FDIC

FEDERAL DEPOSIT INSURANCE CORPORATION

Current Expected Credit Losses (CECL) Status Update 2018

FDIC Atlanta Regional Regulatory Conference Call

September 27, 2018

CECL Overview

- 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
- ASC Topic 326
- 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 Overview

- **Replaces:**
  - ASC 450-20 (FAS 5) Loss Contingencies
  - ASC 310-10-35 (FAS 114) Accounting by Creditors for Impairment of a Loan
  - ASC 310-30 (SOP 03-3) on Purchase Credit Impaired Loans
- **Partial Replacement to:**
  - ASC 310-40 (FAS 15) related to TDRs. The TDR classification will remain but all references to impaired loans or impairment have been removed. A restructure is still not a "new loan". However, allowance determination is now required based on CECL.

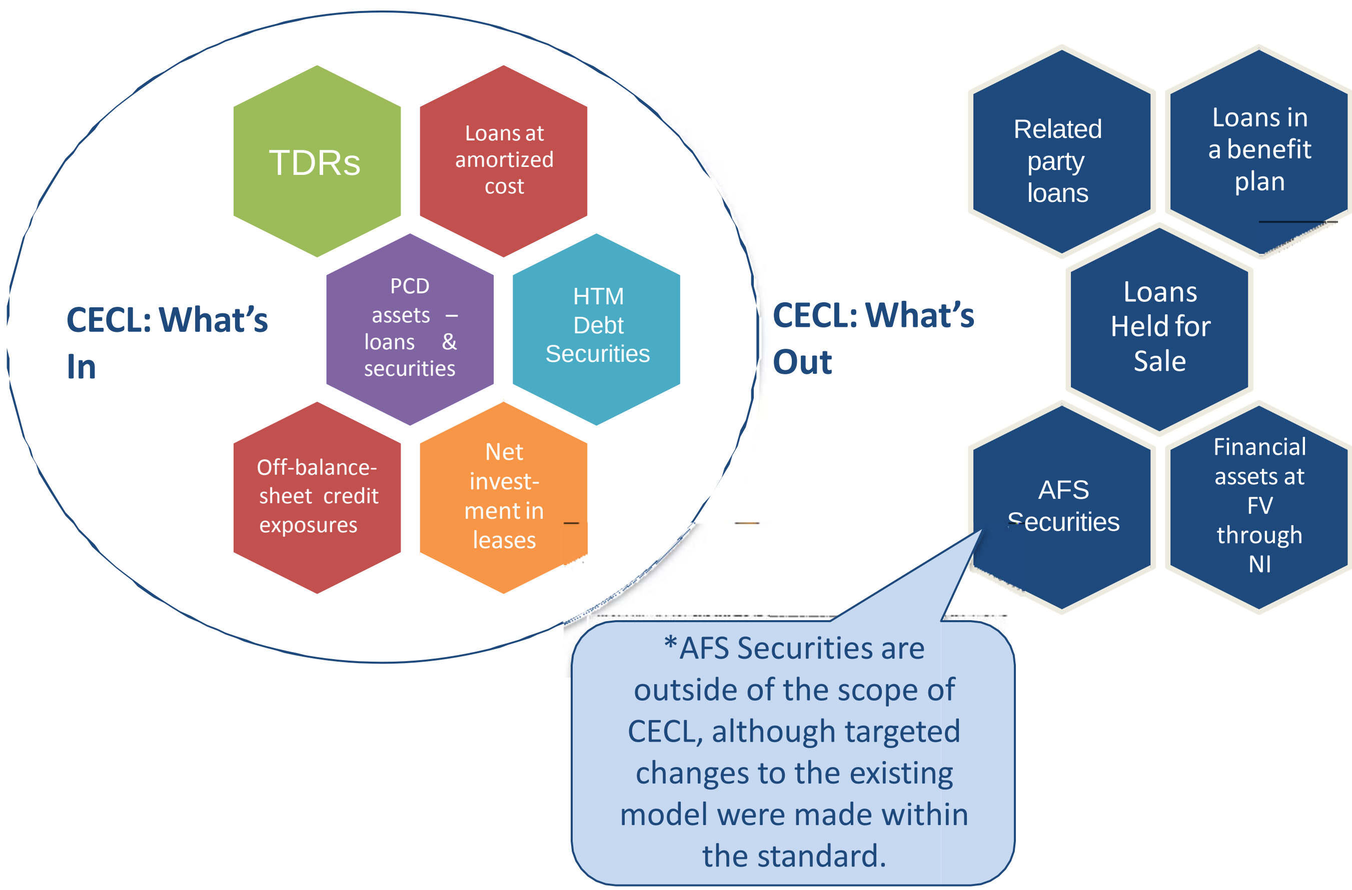
CECL – Measurement

- CECL requires estimate of expected credit losses to be based on **relevant information about past events, current conditions, and reasonable and supportable forecasts** that affect the expected collectability of the financial assets' remaining contractual cash flows
- Qualitative factors remain relevant under CECL
  - To adjust historical credit loss information for current conditions and reasonable and supportable forecasts, institutions should continue to consider all significant factors relevant to determining the expected collectability at each reporting date

CECL – Beyond Forecast

- **What is done if contract term is longer than reasonable and supportable forecast period?**
  - 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 systematic basis
  - Not required to search all possible information that is not reasonably available without undue cost and effort
  - Not required to develop hypothetical pool

CECL: More than Loans

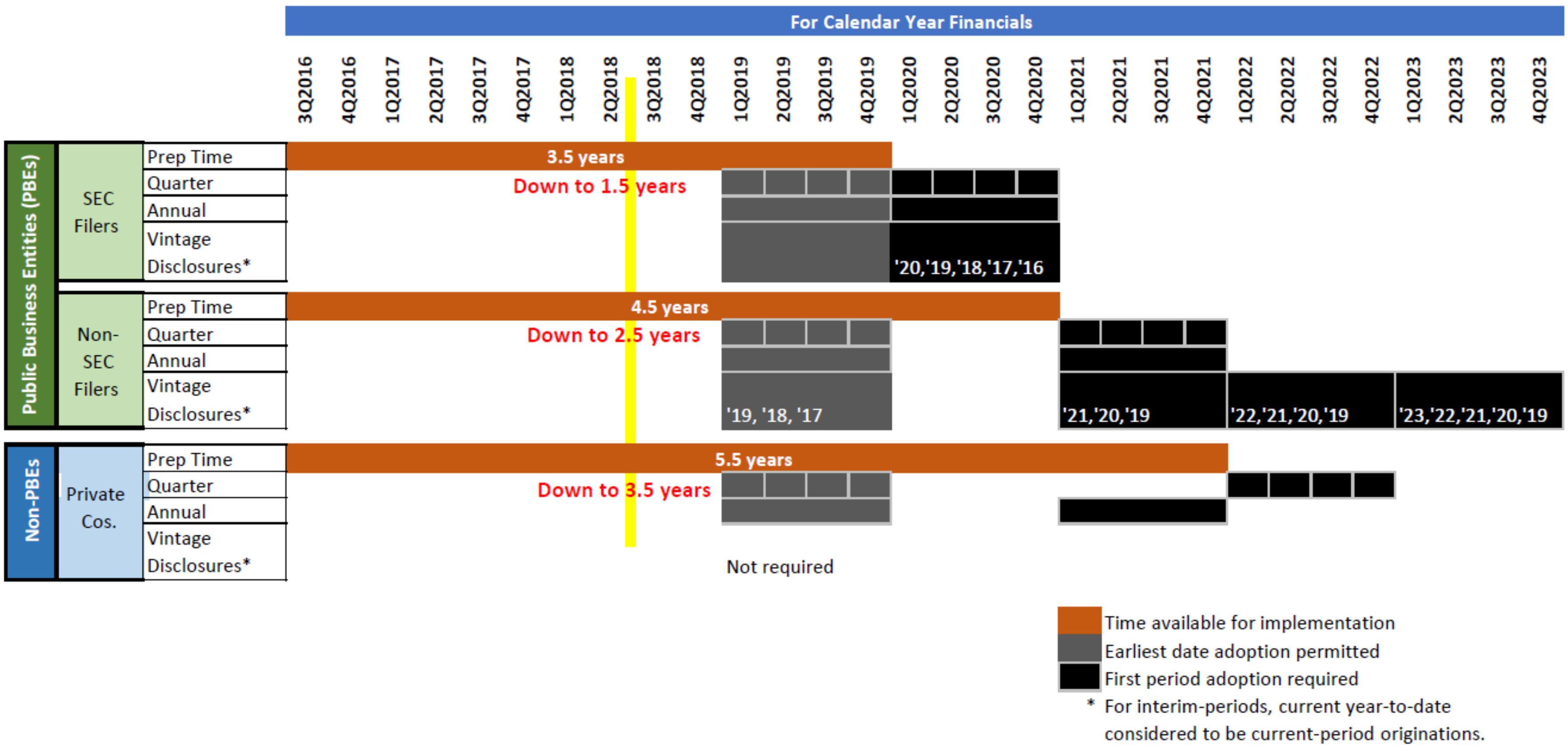


CECL Effective Dates

Entity Type	U.S. GAAP Effective Date	Call Report Effective Date*
Public Business Entities (PBEs) that are SEC Filers	Fiscal years beginning after 15 December 2019, including interim periods within those fiscal years	**Q1 2020 (31 March 2020)**
Other PBEs (Non-SEC Filers)	Fiscal years beginning after 15 December 2020, including interim periods within those fiscal years	**Q1 2021 (31 March 2021)**
Non-PBEs*	Fiscal years beginning after 15 December 2020, including interim periods beginning after 15 December 2021*	**Q4 2021 (31 Dec. 2021)**
Early Application	Early application permitted for fiscal years beginning after 15 December 2018, including interim periods within those fiscal years	**Permissible No earlier than 31 March 2019**

* On July 25, 2018, the FASB voted to propose changing the effective date for non-PBEs to fiscal years beginning after December 15, 2021.

Effective Dates with Countdown



SEC = U.S. Securities and Exchange Commission

Source: Based on the Financial Accounting Standards Board's (FASB's) Federal Financial Institutions Examinations Council Presentation

* On July 25, 2018, the FASB voted to propose changing the effective date for non-PBEs to fiscal years beginning after December 15, 2021.

CECL Implementation

- **During initial implementation activities, agencies encourage institutions to:**
  - Become familiar with the new standard
  - Educate the Board and appropriate staff about the CECL methodology and how it differs from incurred loss methodology
  - Determine the applicable effective date (SEC, PBE, non-PBE)
  - Develop a preliminary timeline with due date deliverables based on institution's effective date
  - Identify functional areas within the institution that should participate in implementation (team members will likely include accounting, credit, IT, methodology modelers, audit)
  - Review existing allowance and credit risk management practices to identify processes that can be leveraged when applying the new Standard

CECL Implementation

- **During initial implementation activities, agencies encourage institutions to:**
  - Establish communication between Institution, Auditor, & Regulator
  - Begin to select loss estimation method(s) that reasonably estimate expected collectability and can be properly supported
  - Determine proper segmentation of financial assets based on similar risk characteristics
  - Perform a system and data assessment
  - Consider a period of time for a parallel run before effective date
  - Consider operational efficiency and adequate controls and documentation. Reasonable and supportable forecasts represent an estimate that will require senior management/Board reviews and approvals
  - Evaluate and plan for potential impact on regulatory capital of CECL and other accounting changes (e.g., leases)

CECL - Data Needs & Sources

- Collect and maintain data relevant to estimating lifetime expected credit losses that align with chosen methodology
- Identify currently available relevant data that should be maintained
- Consider what additional data may be necessary to collect and maintain for a sufficient period of time
- Discuss the availability of historical loss data internally and with core service providers

CECL - Data Needs & Sources

Examples of Basic Required Data

- Unique loan identifier (e.g., account or loan number, borrower number)
- Loan product type
- Origination date
- Origination amount
- Maturity date
- Portfolio segmentation identifier
- Beginning and ending balances of a portfolio segment
- Periodic & cumulative charge-off & recovery amounts by date and unique loan identifier
- Pay down by unique loan identifier (scheduled payment and prepayments)

CECL - Data Needs & Sources

Other Types of Useful Data

- Collateral/Asset Type
- Performance Status (e.g., current, past due)
- Other relevant credit risk metrics (e.g., LTV, credit scores, geographic location)
- Renewal and/or modification date
- Credit quality risk tracking
- Any data necessary to make current condition and forecast adjustments

CECL - Data Needs & Sources

- **What if your bank doesn't have all of the data needed to determine lifetime loss rates?**
  - Peer data
  - Other external data
  - Extrapolate/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).

CECL Implementation

- **Day 1 Adjustment**

  On the effective date: Retained earnings will be reduced and the Allowance for Credit Losses (ACL) will be increased for the difference between the reserve under the incurred loss method and the ACL under the CECL method.

  Debit – Retained Earnings

  Credit - ACL

CECL – PCD Financial Assets

- Purchased credit-deteriorated (PCD) financial assets
  - PCD replaces purchased credit impaired (PCI) utilized in current GAAP
  - In definition, “significant deterioration” has changed to “**more than insignificant deterioration**” in credit quality since origination
    - Expected credit losses are recognized as an allowance through a gross-up to the balance sheet
      - No Day 1 P&L impact
    - Noncredit-related discount or premium must be allocated to individual asset
    - Increases / Decreases in expected credit losses recognized immediately in earnings as a provision for credit losses

CECL – PCD Financial Assets

ABC Bank pays $750,000 for a debt instrument with a par amount of $1,000,000. The instrument is classified at amortized cost. At the time of purchase, the expected credit loss embedded in the purchase price is $175,000. There has been a decline in the credit quality of the debt instrument which is considered more than insignificant. What is the entry to record purchase?

Loan – Par Amount	$ 1,000,000	
Loan – Noncredit Discount		$ 75,000
Allowance for Credit Losses		175,000
Cash		750,000

CECL – Regulatory Capital

- Regulatory agencies issued a Notice of **Proposed** Rulemaking (NPR) to address:
  - The regulatory capital treatment of allowances under CECL
  - Propose an ***optional*** transition to phase in the day-one regulatory capital effects of adopting CECL
- Federal Register Notice was issued on May 14, 2018
- Sixty day comment period closed on July 13, 2018
- https://www.fdic.gov/news/board/2018/2018-04-17-notice-dis-a-fr.pdf

CECL – Regulatory Capital

- **Allowance for Credit Losses**
  - Newly defined term in the capital rules for banks upon adoption of CECL.
  - ACL would include credit loss allowances related to financial assets measured at amortized cost, except for allowances for PCD assets.
  - ACL would be eligible for inclusion in Tier 2 capital subject to the current limit for including ALLL

CECL – Regulatory Capital

- **CECL Transition NPR**
  - Provide an option to phase-in the day one adverse capital impact of CECL adoption over a three year period.
  - Assuming a bank needs to recognize an increase to ACL of $200M:

(In thousands)	Transitional Amounts	Transitional Amounts Applicable during Each Year of the Transition Period		
		Year 1 - 75%	Year 2 - 50%	Year 3 - 25%
Increase retained earnings and average total consolidated assets by the CECL transitional amount	$ 158.00	$ 118.50	$ 79.00	$ 39.50
Decrease temporary difference DTAs by the DTA transitional amount	$ 42.00	$ 31.50	$ 21.00	$ 10.50
Decrease ACL by the ACL transitional amount	$ 200.00	$ 150.00	$ 100.00	$ 50.00

CECL – Call Report Revisions

- **Proposed revisions to Call Report forms and instructions for implementation of CECL to be issued for industry comment**
- **Revisions planned to be in place for March 2019 Call Report for any early adopters**
- **Affected Call Report schedules include:**
  - Schedule RI – Income Statement
  - Schedule RI-B – Charge-offs and Recoveries on Loans and Leases and Changes in Allowance for Loan and Lease Losses
  - Schedule RI-C – Disaggregated Data on the Allowance
  - Schedule RC – Balance Sheet
  - Schedule RC-R – Regulatory Capital

CECL – Exam Expectations

- **What should institutions expect from examiners during the implementation period?**
  - Examiners will begin discussing the status of implementation plans or efforts
  - Examiner expectations will be tailored based on size and complexity of the institution and effective date
  - Regulatory agencies expect a good faith effort to achieve a sound and reasonable implementation of the standard

CECL Resources

- **FDIC's Accounting and Auditing Resource Center**
  - https://www.fdic.gov/regulations/accounting/cecl.html
    - **Link to ASU 2016-13**
    - **Interagency Joint Statement**
    - **Interagency Frequently Asked Questions**

- **FDIC, FRB, CSBS and SEC on the Ask the Fed platform**
  - FIL-8-2018 Community Bank Webinar: Implementation Examples for the Current Expected Credit Losses Methodology (CECL)
  - FIL-34-2018 Community Bank Webinar: Current Expected Credit Losses Methodology Q&A Webinar for Community Bankers
  - The webcasts are recorded and the link on the FIL will allow you to listen as your schedule permits.

QUESTIONS

Contact Information

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