CECL

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Topics

- Level set on CECL
- Effective Dates
- PCD and AFS
- Training
- WARM
- Messaging
- IPS Update
- Regulatory Capital
- Call Report

CECL

- In June 2016, the FASB issued ASU No. 2016-13, “Measurement of Credit Losses on Financial Instruments,” which introduces the current expected credit losses methodology (CECL) for estimating allowances for credit losses.

- Replaces the current incurred loss model triggered by the “Probable” threshold and “incurred” notion.

- Introduces the CECL methodology, which requires a determination on day one of the expected amount to be collected on a pool of originated loans over the life of the loan.

- The difference between the originated loan amount and expected amount to be collected over the life of the loan is the day one CECL allowance.

CECL

- It broadened the range of data incorporated into the measurement of credit losses
- The incurred model used information on past events and current conditions to recognize the amount of loss that had already been incurred
- The CECL model considers past events, current conditions and **reasonable & supportable forecasts** to establish an allowance that represents the amount expected not to be collected

CECL

- The expected impact is an increase to the ACL (allowance for credit losses account, formerly the ALLL) and an increase in the provision expense.

Day 1 Adjustment

On the effective date: Retained earnings will be reduced and the ACL will be increased for the difference between the ALLL under the incurred loss method and the ACL under the CECL method.

	DR	CR
• Debit- Retained Earnings	XXX	
• Credit- ACL (Allowance for Credit Losses)		XXX

(ALLL term will be changed to ACL)

What to do after Reasonable and Supportable

- What to do if contract term is longer than reasonable and supportable period
- Not required to search all possible information that is not reasonably available without undue cost and effort
- Not required to develop hypothetical pool
- Revert to historical loss and consider need to adjust
- May revert at input level or based on entire estimate
- May revert immediately, on a straight-line basis or using another rational and systematic basis

Effective Dates

New Accounting Standard Effective Dates		
	U.S. GAAP Effective Date	Regulatory Report Effective Date*
PBEs That Are SEC Filers	Fiscal years beginning after 12/15/2019, including interim periods within those fiscal years	3/31/2020
Other PBEs (Non-SEC Filers)	Fiscal years beginning after 12/15/2020, including interim periods within those fiscal years	3/31/2021
Non-PBEs	Fiscal years beginning after 12/15/2021, including interim periods within those fiscal years	3/31/2022
Early Application	Early application permitted for fiscal years beginning after 12/15/2018, including interim periods within those fiscal years	

On July 17, 2019 the FASB proposed to change the effective date for smaller reporting companies and non SEC filers to 2023.

Proposed Revised Dates

- SEC filers except smaller reporting companies would continue with a 2020 effective date
- All other entities would have a revised effective date of 2023

Definition of a Smaller Reporting Company (SRC)

- It has a public float of less than $250 million, or
- It has less than $100 million in annual revenues and
  - No public float or
  - Public float of less than $700 million
- Public float is calculated by multiplying the number of the common shares held by non-affiliates by the market price and in the case of an IPO, adding the common shares covered by the registration statement by their estimated public offering price.
- A company may have no public float because it has no public common shares outstanding or because there is no market price for its common shares.

PCI to PCD

- The CECL standard eliminates the concept of Purchase Credit Impaired Loans and replaces it with the new concept of Purchase Credit Deteriorated Loans.

- PCI- If based on current information and events, it is probable that the investor is unable to collect all cash flows expected.

- PCD- If there has been a more than insignificant deterioration in credit quality since inception.

PCD Example

- Assume bank pays $750M for a loan with UPB of $1 million. Bank estimates the allowance for credit losses on the UPB to be $175M.

- Entry

	Dr	Cr
Loan	$1,000,000	
Discount on loan		$ 75,000
ACL		$175,000
Cash		$750,000

Available-for-sale (AFS) Debt Securities

- Excluded from the scope of CECL. However,
- Targeted improvements where made that eliminate “other than temporary”.
- Credit loses are recorded through an allowance but the allowance is limited to the amount FMV is less than amortized cost.
- The consideration for the length of time the FMV is below amortized cost is removed.

AFS Example

- Example of floor:

	Example 1	Example 2	Example 3
Amortized Cost	100	100	100
Fair Value	97	103	94
Credit Loss	2	5	9
Allowance	2	0	6

Training Materials

Accounting and Securities Disclosure (ASDS) Website link:

https://fdicnet.fdic.gov/content/rms/home/supervision/accounting.html

Training Webinars and Materials Available:

Internal Training:
https://fdicnet.fdic.gov/content/rms/home/supervision/accounting/internal-training.html

Interagency Training:
https://fdicnet.fdic.gov/content/rms/home/supervision/accounting/interagency-training.html

Larger Banks

- Using complex models
- Many are using DFST and CCAR systems in initial work
- Incorporating interdepartmental teams
- Many are using the 9 quarters as their beginning reasonable and supportable period
- SEC banks should be performing parallel runs now
- SOX controls

CECL Considerations

- Data and methods
- Quantity of data
- Quality of data
- Missing data
- Use of third-party vendors
- Capital planning
- Documentation and controls

Possible Methods for Community Banks

The methods below were illustrated on the FDIC/FED training webinar on February 21, 2018 (to examiners) and February 27, 2018 (to bankers): (FIL-8-2018)

- Snapshot/Open Pool Method
- Remaining Life Method
- Vintage Method

- Institutions may choose non-loss rate methods (e.g., PD/LGD, roll-rate, discounted cash flows).
- *There is no one method that is appropriate for every portfolio.*
- **A Q&A Webinar was done July 30, 2018 and is available to review** (FIL-34-2018)

WARM Method

- WARM- Weighted Average Remaining Maturity

- The WARM method uses an average annual charge-off rate. This average annual charge-off rate contains loss content over several vintages and is used as a foundation for estimating the credit loss content for the remaining balances of financial assets in a pool at the balance sheet date.

- The average annual charge-off rate is applied to the contractual term, further adjusted for estimated prepayments to determine the unadjusted historical charge-off rate for the remaining balance of the financial assets. The calculation of the unadjusted historical charge-off rate does not include a reasonable and supportable forecast period.

- FASB issued Q&A approving the WARM method 1/10/2019

- Webinar April 11, 2019 with banking agencies, FASB, SEC, NCUA and CSBS

Calculate Charge-off Rate

Table 1: Calculate Average Annual Charge-off Rate				
		A	B	C = B/A
Year	Amortized Cost	Average Balance	Actual Annual Net Charge-offs	Annual Charge-off Rate
2015	$ 5,126			
2016	8,969	7,048	21	0.30%
2017	11,220	10,094	51	0.51%
2018	12,312	11,766	42	0.36%
2019	12,936	12,624	32	0.25%
2020	13,980	13,458	49	0.37%
Balances are in thousands except charge-off rate data				
		Average annual charge-off rate		**0.36%**

Estimate Charge-off Rate and Amount

Table 2: Estimated Amortized Cost Basis				
		A	B	A*B
Year End	Est. Paydown	Projected Amort Cost	Avg Annual Charge-off Rate	Allowance for Credit Losses
2020 Actual Amortized Cost		$ 13,980	0.36%	$ 50
2021	$ 3,700	10,280	0.36%	37
2022	3,900	6,380	0.36%	23
2023	3,000	3,380	0.36%	12
2024	2,160	1,220	0.36%	4
2025	1,220	-	0.36%	-
Est. unadjusted charge-off amount for remaining balance				126
Paydown & amortized cost balances in thousands				
Unadjusted historical charge-off rate for remaining balance				0.90%
Qualitative Adjustment				0.25%
Total allowance for credit losses rate as of 2020				**1.15%**
Total allowance of credit losses as of 2020 ($13,980 x 1.15%)				**161**

Weighted Average Life

Table 4: Weighted Average Determination						
		B	C	D = BxC		D/A
	Year End	Est. Paydown	Remg Life	Method 2:		
	2020 Amort Cost	13,980	A			
	2021	$ 3,700	1.00	$	3,700	0.26
	2022	3,900	2.00		7,800	0.56
	2023	3,000	3.00		9,000	0.64
	2024	2,160	4.00		8,640	0.62
	2025	1,220	5.00		6,100	0.44
Paydown balances in thousands						
			2.52		Sum	2.52
Method 1 (excel formula):						
2.52 = Sumproduct (column B: Column C) / A						

Alternative WARM

Table 3: Estimated Amortized Cost Basis					
	Year End	Est. Paydown	Projected Amort Cost	Remg Life	
	2020 Actual Amortized Cost		13,980	1.00	
	2021	$ 3,700	$ 10,280	2.00	
	2022	3,900	6,380	3.00	
	2023	3,000	3,380	4.00	
	2024	2,160	1,220	5.00	
	2025	1,220	-		
Weighted avg amortization adjusted remaining life				2.52	A
Paydown & amortized cost balances in thousands					
Average annual charge-off rate				**0.36%**	**B**
Unadjusted historical charge-off rate for remaining balance				0.90%	**A * B**
Qualitative Adjustment				0.25%	
Total allowance for credit losses rate as of 2020				**1.15%**	
Total allowance of credit losses as of 2020 ($13,980 x 1.15%)				**161**	

What if Data is Incomplete?

- What if your bank doesn't have all the data needed to determine lifetime loss rates?

  a. Peer data
  b. Other external data
  c. Consider proxies
  d. Extrapolation/interpolate

- The agencies expect a good faith effort. However, the agencies will expect improvement over time in institutions' processes for estimating lifetime expected credit losses (develop history for lifetime loss rates and improve documentation)

Regulator Views on Segmentation

- Suggested start is Call Report segmentation
- Consider products with common risk characteristics
- Different CECL methodologies can be used for different products
- Remember the greater the number of methods used, the more complex the systems and required controls and processes

Considerations, Questions and Messaging

Use of Third-party Vendors

- No requirement to engage third-party service providers
- Many institutions are using third-party providers
- Cannot employ vendor as their “silver bullet”

Scalable to Size and Complexity

- CECL is scalable to size and complexity of institution
- “Small Banks Don’t Need Big Models”
- No bright lines around “smaller and less complex”
- Simpler method does not necessarily equate to lower quality outcome
- Successful implementation of CECL will require significant effort

Quality of Data

- Think about quality of historical data
  - What data does the bank currently have available and how long is it maintained?
  - Is the data stored in a controlled environment?
  - Is management comfortable that the data is reasonably complete and accurate?

- **This data is being used to derive bank's most significant estimate, so quality is important!**

Data Improvements / Changes

- Some think they will be able to get all of their data from core provider—not true
- Most providers can provide data going back only 1–2 years and may come at a cost
- Bank should start to save data it currently has
- Bank should inventory legacy data it has
- Depending on these answers and volume of additional data, may need to make changes to data-archiving processes or systems

New Interagency Policy Statement for Allowance

(In process)

Interagency Policy Statement (currently in process)

- Will Supersede:
  - 2006 IPS on Allowance for Loan and Lease Losses.
  - 2001 Policy Statement on Allowance for Loan and Leases losses.
  - 2002 Interpretive Ruling and Policy Statement 02-3, Allowance for Loan and Lease Methodologies and Documentation for Federally Insured Credit Unions.
  - Will be effective in conjunction with each institution’s adoption of Topic 326.

Policy Statement will cover:

- Measurement
- Regulatory Expectations for design and documentation
- Validation
- Internal controls
- Maintaining appropriate ACL

Policy Statement will also cover:

- Responsibilities of the Board of Directors
- Responsibilities of Management
- Responsibilities of Examiners

CECL and Regulatory Capital

CECL and Regulatory Capital

- Regulatory capital **optional transition**
  - Optional 3 year transition for day-one decline in CET1 due to adopting CECL
    - Year **1** @ **75%** Year **2** @ **50%** Year **3** @ **25%**
  - In the **first year** after adopting CECL, for regulatory capital purposes, the electing bank would:
    - **Add** back to **retained earnings** and **average total consolidated assets**
      75% of any decrease in retained earnings due to CECL adoption,
    - **Exclude 75%** of **additional DTAs** created by adopting CECL for regulatory capital purposes, including DTAs subject to threshold deductions and risk-weighted assets, and
    - **Exclude 75%** of the increase in **ACL** from adopting CECL when calculating its allowance includable in **tier 2** capital.
  - These percentages would decrease to 50% in the second year after adopting CECL, 25% in the third year, and 0% in the fourth and later years.

Call Report

General Types of Call Report Changes

- Nomenclature changes from “Allowance/Provision for Loan and Lease Losses” to “Allowance/Provision for Credit Losses”
- No more PCI!
- No more OTTI!
- For unfunded commitments we will now measure expected loss over contractual periods where the bank is obligated to extend credit *but there is no allowance required for unfunded commitments that are unconditionally cancellable by the bank.*
- Some schedules are expanded to account for allowances for credit losses on additional assets (AFS securities,

Timing of Changes

- The first time all banks will be reporting on ASU 2016-13 is 4Q2022*.
- Call Report revisions begin 1Q2019 (to account for any banks that are early-adopting) and will not be fully phased in until 4Q2022*. *Different implementation dates will make some Call Report data non-comparable.*
- Starting with the 1Q2019 Call Report there will be guidance in the instructions on what banks who have adopted should report. Each quarter will include instructions through the full transition until 4Q2022*.

***Subject to change depending on FASB's proposed effective date change the for smaller reporting companies and non SEC filers to 2023.**

Significant Schedule RI Changes

- RI Income Statement Memo Item 14: “OTTI on HTM and AFS debt securities recognized in earnings” is eliminated for those institutions adopting.

- RI-B Charge-offs and Recoveries on Loans and Leases and Changes in Allowance for Credit Losses: Part II “Changes in Allowance for ALLL” now termed “Changes in Allowances for credit losses. Further, the table that is currently in Part II changes from one column to three columns to account for loans and leases, HTM debt securities, and AFS Debt Securities.

Appendix

Schedule RI-B Part II (Old vs. New)

Schedule RI-B—Continued

Part II. Changes in Allowance for Loan and Lease Losses

Dollar Amounts in Thousands	RIAD	Amount
1. Balance most recently reported for the *December 31, 2017*, Reports of Condition and Income (i.e., after adjustments from amended Reports of Income)	B522	
2. Recoveries (must equal Part I, item 9, column B, above)	4605	
3. LESS: Charge-offs (must equal Part I, item 9, column A, above less Schedule RI-B, Part II, item 4)	C079	
4. LESS: Write-downs arising from transfers of loans to a held-for-sale account	5523	
5. Provision for loan and lease losses (must equal Schedule RI, item 4)	4230	
6. Adjustments* (see instructions for this schedule)	C233	
7. Balance end of current period (sum of items 1, 2, 5, and 6, less items 3 and 4) (must equal Schedule RC, item 4.c)	3123	

* Describe on Schedule RI-E—Explanations.

Part II. Changes in Allowances for Credit Losses[1]

	Loans and leases held for investment Column A		Held-to-maturity debt securities[2] Column B		Available-for-sale debt securities[2] Column C	
Dollar Amounts in Thousands	RIAD	Amount	RIAD	Amount	RIAD	Amount
1. Balance most recently reported for the December 31, 2018, Reports of Condition and Income (i.e., after adjustments from amended Reports of Income)	B522		XXXX		XXXX	
2. Recoveries (column A must equal Part I, item 9, column B, above)	4605		XXXX		XXXX	
3. LESS: Charge-offs (column A must equal Part I, item 9, column A, above less Schedule RI-B, Part II, item 4, column A)	C079		XXXX		XXXX	
4. LESS: Write-downs arising from transfers of financial assets[3]	5523		XXXX		XXXX	
5. Provisions for credit losses[4,5]	XXXX		XXXX		XXXX	
6. Adjustments* (see instructions for this schedule)	C233		XXXX		XXXX	
7. Balance end of current period (sum of items 1, 2, 5, and 6, less items 3 and 4) (column A must equal Schedule RC, item 4.c)	3123		XXXX		XXXX	

*Describe on Schedule RI-E—Explanations.

Schedule RI-B Memoranda Items

- Memoranda Item 4: “Amount of Allowance for post-acquisition credit losses on PCI loans…” This item is eliminated.
- New Memoranda Items 5 and 6:

	RCFD	Amount
5. Provisions for credit losses on other financial assets measured at amortized cost (not included in item 5, above)[3]	XXXX	
6. Allowance for credit losses on other financial assets measured at amortized cost (not included in item 7, above)[3]	XXXX	

Schedule RI-C Disaggregated Data on the ALLL

Part I remains in the schedule for non-adopters. Part II added for banks that have adopted. By 4Q2022*, only the new table will remain as Part

Part II. Disaggregated Data on the Allowances for Credit Losses[1]

Schedule RI-C, Part II is to be completed by institutions with $1 billion or more in total assets.[2]

Dollar Amounts in Thousands	Amortized Cost (Column A)		Allowance Balance (Column B)	
	RCFD	Amount	RCFD	Amount
Loans and Leases, Held for Investment:				
1. Real estate loans:				
a. Construction loans	XXXX		XXXX	
b. Commercial real estate loans	XXXX		XXXX	
c. Residential real estate loans	XXXX		XXXX	
2. Commercial loans[3]	XXXX		XXXX	
3. Credit cards	XXXX		XXXX	
4. Other consumer loans	XXXX		XXXX	
5. Unallocated			XXXX	
6. Total (sum of items 1.a. through 5)[4]	XXXX		XXXX	

Dollar Amounts in Thousands	Allowance Balance	
	RCFD	Amount
Held-To-Maturity Securities:		
7. Securities issued by states and political subdivisions in the U.S.	XXXX	
8. Mortgage-backed securities (MBS) (including CMOs, REMICs and stripped MBS)		
a. Mortgage-backed securities issued or guaranteed by U.S. Government agencies or sponsored agencies	XXXX	
b. Other mortgage-backed securities	XXXX	
9. Asset-backed securities and structured financial products	XXXX	
10. Other debt securities	XXXX	
11. Total (sum of items 7 through 10)	XXXX	

Schedule RI-E - Explanations

Several new items added in items 4 and 6. Item number 4 will provide reporting on the cumulative effect net of taxes recognized in retained earnings. This will be removed once every bank has adopted.

Items 6a and 6b are used to recognize the allowance for credit losses under CECL for PCD assets and loans HFI and HTM debt securities.

4.a. Adoption of Current Expected Credit Losses Methodology - ASC Topic 326[1,2]	XXXX	
6.a. Initial allowances for credit losses recognized upon the acquisition of purchased credit-deteriorated assets on or after the effective date of ASU 2016-13[1]...	XXXX	
6.b. Effect of adoption of current expected credit losses methodology on allowances for credit losses on loans and leases held for investment and held-to-maturity debt securities[1,2].........................	XXXX	

Changes to Schedule RC – Balance Sheet

- Only asset category that is reported gross (separate items for amortized cost and allowance) is loans.

- Item 2a: HTM Securities – should be reported <u>net</u> of allowance

- Item 3b: Securities purchased under agreements to resell – should be reported <u>net</u> of allowance

- Item 11: Other Assets – should be reported <u>net</u> of allowance for credit losses.

Schedule RC-B Securities

- Allowance for credit losses should <u>not</u> be deducted from amortized cost amounts in Columns A and C.

Schedule RC-C Loans and Leases

- All loans and leases continue to be reported gross of allowance.
- Part I Memo Items 7a and 7b (related to PCI assets) are eliminated.

Schedule RC-F and G Other Assets and Other Liabilities

- Schedule RC-F – All assets are reported <u>net</u> of allowance for credit losses.

- Schedule RC-F Item 1 "Accrued Interest Receivable"- a footnote will be added to exclude any accrued interest receivable that are reported elsewhere as part of a FA's amortized cost.

- Schedule RC-G Item 3 :Allowance for Credit Losses on Off Balance Sheet Credit Exposures" – only report the allowance for off balance sheet credit exposures that are not unconditionally cancellable by the bank.

Schedule RC-H, K, and N

- Schedule RC-H Selected Balance Sheet Items Item 3 “Securities Purchased Under Agreements to Resell” – Report at amortized cost net of any allowance for credit losses.

- Schedule RC-H Items 10-17 – Instructions will be revised to state that the allowance for credit losses should not be deducted from amortized cost for HTM debt securities in Column A.

- RC-K Quarterly Averages – Instructions will be revised to state that the allowance for credit losses should not be deducted from amortized cost amounts when calculating averages for all debt securities.

- Schedule RC-N Past Due and Nonaccrual Loans and Leases and Other Assets Memoranda Items 9a and 9b – These are eliminated as they relate to PCI loans. We will see them until all banks have adopted in 4Q2022*.

Schedule RC-R Regulatory Capital

- There are a number of changes on this schedule and many related to re-naming the ALLL to the ACL.
- The instructions for RC-R will be revised to explain how a bank that has elected the phase-in option should calculate the line items 30a, 36, 45a.
- RC-R Item 2 “Retained Earnings” – should include the applicable portion of the CECL transition amount here.
- RC-R Item 2a – this is a new line item that asks institutions to indicate if they will be using a CECL transition election. This will be removed in 1Q2025*.

Schedule RC-R Regulatory Capital, Continued

- RC-R Part II Risk-Weighted Assets – Instructions will be revised to state that risk-weighting for HFI loans, HTM securities, and other FAs should be calculated at amortized cost gross of ACL but net of ACL for PCD.

- RC-R Part II Memoranda Item 4 – this is a new item.

	RCFD	Amount
4. Amount of allowances for credit losses on purchased credit-deteriorated assets[1]:		
a. Loans and leases held for investment	XXXX	
b. Held-to-maturity debt securities	XXXX	
c. Other financial assets measured at amortized cost	XXXX	

Questions?

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