

DATE: February 6, 2020

MEMORANDUM TO: The Board of Directors

FROM: Doreen R. Eberley
Director, Division of Risk Management Supervision

SUBJECT: Interagency Policy Statement on Allowances for Credit Losses

RECOMMENDATION AND SUMMARY

Staff recommends that the Federal Deposit Insurance Corporation (FDIC) Board of Directors (FDIC Board) authorize publication in the *Federal Register* of the attached Interagency Policy Statement on Allowances for Credit Losses (interagency policy statement)..

The staffs of the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (collectively, the banking agencies), and the National Credit Union Administration (NCUA) (collectively, the agencies) have prepared this interagency policy statement in response to changes in the accounting for credit losses under U.S. generally accepted accounting principles (U.S. GAAP) as promulgated by the Financial Accounting Standards Board (FASB).

These accounting changes are set forth in FASB Accounting Standards Update No. 2016-13 (ASU 2016-13), as amended in subsequent updates, which are codified in Accounting Standards Codification Topic 326, Financial Instruments – Credit Losses (ASC Topic 326). FASB ASU 2016-13 introduces the current expected credit losses (CECL) methodology, which replaces the existing incurred loss methodology in U.S. GAAP.

Concur:

Nicholas J. Podsiadly
General Counsel

Section 37(a) of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1831n(a)) states that, in general, the accounting principles applicable to the Consolidated Reports of Condition and Income (Call Reports) required to be filed with the banking agencies “shall be uniform and consistent with generally accepted accounting principles.” The agencies have previously issued supervisory guidance that addresses the allowance for loan and lease losses (ALLL) as determined under the incurred loss methodology. This interagency policy statement describes the accounting for credit losses in accordance with ASC Topic 326; principles regarding the design, documentation, and validation of expected credit loss estimation processes; the maintenance of appropriate allowances for credit losses (ACLs); the responsibilities of boards of directors and management with respect to ACLs; and examiner reviews of ACLs. The agencies would be maintaining conformance with U.S. GAAP and consistency with ASC Topic 326 through their issuance of this interagency policy statement.

The agencies sought public comment on a proposed interagency policy statement on October 17, 2019 (84 FR 55510). The agencies received 23 comment letters from a variety of stakeholders including trade associations and individual institutions. Many commenters supported the proposed policy statement and stated that supervisory practices and principles were clearly communicated. Several parts of the proposed interagency policy statement were clarified in response to comments received, including the discussions of qualitative adjustments for debt securities, accounting policy elections related to accrued interest receivable, the reporting of expected credit losses for off-balance-sheet credit exposures, and external auditor independence. A number of technical edits also were made to the proposed policy statement. The attached *Federal Register* document includes responses to comments received along with the interagency policy statement.

DISCUSSION

Background

In June 2016, the FASB issued ASU 2016-13, which revises the accounting for credit losses under U.S. GAAP. ASU 2016-13 replaces the incurred loss methodology for financial assets measured at amortized cost and off-balance-sheet credit exposures with the CECL methodology. ASU 2016-13 also modifies the accounting for impairment on available-for-sale (AFS) debt securities. ASC Topic 326 applies to all banks, savings associations, credit unions, and financial institution holding companies (collectively, institutions), regardless of size, that file regulatory reports for which the reporting requirements conform to U.S. GAAP.

ASC Topic 326 provides flexibility to institutions in the selection of credit loss estimation methods, which allows institutions to use judgment in determining the relevant information and estimation methods that are appropriate in their circumstances. Thus, the CECL methodology is scalable to institutions of all sizes. Smaller and less complex institutions are not expected to need to adopt complex modeling techniques to implement ASC Topic 326. Institutions are not required to engage third-party service providers to assist management in estimating credit loss allowances under this new accounting standard. For purposes of the final policy statement, institutions should make good faith efforts to implement ASC Topic 326 in a sound and reasonable manner.¹

The effective dates of ASC Topic 326 vary for different institutions. ASC Topic 326 is effective for U.S. Securities and Exchange Commission (SEC) filers, excluding smaller reporting

¹ See the agencies' Frequently Asked Questions on the New Accounting Standard on Financial Instruments – Credit Losses, issued April 3, 2019, at <https://www.fdic.gov/news/news/financial/2019/fil19020a.pdf>.

companies as currently defined by the SEC, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all other institutions, ASC Topic 326 is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early application of ASC Topic 326 is permitted for all institutions for fiscal years beginning after December 15, 2018, including interim periods within the fiscal year of early application.

Until ASC Topic 326 becomes effective for an institution, it must continue to follow current U.S. GAAP on impairment and the ALLL. The institution also should continue to refer to the agencies' December 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses and the policy statements on allowance methodologies and documentation² (collectively, the ALLL policy statements) until the applicable effective date of ASC Topic 326.

Interagency Policy Statement

The agencies' staffs have developed the interagency policy statement in response to the changes in accounting for credit losses under U.S. GAAP as set forth in ASC Topic 326. The policy statement describes the CECL methodology for determining ACLs applicable to financial assets measured at amortized cost (including loans held for investment and held-to-maturity debt securities), net investments in leases, and certain off-balance-sheet credit exposures in accordance with ASC Subtopic 326-20. It also describes the estimation of an ACL for an impaired AFS debt security in accordance with ASC Subtopic 326-30.

In addition, the interagency policy statement includes and updates concepts and practices detailed in the existing ALLL policy statements that remain relevant under ASC Topic 326.

² The Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions issued by the banking agencies in July 2001 and Interpretative Ruling and Policy Statement 02-3, Allowance for Loan and Lease Losses Methodologies and Documentation for Federally Insured Credit Unions, issued by the NCUA in May 2002, as applicable.

These concepts and practices relate to management's responsibilities for the allowance estimation process, including the need to appropriately support and document the institution's allowance estimates; the board of directors' responsibilities for overseeing management's processes; and the role of examiners in reviewing the appropriateness of an institution's ACLs as part of their supervisory activities.

The principles described in the interagency policy statement are consistent with U.S. GAAP, applicable regulatory reporting requirements,³ safe and sound banking practices, and the agencies' codified guidelines establishing standards for safety and soundness.⁴ The operational and managerial standards included in those guidelines address such matters as internal controls and information systems, an internal audit system, loan documentation, credit underwriting, asset quality, and earnings, and should be appropriate for an institution's size and the nature, scope, and risk of its activities.

The interagency policy statement would become applicable to an institution upon that institution's adoption of ASC Topic 326. After ASC Topic 326 is effective for all institutions, the agencies would rescind the ALLL policy statements.

The interagency policy statement does not affect Attachment 1 to the December 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses. Attachment 1 is being revised through a separate interagency process. See 84 FR 55679 (October 17, 2019).

³ See Section 37(a) of the FDI Act (12 U.S.C. 1831n(a)).

⁴ For FDIC-supervised institutions, see the Interagency Guidelines for Establishing Standards for Safety and Soundness in 12 CFR Part 364, Appendix A, which were adopted under section 39 of the FDI Act (12 U.S.C. 1831p-1).

CONCLUSION

FDIC staff recommends that the Board authorize publication in the *Federal Register* of the attached interagency policy statement.

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