United States Senate
WASHINGTON, DC 20510

May 10, 2019

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, D.C. 20551

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Dear Chairs Powell and McWilliams:

The Financial Accounting Standards Board (FASB) has established the current expected credit loss (CECL) accounting standard, which is set to take effect for certain banks beginning in January 2020. The new CECL standard represents a significant change to the traditional matching principles of accounting, and while it was undertaken to increase loan-loss reserves and credit-loss accounting convergence, it has also injected considerable uncertainty into the business of traditional banking and lending. Throughout FASB's standard-setting process and after it finalized CECL, banks of all sizes have raised meaningful concerns about how the new standard will alter the economics of lending, potentially reducing credit availability to many Americans, and how its pro-cyclical impacts will exacerbate economic cycles.

Accounting policy should not drive economic outcomes. Banks have raised significant concerns about the negative economic consequences. Community and regional banks have proposed changes to the FASB standards to mitigate against its complexity and its potential negative economic consequences. A Bank Policy Institute study found that CECL would have amplified the contraction of bank lending during last decade's financial crisis, emphasizing the concerns about the standard's pro-cyclical impacts. The study further emphasized that banks holding longer-duration loans, such as 30-year mortgages, would have been impacted more severely.[1] Moreover, Moody's Analytics research indicates that CECL can potentially introduce meaningful impacts on the level and volatility of banks' earnings and thus available capital to lend.[2] This volatility will put pressure on the pricing and structure of longer-term lending and lending to non-prime clients; in particular, residential-mortgage and small business loans could become more expensive and less easily available. Finally, a Federal Reserve (Fed) study notes that the standard would increase the reliance on "somewhat opaque, bank-specific idiosyncratic modeling decisions" which could alter the link between loan-loss reserves and actual losses and obscure the comparability among financial statements.[3] Bankers with deep knowledge of the

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[1] Francisco Covas and William Nelson, "Current Expected Credit Loss: Lessons from 2007-2009," Bank Policy Institute, July 2018 at https://bpi.com/wp-content/uploads/2018/07/CECL_WP-2.pdf (see Appendix A).

[2] "Measuring and Managing Credit Risk in Earnings Volatility of a Loan Portfolio under IFR9," Moody's Analytics White Paper, 2017.

[3] Chae, Sarah, Robert F. Sarama, Cindy M. Vojtech, and James Wang (2018). "The Impact of the Current Expected Credit Loss Standard (CECL) on the Timing and Comparability of Reserves," Finance and Economics Discussion

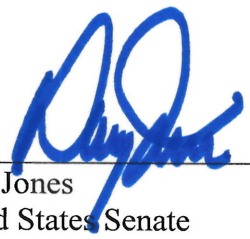
local communities they serve should make lending decisions based on their judgments and supported by sound risk management practices; they should not be artificially constrained by sophisticated, yet imprecise, forward-looking models that cannot accurately predict the future.

Banks have expressed these concerns to the FASB, the SEC, banking regulators and members of Congress. In recent congressional testimony, Federal Reserve Board Chairman Jay Powell said that the Fed did not want the transition to CECL to be "too disruptive, too expensive and too complicated," adding that the Fed will take "appropriate action" if CECL negatively impacts bank lending or economic activity. Nonetheless, we do not think it is appropriate for regulators to adopt a wait-and-see approach. We believe that the potential economic disruptions of the new standard mandate careful study before it goes into effect for any bank. Indeed, the FASB has recognized some of CECL's challenges by its decision to delay the effective date for community banks until January 2021. We think this is an appropriate step for all financial institutions. Meanwhile, regional and large, complex banking organizations have developed forecasting and reserve models in order to understand CECL's effects. These organizations can share this data as part of their supervisory relationships with federal banking regulators, who understand the institutions' business models and should determine their effective capital levels, to allow for a useful study of CECL's overall economic impacts.

Accordingly, we urge a delay of the CECL implementation date for all banks until after the completion of a study about its economic impacts. Furthermore, we request the Fed and Federal Deposit Insurance Corporation (FDIC) immediately conduct an economic impact study. Specifically, the study should include, but not necessarily be limited to, CECL's potential impacts on the economics of lending and the price, availability, and structure of credit, particularly for mortgages, small business loans, and loans to borrowers with lower credit scores. The study should also examine pro-cyclicality, particularly during a recession, effective capitalization, and the relationship of loan-loss reserves and regulatory capital. Finally, the study should consider financial statement comparability as well. We request this joint Fed-FDIC study be completed by December 2020.

Sincerely,

Thom Tillis
United States Senate



Doug Jones
United States Senate

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Cc:

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856