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**National Association of Federally-Insured Credit Unions**

October 19, 2020

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

**RE:** Transition to the Current Expected Credit Loss Methodology  
(RIN: 3133-AF03)

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to share our comments regarding the National Credit Union Administration's (NCUA) proposed rule to offset the adverse capital effects of the Financial Accounting Standard Board's (FASB) current expected credit loss (CECL) standard. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 121 million consumers with personal and small business financial service products. NAFCU and its members appreciate the Board's willingness to offer credit unions important relief to mitigate CECL's impact on credit union capital and net worth. In general, we support the concept of phasing in CECL's negative hit to capital over a multi-year period; however, we remain opposed to subjecting credit unions to CECL compliance and ask that the NCUA engage with the FASB and Congress to explore the benefits of an industry exemption. We also think the NCUA should consider additional actions that could help broaden the availability of an alternative accounting standard that functions as a CECL exemption. As the nation continues its battle against the COVID-19 pandemic, credit unions face unprecedented economic uncertainty and have directed much of their attention to addressing members' financial hardship. This has left little time to explore the nuances of a complex and inappropriately tailored accounting standard whose total costs have been described by the NCUA Chairman as "overwhelmingly exceed[ing] the benefits."<sup>1</sup>

**Phase-in of transitional amount**

The proposal recognizes that CECL could have adverse consequences for credit union capital and net worth levels upon adoption in 2023. NAFCU agrees and we thank the Board for heeding our recommendation to quickly establish parity with the federal banking agencies' equivalent rule for mitigating CECL's negative hit to equity. We also find that the proposed framework for assessing the specific, near-term impact of CECL to be reasonable; namely, by measuring the difference between the allowance for credit losses under Generally Accepted Accounting Principles (GAAP) today and the new allowance required under the CECL methodology (i.e., the day one impact).

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<sup>1</sup> NCUA Chairman Rodney E. Hood, Letter to FASB Urging CECL Exemption for Credit Unions (April 30, 2020), available at <https://www.ncua.gov/about-ncua/leadership/honorable-rodney-e-hood/publications-chairman-rodney-e-hood/letter-fasb-urging-cecl-exemption-credit-unions>.

NAFCU agrees that for the purpose of phasing in CECL's effect on capital, the difference between pre-CECL and post-CECL amounts of retained earnings should be used to determine the credit union's "transitional amount."

As proposed, the phase-in will delay recognition of CECL's full, day one impact over a three-year period. Although this timeframe may be sufficient for some credit unions, NAFCU asks that the Board consider allowing credit unions to specify a longer timeframe if necessary. Some NAFCU members have requested a longer period of five years to absorb the initial, adverse capital effects of CECL and Board Member McWatters indicated at the NCUA's July Board Meeting that he would have preferred an even longer period.

The preamble notes that the decision to use a three-year phase-in was due to statutory constraints in the *Federal Credit Union Act* (FCU Act). Section 216 of the FCU Act permits the NCUA Board to make adjustments to prompt corrective action (PCA) classification standards (including, evidently, indirect adjustments that do not alter capital ratios), provided they conform with any equivalent modifications the federal banking agencies have chosen to adopt pursuant to section 38 of the *Federal Deposit Insurance Act*. The federal banking agencies chose to use a three-year period in their own CECL phase-in rule and, by design, the NCUA's proposal must adhere to this limitation. However, the NCUA should consider other options that accommodate greater flexibility.

While the proposed phase-in can be easily implemented using the statutory authority in Section 216 of the FCU Act, the preamble acknowledges that the phase-in could also be implemented under alternative authority if necessary. Specifically, the preamble notes:

"As an alternative to the phase-in that would be provided by this proposed rule, the Board could have elected to revise definition of "total assets" in a manner enabling FICUs to effect the CECL day-one adjustments without undue adverse consequences."<sup>2</sup>

If the NCUA can accommodate a flexible phase-in period without compromising the extent of available CECL relief, then it should issue the proposal using the alternative described above. While it is understandable why the NCUA would want to utilize a simpler legal justification from an administrative standpoint, the agency has not suggested that adopting an alternative legal basis would have negative consequences for credit unions. Accordingly, NAFCU asks that the NCUA consider issuing the proposal under the alternative "total assets" framework and grant credit unions more options, such as the ability to choose a longer phase-in period.

### **Exemption for credit unions under \$10 million in total assets**

For FICUs with less than \$10 million in total assets, the FCU Act provides an exception to the general requirements that reports and statements filed with the Board comply with GAAP. The proposal provides that such FICUs may make charges for loan losses either in accordance with GAAP or with any reasonable reserve methodology (i.e., incurred loss) provided it adequately

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<sup>2</sup> NCUA, Transition to the Current Expected Credit Loss Methodology, 85 Fed. Reg. 50963, 50966-50967 (August 19, 2020).

covers known and probable loan losses. In the case of federally-insured, state-chartered credit unions, any other applicable standard under State law or regulation would also be permitted in the alternative.

NAFCU supports granting all credit unions the flexibility to continue using an incurred loss methodology to estimate known and probable loan losses. The proposal explains that the \$10 million threshold was selected to conform with 12 U.S.C § 1782(a)(6)(C)(iii), which provides an explicit exception to GAAP for credit unions under the threshold. However, the preamble also notes that an alternative (and possibly broader) exemption might be effectuated under § 1782(a)(6)(C)(ii), but it would necessitate the Board identifying an accounting principle that is “no less stringent” than GAAP.

NAFCU disfavors exemptive relief frameworks that invoke arbitrary asset thresholds. While the \$10 million threshold does present an *administratively* less burdensome mechanism for exempting certain credit unions from the CECL standard, it fails to adequately address CECL’s industry-wide impact. The one-time and ongoing costs associated with CECL compliance are significant for credit unions of all sizes. Furthermore, a narrow, asset-based exemption does little to mitigate prevailing concern regarding CECL’s potential procyclicality. As the nation approaches a tentative economic recovery, CECL-related tightening of credit standards could prolong hardship for millions of credit union members, particularly those in low-income and underserved communities where a return to healthy finances is likely to be slower.<sup>3</sup> Credit unions of all sizes must be equipped to meet the challenge of a true, national recovery effort, and the added burden of a implementing a complex and likely procyclical accounting standard only frustrates this goal.

Accordingly, the NCUA should consider the question of what constitutes an accounting standard that “is no less stringent” than GAAP for the purpose of expanding the scope of CECL relief to the entire industry. In doing so, the agency might explore the possibility of a revised incurred loss methodology that allows more flexible evaluation of qualitative and environmental factors. If the question is complex, as the preamble suggests, then the NCUA should advance its interpretation through a separate rulemaking, which might also serve as an occasion to solicit the views of the FASB itself.

The NCUA should also work directly with the FASB to advance an interpretation of the “no less stringent” requirement that recognizes the unique burden that CECL poses for credit unions. To date, the FASB has not sought to address the question of whether credit unions’ unique, structural characteristics warrant any special flexibility under the CECL standard—a task that would require it to exercise the sort of judgment normally reserved to a financial regulatory agency. Accordingly, the NCUA must either bring the question directly to the FASB or seek to resolve it on its own. NAFCU believes the best approach would be for the NCUA to simply ask for the flexibility it needs to alleviate CECL’s obvious burdens. This could be accomplished by asking the FASB to incorporate within the CECL standard a statement that recognizes the incurred loss methodology

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<sup>3</sup> See Federal Reserve Bank of Philadelphia, “Which Neighborhoods and Households Will Be Most Impacted by COVID-19?” (April 20, 2020) (“Differences in the impact of the pandemic by place suggest that while federal policies such as the CARES Act have been crucial to mitigating the economic impact of the pandemic, they may not be sufficient for every region, city, or neighborhood.”), available at <https://philadelphiafed.org/covid-19/covid-19-equity-in-recovery/which-neighborhoods-and-households-will-be-most-impacted>.

as appropriate for credit unions who are authorized by the NCUA to use alternative accounting principles under Section 202 of the FCU Act.

## **Examinations**

The proposal envisions the NCUA continuing to examine credit loss estimates and allowance balances regardless of whether a FICU is subject to the CECL transition provision. In addition, the NCUA may examine whether FICUs will have adequate amounts of capital at the expiration of their CECL transition provision period.

Consistent with NAFCU's recommendation that credit unions have the option of seeking a longer phase-in period, the NCUA should consider granting longer phase-in requests when a credit union's projected capital level after three years is expected to remain below normal. Such flexibility would allow credit unions to focus on restoring capital levels during an appropriately tailored phase-in timeframe rather than bracing for adverse supervisory consequences or the administrative burden of heightened examiner scrutiny. Adopting this approach would also relieve pressure on credit unions that have experienced unexpected asset growth during the pandemic and may already be struggling to manage multiple stresses on regulatory capital, such as future implementation of the NCUA's risk based capital rule, prolonged compression of net interest margin, and anticipated losses related to COVID-19. An additional factor that would create even greater pressure would be future premium assessments charged to credit unions as a result of excess share growth.

Considering the multitude of externalities that could impact credit union capital in the next three years, the NCUA should also seek to minimize the added burden of CECL-related disruption by adopting flexible standards for examination of credit union capital. Specifically, the NCUA should consider implementing streamlined procedures for evaluating capital plans (including net worth restoration plans) when a credit union is expected to encounter capital stresses related to CECL adoption that persist after any applicable phase-in period. Such an approach would be consistent with the agency's desire to reduce administrative burdens as long as COVID-related financial hardship persists, and would complement the NCUA's other capital relief rule, "Temporary Regulatory Relief in Response to COVID-19—Prompt Corrective Action."<sup>4</sup>

## **Conclusion**

NAFCU supports the NCUA's proposed phase-in, which will grant credit unions important CECL-related relief, but the inclusion of a longer phase-in option along with more flexible examination procedures would be desirable enhancements. NAFCU 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 FASB and Congress to exclude credit unions from coverage under CECL. In light of the FASB's recent actions to delay CECL compliance until 2023, NAFCU believe there is still time

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<sup>4</sup> NCUA, Temporary Regulatory Relief in Response to COVID-19—Prompt Corrective Action, 85 Fed. Reg. 31952 (May 28, 2020) ("[T]he temporary amendments in this interim final rule will allow FICUs to better utilize resources by reducing the administrative burden associated with a temporary increase in shares.").

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for such an intervention to occur before the industry transitions to a standard that has the potential to chill lending activities during a period of critical economic recovery. Even if such an intervention is unlikely, we urge the NCUA to unilaterally consider other actions that can mitigate CECL's future impact.

NAFCU appreciates the opportunity to comment on the proposed CECL phase-in. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2266 or [amorris@nafcu.org](mailto:amorris@nafcu.org).

Sincerely,

A handwritten signature in cursive script that reads "Andrew Morris".

Andrew Morris  
Senior Counsel for Research and Policy