financial Reporting, Disclosure, Specialized Industries, Regulated Industries, Risk, Debt, Equity, Derivatives, Financial Management

Summary: *Banks want federal banking regulators to make it easier to adopt the FASB's credit loss standard. Some banks think the standard as it is currently written does not accurately reflect how they manage their loan portfolios, and they believe more time is needed to study the standard's effects before it can be properly implemented.*

Bank regulators in April issued a proposal to ease the regulatory capital impact of the biggest bank accounting change in decades. It is not enough, banks and trade groups are telling regulators.

In letters to the Federal Reserve, Federal Deposit Insurance Corp., and the Office of the Comptroller of the Currency, banks and trade groups say regulators need to lessen the capital blow of implementing the FASB's new accounting standard beyond what the regulators offered in *Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations*. The proposal allows banks the option to phase in, over a period of three years, the adverse effects on regulatory capital banks expect to feel when they adopt the FASB's new accounting standard, published in June 2016 as Accounting Standards Update **(ASU) No. 2016-13** , *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The standard goes into effect in 2020 or 2021, depending on the size of the financial institution.

The American Bankers Association, the Independent Community Bankers Association, and several individual banks want the regulators to consider changing its proposal from a three-year phase in to a period of five years.

"The longer the better," said James Kendrick, first vice president of accounting and capital policy at the Independent Community Bankers of America. "The more time you've got there to make the transition, the better off all the institutions will be."

Some banks asked the regulators to go a step further, asking them make the FASB consider changes to the accounting standard itself. The American Bankers Association (ABA), asked regulators to analyze the standard's effect on capital before allowing it to be implemented.

The credit losses standard "is inconsistent with the economics of lending, and therefore will not provide financial statement users with decision-useful information," wrote BB&T Corp. in a letter that asked the regulators to delay the standard's implementation until a full study of its economic effect can be conducted. In addition, the Winston-Salem, North Carolina, banking company asked regulators to have the FASB consider breaking up loan loss estimates into two components: an estimate of expected losses over the next 12 months and a second estimate of the expected losses over the contractual term of the underlying financial instruments. KeyCorp of Cleveland called for a similar change.

The FASB's credit loss standard requires banks and other businesses to look to the foreseeable future, consider the losses that could happen over the life of a loan, trade receivable, or security, and set aside reserves to cover the losses. The new accounting attempts to address criticisms that the incurred-loss standard that is being replaced resulted in a delayed recognition of the losses on bad loans and declining securities that came too late in the credit cycle. By the time the banks submitted quarterly filings to the SEC that recognized the write-downs, their stocks and the instruments that were trading on the open market had lost value because the banks were stuck with so many devalued instruments on their balance sheets.

The comment period ended on July 13, 2018, and the FDIC, Fed, and OCC declined to comment on how they might act on the banks' requests for a longer phase-in. The regulators said they were reviewing the banks' comments.

The breadth of the requests, however, underscores the significance of the FASB's new accounting requirements as well as the changes - and work - banks expect to make to comply with the new guidance.

Michael Gullette, an ABA vice president, said the group's request for a longer phase-in time was secondary to its call for more guidance from regulators on how to comply with the FASB's current expected credit loss (CECL) accounting model.

"The calculations are easy - X times Y," Gullette said. "It's all the other analysis that needs to be done so you don't look really stupid in a board meeting, or someone comes to you and says, 'That other bank is a lot lower than you, or why are you so high?' You need to have an understanding of that."

In addition, the provisions of the credit loss standard overlap with other, post-crisis reforms that have shored up bank loss buffers already, he said.

A FASB spokesperson said the board has met regularly with bankers and regulators to answer questions after **ASU No. 2016-13** was published.

"We will continue to work with both regulators and banking institutions to ensure a smooth and effective implementation of the standard, and stand ready to answer any questions as they arise," the spokesperson wrote in an email to *Accounting & Compliance Alert*.

The FASB took the better part of a decade to publish the credit loss standard, which is considered the board's most important work to emerge from the 2008 financial crisis. The odds of the standard-setter revising the standard at this late hour are slim.

"I really highly doubt it," said Stephen Masterson, BDO USA LLP managing director and national leader of the firm's U.S. Financial Institutions Advisory Services practice. "It would be rare for them to reopen something after so many years went into this and so much analysis."

Banks' common equity tier one capital ratio is the key ratio used as a measure of a bank's financial strength. The capital is reduced when reserves are set aside to cover losses on loans and other instruments.

The FASB's new credit loss model requires banks to make new calculations to determine their loan loss allowances, which most banks expect to increase under the new accounting.

"The expectation is that once we implement CECL, if our allowance was 100 today, under the new model it may become 110 or 120 or 130," Masterson said. "And once you deduct that from capital, it's going to have huge impact on your ratios."

For in-depth analysis of the FASB's guidance for credit losses, please see **Catalyst: US GAAP - Financial Instruments-Impairment** , also on Checkpoint.

Additional analysis of the credit loss standard can be found on Checkpoint at *Accounting and Auditing Update Service* **[AAUS] No. 2016-29** and *SEC Accounting and Reporting Update Service* **[SARU] No. 2016-34** (July 2016): *Special Report: Accounting for Credit Losses on Certain Financial Assets-An Explanation and Analysis of Accounting Standards Update No. 2016-13*.