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Via Electronic Delivery

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency (OCC)
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC–2018–0009

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551
Docket No. R-1605 and RIN 7100-AF04

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AE74

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 Conforming Amendments to Other Regulations

Capital One Financial Corporation ("Capital One")[1] appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the

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[1] Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A., and Capital One Bank (USA), N.A., had $250.8 billion in deposits and $362.9 billion in total assets as of March 31, 2018. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients through a variety of channels. Capital One, N.A. has branches located primarily in New York, Louisiana, Texas, Maryland, Virginia, New Jersey and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Currency (collectively, the "Agencies") in response to a notice of proposed rulemaking (the "Notice") revising regulatory capital rules to address banking organizations' implementation of the current expected credit loss methodology ("CECL").[2] As addressed in more detail in this letter, although we appreciate the principles and historical context that led the Financial Accounting Standards Board ("FASB") to adopt CECL, we believe CECL in its current form would be punitive to both banks and consumers. Furthermore, since CECL was first contemplated in 2010, the Agencies have implemented additional capital requirements that address limitations in the existing loss accounting model and have the effect of causing CECL to be redundant.

Accordingly, the Agencies should ensure that the adoption of CECL does not create duplicative bank capital requirements which would necessarily lead to detrimental impacts to lending volume, related economic activity, volatility, transparency, and comparability across banks.

The implementation of CECL should be revised to ensure that duplicative capital requirements are avoided

Absent fundamental changes to CECL or regulatory relief from the Agencies, CECL would (1) result in increased and duplicative capital requirements, and (2) restrict access to credit for consumers and small businesses, particularly during times of macro-economic stress when credit availability is needed most. We, therefore, request that the Agencies, on behalf of the banking system, actively engage with the FASB to seek a delay in CECL implementation in order to study CECL's impact and potential unintended consequences.

Duplicative capital

Simply stated, CECL, which was introduced nearly a decade ago, is now duplicative of other, more effective post-crisis reforms, specifically Basel III and the post-crisis capital stress testing regimes such as Dodd-Frank Act Stress Testing ("DFAST") and Comprehensive Capital Analysis and Review ("CCAR"). Basel III has increased both the quality and quantity of capital, and stress testing ensures that banking institutions have the capital resilience to withstand severe and sustained economic downturns and related loan losses. CCAR (including the Stress Capital Buffer ("SCB") proposal) in particular is far more effective at achieving CECL's goal, and unlike CECL, it does not have the procyclical impacts since it is scenario-based and monitored in advance of a crisis. The Agencies' recently proposed SCB amendments to the CCAR and regulatory capital rules make CECL's redundancy especially apparent. The SCB framework would ensure that bank capital levels adjust concurrently with the economic cycle and changes in the bank's risk profile, all in advance of a downturn. Put another way, SCB implementation would force banking organizations to recognize and capitalize for potential economic downturn losses sooner, just as CECL is intended to do.

[2] Federal Reserve, FDIC, and OCC, *Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations*, 83 Fed. Reg. 22312 (May 14, 2018).

Restricted credit access

Estimating credit losses is inherently uncertain, whether under the current incurred loss method or CECL. Neither approach will have the benefit of perfect foresight into future economic conditions. CECL reserves are highly sensitive to net charge-off rate forecasts. Imperfect forecasts could be due to either modeling inaccuracies or the hard-to-predict nature of an economic crisis.[3] This lack of perfect foresight will result in CECL's impact on capital being significantly more procyclical than the current accounting model and thus would function contrary to its intended purpose by exacerbating, rather than limiting, the effect of an economic downturn. CECL requires banks to predict economic conditions over a "reasonable and supportable" period while also estimating losses for the entire life of a loan and anticipate exactly whether—and precisely when—a downturn would occur. Because such perfect foresight is impossible, banks would inevitably be forced to adjust their expectation of lifetime credit loss once a downturn occurs, increasing projected loan losses at that point. Thus, loss reserves (and without regulatory capital relief, required capital) would rise as the economy worsens. The effect on capital would reduce lending, and the additional capital cost would be passed on to consumers and small businesses through higher pricing, reduced loan tenors, and less access to credit for already underserved borrowers. This procyclical effect is at odds with the Agencies' macro-prudential objectives of ensuring the availability of credit under stress.

CECL would also discourage normal bank lending even during healthy economic periods by further front-loading the capital costs of originating loans. Under CECL, when a bank increases its lending, all of the estimated losses over the life of those loans reduce capital on the day of origination. However, the revenue expected to be earned by the newly originated loans add to capital as retained earnings gradually over the entire life of the loans, creating a divergence with the true economics.

The Agencies could minimize CECL's regulatory capital impact by advocating for a modified CECL model with the FASB and revising their capital rules to offset the capital impacts of CECL. We propose an approach that would retain CECL's intended approach of establishing an allowance for the lifetime of an asset on the balance sheet, but recognize the provision for losses in two parts: (1) loss expectations within the first year would be recorded to provision for losses in the income statement, while (2) loss expectations beyond the first year would be recorded to Accumulated Other Comprehensive Income ("AOCI").

This approach to bifurcate CECL's impact to allowance would:

- Be consistent with the FASB's CECL accounting objectives of (1) presenting financial assets at the amount expected to be collected over the life of the asset, and (2) building reserves earlier than today's incurred loss model;

- Further bank transparency and comparability by providing a delineation between (1) expected losses over a shorter and more accurate loss forecasting time horizon, and (2)

[3] Tunay, Soner, *Impacts of CECL: Empirical Assessments and Implications*, Accenture (May 22, 2018).

the expected losses beyond that period of time that are less certain and have a higher likelihood of forecast misstatement; and

- Not introduce any new complexities beyond those required by CECL, such as the complications required by the IFRS9 dual-measurement approach and staging, which forces banks to track loss degradation from origination.

This approach also highlights CECL's impact to capital. Loss estimates in the first year would flow through earnings and be immediately reflected in Common Equity Tier 1 ("CET1") capital. Losses beyond the first year and recorded in AOCI would be easily identified in financial statements and regulatory reporting. Thus, the Agencies could identify and counteract CECL's redundant capital charge by adding to the capital rules an adjustment for CECL's component of losses included in AOCI, similar to the existing AOCI adjustment for certain cash flow hedges.[4] While the Agencies should provide a CET1 addback in any case to ensure CECL remains capital neutral, the above approach makes this capital relief more transparent and fits well within the existing capital framework. If the FASB does not change CECL as described above, the Agencies could still offset the capital impacts of CECL by requiring banks to calculate the difference in required allowance between CECL and current accounting rules and adding that incremental allowance to CET1.

The proposal to integrate CECL with CCAR is premature

The Agencies should reconsider their planned approach for integrating CECL with CCAR and delay CECL for purposes of CCAR until an industry standard practice emerges. Transparency and comparability across banks are key CCAR objectives, yet premature integration of CECL in CCAR would cause CCAR results to differ based not on banks' underlying financial resiliency, but merely on their varying good-faith approaches to implementing the new standard. In addition, the Notice would require institutions that are SEC filers to implement CECL into accounting methodology and CCAR reporting concurrently in the first quarter of 2020. This would create significant operational complexity and uncertainty as well as governance challenges. Therefore, the Agencies should defer the integration of CECL into CCAR until at least the CCAR 2021 cycle to enable banks to refine their approaches for CECL based on regulatory feedback and industry practices before applying those approaches to a stress scenario which could amplify methodological differences across institutions. In addition, the Agencies should have CECL/CCAR integration be subject to the same three-year phase-in proposed by the Notice for baseline capital requirements. Specifically, the Agencies should apply phase-ins to CECL's impact on allowance builds in the stress scenario, in addition to the starting baseline allowance.

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[4] *See* 12 C.F.R. §§ 3.22(b)(1)(ii), 217.22(b)(1)(ii), 324.22(b)(1)(ii).

We appreciate the opportunity to highlight the topics raised in this letter, and we would be happy to meet with the Agencies to discuss these comments further.

Sincerely,

[redacted]

R. Scott Blackley
Chief Financial Officer