American Bankers Association
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The Honorable Gregory Meeks
Chairman
Consumer Protection and Financial Institutions Subcommittee
House Financial Services Committee
Washington, D.C. 20515

Dear Chairman Meeks:

The Current Expected Credit Loss accounting standard goes into effect January 1, 2020, for Securities and Exchange Commission registrants. This standard will change the measurement of the loan loss reserve from one that represents losses currently in a bank's portfolio to one that represents losses forecasted over the remaining life of the portfolio. Banks will incur significant operational costs to implement this change, which is theoretically meant to decrease the procyclicality of the banking industry. In practice, however, bank testing indicates it could significantly increase procyclicality and increase the cost of key consumer lending products, such as 30-year mortgages.

Federal banking regulators have not yet performed any detailed analysis to determine what impact CECL implementation will have on consumer lending. Bankers therefore have requested that the standard's effective date be delayed until regulators can study the impact of CECL and assess ways to mitigate any ill effects.

Background

Economic activity is generally dependent on the availability of credit, and the availability of credit is highly dependent on bank capital levels. As borrowers become more likely to default on loans, banks increase reserves for losses, which lowers bank capital. Lower capital, in turn, constricts bank lending, which generally results in further strain on the economy.

Because increases to loan loss reserves pull money out of the economy when the economy is already in a downturn, they are "procyclical." This makes it especially important that loan loss reserves are accounted for properly. Accounting that overstates loss reserves during an economic downturn will aggravate the procyclicality and that is what we believe CECL will do.

If accounting artificially drains lending capability across the industry, all borrowers will be adversely impacted. But consumers – particularly those with longer-term loans and those with less-than-prime credit – will be hit the hardest, as rates will eventually need to increase for these borrowers. Many consumer loans and mortgages will likely cost more, while loans with shorter terms, such as those made to commercial borrowers, would likely see less change in their costs.

CECL's theoretical design of earlier loss recognition (effectively recording losses at origination, rather than when a loss actually occurs) was meant to be countercyclical. Reserves would be established before a crisis, not during a crisis. However, using real-world models that have been shared with banking regulators, some larger banks are finding disturbing results. Those models suggest that CECL would have resulted in slightly higher allowances for losses on consumer loans prior to the crisis, which is FASB's intent. But they also show CECL would have caused allowances to spike higher than the losses that were actually recorded during the crisis, and it would have kept allowances elevated longer. In other words, a limited study of CECL indicates that the standard could make the procyclicality problem worse.

The potential spike in loan loss allowances is caused by CECL's requirement to forecast economic factors over a period of several years. This long-range forecasting can result in several errors, including: missing the turn in the economy, thereby minimizing any earlier loss recognition that CECL was theoretically supposed to provide, and overshooting the severity of the crisis, both in the depth and the length of the recession. During the financial crisis, both forecasting errors were made by virtually all professional forecasters.

Banking agencies have agreed to allow banks to phase-in CECL's impact to regulatory capital over three years. However, the phase-in applies only to the initial impact at the effective date, which for SEC registrants is January 1, 2020. Changes thereafter from new loans and from changes in the current and forecasted credit conditions are not included in the phase-in. That means there could be modest initial differences in allowances as of the effective date if the economic environment at the time is as benign as it is today. However, if conditions later deteriorate and an updated forecast requires large loss provisions, the phase-in would do little to mitigate CECL's negative impact.

Put another way, the regulators' planned phase-in does not recognize the *ongoing* impact of CECL and would not provide relief from procyclical swings after the effective date that would affect credit availability.

There are four primary studies that address CECL's procyclicality, and they each have strengths and limitations. But not one of them actually looks at an individual bank's portfolio, as ABA has. Our examination has led us to conclude that CECL increases procyclicality. Given the disparity between our conclusions and those of the other studies, and given the potential risk to the economy, ABA believes regulators should perform a separate and detailed quantitative impact study. It's important that stakeholders agree on how the study should be performed, including the key assumptions that would be made in modeling CECL estimates. It's also important that the study examine how the industry and regulators should react to the findings in regards to both capital management and product mix.

Conclusion

CECL's potential adverse impact on the cost and availability of credit during recessionary times poses a significant risk to consumers and the economy alike. For this reason, we strongly recommend that the CECL accounting standard be delayed until a quantitative impact study is performed.

Sincerely,

James C. Ballentine

cc: The Honorable Blaine Luetkemeyer