

Hot topics:

Takeaways from the 2020 AICPA Online Conference on Credit Unions

Nov. 13, 2020



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Conference overview

The annual American Institute of Certified Public Accountants (AICPA) Online Conference on Credit Unions was held from Oct. 19 through 21, 2020. For the first time in its history, the conference was 100% virtual, due to the COVID-19 pandemic. Conference topics focused on the current environment affecting credit unions, including the ever-changing economic outlook. As expected, the COVID-19 pandemic underscored nearly every presentation by economists, regulators, auditors, and credit union leaders alike.

Economists discussed the unusual nature of the current environment and the struggles credit unions currently face. The steep spike in unemployment and large amount of government stimulus has affected multiple facets of credit unions' financial results. Economic uncertainty, civil unrest, political battles, and the unknown parameters of a possible future stimulus package all lead to an unprecedented level of uncertainty. While entertainment industries and small businesses continue to suffer, a number of industries are on the mend.

Conference panelists also highlighted the accounting and reporting implications of the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act), including Section 4013, which granted a limited exemption from applying troubled debt restructuring (TDR) accounting to COVID-19-related loan modifications, as well as the interagency statement (IAS) that outlines when a lender may presume that a borrower is not experiencing financial difficulty when determining TDR status. Panelists also discussed accounting considerations related to the Small Business Administration's (SBA) Paycheck Protection Program (PPP).

Conference speakers discussed the impact of COVID-19 on the allowance for loan losses estimate, the impact on future accounting standards, considerations related to asset impairment, and other credit union hot topics.

The 2021 conference is slated for Oct. 18-20, 2021, online and – we are hopeful – on-site at the Miami Intercontinental in Miami, Florida.

We hope you find this summary useful.

Economic updates

The conference offered two distinct sessions featuring Bill Handel, general manager and chief economist at Raddon, a Fiserv Company, and Douglas Duncan, senior vice president and chief economist at Fannie Mae. Each individual provided a unique perspective on the current economy and outlook for the future, but they were in agreement that this is certainly an unusual economic landscape.

Handel kicked off the conference stating that the impact of the COVID-19 pandemic on the economy and credit union industry could not have been predicted. He noted that the COVID-19 pandemic has been “life-changing,” while Duncan called the current economic environment “unprecedented.” Handel noted that while economists might have predicted a slowdown in the economy, no one could have predicted the acceleration and severity that has taken place since March 2020.

As seems to be the case with most things in 2020, the current recession is not comparable to anything seen before, and the recovery is bound to be just as unique. Handel noted that a record decline in gross domestic product (GDP) of 31% in the second quarter of 2020 and record unemployment rates in excess of 14% wreaked havoc on the economy and caused a shift in members’ focus. Personal saving rates increased from 8.3% pre-COVID-19 (February 2020) to 33.6% in April 2020, partly attributed to stimulus checks. While the saving rate has dropped down to 14.3% as of Sept. 2020, this is still well above the average of 7.4% experienced between 2016 and 2019.¹

According to Handel, consumer spending at the start of COVID-19 decreased dramatically, but industries such as building materials and gardening supplies, food and beverage, and travel have begun to see a steady increase in spending since April 2020’s low point. Credit card balances outstanding has decreased as consumers pay down balances to support their remote purchasing power.

Handel pointed out that while we are not as debt laden as we have been in prior recessions, stimulus checks will end at some point, and it is unknown what will happen to consumer spending when that occurs. In addition, small businesses have been hit the hardest, and there remains uncertainty as to whether they will be able to recover. Despite all of this, Duncan noted that we are technically in the shortest recession ever, and Handel noted that there have been strong rebounds in many sectors of the economy.

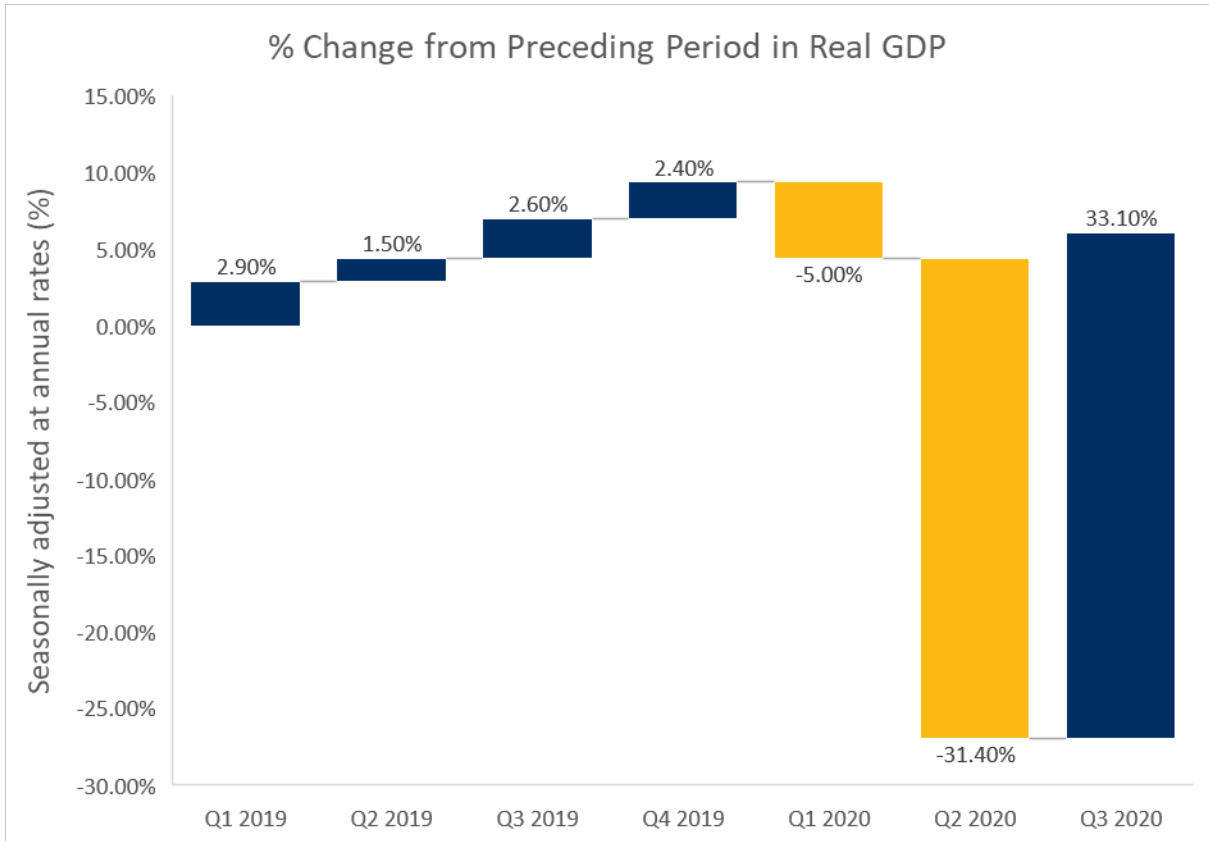
Conference takeaway: Douglas Duncan, senior vice president and chief economist at Fannie Mae, stated that the COVID-19 pandemic has been “life-changing.” He said that the current recession is unlike anything we’ve seen before, and the recovery is expected to be just as unusual.

GDP

With the impact of COVID-19, GDP decreased in the first quarter, marking the end of the longest economic expansion in history. After a modest decline in the first quarter, the second quarter saw a decline of nearly \$1.7 trillion or 31.4%.² However, the third quarter has increased substantially, covering a significant portion of that decline. Due to the severity of the decline in the first and second quarters, GDP is expected to remain relatively flat over a two-year period.

¹ <https://fred.stlouisfed.org/series/PSAVERT>

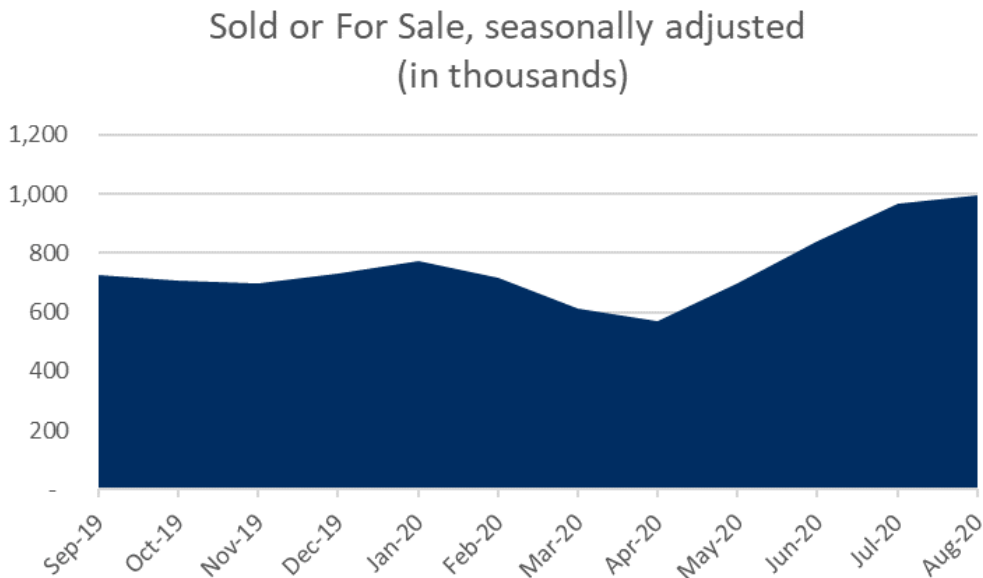
² <https://www.bea.gov/news/2020/gross-domestic-product-third-quarter-2020-advance-estimate>



Source: U.S. Bureau of Economic Analysis.

Real estate

Despite the pandemic, the housing market remains strong and home sales are increasing. Interest rates remain at historic lows, and the mortgage debt service ratio is the lowest in the history of data captured (since 1980).³ The number of homes sold or for sale continues to rise and has recovered from the decline experienced at the start of the COVID-19 pandemic.



Source: U.S. Census Bureau

³ <https://www.federalreserve.gov/releases/housedebt/default.htm>

Duncan stated that single-family homes are a larger portion of total loans (for banks and credit unions) than before the recession. Duncan noted that there are early signs of buyer movement away from higher-density populations. While this movement has been underway for the past three or four years, the COVID-19 pandemic and civil unrest might be accelerators to this trend.

Handel stated that where we work is likely to be permanently altered, and as such demand for office space likely will grow at a slower pace than the economy.

Delinquencies

While forbearance provided through the CARES Act and IAS resulted in a drop in delinquencies, Duncan noted that it's still important to evaluate the trends happening over a longer period.

Auto. Auto loan delinquencies continue to be near peak levels in 2020, despite the short-term forbearance relief provided.

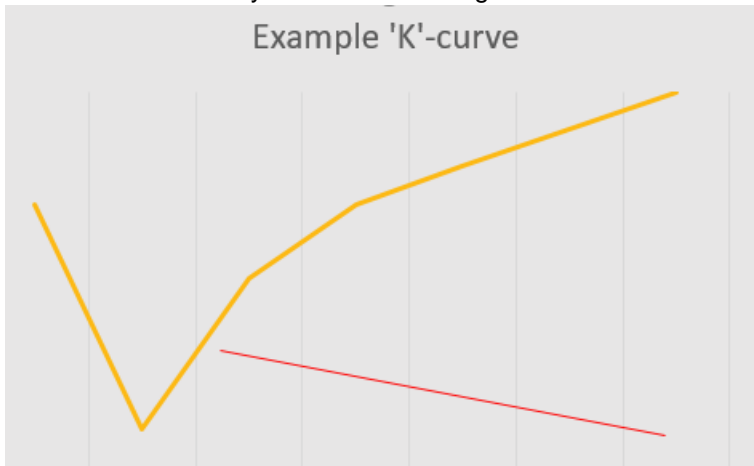
Credit cards. Balances fell sharply in the second quarter of 2020, as individuals used stimulus money to pay down balances or to make sure they are current to allow for more spending power while purchasing from home. Credit card delinquencies have increased in 2020, but this is largely a function of lower outstanding balances.

Student loans. The number of total outstanding student loans continues to increase. Student loan delinquencies dropped dramatically, but this relates to CARES Act treatment and not to a large share of student loans suddenly becoming current.

HELOC. Total outstanding home equity line of credit (HELOC) loans continues a long history of decline and approximates levels seen in 2004. Delinquent HELOC loans saw an increase in 2020 but remain below 1.5% of total outstanding balance.

Outlook

Many discussions about what shape the recovery curve might take have occurred, and both presenters discussed the possibility of a "K-curve." The "K-curve" represents different industries rebounding at different rates. For example, while residential real estate is on the rise, the service sector continues to see a slower recovery and the continuing failure of small businesses.

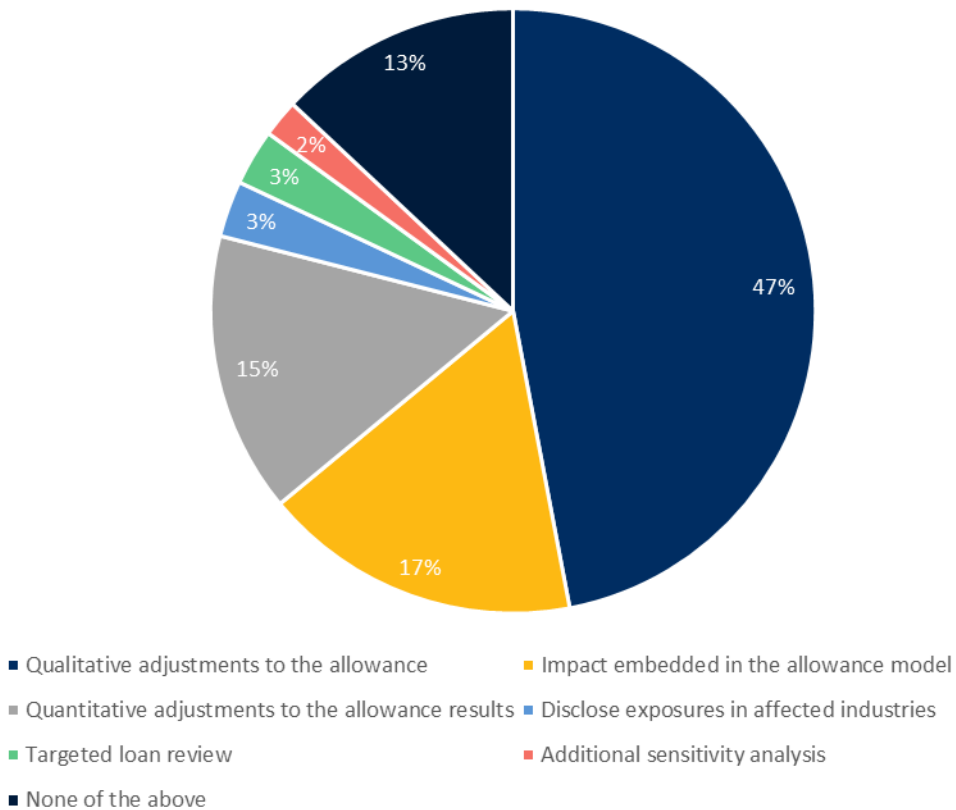


The speakers said they expect longer-term repercussions of COVID-19, including higher-than-average unemployment levels extending into 2021, permanent higher percent of individuals shopping online, and a continued exodus from larger cities. The travel industry likely will be permanently affected, with the volume of business travel continuing to be reduced as virtual working becomes a new norm. The Federal Reserve has announced an expected low-rate environment through 2023, causing continued margin compression. Credit unions will need to continue to adapt to this forever-changed environment. Both speakers acknowledged that while there is still a vast amount of uncertainty, they believe that the worst is likely behind us.

Allowance for loan losses in a COVID-19 environment

Multiple conference panelists discussed the importance of calculating an appropriate allowance for loan losses in the current environment. A survey of the audience on how their credit union is addressing the changes in the current environment provided the following results:

How are you addressing the changes in environment and affected exposures in your portfolio?



Source: Audience poll results during the conference.

As delinquencies and risk ratings can be an indicator of, or have a direct impact on, the allowance for loan losses calculation, it is essential to evaluate risk ratings, nonaccrual status, and appropriate reserves for those loans that are in deferral. Regulators and auditors alike noted that it might be prudent to consider those segments that represent a higher risk. One could consider moving loans to a separate pool or segment in the allowance calculation or at least monitoring performance over time.

The topic of accrued interest collectability was discussed by many speakers who underscored that while the guidance allows for modifications not to be accounted for as TDRs, the underlying question of collectability on the loan and any accrued interest on the loan remains. It might be appropriate to establish an allowance on accrued interest, reverse accrued interest when put on nonaccrual, or charge-off accrued interest, depending on the circumstances.

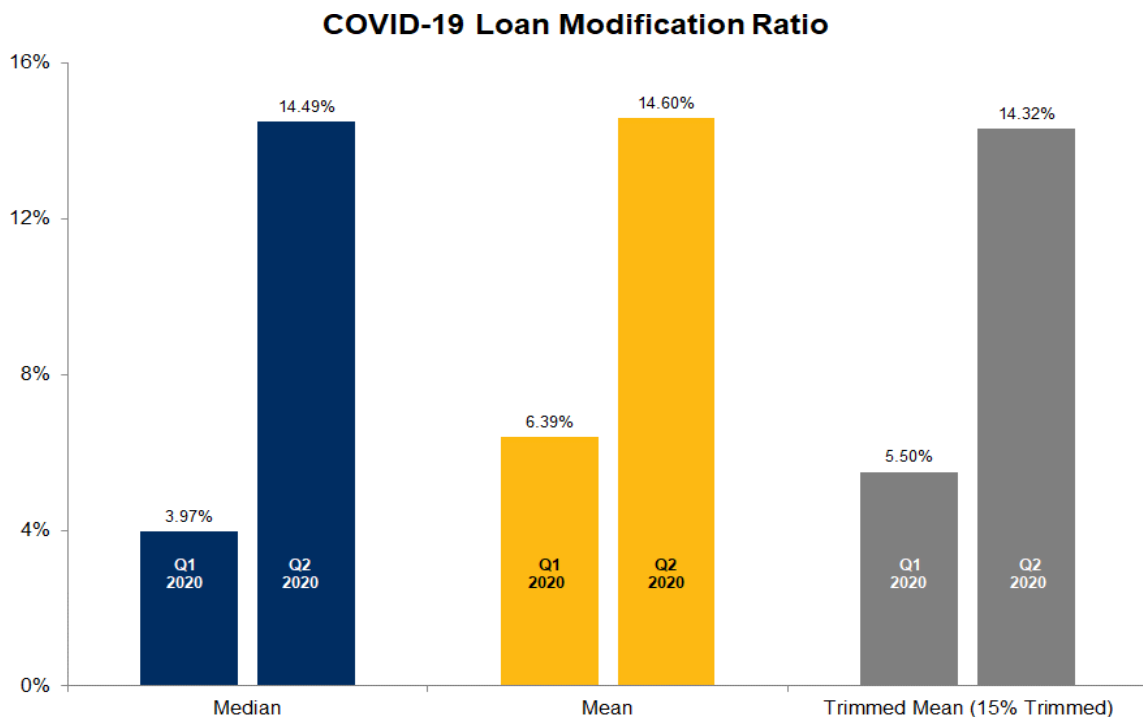
Resource: On Oct. 7, 2020, Crowe issued “[Financial Reporting Considerations: Evaluating Accrued Interest Receivable on Loan Deferrals/Modifications](#),” to assist financial institutions with evaluating the accrual status of loans in deferral and assessing the collectibility of related accrued interest receivable balances.

COVID-19-related accounting topics

Loan modifications

The CARES Act and IAS provided relief and encouraged credit unions to work constructively and proactively with borrowers affected by COVID-19. Credit unions performed modifications in the form of principal and interest deferrals for 90 days or more, skip-a-pay programs, interest-only payment plans, loan amortization adjustments, and PPP participation, among others.

Crowe observation: Although not presented at the conference, the following chart illustrates the amount of loans modified and in deferral as of June 30, 2020.



Source: S&P Global Market Intelligence, for publicly traded banks.

National Credit Union Administration (NCUA) representatives reminded attendees of the importance of ensuring the credit union is maintaining records related to the CARES Act Section 4013 loans. The June 30, 2020, call report included a new section for disclosure of loans modified under the CARES Act. The NCUA clarified that this should include only loans modified by the CARES Act, and only those that are in deferral period at the end of the reporting period. Skip-a-pays that are part of the normal course of business would not be included; however, payments skipped under the CARES Act should be included.

On Aug. 3, 2020, the agencies issued “Joint Statement on Additional Loan Accommodations Related to COVID-19”⁴ to address additional modifications made for borrowers who may continue to experience

⁴ https://www.ffiec.gov/press/PDF/Statement_for_Loans_Nearing_the_End_of_Relief_Period.pdf

financial hardship after an initial deferment period. Regulators reminded attendees to ensure credit unions are maintaining an appropriate allowance for loan losses. Past due status should be calculated based on the contractual term of the loans, and during this deferral period, past due status needs to be evaluated differently from the way it was evaluated pre-COVID-19. In the past, 60 or 90 days past due was a primary driver for concern; however, in the current environment, a deferred loan that is 15 or 30 days past due could be cause for concern. In addition, nonaccrual status should be determined based upon whether full recovery of principal and interest is expected after the deferral period has ended.

Conference takeaway: Credit unions can use the CARES Act Section 4013 for any qualifying loan modification, regardless of whether the loan was modified previously under Section 4013 or the IAS. As a reminder, the ability to qualify for a loan modification under the CARES Act requires an objective evaluation of whether the criteria are met.

Accounting for PPP loans

According to the NCUA, credit unions of all sizes participated in the Paycheck Protection Program. Panelists reminded credit unions that several PPP resources exist, including four Technical Q&As issued by the AICPA Depository Institutions Expert Panel (DIEP)⁵ that address these key considerations:

- A PPP advance should be accounted for as a loan rather than a facilitation of a government grant.
- The SBA guarantee is not legally detachable from the contract. As such, the guarantee is considered embedded and should be considered in estimating the allowance for loan losses.
- A loan origination fee from the SBA should be accounted for as a nonrefundable loan origination fee under Financial Accounting Standards Board (FASB) Accounting Standards Codification 310-20, "Receivables – Nonrefundable and Other Costs." As a result, it should be offset against loan origination costs and deferred and amortized over the contractual life of the loan as an adjustment yield.
- Upon submission to the SBA for forgiveness, the loan should be classified as an interest-bearing loan through receipt of payment from the borrower or the SBA.

On Oct. 8, 2020, an interim final rule was issued that addresses loans of \$50,000 or less. Borrowers may use "PPP Loan Forgiveness Application Form 3508S"⁶ to make the certifications. In addition, borrowers must retain certain documents for six years after the date the loan is forgiven or repaid in full. Although they are not required to submit those documents, they must provide access to authorized SBA representatives upon request.

Conference takeaway: Panelists noted that PPP loans confirmed by the SBA as eligible for forgiveness should continue to be accounted for as loans until the obligation has been settled in full by the SBA.

Focus on future examinations

In July, the NCUA refreshed its supervisory priorities for 2020 in "Update to NCUA's 2020 Supervisory Priorities" (letter 20-CU-22)⁷ due to the COVID-19 pandemic. Regarding upcoming examinations, the NCUA representatives indicated examiners would exercise flexibility and place additional focus on how management has considered the risks and response to the pandemic, and they provided the following considerations and points of focus:

- Examiners will place emphasis on CARES Act compliance. Examiners will not criticize credit unions for working with borrowers in a safe and sound manner, even if those loans ultimately develop weaknesses or subsequently are downgraded. However, examiners will focus on whether credit unions are making timely and accurate assessments of loan quality.
- Early in 2020, examiners had a focus on current expected credit loss (CECL) standard

⁵ <https://www.aicpa.org/interestareas/frc/recentlyissuedtechnicalquestionsandanswers.html>

⁶ <https://home.treasury.gov/system/files/136/PPP-Loan-Forgiveness-Application-Form-3508S.pdf>

⁷ <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/update-ncuas-2020-supervisory-priorities>

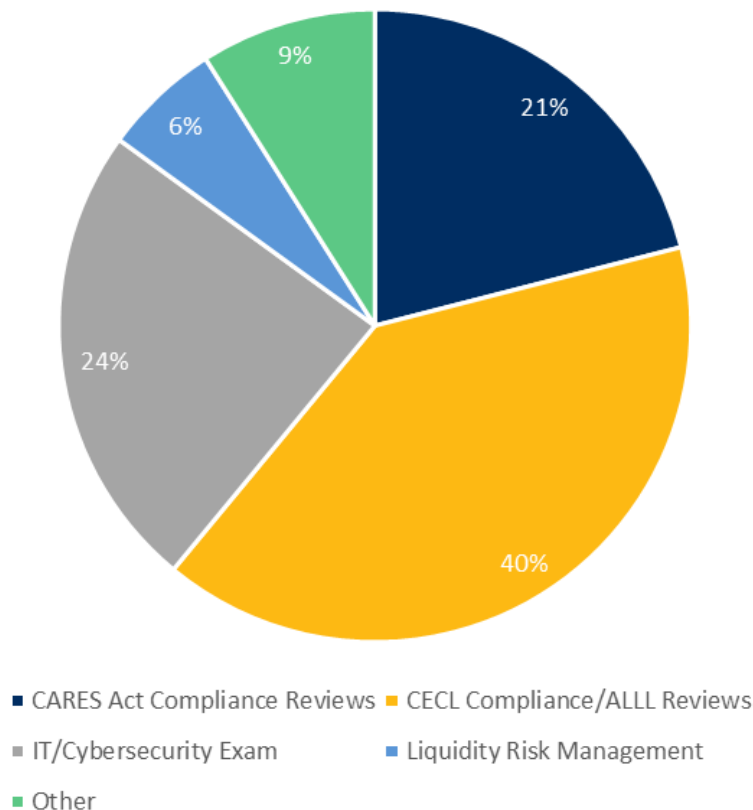
Takeaways from the 2020 AICPA Online Conference on Credit Unions

- preparation. That review has been suspended, and the focus has shifted to the allowance for loan losses and how management has addressed the additional risks associated with the COVID-19 pandemic.
- While generally credit unions have done an excellent job managing liquidity, there may be liquidity risk down the road due to COVID-19 that examiners will expect credit unions to have evaluated.
- Examiners' priorities related to *Bank Secrecy Act*/anti-money laundering, London Interbank Offered Rate (LIBOR) transition planning, and serving hemp-related businesses have not changed.
- Examiners will place emphasis on how management has considered the risks and responses to COVID-19 as well as the reasonableness of management's response to the pandemic and, as new information becomes available, how management has evaluated and addressed the impact of the pandemic on longer-term business strategies.

Conference takeaway: Examiners will not criticize institutions for working with borrowers in a safe and sound manner, even if those loans ultimately develop weaknesses or subsequently are downgraded. However, examiners will be focused on whether institutions are making accurate and timely assessments of asset quality.

When the NCUA asked attendees about which supervisory priority is the most challenging, these were the responses:

Which supervisory priority do you see as the most challenging for your credit union?



Source: Audience poll results during the conference.

COVID-19 operations impact

A panel including CFOs and consultants indicated that going to a remote workforce in such a short period of time certainly created some challenges for credit unions. While panelists stated that most employees are very productive working remotely, they had some concern regarding what the culture will look like in the long term and how to continue the “community feel” of a workplace. All panelists acknowledged that post-COVID-19 will not look the same as pre-COVID-19 in terms of how and where people work.

Accounting standards update

In June 2020, the FASB issued Accounting Standards Update 2020-05, which delayed the adoption date of CECL to Jan. 1, 2023, and the lease standard to Jan. 1, 2022. With these delayed adoption dates, credit unions have the benefit of learning from those public business entities that already have adopted the standards. For certain public business entities, 2020 saw the adoption of CECL, and 2019 saw the adoption of the lease standard.

CECL – observations and challenges

Accounting firm representatives provided a summary of what has been learned from those that adopted the CECL standard in 2020. With the COVID-19 pandemic, adoption of CECL proved to be difficult as unemployment rates reached all-time highs and GDP dropped. Challenges in the current environment include:

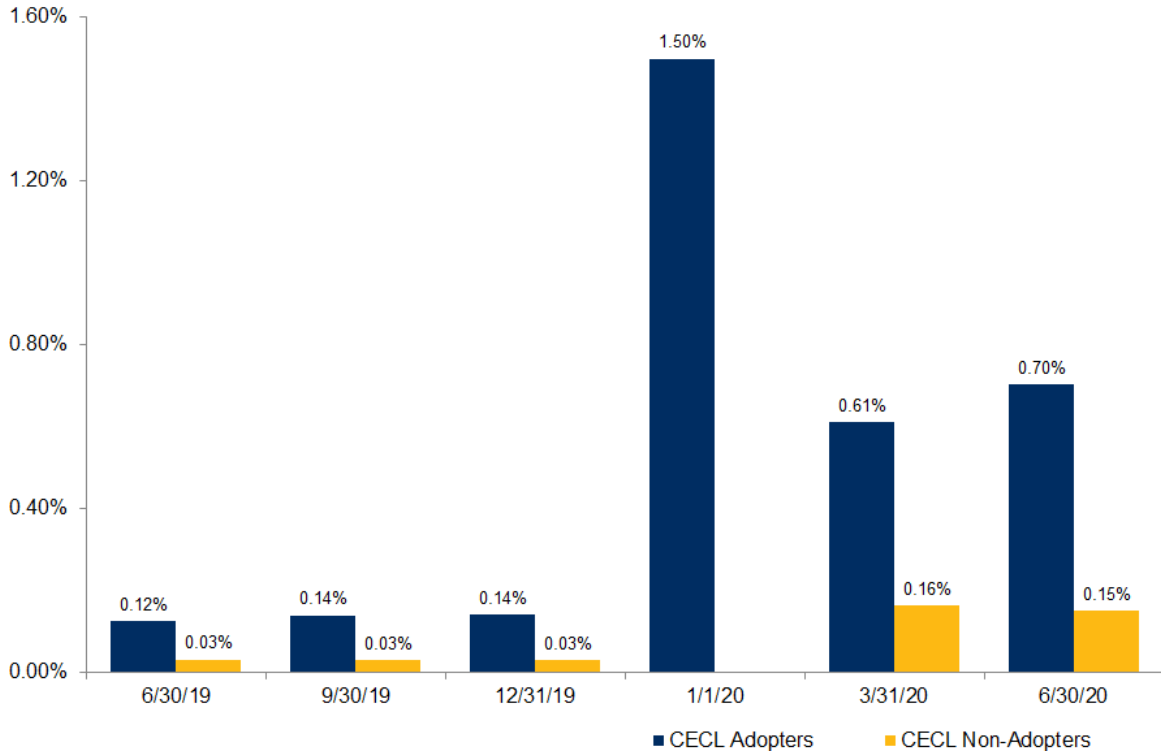
- Extreme economic circumstances challenged the effectiveness of the model. Many CECL models were primarily driven by home price index changes and changes in unemployment.
- Developing a reasonable and supportable forecast is the most difficult part of applying the standard.
- Rapidly changing economic conditions placed significant pressure to adapt.

Regardless of the economic environment, advice to those that have not adopted, includes:

- Do not ignore unique pockets of portfolios that may require separate segmentation.
- Spend more time on documentation in advance.
- Do not forget about off balance sheet exposure and held-to-maturity securities.
- Run models through stressed scenarios.
- Perform as many parallel runs as possible.
- Use of qualitative factors will continue.
- Utilize quality data.

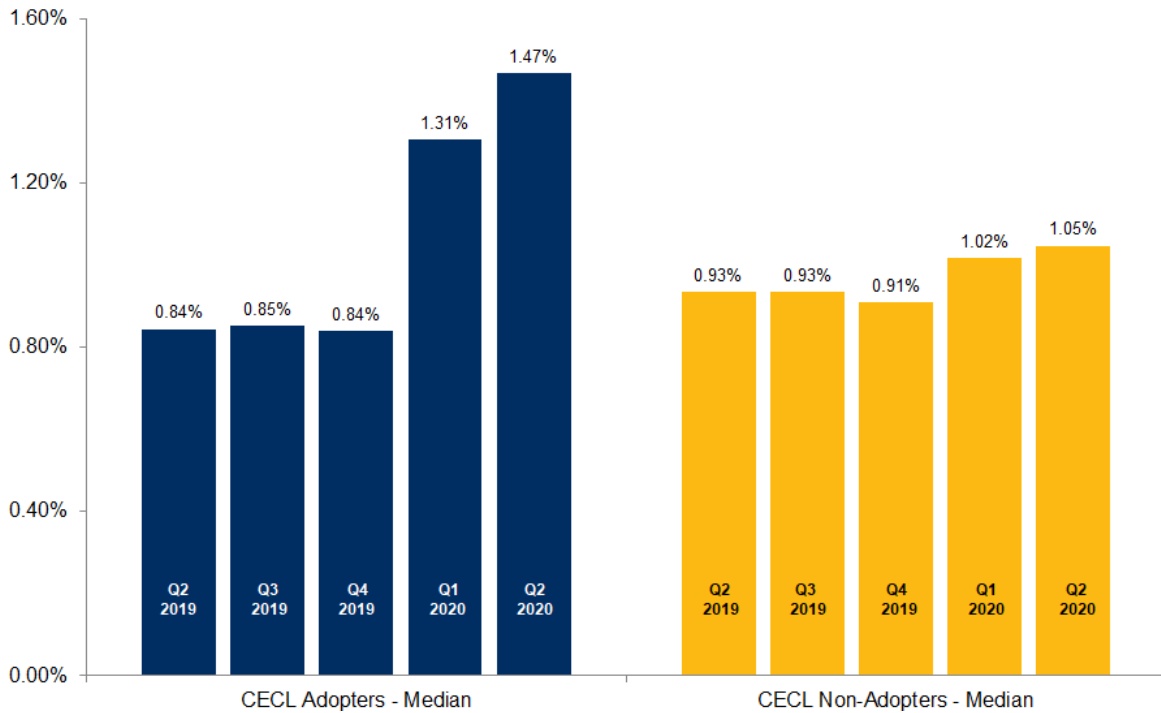
Crowe observation: Although not presented at the conference, the following charts illustrate the impact of CECL (four-quarter lookback of provision for credit losses, ACL to loans ratio, and the day one CECL impact on retained earnings (R/E) at Jan. 1, 2020) for public company banks.

Provision (and Day One R/E adoption) / Average Gross Loans
CECL Adopters vs Non-Adopters



Source: S&P Global Market Intelligence and Crowe analysis, June 30, 2020.

Loan Loss Reserves / Gross Loans - Median
CECL Adopters vs Non-Adopters



Source: S&P Global Market Intelligence and Crowe analysis, June 30, 2020.

FASB resources – CECL

FASB Technical Director Hillary Salo commented that the FASB currently is assessing costs and benefits to institutions that already have adopted CECL. The transition resource group formed has contributed to codification improvements, including contractual terms, recoveries, capitalized interest, accrued interest, discounting cash flows at the effective interest rate, and determining the estimated life of a credit card receivable.

As part of its Post-Implementation Review (PIR), the FASB plans to hold a roundtable on accounting for credit losses in 2021. This roundtable will help the FASB board members determine any necessary changes for entities, including credit unions, adopting CECL in 2023.

NCUA Chief Accountant Alison Clark noted that the transition to CECL for regulatory capital will occur as a phase-in over three years. After a one-time entry on the March 31, 2023, call report, the call report automatically will calculate the phase-in over the three-year period. There will be a 100% add back for the first three quarters of 2023. The phase-in is not optional, unless a credit union early adopts CECL.

Conference takeaway: The FASB noted that it will hold a roundtable on accounting for credit losses to determine how best to serve those adopting CECL in 2023. However, at the time of the conference, no change to the implementation timeline or adoption plan for credit unions is expected.

Leases – observations and challenges

One speaker provided a summary of what has been learned from those that adopted the lease standard in 2019, including:

- Identifying leases is not always a straightforward process.
- Extracting and maintaining required data can be challenging.
- Systems and processes might need more consideration than expected.
- Applying accounting requirements can be complex.
- Communicating an implementation plan is key.

It is important to note that the right-of-use (ROU) asset and lease liability may equal one another in the absence of lease incentives, rent escalators, or initial direct costs. Only a difference between the ROU asset and lease liability at adoption will result in an adjustment in opening equity balances.

Salo stated that a number of PIR activities already have occurred and an exposure draft is expected in the fourth quarter of 2020 to address sales-type leases with substantial variable lease payments, remeasurement of lease payments based on a reference index or rate, and reduction of scope in a lease contract.

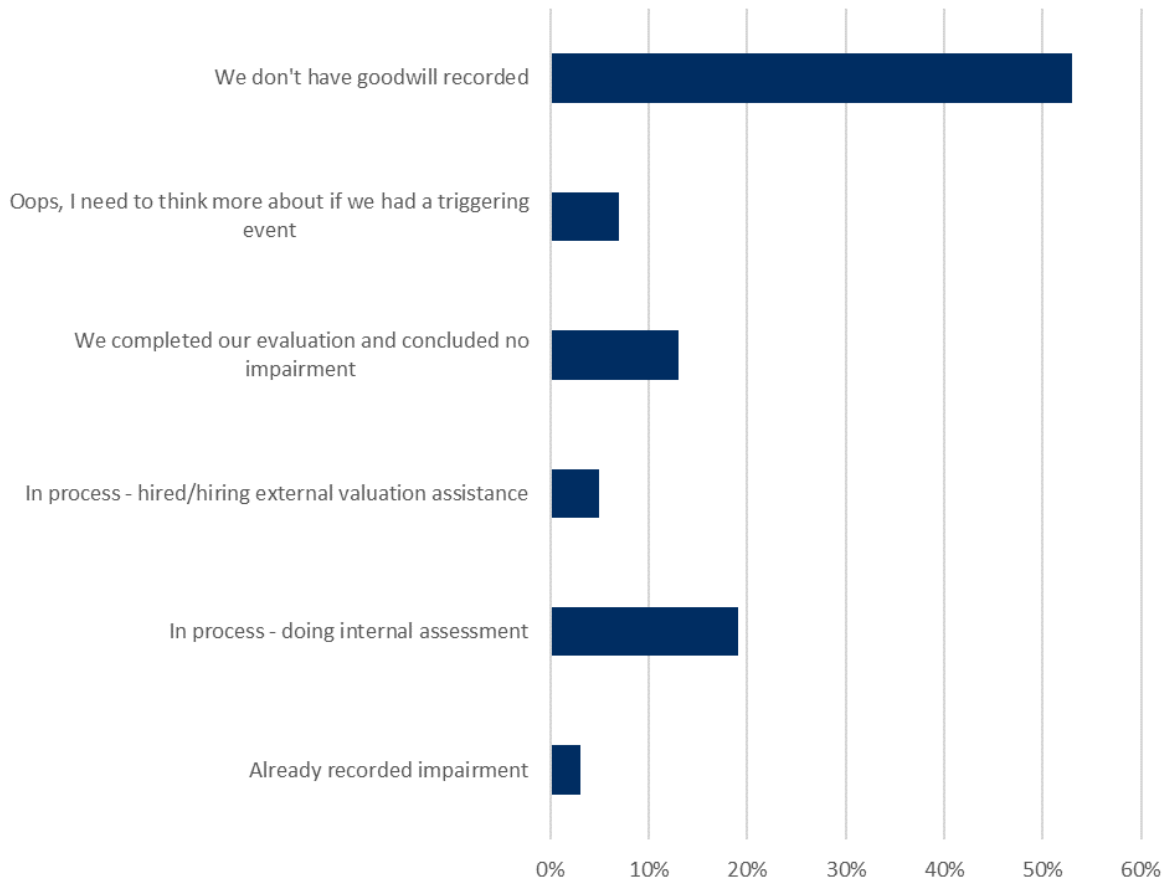
Other industry hot topics

Asset impairment

Auditors provided insight into the type of impairments that are being seen in the public company space, including mortgage servicing rights (MSR), goodwill, and debt securities impairment. The largest area of impairment has been occurring on MSRs, as the decline in interest rates and increase in delinquency placed pressure on MSR values. If a credit union has goodwill, an impairment analysis might need to be more robust given the environment, and credit unions should consider whether a triggering event has occurred that would prompt an interim analysis.

A survey of the audience on their goodwill observations provided the following results:

Goodwill observations for 2020



Source: Audience poll results during the conference.

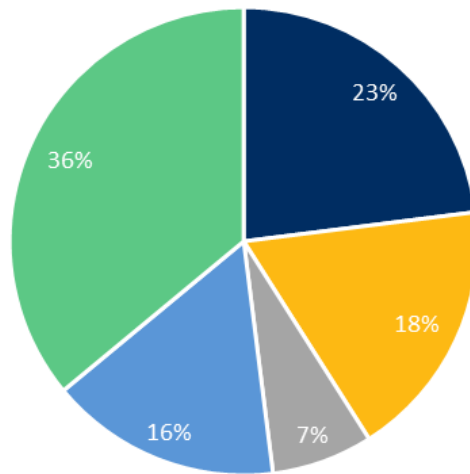
Other topics

Other conference sessions included these topics:

- Mortgage banking
- Stress testing
- Machine learning
- Hedging
- Cannabis banking
- Mergers and acquisitions
- Loan participations
- Regulatory compliance
- Investments

Panelists discussed the current challenges facing the credit union industry. The net interest margin squeeze is apparent across all financial institutions, not just credit unions. This is forcing institutions to evaluate how else they can diversify, cross-train employees, and improve mobile services in order to compete. When asked what the greatest challenge has been for credit unions, attendees answered as follows:

What is the greatest challenge for your credit union currently?



- Liquidity management including related investment strategy
- Managing non-interest income including deposit pricing philosophy
- Managing non-interest expense
- Driving loan portfolio growth
- All of the above

Source: Audience poll results during the conference.

Learn more

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