CECL

It's 2019 – Where should we be in terms of preparation and implementation?

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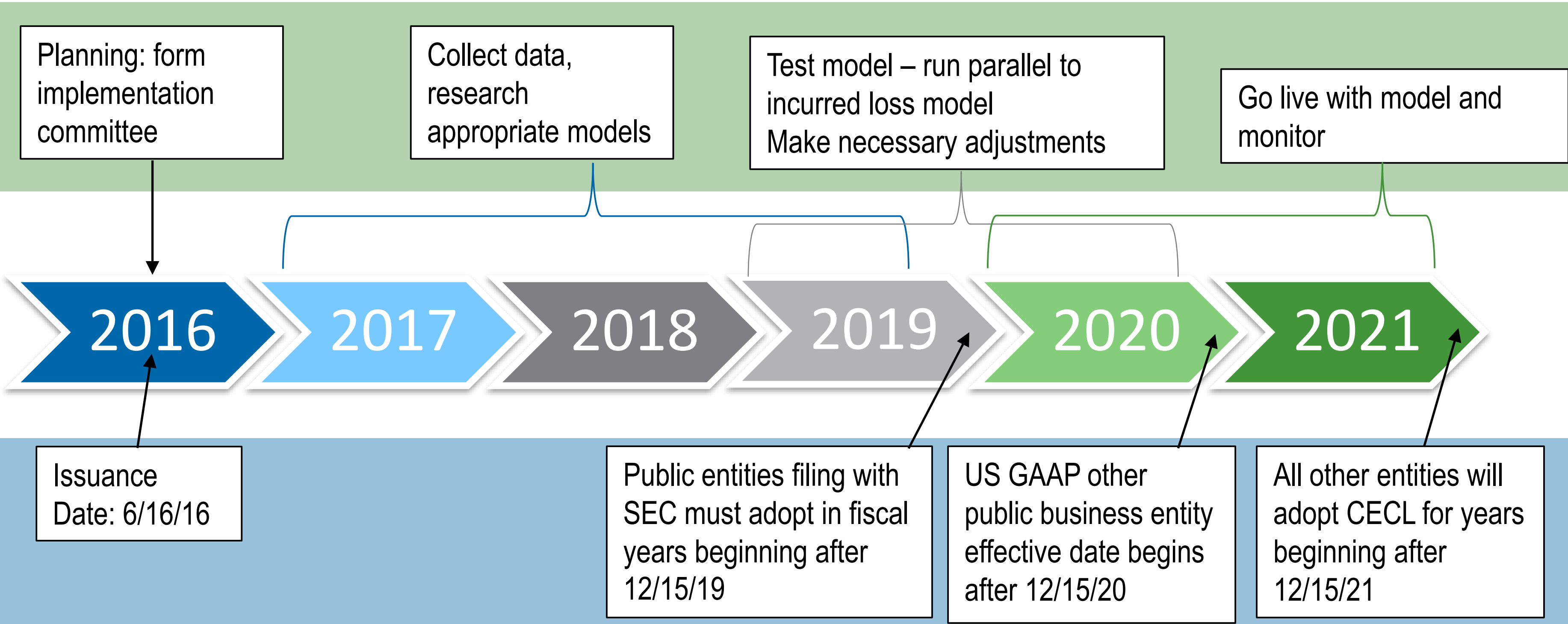
Road Map

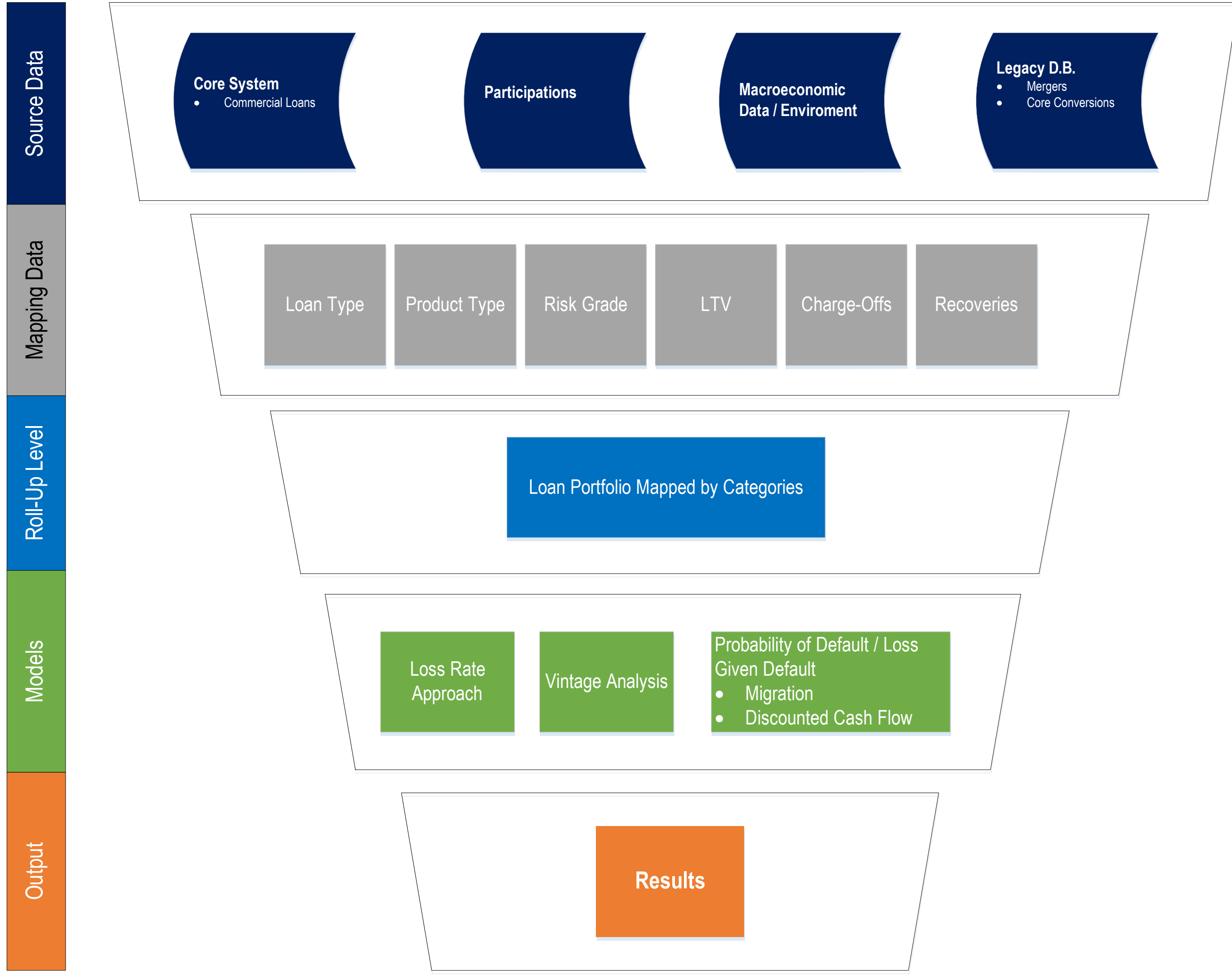
- Implementation Dates / Time
- Data Needs and Considerations
- Model Determination
- Financial Instrument Considerations

Preparing for Implementation



Preparing for Implementation

Financial Institutions Group



Source Data – Planning Matrix

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	Core System Commercial Loans	Participations	Macroeconomic Data	Legacy D.B. • Mergers • Core Conversion
Source / Format	Core System	Excel, CSV, etc	E.g. CPI, Vacancy, unemployment, price index	Legacy systems
Timing	Annually, quarterly, monthly? Must ensure consistency (e.g. quarterly should on the same quarter every year: Mar. 2015 and Mar. 2016)			
Retention / Look back period	3 years, 4 years, 5 years or “equal to the average remaining life of the portfolio/segment”? Consider statistically significant data			
Data scrub	Text format, number format, integers, loan type mapping, unique data fields, credit score versions, loan level detail…			
Ancillary needs	Updated risk ratings, retention	Updated risk ratings, retention	Statistically significant correlation based don historical trends and future expectations	Updated risk ratings, retention

Potential Estimation Methodologies

FASB guidance identified several potential estimation methodologies:

- Expected Loss Rate: Lifetime historical loss rates applied to financial assets with similar key risk characteristics. Historical loss information can be internal, external, or both. The institution needs to select a reasonable period to base its historical loss rate information. A reasonable period should consider have similar underwriting standards and contractual terms in comparison with the current portfolio.

- Vintage Analysis: Vintage refers to the date of origination. A vintage analysis is similar to the expected loss rate approach, except it further segments the portfolio by date of origination. Segmenting by origination will reveal the timing of historical loss experience.

Potential Estimation Methodologies

- Probability of Default and Loss Given Default Modeling: Statistical-based calculation that uses various loan risk parameters. Contains two components:
  - Probability of Default - probability that loan in a segment will default (PD).
  - Loss-Given Default - measures the expected loss, net of recoveries, expressed as a percentage.
  - Exposure at Default (EAD) - current balance at default
  - Expected Loss = EAD x PD X LGD
- Migration Analysis (A PD Methodology): Tracks performance of financial assets over time, based on risk characteristics. This type of analysis uses loan-level attributes to track the movement of loans through various loan classifications in order to estimate the percentage of losses likely to be incurred in the current loan portfolio.
  - Significant amount of data required
  - Effective risk-rating methodology is a must

Overview of Approaches

Loss Rate Approach

- Simple to create and understand
- Similar to current ALLL approach for most institutions
- May show historically irrelevant data points
- Auditor and regulator expectations might not be met

Vintage Analysis

- Simple to create and understand (a variation of loss rate approach)
- Method is useful as a forecasting tool
- Establishes relationships to environmental factors
- Long-term historical data required

PD and LGD (includes Migration)

- Improves credit risk management process
- Deeper insight into loss driving factors
- Significant amount of data required
- Complexity- difficult to verify results

The Right Method for You

The proposed standard requires community banks to use methods that estimate and reflect past events, current conditions and reasonable and supportable forecasts about the future. Your institution can choose from a variety of methods, including the loss-rate, roll-rate and probability of default models. When determining which method is the right fit for you, some key considerations include:

- Balancing the results needed with the time and effort required to
- Gather the applicable data
- Ability to apply the method consistently over time
- Support for any forward looking
- Views and subjectivity
- Governance and controls
- Model risk
- Expectations of auditors and regulators

Key Takeaways – Do's and Don'ts

Do

- Start planning today
  - Document methodology
    - Assumptions
    - Segments
    - Calculations
    - Data requirements
    - Look-back period
  - Monitor for changes
    - Adjust model accordingly
    - Communicate with all parties involved
- Form an Implementation Committee
- Discuss data considerations
- Consult with your accounting professionals
- Consider future capital impact
- Evaluate budget
- Educate your board

Don't:

- Wait
- Implement model today
  - Current accounting is still effective, therefore, increasing ALLL beyond incurred loss model to mitigate CECL impact is not allowed.

DoerenMayhew
CPAs AND ADVISORS

Financial Instruments Standard

ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities – issued Jan. 5, 2016.

- Effective Date – Dec. 31, 2019 and interim periods within fiscal years beginning after Dec 15, 2019. Early adoption is permitted.

Financial Instruments Standard

Equity Investments

- Eliminates the available-for-sale (AFS) category – all will be carried at fair value with changes in earnings (trading). Initial adoption will post to retained earnings.
- Provides a practical expedient for equities without a readily determinable FV to be recorded at amortized cost, less impairment, adjusted for observable price changes

Thank You

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