December 9, 2021
Board of Governors of the Federal Reserve System

Statement on the current expected credit loss methodology (CECL) and stress testing

In 2016, the Financial Accounting Standards Board issued Accounting Standards Update No. 2016-13, which introduced the current expected credit loss methodology or CECL. CECL requires firms to recognize lifetime expected credit losses for financial assets measured at amortized cost, rather than those credit losses that are probable of having been incurred, in their allowance for credit losses as of the financial reporting date. The majority of banking organizations currently subject to Federal Reserve supervisory stress testing adopted CECL on January 1, 2020, with all such organizations scheduled to have adopted CECL by 2023. Under the regulatory capital rule, banking organizations have been allowed to phase in the potential adverse impact of CECL on regulatory capital over a three- or five-year transition period.[1]

Prior to the transition to CECL, the Federal Reserve stated that it intended to maintain its pre-existing framework for calculating allowances on credit losses in the supervisory stress test through the end of 2021 and, during that time, would evaluate appropriate future enhancements to this framework.[2] This statement provides additional information on the position that the Federal Reserve plans to take on incorporating the CECL accounting standard into its supervisory stress test.

The existing supervisory stress test framework generally assumes that the level of the allowance on credit losses at the end of a given quarter equals the amount needed to cover projected loan losses over the next four quarters. Because this calculation is based on projected losses under the severely adverse scenario, it typically differs from a banking organization's actual allowance on credit losses at the beginning of the planning horizon, which is based on information available as of the balance sheet date. Reflecting the uncertainty in the timing of when banking organizations recognize losses, any difference between the actual allowance and the assumed allowance under stress at the beginning of the planning horizon is spread out over the nine quarters of the planning horizon to smooth its effect on capital. Despite differences in the horizon over which losses are estimated, this approach is conceptually similar to the CECL standard, as both methods are based on a forward-looking estimate of losses.

During the transition to CECL, the Federal Reserve and other federal bank regulatory agencies stated their intention to continue to closely monitor the effect of CECL on bank capital, lending practices, and aggregate level of loss absorbency through the economic cycle.[3] In view of this effort and the ongoing objectives to reduce uncertainty, allow for better capital planning at affected

[1] See 12 C.F.R., part 217, subpart G.
[2] See "Statement on the current expected credit loss methodology (CECL) and stress testing" (December 21, 2018), available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20181221b1.pdf.
[3] Moreover, the Consolidated Appropriations Act, 2020 (Public Law No: 116-93) directed the U.S. Department of the Treasury in consultation with prudential regulators including the Federal Reserve to study the need, if any, for changes to regulatory capital requirements necessitated by CECL. This study, available at https://home.treasury.gov/system/files/216/The-CECL-Accounting-Standard-and-Financial-Institution-Regulatory-Capital-Study-9-15-20.pdf, noted that as of September 15, 2020, "a definitive assessment of the impact of CECL was not feasible in light of the state of CECL implementation across financial institutions and current market dynamics relating to the COVID-19 global pandemic."

firms, and gather relevant information on the impact of CECL, the Federal Reserve is extending the period of time over which it will maintain the current framework for allowance for credit losses in the supervisory stress test through the 2023 stress testing cycle while continuing to evaluate appropriate future enhancements. As previously noted, the Federal Reserve expects that the current framework, by taking into account a banking organization's allowances at the beginning of the planning horizon, will continue to largely offset the impact in the supervisory stress test of CECL on the allowance at the beginning of the planning horizon.