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July 13, 2018

Board of Governors of the Federal Reserve System
Attention: Ann E. Misback, Esq., Secretary
20th Street & Constitution Avenue, NW
Washington, D.C. 20551
Via email submission to: regs.comments@federalreserve.gov

Office of the Comptroller of the Currency
Attention: Legislative and Regulatory Activities Division
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Via email submission to: regs.comments@occ.treas.gov

Federal Deposit Insurance Corporation
Comments/Legal ESS
Attention: Robert E. Feldman, Executive Secretary
550 17th Street, NW
Washington, D.C. 20249
Via email submission to: comments@FDIC.gov

Re: Regulatory Capital Rules Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Confirming Amendments to Other Regulations (OCC Docket ID OCC-2018-0009 and RIN1557-AE32; FRB Docket No. R-1605 and RIN 7100 AF-04; FDIC RIN 3064-AE74)

Ladies and Gentlemen:

Citizens Financial Group, Inc. (Citizens) appreciates the opportunity to comment on the Notice of Proposed Rulemaking *Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Confirming Amendments to Other Regulations* (NPR). The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the Agencies) are inviting public comment on this joint proposal to address changes to U.S. generally accepted accounting principles (GAAP) described in Accounting Standards Update No. 2016-13, Topic 326, *Financial Instruments-Credit Losses* (ASU). Specifically, the NPR would revise the regulatory capital rules of the agencies to address the implementation of the current expected credit losses (CECL) methodology as detailed in the ASU. Citizens respectfully submits the comments outlined below in reference to this joint NPR.

Citizens is one of the nation's oldest and largest financial institutions, with \$153.5 billion in assets as of March 31, 2018. Headquartered in Providence, Rhode Island, Citizens offers a broad range of retail and commercial banking products and services to individuals, small businesses, middle-market companies, large corporations and institutions. Citizens helps its customers reach their potential by listening to them and by understanding their needs in order to offer tailored advice, ideas and solutions. In Consumer Banking, Citizens provides an integrated experience that includes mobile and online banking, a 24/7 customer contact center and the convenience of approximately 3,300 ATMs and approximately 1,150

branches in 11 states in the New England, Mid-Atlantic and Midwest regions. Consumer Banking products and services include a full range of banking, lending, savings, wealth management and small business offerings. In Commercial Banking, Citizens offers corporate, institutional and not-for-profit clients a full range of wholesale banking products and services, including lending and deposits, capital markets, treasury services, foreign exchange and interest rate products, and asset finance.

Executive Summary

CECL arguably represents the most important change to accounting rules for financial institutions in recent history. As part of the initial consideration for the accounting change, Citizens provided feedback that outlined our concerns related to the standard in our original comment letter to the FASB. Additionally, since adoption of the final standard we have actively engaged with the Agencies, the United States Securities and Exchange Commission (SEC), and the Financial Accounting Standards Board (FASB) detailing our primary concerns related to the standard's impact on financial institutions, financial statement users and perhaps most importantly, consumers and businesses in the United States, including the following:

- CECL will increase financial institution capitalization to unnecessarily high levels.
- CECL is inconsistent with the economics of lending, as noted by two of the seven FASB Board members.
- The pro-cyclicality of CECL will exacerbate economic cycles, which will be harmful to consumers and businesses, especially in an economic downturn.
- CECL will likely drive unintended changes to the availability, terms, and price of credit.
- The nature of the standard will negatively impact bank financial statement comparability.
- The standard places U.S. banks at a competitive disadvantage to IFRS-9 banks since life-of-loan loss estimates apply to a much smaller portion of the portfolio for IFRS-9 as compared to CECL.
- Without the appropriate additional considerations, the incorporation of CECL into CCAR and the FRB's stress testing framework will have implications for BHC's ability to distribute excess capital to shareholders.

A key component of the NPR is the proposal of a capital impact phase-in. It appears that the objective of the capital phase-in is to ensure that the Agencies and the industry have the appropriate amount of time to understand the capital implications of the standard. Citizens supports that objective, but we do not agree that the NPR appropriately addresses CECL's primary problems as we detail later in this letter.

The current regulatory capital framework was designed in conjunction with the existing incurred loss methodology used for loan loss reserving. The current minimum capital requirements reflect consideration of both unexpected credit losses as well as the expected credit losses as defined by the existing loan loss reserving methodology. Without any changes to the existing capital framework, the adoption of CECL results in an increase to effective capitalization levels, since expected credit losses will be fully provided for in the allowance for credit losses, and will also be inherently considered in regulatory capital requirements. It is important to note that the difference between the existing incurred loss reserves and the higher CECL reserves will not be consistent throughout a credit cycle. Since macroeconomic models and economic forecasts are unable to accurately predict the turning point in an economic cycle, we believe the CECL methodology will be more pro-cyclical than the incurred loss methodology and that allowance under CECL will be highly volatile and sensitive to the exogenous macroeconomic environment. Our historical internal analyses show the CECL reserve increase is greater during periods of stress than in more benign periods, and that given the economic forecasts available when setting reserves (as opposed to perfect foresight of a downturn, which is not available before the

downturn), CECL does little to prevent “too little, too late.” More so, had CECL been implemented in 2006, prior to the Great Recession, the calculated CECL reserves at the worst of the downturn would have been 50% - 100% greater than the incurred loss reserves, which would have been detrimental to the banking industry’s ability to meet the credit needs of consumers and businesses in the downturn and would have exacerbated the recession.

Under the proposal, a banking organization that experiences a reduction in retained earnings on the CECL adoption date may elect to phase-in the regulatory capital impact over a three-year transition period. The effectiveness of the transition period will be largely dependent on the credit and forecast economic environment at the time CECL is adopted and the stability of this forecast throughout the entire phase in period. If the environment is relatively benign upon adoption, but then deteriorates significantly during the transition period there would be no additional capital relief to offset the subsequent decline in capital that such deterioration would trigger. The capital transition is based only on the incremental CECL reserves at the time of adoption. We believe that the most appropriate way to address this problem is by making the impacts of CECL capital neutral. Absent that, however, the transition period will lack effectiveness unless it is not only calibrated to the day 1 capital impact, but also to the ongoing capital impacts over the life of the phase-in period. A phase-in that accounts for ongoing capital impacts is critical since subsequent changes in the economic environment can have material impacts on the CECL reserve and the additional capital requirements driven by the CECL reserve change. Finally, market participants have a long history of incorporating information into equity prices when that information is known. With the existing proposal, all investors will have all of the information needed to calculate and adjust any bank’s stock price for the fully phased-in capital impact. Therefore, the effectiveness of a capital phase-in for CECL that is only based on the day 1 capital impact will be of minimal help for banks in their capital planning process.

In our NPR response we find it necessary that we include our views on the primary weaknesses of the standard, since they are critical to what the NPR attempts to address. We have, therefore, included recommendations that do not apply specifically to the NPR, but rather are focused on the final standard, and therefore may be out of the control of the Agencies. Specifically, we believe that CECL has not been appropriately evaluated as it pertains to the potential for its unintended, long-term and systemic impacts to the overall economy or its potential impact to the availability, structure, and pricing of credit. Finally, Citizens Bank has collaborated with The Clearing House and Financial Services Roundtable and supports their comment letter.

Recommendations

Accordingly, Citizens is recommending that the Agencies actively engage with the FASB to seek a delay in the implementation of CECL to provide appropriate time to address the numerous uncertainties associated with the ASU, instead of implementing a simple capital phase-in, which fails to address the true problems of CECL. These recommendations have been described in further detail in the remainder of this letter.

1. Request for Capital Neutrality

For the reasons discussed above, we urge the agencies to consider some form of permanent regulatory capital relief such that the ASU has the effect of being “capital neutral” with respect to both stress and non-stress capital requirements to the extent possible. We believe that capital neutrality can be achieved via three potential approaches, or some combination of the three:

- Allow a dollar-for-dollar CET1 credit for the additional loss absorbency on banks’ balance sheets from the CECL provisions, which are more closely related to unexpected losses that capital is provided for, or
- Incorporate an RWA reduction commensurate with the incremental increased loss absorbency of CECL, or

- Recalibrate regulatory capital minimums downward.

Providing this relief will enable banks to retain current capital levels and not impact their lending risk appetite or the amount of capital available to lend. This approach also ensures that capital levels under stress remain unchanged, and will have minimal impact on banks' ability to distribute capital to shareholders.

The NPR attempts to address the capital impact through the capital phase-in component of the NPR, but as stated in our introductory section, the capital phase-in does not address the underlying problems of CECL. Citizens does not believe that the phase-in provisions provide tangible capital relief as banks will manage capital based upon the long-term impact of CECL and will discount the short-term relief accorded by these provisions. Further, any transition adjustments are generally disregarded by the financial markets, as greater focus is typically given to capital ratios calculated on a fully phased-in basis.

The effort required to address the capital neutrality issues presented above are not insignificant and would require time and effort by the Agencies and the industry to ensure that they are calibrated and applied appropriately so that the framework would work in various credit cycles.

2. Address Unintended Consequences of CECL Related to Business Decisions and Economic Impacts

Implementation of the CECL methodology, which requires banks to establish reserves for losses over the life of a loan, is expected to reduce Common Equity Tier 1 (CET1) and Tier 1 capital levels without any underlying change to the risk profile of the bank. As mentioned above, we believe it is imperative that the changes proposed in the NPR promote capital neutrality to the extent possible and not alter the capital adequacy or levels of an institution due to the implementation of CECL. Without the appropriate changes to promote capital neutrality we are concerned that CECL may have significant and adverse impacts on pricing, terms, and supply of credit because CECL is misaligned with the economics of lending. In the ASU, FASB Board Members Larry Smith and Jim Kroeker mention on at least six separate occasions in their dissenting opinion that CECL is not aligned to the economics of lending. We agree with the concerns identified by Smith and Kroeker, which are detailed below. This fact, that CECL is not aligned to the economics of lending, will ultimately lead to banks changing how they lend, impacting loan terms and pricing to borrowers.

- “Messrs. Kroeker and Smith believe that recognition of lifetime expected credit losses as an expense at inception or purchase reflects the risk of loss (that is, credit risk) through the income statement and is inconsistent with the definition of an expense included in FASB Concepts Statement No. 6, *Elements of Financial Statements*. Messrs. Kroeker and Smith believe that this conceptual shortcoming of this Update thereby results in financial reporting that does not faithfully reflect the economics of lending activities.” (p 235 of the ASU)
- “Consequently, they do not support the issuance of this Update, despite the transparency of providing information about lifetime expected losses, because the reporting of operating results under the current expected credit loss model is a poorer reflection of the economics of lending activities than the existing incurred loss model.” (p 236 of the ASU)
- “The result of applying the Update is that on Day 1 of an origination or purchase, the income statement is charged with an expense so that (assuming expectations of credit losses are met) the future interest income stream will reflect the original contractual (or purchased) yield. Messrs. Kroeker and Smith believe that this is an inappropriate reflection of the true economics of lending.” (p 237 of the ASU)

- “Under the expected credit loss model, a growing portfolio of loans (whether through purchase or origination) will have a negative effect on profitability because of the requirement to record full lifetime expected losses when the loans are originated. Messrs. Kroeker and Smith find this result puzzling and counterintuitive. Furthermore, recognizing full lifetime losses on loans (in a manner inconsistent with the underlying economics) could have unintended implications to lending institutions’ willingness to lend under certain circumstances and to certain types of borrowers.” (p 238 of the ASU)
- “While they disagree with recognizing a loss at inception in an amount equal to the expected credit losses, they believe that a reasonable, cost-effective approach could be developed to address their concerns that would better reflect the economics of lending than the model proposed in this Update.” (p 239 of the ASU)
- “Messrs. Kroeker and Smith believe that there are different models that could be considered, all of which would incorporate the concept of either disclosing or including on the face of the balance sheet full lifetime expected losses. In any of those models, a method of recording the losses in the income statement would have to be developed. Messrs. Kroeker and Smith believe that developing a model that incorporates (1) the transparency of displaying full lifetime expected losses and (2) a method of recording interest income along with related expected credit loss provisions would result in a more faithful reflection of the economics of lending (under a value realization approach).” (p 240 of the ASU)

As articulated by Smith and Kroeker, the misalignment of CECL to the economics of lending will likely impact banks’ lending practices, harming consumer and business clients especially in a downturn. The efforts required to appropriately address the potential unintended consequences of CECL due to this misalignment are not insignificant and would require time and effort by the Agencies and the industry to ensure that the impacts are well understood and addressed appropriately.

3. Ensure Consistency between CECL, the stress testing framework and the Stress Capital Buffer Proposal

On November 3rd, 2017 and March 1st, 2018, the FRB invited all CCAR banks to Washington, D.C. to discuss how to appropriately incorporate CECL into CCAR. The discussions were productive and the banks were asked to generate various proposed suggestions on how to include the new CECL standard into CCAR. Those proposals will be presented to the FRB in July and August. It was agreed that the proposals should incorporate the below characteristics:

- Realism: The framework should be realistic, reflecting how banks would actually respond to a stress scenario given the expected information available to banks for each period in the scenario and promote the credibility of the stress tests;
- Consistency: Although CECL allows for banks to implement a wide range of methodologies to develop their forecasts, methodologies for CCAR should be consistent and promote comparability;
- Simplicity: Although the most accurate way to incorporate CECL into CCAR would require numerous complexities, the approach should avoid unnecessary complications in CECL forecasting while supporting the other principles. An overly complex approach would present operational challenges and could possibly reduce the comparability and transparency of the results; and

- Transparency: The approach should be transparent to all stakeholders, including banks, market participants, academic experts and other members of the public.

How CECL is incorporated into CCAR cannot be analyzed in isolation; specifically, the impact of CECL in CCAR must be coordinated with the analysis of the construction of the proposed Stress Capital Buffer (SCB). The SCB proposal would effectively codify the role of stress tests in determining bank's binding capital requirements, which will determine their ability to distribute capital to shareholders. The proposal does not change minimum capital requirements or address how CECL will be incorporated into CCAR or the SCB.

It is critical that the Federal Reserve consider the collective impact of the implementation of CECL, the incorporation of CECL into CCAR, the stress buffer proposal and the overall transparency the Federal Reserve's capital planning and stress testing framework when determining the treatment of CECL for purposes of all capital requirements (including stress capital requirements).

The efforts required to appropriately analyze and address how CECL should be implemented in CCAR and also its interplay with the proposed SCB are not insignificant and will require time and effort by the Agencies and the industry to ensure that it is calibrated and applied appropriately so that the capital phase it would be appropriate through the entire phase in transition.

4. Request for Regulatory Support for Alternative Approaches and Delayed CECL Implementation

The ASU alters the way allowances are formulated for financial assets, shifting from an "incurred" to "expected" credit loss methodology. The FASB and SEC have acknowledged that neither is responsible for any impact analysis as part of consideration for implementing a new accounting standard. Going back to the original comment letters provided by the industry prior to the adoption of CECL, many in the industry have been concerned about the impact CECL will have on various aspects of banking. The impact to regulatory capital, although unknown, is expected to be significant and all banks will be required to change the fundamental manner in which they operate if the Agencies fail to adopt regulatory capital reform that promotes capital neutrality. Due to CECL's misalignment to the economics of lending, there is a significant risk that banks' lending practices and business mix will change as a result of CECL with a very real possibility that it will harm both consumer and business borrowers, especially in a downturn and therefore exacerbate future recessions.

Additionally, alternative proposals are being discussed in the industry that we feel may more appropriately satisfy the FASB's original goals of (a) better preparing the industry to have reserves that are not "too little, too late" and (b) creating reserve accounting convergence between the IASB and the FASB. Even Smith and Kroeker in their dissent note that, "they believe that a reasonable, cost-effective approach could be developed to address their concerns that would better reflect the economics of lending than the model proposed in this Update." We feel that given the potential unintended negative consequences of CECL and the macro prudential responsibilities of the Agencies, that the Agencies should support exploring alternatives to the standard as it is currently written.

To appropriately address the above issues a thoughtful, thorough, holistic impact analysis is required, which has not been completed at this time. This type of impact analysis is not an insignificant undertaking and would require time and effort by the Agencies and the industry to ensure that it is complete and incorporates the complexities of the standard and how the standard will behave with the information available at the time under various credit and economic environments. Recognizing the challenges associated with this important work, we respectfully ask, and urge the Agencies to request an implementation delay from the FASB.

Thank you for your attention to these matters and for contemplating our views. Please feel free to contact me (John.Woods@citizensbank.com; 203-900-6700) or Michael Fadil (Michael.Fadil@citizensbank.com; 401-464-3540) if you would like to further discuss our views.

Sincerely



John F. Woods
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Citizens Bank