

June 2021

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

RIN 3133-AF03

Transition to the Current Expected Credit Loss Methodology

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: This final rule facilitates the transition of federally insured credit unions (FICUs) to the current expected credit loss (CECL) methodology required under Generally Accepted Accounting Principles (GAAP). The final rule provides that, for purposes of determining a 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 adoption of CECL. Consistent with regulations issued by the other federal banking agencies, the final rule will 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 final rule also provides that FICUs with less than \$10 million in assets are no longer required to determine their charges for loan losses in accordance with GAAP. These FICUs may instead use any reasonable reserve methodology (incurred loss), provided that it adequately covers known

and probable loan losses. The final rule follows publication of an August 19, 2020, proposed rule and takes into consideration the public comments received on the proposed rule.

DATES: *Effective Date:* [**Insert date 30 days after date of publication in the FEDERAL REGISTER.**]

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I. **This Final Rule**

On July 30, 2020, the NCUA Board (Board) proposed amending the agency's regulations to facilitate the adoption by FICUs of the CECL accounting methodology as mandated by GAAP. The proposed rule was subsequently published in the *Federal Register* on

August 19, 2020.¹ This final rule follows publication of the August 19, 2020, proposed rule and takes into consideration the public comments received on the proposal. Following consideration of the comments, the Board has decided to make the following changes to the proposed rule:

1. The Board has made a technical change to the regulatory text for purposes of clarity. The Board has removed the references to specific calendar dates in the discussion of the transition period for the phase-in. The regulatory text now consistently refers to fiscal years.
2. The final rule also clarifies that state-chartered FICUs with less than \$10 million in assets and that are required by state law to comply with GAAP are eligible for the transition phase-in.

Section IV. of this preamble summarizes the significant issues raised by the public commenters on the proposed rule, as well as the Board's responses to these issues, including the Board's rationale for making the change listed above.

II. Background

A. CECL Accounting Methodology

The CECL standard applies to all banks, savings associations, credit unions,² 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.

¹ 85 FR 50964 (Aug. 19, 2020). The proposed rule is available from the *Federal Register* website at: <https://www.govinfo.gov/content/pkg/FR-2020-08-19/pdf/2020-16987.pdf>

² 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.

The Federal Accounting Standards Board (FASB), which establishes the GAAP standards, provided 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 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) was 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, 2022.³ 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.⁴

CECL differs from the incurred loss methodology currently used by FICUs in several key respects. Most significantly for purposes of this rulemaking, CECL requires the recognition of lifetime expected credit losses for financial assets measured at amortized cost, not just those

³ 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).

⁴ FASB ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments*, June 2016, page 5. FASB ASU No. 2016-13 is available at: https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168232528. 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.

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.⁵

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

B. The Board’s August 19, 2020, Proposed Rule

⁵ 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>

The Board issued the August 19, 2020, proposed rule to mitigate the adverse effects on a FICU's PCA classification that may result from the day-one adjustment. Specifically, the proposed rule provides 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 proposed phase-in is consistent with the similar three-year phase-in provided by the other banking agencies to alleviate the impacts of adopting CECL on the banking organization subject to their supervision.⁶

Under the proposed rule, the phase-in would only be applied to those FICUs that adopt the CECL methodology for fiscal years beginning 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 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

⁶ See the February 14, 2019, proposed rule published by the Office of Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation, at 84 FR 4222 (February 14, 2019), and modified by interim-final rule published on March 31, 2020, at 62 FR 17723 (March 31, 2020).

Board's regulations would allow these FICUs to instead make charges for loan losses in accordance with any reasonable reserve methodology (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.

Interested readers should refer to the preamble of the Board's August 19, 2020, proposed rule for additional background information regarding the proposed regulatory changes.

III. Legal Authority

A. The Board's Rulemaking Authority, Generally.

The Board is issuing this final rule pursuant to its authority under the Federal Credit Union (FCU) Act.⁷ 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.⁸ Other provisions of the FCU Act, confer specific rulemaking authority to address prescribed issues or circumstances. For example, section 216 of the FCU Act directs the Board to establish by regulation a system of PCA to restore the net worth of FICUs.⁹ This final rule is being issued under both the general rulemaking authority conferred by

⁷ 12 U.S.C. 1751 *et seq.*

⁸ 12 U.S.C. 1766(a).

⁹ 12 U.S.C. 1790d. 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.

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 of the FCU Act 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 (FDI) Act.¹⁰ In addition, section 216 of the FCU Act 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.”¹¹ In accordance with the consultation requirements, the NCUA, at the proposed rule stage, briefed relevant staff of the other banking agencies of the contents and purposes of this rulemaking.

With regards to the other factor identified in the quoted statutory language, the February 14, 2019, final rule does not directly raise or lower the leverage limit,¹² 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. Accordingly, the NCUA has determined that both

¹⁰ 12 U.S.C. 1790d(c)(2)(A).

¹¹ 12 U.S.C. 1790d(c)(2)(B).

¹² 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).

conditions set forth in section 216 have been satisfied for purposes of issuing this proposed rule.¹³

The effects of the proposed phase-in on a FICU's net worth calculations are consistent with section 216 of the FCU Act and closely modeled on the CECL transition provisions issued by the other banking agencies. Specifically, the final rule is narrowly tailored to temporarily mitigating the impacts of CECL adoption on the PCA classification of a FICU's net worth. This final rule does not adjust the numeric net worth ratios under the NCUA's PCA system. Further, the rule does not revise the definition of net worth, and FICUs will continue to calculate their net worth and net worth ratios in accordance with existing statutory and regulatory requirements. The sole purpose of the phase-in is to aid FICUs in adjusting to the new GAAP standards in a uniform manner and without disrupting their ability to serve their members.

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.¹⁴ As an alternative to the phase-in that would be provided by this final rule,

¹³ 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.

¹⁴ 12 CFR 702.2(k).

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 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.

C. 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.¹⁵ 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.”¹⁶

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. 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

¹⁵ 12 U.S.C. 1782(b)(6)(C)(i).

¹⁶ 12 U.S.C. 1782(b)(6)(C)(iii).

CECL. Accordingly, smaller FICUs that elect to use a non-GAAP measure are not eligible for the phase-in.

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.

IV. Discussion of the Public Comments on the August 19, 2020, Proposed Rule

A. The Comments, Generally

The public comment period on the proposed rule closed on October 19, 2020. The NCUA received 18 public comments on the proposal. Comments were received from individual FICUs, as well as from national, state, and regional organizations representing FICUs.

Thirteen of the commenters objected to FASB's application of CECL to FICUs, largely due to the anticipated negative impact of the day-one adjustment. The commenters wrote that FICUs building reserves to meet the CECL benchmark will be diverting funds that could otherwise be used to provide credit to members and communities during the ongoing COVID-19 event. They urged the NCUA to continue exploring all avenues, including working with FASB, to exempt FICUs from the CECL requirements.

While believing CECL should not apply to FICUs at all, the commenters unanimously supported the proposed rule. The commenters commended the Board's efforts to assist FICUs with the transition to the CECL methodology. Several of these commenters, however, also offered suggested changes to the proposed rule.

NCUA Response: The Board appreciates the support expressed by the commenters, as well as the specific questions and concerns raised in their individual comments. The Board has addressed these specific comments below. The Board reiterates its belief that, given the unique characteristics of the credit union industry, the CECL accounting standards should not apply to FICUs. The Board will continue to work with FASB, the other banking agencies, and appropriate stakeholders to exempt FICU from these standards.

B. Comments Regarding Transition Phase-In

Comment: Mandatory opt-in for transition phase-in. Under the proposed rule, FICUs would not have the option of electing whether to opt into (or out of) the transition provisions. Several commenters urged the NCUA to reconsider this automatic approach and provide a FICU with the ability to opt into or out of the transition provisions based on its financial condition. The commenters wrote that, for strategic reasons, some FICUs may wish to recognize the full cost and adverse effect on their capital of CECL in one year rather than phasing in the adverse effects over a prolonged period. The commenters wrote that if the NCUA decides it must determine eligibility, the agency should expand the factors upon which the determination is made beyond a reduction in earnings caused by the application of CECL. For example, the NCUA might consider additional factors, such as asset quality and overall risk in the loan portfolio, current financial condition of the credit union, and the current state of the economy at the time of

the determination. Alternatively, the NCUA could limit the mandatory opt-in for FICUs with a lower CAMEL rating.

NCUA Response: The Board has declined to adopt these comments. As the commenters note, it is true that some FICUs will have a business rationale for recognizing the day-one effects of CECL on their capital ratios. This final rule does not compel any FICU to make use of the transition phase-in. A FICU that determines adoption of CECL is in its best interests has the option to do so, and is free to make this decision at any time until the effective date established by FASB for CECL implementation (fiscal years beginning after December 15, 2022). The Board continues to believe, however, that requiring an affirmative opt-in from the majority of FICUs that require the phase-in would constitute an unnecessary administrative exercise. 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.

Comment: Option for longer phase-in. Two commenters suggested that the NCUA consider granting longer phase-in requests when a FICU's projected capital level after three years is expected to remain below normal. According to the commenters, such flexibility would allow FICUs to focus on restoring capital levels during an appropriately tailored phase-in timeframe rather than bracing for adverse supervisory consequences or the administrative burden of heightened examiner scrutiny.

NCUA Response: The Board believes that the three-year period will suffice to alleviate the most detrimental impacts on a FICU's capital ratios resulting from adoption of CECL. Further, and as noted above, the Board is promulgating this rule pursuant to the legal authority conferred by section 216 of the FCU Act. In general, section 216 charges the NCUA with

establishing PCA regulations that are “comparable” to section 38 of the FDI Act—the statute that applies PCA to other federally insured depository institutions.¹⁷ More specifically with regards to this rulemaking, section 216 authorizes the Board to “correspondingly” revise its regulations in response to changes made by the other banking agencies to the leverage limit under section 38 of the FDI Act.¹⁸ In accordance with these statutory directives, the phase-in provided by this final rule is modelled on the transition provisions adopted by the other banking agencies, and provides a similar three- year phase-in period.¹⁹ The Board therefore declines to make the suggested change in order to maintain consistency with the CECL transition provisions issued by the other banking agencies.

1. *Comment: Redefining “total assets” in the net worth calculation.* Related to the preceding comment, one commenter noted the preamble language stating that “[a]s an alternative to the to the phase-in ... 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.”²⁰ The commenter wrote that, while the NCUA’s reliance on the authority provided by section 216 of the FCU Act is understandable from an administrative standpoint, the agency should consider issuing using the alternative “total assets” framework to grant FICUs more options, such as the ability to choose a longer phase-in period.

¹⁷ 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. No. 102–242, 105 Stat. 2236 (1991).

¹⁸ *Supra*, note 10.

¹⁹ *Supra*, note 6.

²⁰ *Supra* note 1 at 50966–50967.

NCUA Response: The commenter is correct that the Board, in large measure, opted for the phase-in due to its ease of administration. Ensuring the administrative simplicity of its regulations is a significant consideration for the Board, especially during this pandemic period and the resulting economic fallout. Ease of administration, however, was only one of several considerations that factored into the Board’s decision. In making note of the statutory authority to re-define “total assets” in the preamble to the August 19, 2020, proposed rule, the Board simply wished to acknowledge the existence of an alternative legal basis for this rulemaking. A rule implementing this alternate statutory authority would have almost surely been more time-consuming and complex than the phase-in. The re-definition of “total assets” might have possible effects beyond CECL implementation to include the NCUA’s PCA system as a whole. Moreover, and as noted previously, the NCUA is statutorily charged to maintain PCA regulations that are “comparable” with section 38 of the FDI Act. A change to the definition of “total assets” would require careful analysis to ensure compliance with the statutory comparability requirement. Given these considerations, the Board continues to believe that a phase-in issued on the authority provided by section 216 of the FCU Act is the most effective, administratively simple, and quickest manner to mitigate the day-one impacts of CECL implementation on FICUs.

Comment: Non-calendar fiscal years. One commenter objected that the proposed regulatory text measures the phase-in benefit by calendar dates and fails to account for FICUs that have non-calendar fiscal years. Specifically, the commenter wrote that the regulatory text refers to specific calendar date in the provisions for measuring the CECL transition amount. The commenter wrote that the calendar dates fail to capture the impact for FICUs with non-calendar

fiscal years. The commenter wrote that this is inconsistent with the preamble, which references a credit union's fiscal year and, in Section III.E., refers to a hypothetical FICU with a calendar fiscal year, impliedly acknowledging that FICUs may have a fiscal year other than a calendar fiscal year.²¹ The commenter also noted that the regulation issued by the other banking agencies defines the CECL transition amount based on the regulated entity's fiscal year without referencing specific dates.²² The commenter suggested that to remedy this problem, the NCUA should follow the approach of the other banking agencies and define the CECL transitional amount by reference to a credit union's fiscal year rather than set calendar dates.

NCUA Response: As the commenter notes, the preamble to the proposed rule correctly provides that the transition period is based on the credit union's fiscal year (which may be a non-calendar year in the case of state-chartered credit unions) and not on specific dates. The commenter notes preamble language referencing the possibility of a non-calendar year fiscal year. Another example is the preamble language providing that "[t]he 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" (emphasis added).²³ The Board agrees that the references to specific dates were potentially confusing. The Board has therefore removed the references to specific calendar dates, and the regulatory text now consistently refers to fiscal years.

²¹ *Id.* at 50968.

²² 12 CFR 3.301(b)(2).

²³ *Supra* note 1, at 50967.

Comment: Calculation of transitional amount. One commenter noted that proposed § 702.703(b)(2) defines the transition amount for the fourth through twelfth quarters as the difference between a FICU's retained earnings on December 31, 2023 and December 30, 2024. The commenter wrote that the NCUA may have intended to refer to years 2022 and 2023 in this provision, since this measurement of the CECL transitional amount applies to Call Reports filed beginning on the first day in 2024, and it does not seem feasible to calculate the amount by reference to a figure that cannot be determined until the last day in 2024.

NCUA Response: As noted in the preceding response, the NCUA has removed the references to specific calendar dates in the regulatory text. For purposes of calculating the fourth through twelfth quarters of the transition period, the regulatory text now provides that the CECL transitional amount is equal to the difference between the credit union's retained earnings as of the end of the fiscal year in which the credit union adopts CECL and the credit union's retained earnings as of the beginning of its next fiscal year.

Comment: Examinations and stress testing. Several comments, while generally supportive of the proposed rule, had questions regarding the NCUA examination and stress testing protocols resulting from its implementation. One of these commenters suggested that the NCUA should consider implementing streamlined procedures for evaluating capital plans (including net worth restoration plans) when a FICU is expected to encounter capital stresses related to CECL adoption that persist after any applicable phase-in period. Another commenter warned that incorporating CECL into the stress testing regimen will increase capital volatility within the modelling and complicate stress testing estimations. The commenter urged the NCUA

to continue discussions with covered FICUs and state regulators to ensure the regulatory stress testing framework can incorporate CECL when appropriate.

NCUA Response: The NCUA will monitor and periodically assess the efficacy of the CECL transition phase-in provisions. The Board will take these comments regarding capital plans and stress testing under advisement and, should it be deemed necessary, issue supplemental guidance or implement revised procedures to assist FICUs in their implementation of the rule.

Comment: Need for Call Report guidance. One of the commenters requested clarification on how the phased-in retained earnings would be reported on a FICU's Call Report. For example, the commenter asked whether the Call Report will reflect the phase-in adjustment through the addition of a new field.

NCUA Response: The Board notes that a new field has been provided in the Call Report for purposes of the phase-in. The NCUA will issue additional guidance and Call Report revisions as deemed necessary to assist FICUs in implementing this final rule.

C. Comments Regarding GAAP Exemption for Small FICUs

Comment: Future ability to phase-in CECL. Five commenters encouraged the NCUA to authorize a FICU accumulating \$10 million, or greater, in assets after CECL has been implemented to phase-in the day-one negative impact. These commenters wrote that the one-time adjustment will be equally injurious to FICUs adopting CECL in the future and compensating for that is as important as doing so now.

NCUA Response: The Board has not revised the rule in response to these commenters. The final 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. Unlike FICUs that already (or soon will) exceed the \$10 million asset threshold for GAAP compliance, other FICUs will have more time and be better positioned to adjust their asset growth. The Board expects that smaller FICUs will undertake the necessary analysis to determine the possible impact of coming into GAAP compliance in developing their business plans. As a result, the Board does not believe that the phase-in is necessary or appropriate for such FICUs.

Comment: Transition phase-in for small federally insured state-chartered credit unions subject to GAAP. As provided in the preamble to the proposed rule, the exemption from the GAAP standards does not extend to smaller State-chartered FICUS that are required to comply with GAAP under State law.²⁴ One commenter inquired about the ability of these state-chartered FICUs to use the transition phase-in. The commenter noted that the regulatory text does not specify if these credit union are eligible for the transition provision. The commenter recommended the NCUA's final rule should make the proposed three-year phase-in available to FICUs that must follow GAAP, regardless of the size of the FICU.

NCUA Response: The transition provisions were designed to apply to all FICUs that adopt CECL, irrespective of their asset size. As the preamble to the proposed rule makes clear, the only FICUs "not eligible for the phase in" are "smaller FICUs that elect to use a non-GAAP measure."²⁵ State-chartered FICUs that are required by state law to follow GAAP are prohibited from making such election. Accordingly, the Board intended them to be eligible for the

²⁴ *Id.*

²⁵ *Id.*

transition relief provided by this rulemaking. The Board has revised the regulatory text to clarify the eligibility of these credit unions. The final rule clarifies that state-chartered FICUs with less than \$10 million in assets and that are required by state law to comply with GAAP are eligible for the transition phase-in.

Alternative GAAP structure for FICUs. The preamble to the proposed rule notes that “section 202 of the FCU Act could also potentially, as an alternative to the provisions [of the proposed rule], authorize the Board to provide a transition of the day-one effects of CECL implementation.”²⁶ This provision authorizes the Board to prescribe an alternative accounting principle to GAAP, so long as it is “no less stringent” than the GAAP principle it replaces.²⁷

Four commenters wrote that the NCUA should consider the question of what constitutes an accounting standard that “is no less stringent” than GAAP for the purpose of expanding the scope of CECL relief. In doing so, commenters suggested that the NCUA might explore the possibility of a revised incurred loss methodology that allows more flexible evaluation of qualitative and environmental factors. The commenters also suggested that the NCUA should work directly with the FASB to advance an interpretation of the “no less stringent” requirement that recognizes the unique burden that CECL poses for FICUs. One of these commenters wrote that the NCUA should request that FASB recognize the incurred loss methodology as an appropriate alternative accounting principle under section 202 of the FCU Act.

NCUA Response: The development of an alternate set of accounting standards that are “no less stringent” than GAAP would be a complex and time-consuming endeavor necessitating

²⁶ *Id.*

²⁷ 12 U.S.C. 1782(b)(6)(C)(ii).

consultations with FASB and other stakeholders. At this time, the Board believes that GAAP compliance is the most effective way to help ensure that financial reporting is transparent and consistent between FICUs. The Board, however, will continue to explore ways to alleviate the compliance burdens imposed by GAAP. As noted, the Board is committed to working with FASB, the other banking agencies, and appropriate stakeholders on a possible exemption for FICUs from the CECL accounting standards.

Comment: Transition phase-in for small federally insured state-chartered credit unions subject to GAAP. As provided in the preamble to the proposed rule, the exemption from the GAAP standards does not extend to smaller state-chartered FICUS that are required to comply with GAAP under state law.²⁸ One commenter inquired about the ability of these state-chartered FICUs to use the transition phase-in. The commenter noted that the regulatory text does not specify if these credit union are eligible for the transition provision. The commenter recommended the NCUA’s final rule should make the proposed three-year phase-in available to FICUs that must follow GAAP, regardless of the size of the FICU.

NCUA Response: The transition provisions were designed to apply to all FICUs that adopt CECL, irrespective of their asset size. As the preamble to the proposed rule makes clear, the only FICUs “not eligible for the phase in” are “smaller FICUs that elect to use a non-GAAP measure.”²⁹ State-chartered FICUs that are required by state law to follow GAAP are prohibited from making such election. Accordingly, the Board intended them to be eligible for the transition relief provided by this rulemaking. The Board has revised the regulatory text to clarify the eligibility of these credit unions. The final rule clarifies that state-chartered FICUs with less

²⁸ *Id.*

²⁹ *Id.*

than \$10 million in assets and that are required by state law to comply with GAAP are eligible for the transition phase-in.

Comment: GAAP relief for federally insured state-chartered credit unions. As noted above, the preamble to the proposed rule provides that state-chartered FICUs subject to state laws and regulations may be required to comply with GAAP or other accounting standards under applicable state requirements.³⁰ One commenter wrote that approximately half the states either have explicit statutory or regulatory requirements for all FISCUs to comply with GAAP, or it is unclear whether such an express requirement exists. Two commenters suggested that the NCUA should work with the appropriate supervisory authorities to promote regulatory relief in states where the impediments are regulatory in nature. For those states with statutory mandates regarding GAAP adherence, the commenter asked that the NCUA pursue potential legislative fixes and to notify state legislative leaders of the exemption and the advantage federal credit unions would have over similarly sized FISCUs if not provided legislative relief.

NCUA Response: The Board will continue to work with FASB and other stakeholders, including appropriate State regulators, to minimize the detrimental impacts of GAAP compliance on FICUs. The Board also notes that, as discussed in the preceding comment response, state-chartered FICUs with less than \$10 million in assets and that are required by state law to comply with GAAP are eligible for the transition phase-in.

V. Description of Final Rule

A. New Subpart G to Part 702

³⁰ *Supra* note 1, at 50965.

The final rule adds a new subpart G to the PCA regulations in 12 CFR part 702, captioned “CECL Transition Provisions.” New subpart G applies to FICUs that meet the eligibility criteria specified in the final rule. Notwithstanding the CECL transition provisions, all other aspects of part 702 would continue to apply.

B. Eligibility for Transition Provisions

FICUs that have not adopted CECL prior to their first fiscal year beginning after December 15, 2022 (the 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. 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 will 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.

The NCUA will 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 will 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 reporting quarters of the fiscal year in which the FICU adopts CECL. The FICU may use this period to build capital and to make resulting material adjustments to its CECL transitional amount. The NCUA will base its subsequent calculations regarding the phase-in based on the CECL transitional amount reported by the FICU as of the fourth reporting quarter of the fiscal year in which the FICU adopts CECL, and further adjustments to the amount are not permitted.

Beginning with the fourth reporting quarter of the fiscal year in which the FICU adopts CECL, the NCUA will deem retained earnings and total assets to be increased by 67 percent of the FICU's CECL transitional amount. This percentage will be decreased to 33 percent beginning with the fourth quarterly Call Report of the following fiscal year (the eighth reporting quarter of the FICU's CECL implementation). Commencing with the twelfth reporting quarter of the FICU's CECL implementation, 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 ($\$200,000 \times 67$ 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 ($\$200,000 \times 33$ 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 (Calendar Fiscal Year)

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% (4 th quarter of 2023 and first three quarters of 2024)	Four quarters at 33% (4 th quarter of 2024 and first three quarters of 2025)	Full Recognition of Day-One Adjustment (commencing 4 th 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 of the FCU Act 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).”³¹ The limitation is not applicable to this final 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.

³¹ 12 U.S.C. 1790d(c)(2)(A).

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

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 final 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 will eliminate the adverse PCA consequences for smaller FICUs resulting from CECL, and these FICUs will not be subject to the phase-in procedure detailed above.

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. These credit unions are eligible for the phase-in.

VI. Department of the Treasury Report

The Senate Committee Report to the Financial Services and General Government Appropriations Act, 2020³², 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.”³³ The Department of the Treasury issued its report on September 15, 2020.³⁴

While the report affirms the Department of the Treasury’s support for the goals of CECL, it also acknowledged that a “definitive assessment of the impact of CECL on regulatory capital is not currently feasible, in light of the state of CECL implementation across financial institutions and current market dynamics.”³⁵ Accordingly, the report provides that the Department of the Treasury “will continue to actively monitor CECL implementation and consult with relevant stakeholders, including the prudential regulators, FASB, and the SEC.”³⁶ Among other recommendations, the report suggests that the prudential regulators “monitor the use and impact

³² Division C of the Consolidated Appropriations Act, 2020; Public Law 116-93, approved December 20, 2019.

³³ Senate Report 116-111, at page 11.

³⁴ U.S. Department of the Treasury, “*The Current Expected Credit Loss Accounting Standard and Financial Institution Regulatory Capital*” (2020). The report is available at: <https://home.treasury.gov/system/files/216/The-CECL-Accounting-Standard-and-Financial-Institution-Regulatory-Capital-Study-9-15-20.pdf>

³⁵ *Id.*, at page 5.

³⁶ *Id.*

of transitional relief granted, and extend or amend the relief, as necessary.”³⁷ Further, the report provides that “FASB, together with the prudential regulators, should examine the application of CECL to smaller lenders.” The report highlights FICUs and community banks in this regard, noting that the NCUA and the FDIC have separately asked for relief from FASB.³⁸

This final rule is consistent with the Department of the Treasury’s report, particularly with respect to the recommendation regarding transitional relief. The Board will continue to assess the impacts of CECL on regulatory capital and will consider these—and any other future recommendations made by the Department of the Treasury—in taking further action to address the impacts of CECL implementation on the credit union industry.

VII. 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 final rule. For example, the 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.

³⁷ *Id.*

³⁸ *Id.*, at pages 28-29.

³⁹ 5 U.S.C. 603(a).

⁴⁰ 80 FR 57512 (Sept. 24, 2015).

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 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 13132⁴² 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 final rule would not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The Board

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).

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 final rule will 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 18th day of February 2021.

Melane Conyers-Ausbrooks
Secretary of the Board

For the reasons discussed above, the NCUA amends part 702 as follows:

PART 702 – CAPITAL ADEQUACY

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

Authority: 12 U.S.C. 1766(a), 1784(a), 1786(e), 1790d.

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

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.

702.701 Authority, purpose, and scope.

702.702 Definitions.

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. No. 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.* (1) 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) that make charges for loan losses in accordance with:

(i) Generally accepted accounting principles (GAAP) under § 702.402(d)(1)(i); or

(ii) In the case of Federally-insured, State-chartered credit unions, any other applicable standard under State law or regulation under § 702.402(d)(1)(ii)(B).

(2) The transition provisions of this subpart do not apply to Federally-insured credit unions, whether Federally or State-chartered, including credit unions defined as “new” pursuant to section 1790d(b)(2), that make charges for loan losses using a reasonable reserve methodology under § 702.402(d)(1)(ii)(A).

§ 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 the first day of the fiscal year in which the credit union adopts CECL.

§ 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 its first fiscal year beginning after 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 as of the beginning of the fiscal year in which the credit union adopts CECL and the credit union's retained earnings as of the closing of the fiscal year immediately prior to the credit union's adoption of CECL.

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

year in which the credit union adopts CECL and the credit union's retained earnings as of the beginning of its next fiscal year.

(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 the fiscal year in which the credit union adopts CECL);

(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 the fiscal year in which the credit union adopts CECL and first three reporting quarters of the next fiscal year); 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.