FEDERAL RESERVE BANK *of* NEW YORK

Evolution from incurred to expected losses

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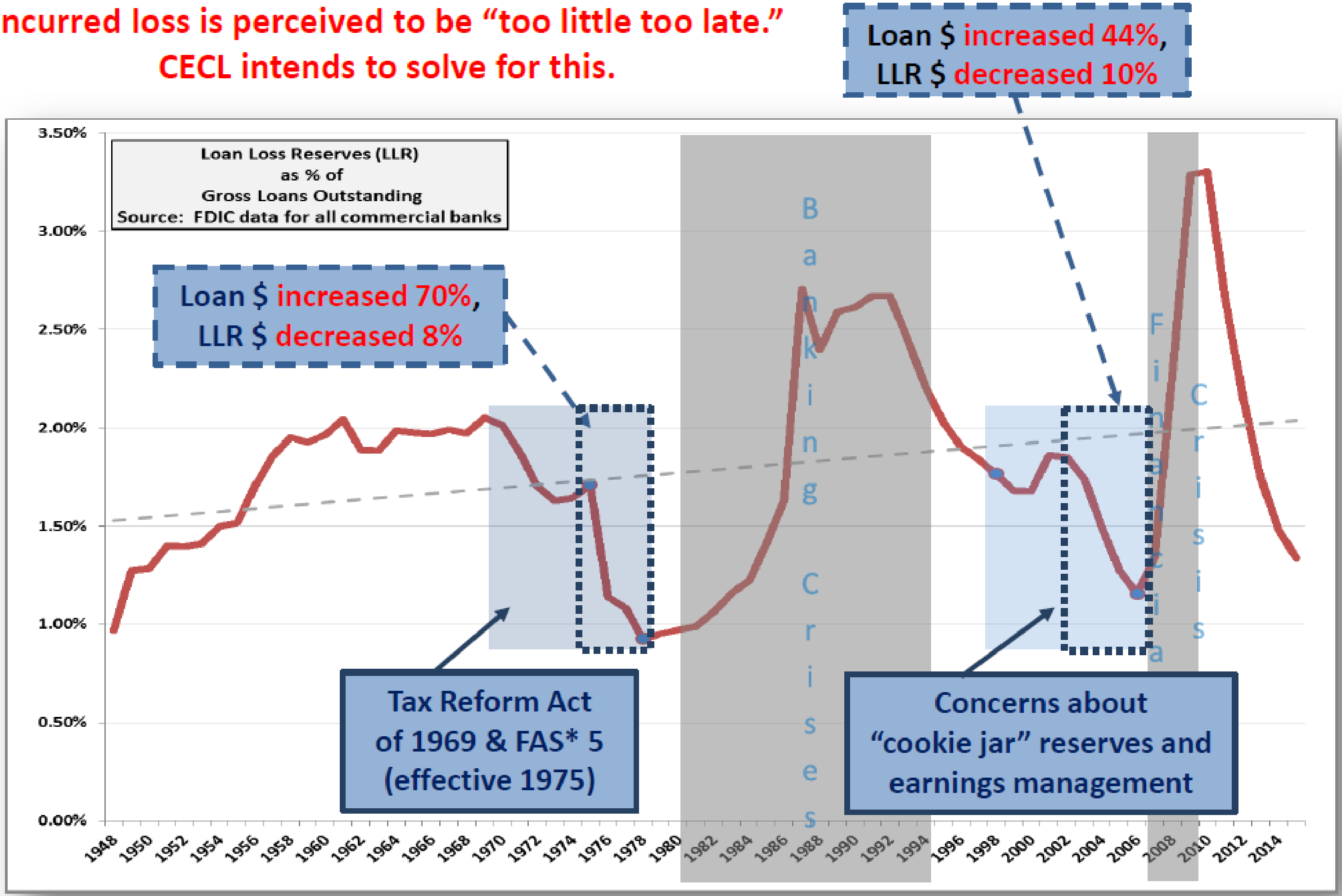
Agenda

- Post crisis call to action
- Development of incurred loss methodology in U.S.
- Balance sheet vs. income statement focus
- Operational Complexity Concerns of Community Banks

The views that I express are my own and do not necessarily represent those of the Federal Reserve Bank of New York or the Federal Reserve System.

Incurred Loss thresholds delayed loss recognition

Incurred loss is perceived to be "too little too late."
CECL intends to solve for this.



Source: Financial Accounting Standards Board (FASB)
*FAS – Financial Accounting Standard

Post-crisis call to action

G20 April 2009 Summit Declaration

Strengthening the Financial System

"…accounting standard setters should take action to improve accounting standards for provisioning, off-balance sheet exposures and valuation uncertainty; …and achieve a single set of high-quality global accounting standards"

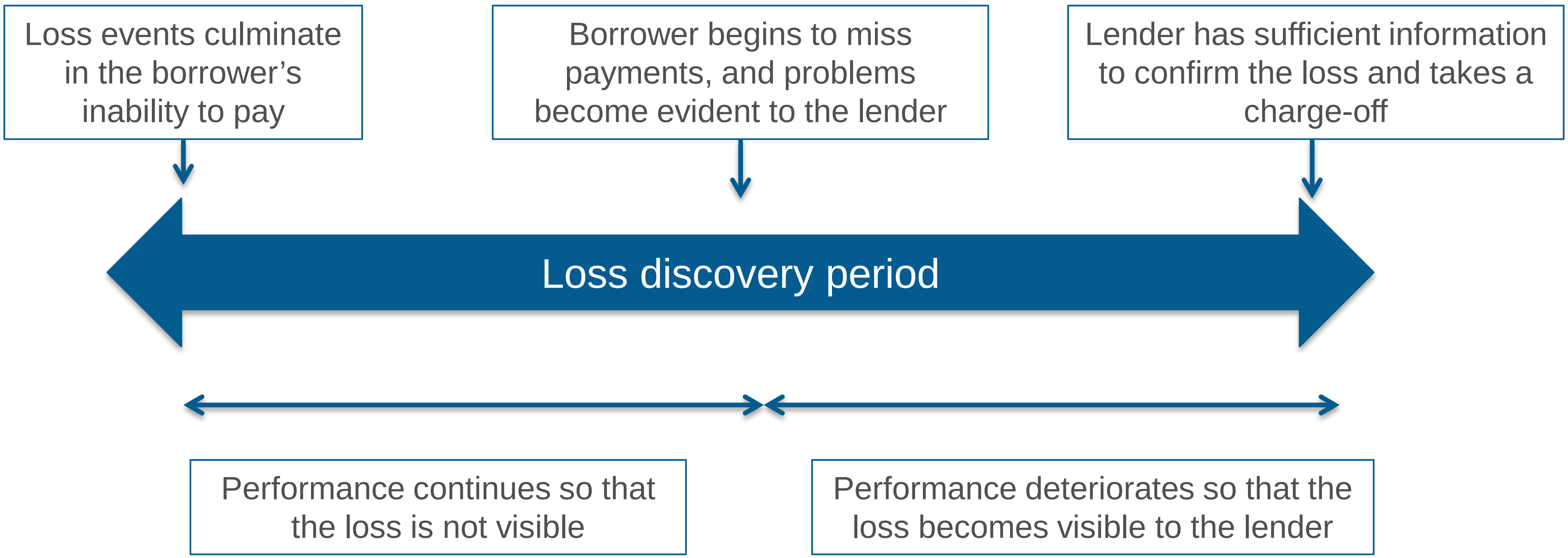
BCBS Aug 2009

Guiding principles for the replacement of IAS 39

1. Usefulness and relevance
2. Faithful representation: reflecting the business model
3. Avoid undue complexity
4. Accounting lessons from the financial crisis
5. Transparency and disclosure

Development of incurred loss methodology in U.S.

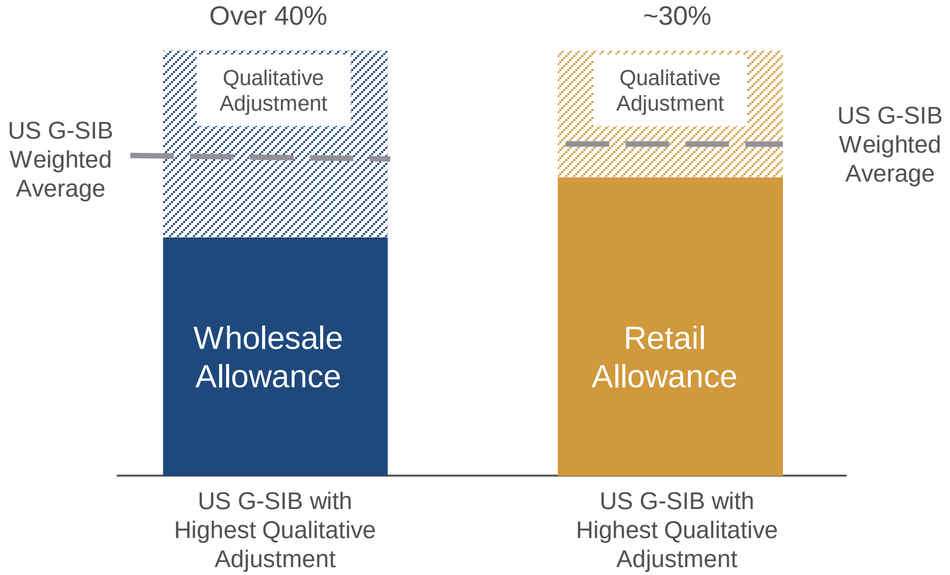
- Divergent implementation before divergent standards
  - Collective evaluation for impairment



Adapted from Grant Thornton: Allowance for loan and lease losses (ALLL): Loss Discovery Periods

Qualitative Factors Material for Some US G-SIBs

Qualitative Adjustment as % of Loan Allowance



*The illustrative examples only include US G-SIBs with material wholesale or retail allowances as of YE 2017

While retail loan allowances saw a steep decline in recent periods, the portion of qualitative adjustments remained more consistent

A wide range of qualitative adjustments exist for the collective evaluation for impairment, including:

- Lending policies and procedures, including underwriting standards;
- Business conditions that affect collectability;
- Nature and volume of portfolio;
- Concentrations of credit;
- Value of underlying collateral;
- External factors, such as competition, legal or regulatory requirements.

Differences between CECL and IFRS 9

	Stage 1	Stage 2	Stage 3
CECL	Lifetime ECL	Lifetime ECL	Lifetime ECL
	Effective interest rate based on contractual cash flow	Discontinue accrual on nonperforming loans	
IFRS 9	12-month ECL	Lifetime ECL	Lifetime ECL
	Effective interest on gross carrying amount	Effective interest on gross carrying amount	Effective interest on amortized cost carrying amount

Balance sheet vs. income statement focus

The “basis for conclusion” in the CECL standard provides support for a balance sheet focus, while the dissenting views focused on income statement presentation

Balance sheet view

- Provide users with decision-useful information about expected credit losses
- Understand realizability of assets as of the end of reporting period
- Eliminate thresholds for earlier recognition
- Inappropriate to defer losses that were expected

Income statement view

- Disagree that expected credit losses is an expense at inception or purchase of financial asset
- Credit risk *deterioration* should be reflected in the income statement
- Should consider interest income and credit impairment charges together to reflect economics of lending

Operational Complexity Concerns of Community Banks