

ask the Regulators



CECL Questions and Answers for Community Institutions July 30, 2018

Erik Soell: Good afternoon, everyone. Welcome to today's session. Our topic: CECL Questions and Answers for Community Institutions. This is Erik Soell from the Fed. We have lots of smart people from different agencies, as seen here on Slide 1, assembled in this room to address your questions related to CECL. We have all collected your questions over the past few months and have selected a set of Q&A's to cover in this webinar in the next 90 minutes. Time permitting, we will also be taking questions that you send us during the call, and we've gotten lots of questions before the session and even in the last few minutes. So, that's great. Keep that coming.

Let's jump to Slide 2. As I said, please keep sending us your questions for today, especially if we need to clarify a point or maybe even restate something. This is the time to do that. So, you can contact us at either the email address rapid@stls.frb.org or, if you're in the webinar, you can use the Ask Question button. As I said, we've received lots of questions, many of which we are going to cover today. So, for the webinar experience, you can listen to the audio through your PC speakers or through your phone. If you use the phone option, make sure that the slides sync with the audio, and you have to change some settings to do that. So, if you're in the webinar, go to the little grey gear at the upper right corner of the slide window just above the presentation, and, from there, you can see a few options in the Media Chooser, and it's easy. Just select the Phone option, and you'll be all synced up.

A reminder, we do record every session, and we are recording today's session. And if you want to get the link to the recording, use the exact same link that you used for today. And we will send out a survey after the call for your thoughts and ideas. We appreciate everyone's feedback. As a reminder, the opinions expressed in the presentations are statements of the speaker's opinion and are intended only for informational purposes and are not formal opinions of nor binding on any of the agencies on today's call. So, let's go to Slide 3, and I would love to have all of our presenters introduce themselves and just do a quick introduction. So, Joanne, I'm going to start with you. Would you start us off?

Joanne Wakim: Sure. Joanne Wakim, Chief Accountant, Federal Reserve.

Bob Storch: Hi, this is Bob Storch, Chief Accountant at the FDIC.

John Rieger: John Rieger, Deputy Chief Accountant at the FDIC.

Sydney Menefee: Sydney Menefee, incoming Chief Accountant at the OCC.

Mike Berrigan: From the SEC, this is Mike Berrigan, Professional Accounting Fellow within the Office of the Chief Accountant.

Jami Flynn: For CSBS, this is Jami Flynn with the Director of Supervisory Processes.

Shayne Kuhaneck: With the Financial Accounting Standard Board, this is Shayne Kuhaneck, Assistant Director of Technical Activities.

Erik Soell: Awesome. All right, thank you. So, let me hand this over to Joanne for a few opening thoughts before we begin. So, Joanne.

Joanne Wakim: Great. Thanks, Erik. And thank you to everyone on the line for taking time out to be with us during the webinar. It's great to be here with you today. Each of us assembled in this room has received questions from you on CECL over the past few months at our various outreach events, and we're going to cover those questions today. Our goal with this webinar and all of our agency webinars is to keep the information pipeline open and to be a resource to you for your questions. Some questions came in that involve unique facts and circumstances, and we won't be addressing those today. Our focus will be on questions, issues, or themes that make sense for us to answer on an interagency basis. For questions that involve specific facts and circumstances unique to your institution, you should reach out to your primary regulator. That will always be the right place to get answers to those very specific questions. So, with that, Erik, let's get started.

Erik Soell: All right. So, we're going to jump into the Q&A. So, I'm going to start on Slide 6 with the Q&A questions, and you'll see we're going to go through these. So, let's start. Question number 1. Small and less complex. Is there a definition of small and less complex or a set of factors to consider in determining whether an institution fits that description? Would most institutions under the FDIC's \$10 billion threshold for large and highly complex qualify?

Joanne Wakim: This is Joanne. I'll take this question. We use the phrase smaller and less complex in our FAQs. You will find that phrase in FAQ number 7, number 8, and number 22. The topics for those questions are whether complex modeling techniques are required for community banks, and then also on segmentation. We added those questions because we had heard that community banks believed CECL would require them to hire PhDs and to use econometric models or maybe run a discounted cash flow method for pools of loans. So, we use the phrase "smaller and less complex" to really get across the idea that CECL is scalable to institutions of all sizes. And it would be good here to consider the range of methods that we currently have under the incurred loss (method). Currently, under the incurred loss methodology, allowance methods are also scaled to the size and the

complexity of the institution, ranging from a simple spreadsheet to complex econometric models. We, as agencies, expect a similar array of methodologies when CECL is implemented, but it the methodology at any institutions should match up with the size and complexity of an institution, just as we find today.

The agencies do not have a definition for smaller and less complex. We have not established a bright line. Maybe another way to really look at it as that we're saying generally an institution should not have to leapfrog into an econometric model or a discounted cash flow model for pools to estimate CECL if you are not already using that type of methodology. So for example, if you're using a loss rate based methodology, and there are several of those, it's not likely that you'll have to move to an econometric model or a discounted cash flow model. It is likely you'll be able to continue use the type of methodology that you have been using under the incurred loss (method). But please note, your assumptions and inputs will need to change in order to arrive at a lifetime estimate.

Erik Soell: Excellent. All right, next question, number 2. This is on supervisory expectations. So, what can community institutions expect during 2018 examinations related to CECL? Do examiners have a standard set of expectations for community institutions?

John Rieger: This is John Rieger from the FDIC. Thanks, Erik. Community banks can expect that examiners will be interested in and asking how they are progressing in their preparation for CECL. An excellent reference point is the FAQ's number 22, which was prepared by the agencies. And I'll just highlight a few of those items. To become familiar with the new accounting standard, and educate the board of directors and appropriate institutional staff about CECL and how it differs from the incurred loss model. You have to determine the applicable effective date. That's going to be very important, whether you're a publicly traded company, a PBE (that is not an SEC filer), or a non-PBE.

You need to determine the steps and the timing needed to implement the new accounting standard; identify the functional areas within the institution that should participate in the implementation of the new standard; discuss the accounting standard with the board of directors, audit committee, industry peers, and your external auditors; review existing allowance and credit risk management practices; and determine the allowance estimation method or methods that you will be using. You need to evaluate and plan for the potential impact of the new accounting standard on your regulatory capital. Now, I'm going to turn it over to Jami and the CSBS.

Jami Flynn: Excellent. Thank you, John. I'd just like to make note that the FDIC, Federal Reserve, and CSBS have partnered to develop a plan to evaluate CECL preparedness. We have also partnered to provide tools to assist regulators and financial institutions to begin the dialog, engage CECL preparedness efforts. Please note, at this stage, our focus is on information gathering, and we are not examining for CECL, at this time. I'll now turn it over to Sydney.

Sydney Menefee: Thanks, Jami. Similar to the CSBS, FDIC, and the Fed, the OCC's focus is CECL readiness, and we are not examining for CECL. As part of the OCC's recently completed periodic monitoring at community banks, OCC examiners discussed similar readiness topics that John mentioned with OCC's supervised institutions, and we expect those conversations to continue.

Erik Soell: Excellent. Let's go to Question number 3. So, this is on Slide 7. Again, supervisory expectations. How will the agencies evaluate the institutions' process to determine allowance for credit losses, or ACL, under CECL? Will examiners challenge institutions if their method results in a lower ACL under CECL than under the incurred loss model?

Bob Storch: Thanks, Erik. This is Bob Storch from the FDIC. An institution should have support and documentation for their CECL allowances. These allowances should be reasonable and supportable, and the allowances should make sense for the institution, taking into consideration the institution's risk appetite and underwriting standards, the quality of its loans, and the performance and other characteristics of its portfolio. When an institution first adopts CECL, if the overall CECL allowance is lower than the overall allowance that had existed under the incurred loss methodology immediately before adoption, the institution should be prepared to offer documentation and support for the lower allowance under CECL.

More broadly, and on an ongoing basis, your examiner would challenge your bank if your allowance level is unreasonably low. If your examiner's review of your CECL estimation process indicates that the inputs into your allowance estimate, including historical loss information and management's forecasts, assumptions, and judgments, do not appear reasonable and are not properly supported. Each institution's allowances for credit losses under CECL should be based on an institution-specific analysis of the loans in its portfolio and the other assets and exposures within the scope of CECL. Because allowance levels under CECL depend on institution-specific factors, the agencies will not establish benchmark targets or ranges for allowance levels upon adoption of CECL or going forward. The agencies' objective is not to drive institutions to maintain allowance levels that approximate the peer group median but to maintain allowances that are appropriate for their specific portfolios under CECL.

Erik Soell: Excellent, thank you. All right, next question, number 4. Third-party vendors. So, do the agencies have a specific expectation regarding the use or purchase of third-party vendor services to implement CECL?

Joanne Wakim: This is Joanne from the Fed. So, we have heard from you, from bankers, that many institutions are seeking help from third-party service providers either to assist in capturing and maintaining data or to provide supplemental data or in the estimation methodology itself. Question number 16 of our FAQs discusses third-party vendors. And just

to reiterate, we will not require institutions to engage third-party service providers. At the same time, we will not preclude institutions from engaging third-party service providers. You may decide that using a vendor is the appropriate path for your institution, but it's not something that we will be requiring. So, it's a decision that each organization will need to make for itself. If you do choose to use a third-party vendor to assist you with your process, you should follow the agencies' guidance on third-party service providers.

The FAQ I just mentioned, FAQ 16, includes links to each agency's guidance on the use of vendors, and you can also see them on the slide. If you choose to use a third-party, remember, you are still responsible for understanding all the inputs, the assumptions, and the methodology that goes into the estimation for your CECL allowance. That responsibility cannot be outsourced to someone else, because CECL has to be management's estimate.

Sydney Menefee: And Joanne, I just wanted to add that-- and it isn't in the guidance she just mentioned. I would like to direct OCC's supervised institutions to the third-party risk management and CECL webinar available on BankNet that originally aired on April 26. The slide's transcript and playback are all available on BankNet.

Erik Soell: All right, let's jump to Slide 8. We're going to go to Question number 5 on charge-offs and recoveries. So, when determining historical loss rates to use in the calculation for ACL, how should recoveries be considered in the charge-offs? For example, net or gross of recoveries?

Shayne Kuhaneck: Thanks, Erik. This is Shayne from the FASB. I think I'll answer this one. The simple answer is that recoveries should be considered when you're doing your loss, but I do think that there needs to be a little bit of an explanation here, because this is a live, active discussion and was discussed by the Transition Resource Group at the recent June 11, 2018 meeting. And, as you all may remember, the Transition Resource Group comes together periodically to talk about implementation issues that institutions are experiencing out there in the marketplace. And it's comprised of a broad spectrum of stakeholders.

So, by way of background, prior to that meeting, stakeholders informed the staff that there was diversity in views on whether future expected cash received; that is, expected recoveries; from a financial asset that had been written off or may be written off in the future were to be included in the calculation of expected credit losses. They commented that the principle in paragraph 326-20-30-1 implies that a recovery of financial assets should be included in the net amount expected to be collected and, therefore, by extension, be included in the allowance calculation. However, because paragraph 326-20-35-8 specifically states that recoveries on written-off assets should be recorded when received, stakeholders disagree whether it is appropriate or inappropriate, whether an entity is required to include estimates of expected recoveries when measuring the expected credit loss for financial assets on an individual or pool basis.

So, during the TRG meeting, the staff noted the following. The staff believes that the board's intent is clear that expected recoveries should be estimated and included in the calculation of the allowance if the information used to measure expected recoveries is determined to be reasonable and supportable. Given that the issue of including expected recoveries is a broad issue about the application of the CECL model, the staff believes including expected recoveries should be applied consistently. That is, at the pool level or when determining the loss on individual assets. The staff acknowledged that applying expected recoveries to an individual financial asset may yield different results than including expected recoveries on a pool basis. However, the overall framework of Topic 326 should be consistently applied regardless if an entity is measuring the allowance of credit losses on a pool basis or an individual basis. The staff believes that because estimation of expected recoveries is an input to the overall calculation of the allowance for credit losses that offsets the expected amount of loss, it relates to the measurement of the underlying asset and therefore should be included as part of the valuation account and not a direct write-up of the assets. The staff also highlighted that if an estimate of expected recoveries is included when measuring expected credit losses, this may result in assets with expected recoveries that are greater than their amortized cost basis.

So, at the meeting, several TRG members questioned whether entities would be required to include an estimate of expected recoveries in the allowance calculation. These TRG members, instead, supported providing entities with the option to include expected recoveries in the calculation of the allowance for credit losses, noting that this would be a more practical outcome, especially for certain portfolios such as credit cards. Some TRG observers did not support including expected recoveries in the allowance calculation for individual assets. These observers noted that it might be difficult to justify having expected recoveries on an individual asset without any incremental performance. Finally, some TRG members supported requiring that expected recoveries in excess of the amortized cost basis be classified as an asset on the balance sheet, as opposed to a debit balance allowance.

So, given all of the feedback at the TRG meeting, the staff plans to address the issues raised by the TRG members and the observers with the board at an upcoming meeting that will likely be at the end of August or the first week in September. The staff will address specific discussions raised by TRG members and observers regarding whether recoveries should be a required input that is used to measure the allowance or if entities should be provided an accounting policy election to include recoveries in the measurement of expected credit losses either on a group or individual basis, relative disclosures, and whether any presentation requirements are necessary for situations where the allowance is a negative or an asset balance.

Erik Soell: Excellent. Thank you, sir. All right, Question 6 on Slide 8. This is on peer data. So, is it acceptable to use data from various regulatory reports, for example, FFIEC Call Reports? What types of peer data are available as a reference for historical loss experience?

Sydney Menefee: I can take this one. This is Sydney with the OCC. It is acceptable to use external data, such as peer data, for example, from the call report. Similar to practice today, when an institution does not have historical loss data to estimate credit losses for a group of loans with similar risk characteristics, reference to peer data may be appropriate, provided, of course, that the data is relevant to the institution's group of loans. While we most often see the use of proxy data today when an institution offers a new product for which it does not have a historical loss data, we may see this more often in the beginning years of CECL, because institutions may fill gaps in their own internal historical loss data by referencing peer data. An institution should only use peer data as a proxy if their own historical loss experience until it has developed sufficient loss experience necessary to estimate losses over the life of its own loan.

So, as I mentioned, it may be appropriate to reference peer data in the beginning years of CECL. However, the bank should eventually accumulate and rely on its own historical loss data. Some examples of regulatory reports institutions may find helpful include, but are not limited to, the OCC's Mortgage Metrics Report; Call Report; Uniform Bank Performance Report, more commonly referred to as the UBPR; and the FDIC's Statistics on Depository Institutions. I also will highlight, peer data is not the only source of data. Institutions are permitted to use external data from private, third-party data service providers. That may also be an acceptable source.

Erik Soell: Excellent. Thank you. So, we just talked about historical data, so let's jump to number 7 on the bottom of Slide 8, historical data. What is the minimum number of years of historical data required to calculate the ACL?

Sydney Menefee: Okay, I'll take that one, as well. The standard requires institutions to recognize expected credit losses over the contractual life of the loan adjusted for prepayment and reasonably expected TDRs. As such, institutions will need historical loss data that covers the expected life of the loan. If a bank does not have sufficient internal loss data to cover the life of the loan, the institution will likely need to obtain external loss data or employ qualitative factors to estimate those expected credit losses.

Erik Soell: Okay, thank you. Let's go to Question 8 on the top of Slide 9. So, this is on low historical loss experience. What guidance is available for institutions with zero or extremely low historical loss experience? To what extent may institutions rely on qualitative adjustments to determine the appropriateness of the ACL?

Bob Storch: Thanks, Erik. This is Bob Storch from the FDIC, and I see in one of the questions that was submitted during this event, it's a very similar issue. So, maybe we'll be able to cover that while I respond to this question that's on the slide. In fact, this issue of zero or very low historical losses exists today under the incurred loss methodology, because it's not uncommon for smaller institutions in particular to have an extremely low or zero net charge-off rates in some years.

In the context of incurred losses, if you refer back to the agencies' 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses, it was accompanied by a series of questions and answers on the Allowance for Loan and Lease Losses, again, under the incurred loss methodology. And there was a Question 15 that raised a similar concern about zero or low historical loss experience. So, I'd refer you to that at least for the concepts in the response to Question 15, because they'll continue to be applicable. Obviously, the incurred loss methodology is being replaced.

So, judgment is really important when an institution has zero or extremely low historical loss experience, because each institution's allowance for credit losses under CECL should be based on an institution-specific analysis of the loans in its own portfolio. Because the institution's historical loss experience is extremely low, allowances must be supported based on qualitative factors reflecting the effect of current conditions and reasonable and supportable forecasts on the collectability of the loans in the portfolio.

In addition to current and forecasted changes and local and national economic conditions compared to the conditions that existed over the historical loss period, management should consider such factors as changes in lending policies, changes in the trend and volume of past due and adversely classified or graded loans. And the effect of changes in loan concentrations to determine appropriate allowance levels under CECL. Even taking qualitative factors into consideration, an institution with zero or extremely low historical loss experience would be expected to have lower allowances for credit losses than an institution with a moderate or high level of historical loss experience.

I've already mentioned the focus on institution-specific factors, and, in the frequently asked questions that pertain to CECL that have been referenced already a number of times, Question 17 indicates that the agencies will not establish benchmark targets or ranges for allowance levels upon adoption of CECL or going forward. And that, again, points to the need for an institution to use judgment to come up with an appropriate allowance level.

As a somewhat related matter, in building a little bit on what Sydney talked about already, for new product lines, where an institution won't have had experience of its own, consistent with existing GAAP, an institution would need to look to external historical loss information but would need to consider adjustments to the historical loss information for factors that are identified in the standard itself. Now, the specific paragraph reference is ASC 326-20-30-8. Once sufficient internal historical loss information is available for a product line, the agencies believe such loss information provides a better starting point for estimating allowances under CECL even though the need for adjustments for the same types of qualitative factors should still be considered.

Erik Soell: All right, excellent. Thank you, Bob. So, let's talk about qualitative factors. Question number 9. What qualitative factors would be considered reasonable when using a loss rate method to calculate the ACL?

Joanne Wakim: This is Joanne Wakim, and I'll take that question. Similar to today's practices under the incurred loss methodology, an institution will continue to incorporate qualitative factors when estimating the allowance under CECL. Question number 24 of our FAQs talks about qualitative adjustments. Our FAQs and the accounting standard itself provide examples of factors an institution may consider.

We also have qualitative or environmental factors identified in the December 2006 Interagency Policy Statement on the Allowance. They should continue to be relevant under CECL. However, just like today, we do not require there to be an automatic qualitative adjustment for each of these factors. Currently, under the 2006 Interagency Policy Statement, examiners would not expect to see a qualitative adjustment for every one of these." It will be the same under CECL. These are factors that institutions should consider. There is a difference related to qualitative factors going from the incurred loss to CECL. Under incurred loss, qualitative factors are analyzed and quantified in order to provide an estimate of the allowance considering conditions up to the reporting date. Under the incurred, you'll only be looking at conditions up to the reporting date. However, with CECL, the qualitative factor analysis would need to also incorporate adjustments for conditions going out beyond the reporting date into the forecast period. Then after the forecast period, an institution would revert back to historical loss data that's unadjusted, so no qualitative factors there.

Now, let's talk specifically about the loss rate method to put a little bit more color around that. So, the way the qualitative adjustment would work, you take your historical loss data that you're looking at by portfolio, then you would look at the economic conditions, underwriting standards, and other factors that existed during that historical period. And then you would compare the economic conditions from that period to the current conditions and the conditions you expect over the forecast period. Then you would need to make a qualitative adjustment for the difference in conditions.

Examples of such factors that you might consider might be changes in interest rate, changes in real estate values, underwriting standards, your portfolio mix, or loan term. And if those conditions were different, those that existed during your loss rate history are different from now, then you would need to make some adjustments.

Erik Soell: Excellent. Thank you. All right, let's go to Slide 10 and Question 10. So, is there a minimum preferred range for the reasonable and supportable forecast period? How can institutions estimate losses if the reasonable and supportable forecast does not cover the entire contractual life of the loan?

Sydney Menefee: This is Sydney Menefee with the OCC. The standard does not prescribe bright lines establishing a minimum length of time for the reasonable and supportable forecast period. As such, the determination of an appropriate forecast period requires management judgment. The standard requires reversion to historical loss

information for periods beyond the reasonable and supportable forecast period, commonly referred to as the reversion period. Because of the judgment involved in forecasting, the reasonable and supportable forecast period is expected to vary among banks. Some banks may be able to develop or obtain a reasonable and supportable forecast that covers the entire contractual life of their financial assets, while other banks may not.

Nevertheless, it would be inappropriate for a bank to assert that it cannot develop a reasonable and supportable forecast of any length and therefore rely solely on historical loss information to estimate expected credit losses. It would also be inappropriate for the bank to artificially curtail its reasonable and supportable forecast period and ignore available information that is relevant to the expected credit loss estimate. Each bank should document and support the appropriateness of the forecast period selected. The length of the forecast period is not an accounting election. Thus each bank should periodically review its reasonable and supportable forecast period and make any necessary changes.

Erik Soell: Great. Question number 11. So, reasonable and supportable forecasts. What are the agencies' expectations regarding the use of economic forecasts? Do the agencies expect institutions to use multiple scenarios when developing reasonable and supportable forecasts?

Joanne Wakim: This is Joanne Wakim. The agencies will not require the use of multiple scenarios. However, we will not preclude the use of multiple scenarios if you, as management, deem that it's appropriate for you to use. The AICPA Depository Institution Expert Panel is currently writing a white paper on this subject, and this should be a point of reference for community bankers when it's published. In the meantime, the agencies will not be issuing guidance on this topic. However, forecasting is a new feature under CECL. It'll be an area that we monitor to see how practice develops.

Erik Soell: Excellent. Thanks, Joanne. So, let's go to Slide 11, Question number 12 on segmentation. What is the appropriate level of loan pool segmentation? How granular should it be? Would it be acceptable for a community bank to pool loan segments based on the FFIEC call report categories?

Joanne Wakim: This is Joanne. I'll take this question, as well. Loan pool segmentation that's appropriate for one institution may not be appropriate for another. Segmentation will depend on facts and circumstances. Institutions will need to use judgement to determine how best to segment pools such that there's an appropriate grouping of similar risk characteristics in your pools. You will need to ensure a proper balance between identifying a segmentation that has sufficient granularity to produce a meaningful result, meaning it breaks out different risks in order to adequately capture those risks when you're estimating losses, but also ensuring that the segmentation is not so granular that the pool is too small to identify potential risks. It does require judgment.

For institutions with either very low loss occurrences or very small loan portfolios, you might need to segment at a higher level, because otherwise it would be difficult to identify trends, because the data just isn't statistically significant; the pool is too small, or you just don't have any loss events. The FFIEC call report code segmentation may be a good starting point for certain institutions. However, the more complex you are or, the more losses you experience generally, you might need to have more segmentation beyond the call report codes.

Erik Soell: Thanks, Joanne. Question 13, segmentation and life of loan. Is it appropriate to pool loans with different maturities into one segment? For example, can a 7-year term commercial real estate loan be pooled with a 5-year CRE loan if the loan risk characteristics are similar? If, yes, how is the average life of loan calculated for such a pool?

Shayne Kuhaneck: This is Shayne from the FASB. I'll go ahead and take this one. The short answer is, it depends. But there is no requirement in the standard that require that all loans within a pool have the same term. However, there is a requirement in the standard to measure expected credit losses of financial assets on a collective or pool basis when similar risk characteristics exist. And one of those risk characteristics that should be considered as listed in paragraph 326-20-55-5 is the term of the financial asset.

So, while the question assumes the risk characteristics are the same, entities will need to think about how the different terms within the pool impact that analysis. As soon as a determination is made that the 5-year and 7-year loans in the example exhibit the same risk characteristics, the other element entities will need to think about is capturing all the losses over the contractual term factoring in prepayments. So, paragraph 326-20-30-6 of the standard requires an entity estimate expected credit losses over the contractual term of the financial asset taking into consideration prepayments.

So, again, using the example of 5-year and 7-year loans provided, if losses are experienced in years 5 through 7, an entity will need to capture those losses and not simply ignore them. Alternatively, history might show that after year 4, for example, losses are not experienced in the portfolio or that prepayments would suggest a life of less than seven years. Regarding the calculation of the average life of the pool, I think it is important to note that we need to be careful when we use the term-- quote-- "average life," because our experience in talking to different stakeholders would suggest that it appears to mean different things to different people.

So, for example, if when you say, "average life" you mean the weighted average remaining maturity similar to the calculation that was presented by this same group during our webinar that led to this Q&A, I would say that is an appropriate calculation, as it captures losses over the remaining life of the instrument. If, when you say, "average life," you are referring to a simple weighted average calculation that takes a group of 7-year loans and reduces it to five, because some are three years long and others are seven and losses

happen in the years 5 through 7 that would be inappropriate. The key is to capture losses over the contractual life, considering prepayments.

Joanne Wakim: And, actually, I just wanted to ask Shayne a question. So, Shayne, you mentioned that people often confuse weighted average life with weighted average remaining maturity, and you mentioned the webinar that we held in February. Sometimes we do hear people say that the weighted average remaining maturity method is a method that the FASB previously rejected--. Could you weigh in on that?

Shayne Kuhaneck: So, that's a great question, Joanne. I think that one of the things that people point to and say that the FASB discredited a weighted average life was, in the early days of CECL, when we first released the standard, a former board member gave a presentation. And one of the slides in that presentation had a simple calculation of a weighted average life, and it highlighted that that weighted average life would not be acceptable for calculating CECL. And, under that scenario, we were absolutely thinking about the simple weighted average life calculation that I just described, meaning that, you know, you're not accounting for those losses that may happen. Again, in this example, years 5 through 7.

But, since that time, we've had extensive conversations with this group and other stakeholders about the weighted average remaining maturity methodology, gotten into the numbers, contemplated that actual calculation, and we believe that that is appropriate going forward.

Joanne Wakim: Okay, thank you.

Erik Soell: Okay, Erik here. Before we jump to Question 14, we got a couple questions in just asking, again, like, how people could get this information. And just a reminder, we are recording this session, so you can come back and get the link on the exact same link that's used for the webinar where you can get the recording for the session there, because I know we're covering a lot of information here. All right, Slide 12, Question 14. What factors should be considered when determining an average life for a pool of loans? How are prepayments considered in calculating the average life for a pool of loans?

Bob Storch: Thanks, Erik. This is Bob Storch for the FDIC once again. I'd like to start out by reiterating some of Shayne's response to the previous question by indicating that the meaning of the term "average life" has to be defined and understood before it can be determined whether it's appropriate to be using "average life"-- quote, unquote-- to estimate the allowance for credit losses.

When we think about what the standard requires, expected credit losses are to be estimated over the contractual term of the financial assets in a pool. When determining the contractual term of a financial asset, as has been mentioned, an entity should consider

expected prepayments but not expected extensions, renewals, and modifications. However, troubled debt restructurings that are reasonably expected to be executed can extend the contractual term. The contractual term should be the starting point of any calculation. In order to estimate prepayments, an institution should look to its own historical information, if it's available, on loan prepayments to determine the extent to which prepayments actually reduce the contractual term.

If no history is available for the types of loans in a loan pool, look to prepayment experience on similar loan products or peer information. If it's not possible to document prepayments to arrive at a reasonable and supportable estimate of these prepayments, it may be necessary to limit your calculation to the contractual term until historical information or other relevant information is developed that supports adjustments for prepayments. When credit losses are estimated using an estimation method other than a discounted cash flow method, the standard mentions that prepayments may be embedded in the credit loss information, which will mean that the contractual term would not need to be adjusted for prepayments.

Erik Soell: Excellent. Thanks, Bob. All right, let's go to Question 15, life of loan. How is the life of loan determined for lines of credit with 1-year maturity?

John Rieger: I'll take that, Erik. This is John Rieger from the FDIC. For lines of credit, the life of a loan should be based on the contractual terms of the line of credit agreement. If the line of credit is one year for the ACL, it should be based on the 12 months. Now, as in prior questions, we used the contractual term unless a TDR is reasonably expected. Also, remember, however, for lines of credit, there may be a portion that is drawn on and a portion that is undrawn. For the unused portion of the line of credit, the (an) expected loss number should also be determined. Now, this ACL results in an "other liability" on the balance sheet and is not recorded as a contra to the outstanding loan balance, since no loan exists for the undrawn portion.

Erik Soell: Great. All right, Question 16. This is on renewals. So, how should renewed loans be considered in the calculations of ACL? For example, if a loan pool has an average life of five years and a loan is renewed at the end of five years, does the renewed loan start a new 5-year period or should it remain in the original 5-year pool?

Shayne Kuhaneck: This is Shayne from the FASB. I'll take this one. So, I'm not exactly sure if this question is asking if an entity can include the renewal period in the calculation of credit losses, or when is a loan considered to be a new loan? So, I guess I'll address both. So, the first question about including renewal periods in the calculation, paragraph 326-20-30-6 states that an entity shall not extend the contractual term for expected extensions, renewals, and modifications unless it has a reasonable expectation at the reporting date that it will execute a trouble debt restructuring with a borrower. So, the answer to the first question is, no, you would not include the renewal period in the calculation of credit losses

So, the second question. The amendments made for CECL did not amend the guidance for determining whether a loan is a new loan. So, entities should continue to make that determination by using the guidance in Subtopic 310-20.

Erik Soell: All right, thank you, sir. So, let's just go to Slide 13. We're going to go to Question 17 on credit cards. How are historical losses on open-ended credit, for example credit cards, determined under CECL?

Shayne Kuhaneck: This is Shayne, again, from the FASB. I'll go ahead and start off, and then I think Joanne may actually have some follow-on points after me. So, this topic was discussed at the Transition Resource Group meeting that was held in June of 2017 and then again at a follow-on board meeting in October of 2017. Both the June and October staff papers are available on the FASB implementation website. And so I encourage you to go to the website and read both discussion papers and the meeting minutes from the June 2017 TRG meeting, as we could likely spend our entire time here today just discussing this topic.

However, in short, the question that was posed to the staff for the June 2017 TRG meeting was as follows, "Should all principal payments expected to be received after the measurement date be applied to the credit card receivable balance existing at the measurement date until that balance is exhausted, or should those payments be allocated in some manner between the measurement date balance and future credit card receivables expected to be originated through subsequent usage of the unconditionally cancelable loan commitment associated with the credit card account?" It's a mouthful, but, essentially, "How are future payments allocated?" was the question.

So, during the meeting the TRG members generally noted the entities could either consider future credit card receivable balances or not consider future credit card receivable balances when determining how to allocate future payments for estimating the life of the credit card receivable balance, so long as losses were not recorded for commitments that are unconditionally cancelable. So, essentially, it depends. During that same TRG meeting, a separate question was asked of the staff which was, "In estimating the net amount expected to be collected on a credit card receivable or in determining the remaining life of that receivable, should an entity consider all payments expected to be collected after the measurement date or only some portion of the payments expected to be collected?" So, again, bit of a mouthful, but, essentially, "How is the amount of the payment determined?"

As part of the discussion, two views were presented. View A was all payments expected to be collected from the borrower should be considered. View B was only a portion of the payments expected to be collected from the borrower. So, in a follow-on meeting in October of 2017, the staff recommended to the board that, similar to the original question presented to the TRG on allocation, the difference between View A and View B has to do with the precision of the measurement of a receivable's estimated life, which affects the measurement of expected credit losses.

The new guidance on credit losses allows various approaches to be used to determine management's best estimate that is consistent with a credit risk management perspective. Therefore, depending upon an entity's facts and circumstances, the staff believes either view could be appropriate. The board agreed with this recommendation and now I'll turn it over to Joanne for a few more comments on this topic.

Joanne Wakim: Okay. What Shayne just talked about was a mouthful, and I know that sometimes I boil it down to this idea that for revolvers, you have to figure out how to estimate a life of that asset. And so you have cash flows coming in after the reporting date, but sometimes you also have future draw, an increase in the balance after year end. That future draw might generate a bigger payment after the reporting date. For example, someone had a \$1,000 charge after the reporting date, and then made a bigger cash payment after the reporting date because of that future draw. On that issue, the TRG's discussion was really around flexibility in how an institutions handles that. The FASB stated they are not going to weigh in. From a regulatory perspective, what other considerations do we think are out there for credit cards? One of the things that we think about is the importance of segmentation. For credit card portfolios, borrower payment behavior is a risk characteristic, and we think that should be considered when segmenting the credit card portfolio.

For example, credit card borrowers that consistently pay their credit card balance in full and on time each billing cycle are often referred to as transactors. And, generally, transactors do not carry an outstanding credit card balance, or they don't incur financing charges or late fees. Generally, you have minimal credit losses on transactors. The credit card borrowers that do not pay their outstanding credit card balance in full at each billing cycle-- they're referred to as revolvers. These borrowers tend to carry balances longer. They're more likely to incur financing charges and other fees.

And, generally, revolvers experience a higher level of credit losses compared to transactors. Given these differences, and given these different risks and the different types of borrowers, it would generally be inappropriate to include transactors and revolvers within the same segment when you're estimating your credit losses on credit card loans. And an institution with significant credit card loans should consider further segmentation of the revolver segment in order to ensure that the drivers of loss are appropriately factored into the allowance estimation.

Additional segmentation factors may include, but are not limited to, the average historical payment rate, utilization rates, the credit bureau score, the trend of the borrower's credit bureau score, the delinquency status, delinquency history, and maybe any borrowers that are subject to a repayment program.

Erik Soell: Excellent. All right. So, we are on Question 18 in the middle of Slide 13. This is on methods. So, some have suggested that the vintage method will be the minimum

standard required to implement CECL. For example, other types of loss rate methods will not be acceptable. Is this accurate?

John Rieger: Hello, Erik. This is John from the FDIC. I'll take the first part of this and then Shayne will add on some comments. From a regulator's perspective, this is not accurate. It is true that PBEs are required to disclose credit quality indicators by vintage year. So, the PBEs will need to track loans by vintage. However, the CECL accounting standard does not require expected credit losses be estimated using a vintage-year method. Likewise, the banking agencies are not requiring institutions to use a vintage-year method. The vintage-year method is only one of several acceptable methods for estimating credit losses under CECL. Depending upon the amount and type of data available to an institution, other loss rate methods may be more suitable for an institution to use. The agencies are not mandating any specific method in determining expected credit losses under CECL. I'm going to turn it over to Shayne for comments.

Shayne Kuhaneck: Thanks, John. And, you know, just to piggyback off of what John has said. I would wholeheartedly agree with it not being a requirement. In fact, paragraph 326-20-30-3 specifically states, "The allowance for credit losses may be determined using various methods." That same paragraph goes on to detail that various methods can include discounted cash flow, loss rate, roll rate, probability of default, and methods that utilize aging schedules as all being acceptable.

Oftentimes, we, the FASB, have used the vintage method to illustrate one way an entity can determine losses. However, that is largely because it happens to be one way that lends itself to showing people the math behind the calculation in a relatively simple way. This does not mean that we believe that vintage is the preferred method. In fact, a vintage model may not be appropriate for some products and or smaller portfolios with limited losses, historically. The methodology chosen will likely be dependent on the type of product, the size of the portfolio, and the extent of the historical data available, along with other factors. I would encourage you all to look at Examples 1, 2, and 5 in the implementation guidance of the standard, where we have provided examples using methods other than vintage.

Erik Soell: Great. Thank you. So, let's go to Question 19 at the bottom of Slide 13. So, again, on methods. Is it acceptable to use different loss rate methods for different pools of loans? Can institutions select a method after seeing the results of using several methods? How often can institutions change methods used to estimate the ACL?

Sydney Menefee: This is Sydney with the OCC, and I'll take that one. As John and Shayne just stated in the previous question, the standard does not require any specific methodology for calculating the allowance for credit losses. And institutions can use different methods for different pools. So, the method will likely depend on the product type, the size of the portfolio, and the extent of the historical loss data available. Therefore,

institutions can, for example, select the vintage method for its residential portfolio and probability of default method for commercial real estate portfolio. While it may be acceptable to apply different methods for different pools of loans, it is not appropriate to simultaneously run several methods on the same portfolio and cherry-pick the method that produces preferred results.

And to the final point on this question relating to changing methodologies, as noted in the agencies' 2006 Interagency Policy Statement on the Allowance, the allowance represents one of the most significant estimates in institutions' financial statements and regulatory reports. Because of its significance, each institution has a responsibility for developing, maintaining and documenting a comprehensive, systematic, and consistently applied process for determining the amount of the allowance. Therefore, while a change in a bank's methodology is allowed and at times warranted, such changes should be well-documented and infrequent.

Erik Soell: All right, thank you. Let's jump to Slide 14, Question 20. Is it appropriate to use one loss rate method, for example, open pool or WARM (weighted average remaining life)WARM and then transition to another loss rate method, for example, vintage, at a later time when the institution has collected a sufficient amount of data?

Joanne Wakim: This is Joanne, and I'll take this question. This question kind of overlaps a bit with what Sydney was talking about but addresses the unique situation we have with this transition to a new accounting model. At implementation of CECL, an institution may gravitate to a certain method of estimating CECL if you don't have extensive historical loss data. The agencies have said that we are not requiring you to bear the cost or burden to retrieve historical data going back many years. But we are saying, 'Start with what you have now.'"

If you start your implementation of CECL and make decisions based on data that you have now, you may want to transition to another loss method when you get more data. We will have no objections if you decide to change your method because you've got longer period of your own historical loss data as long as the method that you're changing to is an acceptable method, in general, under CECL, and then you've documented and supported the reason for the change.

As Sydney mentioned, what is not acceptable would be changing your method to produce a certain result. And, again, as Sydney noted, changing your method to estimate your allowance is normally an uncommon event. However, when there was a reason for a change, you just should ensure that you properly document why you're changing the method. And then once the method is chosen, you should apply that method in a consistent manner, and there is guidance in the 2006 Interagency Policy Statement about expectations when you change your methodology. Before moving onto the next question, I did want to mention, one question came in asking for an example of the weighted average remaining

maturity (method) methodology. We held a February webinar that walked through different loss rate methods including that method, and I think a link to that webinar is on the resource slide.

Erik Soell: Excellent. Thank you. All right, let's go to Question 21. So, this is on supervisory expectations. Will agencies object to institutions' use of the weighted average remaining maturity method commonly referred to as "WARM?"

Sydney Menefee: This is Sydney with the OCC, and, as Joanne just alluded to, there was a webinar back in February that showed an example of WARM. And, as we've been saying, you know, kind of throughout this little section of the webinar, the standard does not require any specific methodology for calculating allowance. And the agencies do not object to any one particular method, including WARM, as long as it complies with GAAP and is appropriate for the institution. While the agencies do not object to WARM, it may be more complex than is readily apparent. As such, it may only be appropriate for smaller, less complex banks and for certain types of loan portfolios. I encourage you to speak with your auditor, if applicable, and your examiner if you like to better understand the pros and cons with a particular method, such as WARM.

Erik Soell: Are we good with that question?

Sydney Menefee: Hm-hmm [affirmative].

Erik Soell: Great. Before we jump to number 22, let me just tell you all on Slide 19, we have a ton of resources. Everyone has been referencing the CECL standard. Joanne just mentioned the February webinar that we did. All of those links are there, so I just want to highlight that for you all so that you'll see those in the slides. All right, let's go back to Slide 14, Question 22. Is there a requirement to disclose the quantitative impact on the adoption of CECL on capital and the financial statements? For example, in Form 10-K.

Mike Berrigan: Thanks, Erik. This is Mike with the SEC. Let me first mention SAB (Staff Accounting Bulletin) Topic 11M or SAB 74, which provides the staff view on appropriate disclosures about potential material effects on a new standard once adopted. The SAB includes disclosures that the staff believes should generally be considered by a registrant and includes, first, a discussion of the impact the adoption of the standard is expected to have on the financial statements of the registrant if known or reasonably estimable as well as, second, disclosure of the potential impact of other significant matters that a registrant believes might result from the adoption of the standard.

So, assuming the impact on capital, upon the adoption of CECL, is a significant matter to the registrant, and is known or reasonably estimable, I believe the entity should provide quantitative disclosures. Now, that said, I do understand that there may be challenges in evaluating the quantitative impact CECL is expected to have on capital once adopted. So, to

be clear, a registrant is not required to disclose what they don't know. For entities that are still evaluating the impact of the new standard consistent with Topic 11M, if the effect of the new standard is not known or reasonably estimable, a registrant should consider qualitative disclosures to assist users in determining the significance of the effect of the standard will have once adopted.

So, for instance, additional qualitative disclosures might include a description of the effect of accounting policies that a registrant expects to apply, a comparison to the registrant's current accounting policies, or the status of its process to implement the new standard, as well as significant implementation matters yet to be addressed. These disclosures provide users with an understanding of the registrant's implementation status. And while a registrant may not know the specific impact of adoption, registrants may consider whether directional quantitative disclosures or ranges might be appropriate for disclosure. And, lastly, I'll just add that I would expect similar observations from revenue [recognition] implementation, that as we continue to get closer to the date of adoption, I would expect that we will continue to see more fulsome disclosures with regards to the adoption of CECL, reflective of registrant's implementation progress.

Erik Soell: All right, let's jump to Slide 15, Question 23, individual impairment. What types of loans are required to be evaluated individually under CECL? Does CECL eliminate the need to identify and measure impaired loans?

Shayne Kuhaneck: So, this is Shayne from the FASB. I'll take that one, and I think we've had a couple questions come in with respect to the old FAS 114 methodology and how CECL impacts the FAS 114 methodology. So, hopefully, this will answer those questions, as well. So, the notion of an impaired loan has been removed from the new standard. So, now an entity will estimate expected credit losses over the contractual term considering prepayments for all loans. That measurement of expected credit losses is required to be made on a collective pool basis when similar risk characteristics exist, as I mentioned previously in a previous question.

However, there may be instances where a loan within a pool exhibits different risk characteristics from the rest of the loans in the pool. In this instance, the entities should determine whether that loan should be removed from the current pool and pooled with other similar loans or be analyzed individually. There could still be instances where the CECL reserve is determined, for an individual loan, because it exhibits different risk characteristics. I would point people to Examples 2 and 4 in the standard, where we have provided examples where this might be the case. Finally, if you do take a look at those examples, you will note that an entity is not required to use a DCF (discounted cash flow) approach to calculate a loss reserve on an individual loan. A DCF is only required in those instances where a concession is granted, and the only way to capture the loss due to the concession is by performing a DCF. So, for example, you've given an interest rate concession. This was clarified at a board meeting in September of last year.

Again, that staff white paper and meeting minutes are posted on the FASB implementation webpage. I'll continue to plug that every time I get a chance [laughter]. So, to recap, there is no more concept of a-- quote-- "impaired loan." An entity calculates expected lifetime losses for all loans. Secondly, an entity is required to calculate the reserve on a pool basis when similar risk characteristics exist. Third, a reserve can be calculated on an individual loan if it does not have the same risk characteristics as other loans in a pool. And then, finally, a DCF is not required unless the only way to capture the effect of the concession is with a DCF.

Erik Soell: Great, thank you, sir. All right, Question 24, troubled debt restructurings. So, does determination and measurement of expected losses on TDRs remain the same under CECL?

Joanne Wakim: This is Joanne, and I'll take that question. When it comes to TDRs, there are two issues. First is identification, and the other is measurement. For identification, nothing is changed in terms of how to identify or what constitutes a TDR. That remains unchanged. For measurement, under CECL, the standard allows banks to estimate expected credit losses for TDRs in a pool. You can also do it individually.

And methods other than a discounted cash flow can be used to measure credit losses on TDRs. However, for certain concessions such as interest rate reductions, you can't measure that without using a DCF method. The FASB has said that, "If a concession has been granted in a TDR and you can't measure that loss without using a discounted cash flow, then you would need to either use a discounted cash flow methodology or use a method that can be reconciled to a discounted cash flow method in order to make sure that you measure the impact of the concession."

Erik Soell: Question 25 on risk rating. So, we're at the bottom of Slide 15. How do loan risk ratings impact the calculation of the ACL under CECL?

Bob Storch: That question comes to me. This is Bob Storch. CECL requires that loans be segmented based on similar risk characteristics, as we've mentioned a number of times already. Risk ratings or credit risk grades or classifications are an example of risk characteristics that can be used to segment loans in order to measure expected credit losses on a collective basis. I would anticipate that the level of expected credit losses under CECL would correspond to the risk ratings on loans with respect to directional consistency. And by that, I mean that if lower loan risk ratings on a group of loans indicates increased credit risk, then the estimated expected credit losses for each lower risk rating should be higher. If they're not, the institution should be prepared to explain why there's a departure from what would otherwise appear to be a logical directional relationship.

Then in terms of the impact on the calculation of CECL, if the portfolio is large enough, it may be possible to segment loans by each separate risk grading or credit grade,

but [said,] many smaller institutions with small portfolios may not have a sufficient size or number of loans by risk grade that there's relevant historical loss data for each separate credit risk grade. So, a segment may need to include loans from several credit risk grades, which would require the institution to look at the composition of that portfolio over time, how it's changed, and through other qualitative adjustments reflect how current conditions and how the reasonable and supportable forecast would affect the collectability of that portfolio of a mixture of loans and different risk gradings compared to how those portfolios have performed with respect to historical losses.

Erik Soell: Excellent, thank you. All right, so we are on Slide 16, Question 26. How does CECL affect the revenue recognition and expense matching principle?

Shayne Kuhaneck: So, this is Shayne from the FASB. I'll go ahead and take this one. So, the question seems to be getting at the recognition of a Day 1 loss under the standard. Obviously, the board debated this extensively during the development of the standard, so I'm not going to reargue the case, but rather highlight some of the reasons why the board landed where they did, many of which and more are articulated in the basis for conclusions of the standard in paragraphs BC 35 through BC 49.

The current incurred loss method of accounting for credit losses has been in place since 1975, when FAS 5 was issued. And adhering to FAS 5 has resulted in a delayed accounting recognition of changes in credit risk, which is attributable to the probable threshold in FAS 5. In the 2000's 2000s FAS 5 left reserve levels at multi-decade low points just before the financial crisis. In the lead up to the financial crisis, the message heard from bankers and investors was that the incurred loss method was not providing useful information, since it limited recognition of losses to those that were probable, and it did not use forward-looking information. In effect, the incurred loss method is a backward-looking method, because it does not permit the consideration of forward-looking estimates. So, during the financial crisis, the FASB and the IASB formed the Financial Crisis Advisory Group. The expert group confirmed those views and recommended exploring an expected loss method that uses forward-looking information.

And, in fact, the board actually tried to address income recognition. In the May 2010 proposed update, the board proposed that interest income should always be calculated on the basis of the amortized costs less any allowance for credit loss impairment to the financial asset. This proposed change was strongly opposed by many stakeholders including preparers, auditors, regulators, and many investors. Users consistently asserted that interest income should not be further diluted for changes in cash flows related to credit losses. Therefore, the board decided not to amend the guidance on interest income recognition, thereby keeping loss reserves separate from interest income.

The bottom line? The board thinks the new standard better aligns the accounting rules with the underlying economics of lending, in particular, the expansion and contraction

of credit risk. Users criticize previous GAAP because the thresholds required to recognize credit losses delay the recognition until the credit losses were probable, even if an entity may have had an expectation of a future loss.

Diversity also existed in application of when the probable threshold has been reached to combine the fact that delayed recognition and diversity resulted in a misalignment between the accounting standard and the market's perception of credit risk as evidenced by a significant disparity in market value as compared with book values of creditors, most evident in a stressed economic environment.

As a result, users supported an approach for the allowance for credit losses based on management's expectations of credit losses over the contractual life of the financial assets. And I know you have probably heard me or Hal say this in presentations before, "CECL doesn't change the economics of lending." Said differently, "The loss is the loss." CECL simply changes the timing of when the loss is recognized.

Erik Soell: Thank you, Shayne. So, Question 27, non-public business entity effective date. Will there be a change in the effective date for non-public business entities?

Shayne Kuhaneck: So, again, this is Shayne from the FASB. I will take this one, and while I may have annoyed you with my answer on the last question, hopefully, I will make you happy with this and then you'll consider me to still be a good guy [laughter]. So, this is a timely question, as the board just discussed this topic last week at its board meeting on July 25th. At that meeting, the board decided to clarify its original intent to provide non-public business entities with additional time to adopt the standard.

Stakeholders noted, through a submission to the TRG and a follow-on agenda request, that the transition and effective date requirements of Update 2016-13 required both non-SEC filer PBEs and non-PBEs to adjust retained earnings for the cumulative effect of adopting CECL, as of January 1, 2021 for calendar year entities. To make this adjusting entry as of January 1, 2021, both populations of entities with calendar year-end reporting periods would be required to have the appropriate reporting systems and internal controls in place as of that date. Consequently, the requirement effectively negated the benefit of providing non-PBEs with an extra year the board originally intended to provide.

Therefore, the board decided to make targeted amendments to the transition paragraph of Update 2016-13. The proposed amendment to paragraph 326-10-65-1 would clarify that non-PBEs must adopt Update 2016-13 for fiscal years beginning after December 15, 2021 and interim periods within those fiscal years. So, January 1, 2022 for a calendar year-end entity. I think this also addresses a few of the questions that came in. I think the questions were along the lines of, "Is this real or am I reading the article to be real?" I certainly hope so, because my team is in the process of drafting these amendments as we

speak, with a target to publish the exposure draft in the fourth quarter of this year with a 30-day comment period. So, yes, this is real.

And, finally, I'd like to take this opportunity to thank those of you on the phone who submitted TRG issues or agenda requests to alert the board to this issue. If not, for all of you out in the field, we would have never had any idea that we had this problem. And so, because you alerted us to it, we are able to address it and take care of it, and you'll see that exposure draft come out very shortly.

Bob Storch: So, this is Bob Storch. I would just add that if you've reviewed the frequently asked questions that the agencies have issued, those frequently asked questions do reflect the existing effective dates that are in the standard as it was originally issued, and, in fact, there are some lengthy explanations of, given how the standard was issued, how a non-public business entity would need to implement the standard in 2021. With this amendment anticipated, I would imagine the agencies will be revising those questions in the next update to the frequently asked questions to avoid any confusion that may otherwise linger once the FASB presumably follows through and in final form adopts the amendments that Shayne just talked about.

Shayne Kuhaneck: This is Shayne, again. I would just like to take this last opportunity to plug that we are open for business, whether that be a technical inquiry or a TRG submission. If you're having issues with the guidance, please, you know, submit a technical inquiry or even just come up to me in various conferences or speeches that I'm giving. Introduce yourself, and it may be just as simple as, "Shayne, I think we have a problem," and I'd be happy to talk to you about it. So, again, I would plug that and the resources that Erik mentioned on the resource page.

Joanne Wakim: Does this mean institutions should slow down or change their process for implementing CECL? I'll just open that up and see if anybody wants to add any observations on that.

Shayne Kuhaneck: This is Shayne. I would say I travel around to quite a few different venues, speak to a pretty broad swath of stakeholders, and the consistent message is that, "Data continues to be challenging," and so I would recommend not slowing down, and I would recommend continuing to collect that data. And if you haven't started, to start to see where your gap is. You know, while you have the extra time I think it's a perfect opportunity, you know, to keep moving forward with your plans. That's what I would say.

Joanne Wakim: I would say that the examiners will be looking for a good faith effort. What is a good faith effort? As the examiners go out and ask the questions in the survey, I think either being able to say "Yes" or being able to answer those questions would be evidence of a good faith effort. Also, if there are some questions you are not able to answer, taking action would be evidence of a good faith effort.

Erik Soell: Okay, so this is Erik. We've gotten a lot of questions that have come in. We're going to try to hammer through as many of these as we can in 10 minutes or so, so let me start. First question, "Do financial institutions under CECL have to reserve for credit loss inherent in certain bonds? If so, what about federally backed bonds? There is no credit risk there, so why should we have to reserve anything at all?"

Bob Storch: Erik, this is Bob Storch. I'll take a shot at that question. I would point out that if you look in the accounting standard itself, there is an Example 8. It starts in paragraph 326-20-55-48, where it gives an example, and it's not meant to be the sole example of where potential default is greater than zero, but expected nonpayment is zero. And the example is specifically with respect to [U.S.] Treasury securities, which obviously is a large part of many banks' securities portfolios. That particular example cites a number of factors to consider with respect to whether the expectation of nonpayment is zero. There may be some that suggest it could be zero and others that say "not zero."

So, when you get to other federally U.S. Government guaranteed securities, you have to also, at least in concept, look at what are the factors that would suggest a nonpayment versus payment, weigh the evidence on both sides, and come to a conclusion. Joanne mentioned earlier in one of the responses to a question the AICPA's Depository Institutions Expert Panel, or the DIEP. They have been working on a paper where they do outline some additional considerations on the payment versus nonpayment criteria to look at with respect to mortgage-backed securities issued by government sponsored or government agencies.

So, that sort of thought process would be applicable to these federally guaranteed or federally backed bonds so that, in fact, if the risk of expected nonpayment is zero then you would not be expected to have an allowance. But, again, that's another topic if you're working with your auditors. Talk to them about their views on the composition of your securities portfolio and where the risk of nonpayment may be zero and what expectations they would have for evidence for the audit.

Erik Soell: Excellent. All right, next question that came in. We have existing available-for-sale bonds that have an unrealized loss. Will CECL require us to reserve for these? These are federally backed bonds.

Bob Storch: This is Bob Storch, once again. And so we just mentioned federally backed bonds. So, the answer would be the same, really, in my view, whether they're available for sale or held to maturity. And remember, held-to-maturity debt securities are within the scope of CECL. Available-for-sale securities technically are not within the scope of CECL. Accounting Standards Update 2016-13 does address the impairment model that applies to available-for-sale bonds. So, as a generalization, for available-for-sale bonds with an unrealized loss, consider whether they're guaranteed or backed by the federal government or they're just other types of debt securities.

When there is an unrealized loss on an individual available-for-sale security, the institution would need to determine whether there is, in fact, a credit loss embedded in that unrealized loss and recognize an allowance for that credit loss. To the extent some of the unrealized loss is due to factors other than credit, then that portion of the unrealized loss would go through other comprehensive income and reside in accumulated other comprehensive income, net of tax, like it does today for available-for-sale securities.

Erik Soell: Great, thank you. All right, next question. So, what is the expectation for community banks to have a third-party validate or review the CECL model or methodology prior to implementation?

Joanne Wakim: This is Joanne, and I'll take that question. We don't have any requirement or expectation that a community bank would have to hire a third-party to validate or review the CECL methodology prior to implementation. We do understand that methodologies will evolve, and we do not expect institutions to be at a best practice right at implementation. There is no expectation at this point that any community bank would have to hire a third-party as part of their implementation efforts.

Erik Soell: Great, thank you. Next question, "I don't understand the difference between the weighted average remaining maturity and the weighted average life. Can you all give some examples?"

Shayne Kuhaneck: So, this is Shayne from the FASB. You know, I think it's tough to give examples on the fly [laughs], but what I would recommend is it was-- correct me if I'm wrong-- February was the webinar where we did an extensive example on the WARM methodology. And so, if you haven't gone through that example, I would encourage you to look at that example, because I think, as Sydney mentioned, it may not be as simple. It may be a little bit more involved than you think. And the key is that it's taking into account the remaining life of the instrument. And then the second part of that would be when you're comparing what you say is a weighted average life, I would ask you, which I obviously can't do, because you're not here, "What do you mean when you say weighted average life? What is your calculation of weighted average life?" and then compare that to the WARM methodology and then you can see the differences. So, that's how I would answer that question.

Erik Soell: Okay, let's take one final question. So, regulators have stated that community banks should not have to implement complex models for CECL, since there have been no specific guidelines regulated regarding implementation. What exactly do they mean?

Bob Storch: This is Bob Storch. I'll take a stab at that. I think what we mean by that is that the agencies are not going to dictate or require institutions to adopt a particular method or particular methods for different pools for estimating expected credit losses.

That's something the institution would need to do based on their analysis of what methods are the best fit under their circumstances for their institution, the types of portfolios they have, thinking about the methods they're applying today and whether they can be leveraged with appropriate changes in the inputs and assumptions to achieve the objectives of CECL. So, going back to the February 2018 webinar that's been referenced a few times, there were some loss rate methods that may be practical for community institutions to choose from. I think the caveat is, certainly again, the agencies are not requiring those methods to be used.

Other methods that achieve the objectives of the standard can be used as well. I know the OCC has had some webinars where they've tried to explain how even a probability-of-default/loss-given-default approach could be used by community institutions. So, I think the agencies are reluctant to simply provide a template or a formula that would be given out to all institutions with the expectation it's going to work for everyone so that each institution needs to look at the available methods, talk to their peers, talk to their examiners, talk to their auditors if they have them, and, again, look at what they're already doing and whether that can be leveraged for use in the future.

Erik Soell: Okay, so we're going to wrap up, but we're not done. So, we want do a couple things before we close out. First, we want to do a polling question. So, if you're on the webinar, we're going to put a polling question up right now. The question is, "Where does your institution plan to be in the implementation road map by the end of the year 2018?" There's five options: awareness building; mobilizing team, and designing a plan; build, the method process and deploy resources; test and validate; or parallel run. So, you have those five options. I'd love for you guys to take a few minutes. Answer that, and then let me turn it over to Sydney to offer some closing comments really quickly.

Sydney Menefee: Thank you, Erik. We want to thank everyone for participating in today's webinar and for submitting questions in advance. We continue to believe CECL is an improvement over the existing accounting for credit losses, but we also recognize that any change, even changes for the better, can be challenging. That is why we are hosting webinars and providing the referenced resources. We encourage institutions to leverage those resources and to contact their examiners and their regulators with any questions about CECL and its implementation. With that, I'll turn it back over to Erik.

Erik Soell: Great. Thank you. So, we're going show the results here. Any second, the folks in St. Louis feel free to put that up. I do want to mention Slide 19 and 20 has a lot of good resources. Frankly, everything we've mentioned today you can find on the resources there. And here are the results as we see them. So, the third option has the most, 37% build method process and develop the resources, followed by mobilize the team and design a plan, and then pretty even between the first, fourth and fifth option on the page there. So, I think that's pretty good. I'm seeing a lot of people nod here. Seems like that's some good feedback from everyone here.

So, before we wrap up, any final comments or questions from anyone in this room? Great. Let me do a couple things. So, thank you all for joining us on the phone. We have thousands of people with us today, so thank you for taking time to do this. Remember, we did record this. You can get that at the exact same link that you got into today's webinar. That will be available tomorrow, so give us a little time to do all that post production stuff, which we will do. And, really, thanks to everyone in this room. You guys cannot imagine the amount of work and coordination that goes into putting something like this together, and it's been a great interagency effort. So, kudos to you guys.

We do have a survey coming out. We would love for you to give us your feedback. What did you like, and, frankly, what did you not like? So we can make sure that we address that in the future. And you can always send us an email at rapid@stls.frb.org if you have topic ideas, questions for us, any of that. We always welcome it. So, for everyone assembled here today, thank you for joining us. We will talk to you next time.

(END OF RECORDING)