October 18, 2019

The Honorable Steve Mnuchin
Secretary
U.S. Department of Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220

Dear Secretary Mnuchin:

The Dodd-Frank Wall Street and Consumer Protection Act established the Financial Stability Oversight Council (FSOC) with the intent "to respond to emerging threats to the stability of the U.S. financial system."[1] In order to carry out these duties, FSOC is directed to "provide direction to, and request data and analyses from, the Office of Financial Research to support the work of the Council."[2] In its mission to support FSOC, Dodd-Frank tasks OFR with "collect[ing] and standardiz[ing] data, conduct[ing] applied and long-term research, and develop[ing] new tools to measure and monitor risk."[3] It is due to these specific statutory obligations that we ask you direct the OFR to conduct a study on the Current Expected Credit Loss (CECL) accounting standard.

CECL constitutes the largest change to U.S. GAAP accounting in decades and will undoubtedly have a significant effect on numerous facets of the economy. The Research and Analysis Center within OFR "conducts applied and essential long-term research and analysis to support the stability of the U.S. financial system,"[4] and as such, is perfectly positioned to provide analyses on the potential impacts of this accounting standard. Specific to OFR, CECL will have a direct effect on multiple categories OFR examines in its Financial System Vulnerabilities Monitor (FSVM) including, but not limited to macroeconomic, solvency and leverage, and contagion.

The American Bankers Association[5] and the National Association of Federally-Insured Credit Unions[6] have all collected data from their members estimating the effect of CECL on the balance sheets of financial institutions. All three associations indicate CECL will result in a drastic increase in loss reserves, causing a substantial increase in regulatory capital that will limit lending. The information from these associations should be alarming, particularly when the information from the American Bankers Association includes banks that in aggregate hold more than 10% of loans in the industry. The solvency and leverage category of the OFR's FSVM

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[1] Pub.L. 111-203 § 112
[2] Id.
[3] Id.
[4] Office of Financial Research Annual Report to Congress, 2018. https://www.financialresearch.gov/annual-reports/files/office-of-financial-research-annual-report-2018.pdf
[5] https://www.aba.com/-/media/documents/data/cecl-loss-rate-expectations-may-2019.pdf
[6] https://www.nafcu.org/system/files/files/NAFCU%20CECL%20FAQ_3.pdf

specifically considers capital when determining factors that affect financial stability. Considering CECL has a direct impact on regulatory capital, an examination of any potential change in regulatory capital as a result of CECL falls squarely into the OFR's analyses of financial stability.

In addition, a 2018 study found "CECL would have been highly procyclical had it been in place during the past crisis, amplifying the contraction in bank lending and the severity of the crisis."[7] The potential procyclicality of CECL should be specifically concerning for FSOC and its members. Similar to past accounting standards, i.e. mark-to-market, CECL has the potential to deepen and lengthen any future economic downturn by restricting lending to both consumers and businesses. The macroeconomic effects of a lengthened recession coupled with a notable decrease in lending are wide ranging, and therefore warrant examination by OFR. It is vital OFR examine the procyclical and macroeconomic affects of CECL because to date, no federal agency has conducted a macroeconomic study examining these effects.

The impact of CECL is seen far beyond traditional depository institutions. Credit card companies, Federal Home Loan Banks, insurance companies, Fannie Mae and Freddie Mac, Sallie Mae, and auto lenders have also expressed significant concern with the proposed standard. CECL applies to any institution following U.S. GAAP, and poses a unique contagion risk that must be examined. This risk is heightened when combined with the assertion that CECL is inherently procyclical during times of economic stress. Once again, this information is more pertinent as FASB did not conduct a quantitative impact study examining the organizations that would be affected and the impact the standard would have on these organizations.

Not only will CECL affect many of the financial stability factors OFR considers, but on December 19, 2018 FSOC met to discuss CECL, and particularly highlighted how "market participants had raised concerns regarding CECL's procyclicality and effects on loan terms and structures."[8] In addition, the Council discussed "whether CECL could be procyclical, could lead to double-counting of credit losses, and reflects how firms conduct their businesses."[9] Clearly the members of FSOC have voiced concerns regarding the affects of CECL in the past, and should require additional analyses on the issue.

Given the above factors, we request FSOC require OFR to conduct a study on the impacts of CECL on financial stability. When conducting the study, OFR should use all data and analyses tools available, in addition to its statutory authority to "require the submission of periodic and other reports from any nonbank financial company or bank holding company for the purpose of assessing the extent to which a financial activity… poses a threat to the financial stability of the United States."[10] In particular, OFR should examine the following:

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[7] Covas, Francisco and William Nelson. "Current Expected Credit Loss: Lessons from 2007- 2009." (2018) Bank Policy Institute Working Paper. Available at: https://bpi.com/wpcontent/uploads/2018/07/CECL_WP-2.pdf

[8] Minutes of the Financial Stability Oversight Council, December 19, 2018. https://home.treasury.gov/system/files/261/December192018_minutes.pdf

[9] Id.

[10] Pub.L. 111-203 § 112

1. The pro-cyclical nature of CECL, and its impacts on macroeconomic factors, particularly access to credit, market volatility, and its effects in an economic downturn.

2. The impact of CECL on the solvency and leverage of financial institutions, with focus on the impact on loss reserves and regulatory capital. OFR should also examine these consequences in both benign and stressed times.

3. Potential impacts of procyclicality to the various institutions complying with CECL. OFR should focus on the contagion risk CECL could represent during times of economic stress.

4. Any other ramifications CECL could have on financial stability.

FSOC was established to protect the financial system of the United States and OFR conducts the essential analyses and research necessary for FSOC to accomplish its statutory goal. Numerous industries and organizations have voiced concern over the impact CECL will have, not only on businesses, but on the individuals and families they serve. These wide-ranging effects have certainly reached a point where more information is needed to understand any potential negative impact CECL could have. We respectfully request that FSOC, or any of its members, direct the OFR to conduct a study on the impacts CECL will have on financial stability.

Sincerely,

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