Current Expected Credit Loss (CECL) Update: Current Supervisory Views

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Welcome

• **Logistics:**
  – Call-in number: 888-625-5230
  – Conference code: 8987 1833#

• **Webinar:**
  – You can choose to listen to the audio through your PC speakers or dial in through the phone option. **Please note:** If you experience problems with the PC audio at any time, you can dial in using the number and code above.
  – Polling
  – **Materials** button

• **How we’ll take questions:**
  – Use the **Ask Question** button in the webinar
  – Email us at [fedperspectives@stls.frb.org](mailto:fedperspectives@stls.frb.org)
Purpose Statement

• After this session, you will be able to:
  – Describe the agencies’ initial supervisory views on the current expected credit loss (CECL) methodology and its implementation, including:
    • How institutions should prepare for CECL
    • Early considerations regarding capital
    • Scalability and methodology
    • Data
  – Describe the interagency CECL coordination process
Overview of CECL
CECL: A Recap of Who Should Implement

The new accounting standard applies to all banks, savings associations, credit unions, and financial institution holding companies that file regulatory reports prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP), regardless of size.
CECL: What’s Changing for Institutions

- Move from incurred loss to a lifetime horizon
- Single measurement objective applied to all financial assets carried at amortized cost:
  - Requires an allowance on held-to-maturity securities
- Institutions will use a broader range of data to estimate expected losses:
  - Requires collective or pool-basis assessment of credit losses
- Accounting for available-for-sale debt securities
- Accounting for purchased credit impaired loans

Earlier Recognition of Credit Losses!
CECL: What’s Not Changing for Institutions

- Scalability
- Credit risk review and management processes
- Consideration of qualitative factors affecting collectability
- Interest income recognition and nonaccrual policies
- Write-off (i.e., charge-off) policies
- Accounting treatment for loans held for sale
## Effective Dates

<table>
<thead>
<tr>
<th>Entity Type</th>
<th>U.S. GAAP Effective Date</th>
<th>Regulatory Report Effective Date*</th>
</tr>
</thead>
<tbody>
<tr>
<td>PBEs that are SEC** Filers</td>
<td>Fiscal years beginning after December 15, 2019, including interim periods within those fiscal years</td>
<td>Q1 2020</td>
</tr>
<tr>
<td>Other PBEs*** (Non-SEC Filers)</td>
<td>Fiscal years beginning after December 15, 2020, including interim periods within those fiscal years</td>
<td>Q1 2021</td>
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<tr>
<td>Non-PBEs</td>
<td>Fiscal years beginning after December 15, 2020, including interim periods beginning after December 15, 2021</td>
<td>Q4 2021</td>
</tr>
<tr>
<td>Early Application</td>
<td>Early application permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years</td>
<td>Permissible no earlier than March 31, 2019</td>
</tr>
</tbody>
</table>

* For institutions with calendar year ends. Call Report: Consolidate Report of Condition and Income
** PBEs: public business entities; SEC: U.S. Securities and Exchange Commission
*** A PBE that is not an SEC filer would include (1) an entity that has issued securities that are traded, listed, or quoted on an over-the-counter market and (2) an entity that has issued one or more securities that are not subject to contractual restrictions on transfer and is required by law, contract, or regulation to prepare U.S. GAAP financial statements and make them publicly available periodically (e.g., pursuant to Section 36 of the Federal Deposit Insurance Act and Part 363 of the Federal Deposit Insurance Corporation’s [FDIC’s] regulations).
Initial Supervisory Views
How Institutions Should Prepare

• Do:
  – Become familiar with the new accounting standard – Accounting Standards Update (ASU) 2016-13
  – Develop an implementation plan and timeline with key stakeholders:
    • Board of directors
    • Industry peers
    • External auditors
    • Supervisory agencies
  – Review existing allowance and credit risk management practices
  – Determine how and when to begin collecting additional data
  – Consider potential impact on capital
  – Keep examination team up to date
How Institutions Should Prepare (continued)

• Don’t:
  – Include CECL concepts in current allowance
  – Artificially inflate allowance levels before effective date
  – Overload at adoption:
    • Record initial effect of CECL adoption through retained earnings, instead of profit and loss
    • No “cookie jar” reserves
  – Wait to prepare
Early Considerations Regarding Capital

• Institutions are encouraged to take steps to assess the potential impact on capital.

• Impact on an institution’s capital will depend on:
  – Existing allowance level
  – Composition and credit quality of its portfolio
  – Current and forecasted economic conditions
Scalability

• Specific estimation methods are not prescribed.
• One may apply different estimation methods to different groups of financial assets.
• One may continue using existing methods for estimating allowances but must change inputs and assumptions to achieve lifetime loss estimates.
• Banking agencies will not mandate the use of a single approach for applying the CECL methodology.
Estimation Methods

• Allowance for credit loss may be determined using various methods, including:
  – Discounted cash flow models
  – Vintage analysis
  – Loss-rate methods
  – Roll-rate methods
  – Probability-of-default methods
• Choose the method that best suits each portfolio
• Most institutions are not expected to:
  – Implement complex models
  – Hire consultants to develop their models
Data Needs

• The selected estimation method may drive the need to capture additional data and/or retain data longer than in the past.

• Examples of data:
  – Origination and maturity dates
  – Common risk characteristics used to segment portfolio
  – Origination loan amount
  – Initial and subsequent charge-off dates and amounts by loan
  – Paydowns by loan
  – Recovery amount and dates by loan
  – Cumulative loss amounts
Supervisory/Examination Approach

• Tailored by supervisory portfolio
• Two distinct phases:
  - Pre-implementation
  - Post-implementation
• Expect institutions to make *good faith efforts*
Interagency and System Implementation Plan
Regulatory Agencies’ Preparation

- Establish an interagency steering committee
- Conduct outreach with bankers and auditors
- Develop internal and external training and communication plans
- Inventory existing supervisory guidance to be updated
- Develop additional guidance and tools:
  - Call Report changes
  - Transition-specific and ongoing accounting considerations
Future Supervisory Guidance

- Interagency FAQs (every 6 to 12 months)
- Interagency policy statement
To ask a question

- Use the chat feature in the webinar *(Ask Question* button on bottom of screen)
- Email us at [fedperspectives@stls.frb.org](mailto:fedperspectives@stls.frb.org)
Thanks for joining us.

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