NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

NCUA-2020-0074

RIN 3133-AF03

Transition to the Current Expected Credit Loss Methodology

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: The NCUA Board (Board) is seeking comment on a proposed rule to address changes to the U.S. generally accepted accounting principles (GAAP). Specifically, the proposed rule would provide that, for purposes of determining a federally insured credit union's (FICU's) net worth classification under the prompt corrective action (PCA) regulations, the Board will phase-in the day-one adverse effects on regulatory capital that may result from the adoption of the current expected credit losses (CECL) accounting methodology. Consistent with regulations issued by the other federal banking agencies, the proposed rule would temporarily mitigate the adverse PCA consequences of the day-one capital adjustments, while requiring that FICUs account for CECL for other purposes, such as Call Reports. The proposed rule would

also provide that FICUs with less than $10 million in assets are no longer required to determine their charges for loan losses in accordance with GAAP. The Board's regulations would provide that these FICUs may instead use any reasonable reserve methodology (incurred loss), provided that it adequately covers known and probable loan losses.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER.]

ADDRESSES: You may submit comments, by any of the following methods **(Please send comments by one method only)**:

• Federal eRulemaking Portal: http://www.regulations.gov. The docket number for this proposed rule is NCUA-2020-0074 and is available at https://www.regulations.gov/. Follow the instructions for submitting comments.

• Fax: (703) 518–6319. Include "[Your name] Comments on "Transition to the Current Expected Credit Loss Methodology" in the transmittal.

• Mail: Address to Gerard Poliquin, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

• Hand Delivery/Courier: Same as mail address.

Public inspection: All public comments are available on the Federal eRulemaking Portal at: http://www.regulations.gov as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information.

Due to social distancing measures in effect, the usual opportunity to inspect paper copies of comments in the NCUA's law library is not currently available. After social distancing measures are relaxed, visitors may make an appointment to review paper copies by calling (703) 518-6540 or e-mailing OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: *Policy and Accounting:* Alison L. Clark, Chief Accountant, Office of Examinations and Insurance, at (703) 518-6360; *Legal:* Ariel Pereira, Staff Attorney, Office of General Counsel, at (703) 548-2778; or by mail at National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314.

SUPPLEMENTARY INFORMATION

I. Background

A. The NCUA's Minimum Capital Standards

The NCUA's primary mission is to ensure the safety and soundness of FICUs. The NCUA performs this function by examining and supervising federally chartered credit unions, participating in the examination and supervision of federally insured, state-chartered credit unions in coordination with state regulators, and insuring members' accounts at all FICUs. In its role as the administrator of the National Credit Union Share Insurance Fund (NCUSIF), the NCUA is responsible for the regulation and supervision of 5,196 FICUs with 121.3 million members and $1.63 trillion in assets across all states and U.S. territories.[1]

[1] Based on credit union data as of March 31, 2020. *See* National Credit Union Administration, *2020 Annual Performance Plan*, 1 (January 2020), https://www.ncua.gov/files/agenda-items/AG20200123Item1b.pdf

On August 7, 1998, Congress enacted the Credit Union Membership Access Act.[2] Section 301 of the statute added a new section 216 to the Federal Credit Union Act (FCU Act).[3] Section 216 directed the Board to adopt by regulation a system of PCA to restore the net worth of FICUs. For FICUs, other than those that meet the statutory definition of a "new" FICU, section 216 requires a framework of mandatory supervisory actions indexed to five statutory net worth categories, ranging from "well capitalized" to "critically undercapitalized." The mandatory actions and conditions triggering conservatorship and liquidation are expressly prescribed by statute.[4] To supplement the mandatory actions, section 216 charged the NCUA with developing discretionary actions which are "comparable" to the "discretionary safeguards" available under section 38 of the Federal Deposit Insurance Act—the statute that applies PCA to other federally insured depository institutions.[5]

For FICUs that section 216 defines as "new"—those that have been in operation less than ten years and have $10 million or less in assets—the statute directed the NCUA to develop an alternative system of PCA to apply instead of the system of PCA for all other FICUs.[6] Although section 216 does not prescribe specific attributes for this component of PCA, it instructed the NCUA to recognize that "new" FICUs initially have no net worth, need reasonable time to accumulate net worth, and need incentives to become "adequately capitalized" by the time they

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[2] Pub. L. 105–219, 112 Stat. 913 (1998).
[3] The FCU Act is codified at 12 U.S.C. 1751 *et al.* Section 216 of the act is codified at 12 U.S.C. 1790d.
[4] 12 U.S.C. 1790d(e), (f), (g), (i); 12 U.S.C. 1786(h)(1)(F), 1787(a)(3)(A).
[5] 12 U.S.C. 1790d(b)(1)(A). Section 38 of the FDI Act, 12 U.S.C. 1831o, was added by section 131 of the Federal Deposit Insurance Corporation Improvement Act, Pub. L. 102–242, 105 Stat. 2236 (1991).
[6] 12 U.S.C. 1790d(b)(2)(A).

reach either ten years in operation or exceed $10 million in assets (*i.e.,* no longer meet the definition of "new").[7]

The NCUA implemented the regulatory PCA system mandated by section 216 through a final rule published on February 18, 2000.[8] The NCUA's PCA regulations are codified in 12 CFR part 702, "Capital Adequacy." As required by section 216, the NCUA regulations provide that a FICU's capitalization classification is determined by calculating its "net worth ratio," which is defined as being the ratio of the FICU's net worth to its total assets.[9] Both section 216 and part 702 define "net worth" as including the retained earnings balance of the FICU as determined under GAAP. Net worth also includes certain loans to, and accounts in, a FICU established pursuant to section 208 of the FCU Act.[10] For low-income designated credit unions, net worth also includes secondary capital accounts that are uninsured and subordinate to all other claims, including claims of creditors, shareholders, and the NCUSIF.[11] The regulations provide that a FICU's total assets may be measured by either its (1) average quarterly balance; (2) average monthly balance; (3) average daily balance; or (4) quarter-end balance.[12]

With respect to the alternate PCA system for "new" FICUs, the Board has implemented these requirements in subpart C of the part 702 regulations. In general, the regulations adopt relaxed net worth ratios for new FICUs. However, the PCA system for new FICUs mirrors in most important respects the system for all other FICUs. For example, the regulations index the

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[7] 12 U.S.C. 1790d(b)(2)(B).
[8] 65 FR 8560 (February 18, 2000).
[9] 12 U.S.C. 1790d(o)(3); 12 CFR 702.2(g).
[10] 12 U.S.C. 1790d(o)(2)(B); 12 CFR 702.2(f)(4). Section 208 of the FCU Act (12 U.S.C. 1788) regards special assistance to avoid liquidation.
[11] 12 U.S.C. 1790d(o)(2)(C); 12 CFR 702.2(f)(2).
[12] 12 CFR 702.2(k).

capital classification of new FICUs to the same five net worth categories used for other FICUs. Further, the definitions of “net worth,” “total assets,” and “net worth ratio” also apply to new FICUs.

B. Current Expected Credit Loss (CECL) Methodology

In response to the global economic crisis of 2007-2009, several observers expressed concern that GAAP restricted the ability of institutions to record credit losses that were expected, but that did not yet meet the “probable” threshold under the current incurred loss methodology. Credit loss reserves help mitigate the overstatement of income on loans and other assets by accounting for future losses. In response, in June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016–13, which revises the accounting for credit losses under GAAP.[13]

The new accounting standard applies to all banks, savings associations, credit unions,[14] and financial institution holding companies, regardless of size, that file regulatory reports for which the reporting requirements conform to GAAP. Adoption of CECL is expected to result in greater transparency of expected losses at an earlier date during the life of a loan. ASU No. 2016-13 emphasizes that CECL does not change the economics of lending, but only the timing of when losses are recorded. As ASU No. 2016-23 states:

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[13] FASB ASU No. 2016–13*, Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments,* June 2016, available at: https://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176168232528.

[14] CECL applies to all credit unions, irrespective of whether the credit union is federally insured or whether it is chartered federally or under state law.

In other words, the same loss ultimately will be recorded, regardless of the accounting requirements. What changes is an accounting threshold for the recognition of credit losses, which affects only the timing of when to record credit losses, not the ultimate amount realized on the financial assets. [15]

CECL differs from the incurred loss methodology in several key respects. Most significantly for purposes of this proposed rule, CECL requires the recognition of lifetime expected credit losses for financial assets measured at amortized cost, not just those credit losses that have been incurred as of the reporting date. CECL also requires the incorporation of reasonable and supportable forecasts in developing an estimate of lifetime expected credit losses, while maintaining the current requirement for consideration of past events and current conditions. Furthermore, the probable threshold for recognition of allowances in accordance with the incurred loss methodology is removed under CECL. Taken together, estimating expected credit losses over the life of an asset under CECL, including consideration of reasonable and supportable forecasts but without applying the probable threshold that exists under the incurred loss methodology, results in earlier recognition of credit losses.[16]

FASB established a staggered effective date for CECL. In doing so, it has recognized two classes of institutions subject to CECL: (1) Public business entities (PBEs) that meet the definition of a U.S. Securities and Exchange (SEC) filer, excluding entities eligible to be smaller

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[15] *Supra* note 13, at 244.

[16] See *Frequently Asked Questions on the New Accounting Standard on Financial Instruments – Credit Losses*, issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency on April 3, 2019, for a more comprehensive discussion of the changes made by CECL to existing GAAP standards. The document is available at: https://www.ncua.gov/files/letters-credit-unions/financial-instruments-credit-losses-faqs.pdf

reporting companies (SRCs) as defined by the SEC, and (2) all other entities, which includes FICUs. The effective date for SEC-filers (other than SRCs) is fiscal years beginning after December 15, 2019. All other entities (including all FICUs) are required to commence implementation of the standard for fiscal years beginning after December 15, 2022.[17] All entities subject to CECL, however, may voluntarily elect to adopt CECL earlier than the specified implementation date, commencing as early as fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.[18]

Upon adoption of CECL, an institution will record a cumulative-effect adjustment to retained earnings (known as "the day-one adjustment"). The day-one adjustment will be equal to the difference, if any, between the amount of credit loss allowances required under the incurred loss methodology and the amount of credit loss allowances required under CECL. A critical consideration for institutions subject to the new accounting rules will be the impact of CECL on capital. Institutions could experience a sharp increase in expected credit losses on the effective date as a result of the day-one adjustment, which could lower their capital classification under

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[17] FASB originally established the following three categories of entities subject to CECL: (1) PBE SEC filers; (2) PBEs that are not SEC filers; and (3) non-PBEs (including FICUs). The original implementation date for non-PBEs was December 15, 2020. FASB subsequently delayed the implementation date for non-PBEs until December 15, 2021.
(https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168232528&acceptedDisclaimer=true) FASB issued a second update consolidating the entities subject to CECL into two categories (SEC filers (not including SRCs) and all other entities) and further extending the implementation dates as described above. (https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176173775344&acceptedDisclaimer=true).

[18] *Supra* note 13, at 5. Section 4014 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (Pub. L. 116–136) suspended mandatory compliance with CECL between March 27, 2020 (the date of enactment of the CARES Act) and the earlier of: (1) the date on which the national emergency concerning the novel coronavirus disease (COVID–19) outbreak declared by the President on March 13, 2020, under the National Emergencies Act (50 U.S.C. 1601 *et seq*.) terminates; or (2) December 31, 2020. This provision is not applicable to virtually any FICU because, as noted, they are not required to begin compliance with CECL until December 15, 2022, and a very small number have adopted it earlier voluntarily.

relevant statutory and regulatory authorities (such, as for example, under the Board's PCA regulations for credit unions).

C. February 14, 2019, and March 31, 2020, Banking Agency Rules on CECL Implementation

On February 14, 2019,[19] the Office of Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (the "other banking agencies") issued a final rule to temporarily mitigate the impacts of CECL implementation on institutions subject to their supervision ("banking organizations"). The final rule provides banking organizations with the option to phase-in over a three-year period the adverse effects to capital ratios that may result from the day-one adjustment. The rule uses the term "electing banking organizations" to refer to banking organizations that opt to use the phase-in. When calculating regulatory capital ratios during the first year of an electing banking organization's adoption of CECL, the organization must phase-in 25 percent of the transitional amounts. The electing banking organization will phase-in an additional 25 percent of the transitional amounts over each of the next two years. At the beginning of the fourth year, the banking organization will have completely reflected in regulatory capital the day-one effects of CECL.[20] Regardless of its election to use the phase-in, a banking organization will be required to account for CECL for other purposes, such as Call Reports.[21]

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[19] 84 FR 4222 (February 14, 2019).

[20] *Id*. at 4227-4228.

[21] *Id.* at 4230. *See also* the other banking agencies' *Federal Register* notice soliciting comment on the revisions to the Call Reports under the Paperwork Reduction Act of 1995 (42 U.S.C. 3501-3521) published at 83 FR 49160 (Sept. 28, 2018).

On March 31, 2020, [22] the other banking agencies issued an interim final rule, effective upon publication, further delaying full CECL implementation requirements to allow banking organizations to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of COVID–19, while also maintaining the quality of regulatory capital. The March 31, 2020, interim final rule provides banking organizations that adopt CECL during the 2020 calendar year with the option to delay for two years the estimated impact of CECL on regulatory capital, followed by a three-year transition period to phase out the aggregate amount of the capital benefit provided during the initial two-year delay (*i.e.,* a five-year transition, in total). The interim final rule does not replace the three-year transition option in the February 14, 2019, final rule, which remains available to any banking organization at the time that it adopts CECL. Banking organizations that have already adopted CECL have the option to elect the three-year transition option contained in the February 14, 2019, final rule or the five-year transition contained in the March 31, 2020, interim final rule.

Further, as noted above, the CECL effective date is for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years for smaller reporting companies and nonpublic business entities (private companies) (a category that includes FICUs). Unless banking organizations falling into these two categories are early adopters of CECL in 2020, they will only receive the benefit of the three-year transition provided in the February 14, 2019, final rule. This places these banking organizations in a similar position to FICUs eligible for the three-year transition provided under this proposed rule.

[22] 62 FR 17723 (March 31, 2020).

D. Proposed Rule Overview

Consistent with the other banking agencies' February 14, 2019, final rule, the NCUA Board is issuing this proposed rule to mitigate the adverse effects on a FICU's net worth category that may result from the day-one adjustment.[23] Specifically, the proposed rule would provide that, for purposes of the PCA regulations, the Board will phase-in the day-one effects on a FICU's net worth ratio over a three-year period (12 quarters). The phase-in would only be applied to those FICUs that adopt the CECL methodology on or after December 15, 2022. FICUs that elect to adopt CECL earlier than the deadline established by FASB would not be eligible for the phase-in. Further, unlike banking organizations subject to the rule issued by the other banking agencies, eligible FICUs would not have the choice of opting into (or out of) the phase-in. Rather, the Board will apply the phase-in for all FICUs that meet the prescribed eligibility criteria.

FICUs would continue to calculate their net worth in accordance with GAAP as generally required by section 216, and would also continue to be required to account for CECL for all other purposes, such as Call Reports. Further, under the proposed rule, FICUs with less than $10 million in assets would no longer be required to determine their charges for loan losses in accordance with GAAP. This provision would eliminate the adverse PCA consequences for smaller FICUs resulting from CECL. The Board's regulations would allow these FICUs to instead make charges for loan losses in accordance with any reasonable reserve methodology

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[23] The Senate Committee Report to the Financial Services and General Government Appropriations Act, 2020 (Division C of the Consolidated Appropriations Act, 2020; Public Law 116-93, approved December 20, 2019), directs the Department of the Treasury, in consultation with the other banking agencies and the NCUA to "conduct a study on the need, if any, for changes to regulatory capital requirements necessitated by CECL" (Senate Report 116-111, at page 11). The Board will take the results of this study into consideration as this rulemaking progresses.

(incurred loss), provided that it adequately covers known and probable loan losses. Accordingly, FICUs in this asset-size category that choose to use the incurred loss methodology would not be subject to the phase-in described in this proposed rule.[24] The Board also notes that, despite the language of the proposed rule, state-chartered, federally insured credit unions subject to State laws and regulations may be required to comply with GAAP or other accounting standards under applicable State requirements.

Section III of this preamble discusses the provisions of the proposed rule in greater detail.

II. Legal Authority

A. The Board's Rulemaking Authority, Generally.

The Board is issuing this proposed rule pursuant to its authority under the FCU Act. The FCU Act grants the Board a broad mandate to issue regulations governing both federal credit unions and all FICUs. For example, section 120 of the FCU Act is a general grant of regulatory authority and authorizes the Board to prescribe rules and regulations for the administration of the act.[25] Other provisions of the act, such as section 216, confer specific rulemaking authority to address prescribed issues or circumstances.[26] This proposed rule is being issued under both the

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[24] The GAAP exemption for smaller FICUs does not perfectly overlap with the statutory definition of a "new" FICU. As discussed above, section 216 defines "new" FICUs, in part, as those with total assets of "$10 million or less," while the GAAP exception under section 202 applies to FICUs with total assets of "less than $10 million." Accordingly, new FICUs with $10 million in total assets are subject to GAAP; however, the majority of FICUs that have existed for ten years or less have less than $10 million in total assets and will therefore be exempt from GAAP pursuant to section 202 and this proposed rule.

[25] 12 U.S.C. 1766(a).

[26] Other provisions of the FCU Act providing the Board with specific rulemaking authority include section 207 (12 U.S.C. 1787), which is a specific grant of authority over share insurance coverage, conservatorships, and liquidations. Section 209 (12 U.S.C. 1789) grants the Board plenary regulatory authority to issue rules and regulations necessary or appropriate to carry out its role as share insurer for all FICUs.

general rulemaking authority conferred by section 120 of the FCU Act and also, as discussed below, the more specific grant of authority under section 216.

B. CECL Transition

Section 216 authorizes the NCUA Board to issue regulations adjusting the net worth ratio requirements for FICUs if the other "banking agencies increase or decrease the required minimum level for the leverage limit" pursuant to section 38 of the Federal Deposit Insurance Act.[27] The quoted statutory language establishes two conditions for Board rulemaking under this provision: (1) the other banking agencies must revise the leverage limit; and (2) the revision must be pursuant to section 38 of the Federal Deposit Insurance Act. In addition, section 216 also requires that the Board determine—in consultation with the other banking agencies—"the reason for the increase or decrease in the required minimum level for the leverage limit also justifies adjustment to the net worth ratios."[28] In accordance with the consultation requirements, the NCUA has briefed relevant staff of the other banking agencies of the contents and purposes of this proposed rule.

With regards to the two factors identified in the quoted statutory language, the other banking agencies specify in the preamble to their February 14, 2019, final rule, that they are issuing the regulatory changes under the authority of section 38 of the Federal Deposit Insurance

[27] 12 U.S.C. 1790d(c)(2)(A).
[28] 12 U.S.C. 1790d(c)(2)(B).

Act.[29] The 2019 final rule, however, does not directly raise or lower the leverage limit,[30] or any other of the capital ratios applicable to banking organizations. For example, the leverage limit (defined as the ratio of tier 1 capital to average total consolidated assets) remains unchanged at 4 percent. Nevertheless, the stated intent of the other banking agencies was to effectively modify the capital ratios for purposes of PCA oversight. As the preamble to the final rule provides:

> For purposes of determining whether an electing banking organization is in compliance with its regulatory capital requirements (including capital buffer and prompt corrective action (PCA) requirements), the agencies will use the electing banking organization's regulatory capital ratios as adjusted by the CECL transition provision.[31]

The regulatory text of the final rule also provides that the transition provision requires an electing banking organization to make certain adjustments "in its calculation of regulatory capital ratios."[32] Other regulatory text discusses adjustments to specific capital ratios under the transition provision. For example, the regulation provides that an electing banking organization will "[i]ncrease average total consolidated assets as reported on the Call Report *for purposes of the leverage ratio*."[33]

The quoted preamble language and regulatory text make clear that, while the other banking agencies did not expressly revise the numeric capital thresholds, they issued the

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[29] *See* the Paperwork Reduction Act statement at 84 FR 4231-42333, which provides: "This information collection [contained in this rule] is authorized by section 38(o) of the Federal Deposit Insurance Act (12 U.S.C. 1831o(c))…." *See also* footnote 35 of the Federal Reserve Board's Regulatory Flexibility Act statement on page 4234.
[30] Termed the "leverage ratio" in the banking agencies' regulations governing capital adequacy standards. *See,* 12 CFR 12 CFR 3.10 (OCC), 217.10 (FRB), and 324.10 (FDIC).
[31] *Supra* note 19, at 4229.
[32] 12 CFR 3.301(c)(1) (OCC), 217.301(c)(1) (FRB), and 324.301(c)(1) (FDIC).
[33] 12 CFR 3.301(c)(1)(iv) (OCC), 217.301(c)(1)(iv) (FRB), and 324.301(c)(1)(iv) (FDIC) (emphasis added).

February 14, 2019, final rule for purposes of effectively adjusting the leverage limit and other capital ratios that would be used for PCA oversight. Accordingly, the NCUA has determined that both conditions set forth in section 216 have been satisfied for purposes of issuing this proposed rule.[34]

The Board is following the lead of the other banking agencies and issuing this proposed rule to phase-in the possible adverse consequences on a FICU's PCA classification resulting from the day-one adjustment. The rule would not revise the definition of net worth, which as discussed above is statutorily prescribed. FICUs would continue to calculate their net worth and net worth ratios in accordance with existing statutory and regulatory requirements. It is true, however, that the effect of the phase-in could be to effectively, albeit temporarily, increase a FICU's net worth. However, any such deemed increases would be consistent with the authority conferred to the NCUA under section 216 to adjust its PCA determinations in conformity to similar action by the other banking agencies. The effects of the proposed phase-in on a FICU's net worth calculations are consistent with section 216 and closely modeled on the CECL transition provisions issued by the other banking agencies. Specifically, the proposed rule is narrowly tailored to temporarily mitigating the impacts of CECL adoption on the PCA classification of a FICUs net worth. Further, this proposed rule does not adjust the numeric net worth ratios under the NCUA's PCA system. The sole purpose of the proposed phase-in is to aid FICUs to adjust to the new GAAP standards in a uniform manner and without disrupting their ability to serve their members.

[34] The Board also finds that the other banking agencies' March 31, 2020, interim final rule on this subject does not affect this analysis because it affects only those banking organizations that have adopted CECL as of 2020 and does not alter the three-year phase-in for other banking organizations that are covered in the same category of FASB's standards.

The Board notes that while section 216 defines "net worth"—the numerator for determining the net worth ratio—it does not define the term "total assets," which comprises the denominator of the equation. The definition of the term is left to the regulatory discretion of the Board. The Board has elected to exercise this discretion and defined "total assets" in part 702. Specifically, the regulations provide that a FICU's total assets may be measured by either its (1) average quarterly balance; (2) average monthly balance; (3) average daily balance; or (4) quarter-end balance.[35] As an alternative to the phase-in that would be provided by this proposed rule, the Board could have elected to revise the definition of "total assets" in a manner enabling FICUs to effect the CECL day-one adjustments without undue adverse consequences. The Board opted for the proposed phase-in given its simplicity and ease of administration. Nonetheless, the Board acknowledges that an alternative legal basis exists for rulemaking to mitigate the consequences of CECL implementation.

B. Small FICU Charges for Loan Losses

Section 202 of the FCU Act requires that, in general, "applicable reports and statements required to be filed with the Board shall be uniform and consistent with" GAAP.[36] The statute, however, also provides an exception to GAAP compliance for FICUs with total assets of "less than $10,000,000, unless prescribed by the Board or an appropriate State credit union supervisor."[37]

[35] 12 CFR 702.2(k).
[36] 12 U.S.C. 1782(b)(6)(C)(i).
[37] 12 U.S.C. 1782(b)(6)(C)(iii).

The Board's regulations in § 702.402 require that charges for loan losses be made in accordance with GAAP and does not distinguish based on the asset size of FICUs. In effect, § 702.402 exercises the Board's discretion under section 202 of the FCU Act to override the exception for smaller FICUs by prescribing regulations. For reasons discussed more fully below, the Board has elected to once again exercise its statutory discretion under section 202 of the FCU Act. The Board's regulations will no longer require that FICUs with total assets less than $10 million make charges for loan losses in accordance with GAAP. Instead the regulations will allow these FICUs to make such charges under any reasonable reserve methodology (incurred loss) provided it adequately covers known and probable loan losses. The transition provisions described above apply to FICUs adopting CECL. Accordingly, smaller FICUs that elect to use a non-GAAP measure are not eligible for the phase-in. The Board also notes that, despite the language of the proposed rule, section 202 makes clear that state-chartered, federally insured credit unions subject to State laws and regulations may be required to comply with GAAP or other accounting standards under applicable State requirements.

C. Alternatives to GAAP

The Board also notes that section 202 of the FCU Act could also potentially, as an alternative to the provisions discussed above, authorize the Board to provide a transition of the day-one effects of CECL implementation. This provision authorizes the Board to prescribe an accounting principle for application to any FICU if the Board determines that the application of a GAAP principle is not appropriate. Because the Board has clear authority to effect the transition to CECL under section 216, it is not necessary to rely on section 202. As the statute provides, the alternative principle would need to be as stringent as the GAAP principle it replaces, which would bear further study to determine whether a phase-in of CECL would be deemed no less stringent than CECL. Furthermore, the Board might need to engage in a fuller analysis of the appropriateness of CECL as applied to all insured credit unions with $10 million or greater in assets, which would likely be time-consuming as compared to the more direct, across-the-board approach proposed above. The transition analyzed and proposed above would provide relief to all insured credit unions subject to CECL beginning with fiscal years commencing after December 15, 2022, in a streamlined, prompt fashion.

III. Proposed Rule

A. Proposed New Subpart G to Part 702

The NCUA proposes to add a new subpart G to part 702, captioned "CECL Transition Provisions," which would apply to FICUs that meet the eligibility criteria specified in the proposed rule. Notwithstanding the CECL transition provisions, all other aspects of part 702 would continue to apply.

B. Eligibility for the Transition Provisions

As discussed above, the proposed rule is designed to facilitate a FICU's transition to CECL without disrupting its ability to serve its members as a result of a PCA re-classification. An early-adopter FICU is presumed to have undertaken the necessary analysis to determine the impact of the day-one adjustment and to have made its early adoption decision accordingly. As a result, the Board does not believe that the phase-in is either necessary or appropriate for such FICUs. FICUs that have not adopted CECL prior to the December 15, 2022, implementation date established by FASB are eligible for the phase-in. The NCUA will use the phase-in to determine the FICU’s net worth category under § 702.102 or § 702.202 (for FICUs statutorily defined as “new”). To be eligible for the transition provision, the FICU must record a reduction in retained earnings due to the adoption of CECL.

C. NCUA Implementation of the Transition Provisions.

Eligible FICUs would not have the option of electing whether to opt-into (or out of) the transition provisions. Although this differs from the other banking agencies’ rule, it is consistent with the goal of this rulemaking to mitigate disruptions caused by CECL adoption. As noted, eligibility for the transition provision is limited to those FICUs for which the phase-in is truly necessary–that is, they will experience a reduction in retained earnings as a result of CECL. The Board believes that requiring these FICUs to affirmatively opt-into the transition provisions would constitute an unnecessary administrative exercise to confirm their already obvious need for the phase-in. Moreover, some FICUs eligible for the phase-in may inadvertently fail to make the election in the Call Report, thereby reducing the benefit of the transition provision. Automatic implementation of the phase-in by the NCUA will help to ensure its uniform application and that its benefits are provided to the greatest possible number of eligible FICUs.

The final rule issued by the other banking agencies relies on banking organizations to calculate the phase-in amounts. In contrast, the NCUA will make the required phase-in calculations. As above, the Board has determined that this will help ensure the uniform implementation of the phase-in, as well as facilitate the accurate calculation of the transition amounts.

D. Mechanics of the CECL Transition Provisions

To calculate the transitional amount under the CECL transition provision, the NCUA would compare the differences in a FICU's retained earnings between: (1) the FICU's closing balance sheet amount for the fiscal year-end immediately prior to its adoption of CECL (pre-CECL amount); and (2) the FICU's balance sheet amount as of the beginning of the fiscal year in which the FICU adopts CECL (post-CECL amount). The difference in retained earnings constitutes the transitional amount that would be phased-in to the net worth ratio calculation over the proposed transition period, which would be the three-year period (twelve quarters) beginning the first day of the fiscal year in which the FICU adopts CECL. Specifically, a FICU's CECL transitional amount would be the difference between the pre-CECL and post-CECL amounts of retained earnings.

Under the proposed rule, the NCUA would phase-in the FICU's CECL transitional amount. The NCUA would also phase-in the CECL transitional amount to the FICU's total assets for purposes of the net worth ratio. Both the FICU's retained earnings and total assets would be deemed increased by the CECL transitional amount. The CECL transitional amount would be phased-in over the transition period on a straight line basis automatically as part of the Call Report.

As noted, FICUs are currently required to commence implementation of the standard for fiscal years beginning after December 15, 2022. In determining the net worth ratio of a FICU, the NCUA would deem retained earnings and total assets as reported on the Call Report to be increased by 100 percent of the FICU's CECL transitional amount during the first three quarters of calendar year 2023. The FICU may use this period to build capital and to make resulting material adjustments to its CECL transitional amount until December 30, 2023. The NCUA would base its subsequent calculations regarding the phase-in based on the CECL transitional amount reported by the FICU as of December 31, 2023 (the due date for the fourth quarterly report of calendar year 2023), and further adjustments to the amount are not permitted.

Beginning with the fourth quarterly Call Report of calendar 2023, the NCUA would deem retained earnings and total assets to be increased by 67 percent of the FICU's CECL transitional amount. This percentage would be decreased to 33 percent beginning with the fourth quarterly Call Report in calendar year 2024. Commencing with the fourth quarterly Call Report in calendar year 2025, the FICU's net worth ratio will completely reflect the day-one effects of CECL. All other items remaining equal, this computation will result in a gradual phase-in of the CECL day-one effects.

E. Example of Transition Schedule

As an example of the proposed phase-in, consider a hypothetical FICU that has a calendar fiscal year. On the closing balance sheet date immediately prior to adopting CECL, the FICU has $10 million in retained earnings and $1 million of Allowance for Loan and Lease Losses (ALLL) (i.e., credit loss). On the opening balance sheet date of January 1, 2023, immediately after adopting CECL, the FICU determined it needs $1.2 million of allowance for credit losses. The FICU would recognize the adoption of CECL by recording a reduction in beginning retained earnings of $200,000. For each of the first three quarterly reporting periods in 2023, the NCUA would deem both the FICU's retained earnings and total assets to be increased by the full $200,000. Commencing with the fourth quarterly Call Report submitted in 2023 the FICU’s retained earnings and total assets would be deemed increased by $134,000 ($200,000 × 67 percent) , for purposes of calculating the FICU’s net worth ratio. The $134,000 increase would remain constant for the first three quarters in 2024. Starting with the fourth quarterly Call Report in 2024, retained earnings and total assets would be deemed increased by $66,000 ($200,000 x 33 percent). Using the same mathematical equation, the $66,000 increase would remain constant for the first three quarters in 2025. Upon the FICU’s submission of its fourth quarterly report in 2025, there would be zero increase in retained earnings and total assets, thus the FICU’s net worth ratio will completely reflect the day-one effects of CECL.

Table 1 presents the example above in tabular format:

Table 1— Example of a CECL Transition Provision Schedule

In thousands	Transitional Amount	Transitional amounts applicable during each quarter of the transition period (12 quarters total).			
		Quarters 1-3	Quarters 4-7	Quarters 8-11	Quarter 12
		First three quarters of 2023	Four quarters at 67% (4th quarter of 2023 and first three quarters of 2024)	Four quarters at 33% (4th quarter of 2024 and first three quarters of 2025)	Full Recognition of Day-One Adjustment (commencing 4th quarter of 2025)
Increase retained earnings and total assets by the CECL transitional amount	$200	$200	$134	$66	0

F. Statutory Limit on Amount of Net Worth Ratio Change

Section 216 limits any change to the net worth ratio thresholds for each of the five net worth categories to "an amount that is equal to not more than the difference between the required minimum level most recently established by the Federal banking agencies and 4 percent of total assets (with respect to institutions regulated by those agencies)."[38] The limitation is not applicable to this proposed rule because, as noted above, the Board is following the lead of the other banking agencies and not modifying any specific net worth ratio threshold amount. Therefore, applying this element would be impracticable and would frustrate the purpose of the statutory provision. While the effect of the proposed regulatory amendments will be to adjust the calculation of the net worth ratios and, in some instances, the resultant net worth classifications, the actual numeric threshold amounts will remain the same. For example, a FICU will continue to be "well capitalized" if its net worth ratio is 7 percent or higher and it meets any applicable risk-based net worth requirement.

G. NCUA Oversight

For purposes of determining whether a FICU is in compliance with its PCA requirements, the NCUA will use the FICU's net worth ratio as adjusted by the CECL transition provision. Through the supervisory process, the NCUA will continue to examine credit loss estimates and allowance balances regardless of whether the FICU is subject to the CECL transition provision. In addition, the NCUA may examine whether FICUs will have adequate amounts of capital at the expiration of their CECL transition provision period.

H. Small FICU Determination of Charges for Loan Losses

[38] 12 U.S.C. 1790d(c)(2)(A).

As discussed, section 202 of the FCU Act provides an exception for FICUs with less than $10 million in total assets to the general requirements that reports and statements filed with the Board comply with GAAP. As also noted above, the Board's regulations in § 702.402 require that charges for loan losses be made in accordance with GAAP and does not distinguish between the asset size of FICUs. The Board, however, is aware that compliance with GAAP may be burdensome for smaller FICUs. This difficulty is likely to be exacerbated with the adoption of CECL. Accordingly, the proposed rule provides that FICUs with total assets of less than $10 million may make charges for loan losses either in accordance with GAAP or with any reasonable reserve methodology (incurred loss) provided it adequately covers known and probable loan losses. This provision would eliminate the adverse PCA consequences for smaller FICUs resulting from CECL, and those FICUs would not be subject to the phase-in procedure detailed in this proposed rule. The Board does note, however, that pursuant to section 202 state-chartered, federally insured credit unions subject to State laws and regulations may be required to comply with GAAP or other accounting standards under applicable State requirements.

IV. Regulatory Procedures

A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities.[39] For purposes of this analysis, the NCUA considers small credit unions to be those having under $100 million in assets.[40] The Board fully considered the potential economic impacts of the proposed phase-in on small credit unions during the development of the proposed rule. For

[39] 5 U.S.C. 603(a).
[40] 80 FR 57512 (Sept. 24, 2015).

example, the proposed rule would, to the extents authorized by statute, completely exempt some of the smallest FICUs (i.e., those with total assets less than $10 million) from the adverse effects of CECL. Accordingly, NCUA certifies that it would not have a significant economic impact on a substantial number of small credit unions.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency by rule creates a new paperwork burden on regulated entities or increases an existing burden. [41] For purposes of the PRA, a paperwork burden may take the form of a reporting, disclosure or recordkeeping requirement, each referred to as an information collection. The proposed changes to part 702 may revise existing information collection requirements to the Call Report. Should changes be made to the Call Report, they will be addressed in a separate *Federal Register* notice. The revisions to the Call Report will be submitted for approval by the Office of Information and Regulatory Affairs at the Office of Management and Budget prior to their effective date.

C. Executive Order 13132, on Federalism

Executive Order 13132[42] encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency, as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles. The proposed rule would not have substantial direct effects on the states, on the relationship between the national government and the states, or on

[41] 44 U.S.C. 3501-3520.
[42] Executive Order 13132 on Federalism, was signed by former President Clinton on August 4, 1999, and subsequently published in the *Federal Register* on August 10, 1999 (64 FR 43255).

the distribution of power and responsibilities among the various levels of government. The Board has therefore determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

D. Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999.[43]

List of Subjects in 12 CFR Part 702

Credit unions, Investments, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board, this 30th day of July, 2020.

Gerard Poliquin
Secretary of the Board

For the reasons discussed above, the NCUA proposes to amend part 702 as follows:

PART 702 – CAPITAL ADEQUACY

[43] Public Law 105–277, 112 Stat. 2681 (1998).

1. The authority citation for part 702 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1790d.

2. Revise § 702.402(d)(1) to read as follows:

§ 702. 402 Full and Fair disclosure of financial condition.

* * * * *

(d) * * *

(1)(i) Federally insured credit unions with total assets of $10 million or greater shall make charges for loan losses in accordance with generally accepted accounting principles (GAAP);

(ii) Federally insured credit unions with total assets of less than $10 million shall make charges for loan losses in accordance either with either:

(A) Any reasonable reserve methodology (incurred loss) provided it adequately covers known and probable loan losses; or

(B) In the case of Federally-insured, State-chartered credit unions, any other applicable standard under State law or regulation;

* * * * *

3. Add subpart G to read as follows:

Subpart G – CECL Transition Provisions

Sec.

702.704 CECL transition provisions.

§ 702.701 Authority, purpose, and scope.

(a) *Authority.* This subpart is issued by the National Credit Union Administration Board pursuant to section 216 of the Federal Credit Union Act, 12 U.S.C. 1790d, as added by section 301 of the Credit Union Membership Access Act, Pub. L. 105-219, 112 Stat. 913 (1998).

(b) *Purpose*. This subpart provides for the phase in of the adverse effects on the regulatory capital of federally insured credit unions that may result from the adoption of the current expected credit losses (CECL) accounting methodology.

(c) *Scope.* The transition provisions of this subpart apply to federally insured credit unions, whether federally or state-chartered, including credit unions defined as “new” pursuant to section 1790d(b)(2) with total assets of at least $10 million.

§ 702.702 Definitions.

In addition to the definitions set forth in § 702.2, the following definitions apply to this subpart:

Current Expected Credit Losses (CECL) means the current expected credit losses methodology under GAAP.

CECL transitional amount means the decrease of a credit union’s retained earnings resulting from its adoption of CECL, as determined pursuant to § 702.703(b).

Transition period means the 12-quarter reporting period beginning with the quarterly Call Report for the quarter ending March 31, 2023 and ending with the quarterly Call Report for the quarter ending December 31, 2025.

§ 702.703 CECL transition provisions.

(a) *Eligibility*— The NCUA shall use the transition provisions of this subpart in determining a credit union's net worth category under this part, as applicable, if:

(1) The credit union has not adopted CECL before December 15, 2022; and

(2) The credit union records a reduction in retained earnings due to the adoption of CECL.

(b) *Determination of CECL transition amount.* (1) For purposes of calculating the first three quarters of the transition period, as described in paragraph (c)(1) of this section, the CECL transitional amount is equal to the difference between the credit union's retained earnings on December 15, 2022, and the credit union's retained earnings on January 1, 2023.

(2) For purposes of calculating the fourth through twelfth quarters of the transition period, as described in paragraphs (c)(2) and (3) of this section, the CECL transitional amount is equal to the difference between the credit union's retained earnings on December 31, 2023, and the credit union's retained earnings on December 30, 2024.

(c) *Calculation of CECL transition provision.* In determining the net worth category of a credit union as provided in paragraph (a) of this section, the NCUA shall:

(1) Increase retained earnings and total assets as reported on the Call Report for purposes of the net worth ratio by 100 percent of its CECL transitional amount during the first three quarters of the transition period (first three reporting quarters of 2023);

(2) Increase retained earnings and total assets as reported on the Call Report for purposes of the net worth ratio by sixty-seven percent of its CECL transitional amount during the second

four quarters of the transition period (fourth reporting quarter of 2023 and first three reporting quarters of 2024); and

(3) Increase retained earnings and total assets as reported on the Call Report for purposes of the net worth ratio by thirty-three percent of its CECL transitional amount during the final four quarters of the transition period (fourth reporting quarter of 2024 and first three reporting quarters of 2025).

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