

**December 19, 2016 (Questions 1–23)  
September 6, 2017 (Questions 24–37)**

**Frequently Asked Questions on the New Accounting Standard on  
Financial Instruments – Credit Losses**

The Financial Accounting Standards Board (FASB) issued a new accounting standard, Accounting Standards Update ([ASU No. 2016-13](#)), Topic 326, *Financial Instruments – Credit Losses*, on June 16, 2016. The new accounting standard introduces the current expected credit losses methodology (CECL) for estimating allowances for credit losses.

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC) (hereafter, the agencies) issued a [Joint Statement](#) on June 17, 2016, summarizing key elements of the new accounting standard and providing initial supervisory views with respect to measurement methods, use of vendors, portfolio segmentation, data needs, qualitative adjustments, and allowance processes.

The agencies have developed these frequently asked questions (FAQ) to assist institutions and examiners. The agencies plan to publish additional FAQs and/or update existing FAQs periodically.<sup>1</sup>

The new accounting standard applies to all banks, savings associations, credit unions, and financial institution holding companies (hereafter, institutions), regardless of size, that file regulatory reports for which the reporting requirements conform to U.S. generally accepted accounting principles (GAAP).

Further, ASU 2016-13 applies to all financial instruments carried at amortized cost (including loans held for investment (HFI), net investment in leases, and held-to-maturity (HTM) debt securities, as well as trade and reinsurance receivables and receivables that relate to repurchase agreements and securities lending agreements) and off-balance-sheet credit exposures not accounted for as insurance, including loan commitments, standby letters of credit, and financial guarantees. The new accounting standard does not apply to trading assets, loans held for sale, financial assets for which the fair value option has been elected, or loans and receivables between entities under common control. While there are differences between CECL and current U.S. GAAP, the agencies expect the new accounting standard will be scalable to institutions of all sizes. However, inputs to allowance estimation methods will need to change to properly implement CECL.

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<sup>1</sup> The focus of the FAQs is on the application of CECL and related supervisory expectations.

The new accounting standard also makes targeted improvements to the accounting for credit losses on available-for-sale (AFS) debt securities, including lending arrangements that meet the definition of debt securities under U.S. GAAP and are classified as AFS.

Until the new standard becomes effective, institutions must continue to follow current U.S. GAAP on impairment and the allowance for loan and lease losses (ALLL) along with the related supervisory guidance on the ALLL.

### **1. Why is the FASB changing the existing incurred loss methodology? [December 2016]**

In the period leading up to the global economic crisis, institutions and financial statement users expressed concern that current U.S. GAAP restricts the ability to record credit losses that are expected, but that do not yet meet the “probable” threshold. After the crisis, various stakeholders requested that accounting standard-setters<sup>2</sup> work to enhance standards on loan loss provisioning to incorporate forward-looking information. Standard-setters concluded that the existing approach for determining the impairment of financial assets, based on a “probable” threshold and an “incurred” notion, delayed the recognition of credit losses on loans and resulted in loan loss allowances that were “too little, too late.”

### **2. What are some of the concerns the FASB is addressing with CECL? [December 2016]**

By issuing CECL, the FASB:

- Removed the “probable” threshold and the “incurred” notion as triggers for credit loss recognition and instead adopted a standard that states that financial instruments carried at amortized cost should reflect the net amount expected to be collected.
- Broadened the range of data that is incorporated into the measurement of credit losses to include forward-looking information, such as reasonable and supportable forecasts, in assessing the collectability of financial assets.
- Introduced a single measurement objective for all financial assets carried at amortized cost.

### **3. What does the new accounting standard change in existing U.S. GAAP? [December 2016]**

- *Introduction of a new credit loss methodology.*<sup>3</sup>  
The new accounting standard developed by the FASB has been designed to replace the existing incurred loss methodology in U.S. GAAP. Under CECL, the allowance for credit losses is an estimate of the expected credit losses on financial assets measured at amortized cost, which is measured using relevant information about past events, including historical credit loss experience on financial assets with similar risk characteristics, current conditions, and reasonable and supportable forecasts that affect

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<sup>2</sup> Collectively, the FASB and the International Accounting Standards Board.

<sup>3</sup> A complete copy of ASU 2016-13 is available [here](#).

the collectability of the remaining cash flows over the contractual term of the financial assets.<sup>4</sup> In concept, an allowance will be created upon the origination or acquisition of a financial asset measured at amortized cost. The allowance will then be updated at subsequent reporting dates. The allowance for credit losses under CECL is a valuation account, measured as the difference between the financial assets' amortized cost basis and the amount expected to be collected on the financial assets (i.e., lifetime credit losses).<sup>5</sup>

- *Earlier recognition of credit losses.*  
Today's incurred loss methodology is based on a "probable" threshold and an "incurred" notion, the effect of which is to delay the recognition of credit losses on loans, and thereby resulting in allowances that are "too little, too late." By removing the "probable" threshold and the "incurred" notion, CECL eliminates the triggers used for recognizing credit losses under existing U.S. GAAP. Under CECL, the total amount of net charge-offs on financial assets does not change, but rather the timing of credit loss provision expenses changes.

Although the measurement of credit loss allowances is changing under CECL, the FASB's new accounting standard does not address when a financial asset should be placed in nonaccrual status. In addition, the FASB retained the existing write-off guidance in U.S. GAAP, which requires an institution to write off a financial asset in the period the asset is deemed uncollectible.

- *Leverage of existing credit risk management practices.*  
Similar to today's practices under the incurred loss methodology, management will continue to incorporate qualitative and quantitative factors, including information related to underwriting practices, when estimating allowances for credit losses under CECL. However, better alignment of allowance estimation practices with existing credit risk assessment and risk management practices is likely, as the new accounting standard allows a financial institution to leverage its current internal credit risk systems as a framework for estimating expected credit losses.
- *Forward-looking information.*  
CECL is forward-looking and broadens the range of data that must be considered in the estimation of credit losses. More specifically, CECL requires consideration of not only past events and current conditions, but also reasonable and supportable forecasts that affect expected collectability. Institutions must revert to historical credit loss experience for those periods of the contractual term of financial assets beyond which the institution is able to make or obtain reasonable and supportable forecasts of expected credit losses.

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<sup>4</sup> When determining the contractual term of a financial asset, an entity should consider expected prepayments but not expected extensions, renewals, or modifications, unless the entity reasonably expects it will execute a troubled debt restructuring with a borrower. Refer to Accounting Standards Codification (ASC) 326-20-30-6 in ASU 2016-13.

<sup>5</sup> Refer to ASC 326-20-30-1 for the description of this valuation account.

- Reduction in the number of credit impairment models.*

Impairment measurement under existing U.S. GAAP has often been considered complex because it encompasses five credit impairment models for different financial assets.<sup>6</sup> In contrast, CECL introduces a single measurement objective to be applied to all financial assets carried at amortized cost, including loans HFI and HTM debt securities. That said, CECL does not specify a single method for measuring expected credit losses; rather, it allows any reasonable approach, as long as the estimate of expected credit losses achieves the objective of the FASB's new accounting standard. Under today's incurred loss methodology, institutions use various methods, including historical loss rate methods, roll-rate methods, and discounted cash flow methods, to estimate credit losses. CECL allows the continued use of these methods; however, certain changes to these methods will need to be made in order to estimate lifetime expected credit losses.
- Purchased credit-deteriorated (PCD) financial assets.*

CECL introduces the concept of PCD financial assets, which replaces purchased credit-impaired (PCI) assets under existing U.S. GAAP. The differences in the PCD criteria compared to today's PCI criteria will result in more purchased loans HFI, HTM debt securities, and AFS debt securities being accounted for as PCD financial assets. In contrast to today's accounting for PCI assets, the new standard requires the estimate of expected credit losses embedded in the purchase price of PCD assets to be estimated and separately recognized as an allowance as of the date of acquisition. This is accomplished by grossing up the purchase price by the amount of expected credit losses at acquisition, rather than being reported as a credit loss expense.
- AFS debt securities.*

The new accounting standard also modifies today's accounting for impairment on AFS debt securities. Under this new standard, institutions will recognize a credit loss on an AFS debt security through an allowance for credit losses, rather than a direct write-down as is required by current U.S. GAAP. The recognized credit loss is limited to the amount by which the amortized cost of the security exceeds fair value. A write-down of an AFS debt security's amortized cost basis to fair value, with any incremental impairment reported in earnings, would be required only if the fair value of an AFS debt security is less than its amortized cost basis and either (1) the institution intends to sell the debt security, or (2) it is more likely than not that the institution will be required to sell the security before recovery of its amortized cost basis.
- Vintage disclosures by public business entities (PBE) in U.S. GAAP financial statements.*

Under the new accounting standard, disclosures of credit quality indicators of financing receivables and net investment in leases, such as loan-to-value ratios, credit scores, and risk ratings, need to be disaggregated by vintage (i.e., year of origination) to provide

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<sup>6</sup> Current U.S. GAAP includes five different credit impairment models for instruments within the scope of CECL: ASC Subtopic 310-10, Receivables-Overall; ASC Subtopic 450-20, Contingencies-Loss Contingencies; ASC Subtopic 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality; ASC Subtopic 320-10, Investments-Debt and Equity Securities - Overall; and ASC Subtopic 325-40, Investments-Other-Beneficial Interests in Securitized Financial Assets.

users of financial statements greater transparency regarding the credit quality trends within the portfolio from period to period. This information can be used to better understand and evaluate management's prior and current estimates of credit losses.<sup>7</sup>

For PBEs,<sup>8</sup> the disaggregation of credit quality indicators by vintage is required for a minimum of five annual reporting periods, with the balance for financing receivables and net investment in leases originated before the fifth annual reporting period shown in the aggregate. For example, assume an institution is preparing disclosures for the year ended December 31, 2020. The vintage-based disclosure should include information for financing receivables and net investment in leases originated during 2020, 2019, 2018, 2017, 2016, and prior to 2016. The standard provides transition relief for PBEs that are not U.S. Securities and Exchange Commission (SEC) filers.<sup>9</sup> Institutions that are not PBEs have the option to make the vintage disclosures in their U.S. GAAP financial statements, but are not required to do so.

#### 4. When does the new accounting standard take effect?<sup>10</sup> [December 2016]

The FASB issued the final standard on June 16, 2016, and set three different effective dates. The effective date applicable to an institution depends on the institution's characteristics.

For a PBE that is an SEC filer, as both terms are defined in U.S. GAAP, the new credit losses standard is effective for fiscal years beginning **after December 15, 2019, including interim periods** within those fiscal years. Thus, for an SEC filer that has a calendar year fiscal year, the standard is effective **January 1, 2020**, and it must first apply the new credit losses standard in its financial statements and regulatory reports (e.g., the Call Report) for the quarter ended **March 31, 2020**. An SEC filer is an entity that is required to file its financial statements with the SEC under the federal securities laws or, for an insured depository institution (IDI), the appropriate federal banking agency under section 12(i) of the Securities Exchange Act of 1934.

For a PBE that is not an SEC filer, the credit losses standard is effective for fiscal years beginning **after December 15, 2020, including interim periods** within those fiscal years. Thus, for a PBE that is not an SEC filer and has a calendar year fiscal year, the standard is

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<sup>7</sup> Refer to ASC 326-20-50-6 for more information on vintage-based disclosures and ASC 326-20-55-79 for Example 15: *Disclosing Credit Quality Indicators of Financing Receivables by Amortized Cost Basis*.

<sup>8</sup> For information on the meaning of PBEs, as well as PBEs that are not SEC filers, refer to the response to question 4.

<sup>9</sup> For PBEs that are not SEC filers, the FASB allows a "phase-in" approach. This option permits such entities to start with a three-year vintage disclosure and then phase in over the next two years to the full five-year requirement described above. For example, for PBEs that are not SEC filers that adopt CECL as of January 1, 2021, their financial statements for December 31, 2021, should include vintage disclosures for years 2021, 2020, 2019, and prior to 2019. The financial statements for December 31, 2022, would include vintage disclosures for years 2022, 2021, 2020, 2019, and prior to 2019.

<sup>10</sup> Refer to ASC 326-10-65-1 for effective dates.

effective **January 1, 2021**, and the entity must first apply the new credit losses standard in its financial statements and regulatory reports (e.g., the Call Report) for the quarter ended **March 31, 2021**. A PBE that is not an SEC filer includes (1) an entity that has issued debt or equity securities that are traded, listed, or quoted on an over-the-counter (OTC) market, or (2) an entity that has issued one or more securities that are not subject to contractual restrictions on transfer and is required by law, contract, or regulation to prepare U.S. GAAP financial statements<sup>11</sup> and make them publicly available periodically (e.g., pursuant to Section 36 of the Federal Deposit Insurance Act and Part 363 of the FDIC's regulations).

For an entity that is not a PBE, the credit losses standard is effective for fiscal years beginning **after December 15, 2020**, and for interim period financial statements for fiscal years beginning **after December 15, 2021**. Thus, an entity with a calendar year fiscal year that is not a PBE must first apply the new credit losses standard in its financial statements and regulatory reports (e.g., the Call Report) for **December 31, 2021**. However, such an institution would include the CECL provision for expected credit losses for the entire year ended December 31, 2021, in the income statement in its financial statements and regulatory reports for year-end 2021.

Early application of the new credit losses standard will be permitted for all institutions for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

The following table provides a summary of the effective dates.

CECL Effective Dates		
	U.S. GAAP Effective Date	Regulatory Report Effective Date*
PBEs That Are SEC Filers	Fiscal years beginning after 12/15/2019, including interim periods within those fiscal years	3/31/2020
Other PBEs (Non-SEC Filers)	Fiscal years beginning after 12/15/2020, including interim periods within those fiscal years	3/31/2021
Non-PBEs	Fiscal years beginning after 12/15/2020, and interim periods for fiscal years beginning after 12/15/2021	12/31/2021
Early Application	Early application permitted for fiscal years beginning after 12/15/2018, including interim periods within those fiscal years	

\*For institutions with calendar year ends

<sup>11</sup> The Consolidated Reports of Condition and Income (Call Report) filed by banks and savings associations, the 5300 Call Report filed by credit unions, and the Consolidated Financial Statements for Holding Companies (FR Y-9C) are not considered U.S. GAAP financial statements.

## 5. How should an institution apply the new accounting standard upon initial adoption? [December 2016]

As of the new accounting standard's effective date, institutions will apply the standard based on the characteristics of financial assets as follows:<sup>12</sup>

- **Financial assets carried at amortized cost** (e.g., loans HFI and HTM debt securities) that are not PCD assets: A cumulative-effect adjustment for the changes in the allowances for credit losses will be recognized in retained earnings on the statement of financial position (balance sheet) as of the beginning of the first reporting period in which the new standard is adopted.
- **Purchased credit-deteriorated assets:** Financial assets classified as PCI assets prior to the effective date of the new standard will be classified as PCD assets as of the effective date. For all assets designated as PCD assets as of the effective date, an institution will be required to gross up the balance sheet amount of the financial asset by the amount of its allowance for expected credit losses as of the effective date. Subsequent changes in the allowances for credit losses on PCD assets will be recognized by charges or credits to earnings. The institution will continue to accrete the noncredit discount or premium to interest income based on the effective interest rate on the PCD assets determined after the gross-up for the CECL allowance at adoption.
- **AFS and HTM debt securities:** A debt security on which other-than-temporary impairment had been recognized prior to the effective date of the new standard will transition to the new guidance prospectively (i.e., with no change in the amortized cost basis of the security). The effective interest rate on such a debt security before the adoption date will be retained and locked in. Amounts previously recognized in accumulated other comprehensive income (OCI) related to cash flow improvements will continue to be accreted to interest income over the remaining life of the debt security on a level-yield basis. Recoveries of amounts previously written off relating to improvements in cash flows after the date of adoption will be recognized in income in the period received.

## 6. Does the new accounting standard apply to all institutions? [December 2016]

The new accounting standard applies to all banks, savings associations, credit unions, and financial institution holding companies, both public and private, regardless of size, that file regulatory reports for which the reporting requirements conform to U.S. GAAP.

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<sup>12</sup> Refer to ASC 326-10-65-1 for transition considerations.

**7. What are some acceptable methods for estimating allowance levels under CECL? [December 2016]**

CECL does not prescribe the use of specific estimation methods.<sup>13</sup> Rather, allowances for credit losses may be determined using various methods that reasonably estimate the expected collectability of financial assets and are applied consistently over time. For example, acceptable methods include loss rate, roll-rate, vintage analysis, discounted cash flow, and probability of default/loss given default methods. Neither a vintage nor a discounted cash flow method is required for estimating expected credit losses. Additionally, an institution may apply different estimation methods to different groups of financial assets. To properly apply an acceptable estimation method, an institution's credit loss estimates must be well supported.

However, inputs will need to change in order to achieve an appropriate estimate of expected credit losses. For instance, the inputs to a loss rate method would need to reflect expected losses over the contractual term, rather than the annual loss rates commonly used under the existing incurred loss methodology. In addition, institutions would need to consider how to adjust historical loss experience not only for current conditions, as is required under the existing incurred loss methodology, but also for reasonable and supportable forecasts that affect the expected collectability of financial assets. Nevertheless, taking these factors into account, the agencies expect that smaller and less complex institutions will be able to adjust their existing allowance methods to meet the requirements of the new accounting standard without the use of costly and/or complex modeling techniques.

CECL allows institutions to apply judgment in developing estimation methods that are appropriate and practical for their circumstances. The agencies expect supervised institutions to make good faith efforts to implement the new accounting standard in a sound and reasonable manner. After the effective date of CECL, the agencies will assess the implementation of the accounting standard and consider the need to issue additional supervisory guidance to aid in the development of practices for the sound application of the standard.

**8. How should institutions segment HFI loan and HTM debt security portfolios under CECL? [December 2016]**

CECL requires institutions to measure expected credit losses on financial assets carried at amortized cost on a collective or pool basis when similar risk characteristics exist. Similar risk characteristics may include one or a combination of the following:<sup>14</sup>

- Internal or external (third-party) credit scores or credit ratings;
- Risk ratings or classifications;
- Financial asset type;
- Collateral type;

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<sup>13</sup> Refer to ASC 326-20-30-3 for the use of measurement methods.

<sup>14</sup> Refer to ASC 326-20-55-5. The list of risk characteristics is not intended to be all inclusive.



- Asset size;
- Effective interest rate;
- Term;
- Geographical location;
- Industry of the borrower;
- Vintage;
- Historical or expected credit loss patterns; and
- Reasonable and supportable forecast periods.

Although the new accounting standard provides examples of similar risk characteristics, smaller and less complex institutions may conclude that the segmentation practices they have used under the incurred loss methodology are also appropriate under the expected loss methodology, or they may refine those practices. In addition, institutions will need to determine how to segment their HTM debt securities portfolios.

If a financial asset does not share risk characteristics with other financial assets, the new accounting standard requires the expected credit losses on that asset to be measured on an individual asset basis. As under the incurred loss methodology, financial assets on which expected credit losses are measured on an individual basis should not also be included in a collective assessment of expected credit losses.

**9. Will there be an allowance for credit losses on off-balance-sheet credit exposures under CECL?<sup>15</sup> [December 2016]**

For off-balance-sheet credit exposures, an institution will estimate expected credit losses over the contractual period in which they are exposed to credit risk. Similar to today's practices, an institution will report in net income as an expense the amount necessary to adjust the allowance for credit losses on off-balance-sheet credit exposures, which is reported as a liability, for management's current estimate of expected credit losses on these exposures. For the period of exposure, the estimate of expected credit losses should consider both the likelihood that funding will occur and the amount expected to be funded over the estimated remaining life of the commitment or other off-balance-sheet exposure.

In contrast, the FASB decided that no credit losses should be recognized for off-balance-sheet credit exposures that are unconditionally cancellable by the issuer. To illustrate, Bank A has a significant credit card portfolio, including funded balances on existing cards and unfunded commitments (i.e., available credit) on credit cards. Bank A's cardholder agreements stipulate that the available credit may be unconditionally cancelled at any time. When determining the allowance for expected credit losses, Bank A estimates the expected credit losses over the estimated remaining lives of the funded credit card loans. However, Bank A would not evaluate or record an allowance for unfunded commitments on credit cards because it has the ability to unconditionally cancel the available lines of credit.

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<sup>15</sup> Refer to ASC 326-20-30-11 and ASC 326-20-55-54 for Example 10: *Application of Expected Credit Losses to Unconditionally Cancellable Loan Commitments*.

**10. How will CECL affect the HTM debt securities portfolio? [December 2016]**

CECL applies to HTM securities since they are carried at amortized cost and are within the scope of the standard. Therefore, in contrast to today's accounting, institutions generally will need to establish allowances for credit losses on their HTM debt securities as of the date they adopt CECL and maintain such allowances thereafter. Because CECL requires institutions to measure expected credit losses on a collective or pool basis when similar risk characteristics exist, HTM securities that share similar risk characteristics will need to be collectively assessed for credit losses.

**11. Does the accounting for credit losses on AFS debt securities change under the new accounting standard?<sup>16</sup> [December 2016]**

Yes. The new accounting standard makes targeted improvements to the accounting for credit losses on AFS debt securities. Under this standard, institutions will record credit losses on AFS debt securities through an allowance for credit losses rather than the current practice of write-downs of individual securities for other-than-temporary impairment.

Similar to today, at each reporting date, an institution must determine whether a decline in the fair value of an individual AFS debt security below its amortized cost basis is the result of credit factors or other factors.

Other targeted improvements to the existing impairment methodology for AFS debt securities include:

- Limiting allowances for credit losses on individual AFS debt securities to the excess of the amortized cost basis over fair value; and
- Permitting the reversal of allowance amounts in current period earnings to the extent that expected cash flows improve.

When evaluating whether a credit loss exists on an individual AFS debt security that is impaired, an entity would not be permitted to ignore whether credit losses exist simply because fair value has been less than amortized cost for only a limited period of time.

Finally, the AFS debt security impairment methodology retains today's "intend to sell" and "more-likely-than-not required to sell" guidance that requires a write-down to fair value through earnings.

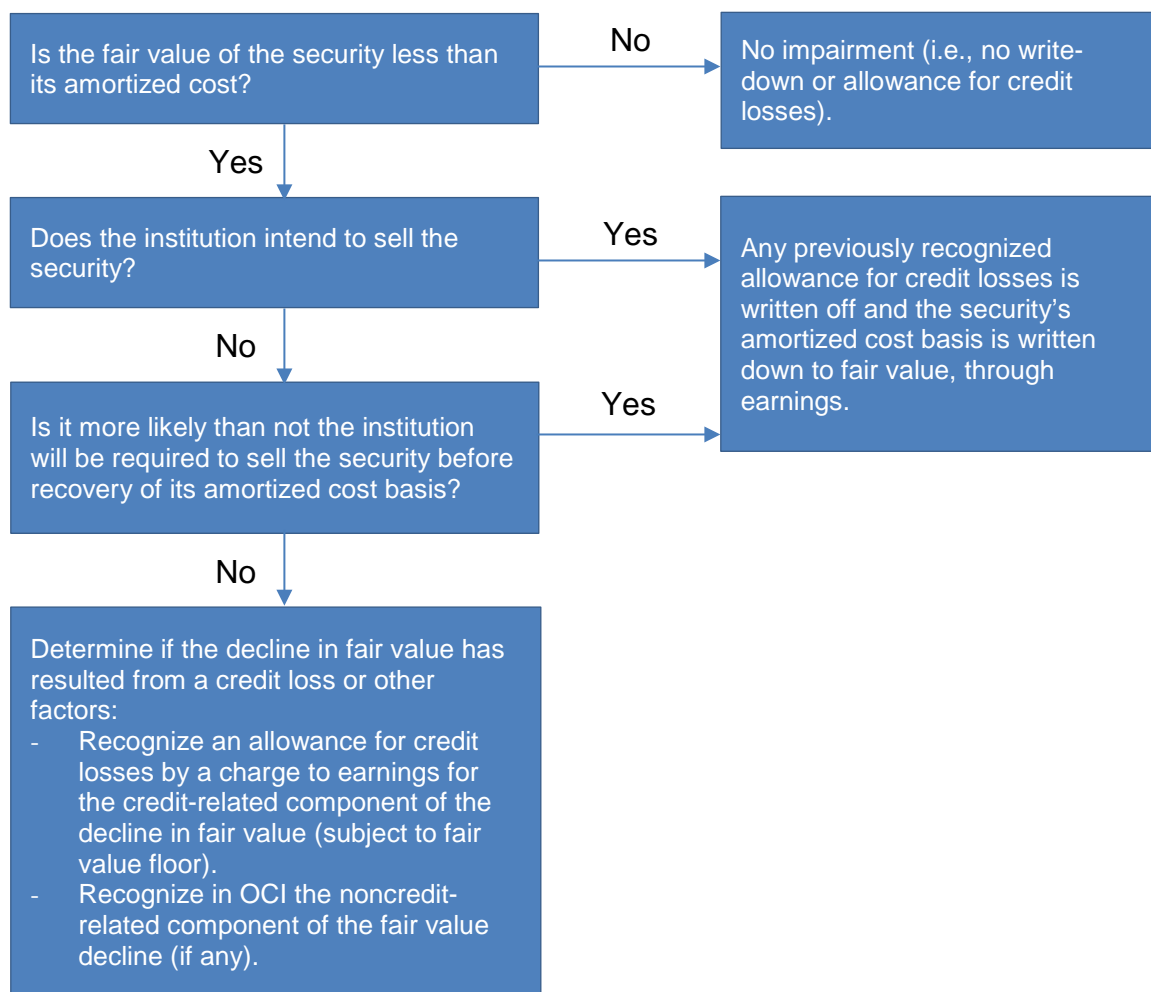
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<sup>16</sup> This question does not address accounting for credit losses on a transferor's interests in securitized transactions accounted for as sales and purchased beneficial interests in securitized financial assets covered by the guidance in ASC Subtopic 325-40, Investments-Other-Beneficial Interests in Securitized Financial Assets. Refer to ASC 325-40-35-6A through 325-40-35-10A.

The following table summarizes the differences between current U.S. GAAP and the new standard on AFS debt securities.

Current U.S. GAAP	New Accounting Standard
Credit losses recognized through a direct write-down of the amortized cost basis.	Allowance approach.
Credit losses can exceed total unrealized losses.	Fair value floor for credit losses.
No immediate reversals of previously recognized credit losses.	Allows immediate full or partial reversals of previously recognized credit losses, as appropriate.

The AFS impairment methodology is summarized in the following diagram:



**12. Is there a difference between the AFS methodology and CECL under the new accounting standard? [December 2016]**

Yes. CECL requires an institution to measure expected credit losses upon the initial recognition of financial assets carried at amortized cost (e.g., loans HFI and HTM securities) and perform the credit loss assessment on such assets on a collective (pool) basis when similar risk characteristic(s) exist. In contrast, for AFS debt securities, the new accounting standard maintains the current requirement to assess credit losses at the individual security level only when the amortized cost of an AFS debt security exceeds fair value.<sup>17</sup> In addition, AFS impairment is required to be measured using a discounted cash flow approach, whereas CECL does not specify a measurement approach.

**13. Will the accounting for a troubled debt restructuring (TDR) change? [December 2016]**

Yes. Although the guidance for determining whether a modification of terms on a financial asset is a TDR will remain unchanged from today's U.S. GAAP, the new standard makes certain changes to the existing accounting for TDRs. An institution will continue to account for a modification as a TDR if the institution for economic or legal reasons related to a borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. However, the FASB determined that credit losses on TDRs should be calculated under the same expected credit loss methodology that is applied to other financial assets carried at amortized cost – in other words, under CECL. This is in contrast to current guidance, which requires that impairment on loans that are TDRs be measured using specific methods applicable to individually impaired loans (e.g., discounted cash flow and fair value of collateral).

Further, the new accounting standard requires:

- The value of concessions made by the creditor in a TDR to be incorporated into the allowance estimate; and
- The pre-modification effective interest rate to be used to measure credit losses on a TDR when applying the discounted cash flow method.

**14. How should institutions account for PCD financial assets under CECL? [December 2016]**

CECL introduces the concept of PCD financial assets, which replaces PCI assets under existing U.S. GAAP. For PCD assets, the new accounting standard requires institutions to estimate and record an allowance for credit losses for these assets at the time of purchase. This allowance is then added to the purchase price to establish the initial amortized cost basis of the PCD assets, rather than being reported as a credit loss expense. In contrast, for purchased financial assets within the scope of CECL that are not PCD assets, an institution is required to measure expected credit losses by a charge to the provision for credit losses (expense) in the period the non-PCD assets are acquired.

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<sup>17</sup> Refer to ASC 326-30-30-2, 326-30-35-1, 326-30-35-2, and 326-30-35-4 for additional information on this requirement.

In addition, the definition of PCD assets is broader than the definition of PCI assets in current accounting standards. The new accounting standard defines “purchased financial assets with credit deterioration” as “acquired individual financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a **more-than-insignificant** deterioration in credit quality since origination, as determined by an acquirer’s assessment.”<sup>18</sup>

In practical terms, loans HFI, HTM debt securities, and AFS debt securities that qualify as PCD will reflect an allowance for credit losses and a noncredit discount (or premium) for the difference between the asset’s par value (unpaid principal balance) and purchase price as of the acquisition date. This is accomplished by grossing up the purchase price by the amount of expected credit losses at acquisition. This method is less complex and more transparent compared with the requirements of today’s PCI model, and creates comparability of allowances for credit losses with non-PCD purchased and originated loans and non-PCD debt securities.

For example, assume that Bank A pays \$750,000 for a loan with an unpaid principal balance of \$1 million.<sup>19</sup> The loan will be HFI and measured on an amortized cost basis. At the time of purchase, Bank A estimates the allowance for credit losses on the unpaid principal balance to be \$175,000.

At the purchase date, Bank A’s statement of financial position would reflect an amortized cost basis for the loan of \$925,000 (that is, the amount paid plus the allowance for credit losses) and an initial allowance for credit losses of \$175,000 associated with the loan.

The difference between the unpaid principal balance of \$1 million and the amortized cost of \$925,000 at the acquisition date is a noncredit discount. This \$75,000 noncredit discount would be accreted into interest income over the life of the financial asset on a level-yield basis (provided the loan appropriately remains on accrual status). The allowance for credit losses is evaluated each quarter and adjusted as necessary by a charge or credit to the provision for credit losses.

The acquisition-date journal entry is as follows:

Account	Debit	Credit
Loan (HFI) – Unpaid principal balance	\$1,000,000	
Loan (HFI) – Noncredit discount		\$75,000
Allowance for credit losses		\$175,000
Cash		\$750,000

<sup>18</sup> Refer to the “Glossary” section of ASC 326.

<sup>19</sup> Refer to ASC 326-20-55-61 through 326-20-55-65 for Example 12: *Recognizing Purchased Financial Assets with Credit Deterioration*.

When accounting for PCD financial assets under CECL, other changes from today's practices include:

- An entity must allocate the noncredit discount or premium resulting from the acquisition of a pool of PCD financial assets to each individual asset in the pool;
- When using a method to estimate the allowance for credit losses that discounts expected future cash flows, the discount rate used is the rate that equates the purchase price of the PCD asset with the present value of the estimated future cash flows at the acquisition date; and
- When using a method to estimate the allowance for credit losses other than one that discounts expected future cash flows, the allowance estimate is based on the unpaid principal balance (face or par value) of the PCD asset.

**15. Has the “collateral-dependent” definition changed in the new accounting standard? [December 2016]**

Yes. The “collateral-dependent” definition has been altered slightly. The new accounting standard defines a collateral-dependent financial asset as “a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity’s assessment as of the reporting date.”<sup>20</sup>

The standard allows institutions to use, as a practical expedient, the fair value of the collateral to measure expected credit losses on collateral-dependent financial assets.

Similar to existing U.S. GAAP, if an institution uses the practical expedient on a collateral-dependent financial asset and repayment or satisfaction of the asset depends on the sale of the collateral, the fair value of the collateral should be adjusted for estimated costs to sell (on a discounted basis). However, the institution would not need to incorporate in the net carrying amount of the financial asset the estimated costs to sell the collateral if repayment or satisfaction of the financial asset depends only on the operation, rather than on the sale, of the collateral.

Example 6 in ASU 2016-13 illustrates one way to implement the collateral-dependent concepts.<sup>21</sup> The example below is based on Example 6 in the standard. Assume that:

Bank F provides commercial real estate loans to developers of luxury apartment buildings. Each loan is secured by a respective luxury apartment building. Over the past two years, comparable standalone luxury housing prices have dropped significantly, while luxury apartment communities have experienced an increase in vacancy rates.

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<sup>20</sup> Refer to ASC 326-20-35-5.

<sup>21</sup> Refer to ASC 326-20-55-41 through 326-20-55-44.

At the end of 20X7, Bank F reviews its commercial real estate loan to Developer G and observes that Developer G is experiencing financial difficulty as a result of, among other things, decreasing rental rates and increasing vacancy rates in its apartment building.

After analyzing Developer G's financial condition and the operating statements for the apartment building, Bank F believes that it is unlikely Developer G will be able to repay the loan at maturity in 20X9. Therefore, Bank F believes that repayment of the loan is expected to be substantially through the foreclosure and sale (rather than the operation) of the collateral.

As a result, in its financial statements for the period ended December 31, 20X7, Bank F utilizes the [collateral-dependent] practical expedient and uses the apartment building's fair value, less costs to sell, when developing its estimate of expected credit losses.

**16. Should institutions use third-party vendors to assist in measuring expected credit losses under CECL? [December 2016]**

The agencies will not require institutions to engage third-party service providers to assist management in calculating allowances for credit losses under CECL. If an institution chooses to use a third-party service provider to assist management with this process, the institution should follow the agencies' guidance on third-party service providers.<sup>22</sup>

Specifically with regard to data, to implement CECL, an institution should collect and maintain relevant data to support its estimates of lifetime expected credit losses in a way that aligns with the method or methods it will use to estimate its allowances for credit losses. As such, the agencies encourage institutions to discuss the availability of historical loss data internally and with their core loan service providers because system changes related to the collection and retention of data may be warranted. Depending on the estimation method or methods selected, institutions may need to capture additional data and retain data longer than they have in the past on loans that have been paid off or charged off to implement CECL.

**17. Will the agencies establish benchmarks or floors for allowance levels? [December 2016]**

No. At the time of adoption, the actual impact of CECL on an institution's allowance levels will depend on many factors. These factors include current and future expected economic conditions, the level of an institution's allowance balances, its portfolio mix, its underwriting practices, and its geographic locations and those of its borrowers. Because allowance levels depend on these institution-specific factors, the agencies cannot reasonably forecast the expected change in allowance levels across all institutions. For similar reasons, the agencies

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<sup>22</sup> For the agencies' guidance on third-party service providers, refer to the following:

- FRB, [Supervision and Regulation Letter 13-19/Consumer Affairs Letter 13-21, "Guidance on Managing Outsourcing Risk"](#)
- FDIC, [Financial Institution Letter 44-2008, "Guidance for Managing Third-Party Risk"](#)
- NCUA, [Supervisory Letter No. 07-01, "Evaluating Third Party Relationships"](#)
- OCC, [Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance"](#)

will not establish benchmark targets or ranges of allowance levels upon adoption of CECL or for allowance levels going forward.

**18. Will adoption of the new accounting standard impact U.S. GAAP equity and regulatory capital? [December 2016]**

Yes. Upon initial adoption, the earlier recognition of credit losses under CECL will likely increase allowance levels and lower the retained earnings component of equity, thereby lowering common equity tier 1 capital for regulatory capital purposes.<sup>23</sup>

However, the actual effect of CECL upon implementation will vary by institution and depend on many factors, such as those identified in the response to question 17, and the effect of these factors on the collectability of an institution's HFI loans and HTM debt securities upon adoption.

The agencies will monitor changes to institutions' regulatory capital due to the adoption of the expected credit loss methodology.

**19. Can institutions build their allowance levels in anticipation of adopting CECL? [December 2016]**

No. Institutions must continue to use the existing U.S. GAAP incurred loss methodology until CECL becomes effective. It is not appropriate to begin increasing allowance levels beyond those appropriate under existing U.S. GAAP in advance of CECL's effective date.

When estimating allowance levels before CECL's effective date, the implementation of the CECL methodology is a future event. It is therefore inappropriate to treat CECL as a basis for qualitatively adjusting allowances measured under the existing incurred loss methodology.

**20. How will the agencies coordinate their efforts to address the implementation of CECL? [December 2016]**

Recognizing the operational impact CECL may have, particularly for smaller and less complex institutions, the agencies are working together to ensure consistent and timely communications, training, and supervisory guidance.

The agencies will develop supervisory guidance to clarify expectations, but will not provide an approved formula or mandate a single approach that institutions must follow when applying CECL.

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<sup>23</sup> For credit unions, implementation of CECL will impact retained earnings and will likely lower regulatory net worth. However, it will not impact the measurement under the NCUA's risk-based capital rule that becomes effective in 2019. Under this new rule, the entire allowance balance will be reflected in capital for purposes of the new risk-based capital calculation.



The agencies' accounting policy staffs are cataloguing current policy statements, examination materials, reporting forms and instructions, and training programs to determine the revisions needed in response to CECL.

## **21. Will the agencies provide support to institutions? [December 2016]**

Yes. The agencies are performing ongoing outreach to the industry and other stakeholders to understand potential implementation issues and communicate supervisory views. The agencies will use this information to determine the nature and extent of support and other assistance needed.

The agencies issued a Joint Statement on June 17, 2016, summarizing key elements of the new accounting standard and providing initial supervisory views with respect to measurement methods, use of vendors, portfolio segmentation, data needs, qualitative adjustments, and allowance processes.

The agencies have developed these FAQs to assist institutions and examiners. The agencies plan to publish additional FAQs and/or update existing FAQs periodically.

## **22. What should institutions do to prepare for the implementation of CECL? [December 2016]**

To plan and prepare for the transition to and implementation of the new accounting standard, each institution is encouraged to:

- Become familiar with the [new accounting standard](#) and educate the board of directors and appropriate institution staff about CECL and how it differs from the incurred loss methodology;
- Determine the applicable effective date of the standard based on the PBE criteria in U.S. GAAP;
- Determine the steps and timing needed to implement the new accounting standard;
- Identify the functional areas within the institution that should participate in the implementation of the new standard;
- Discuss the new accounting standard with the board of directors, audit committee, industry peers, external auditors,<sup>24</sup> and supervisory agencies to determine how to best implement the new standard in a manner appropriate for the institution's size and the nature, scope, and risk of its lending and debt securities investment activities;
- Review existing allowance and credit risk management practices to identify processes that can be leveraged when applying the new standard;
- Determine the allowance estimation method or methods to be used;
- Identify currently available data that should be maintained and consider whether any additional data may need to be collected or maintained to implement CECL. Examples

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<sup>24</sup> When discussing the new accounting standard and its implementation with their external auditors, institutions and their audit committees should be mindful of applicable independence requirements.

of types of data that may be needed to implement CECL include: origination and maturity dates, origination par amount, initial and subsequent charge-off amounts and dates, and recovery amounts and dates by loan; and cumulative loss amounts for loans with similar risk characteristics;<sup>25</sup>

- Identify necessary system changes to implement the new accounting standard consistent with the new standard's requirements and the allowance estimation method or methods to be used; and
- Evaluate and plan for the potential impact of the new accounting standard on regulatory capital.

CECL is scalable to institutions of all sizes and the agencies expect smaller and less complex institutions will not need to adopt complex modeling techniques to implement the new standard.

### **23. What should institutions expect from their examination teams prior to the effective date of the new accounting standard? [December 2016]**

During the early part of the implementation phase for the new accounting standard, examiners may begin discussing the status of an institution's implementation efforts.<sup>26</sup> Throughout the implementation phase, examiners will tailor their expectations based on the size and complexity of the institution and the effective date of the new accounting standard applicable to the institution. In doing so, examiners will be mindful of the scope and scale of changes necessary for each institution to make a good faith effort to achieve a sound and reasonable implementation of the new accounting standard. For further information on planning and preparing for the new accounting standard, including examples of initial implementation efforts, refer to the response to question 22.

Until CECL's effective date, the agencies will continue to examine credit loss estimates and allowance balances using examination procedures applicable to ensuring compliance with an incurred credit loss methodology consistent with existing U.S. GAAP, the guidance in the December 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses, and the agencies' policy statements on allowance methodologies and documentation.<sup>27</sup>

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<sup>25</sup> Refer to the response to question 8 for information on segmenting portfolios.

<sup>26</sup> The implementation phase is the period from the issuance of the final standard to its adoption date by an institution.

<sup>27</sup> Refer to the *Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions* issued by the FRB, the FDIC, and the OCC in July 2001 and to Interpretative Ruling and Policy Statement 02-3, *Allowance for Loan and Lease Losses Methodologies and Documentation for Federally Insured Credit Unions*, issued by the NCUA in May 2002.

## 24. Are qualitative factors still relevant under CECL? [September 2017]

Yes. An institution should not rely solely on past events to estimate expected credit losses. Therefore, similar to today's practices under the incurred loss methodology, an institution will continue to incorporate qualitative and quantitative factors when estimating allowances for credit losses under CECL.

Historical loss information will generally provide an appropriate starting point for an institution's assessment of expected credit losses. The new credit losses standard acknowledges that, because historical experience may not fully reflect an institution's expectations about the future, the institution should adjust historical loss information, as necessary, to reflect the current conditions and reasonable and supportable forecasts not already reflected in the historical loss information. To adjust historical credit loss information for current conditions and reasonable and supportable forecasts, the institution should continue to consider all significant factors relevant to determining the expected collectability of financial assets as of each reporting date. The new accounting standard provides examples of factors an institution may consider.<sup>28</sup> Depending on the nature of the asset, not all of the factors may be relevant and other factors also may be relevant and should be considered. The agencies believe the qualitative or environmental factors identified in the December 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses should continue to be relevant under CECL and are covered by the examples of factors that may be considered under the new credit losses standard.

## 25. What data do institutions need to implement CECL? [September 2017]

An institution should collect and maintain data relevant to estimating lifetime expected credit losses<sup>29</sup> that align with each method the institution will use to estimate its allowances for credit losses under CECL.<sup>30</sup> The institution should begin by identifying currently available relevant data that should be maintained. The institution should then consider whether additional data may be relevant, and therefore would need to be collected and maintained for a period sufficient to implement each method it has selected.

The agencies encourage institutions to discuss the availability of historical loss data internally with lending, credit risk management, information technology, and other functional areas and with their core loan service providers. System changes and other changes related to the collection and retention of data may be warranted. For example, depending on the estimation method or methods selected to implement CECL, institutions may need to capture additional data and retain data longer than they have in the past on loans and other financial assets that have been paid off or charged off. Examples of certain other types of data that may be needed to implement CECL are identified in the response to question 22.

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<sup>28</sup> Refer to ASC 326-20-55-4 for the examples. The examples of factors are not intended to be all-inclusive.

<sup>29</sup> Lifetime expected credit losses means an estimate of expected credit losses over the entire contractual term of financial assets. See footnote 4 in the response to question 3 for information on determining the contractual term.

<sup>30</sup> As stated in the response to question 7, an institution may apply different estimation methods to different pools of financial assets. However, only one estimation method needs to be applied to each pool of financial assets.

When developing estimates of expected credit losses on financial assets, the institution should consider available information relevant to assessing the collectability of cash flows. This information may include internal information, external information, or a combination of both relating to past events, current conditions, and reasonable and supportable forecasts.

**26. Will the agencies require institutions to reconstruct data from earlier periods that are not reasonably available in order to implement CECL? [September 2017]**

No. The agencies will not require institutions to undertake efforts to obtain or reconstruct data from previous periods that are not reasonably available without undue cost and effort. However, an institution may decide it would be beneficial to do so to more effectively implement CECL. An institution may find that certain data from previous periods relevant to its determination of its historical lifetime loss experience are not available or no longer accessible in the institution's loan system or from other sources. The institution should promptly begin to capture and maintain such data on a go-forward basis so it can build up a more complete set of relevant historical loss data by the effective date of the new credit losses standard or as soon thereafter as practicable.

**27. For PCD financial assets, how should institutions account for changes in expected credit losses under CECL in periods after their acquisition date? [September 2017]**

The allowance for credit losses on financial assets within the scope of ASC 326-20, including PCD financial assets, should be evaluated each quarter and adjusted as necessary by recognizing a credit loss expense or a reversal of credit loss expense.

For example, continuing the example in the response to question 14, Bank A paid \$750,000 for a loan classified as HFI with an unpaid principal balance of \$1 million. Bank A determined that the loan qualified as a PCD financial asset. At the purchase date, Bank A estimated the allowance for credit losses on the unpaid principal balance was \$175,000, and the noncredit discount on the loan was \$75,000.

Assume that at the end of the following quarter, Bank A reevaluates the expected credit losses on the loan and estimates that the allowance for credit losses on this PCD financial asset should be \$200,000.<sup>31</sup> Further assume this PCD financial asset does not share risk characteristics with other financial assets.

The quarter-end journal entry to record the change in the allowance is as follows:

Account	Debit	Credit
Provision for credit losses	\$25,000	
Allowance for credit losses		\$25,000

The change in the estimate of expected credit losses on the PCD financial asset does not affect the remaining balance of the \$75,000 noncredit discount that was calculated at the

<sup>31</sup> The PCD financial asset was not deemed uncollectible in this period.

purchase date. The noncredit discount is accreted into interest income over the life of the PCD financial asset on a level-yield basis (provided the loan remains on accrual status).

Now assume that at the end of the next quarter, Bank A again reevaluates the expected credit losses on the loan and estimates that the allowance for credit losses should be \$190,000, a decrease of \$10,000 from the allowance at the end of the previous quarter.<sup>32</sup>

The journal entry to record the change in the allowance at the end of this quarter is as follows:<sup>33</sup>

Account	Debit	Credit
Allowance for credit losses	\$10,000	
Provision for credit losses		\$10,000

Again, the remaining balance of the \$75,000 noncredit discount, originally calculated at the purchase date, is not affected by the change in the estimate of expected credit losses on the PCD financial asset. The noncredit discount continues to be accreted into interest income over the contractual life of the PCD financial asset on a level-yield basis (provided the loan remains on accrual status).

## 28. What is a PBE, and how does PBE status affect implementation of the new credit losses standard? [September 2017]

A PBE is a business entity that meets any one of five criteria set forth in the “Glossary” of the new credit losses standard. The FASB originally established the PBE definition for use in specifying the scope of future financial accounting and reporting guidance through ASU No. 2013-12, *Definition of a Public Business Entity*, in December 2013. As it relates to the implementation of the new credit losses standard, PBE status affects the effective date applicable to the institution as discussed in the response to question 4. Additionally, the new credit losses standard requires institutions that are PBEs to disclose credit quality indicators by vintage.<sup>34</sup>

The determination of whether an institution is a PBE is the responsibility of each institution’s management. Institutions are encouraged to review the responses to questions 29 through 32 in making this determination.

<sup>32</sup> The PCD financial asset was not deemed uncollectible in this period.

<sup>33</sup> If at a future date, Bank A reevaluates the expected credit losses on the loan and estimates the allowance for credit losses should be less than the Day 1 estimate of \$175,000, the journal entry to record the change in the allowance also would be recorded as a credit to the provision for credit losses.

<sup>34</sup> Refer to the response to question 3 and, in particular, footnote 7.

## 29. When is a PBE considered an SEC filer? [September 2017]

Although all SEC filers are considered PBEs, not all PBEs meet the definition of an SEC filer. Since the FASB set different effective dates for PBEs that meet the definition of an SEC filer and PBEs that do not meet the definition of an SEC filer, determining whether an institution is an SEC filer is an important first step in planning for implementation of the new credit losses standard.<sup>35</sup>

A PBE is considered an SEC filer if it is required to file or furnish its financial statements with either of the following:<sup>36</sup>

1. The SEC.
2. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that section.

Therefore, an IDI that is required to file its financial statements with the appropriate federal banking agency under Section 12(i) of the Securities Exchange Act of 1934 is considered an SEC filer.<sup>37</sup>

The inclusion of the financial statements of an institution that is not otherwise an SEC filer in a submission by another SEC filer does not cause the institution to be considered an SEC filer.<sup>38</sup>

## 30. Can an institution that is not an SEC filer be considered a PBE? [September 2017]

Yes, an institution that is not an SEC filer can be considered a PBE. To determine whether an institution that is not an SEC filer is a PBE, the institution must evaluate the following criteria and conclude that it meets at least one of these criteria:<sup>39</sup>

1. It is not required by the SEC to file or furnish financial statements, but does file or furnish financial statements (including voluntary filers), with the SEC (including other

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<sup>35</sup> The standard also provides transition relief with regard to disclosure of vintage-based credit quality indicators for PBEs that are not SEC filers. Refer to ASC 326-10-65-1(h). For further detail regarding applicable effective dates, refer to the response to question 4.

<sup>36</sup> Refer to the “Glossary” section of ASC 326-10 for the definition of SEC filer.

<sup>37</sup> Section 36 of the Federal Deposit Insurance Act and Part 363 of the FDIC’s regulations, “Annual Independent Audits and Reporting Requirements” (commonly referred to as the FDICIA requirement), are not part of the Securities Exchange Act of 1934 or the rules promulgated thereunder. Therefore, the FDICIA requirement to prepare and make U.S. GAAP financial statements publicly available on a periodic basis does not cause an IDI to be considered an SEC filer under the second criterion included in the response to this question.

<sup>38</sup> Refer to the “Glossary” section of ASC 326-10 for the definition of SEC filer.

<sup>39</sup> Refer to the “Glossary” section of ASC 326-10 for the definition of PBE.

entities whose financial statements or financial information are required to be or are included in a filing).<sup>40</sup>

2. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
3. It has issued securities that are traded, listed, or quoted on an exchange or an OTC market.<sup>41</sup>
4. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements<sup>42</sup> (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An institution must meet both of these conditions to meet this criterion.

**31. What is meant by “contractual restrictions on transfer” as used in the second and fourth criteria listed in the response to question 30? [September 2017]**

Management preapproval of the transfer or resale of securities issued by an institution represents a contractual restriction on transfer for purposes of the PBE definition. Contractual restrictions on transfer can be either explicit or implicit.

For example, S corporation shareholder agreements commonly include restrictions that explicitly require a shareholder to obtain management preapproval of any share transfer to ensure the S corporation maintains its pass-through status for federal income tax purposes. However, the fact that an institution is an S corporation does not guarantee the existence of shareholder agreements or that such a restriction is included in any shareholder agreements. Similar restrictions that require management preapproval also may be present in shareholder agreements of closely held institutions that are not S corporations.

An explicit contractual restriction that limits transfers of an institution’s securities to existing shareholders would also meet the same objective because the securities cannot be sold to new investors. However, other provisions may not lead to the same conclusion. For example, a “right of first refusal” would not represent a contractual restriction on transfer because it only gives management the right to purchase the security before it can be sold to another party. This right does not prevent the holder from transferring the security altogether.

An implicit contractual restriction on transfer is presumed to exist when an institution is wholly owned (i.e., 100 percent owned) by its parent holding company. In effect, the holding

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<sup>40</sup> An entity may meet the definition of a PBE solely because its financial statements or financial information is included in another entity’s filing with the SEC. In that case, the entity is only a PBE for purposes of financial statements that are filed or furnished with the SEC. Refer to the response to question 32 for further detail.

<sup>41</sup> For purposes of this criterion and the next criterion, “securities” include both debt and equity securities.

<sup>42</sup> The Call Report filed by banks and savings associations, the 5300 Call Report filed by credit unions, and the Consolidated Financial Statements for Holding Companies (FR Y-9C) are not considered U.S. GAAP financial statements.

company must approve the transfer of any or all of the institution's currently outstanding securities, which constitutes an implicit contractual restriction on transfer.

Before concluding on an institution's PBE status, the institution should determine if any contractual restrictions, whether implicit or explicit, exist by reading shareholder and debt agreement(s), if any; consulting with its parent holding company, if any; reviewing the legal entity structure of its consolidated group, if any; and considering other relevant information.

**32. When an institution is determining its PBE status, must it consider securities outstanding at the parent holding company level, or should the PBE determination be made individually for each entity within an organizational structure? [September 2017]**

The PBE definition should be applied on an entity-by-entity basis. Here are two illustrations of this analysis:

Illustration 1: Holding Company and Bank Subsidiary Scenario

Assume the following:

- A holding company owns 100 percent of the common stock issued by its bank subsidiary.
- The bank subsidiary is not an SEC filer and does not meet the first two criteria listed in the response to question 30.
- The bank subsidiary has no other debt or equity securities outstanding that would cause it to meet the last two criteria listed in the response to question 30.
- The holding company is not an SEC filer, but has issued unrestricted common stock that trades on an OTC market.

In this case, each of the two entities will reach a different conclusion as to whether it is a PBE.

The holding company would be considered a PBE under the third criterion listed in the response to question 30 because it has issued common stock that trades on an OTC market. Therefore, the holding company's consolidated financial statements would be required to be prepared using accounting standards and effective dates applicable to PBEs.

The bank subsidiary would not be a PBE under any of the criteria because an implicit contractual restriction on transfer exists for its issued securities, which are 100 percent owned by its parent holding company. The subsidiary should not "look through" to the holding company, even if the holding company's only significant asset is its investment in the bank subsidiary. Therefore, the bank subsidiary would be able to use the effective date of the new credit losses standard for entities that are not PBEs when it prepares its regulatory reports (e.g., the Call Report) and stand-alone U.S. GAAP financial statements, if applicable. Additionally, if the bank subsidiary, as a non-PBE, prepares stand-alone U.S. GAAP



financial statements, the bank subsidiary has the option to disclose credit quality indicators by vintage, but is not required to do so.<sup>43</sup>

Notwithstanding the effective date of the new credit losses standard that applies to the bank subsidiary's regulatory reports and stand-alone financial statements, if applicable, the subsidiary must provide financial information to the holding company for the purposes of the holding company's consolidated financial statements based on the standard's effective date and disclosure requirements that apply to a PBE that is not an SEC filer. Therefore, it may be advisable for the bank subsidiary to elect to early adopt the new credit losses standard for its regulatory reports and stand-alone financial statements, if applicable, at the same time that the holding company adopts the standard because the bank would need to be able to provide this information to the holding company for the holding company's consolidated financial reporting.<sup>44</sup>

#### Illustration 2: Unconsolidated variable interest entity (VIE)

Assume the following:

- An institution that is not an SEC filer has issued debt securities to a VIE that the institution is not required to consolidate under U.S. GAAP.
- In turn, the VIE holding the debt securities has issued unrestricted securities (for example, trust preferred securities) to third-party investors.

The institution would not be required to "look through" the VIE for the purposes of determining whether the institution is a PBE. However, the institution should evaluate whether it meets any of the criteria in the definition of a PBE listed in the response to question 30 on a stand-alone basis. For example, the debt securities issued by the institution that are owned by the VIE need to be evaluated under the fourth criterion in the response to question 30. The agencies would expect the institution to conclude that the debt securities have an implicit contractual restriction on transfer if 100 percent of the debt securities are held by the VIE that issued the trust preferred securities. In that situation, the VIE could not sell the debt securities it holds without the involvement of the management of the institution. The institution would also need to determine whether it is required to periodically prepare financial statements and make them publicly available, the second condition in the fourth criterion in the response to question 30. Both conditions must be met for the institution to be a PBE.

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<sup>43</sup> Although vintage disclosures would not be required, the bank subsidiary would be required to disclose the information specified in ASC 326-20-50-5 on credit quality indicators in its stand-alone U.S. GAAP financial statements.

<sup>44</sup> Early application of the new credit losses standard is permitted for all institutions for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

**33. Is an insured depository institution that is subject to Section 36 of the Federal Deposit Insurance Act and Part 363 of the FDIC’s regulations, “Annual Independent Audits and Reporting Requirements” (commonly referred to as the FDICIA requirement), considered a PBE? [September 2017]**

The fact that an IDI is subject to the FDICIA requirement<sup>45</sup> does not in and of itself mean the IDI is a PBE. An IDI subject to the FDICIA requirement that is not an SEC filer would need to evaluate each criterion in the definition of a PBE listed in the response to question 30 to determine whether it is a PBE. If the IDI is a subsidiary of a holding company, the IDI and the holding company should separately evaluate each of the PBE criteria to determine whether each entity is a PBE.

For example, assume an IDI subject to the FDICIA requirement is not an SEC filer and does not meet any of the first three criteria listed in the response to question 30. The final criterion in that response includes two conditions, both of which must be met for the IDI to be a PBE. These conditions are:

1. The entity has one or more securities that are not subject to contractual restrictions on transfer, and
2. The entity is required by law, contract, or regulation to prepare U.S. GAAP financial statements and make them publicly available on a periodic basis.

An IDI subject to Section 36 and Part 363 is required to prepare audited annual U.S. GAAP financial statements, which the IDI must include in a report that it files with the FDIC, its primary federal regulator (if other than the FDIC), and the appropriate state banking regulator (if applicable). The IDI must make this report, including the U.S. GAAP financial statements, publicly available. Thus, an IDI subject to the FDICIA requirement meets the second condition in the criterion above<sup>46</sup> and needs to determine if it meets the first condition in that criterion to conclude whether it is a PBE.

When an IDI is subject to Section 36 and Part 363, the IDI’s only securities outstanding are common stock, and the IDI is not an SEC filer, the IDI should consider whether contractual restrictions on transfer exist on its common stock. If the common stock of the IDI is wholly owned by a holding company, an implicit restriction on the transfer of the IDI’s common stock is presumed to exist. Therefore, the IDI would not meet the first condition in the criterion above, and, thus, the IDI is not a PBE. If there is no holding company or the holding company owns less than 100 percent of the IDI’s common stock, and the IDI determines that no contractual restrictions on transfer exist on its common stock, the IDI

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<sup>45</sup> The FDICIA requirement applies to an IDI with \$500 million or more in consolidated total assets as of the beginning of its fiscal year. The FDICIA requirement does not apply directly to holding companies, but an IDI can satisfy the audited financial statement requirement of Section 36 and Part 363 at the consolidated holding company level if certain conditions are met.

<sup>46</sup> Even if the IDI satisfies the audited financial statement requirement of Section 36 and Part 363 at the consolidated holding company level, the IDI meets the second condition in this criterion because the IDI is the entity subject to the requirement to prepare and make publicly available U.S. GAAP financial statements.

would be a PBE under the final criterion listed in the response to question 30, as it meets both conditions under that criterion (i.e., conditions 1 and 2 above).

The FDICIA requirement to prepare and make U.S. GAAP financial statements publicly available on a periodic basis is not part of the Securities Exchange Act of 1934 or the rules promulgated thereunder. Therefore, when an IDI is subject to the FDICIA requirement, this does not cause the IDI to be an SEC filer.

**34. For an institution with a calendar fiscal year that is not a PBE, how and when should the new credit losses standard be incorporated into the institution’s Call Report? [September 2017]**

For an institution that is not a PBE, the new credit losses standard is effective for fiscal years beginning after December 15, 2020, and for interim period financial statements for fiscal years beginning after December 15, 2021, unless the institution elects to early adopt the new credit losses standard.

This response applies to an institution with a calendar fiscal year that is not a PBE and has not elected early adoption.

An institution with a calendar year fiscal year that is not a PBE must continue to apply current U.S. GAAP (i.e., the incurred-loss methodology) in its financial statements and regulatory reports (e.g., the Call Report) for March 31, 2021; June 30, 2021; and September 30, 2021. This means that the Call Reports for the first three calendar quarters of 2021 for such an institution will not reflect any adjustments for the new credit losses standard.

The institution must first apply the new credit losses standard in its financial statements and regulatory reports (e.g., the Call Report) for the period ending December 31, 2021. Although the effect of adopting the new credit losses standard will first be reported in the fourth quarter 2021 Call Report, the amount of the adjustments resulting from the adoption of the standard must be measured as of the beginning of the fiscal year, i.e., as of January 1, 2021.

To record the impact of initially applying the new credit losses standard when preparing its fourth quarter 2021 Call Report:

- The institution must estimate its allowances for credit losses on loans HFI, HTM debt securities, and other on-balance-sheet financial assets within the scope of ASC 326-20, and its liabilities for credit losses on off-balance-sheet credit exposures within the scope of ASC 326-20 by applying the new credit losses standard to these assets and exposures as of January 1, 2021.<sup>47</sup>

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<sup>47</sup> The new credit losses accounting standard’s CECL methodology applies to all financial instruments carried at amortized cost (including loans HFI and HTM debt securities, as well as trade and reinsurance receivables and receivables that relate to repurchase agreements and securities lending agreements), a lessor’s net investments in leases, and off-balance-sheet credit exposures not accounted for as insurance (including loan commitments, standby

- The institution must then calculate the difference between its allowances and liabilities for credit losses measured in accordance with the new credit losses standard as of January 1, 2021, and the allowances and liabilities for these exposures reported on its Call Report balance sheet as of December 31, 2020, that were measured based on U.S. GAAP in effect on that date (i.e., the incurred loss methodology). The sum of these differences, net of applicable income taxes, is the “cumulative-effect adjustment” as of the effective date of the new credit losses standard.
- The cumulative-effect adjustment is recognized as an adjustment to the beginning balance of retained earnings as of January 1, 2021.<sup>48</sup>

Additionally, the following is one acceptable approach for reflecting the credit loss expenses for the entire calendar year measured in accordance with the new credit losses standard when the institution prepares its fourth quarter 2021 Call Report:

- The institution, in effect, will reverse its provision for loan and lease losses, any other-than-temporary impairments on debt securities, and any provision for credit losses on off-balance-sheet credit exposures recognized during the first nine months of 2021 under the incurred loss methodology (i.e., January 1, 2021, through September 30, 2021).<sup>49</sup>
- The institution must then estimate, based on the new credit losses standard, its allowances and liabilities for credit losses on financial assets within the scope of the standard as of December 31, 2021.
- The amounts necessary to adjust the balances of the allowances and liabilities for credit losses to the year-end 2021 estimated amounts should be reported as credit loss expenses in the Call Report income statement for December 31, 2021.<sup>50</sup> The amount reported should take into consideration the initially estimated balances in these accounts as of January 1, 2021, as measured under the new credit losses standard. The amount should also incorporate the activity (e.g., charge-offs and recoveries) affecting these accounts during the entire calendar year.

Similarly, the Call Report balance sheet for December 31, 2021, should reflect the allowances and liabilities for credit losses estimated in accordance with the new credit losses standard as of that date.

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letters of credit, and financial guarantees). The new credit losses standard also modifies the accounting for impairment on AFS debt securities.

<sup>48</sup> AFS and HTM debt securities on which other-than-temporary impairment had been recognized prior to the effective date of the new credit losses standard will transition to the new credit losses standard on a prospective basis with respect to such impairment (i.e., with no cumulative-effect adjustment for prior other-than-temporary impairment recognized as an adjustment to the beginning balance of retained earnings as of January 1, 2021). Financial assets classified as PCD will also transition to the new credit losses standard on a prospective basis. Refer to the response to question 5.

<sup>49</sup> The loan and lease charge-offs and recoveries during the first nine months of 2021 would be the same under the incurred loss methodology and the CECL methodology.

<sup>50</sup> Provisions for credit losses on off-balance-sheet credit exposures are included as other noninterest expense in the Call Report income statement.

When the effect of adopting the new credit losses standard as of January 1, 2021, is reported in the Call Report for the fourth quarter of 2021, the Call Reports for the first three quarters of 2021 should not be amended to reflect the implementation of the standard.

**35. Can you provide a numerical example illustrating the response to question 34 (i.e., for an institution with a calendar year fiscal year that is not a PBE, how and when should the new credit losses standard be incorporated into its Call Reports)? [September 2017]**

Included in this response for illustrative purposes is a numerical example of the response to question 34. This example considers only the impact of initially applying CECL to loans HFI and not to other financial assets and off-balance-sheet credit exposures within the scope of ASC 326-20.<sup>51</sup>

Assume the following:

- The institution recorded allowances for loan and lease losses of \$150,000 as of December 31, 2020, and \$175,000 as of September 30, 2021, measured in accordance with current U.S. GAAP (i.e., the incurred loss methodology).
- The institution recorded charge-offs, net of recoveries, on loans HFI of \$65,000 and a provision for loan and lease losses of \$90,000 during the first nine months of 2021 (i.e., January 1, 2021, through September 30, 2021).
- The institution recorded charge-offs, net of recoveries, on loans HFI of \$20,000 during the final three months of 2021 (i.e., October 1, 2021, through December 31, 2021).
- The institution estimated its allowance for credit losses on loans HFI under CECL to be \$200,000 as of January 1, 2021, and \$235,000 as of December 31, 2021.

The institution calculates the difference between its allowance for credit losses on loans HFI under CECL as of January 1, 2021, and its allowance for loan and lease losses on these same loans under current U.S. GAAP as of December 31, 2020, to be \$50,000 (\$200,000 minus \$150,000). The \$50,000 difference, net of applicable income taxes, is recognized as an adjustment to the January 1, 2021, beginning balance of retained earnings in the fourth quarter 2021 Call Report. The institution, in effect, then will reverse the \$90,000 provision for loan and lease losses recognized during the nine months of 2021 under current U.S. GAAP and recognize a \$120,000 provision for credit losses for the full 12 months of 2021 as

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<sup>51</sup> The dollar amounts used in this example are for illustrative purposes only and are not intended to represent the amount by which an institution's allowance for credit losses may increase upon initially applying CECL. As stated in the response to question 17, "At the time of adoption, the actual impact of CECL on an institution's allowance levels will depend on many factors. These factors include current and future expected economic conditions, the level of an institution's allowance balances, its portfolio mix, its underwriting practices, and its geographic locations and those of its borrowers."

calculated under CECL<sup>52</sup> to bring the allowance for credit losses under CECL to \$235,000 as of December 31, 2021.

The following table compares the amounts reported by the institution in its Call Reports for December 31, 2020; September 30, 2021; and December 31, 2021 as a basis for illustrating the journal entries the institution would make to reflect the effects of adopting the new credit losses standard. Assume the institution records provision expense entries only as of quarter-end.

Account	12/31/2020 Call Report	1/1/2021 CECL Effective Date	9/30/2021 Call Report	12/31/2021 Call Report
Allowance for loan and lease losses (under the incurred loss methodology)	\$150,000		\$175,000	
Allowance for credit losses on loans HFI (under CECL)		\$200,000		\$235,000
Cumulative-effect adjustment to the January 1, 2021, beginning balance of retained earnings (ignoring applicable tax effect, if any)			\$0	\$50,000
Charge-offs, net of recoveries (year-to-date)			\$65,000	\$85,000
Provision for loan and lease losses (year-to-date) (under the incurred loss methodology)			\$90,000	
Provision for credit losses (year-to-date) (under CECL)				\$120,000

<sup>52</sup> The provision for credit losses for the full 12 months of 2021 under CECL equals the difference between (1) the allowance for credit losses of \$235,000 under CECL as of December 31, 2021, and (2) the allowance for credit losses of \$200,000 under CECL as of January 1, 2021, minus the net charge-offs of \$85,000 for the full 12 months of 2021. The table below provides a rollforward of the allowance for credit losses from December 31, 2020, through December 31, 2021, to illustrate the amount of the provision for credit losses for the full 12 months of 2021 under CECL.

Account	
Allowance for loan and lease losses (under the incurred loss methodology) as of December 31, 2020	\$150,000
Cumulative-effect adjustment to the beginning balance of retained earnings as of January 1, 2021, for the adoption of the new credit losses standard	50,000
Allowance for credit losses on loans HFI (under CECL) as of January 1, 2021	\$200,000
Charge-offs, net of recoveries (year-to-date)	(85,000)
Provision for credit losses (year-to-date) (under CECL)	120,000
Allowance for credit losses on loans HFI (under CECL) as of December 31, 2021	\$235,000

Journal entries as of December 31, 2021:

Account	Debit	Credit
Retained earnings	\$50,000	
Allowance for credit losses on loans HFI		\$50,000

To record the cumulative-effect adjustment to retained earnings (ignoring tax effects, if any) for the change in the balance of the allowance for loan and lease losses as of December 31, 2020, to the initial balance of the allowance for credit losses on loans HFI upon adoption of CECL as of its January 1, 2021, effective date.

Account	Debit	Credit
Allowance for loan and lease losses on loans HFI	\$90,000	
Provision for loan and lease losses on loans HFI		\$90,000
Provision for credit losses on loans HFI	\$120,000	
Allowance for credit losses on loans HFI		\$120,000

To reverse the \$90,000 provision for loan and lease losses measured under the incurred loss methodology during the first nine months of 2021 (i.e., January 1, 2021, through September 30, 2021) and record the \$120,000 provision for credit losses for the full 12 months of 2021 measured under CECL.

Alternatively, recognizing that the allowance under CECL is replacing the allowance under the incurred loss methodology on the balance sheet, and the provision expense under CECL is replacing the provision expense under the incurred loss methodology in the income statement, the institution could instead have recorded the following entry as of December 31, 2021:

Account	Debit	Credit
Provision for loan and lease losses/credit losses on loans HFI	\$30,000	
Allowance for credit losses on loans HFI		\$30,000

To record the provision for credit losses measured under CECL for the final three months of 2021 (i.e., October 1, 2021, through December 31, 2021).<sup>53</sup>

**36. How and when must an institution that is a PBE with a non-calendar fiscal year (e.g., a September 30 fiscal year-end), but is not an SEC filer, incorporate the new credit losses standard into its regulatory reports? [September 2017]**

The following example of a PBE with a September 30 fiscal year-end that is not an SEC filer is provided to illustrate how and when an institution with a non-calendar fiscal year must incorporate the new credit losses standard into its financial statements and regulatory reports

<sup>53</sup> If this alternative approach is taken, the institution's provision expense for the full 12 months of 2021 would be \$120,000, that is, the \$90,000 provision for loan and lease losses measured under the incurred loss methodology during the first nine months of 2021 plus the \$30,000 provision for credit losses for the final three months of 2021.

(e.g., the Call Report). This example applies to an institution that has not elected to early adopt the new credit losses standard.

As stated in the response to question 4, a PBE that is not an SEC filer must apply the new credit losses standard in its financial statements and regulatory reports (e.g., the Call Report) for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. In this example of an institution that is a PBE but is not an SEC filer, the institution's fiscal year begins October 1, 2021. Thus, it must begin to apply the new credit losses standard as of that date. The institution must continue to apply current U.S. GAAP (i.e., the incurred loss methodology) in its financial statements, if applicable, and regulatory reports (e.g., the Call Report) for March 31, 2021; June 30, 2021; and September 30, 2021. This means the Call Reports for the first three calendar quarters of 2021 for a PBE with a September 30 fiscal year-end that is not an SEC filer will not reflect any adjustments for the new credit losses standard.

Such a PBE must first apply the new credit losses standard in its interim period financial statements, if applicable, and in its Call Report for the quarter ended December 31, 2021. The institution must estimate its allowances for credit losses on on-balance-sheet financial assets within the scope of ASC 326-20 and its liabilities for credit losses on off-balance-sheet credit exposures within the scope of ASC 326-20 by applying the new credit losses standard to these assets and exposures as of October 1, 2021.<sup>54</sup> The cumulative-effect adjustment to retained earnings as of October 1, 2021, is the sum of the differences, net of applicable income taxes, between its allowances and liabilities for credit losses measured in accordance with CECL as of that date and the allowances and liabilities for these assets and exposures reported on its Call Report balance sheet as of September 30, 2021, that were measured based on U.S. GAAP in effect on that date.<sup>55</sup> The cumulative-effect adjustment to retained earnings as of October 1, 2021, would be reported in the changes in equity capital schedule of the Call Report for December 31, 2021.

As the Call Report income statement is reported on a calendar year-to-date basis, the institution's income statement in the Call Report for December 31, 2021, will contain provision expenses under the incurred loss methodology for the first three calendar quarters of 2021 (i.e., for the quarters ended March 31, 2021; June 30, 2021; and September 30, 2021) and credit loss expenses determined in accordance with the new credit losses standard for the fourth calendar quarter of 2021 (i.e., for the quarter ended December 31, 2021). Similarly, the institution's Call Report balance sheet for December 31, 2021, should reflect the allowances and liabilities for credit losses estimated in accordance with the new credit losses standard as of that date.

Also, for an institution with a June 30 fiscal year-end, the institution must begin to apply the new credit losses standard as of July 1, 2021. Thus, its interim period financial statements, if applicable, and its Call Reports for March 31, 2021, and June 30, 2021, will not reflect any

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<sup>54</sup> See footnote 47.

<sup>55</sup> See footnote 48, except that for this example of a PBE with a September 30 fiscal year-end that is not an SEC filer, the beginning balance of retained earnings is as of October 1, 2021.



adjustments for the new credit losses standard. The institution's Call Report for September 30, 2021, will reflect an adjustment to the beginning balance of retained earnings as of July 1, 2021, for the cumulative effect, net of applicable income taxes, of the changes in the allowances and liabilities for credit losses resulting from the initial application of the new credit losses standard as of that date. The calendar year-to-date income statement in the Call Report for September 30, 2021, will include provision expenses under the incurred loss methodology for the first two calendar quarters of 2021 (i.e., for the quarters ended March 31, 2021, and June 30, 2021) and credit loss expenses determined in accordance with the new credit losses standard for the third calendar quarter of 2021. The calendar year-to-date income statement in the Call Report for December 31, 2021, will include provision expenses under the incurred loss methodology for the first two calendar quarters of 2021 and credit loss expenses determined in accordance with the new credit losses standard for the third and fourth calendar quarters of 2021.

For an SEC filer with a non-calendar fiscal year (e.g., a September 30 fiscal year-end), the response to this question would be the same as for a PBE that is not an SEC filer with the exception that the dates would be one year earlier (e.g., October 1, 2020, instead of October 1, 2021).

**37. Do the agencies plan to continue to require institutions to use the fair value of collateral to measure expected credit losses for regulatory reporting purposes when a financial asset is considered collateral-dependent? [September 2017]**

Yes. The agencies plan to retain their existing requirement that an institution must use the fair value of collateral for determining the allowance for credit losses for a collateral-dependent loan HFI.

Under CECL, an institution is required to measure expected credit losses based on the fair value of the collateral when an institution determines that foreclosure is probable. The new credit losses standard allows institutions to use, as a practical expedient, the fair value of the collateral to measure expected credit losses on a collateral-dependent financial asset. Under the new credit losses standard, “a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity’s assessment as of the reporting date” is a collateral-dependent financial asset.<sup>56</sup>

Today, for regulatory reporting purposes, the agencies require the use of the fair value of collateral to measure estimated credit losses when an individually evaluated loan that is determined to be impaired, including a loan that is a troubled debt restructuring, is considered to be collateral dependent, regardless of whether foreclosure is probable.<sup>57</sup> Although the new standard uses the term “collateral-dependent financial asset,” the agencies plan to limit their requirement to use the collateral-dependent practical expedient for regulatory reporting purposes to loans. The agencies do not plan to extend this requirement to other financial

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<sup>56</sup> Refer to ASC 326-20-35-5.

<sup>57</sup> Refer to the Glossary entry for “Loan Impairment” in the Call Report instructions.

assets such as HTM debt securities. In addition, an institution should use the fair value of collateral method to measure expected credit losses under CECL only on a loan HFI that individually meets the collateral-dependent definition in the new standard.

For more information on implementation of the collateral-dependent concepts, including when the fair value of collateral should be adjusted for estimated costs to sell, refer to the response to question 15.