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Disclosure of CECL's Impact on Publicly Traded Financial Institutions

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In June 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326)*, requiring organizations to measure current expected credit losses (CECL) for financial instruments based on historical experience, current conditions, and reasonable and supportable forecasts. When implemented, the new accounting standard will replace the current "incurred loss" impairment approach. The new standard requires an estimate of expected credit losses over the life of the portfolio to be effectively recorded upon origination. Implementation of this new standard is almost certain to require earlier recognition of credit losses by most banks as well as an increase in credit loss allowances and reduce retained earnings and tier 1 capital. In December 2018, the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency adopted a joint final rule revising regulatory capital rules to address the implementation of CECL. The final rule makes a number of changes to the regulatory capital rules in order to reflect revised credit loss standards. For most banks, however, the rule's most important feature will be its optional three-year phase-in period for the recognition of CECL's expected adverse effects on regulatory capital. For financial institutions registered with the US Securities and Exchange Commission (SEC), the CECL accounting standard will become effective for fiscal years beginning after December 15, 2019, which means beginning with the first quarter of 2020. As a result, such companies will need to reflect their CECL calculations in their SEC and bank regulatory filings for the quarter ending March 31, 2020, and they are required under the final rule to choose, no later than the end of that quarter, whether or not to elect the phase-in of CECL's effect on regulatory capital. It should be noted, however, that the SEC generally requires its registered companies to make disclosure of the expected date of adoption of a new accounting standard, such as CECL, and the impact the new standard will have on the company, if the impact is known and can be reasonably estimated. Thus, the issue for an SEC-registered financial institution becomes whether CECL is a material matter requiring disclosure in the company's periodic reports filed with the SEC under the Securities Exchange Act of 1934.

To gauge the industry's reaction to the materiality of CECL from an SEC disclosure perspective, we recently reviewed the periodic filings of several SEC-registered bank holding companies to see how they are handling disclosure of CECL's expected impact. None of the companies we reviewed had elected to adopt CECL prior to the effective date for implementation, but many indicated that they were already undertaking significant compliance efforts in preparation for its implementation. We found that disclosures relating to CECL generally were made in two places within the annual report on Form 10-K—the risk factor section and the notes to the financial statements. The disclosure made in the risk factor section of the Form 10-K generally warned that these changes in financial accounting and reporting standards could materially impact the company's financial condition and results of operations and/or materially increase the allowance for loan losses. In the notes to financial statements, most companies included a summary of CECL requirements related to the calculation of the allowance for credit losses and indicated that the company is currently evaluating the impact of CECL on the financial statements. Many companies also indicated that they have hired consultants or formed steering committees to assist them with implementation of the new accounting standard.

Many publicly reporting financial institutions have determined that the implementation of new CECL accounting and reporting standards is likely to have a material impact on their companies. The impact of the CECL standard appears to be greater on smaller community banks due to the increased compliance costs incurred in preparing for the implementation of the CECL standard next year. As CECL appears to be material to all financial institutions, those public financial institutions that have not already done so should consider disclosing the impact of CECL in their next periodic filing with the SEC.

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