



3 Park Place  
Dublin, CA 94568

December 16, 2019

Todd M. Harper, Board Member  
NATIONAL CREDIT UNION ADMINISTRATION  
1775 Duke St  
Alexandria, VA 22314-3428

Re: Proposed Interagency Policy Statement on Allowance for Credit Losses

Dear Mr. Harper:

I am writing on behalf of Patelco Credit Union, a California state-chartered federally insured credit union, to provide comments on the Proposed Interagency Policy Statement on Allowance for Credit Losses (ALLL).

Under the current ALLL Policy guidance, allowance is determined based on the Incurred Loss model using historical information and current conditions to determine losses that are probable or incurred in the portfolio at the reporting period. The proposed changes would require Credit Unions to transition to the Expected Credit Loss (CECL) model which requires historical information, current conditions and “reasonable and supportable expectations about the future” in order to estimate the expected losses throughout the contractual term of the loan.

While the proposed changes to the allowance methodology have Safety & Soundness in mind, the execution and implementation are likely to produce adverse impacts and unintended consequences, specifically towards Credit Unions.

1. MODEL RISK: it is the opinion of the Credit Union that there is significant risk in the development and deployment of CECL models given the lack of maturity, lack of data, and impact of inaccurate assumptions.
  - a. Lack of Maturity- Methodology and models are costly and unproven as models have not been through an entire credit cycle (or multiple cycles). Uncertainty around the design, development or deployment of the models, can severely impact the organization by resulting in too much or too little allowance.
  - b. Lack of Data- products and underwriting standards are constantly evolving as does consumer behavior. In the absence of appropriate time series data, management is required to make assumption which potentially compare unlike products, terms, underwriting standards, etc.
  - c. Assumptions- “Reasonable and Supportable expectations about the future”.
    - i. While CECL is intended to be countercyclical, economic optimism during good periods could lead to inadequate reserves while economic pessimism during bad periods could lead to excessive reserves. In either case, the underlying uncertainty in the model assumptions may cause undue volatility and models may be slow to react in a changing climate.

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- ii. Economic cycles are unique. Modeling to the most available data (the Great Recession which included questionable underwriting practices) may not be appropriate for a more moderate recession.

PROPOSE:

Given the inherent risks of implementing and deploying models prematurely, the Credit Union requests that the NCUA consider delaying the adoption of CECL for Credit Unions until models have been validated, back tested, and standardized industrywide.

2. CAPITAL RISK: changing from reserving for Incurred losses over the loss event period to Expected losses throughout the life of the instrument implies a substantial increase in Allowance. However, the mechanics of how (and when) the reserve is set aside can have adverse business consequences and disparate impact towards Credit Unions.
  - a. Increase in Capital requirements due to the change in methodology uniquely impacts credit unions who may have limited access to Capital resulting in potential corrective action status.
  - b. Timing- Capital cost of implementing all at once can be substantial for a financial institution to absorb and can again result in potential capital classification downgrades.
  - c. Timing- Setting aside 100% of expected life of loan losses at time of originations is a costly proposition and could constrain the ability for the Credit Union to meet our member's borrowing needs.
  - d. Investments- there are likely substantial investments (of money and time) required to adequately deploy a successful CECL program.

PROPOSE:

Given the potential impacts on capital, and the adverse effects on Credit Unions, the Credit Union requests that the NCUA consider providing a "build up period" at the time of adoption so that the Capital impact can be spread out over time.

Additionally, reserving at origination for 100% of the expected lifetime losses seems excessive. One alternative could be to spread the cost over the expected life of the instrument. Another alternative would be to prescribe the loss event period to be greater than today's assumptions, but not quite as punitive as "Life of Loan".

Our Credit Union believes that the implementation of Proposed Interagency Policy Statement on Allowance for Credit Losses (ALLL), as it is currently proposed, would adversely impact the Credit Union financially and strategically, ultimately distracting it from the core mission of service to members. Small and medium credit unions (and even institution of our size) don't need, and can't afford, the cost of CECL implementation the way that it is currently proposed.

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We appreciate the opportunity to provide input into the NCUA's Proposed Interagency Policy Statement on Allowance for Credit Losses (ALLL). As always, we are available to discuss these comments at any time.

Sincerely,

Chris Allen, Chief Risk Officer  
PATELCO CREDIT UNION