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October 19, 2020

Mr. Gerard Poliquin
Secretary of the NCUA
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: Transition to the Current Expected Credit Loss Methodology; RIN 3133–AF03

Dear Mr. Poliquin:

On behalf of America's credit unions, I am writing in response to the National Credit Union Administration's (NCUA) Transition to the Current Expected Credit Loss (CECL) Methodology proposed rulemaking. The Credit Union National Association (CUNA) represents America's credit unions and their 120 million members.

Background

The Financial Accounting Standards Board's (FASB) adoption of CECL is intended to result in greater transparency of expected losses at an earlier date during the life of a loan.[1] CECL differs from the incurred loss methodology in several key respects. Most significantly for purposes of this proposed rule, CECL requires the recognition of lifetime expected credit losses for financial assets, not just those credit losses that have been incurred as of the reporting date. CECL also requires the incorporation of reasonable and supportable forecasts in developing an estimate of lifetime expected credit losses, while maintaining the current requirement for consideration of past events and current conditions. Furthermore, the probable threshold for recognition of allowances in accordance with the incurred loss methodology is removed under CECL. Taken together, estimating expected credit losses over the life of an asset under CECL, including consideration of reasonable and supportable forecasts but without applying the probable threshold that exists under the incurred loss methodology, results in earlier recognition of credit losses.

Upon adoption of CECL, an institution will record a cumulative-effect adjustment to retained earnings (known as the day-one adjustment). The day-one adjustment will be equal to the difference between the amount of credit loss allowances required under the incurred loss methodology and the amount of credit loss allowances required under

[1] Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (June 2016).

CECL. Credit unions will likely experience a (potentially sharp) increase in expected credit losses on the effective date as a result of the day-one adjustment, which could lower their prompt corrective action (PCA) classification. Credit unions are required to comply with CECL for fiscal years beginning after December 15, 2022.

Application of CECL to Credit Unions

As member-owned, not-for-profit financial cooperatives, credit unions are unique financial institutions. Credit unions operate for the purpose of promoting thrift, providing credit at competitive rates, and providing other financial services to their member-owners. While unique in structure and small compared to most banks, the vast majority of credit unions must comply with the same accounting requirements under U.S. generally accepted accounting principles (GAAP)—including CECL—as do the largest publicly traded banks.

While we fully appreciate that GAAP is outside the direct regulatory authority of the NCUA, we have steadfastly maintained that CECL is inappropriate for credit unions. We have raised this issue with FASB on numerous occasions,[2] including most recently during an August call with FASB Chairman Jones.

CECL is intended to address delayed recognition of credit losses resulting in insufficient funding of the allowance accounts of certain covered entities. However, underfunding of allowance accounts has not generally been an issue for credit unions. Further, the typical user of a credit union's financial statements is not a public investor—such as with large, public banks—but instead is the credit union's prudential regulator (*i.e.*, the NCUA).

In addition to the direct impact the upcoming changes will have on credit unions' financial positions, credit unions are very concerned with the compliance burden of the changes, which require extensive resources to analyze the loan portfolio on a granular level to calculate and project life of loan losses. This comes during a global pandemic as well as at a time when many credit unions are struggling to comply with a historic level of new and amended regulations. Even those credit unions able to allocate the resources necessary to comply are encountering major challenges since the level of data analytics required is less common among credit unions, unlike much larger, complex banks.

[2] *See* CUNA Comment Letter to FASB (May 29, 2013), *available at* http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175826998512&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs; CUNA Comment Letter to FASB (Sept. 17, 2018), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Priorities/Removing_Barriers_Blog/CL%20-%20FASB%20-%20CECL%20Effective%20Date_final.pdf; CUNA Comment Letter to FASB (Mar. 4, 2019), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2019/Letters/CL%20-%20FASB%20-%20CECL%20Targeted%20Transition%20Relief_final.pdf; and CUNA Comment Letter to FASB (Sept. 11, 2019), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2019/Letters/CL%20-%20FASB%20-%20CECL%20Delay_final.pdf.

Further, we maintain that CECL will hinder lenders' (including credit unions) ability to uplift low- and moderate-income borrowers in their goal of achieving financial independence and the American dream. A completely unintended, though real, consequence of CECL is that it will force lenders to be more discerning of potential borrowers with less than perfect credit.

We greatly appreciate and echo the concerns Chairman Hood has raised on several occasions regarding how the compliance costs associated with implementing CECL overwhelmingly exceed the benefits. Thus, CUNA agrees with the NCUA's call for FASB to exempt credit unions from complying with CECL.[3] At this time, it is critical that credit unions can focus on serving their members, who are facing mounting financial pressures due to COVID-19.

As discussed below, while the ability to phase in CECL for regulatory capital purposes will be helpful in terms of CECL's initial impact on credit unions' financials, it will not change the long-term financial impact or ongoing compliance challenges facing credit unions. Thus, we urge the NCUA to continue to share with FASB the industry's serious concerns regarding CECL as the NCUA continues its close collaboration with the accounting standard setter. We also request that the NCUA increase its focus on CECL compliance guidance and resources for credit unions.

Proposed Rulemaking

<u>Phase-In</u>

The NCUA's proposal would provide that, for purposes of determining a credit union's net worth classification under PCA, the NCUA will phase-in over a three-year period the day-one adverse effects on regulatory capital that may result from adoption of CECL. Consistent with regulations issued by the federal banking agencies, the proposed rule would temporarily mitigate the adverse PCA consequences of the day-one capital adjustments.

Credit unions would continue to calculate their net worth in accordance with GAAP as generally required by section 216 of the Federal Credit Union (FCU) Act, and would also continue to be required to account for CECL for all other purposes, such as Call Reports.

CUNA supports the proposed phase-in of CECL over a three-year period for regulatory capital purposes. As noted above, a phase-in will alleviate the impact of the day-one adjustment but will not change the overall impact the new accounting methodology will have on credit unions. With that said, we believe a three-year phase-in is appropriate. Not only does it conform with the flexibility provided by the federal banking agencies, it also provides a sufficient amount of time for credit unions to spread out the effect of the day-one adjustment.

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[3] NCUA Chairman Hood Letter to Former FASB Chair Golden (Apr. 30, 2020), *available at* https://www.ncua.gov/about-ncua/leadership/honorable-rodney-e-hood/publications-chairman-rodney-e-hood/letter-fasb-urging-cecl-exemption-credit-unions.

NCUA Implementation of the Transition Provisions

Eligible credit unions would not have the option of electing whether to opt into (or out of) the transition provisions. Although this differs from the federal banking agencies' rule, it is consistent with the goal of this rulemaking to mitigate disruptions caused by CECL adoption. Eligibility for the transition provision is limited to those credit unions for which the phase-in is truly necessary—that is, credit unions that will experience a reduction in retained earnings as a result of CECL. The NCUA believes that requiring these credit unions to affirmatively opt into the transition provisions would constitute an unnecessary administrative exercise to confirm their already obvious need for the phase-in. Moreover, some credit unions eligible for the phase-in may inadvertently fail to make the election in the Call Report, thereby reducing the benefit of the transition provision.

We appreciate the NCUA's rationale for proposing automatic application of the phase-in, which differs from the federal banking agencies' rule permitting banks to choose to opt into the transition provisions. We agree that automatic implementation of the phase-in by the NCUA could help ensure its uniform application and that its benefits are provided to the greatest possible number of eligible credit unions.

While we agree with the perceived benefits of applying the phase-in to all credit unions that will experience a reduction in retained earnings as a result of CECL, we believe there may be instances where a credit union would prefer to recognize the day-one adjustment at a single point in time rather than stretch it out over several years. For example, a credit union may anticipate a reduction in retained earnings as a result of CECL but currently be in a financial position where such a hit will not have a significant impact in terms of PCA. Since the credit union knows its current financial position but does not know where it will be over the next three years, it may prefer to forego the phase-in of CECL. Thus, we request the NCUA consider an approach that permits a credit union to opt out of the phase-in. An opt-out approach would greatly reduce the NCUA's concern that an eligible credit union may inadvertently fail to make the phase-in election in the Call Report.

Calculation of the phase-in amount is another area where the proposal differs from the final rule issued by the federal banking agencies, which relies on banking organizations to calculate the phase-in amounts. In contrast, under the proposal, the NCUA will make the required phase-in calculations.

Again, we agree with the NCUA's assessment that having the agency calculate the phase-in amounts will help ensure the uniform implementation of the phase-in, as well as facilitate the accurate calculation of the transition amounts. While the calculation should yield the same amount regardless of which party is conducting it, we request that the NCUA consider including as part of the process the ability for the credit union to address with the agency any possible disagreements or discrepancies regarding the phase-in amount.

Mechanics of the CECL Transition Provisions

To calculate the transitional amount under the CECL transition provision, the NCUA would compare the differences in a credit union's retained earnings between: (1) the credit union's closing balance sheet amount for the fiscal year-end immediately prior to its adoption of CECL (pre-CECL amount); and (2) the credit union's balance sheet amount as of the beginning of the fiscal year in which the credit union adopts CECL (post-CECL amount). The difference in retained earnings constitutes the transitional amount that would be phased-in to the net worth ratio calculation over the three-year transition period beginning the first day of the fiscal year in which the credit union adopts CECL. Specifically, a credit union's CECL transitional amount would be the difference between the pre-CECL and post-CECL amounts of retained earnings.

We support the proposed calculation of the transitional amount. The calculation is appropriate given the concern of the increase CECL implementation will have on a credit union's loan loss reserves. Further, we believe it is appropriate for the CECL transitional amount to be phased-in over the transition period on a straight-line basis automatically as part of the Call Report.

<u>Small Credit Union Exemption</u>

The FCU Act requires that, in general, "applicable reports and statements required to be filed with the NCUA shall be uniform and consistent with" GAAP.[4] The statute, however, also provides an exception to GAAP compliance for credit unions with total assets of "less than $10,000,000, unless prescribed by the NCUA or an appropriate State credit union supervisor."[5] Thus, federally insured credit unions (FICU) with less than $10 million in assets are generally exempt from GAAP. However, as noted below, per the NCUA's regulations, these credit unions currently must comply with GAAP for purposes of accounting for loan losses.

Section 702.402 of the NCUA's regulations requires charges for loan losses to be made in accordance with GAAP and does not distinguish based on the asset size of the FICU. In effect, § 702.402 exercises the NCUA's discretion under section 202 of the FCU Act to override the exception for smaller credit unions by prescribing regulations.

Under the proposal, the NCUA would exercise its statutory discretion under the FCU Act to no longer require that credit unions with total assets less than $10 million make charges for loan losses in accordance with GAAP. Instead the regulations would allow these credit unions to make such charges under any reasonable reserve methodology (incurred loss) provided it adequately covers known and probable loan losses.

We strongly support the proposed change to exempt credit unions under $10 million in assets from complying with accounting for loan losses in accordance with GAAP. Small, medium, and large credit unions continue to struggle with CECL implementation. The

[4] 12 U.S.C. § 1782 (a)(6)(C)(i).
[5] 12 U.S.C. § 1782 (a)(6)(C)(iii).

NCUA using its statutory authority to exclude the smallest FICUs from the costly—initial and ongoing—expenses required to comply with CECL is critical. While these challenges are not unique to only the smallest FICUs, we recognize the GAAP-exemption threshold of $10 million is explicitly stated in the FCU Act, prohibiting the NCUA from exempting from GAAP credit unions at or above $10 million in assets.

Application to Small FISCUs

As noted above, the proposed exemption from GAAP regarding accounting for loan losses will apply to all FICUs under $10 million in assets. The NCUA has noted that, despite the language of the proposed rule, section 202 makes clear that federally insured state-chartered credit unions (FISCU) subject to state laws and regulations may be required to comply with GAAP or other accounting standards under applicable state requirements. Thus, not all FISCUs under $10 million in assets will benefit from the proposed exemption, depending on the requirements in their state.

Based on our research, it appears that approximately half the states do not have a statutory or regulatory requirement for FISCUs under $10 million in assets to comply with GAAP. Therefore, FISCUs in those states will benefit from the proposed CECL exemption for small credit unions.

The remaining states either have explicit statutory or regulatory requirements for all FISCUs to comply with GAAP or it is unclear whether such an express requirement exists. We recognize that the NCUA has limited authority in terms of exempting a FISCU from a state requirement. However, we ask the NCUA to quantify exactly how many under $10 million FISCUs will continue to be required to comply with GAAP following adoption of a final rule. The NCUA should then work with the state supervisory authorities in those states to promote regulatory changes that would provide such relief in states where the impediments are regulatory in nature. For those states with statutory mandates regarding GAAP adherence, we ask the agency to pursue potential legislative fixes and to notify state legislative leaders of the exemption and the unfair advantage FCUs would have over similarly sized FISCUs if not given legislative relief.

Future Ability to Phase-in CECL

As discussed above, many credit unions will benefit from the proposed three-year phase-in of CECL. Further, numerous credit unions below $10 million in assets will benefit from not being required to comply with CECL.

As credit unions continue to grow, there will be some under $10 million in assets at the time CECL takes effect—December 15, 2022—that exceed the exemption threshold at some later point in time. As proposed, it is unclear whether such a credit union would be able to apply the phase-in at that later point. It seems as though the purpose of the phase-in—to lessen the day-one adjustment—would be as important for a credit union in 2024, for example, as it is in 2023. Therefore, we request the NCUA address this issue to determine whether a credit union that reaches $10 million in assets after the CECL effective date is permitted to phase-in CECL for regulatory capital purposes.

Conclusion

On behalf of America's credit unions and their 120 million members, thank you for considering our comments in support of the CECL transition proposal. If you have questions about our comments, please do not hesitate to contact me.

Sincerely,

Luke Martone
Senior Director of Advocacy & Counsel