CNM Thought Leadership – FASB Roundtable on CECL

by
CNM's Technical Accounting Group

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On January 28th, the FASB held a roundtable meeting to gather additional views on the new Current Expected Credit Loss (CECL) accounting standard (ASC 326). There was no intention by the FASB to reach any conclusions at the meeting, although the information obtained would be considered in the future to determine whether to make amendments to CECL for the matters discussed.

Participants in the roundtable included representatives from the following groups:

- FASB and FASB staff
- Large banks
- Mid-sized banks, who were the main proponents of an alternative credit loss recognition approach
- Community banks and a credit union
- Stock analysts and investors
- Banking regulators
- Large audit firms
- PCAOB
- CFA Institute

The focus of the meeting centered on two topics:

1. Agenda requests to consider an alternative to the income statement impact of the CECL model.
2. Reporting charge-offs and recoveries as a component of the vintage disclosures.

Most of the nearly four-hour discussion was spent on the first topic.

Alternative Income Statement Presentation Proposal

The FASB received agenda requests, primarily from a consortium of mid-sized banks, to consider an alternative approach to reporting the earnings impact of changes in the allowance for credit losses during the period under CECL. The alternative approach would recognize:

1. Credit losses from non-impaired loans expected to be realized in the next 12 months in income from operations,
2. Credit losses from non-impaired loans expected to be realized beyond 12 months in other comprehensive income (OCI), a component of equity, and
3. Total (lifetime) credit losses expected to be realized from loans deemed impaired in income from operations.

Below is an unofficial summary of the main themes that were discussed at the meeting.

Generally, all of the participants agreed that adoption of the proposal would:

- Likely require a delay in the effective date of CECL to allow sufficient time for the necessary changes to be made and adequately tested.
- Raise new implementation issues that would need to be addressed prior to adoption of CECL (e.g., the definition of credit losses expected in the next 12 months).
- Require added disclosures (e.g., a rollforward of credit losses expected in the next 12 months).
- Require the development of a separate and additional set of qualitative factors to measure credit losses expected in the next 12 months.
- Increase the scope and cost of the independent audit of the financial statements.
- Require added processes and related internal controls.

Mid-sized Banks

Representatives of these banks favored the proposal because they believe it will provide more useful and comparable information to investors and lead to better lending decisions by banks.

Large Banks

Representatives of these banks were not supportive of the proposal. They expressed concerns about the added complexity and effort required to comply with a breakout of credit losses expected in the next 12 months. The representatives believed that the process used to develop CECL was very thorough and comprehensive. Application of a 12-month bifurcation is arbitrary and would be difficult to implement.

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Analysts/Investors

The representatives thought that while the proposal could provide useful information, they had concerns about comparability and inconsistent trends (e.g., 12-month expected losses decrease while the allowance for credit losses increases). They also expressed a preference to see the total credit losses reflected in earnings.

Auditors

The audit representatives indicated that they would need to audit all three components of the provision for credit losses, which likely would increase the scope of the audit as well as the cost. They also said that there could be issues related to cutoff on 12-month losses (e.g., whether to include a significant loss expected on Day 366).

Vintage Disclosures of Charge-offs and Recoveries

CECL currently provides a disclosure example that presents charge-offs and recoveries by vintage for the current period on a gross basis. Previously, the FASB staff indicated that such disclosure was intended to be required and CECL would be amended to make that clear.

At the meeting, the FASB staff also clarified that the charge-offs and recoveries were intended to be cumulative and not just for the current period. Bank representatives expressed concerns about the difficulty in reporting recoveries on a gross basis, as recoveries are not tracked in that manner. Furthermore, the bank representatives stated that management does not use that information to manage its loan portfolios, focusing instead on credit risk characteristics.

Other participants expressed the view that a gross presentation was useful to readers of the financial statements. Even though management may not use such information to manage its loan portfolios, readers of the financial statements do not have access to all of the information that is available to management. In lieu of that information, gross charge-offs and recoveries are very useful data to assess the credit performance of loan portfolios.

Next Steps

The FASB is expected to consider whether to amend CECL for the two issues discussed at the roundtable meeting in the near future.

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