Financial Instrument Impairment Model Changes: Current Expected Credit Losses (CECL)

FDIC Atlanta Region Regulatory Conference Call
June 22, 2017
Current Expected Credit Loss (CECL)

  - Introduces CECL methodology and replaces existing incurred loss methodology
  - Provides initial supervisory views regarding implementation of the new standard (FDIC FIL-39-2016)
- Agencies issued Frequently Asked Questions (FAQs) on 12/19/2016 that focus on application of the standard and related supervisory expectations (FDIC FIL-79-2016)
Frequently Asked Questions on CECL

Why are we changing from the existing incurred loss methodology to CECL?
Frequently Asked Questions on CECL

What will change with implementation of CECL?

- Held for Investment Loans
- HTM Debt Securities
- Purchased Credit Deteriorated Loans
Frequently Asked Questions on CECL

Does CECL apply to all institutions?

When does CECL take effect?
# CECL Effective Dates

<table>
<thead>
<tr>
<th>Category</th>
<th>U.S. GAAP Effective Date</th>
<th>Call Report Effective Date</th>
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</thead>
<tbody>
<tr>
<td>Public Business Entities (PBEs) that are SEC Filers</td>
<td>Fiscal years beginning after 12/15/2019, including interim periods within 2020</td>
<td>3/31/2020</td>
</tr>
<tr>
<td>Other PBEs (Non-SEC Filers)</td>
<td>Fiscal years beginning after 12/15/2020, including interim periods within 2021</td>
<td>3/31/2021</td>
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<tr>
<td>Non-PBEs</td>
<td>Fiscal years beginning after 12/15/2020, including interim periods beginning after 12/15/2021</td>
<td>12/31/2021</td>
</tr>
<tr>
<td>Early Application</td>
<td>Early application permitted for fiscal years beginning after 12/15/2018, including interim periods within those fiscal years</td>
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Frequently Asked Questions on CECL

How should banks apply CECL upon initial adoption?

Have the agencies prescribed a specific CECL model or established acceptable benchmarks for the ALLL?
How should institutions account for “purchased credit deteriorated” assets under CECL?

Will adoption of CECL impact regulatory capital?
Frequently Asked Questions on CECL

Can institutions build their ALLL levels in anticipation of adopting CECL?

What should institutions do to prepare for the implementation of CECL?
Planning for the CECL Model

Institutions are encouraged to:

- Become familiar with the standard and educate board of directors and staff
- Determine applicable effective date
- Identify impacted functional areas within the institution (accounting, credit, risk, systems, operations)
- Develop a CECL implementation plan and timeline
- Take inventory of what data is available from existing systems
- Determine measurement method(s) to be used
- Determine what data gaps exist with current systems
- Determine what additional data will be required and whether these data can be extracted with existing resources
- Consider whether to obtain third party support
- Consider documentation needed to support allowance estimates
- Consider controls over financial reporting (Part 363 and SOX)
- Assess potential impact of the new accounting standard on capital
- Discuss implementation plan with external auditor and regulators
Planning for the CECL Model

Data Fields and Identifiers to Consider:

• Loan/financial category
• Account or loan number
• Loan type/purpose
• Borrower/guarantor identities
• Current balance
• Commitment amount
• Origination balance
• Origination and maturity dates
• Interest rate and type (fixed, variable including frequency)
Data Fields and Identifiers to Consider (continued):

- Payment type (P&I, balloon, I/O, etc.)
- Lien position and additional debt secured by property
- Prepayment activity or support for “life of loan” assumptions
- Initial and subsequent charge-off amounts and dates
- Cumulative loss amounts
Planning for the CECL Model

Common Risk Identifiers to Consider:

- Risk rating
- Date of risk rating change
- NAICS or SIC code
- Location of borrower (city/state/zip)
- Location of collateral
- Property type or other collateral type
- Appraised values and dates for collateral

- Collateral coverage (LTV) at origination
- Current LTV
- DSCR/Debt to income ratios on commercial loans
- Recovery amounts
- Credit enhancements
- Default date
Frequently Asked Questions on CECL

Will the accounting for TDRs change?
## Estimating Impact of CECL

### Product Mix by Type and Duration:

<table>
<thead>
<tr>
<th>Duration</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Short</strong></td>
<td>• Shorter duration loans that are already measured based on expected cash flow will have less or little impact (impaired loans already under ASC 310 or short-term loans such as credit cards or 12-month lines of credit or revolvers)</td>
</tr>
<tr>
<td><strong>Medium</strong></td>
<td>• Medium duration loans (auto loans, certain fixed or revolver commercial loans) will be affected more</td>
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<tr>
<td><strong>Long</strong></td>
<td>• Long-term loans such as residential mortgage and/or commercial real estate loans have a longer duration so they will be affected most</td>
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Estimating Impact of CECL

Impact will also depend on allowance level and current and future expected economic conditions upon implementation.

Agencies will not establish benchmark targets or ranges for the change in institutions’ allowance levels upon adoption of CECL or for allowance levels going forward.
Should institutions use third-party vendors to assist in measuring expected credit losses under CECL?
What should institutions expect from regulators prior to CECL’s effective date?
Agency Activities

• June 17, 2016, Press Release and Joint Statement from the Agencies (FIL-39-2016)

• December 19, 2016, New Accounting Standard on Credit Losses: FAQs (FIL-79-2016)

• Ongoing interagency communication with:
  o State Bank Supervisors
  o Auditors
  o Data Processors
  o FASB
  o SEC
  o PCAOB

• Educational outreach

• Dedicated e-mail address: CECL@fdic.gov
Questions

ATLConferenceCall@FDIC.gov