CECL Regulatory Capital Phase-In Final Ruling

On December 18, 2018, the Federal Reserve, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation issued a final rule revising regulatory capital rules in anticipation of the adoption of Accounting Standards Update 2016-13, *Financial Instruments—Credit Losses (Topic 326)*, and the implementation of the current expected credit loss (CECL) methodology, and to provide an option to phase in the day-one impact of CECL on earnings and common tier one capital.

The final ruling follows the original proposal issued in April 2018. Most noticeable is the introduction of the term "adjusted allowance for credit losses" (AACL), which replaces the term "allowance for credit losses." The new term only applies to allowances related to held-to-maturity debt securities, credit losses on off-balance-sheet exposures and loans held for investment. Similar to the proposed rule, allowances related to available-for-sale debt securities and purchased credit-deteriorated (PCD) assets are excluded from the new term. Lastly, the final ruling maintains the revised definition of "carrying value" under the capital rules and optional provision allowing institutions to phase in the regulatory capital effect of adopting CECL over a three-year period.

The final ruling includes an illustration of the phase-in mechanics and considerations for the accounting treatment for business combinations. The final ruling also addresses additional requirements for advanced approaches for banking organizations, including revision of the term "eligible credit reserves" (ECR) to align with the definition of AACL, treatment of allowable ECR shortfall amounts in common tier one capital and illustration of the phase-in effects on supplementary leverage ratio calculations. For more information, see the full final ruling and BKD's article on the original proposal.

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