Current Expected Credit Loss (CECL) Accounting Change

BACKGROUND

On the heels of the 2008 financial crisis, the Financial Accounting Standards Board (FASB) was tasked with exploring more forward-looking alternatives to the incurred loss model for recognizing and reserving against loan losses under Generally Accepted Accounting Principles (GAAP).

The result was the current expected credit loss (CECL) accounting standard. Significantly, CECL’s expected loss methodology requires institutions to calculate and recognize the lifetime expected loss of the loan at origination. This is a change from the current standard, which is based on an incurred loss methodology that requires losses to be identified and recognized only as a loan progresses, based on a probability threshold (i.e., an event indicating the loan is likely to be impaired).

CECL will take effect for SEC filers for fiscal years beginning after December 15, 2019. For public companies that are not SEC filers, CECL will take effect for fiscal years beginning after December 15, 2020. Federal bank regulatory agencies have issued a final rule effective April 1, 2019, to address this change in GAAP, including an optional three-year phase-in of CECL impacts on regulatory capital.

CECL implementation will have both capital and operational impacts. CECL could impact an institution’s loss reserves on mortgage assets, which could also have business implications. CECL implementation also creates operational challenges, particularly around data, models, governance, auditability and ensuring that all the needs of affected areas of an organization are identified and addressed. Because of these impacts, MBA is concerned that CECL could adversely affect the availability, structure, and price of credit, and could increase the volatility of capital levels.

RECOMMENDATIONS

MBA recommends that CECL implementation be delayed pending a quantitative impact analysis to assess the macroeconomic and public policy implications, and to allow for the consideration of potential alternatives and post-issuance field testing. While neither FASB nor FSOC have directly responded to the requests for a delay, FASB recently convened a roundtable meeting with interested parties to discuss issues and alternatives. MBA continues to advocate for a delay in implementation of the new standard, while also working with the FASB to make needed adjustments and improvements.

1 On November 19, 2018, MBA sent a letter to Treasury Secretary Steven Mnuchin—also Chairman of the Financial Stability Oversight Council (FSOC)—advocating delayed implementation pending completion of an impact study. On March 5, 2019, MBA signed on to a coalition letter to the Securities and Exchange Commission (SEC) and FASB making the same request.
For affected institutions, MBA recommends that they begin assessing and implementing their CECL strategy now—if they haven’t already. Our team is working with members and third-party service providers to monitor implementation progress and to identify common issues. We will leverage this dialogue to facilitate members’ implementation of CECL.

Based on preliminary feedback, we recommend that affected institutions not underestimate the time necessary to fully implement CECL, even when relying on third-party models, or the data challenges related to modeling commercial mortgage performance. We also recommend that institutions coordinate across functional areas to identify and address potential CECL impacts across the organization.