October 24, 2018

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
Merritt 7- P.O. Box 5116
Norwalk, CT 06856-5116

The Honorable Jerome Powell
Chairman
The Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th St NW
Washington, D.C. 20429

The Honorable Joseph Otting
Comptroller
Office of the Comptroller of Currency
400 7th Street, SW
Washington, D.C. 20219

Dear Chairman Clayton, Chairman Golden, Chairman Powell, Chairman McWilliams, and Comptroller Otting,

We thank your representatives for participating in our September 4 roundtable to discuss banking industry concerns regarding Accounting Standards Update 2016-13[1] (also known as the "current expected credit loss" accounting standard for the measurement of credit losses, or "CECL") issued by the Financial Accounting Standards Board (FASB). It is evident from our conversation that addressing CECL within the regulated banking industry is an intricate issue because of the differing missions and responsibilities of FASB and the banking agencies, especially considering that, by law, the agencies must require accounting no less stringent than generally accepted accounting standards (GAAP). By requiring lifetime estimates of credit loss to be recorded upon loan origination, implementation of CECL will significantly change how a bank manages the composition of its loan portfolio and, as a result, we are concerned that it will harm consumers and businesses. Specifically, banks may be discouraged from originating longer tenor products like residential mortgage loans to preserve capital during times of stress. Prudential regulators would, thus, be negligent if they did not formally consider those impacts, as well as any other consequences on the regulated banking industry as a whole.

This is why we strongly urge you to consider conducting a formal quantitative impact study, including how CECL would have affected regulatory capital leading up to and going through the

[1] FASB Accounting Standards Board (June 2016). Available at https://asc.fasb.org/imageRoot/39/84156639.pdf.

Great Recession, to assess the key issues we discussed during the roundtable and to also propose solutions where appropriate. Such a study would necessarily address second and third order impacts of the change, such as the potential for both further reductions in economic activity and higher unemployment during economic downturn. As this will have a fundamental impact on financial institutions, their input should be incorporated into the study. Further, given the complexities of this study, we also encourage you to consider a delay of the implementation date to adequately analyze and understand the issue. The following are some of the specific issues that were discussed during the roundtable and should be addressed in the study.

While banking agency support for the CECL standard is based on the assumption that earlier credit loss recognition will result in decreasing the level of procyclicality of the industry, various studies indicate that application of CECL could actually cause more procyclicality.[2] This appears to be driven by high reliance on economic forecasts, most of which struggle in anticipating economic downturns. This increased procyclicality can harm consumers and businesses, especially during a recession. It seems doubtful to us that the agencies or FASB members would have supported the issuance of CECL in its current form had that been understood, especially considering their collective contribution to the 2009 "Report of the Financial Stability Forum on Addressing Procyclicality in the Financial System,"[3] which states that "addressing procyclicality is an integral part of strengthening the macroprudential or systematic orientation of the regulatory and supervisory frameworks."[4]

During the roundtable, we discussed one specific accounting alternative to address this and other alternatives should also be considered, if appropriate. Given Chairman Clayton's past various comments addressing related concerns, such as "...when an accounting standard...gives rise to unwarranted results under bank capital rules, it may be necessary to modify other rules (e.g. the bank capital rules) to eliminate that unwarranted result,"[5] it appears that due course would necessitate a study to determine the most appropriate course of regulatory action if an accounting solution is not feasible.

At the center of our discussions were the higher and more volatile allowances required for thirty-year residential mortgages and for loans to those with lower credit quality. Prudent bank underwriting, pricing, and portfolio management will naturally be responsive to risk and the related costs of capital. Limiting the availability of credit to these borrowers, especially residential home mortgage borrowers, however, and increasing the prices of these products would have broad public policy implications, as any policy that incentivizes banks to venture into products that show higher accounting profitability or alternate terms. These implications must be assessed.

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[2] See F. Covas and W. Nelson. Current Expected Credit Loss: Lessons from 2007-2009. Bank Policy Institute, July 2018. Findings in this paper are also corroborated by preliminary results from various banks during their CECL preparations.

[3] Financial Stability Forum, "Report of the Financial Stability Forum on Addressing Procyclicality in the Financial System." (Apr. 2009). Available at http://www.fsb.org/wp-content/uploads/r_0904a.pdf.

[4] *Id.* at 10.

[5] Clayton, J., Answer to question from Senator Heidi Heitkamp, Committee on Banking, Housing, and Urban Affairs, "Oversight of the U.S. Securities and Exchange Commission," September 26, 2017.

Further, not only will CECL's impact on bank capital seem to adversely affect these consumers, it appears that CECL could also change the community banking industry, as thousands of community banks exist mainly to serve these specific borrowers on a local basis. For example, it was also cited during the roundtable that approximately 650 of these banks may need to raise up to $45 billion in additional capital in order to maintain their "Well Capitalized" status under CECL and that implementation costs are dramatically higher than the agencies or FASB initially estimated. With this in mind, it would be useful to review FASB's cost-benefit analysis that is required prior to issuance of each standard. While we understand that bank examiners are looking for "good faith efforts" by community banks in designing CECL systems, costs taking into account stringent auditing standards, such as those proposed by the PCAOB, appear to be a more appropriate yardstick. More importantly, however, is that beyond the operational cost-benefit review, the study appears needed in order to assess whether community banks will be able to continue to compete in such markets while carrying the additional costs.

We appreciate the candor of the participants during the roundtable and the efforts they have put in thus far in order to understand the challenges of implementing CECL, both relating to bank operations and bank capital. The inherent unreliability of economic forecasting, especially at critical points in the economic cycle shortly prior to downturns and recoveries, and the wide range of acceptable assumptions pose a real challenge in executing your supervisory function under CECL, especially if individual banks must raise capital based on the forecasts and assumptions. Since real money, real banks, and real customers are at stake, we believe a quantitative impact study is needed. We are fully committed to the independent manner in which GAAP is formulated. However, we also believe FASB can have a role if alternatives measures are insufficient. In the end, as banks have an integral role in the economy, we believe that transparency is needed as to how bankers, regulators, and investors are expected to react to the new paradigm and to any effects it may have on the economy more broadly. The quantitative impact study should then seek to shed such light.

Thank you for your attention to this important matter.

Sincerely,

Ted Budd

Ted Budd
Member of Congress

Blaine Luetkemeyer
Member of Congress

Bill Huizenga

Bill Huizenga
Member of Congress

Lee Zeldin
Member of Congress

Warren Davidson
Member of Congress

Alex Mooney
Member of Congress

Cc:

The Honorable Steven T. Mnuchin
Secretary
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1500 Pennsylvania Ave NW
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