DISCOVER

May 15, 2020

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RE: Office of the Comptroller of the Currency [Docket ID OCC–2020–0010] RIN 1557–AE82; Federal Reserve System [Regulation Q; Docket No. R–1708] RIN 7100–AF82; Federal Deposit Insurance Corporation RIN 3064–AF42 Interim Final Rule for Revised Transition of the Current Expected Credit Losses Methodology for Allowances

Mr. Gould, Ms. Misback, and Mr. Feldman:

Discover Financial Services ("Discover") appreciates the opportunity to provide comments to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the "Agencies") regarding the Interim Final Rule ("IFR") addressing the regulatory capital impacts of the current expected credit losses ("CECL") accounting standard. The IFR provided banking organizations with the option to temporarily delay some of CECL's adverse impacts in light of the disastrous economic circumstances arising from the COVID-19 crisis. While the IFR provided much needed assistance for banks to continue serving their customers and support the economic recovery, for the reasons discussed below, we believe the Agencies should adopt more permanent changes to their regulatory capital standards in light of CECL. Such changes should acknowledge that under CECL most banks are required to hold significantly more reserves to absorb credit losses, and would also negate the need for more temporary relief in future economic crises.

Discover is one of the leading direct banks in the United States, offering a broad array of retail banking services to consumers, including deposit products, credit cards, student loans, personal loans, and home equity loans. We have a consumer-centric business model with more than 80% of our consolidated assets comprised of loans to individuals. As a result, like most banks of our size, credit risk is the predominant risk for Discover and a primary factor in evaluating the company's capital needs. Changes necessitated by CECL have accelerated the recognition of credit losses and increased allowances, thereby adversely impacting capital levels. The interaction of CECL and regulatory capital rules is therefore a topic of utmost importance to us. In this regard, we have actively engaged with the Financial Accounting Standards Board ("FASB"), the Agencies, and the Securities and Exchange Commission ("SEC") and have been grateful for the opportunities to discuss CECL's impacts with the Agencies throughout the standard-setting process.

I. CECL Impact Overview.

First and foremost, we want to express our appreciation to the Agencies for releasing the IFR and establishing the optional two year delay of CECL's estimated effect on regulatory capital, as compared to the incurred loss methodology. Not only do we think this is good policy and helpful to our institution, it more importantly, allows us to deploy much-needed capital to consumers and small businesses. We note, however, that the problems with CECL that prompted the Agencies to issue the IFR in the first place are not unique to this particular crisis. It is therefore critical that the Agencies adopt more permanent changes to regulatory capital standards to ensure that banks are able to serve as a source of strength for the economy in future downturns.

We believe permanent adjustments to the regulatory capital framework are warranted to ensure banking organizations' loss absorbency requirements are properly calibrated given the fundamental shift in credit loss reserve methodologies since the current rules were first implemented. By way of background, CECL has significantly increased credit loss allowances for many institutions without any change in the institution's business model or risk profile. For example, on January 1, 2020, upon implementing CECL, Discover was required to increase its loan loss reserves by nearly 75% despite no change in the composition of its assets or exposures. Credit reserves, like capital, are intended to absorb future losses and thus provide protection against risk. As a result, absent regulatory intervention, CECL requires banks to utilize earnings both to build reserves and to replenish retained earnings to continue to meet capital requirements on an ongoing basis. The change in accounting standards acts, in effect, as a new capital requirement by increasing the total loss absorbency requirements for many U.S. financial institutions. In light of these fundamental changes brought about by CECL, the Agencies should revise their capital standards to offset the increase in credit reserves. One way to do this would be to make permanent the IFR's capital offset to neutralize the long-term capital impacts. However, there are multiple ways to address this problem and the approach in the IFR is imprecise and, in many cases, underestimates the adverse impact of CECL.

II. The IFR Underscores the Need for Permanent Capital Adjustments.

The Agencies stated that the IFR was issued to address concerns that CECL may serve as an impediment to banking organizations' ability to serve consumers and businesses during the significant and ongoing economic disruptions caused by the COVID-19 pandemic. Specifically, the IFR states:

> [D]ue to the *nature of CECL* and the *uncertainty* of future economic forecasts, banking organizations that have adopted CECL may continue to experience higher-than-anticipated increases in credit loss allowances. To address these concerns and allow banking organizations to *better focus on supporting lending to creditworthy households and businesses*, the agencies are providing banking organizations that adopt in the current environment an alternative option to temporarily delay a measure of CECL's effect on regulatory capital, relative to the incurred loss methodology.[1]

This section of the IFR highlights some of our main concerns about CECL and underscores the need for a more permanent solution. As noted above, the issues described in the IFR are not specific to the current environment and will be true in future economic crises too unless the Agencies intervene. The FASB itself has clarified that CECL "is intended to reflect—not to drive—economic activity and behavior" and has acknowledged that "regulatory capital requirements and other public policy considerations are decisions appropriately left to regulatory and political bodies."[2]

a. Consumer and Business Impact.

When CECL began to be implemented earlier this year, it replaced the long-standing "incurred loss" model for calculating credit reserves with a new model that requires banking organizations to hold allowances to cover expected losses over the lifetime of the loan. This change represents a major shift in the method for calculating allowances for credit losses with potential to cause significant adverse impacts on lending practices, borrowers, and the broader economy. Requiring banks to recognize all expected credit losses up front, while related revenues are recognized gradually over the life of the loan, fundamentally alters the economics of lending. For instance, CECL is likely to incentivize short-term lending over longer term products (e.g., 20-yr student loans and 30-yr mortgages) and may require some banks to change their pricing practices.

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[1] IFR Federal Register Vol. 85, No. 62 (March 31, 2020) 17725 (italics added).
[2] See Letter from Russell G. Golden, FASB Chairman, to Representatives Scott R. Tipton and Patrick E. Murphy (February 22, 2016).

b. **Pro-Cyclicality and Uncertainty.**

Additionally, for years we have expressed concern about the pro-cyclical nature of the standard and the likely adverse macro-economic impacts on credit markets during recessionary periods. These concerns have also become a reality, and some may argue they are even worse than anticipated. Given the inherent difficulty in forecasting macro-economic conditions, many banks may not foresee the need to build credit reserves until economic conditions have already begun to deteriorate, which would have pro-cyclical effects. Indeed, we are seeing this play out today in a dramatic way as the current crisis unfolds and many banks are being forced to recognize historically unprecedented loan loss provisions. Additionally, the up-front negative impact on earnings when booking new loans under CECL has also created a strong disincentive to grow loans during a stressed environment as banks seek to conserve capital. This effect could further constrain credit availability and limit banks' ability to serve as a source of strength during the current downturn in the economy, which is counter to what consumers and businesses need during this time of stress.

III. CECL does not Account for Capital Requirements Established after the Great Recession that Bolstered Safety and Soundness.

It should also be noted that there have been significant changes to the regulatory capital framework, particularly for large and midsize firms, since the CECL standard was originally proposed in 2012. These developments have increased both the quality and quantity of capital that banking organizations are required to hold to buffer against losses. We acknowledge that tier 1 capital has greater overall loss absorbency because it is available to cover losses other than credit loss; however, credit remains far and away the predominant risk for most lending institutions in the United States.[3]

IV. Conclusion

Discover appreciates the Agencies' attention to this critically important issue and we are grateful for the opportunity to comment on the IFR. We thank you for considering the recommendations in this letter and welcome further constructive dialogue. Please do not hesitate to contact me at johngreene@discover.com.

Sincerely,

John Greene
Executive Vice President, Chief Financial Officer

[3] Id.