NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

December 16, 2019

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

RE: Interagency Policy Statement on Allowances for Credit Losses

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the proposed interagency policy statement (Statement) on allowances for credit losses (ACLs). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 119 million consumers with personal and small business financial service products. Credit unions are able to serve their communities most effectively when resources are allocated to core lending and deposit-taking activities rather than consumed by complex, unwieldly and poorly defined accounting standards. While the proposed Statement modestly improves understanding of supervisory expectations surrounding implementation of the current expected credit loss (CECL) standard, it does little to alleviate the future cost, disruption, and uncertainty associated with the most significant accounting change in decades.

General Comments

NAFCU appreciates the Statement's outline of exam focus areas and description of the types of responsibilities that should be assigned to credit union management and boards of directors. However, we ask that the NCUA develop its own, tailored guidance to clearly communicate examiner expectations well in advance of CECL's 2023 compliance date. The CECL exam questionnaire released in May 2019 offers a sense of what future exams may look like, but the NCUA should seek to aid industry understanding of specific CECL models through continued webinars, workshops and other engagement opportunities. NAFCU also asks that the agency move quickly to propose a rule that would help mitigate CECL's negative impact on credit union net worth.

NAFCU still maintains that credit unions should not be subject to the CECL standard given our industry's record of prudent fiscal management before and after the financial crisis, limited complexity, and structure as not-for-profit, member-owned cooperatives. The NCUA should recognize this difference and identify opportunities to work with the Financial Accounting Standards Board (FASB) to roll back CECL. In light of the FASB's recent actions to delay CECL compliance by an additional year, we believe there is still time for such an intervention to occur before the industry transitions to a standard that has been criticized extensively by members of Congress and emerges from an accounting body whose dictates can supplant the judgment of even independent federal agencies. Even if such collaboration is unlikely, we urge the NCUA to unilaterally consider actions that it may take to mitigate CECL's future impact.

The Statement should include practical examples to illustrate how credit unions can comply with CECL using simplified models.

The Statement provides that ACLs should be measured by considering the effects of past events, current conditions, and reasonable and supportable forecasts on the collectibility of the institution's financial assets. Consistent with the FASB's guidance, it explains in general terms how CECL should be applied and indicates that management is required to use relevant forward-looking information and expectations drawn from reasonable and supportable forecasts when estimating expected credit losses. The Statement offers some examples of risk characteristics relevant to segmentation of financial assets and suggests several methods for estimating expected credit losses. With respect to CECL, a few potential loss estimation models are listed in a footnote, including weighted-average remaining maturity (WARM), but none are described in detail. While application of the WARM method for estimating expected credit losses has been covered separately to some extent in interagency webinars, the Statement should seek to consolidate all official information on this subject, as well as relevant agency Q&As, in a single appendix. This would be particularly helpful for credit unions given that the WARM method is often used to illustrate how smaller institutions might comply with CECL.

Unfortunately, the Statement's brevity on the subject of CECL falls short of the guidance credit unions would prefer to see. For example, the commentary provided on reasonable and supportable forecasts does little to alleviate industry anxiety regarding what is likely the most subjective element of CECL. More can be said about the development and selection of forecasts without impairing the standard's flexibility. While NAFCU appreciates the clarification that "management is not required to search for all possible information" and is not expected to "incur undue costs" when developing forecasts, it would be beneficial for the NCUA to issue separate guidance for credit unions—particularly those that are small—to illustrate the application of simplified models and forecasts that cover common lending profiles.

A similar degree of ambiguity pervades the Statement's discussion of reversion to historical loss information. To clarify elements of the CECL standard that are not well defined by FASB, the NCUA should produce variety of practical examples illustrating how a credit union might apply a simplified and accepted model for estimating ACLs through the full lifecycle of the reasonable and supportable period. This would give credit unions greater certainty and confidence as they prepare to comply with CECL in 2023.

The Statement should clarify that deference to managerial judgment encompasses the decision to rely on independent auditors to validate ACL measurement.

NAFCU appreciates the Statement's deference to managerial judgement and flexibility with respect to what factors should considered when estimating ACLs. In particular, we support the clarification that examiners should not seek adjustments to ACLs for the "sole purpose of achieving ACL levels that correspond to a peer group median, a target ratio, or a benchmark amount when management has used an appropriate expected credit loss framework to estimate expected credit losses." However, NAFCU is concerned that the Statement does not adequately recognize the role that a credit union's auditor will play in terms of validating overall measurement of ACLs. Most credit unions will lean heavily on their auditor's judgment given the highly complex nature of CECL. For smaller credit unions, this reliance will be magnified by resources constraints. It is therefore troubling to find, buried in a footnote, the suggestion that engaging an external auditor to perform the validation process could impair the auditor's independence when performing an audit of the institution's financial statements. The Statement should state clearly that reliance on an independent auditor to validate ACL measurement is appropriate and entitled to the same deference as other managerial decisions.

In addition, the Statement should favor a reasonable approach for estimating ACLs that does not necessitate burdensome compliance or unwieldly documentary requirements. In practical terms, oversight of ACL estimates by management and the credit union's board of directors should not be challenged on the basis of mere procedural missteps so long as there is a good faith effort to comply with applicable accounting rules and reporting requirements. Likewise, credit unions should not be forced to divert scarce resources to resolve speculative disputes over the sufficiency of historical loss information, current conditions or the selection of particular qualitative factors when developing reasonable and supportable forecasts. As credit unions prepare to implement CECL, the NCUA should place the greatest emphasis on the Statement's reminder that "loss estimation methods, and underlying assumptions an institution uses to calculate ACLs require the exercise of a substantial degree of management judgment." Again, the NCUA should recognize that such judgment may involve the decision to seek the advice and technical expertise of an auditor.

NAFCU appreciates the opportunity to comment on the proposed interagency statement on allowances for credit losses. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2266 or amorris@nafcu.org.

Sincerely,

Andrew Morris

Andrew Morris
Senior Counsel for Research and Policy