

US Eases Impact of Accounting Rules for Borrowers Affected by COVID-19

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Original post [here](#).

On March 27, the US acted to delay the implementation of a new accounting rule to ease its impact on banks whose borrowers have been affected by COVID-19.

The new accounting standard, known as “current expected credit losses” (CECL), had been set to take effect this year for the largest US banks and over the next two years for other banks. It requires banks to provision for all “expected” losses over the life of a loan. The previous “incurred loss” standard, which is still in place as banks transition to the new standard, requires them to recognize losses only when they become “probable.”

In an [interim final rule](#), US bank regulators on March 27 gave banks the option to delay the estimated effect of CECL on their regulatory capital, relative to the effect of the incurred-loss method, by up to two years. As in an earlier 2019 [rule](#), banks will be allowed a three-year transition period, so the new rule gives them five years to fully implement CECL. Banks that have already adopted CECL can continue with the three-year transition provided by the 2019 rule, or they can change to the longer five-year option announced on March 27.

Also, in the [CARES Act](#), Congress on March 27 offered optional temporary relief from the CECL standard. Banks, other insured depository institutions, and their affiliates will not have to comply with CECL until the national emergency is over or until December 31, 2020, whichever comes first.

US regulators clarified in a [March 31 statement](#) that banks may avail themselves of both the short-term statutory relief provided by the CARES Act and the longer-term regulatory relief contained in the interim final rule. However, the time period of these relief provisions will overlap and not be additive, as the five-year transition option in regulators’ interim final rule still begins January 1, 2020, for the largest US banks.

CECL is similar to the IFRS 9 international accounting standard, which regulators in most of the world outside the US have implemented. IFRS 9 requires banks to set aside loan loss allowances against all future expected losses for loans to borrowers who are categorized in high-risk groups. Several countries have asked banks to be flexible in applying IFRS 9 in the current crisis. On March 20, the Bank of England and the European Central Bank [said](#) banks should take into account government relief measures in evaluating borrowers and calculating expected losses on their loans.

Accounting standard-setters developed both CECL and IFRS 9 in response to the perceived shortcomings in the incurred-loss method that they had required banks to use in the years before the global financial crisis of 2007-09.

As banks and other financial institutions suffered steep credit losses during the global financial crisis, these institutions as well as users of their financial statements expressed concern that the incurred-loss standard limited a financial institution’s ability to record credit losses that were expected, but not yet probable. (See the YPFS [case study](#) on the Irish experience with the incurred-loss standard and its transition to the new expected-loss standard).

In the US, the Financial Accounting Standards Board introduced CECL in 2016 in [Accounting Standards Update 2016-13](#) (ASU 2016-13). Under the rule, an entity must estimate lifetime expected credit losses for all of its loans, leases, debt securities, trade receivables, and other financial assets that are measured at amortized cost (as opposed to fair value). Estimated losses are based on past events, current conditions, and reasonable and supportable forecasts of future collections. For public business entities that file with the US Securities and Exchange Commission, ASU 2016-13 is effective for fiscal years beginning after December 15, 2019 (that is, in most cases, starting January 1, 2020).

US bank regulators incorporated ASU 2016-13 into US banking regulations in a [2019 joint rule](#). Since banks only recognized probable losses under the old rules but are required to recognize probable and expected losses under the new rules, regulators have [noted](#) that “various analyses suggest that credit losses under CECL can be expected to be higher than under the incurred loss methodology.” For this reason, the 2019 rule included a transition option allowing banks to phase in the effects of CECL on regulatory capital ratios over three years.