ANB Bank

December 11, 2019

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Proposed Interagency Policy Statement on Allowances for Credit Losses

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the proposed Interagency Policy Statement on Allowances for Credit Losses (the "Proposal"). We are leaders of ANB Bank, a $2.6 billion family, and employee, owned community bank serving Colorado, Wyoming and Kansas.

We respond primarily to Questions 1 and 4 in the Request for Comment. Those are:

> *Q1. "Does [the Proposal] clearly describe the measurement of expected credit loss under CECL in accord with Topic 326?"; and*
>
> *Q4. "Has [the Proposal] appropriately included concepts and practices detailed in the existing ALLL policy statements that also are relevant under FASB ASC Topic 326? If not, what additional information should also be included?"*

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We recommend improvements in four specific areas: 1) collateral-dependent loans; 2) recoveries; 3) qualitative factor adjustments and 4) transition matters. Finally, we also provide some concluding observations.

1. Collateral-Dependent Loans

a. Definition of Collateral-Dependent

Topic 326 changes the definition of a collateral-dependent loan[1], from repayment being expected "solely" through operation/sale of the collateral to "substantially", which is a lower but undefined threshold.[2] The Proposal adopts the Topic's change from "solely" to "substantially".[3]

Our concern is that the Proposal provides no clarity on the key term of "substantially".

We recommend that the Proposal either:

- clearly describe the term "substantially" as the minimum share of repayment that must be expected to be coming from operation/sale of the collateral for the loan to be considered collateral-dependent; or,
- retain, for regulatory reporting purposes, the "solely" definition that exists in current guidance.

b. Treatment of Guarantor Support

Topic 326 states that if using the optional practical expedient to calculate the ACL, (i.e., fair value), "the entity also **shall** consider any credit enhancements such as consideration of the financial condition of the guarantor and the willingness of the guarantor to pay."[4] However, the Proposal establishes the collateral's value as the **sole** basis for the ACL, prohibiting the required consideration of guarantor support (i.e., "the ACL for a collateral-dependent loan is measured using the fair value of collateral" [5], with no reference to guarantor support.)

Our concern is that while excluding the guarantor made sense under the prior collateral-dependent definition of "solely", now that the definition of collateral-dependent has been expanded to contemplate at least some guarantor support, it is illogical to exclude that support, if any, from the ACL estimate.

We recommend the Proposal clearly state that some portion of guarantor support can and should be recognized if considered appropriate and realistic by management.

c. "Fair Value" as the Measure of Collectibility

Topic 326 defines "fair value" of the collateral as the price received "in an orderly transaction between market participants" [6], i.e., not a forced liquidation or distress sale. This is substantially similar to the appraisal definition of Fair Market Value. The Proposal does not further define fair value.

Our concern is that "Fair Market Value" as concluded by a good-faith appraisal can nonetheless overstate collectibility for any number of reasons: distress or forced sale; disappearance or non-maintenance of collateral; unexpected liens, etc. CECL's goal is that the ACL incorporate all significant factors that could

[1] When the borrower is experiencing financial difficulty
[2] 326-20-35-5
[3] Proposal, page 28
[4] 326-20-35-5 and 326-20-30-12
[5] Proposal, page 29
[6] Glossary, 326-20-20

affect the collectibility of the portfolio. Loans where the borrower is in financial difficulty are typically the highest-risk and it is illogical that banks should be hamstrung in the ACL calculation by requiring a reserve that is potentially too small under the strict "fair value" definition. **Banks must have the ability to treat such loans more conservatively than just applying the fair value definition, including the use of qualitative factors as appropriate.**

We recommend the Proposal state that the value assigned to collateral for purposes of the ACL **could be lower** (though not higher) than appraised fair value due to consideration of factors including but not limited to those already included in the current guidance[7]:

> *"for a collateral-dependent loan the following factors should be considered . . . under the fair value of collateral method: volatility of the fair value of the collateral, timing and reliability of the appraisal or other valuation, timing of [the] inspection of the collateral, confidence in [the] lien on the collateral, historical losses on similar loans and other factors as appropriate for the loan type."*

2. Recoveries

Topic 326 states that expected recoveries of prior chargeoffs "shall be included"[8] in the ACL. It does not state what degree of certainty management should have as to timing and amount of an expected recovery in order to incorporate it in the ACL. The Proposal likewise does not clearly describe the agencies' expectations for how anticipated recoveries should be calibrated before being incorporated in the ACL.

Our concern is that this amounts to taking recoveries into income before they are actually received. **This is an unsafe and unsound banking practice**. If allowed to stand for regulatory reporting purposes, this will be a **recipe for significant issues during the next downturn**. It will also likely be a significant focus for examiner review regardless of the economic climate.

We recommend that for regulatory reporting purposes, incorporating expected recoveries into the ACL be disallowed. If this is not possible, the Proposal must clearly describe stringent regulatory expectations for how management should incorporate expected recoveries, especially with regard to the required degree of certainty and the timing for any recovery.

3. Qualitative Factor Adjustments

Topic 326 itemizes a list of qualitative adjustments[9] but does not state explicitly whether these are to be applied to collectively evaluated loans only, or also to individually evaluated loans that are not collateral-dependent. It is implied in the Examples, but not specifically stated, that qualitative adjustments could be applied to all loans that are not collateral-dependent. The Proposal likewise does not clearly describe whether qualitative adjustments can or should be made to the results for individually-evaluated loans.

Our concern is that given the change in approach, which no longer includes the concept of loans being individually evaluated for impairment, this ambiguity could give rise to various interpretations.

We recommend that the Proposal clearly state that the ACL for individually-evaluated loans that are not collateral-dependent may include qualitative factor adjustments as per the existing guidance.[10]

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[7] Questions and Answers on Accounting for Loan and Lease Losses (Interagency, 2006), Q. 4
[8] 326-20-30-1, as presented in Accounting Standards Update No. 2019-04, paragraph 13
[9] 326-20-55-4
[10] 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses, pages 7-9.

4. Transition

Topic 326 lays out the new standard, without explicitly “rescinding” common current concepts such as unallocated reserve, impaired loans, impairment, etc. The Proposal likewise does not clearly rescind those concepts.

Our concern is given that CECL requires a significant change from prior guidance, it will be all too easy for prior concepts to be inappropriately carried over, creating misinterpretation and confusion.

We recommend the Proposal should clearly state that under CECL:

- There is no concept of an “unallocated” reserve; and
- There is no concept of an impaired loan or a measurement of impairment.

Concluding Observations

We believe the Proposal should clearly describe the agencies’ considered view of the ACL’s function, and how it has or has not changed given the new CECL standard. We note that key terms from the current guidance, including “prudent” and “conservative”, unfortunately do not appear in the Proposal.

- If the agencies genuinely intend the ACL to represent management’s well-founded estimate of actual future credit losses, as CECL appears to intend, then:
  - at least at this bank, the ACL will likely decline significantly upon transition; and
  - the Proposal should make it clear that such a result is to be anticipated and is (largely) acceptable.
- If, on the other hand, the agencies intend the ACL to be sufficiently large to insulate banks’ income statements from an unforeseen dramatic future economic decline, the Proposal should so state and clearly provide for significant unallocated reserves that are not thinly veiled as unsupported qualitative factor adjustments.

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Thank you for the opportunity to comment. We look forward to receiving the final Policy Statement and a successful implementation of CECL.

Sincerely,

Koger L. Propst	R. Todd Crowley	Susan M. Sturm
President & CEO	Chief Credit Officer	Chief Financial Officer