Current Expected Credit Loss (CECL) Standard – The new way to account for credit and loan loss under accounting rules

The recent economic downturn resulted in the U.S and international accounting standards setters issuing new accounting standards that they believe will work better to avoid some of the issues that contributed to the downturn because lenders were not able to determine losses quickly enough under the rules. The resulting rules are intended to help lenders reserve more for losses, and also make determinations on which loans will go bad much earlier in the process.

OVERVIEW

- In June 2016, the Financial Accounting Standards Board (FASB) issued a new accounting standard governing the way companies will evaluate and account for impaired loans and securities. The new standard, ASU 2016-13, replaces the current incurred loss model for calculating the allowance for loan and credit losses with an expected loss model. As the name suggests, CECL will require companies to take a long forward-looking approach when establishing reserves for loan and credit losses. The CECL standard is effective for SEC registrants in 2020, and for all other companies in 2021. Early adoption of the standard is permitted beginning in 2019.

IMPACT

- CECL probably represents one of the most significant rewrites of U.S. Generally Accepted Accounting Principles (GAAP) in the past 40 years, and once implemented, will fundamentally change how banks and other financial companies recognize credit losses in their loan and held-to-maturity debt security portfolios.
- In contrast to the long-standing U.S. GAAP approach, which required companies to establish a reserve when a loan loss is probable and reasonably estimable, CECL requires day-one upfront recognition of credit losses using long-term economic forecasts over the contractual life of the loan but does not allow a similar upfront recognition of corresponding future revenues associated with the loan.

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- This new standard will significantly change the way companies reserve for loan and credit losses.
- Similarly, the LRS has provided little additional enforcement clarity, which makes it difficult for lenders to accurately assess their potential liability. This outcome has also contributed to the pullback in FHA participation by many lenders.

**MBA’S POSITION / NEXT STEPS**

- MBA believes that the requirements of the CECL standard will adversely impact the availability, structure and price of credit, with a larger proportion of such impact landing on longer-term loans, such as 30-year single-family residential mortgages, commercial and multifamily mortgages, student and business loans.
- Although the goal of CECL was to establish an impairment model that would record credit loss reserves earlier and, therefore, reduce the level of pro-cyclicality of the industry, there is a strong argument that the inherent unreliability of the long-term economic forecasting that is required by CECL will cause more harm than good, as it could actually cause more pro-cyclicality in the industry and increase the volatility of regulatory capital, necessitating increased capital at all times.
- MBA joined efforts by other trade associations and stakeholders asking the FASB to delay implementation of the CECL standard, and in the meantime, conduct a necessary qualitative impact study. The goal of the study would be to analyze both the macroeconomic and public policy implications of CECL implementation, as well as to propose practical solutions for issues identified where appropriate, well before the CECL implementation date.
- While the FASB has not directly responded to the requests for a delay in the implementation of the standard, FASB recently convened a roundtable meeting with interested parties (which was attended by MBA staff) to discuss some areas of the new standard that could be the subject of improvements.
- MBA continues to advocate for a delay in implementation of the new standard, while also working with the FASB to make needed improvements to many aspects of the standard.