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 the day-one adverse effects on regulatory capital that may result from adoption of CECL. Consistent with regulations issued by the other federal banking agencies, the proposed rule would temporarily mitigate the adverse PCA consequences of the day-one capital adjustments, while requiring that FICUs account for CECL for other purposes, such as Call Reports.

The proposed rule would also provide that FICUs with less than $10 million in assets are no longer required to determine their charges for loan losses in accordance with GAAP. These credit unions would instead be able to use any reasonable reserve methodology (incurred loss), provided that it adequately covers known and probable loan losses.

Comments on the proposal are due to NCUA by 10/19/2020.

Background

FASB’s adoption of CECL is intended to result in greater transparency of expected losses at an earlier date during the life of a loan. FASB emphasizes that CECL does not change the economics of lending, but only the timing of when losses are recorded. The standard states that, the same loss ultimately will be recorded, regardless of the accounting requirements. What changes is an accounting threshold for the recognition of credit losses, which affects only the timing of when to record credit losses, not the ultimate amount realized on the financial assets.

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 measured at amortized cost, 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 CECL. Credit unions could experience a sharp increase in expected credit losses on the effective date as a result of the day-one adjustment, which could lower their PCA classification.

Credit unions are required to comply with CECL for fiscal years beginning after December 15, 2022.

Proposed Rulemaking

Consistent with the other banking agencies’ February 2019, final rule, the NCUA is issuing this proposed rule to mitigate the adverse effects on a credit union’s net worth category that may result from the day-one
adjustment. Specifically, the proposed rule would provide that, for purposes of the PCA regulations, the NCUA will phase-in the day-one effects on a credit union’s net worth ratio over a three-year period (12 quarters).

Credit unions would continue to calculate their net worth in accordance with GAAP as generally required by section 216 of the FCU Act, and would also continue to be required to account for CECL for all other purposes, such as Call Reports. Further, under the proposed rule, credit unions with less than $10 million in assets would no longer be required to determine their charges for loan losses in accordance with GAAP. This provision would eliminate the adverse PCA consequences for smaller FICUs resulting from CECL. These credit unions would instead be allowed to make charges for loan losses in accordance with any reasonable reserve methodology (incurred loss), provided that it adequately covers known and probable loan losses.

Small FICU Charges for Loan Losses

Section 202 of 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. 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.”

The NCUA’s regulations in § 702.402 require that charges for loan losses be made in accordance with GAAP and does not distinguish based on the asset size of FICUs. 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. The NCUA has elected to once again exercise its statutory discretion under section 202 of the FCU Act. The NCUA’s regulations will 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 will allow these credit unions to make such charges under any reasonable reserve methodology (incurred loss) provided it adequately covers known and probable loan losses. The transition provisions described above apply to credit unions adopting CECL. Accordingly, smaller credit unions that elect to use a non-GAAP measure are not eligible for the phase-in.

The NCUA also notes that, despite the language of the proposed rule, section 202 makes clear that state-chartered, federally insured credit unions subject to state laws and regulations may be required to comply with GAAP or other accounting standards under applicable state requirements.

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 other banking agencies’ rule, it is consistent with the goal of this rulemaking to mitigate disruptions caused by CECL adoption. As noted, eligibility for the transition provision is limited to those credit unions for which the phase-in is truly necessary—that is, they 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. Automatic implementation of the phase-in by the NCUA will help to ensure its uniform application and that its benefits are provided to the greatest possible number of eligible credit unions.

The final rule issued by the other banking agencies relies on banking organizations to calculate the phase-in amounts. In contrast, the NCUA will make the required phase-in calculations. As above, the NCUA has determined that this will help ensure the uniform implementation of the phase-in, as well as facilitate the accurate calculation of the transition amounts.

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 (twelve quarter) 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.

Under the proposed rule, the NCUA would phase-in the credit union’s CECL transitional amount. The NCUA would also phase-in the CECL transitional amount to the credit union’s total assets for purposes of the net worth ratio. Both the credit union’s retained earnings and total assets would be deemed increased by the CECL transitional amount. The CECL transitional amount would be phased-in over the transition period on a straight line basis automatically as part of the Call Report.

Small FICU Determination of Charges for Loan Losses

Section 202 of the FCU Act provides an exception for credit unions with less than $10 million in total assets to the general requirements that reports and statements filed with the NCUA comply with GAAP. As also noted above, the NCUA’s regulations in § 702.402 require that charges for loan losses be made in accordance with GAAP and does not distinguish between the asset size of credit unions. The NCUA, however, is aware that compliance with GAAP may be burdensome for smaller credit unions. This difficulty is likely to be exacerbated with the adoption of CECL. Accordingly, the proposed rule provides that credit unions with total assets of less than $10 million may make charges for loan losses either in accordance with GAAP or with any reasonable reserve methodology (incurred loss) provided it adequately covers known and probable loan losses. This provision would eliminate the adverse PCA consequences for smaller credit unions resulting from CECL, and those credit unions would not be subject to the phase-in procedure detailed in this proposed rule.

Questions

1) The proposal would phase-in CECL over a three-year period. Is this timeframe appropriate?
2) Unlike the banking agencies’ rule that permits banks to choose to opt into the transition provisions, the NCUA proposal will automatically apply the phase-in for those credit unions where such transition is “truly necessary,” as described above. Do you support such an approach? Is there any reason to instead adopt the approach taken in banking agencies’ rule?
3) Under the banking agencies’ rule, banks must calculate their phase-in amounts. However, under the proposal, the NCUA will make the required phase-in calculations. Do you agree with this approach?
4) Small credit unions (under $10 million) will no longer be required to account for loan losses under GAAP. Will this change be beneficial?
5) NCUA notes that, despite the language of the proposed rule, section 202 makes clear that state-chartered, federally insured credit unions subject to state laws and regulations may be required to comply with GAAP or other accounting standards under applicable state requirements. Therefore, depending on the state, certain small FISCUs will not be able to benefit from the proposed change. Does your state have such a requirement, specifying that all credit unions must adhere to GAAP? Is there anyway to rectify this result?
6) Do you agree with the proposed calculation, which would utilize pre- and post-CECL amounts? If not, what approach would be preferable?
7) Other comments or questions.