October 25, 2018

The Hon. Steven T. Mnuchin
Chairman, Financial Stability Oversight Council
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Request for a Quantitative Impact Study and a Delay in the Implementation of CECL

Dear Chairman Mnuchin:

The undersigned organizations are writing to express our concerns regarding the Accounting Standards Update 2016-13 (also known as the "Current Expected Credit Loss" accounting standard for the measurement of credit losses, or "CECL") issued by Financial Accounting Standards Board (FASB). Effective in 2020 for SEC registrants, 2021 for all other companies, CECL fundamentally changes how banks will recognize credit losses in their loan and held-to-maturity debt security portfolios by requiring upfront recognition of credit losses using economic forecasts over the contractual life of the asset while not providing a similar upfront recognition of associated revenues. Further, CECL requires banks to forecast future economic conditions to develop their future expected losses. Due to the inherent unreliability of the long-term economic forecasting, implementation of CECL will increase the volatility of regulatory capital, necessitating increased capital at all times. In accordance with 2009 recommendations made by the Financial Stability Forum, it was FASB's intent to develop an impairment model that would record credit loss reserves earlier and, thus, reduce procyclicality[1]in the industry.

Preliminary testing by various banks, however, indicates not only that CECL will fail to result in significantly earlier loss recognition, but it will also increase procyclicality.[2] As procyclicality generally causes allowances to spike during times of stress, the resulting impacts on bank capital will adversely affect the cost and availability of credit, especially related to longer duration loans and to borrowers with lower credit quality. Therefore, the impact will be greatest on 30 year residential mortgages, small business loans, and loans to non-prime consumers, especially during downturns in the economy. Said plainly, during a recession, the capital impact related to these products will dissuade most banks from lending. We do not believe the banking agencies would have supported issuance of CECL if this were foreseen.

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[1] Procyclicality is understood that, during times of economic stress, banks increase credit loss allowances, which reduces capital and the accompanying ability to lend to borrowers who need liquidity, thereby exacerbating the economic stress. Spurred on by the additional economic stress, credit loss allowances will further increase, prolonging the cycle. Earlier loss recognition is desired because it theoretically would decrease capital (and lending) before the economy heats up too much, thereby becoming a counter-cyclical force.

[2] See American Bankers Association letter to U.S. Banking Agencies at https://www.aba.com/Advocacy/commentletters/Documents/CECL-capital-transition-071318.pdf

Additionally, many community banks have heavy concentrations of residential mortgages in their loan portfolios. Over 800 banks in the U.S. with under $1 billion in assets maintain greater than 50% of their loan portfolios in residential mortgage products, with another 1,250 of similarly-sized institutions holding mortgages that make up between 30-50% of their portfolios. A recent study indicated that several hundred community banks will need to raise capital merely to comply with CECL at the effective date.[3] With all this in mind, and considering that the heavy costs of implementation naturally hit smaller organizations the most, the impact of CECL could change the face of the community banking industry.

As these issues have both macroeconomic and public policy implications, it is, therefore, imperative that these issues be analyzed and practical solutions provided prior to CECL's effective date. We are not aware of any study that has been completed to assess the potential impact of the CECL accounting standard, as recommended by the U.S. Department of the Treasury in 2017.[4] Therefore, we recommend the FSOC to seek a delay in implementation until such a study can be completed. A transparent, two-pronged quantitative impact study (QIS) should be performed and shared with the industry. The QIS must first evaluate the standard's effect on the overall stability of the banking sector and on the availability, accessibility, and affordability of credit throughout an economic cycle. Additionally, the QIS should then assess how CECL will affect smaller banks, including how the capital impacts and the operational costs of CECL will affect their ability to compete and serve their communities. Any negative impacts identified in connection with the QIS must be evaluated holistically, considering possible solutions within supervisory stress testing processes, accounting standard-setting, regulatory capital weighting for both standardized and non-standardized approaches, and other regulatory guidance.

The CECL standard is a critical and challenging issue to the banking industry, as the expected credit loss provisioning that is required under CECL is fundamentally different than current accounting standards. There is significant uncertainty regarding the impact of the standard on the banking industry through an economic cycle. Therefore, we recommend the FSOC delay implementation until such a study can be completed.

Thank you for your attention to this important matter.

Sincerely,

American Bankers Association
Alabama Bankers Association
Alaska Bankers Association
Arizona Bankers Association
Arkansas Bankers Association
Colorado Bankers Association

[3] See https://stonecastle.com/wp-content/uploads/2018/01/2017-12-18-CECL-and-Tier-2-Final.pdf

[4] Included in Appendix B: Table of Recommendations (page 125) of the June 2017 U.S. Department of the Treasury report, "A Financial System That Creates Economic Opportunities – Banks and Credit Unions"

Connecticut Bankers Association
Delaware Bankers Association
Florida Bankers Association
Georgia Bankers Association
Hawaii Bankers Association
Idaho Bankers Association
Illinois Bankers Association
Illinois League of Financial Institutions
Indiana Bankers Association
Iowa Bankers Association
Kansas Bankers Association
Kentucky Bankers Association
Louisiana Bankers Association
Maine Bankers Association
Maryland Bankers Association
Massachusetts Bankers Association
Michigan Bankers Association
Minnesota Bankers Association
Mississippi Bankers Association
Missouri Bankers Association
Montana Bankers Association
Nebraska Bankers Association
Nevada Bankers Association
New Hampshire Bankers Association
New Jersey Bankers Association
New Mexico Bankers Association
New York Bankers Association
North Carolina Bankers Association
North Dakota Bankers Association
Ohio Bankers League
Oklahoma Bankers Association
Oregon Bankers Association
Pennsylvania Bankers Association
Puerto Rico Bankers Association
Rhode Island Bankers Association
South Carolina Bankers Association
South Dakota Bankers Association
Tennessee Bankers Association
Texas Bankers Association
Utah Bankers Association
Vermont Bankers Association
Virginia Bankers Association
Washington Bankers Association
Western Bankers Association
West Virginia Bankers Association
Wisconsin Bankers Association
Wyoming Bankers Association

cc: Russell G. Golden
Financial Accounting Standards Board

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