FASB Rejects Regional Bank CECL Proposal

FASB recently rejected a proposal developed by regional banks[1] and first discussed at the January 2019 CECL roundtable. The approach would have retained the CECL methodology's intent of establishing a balance sheet allowance for lifetime credit losses, but the income statement provision would be recognized in three parts:

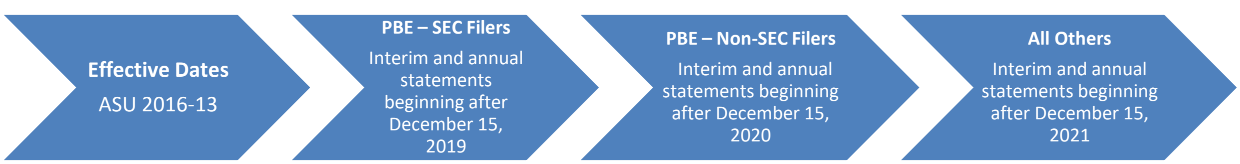
- Nonimpaired financial assets – Loss expectations within the first year would be recorded to provision for losses in the income statement
- Nonimpaired financial assets – Loss expectations beyond the first year would be recorded to accumulated other comprehensive income
- Impaired financial assets – Lifetime expected credit losses would be recognized entirely in earnings

While strongly embraced by midsize banks that put forth the proposal, the proposal received negative feedback from large banks that felt it was too late in the implementation process to introduce alternative models. Community banks and credit unions saw limited benefit and added complexity and cost from the proposed changes. Both large banks and smaller banks saw challenges in the proposal's auditability.

FASB rejected the proposal in a 6–0 vote, citing the operational challenges and lack of incremental improvement. Staff also highlighted the operational challenges of reintroducing a probability threshold and multiple impairment models and the ability to bifurcate Q factors to arrive at the various reserve buckets. Additional outreach to analysts indicated a lack of support for the model in the absence of significant additional disclosure requirements.

FASB also addressed the open question on credit quality vintage disclosures. At the November 2018 transition resource group meeting, FASB caused concern in the industry by indicating it intended that gross write-offs and recoveries were a required part of the vintage disclosure, rather than just an illustrative format. Financial institutions preparing for a 2020 effective date have not included this in their project scope or parallel testing now underway. Other financial institutions cited the cost and operational challenges in adding additional disclosures to an already complex accounting standard that may not apply universally to all entities.

FASB heeded feedback on the January roundtable and—at this point—FASB will not move forward with requiring this disclosure. Preparers should follow the written guidance in the standard and will be in compliance with generally accepted accounting principles if they do not include the disclosure in the illustrative example. Entities can still choose to provide the additional detail. FASB will keep the project on its research agenda and may consider additional standard setting at a future point after the effective date.



[1] *Ally Financial Inc., American Financial Services Association, BB&T Corporation, Capital One Financial Corporation CIT Group Inc., Citizens Financial Group, Inc., Comerica Incorporated, Discover Financial Services, Inc., Fifth Third Bancorp, First Horizon National Corporation, Huntington Bancshares Incorporated, KeyCorp, M&T Bank Corporation, OneMain Holdings, Inc., PNC Financial Services Group, Inc., Regions Financial Corporation, SunTrust Banks, Inc., Synchrony Financial, Synovus Financial Corporation, U.S. Bancorp and Zions Bancorporation*

CECL Standard-Setting Activity

ASU 2016-13
Measurement of Credit Losses on Financial Instruments (Topic 326)

ASU 2018-19
Codification Improvements to Topic 326 (Effective Date)

Exposure Draft – November 2018
Multiple Technical Corrections

Exposure Draft – February 2019
Transition Fair Value Option

As the clock ticks down to implement the new credit impairment model known as CECL, FASB is moving ahead on some—but not all—of the promised updates. At a FASB meeting on February 27, 2019, FASB approved a final Accounting Standards Update (ASU) for most of the CECL-related items included in a November 2018 exposure draft. A final ASU is expected to be issued shortly. See the appendix for a full list of approved updates. Three issues will not be included in the final standard; the first two require further research and the third was an oversight that will be added to a subsequent ASU:

- Extension of the use of negative allowances from amortized cost basis securities to also include available-for-sale (AFS) debt securities (see Issue 3)
- Extension of the scope of transfers between classification and categories for loans and debt securities to also include trade and lease receivables (see Issue 2)
- Transition relief for troubled debt restructurings (TDR). FASB had previously approved a transition election to use a prepayment-adjusted effective interest rate (EIR) in a discounted cash flow (DCF) approach to measure credit losses on TDRs that exist at the adoption date.

The adoption of CECL will be complex and likely will require significant hours to implement correctly. BKD can help educate your team, provide implementation tools and assist with analysis and documentation. If you would like assistance complying with the CECL standard, contact your trusted BKD advisor. BKD has prepared a library of **BKD Thoughtware**® on this topic. Visit our website to learn more.

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Appendix – Approved Technical Corrections

Technical Corrections for ASU 2016-13
Issue 1: Accrued Interest
As written, ASU 2016-13 includes accrued interest in the definition of amortized cost basis. Currently, IT systems do not track accrued interest on an individual loan basis needed for CECL pooling and vintage disclosure requirements. How should the reversal of accrued interest be reflected in the statement of operations when a loan is placed on nonaccrual status? An entity would be allowed to: ▪ Measure the allowance for credit losses on accrued interest receivable balances separately from other components of the amortized cost basis of associated financial assets and net investments in leases ▪ Make an accounting policy election to present accrued interest receivable balances and the related allowance for credit losses for those accrued interest receivable balances separately from the associated financial assets and net investments in leases on the balance sheet. If the accrued interest receivable balances and the related allowance for credit losses are not presented as a separate line item on the balance sheet, an entity would disclose the amount of accrued interest receivable balances and the related allowance for credit losses and where the balance is presented ▪ Elect a practical expedient to separately disclose the total amount of accrued interest included in the amortized cost basis as a single balance to meet certain disclosure requirements in Subtopic 326-20 ▪ Make an accounting policy election to write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses ▪ Make an accounting policy election not to measure an allowance for credit losses on accrued interest receivable amounts if an entity writes off the uncollectible accrued interest receivable balance in a timely manner Additional disclosures would be required based on the elections chosen.
Issue 2: Transfer Between Categories for Loans and Debt Securities
How should the guidance apply when transferring credit-impaired debt securities classified as AFS to held-to-maturity? The amendments would require an entity to reverse any allowance for credit losses or valuation allowance previously measured on a loan or debt security, transfer the loan or debt security to the new classification or category and apply the applicable measurement guidance in accordance with the new classification or category.
Issue 3: Recoveries (Negative Allowances)
The guidance states that recoveries of financial assets and trade receivables previously written off should be recorded when received. Without proper clarification, stakeholders noted this guidance could be interpreted to prohibit the inclusion of recoveries in the estimation of expected credit losses on financial assets measured at amortized cost basis. An entity should include recoveries when estimating the allowance for credit losses. The recoverable amounts included in the valuation account should not exceed the aggregate of amounts previously written off and expected to be written off by the entity. For collateral-dependent financial assets, the allowance for credit losses—that is added to the amortized cost basis of the financial asset(s)—should not exceed amounts previously written off.

Issue 4: TDRs
The amendments will fix an incorrect cross-reference to clarify that an entity use the fair value of collateral to determine expected credit losses when foreclosure is probable.
Issue 5: Conforming Amendment to Subtopic 323-10
Current, unsuperseded guidance in Accounting Standards Codification (ASC) 323, Investments—Equity Method and Joint Ventures*, describes the allocation of equity method losses when an investor has other investments, such as loans and debt securities, in the equity method investee. Stakeholders asked whether the guidance should refer an entity to Topic 326 for the subsequent measurement of those loans and debt.* The amendments will add an updated cross-reference to ASC 326-20 and 326-30 for the subsequent measurement of loans and AFS debt securities, respectively.
Issue 6: Reinsurance Receivables
Are reinsurance recoverables measured on a net present value basis in accordance with Topic 944, Financial Services—Insurance*, covered by the CECL guidance?* The update will clarify that all reinsurance recoverables within the scope of Topic 944 are within the scope of ASC 326-20, regardless of the measurement basis of those recoverables.
Issue 7: Projections of Interest Rate Environments for Variable-Rate Financial Instruments
As written, an entity that chooses to use a DCF method to determine expected credit losses on a variable-rate financial instrument is precluded from forecasting changes in the variable rate for the purposes of estimating expected cash flows and determining the EIR with which to discount those cash flows. The amendments will remove the prohibition of using projections of future interest rate environments when using a DCF method to measure expected credit losses on variable-rate financial instruments. An entity should use the same projections or expectations of future interest rate environments in estimating expected cash flows and in determining the EIR used to discount those expected cash flows.
Issue 8: Consideration of Prepayments in Determining the EIR
For entities electing a DCF approach for CECL, the use of an unadjusted EIR could misstate credit losses for prepayable assets held at a premium or discount since the EIR does not include prepayment assumptions. An entity would be permitted to make an accounting policy election to adjust the EIR used to discount expected future cash flows for expected prepayments on financial assets within the scope of ASC 326-20 and on AFS debt securities within the scope of ASC 326-30 to appropriately isolate credit risk in determining the allowance for credit losses. An entity should not adjust the EIR used to discount expected cash flows for subsequent changes in expected prepayments if the financial asset is restructured in a TDR.
Issue 9: Contractual Extensions and Renewals
Can an entity consider contractual extension or renewal options in determining the contractual term of a financial asset? An entity should consider extension or renewal options—excluding those accounted for as derivatives under ASC 815—that are included in the original or modified contract at the reporting date and are not unconditionally cancelable by the entity.