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December 12, 2019

SENT VIA FIRST CLASS MAIL AND E-MAIL

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attn: Comments
550 17th Street NW
Washington, D.C. 20429
Email: comments@fdic.gov

Re: Proposed Interagency Policy Statement: Proposed Interagency Policy Statement on Allowances for Credit Losses, RIN 3064-ZA10[1]

Dear Secretary Feldman,

The Kentucky Bankers Association (KBA) is pleased to submit this response to the Proposed Interagency Policy Statement (Proposal) from, amongst other agencies, the Federal Deposit Insurance Corporation (FDIC), which proposes guidance "to promote consistency and application of Financial Account Standards Board (FASB) Account Standards Update 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as well as the amendments issued since June 2016 (CECL).[2]

After consulting with representatives from the Kentucky Bankers Association's one hundred and sixty-one (161) member institutions ranging in asset size from twenty-one million dollars ($21,000,000) to over three hundred and seventy billion dollars ($370,000,000.00), the Kentucky Bankers Association finds that the Proposal provides little guidance as to how banks are intended to comply with "the principles consistent with GAAP" and "applicable regulatory reporting requirements" set forth in CECL.[3]

The Proposal sets forth four questions:

(1) Does the proposed interagency policy statement clearly describe the measurement of expected losses under CECL in accordance with FASB Topic 326?
(2) Does the proposed interagency policy statement clearly describe the measurement of credit losses on impairs AFS debt securities in accordance with FASB ASC Topic 326?
(3) Does the proposed interagency policy statement clearly communicate supervisory expectations for designing, documenting, and validating expected credit loss estimation processes, internal controls over ACLs, and maintaining appropriate ACLS?

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[1] Federal Deposit Insurance Corporation, Interagency Policy on Credit Losses, 84 Federal Register 55510, October 17, 2019 (https://www.govinfo.gov/content/pkg/FR-2019-10-17/pdf/2019-22655.pdf).
[2] Proposal, Page 55513.
[3] Proposal, Page 55513.

(4) Has the proposed interagency policy statement appropriately included concepts and practices detailed in the existing ALLL policy statement that also are relevant under FASB ASC Topic 326?

The KBA's answer to all of these questions is no and addresses these issues below with additional commentary related to the causes of these shortcomings.

1.The Proposal Lacks Guidance

General speaking, CECL revolves around the estimation of allowances for credit losses (ACLs). The problem with the Proposal, and CECL itself is that, "Estimating appropriate ACLs involves a high degree of management judgment and is inherently imprecise. An institution's process for determining appropriate ACLs may result in a range of estimates for expected credit losses."[4]

While CECL, "requires losses to be evaluated on a collective, or pool, basis when financial assets share similar risk characteristics"[5] CECL "does not prescribe a process for segmenting financial assets for collective evaluation."[6] This Proposal is rife with continuous unclarity that only further promulgates the lack of directives from FASB in instituting this reckless and irresponsible mandate.

Further, the Proposal provides more questions than answers. For example, on the topic of purchased credit-deteriorated assets (PCD), the Proposal states, "FASB ASC Topic 326 introduces the concept of purchased credit-deteriorated (PCD) assets. PCD assets are acquired financial assets that, at acquisition, have experienced more-than-insignificant deterioration in credit quality since origination. FASB ASC Topic 326 does not provide a prescriptive definition of more-than-insignificant credit deterioration."[7] This essentially leaves banks with no direction as to what a PCD is. However, the next line states, "The acquiring institution's management should establish and document a reasonable process to consistently determine what constitutes a more-than-insignificant deterioration in credit quality."[8] The Proposal appears to suggest throwing a dart with a blind fold and hoping it hits the target; not ideal for guidance or any other regulatory adherence.

The Proposal is also vague in assisting with the creation reasonable and supportable forecasts. The Proposal states, "When estimating expected credit losses, FASB ASC Topic 326 requires management to consider forward-looking information that is both reasonable and supportable and relevant to assessing the collectability of cash flows. Reasonable and supportable forecasts may extend over the entire contractual term of a financial asset or a period shorter than the contractual term."[9] The requirements are set. However, the next sentence states, "FASB ASB Topic 326 does not prescribe a specific method for determining reasonable and supportable forecasts nor does it include bright lines for establishing a minimum or maximum length of time for reasonable and supportable forecasts periods. Judgment is necessary in determining an appropriate period for each institution."[10] This lack of guidance with extreme subjectivity creates potential regulatory problems for banks.

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[4] Proposal, page 55514.
[5] Proposal, page 55514.
[6] Proposal, page 55515.
[7] Proposal, page 55517.
[8] Proposal, page 55517.
[9] Proposal, page 55515.
[10] Proposal, page 55515.

The Proposal also provides general discussion on a variety of other issues without any substantive guidance as to a proper path.

The Proposal does not define a single appropriate method, even as an example, for determining ACLs. "Various methods may be used to estimate the expected collectability of financial assets, with those methods generally applied consistently over time. The same loss method does not need to be applied to all financial assets. Management is not precluded from selecting a different method when it determines the method will result in a better estimate of ACLs."[11]

The historical loss information is variable. "Management should consider whether the historical loss information may need to be adjusted for differences in current asset specific characteristics such as differences in underwriting standards, portfolio mix, or when historical asset terms do not reflect the contractual terms of the financial assets being evaluated as of the reporting date."[12]

Reversion is variable. "FASB ASC Topic 326 does not require the application of a specific reversion technique or use of a specific reversion period. Reversion to historical loss information may be immediate, occur on a straight-line basis, or use any systematic, rational method. Management may apply different reversion techniques depending on the economic environment or the financial asset portfolio."[13]

Additional variables in the Proposal are available under the caveats that "management should consider qualitative factors"[14] and "systems should be tailored to an institution's size and complexity, organizational structure, business environment and strategy, risk appetite, financial asset characteristics…"[15]

While variables can be viewed as providing flexibility, that flexibility can lead to penalties. In one paragraph the Proposal states, "Examiners should accept an institution's ACL estimate and not seek adjustments to the ACLs, when management has provided adequate support for the loss estimation process employed, and the ACL balances and the assumptions used in the ACL estimates are in accordance with GAP and regulatory reporting requirements. It is inappropriate for examiners to seek adjustments to ACLs for the sole purpose of achieving ACL levels that correspond to a peer group median, a target ratio, or a bench amount when management has used an appropriate expected credit loss framework to estimate expected credit losses."[16] However, the next sentence states, "If the examiner concludes that an institution's reported ACLs are not appropriate or determines that its ACL evaluation processes or loss estimation method(s) are otherwise deficient, these concerns should be noted in the report of examination and communicated to the board of directors or management. Additional supervisory action may be taken based on the magnitude of the shortcomings in ACLs."[17]

Those two directives are contradictory. Examiners are cautioned to not seek adjustment but are allowed to penalize an institution. That is an inherently unfair system when no specific metrics or benchmarks are required to ensure compliance. Examiners should be required to provide banks with feedback and suggestions long before any penalties accrue. In a rule that is, in and of

[11] Proposal, page 55515.
[12] Proposal, page 55515.
[13] Proposal, page 55515.
[14] Proposal, page 55516.
[15] Proposal, page 55518.
[16] Proposal, page 55522.
[17] Proposal, page 55522.

itself, unclear banks should receive open and candid feedback and allowed to make adjustments while implementing such an obtuse rule. Clear communication and collective efforts between banks and their regulators are the only means to ensure compliance.

"The standard (CECL) tries to justify itself by saying that there is diversity in the current practice of incurred loss methodology. But the various "suggested" methods in the standard guidance show a diversity in results, even when using perfect foresight or hindsight."[18] Essentially, most experts assert that it is impossible to achieve a great model—making compliance impractical if not impossible.

That problem is compounded when a large number of financial institutions do not have enough data to compile a model that would meet the variable terms set forth above. "According to a 2019 Abrigo Lender Survey, nearly half of all financial institutions have collected and validated data as part of their CECL preparation efforts. However, only 43 percent of respondents expressed confidence that the data they have will be sufficient for CECL. Nearly one in every six institutions in the survey, including some SEC registrants, reported being unsure if they would have sufficient quantity and quality of data to estimate losses under the CECL standard."[19]

The data problem is amplified for smaller banks. "Two-thirds of survey participants representing banks with assets below $1billion plan to look back seven years or less for their CECL estimation process. "Given the extended economic expansionary period, we find that most banks do not have enough loss or default experience in the last seven years to calculate a meaningful CECL result using their bottom-up data," said Chris Emery, Abrigo's director of strategy and engagement. "This can certainly lead to challenges for these institutions, and may result in having to reply on primarily external rather than internal information to substantiate their CECL result."[20]

With lack of guidance and data to lead banks in formulating a compliant model, it is difficult to imagine this Proposal being helpful for any bank to comply with CECL.

For these reasons, the KBA states that additional clarity is needed in the Proposal for banks to comply with the ambiguous mandates of CECL.

2. CECL is Flawed and Implementation Should be Delayed

As expressed above, CECL continues to be vague despite the FDIC's and other agencies best efforts to provide clarification. However, as shown below, this system is flawed and could lead to economic disaster.

However, before adding to its comments, the KBA does recognize the FDIC's limitations. As noted by Chairman Jelena McWilliams, "As you know, that rule is promulgated by FASB, as long as U.S. banks have to follow U.S. GAAP, which is a statutory requirement."[21] "The rulemaking itself, including the studies, etc., it outside our purview."[22]

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[18] Brice Luetkemeyer, *BankThink CECL: A Solution in Search of a Problem*, AMERICAN BANKER, July 26, 2019.
[19] Mary Ellen Biery, *Voices the Data Delimma: Do Financial Institutions Have Enough Data for CECL?* ACCOUNTING TODAY, June 19, 2019.
[20] Mary Ellen Biery, *Voices the Data Delimma: Do Financial Institutions Have Enough Data for CECL?* ACCOUNTING TODAY, June 19, 2019.
[21] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019.
[22] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019.

While the KBA understands these limitations, the KBA believes it is important to point out the shortcomings of this rule to the FDIC as a potential advocate to further delay implementation or to seek the appropriate research necessary before implementation.

A. History

As one author wrote, "Those who fail to learn from history are doomed to repeat it." Winston Churchill's words should serve as a warning to the FASB regarding CECL. If FASB looks to the past, it will appreciate why the implementation of CECL should be paused and substantially rethought."[23]

"CECL raises questions that many admit require further market experience to evaluate. A similar rush by FASB in the face of unanswered concerns resulted in disastrous financial consequences in 2008 when "mark-to-market accounting" was redefined by FASB. Despite warnings from the banking industry, FASB 157 was activated, and things went south almost immediately, causing massive write-downs of loans by bank and non-bank lenders alike. Accounting or paper losses of $500 billion in U.S. banks triggered a global financial crisis that required a decade to work its way through the economy – a lost decade that brought irreparable harm to millions of people."[24]

"As global financial markets went into free fall, the U.S. unemployment rate soared to 11% and housing foreclosures skyrocketed. The Dow crashed from 14,100 in October 2007 to 6,507 in March 2009. That was the same month that Congress held hearings and demanded that FASB and the SEC amend how credit loss securities were recorded – no longer marking them to market. FASB reluctantly agreed, and it is no coincidence that the start of the current and longest bull market in history began at that point."[25]

"A January 2019 survey by Janey, the largest investment house, found that 75% of bank investors oppose CECL."[26] One financial services company has already seen its stock price decrease 12% after it estimates that adopting CECL will reduce fiscal year 2020 earnings by 40%-60%.[27] "We are just now recovering from the 2008 crises induced by FASB, and the last thing we need is another one."[28]

It is important to recognize history and evaluate failures. Before making the tremendous leap into accounting changes, the regulators as a whole must evaluate this process to ensure there is not a repeat of 2007.

B. Congressional Criticism

The concerns regarding CECL are echoed with bipartisan concern from Congress.

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[23] Willian M. Isaac and Thomas P. Vartanian, *Why the Financial Accounting Standard Board Must Hit Pause on CECL*, WASHINGTON TIMES, July 23, 2019.
[24] Willian M. Isaac and Thomas P. Vartanian, *Why the Financial Accounting Standard Board Must Hit Pause on CECL*, WASHINGTON TIMES, July 23, 2019.
[25] Willian M. Isaac and Thomas P. Vartanian, *Why the Financial Accounting Standard Board Must Hit Pause on CECL*, WASHINGTON TIMES, July 23, 2019.
[26] Willian M. Isaac and Thomas P. Vartanian, *Why the Financial Accounting Standard Board Must Hit Pause on CECL*, WASHINGTON TIMES, July 23, 2019.
[27] Liz Kiesche, *Credit Acceptance -12% as CECL Accounting Will "Inject Volatility"*, SEEKING ALPHA, November 4, 2019.
[28] Willian M. Isaac and Thomas P. Vartanian, *Why the Financial Accounting Standard Board Must Hit Pause on CECL*, WASHINGTON TIMES, July 23, 2019.

Representative Blaine Luetkemeyer from Missouri stated that, "Not only will the proposed CECL standard provide to be unduly burdensome for community banks and other financial institutions, it could also affect large swaths of the economy including credit cards and government-sponsored enterprises Fannie Mae and Freddie Mac. With GSEs holding more than $5 trillion in mortgage-backed securities, CECL could have major implications for the U.S. housing market."[29] "Financial institutions across the nation are facing the most significant accounting changes in decades. I have expressed my strong concerns over the broad potential impacts of FASB's CECL standard and urge delayed implementation until you all have studied CECL and understand the consequences."[30]

Representative Greg Meeks from New York stated, "I'm very concerned by CECL. I believe that we should seek to confirm and quantify the expected impact on these groups before implementing an accounting rule that has material, real-world consequences."[31]

Representative Jennifer Wexton of Virginia stated, "I do want to add my name to those expressing concern about CECL and FASB's decision to forego a cost-benefit analysis before implementing those requirements."[32]

Representative Dan Scott from Georgia stated, "We need to put a stop, a stop right now on FASB's ruling in terms of CECL. This ruling is absolutely devastating to our smaller banks, without questions, and our credit unions."[33]

C. CECL's Negative Impact

The negative implications of CECL are real. "CECL goes overboard in requiring the recording of losses where none exist. This in turn results in an unjustified decrease in regulator capital, and potentially reduced lending especially during anticipated economic downturns, with draconian consequences for the economy."[34] The likely outcome of CECL is a very significant increase in artificial – not economic – loan losses, with corresponding adverse effects on regulatory capital. "Applied to the $17 trillion industry, and a little above $15 trillion in mortgages alone as of the fourth quarter of 2018, this could spell disaster, leading to detrimental effects on lending and the economy."[35]

"Banks with large concentrations of consumer loans could be hit the hardest, said Frederick Canon, an analyst at Keefe, Bruyette & Woods and the author of a report estimating CECL's impact on banks his firm covers."[36] Essentially, those banks that serve the public, will be hurt the most; counterintuitive to CECL's purpose of better serving public interests.

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[29] Blaine Luetkemeyer, *BankThink CECL Spells Trouble for Small Banks, Consumers*, AMERICAN BANKER, March 11, 2019.
[30] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019.
[31] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019.
[32] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019.
[33] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019.
[34] Joshua Ronen, *Opinion: A New Accounting Rule on Loan Losses Could be Disastrous for the Economy*, MARKETWATCH, April 22, 2019.
[35] Joshua Ronen, *Opinion: A New Accounting Rule on Loan Losses Could be Disastrous for the Economy*, MARKETWATCH, April 22, 2019.
[36] John Reosti, *Consumer Lenders Could Feel Most Pain From CECL*, AMERICAN BANKER, February 20, 2019.

"In recent congressional testimony, JPMorgan Chase CEO Jamie Dimon charged the rule will constrain banks and stymie lending."[37] "Wells Fargo is 'studying whether we will change the types of products we offer' as a result of CECL, Mario Mastrantoni, director of accounting policy said during a recent roundtable hosted by FASB at its Norwalk, Connecticut headquarters."[38] "Concerns about the impact on lending are real. I know our senior management is concerned."[39]

"Options under consideration skew toward shorter-duration loans, less guaranteed money and tougher pricing, industry observers said."[40] "There are whispers that banks will think about starting to offer shorter-term loans, said Joe McBridge, director of research and applied data at New York data provider Trepp, with mortgages and longer-term commercial real estate loans obviously in the crosshairs."[41] These changes will directly damage low-income families.

"By requiring financial institutions to account for the expected lifetime losses of a loan at the time of origination, CECL threatens to eliminate some lending services and restrict access to credit, particularly for low-income families. The potentially drastic consequences of CECL are looming over communities across the country and should be a cause of alarm for all consumers."[42]

"CECL will drive up costs and those cost will either be passed along to consumers or force institutions to curtail lending. According to the National Association of Home Builders, for every $1,000 increase in the price of a home, more than 100,000 American are priced out of a home."[43]

As Representative Greg Meeks from New York states, "My main concern is the real-world impacts on small community banks, minority banks and access to credit by the underbanked."[44] Any harm to these groups would be devastating. This is why CECL cannot be implemented as currently written. Any rule that disparately impacts lower-income borrowers, underserved communities and their interests is not acceptable.

For these reasons, the KBA requests that the FDIC do everything in its power to delay and study CECL; to truly determine those parties who will be harmed by its impact; and to determine if CECL is an improvement.

3. KBA Supports the Intent of the Guidance

The KBA fully understands the FDIC's limitations and efforts in attempting to provide clarification to a rule it did not write. While the KBA believes the guidance lacks clarity, the KBA appreciates the FDIC and the other agencies efforts. The KBA supports these efforts and believes that delayed implementation is the only means of sorting through the many shortcomings of CECL.

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[37] Joshua Ronen, *Opinion: A New Accounting Rule on Loan Losses Could be Disastrous for the Economy*, MARKETWATCH, April 22, 2019.
[38] John Reosti, *Shorter Terms, Higher Rates: How CECL Could Upend Lending*, AMERICAN BANKER, February 4, 2019.
[39] John Reosti, *Shorter Terms, Higher Rates: How CECL Could Upend Lending*, AMERICAN BANKER, February 4, 2019.
[40] John Reosti, *Shorter Terms, Higher Rates: How CECL Could Upend Lending*, AMERICAN BANKER, February 4, 2019.
[41] John Reosti, *Shorter Terms, Higher Rates: How CECL Could Upend Lending*, AMERICAN BANKER, February 4, 2019.
[42] Blaine Luetkemeyer, *BankThink CECL Spells Trouble for Small Banks, Consumers*, AMERICAN BANKER, March 11, 2019.
[43] Blaine Luetkemeyer, *BankThink CECL Spells Trouble for Small Banks, Consumers*, AMERICAN BANKER, March 11, 2019.
[44] Neil Haggerty, *Absolutely Devastating to Small Lenders: Lawmakers lay into CECL*, AMERICAN BANKER, May 16, 2019..

Thank you for considering our suggestions. If there are any questions, please do not hesitate to contact the undersigned.

Sincerely,

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