Welcome

CECL: Lessons Learned from SEC Adopters

Today's Presenter

Garver Moore

Managing Director

Abrigo

Session Agenda

1. **Myths and Facts**
   Don’t Do What CECL Isn’t
2. **Starting Point: SCALE**
   Options and Limitations
3. **Framing Concept – Two Estimates**
   Turning CECL into two easier problems

Poll Question #1

Which best describes your role?

a. Finance
b. Credit
c. Accounting
d. Lending
e. Other

Poll Question #2

Where are you in your implementation?

a. All done! We are presenting ACL on our financials
b. In parallel testing with intended live methodology
c. Methodology testing
d. Data testing
e. Standing start

Poll Question #3

How would you best describe your financial institution?

a. Predominantly CRE
b. Consumer/Mortgage Focused
c. Mix of CRE and Commercial/SMB
d. Diverse Portfolio

Road Hazards:

Be clear on what CECL isn’t, and don’t do that.

Road Hazards

MYTH

Depth/breadth of data required

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Road Hazards

MYTH

Depth/breadth of data required

FACT

Availability of data is a productive constraint

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Road Hazards

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More data does not mean more *intelligence*

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Road Hazards

MYTH Depth/breadth of data required

FACT Availability of data is a productive constraint

More data does not mean more *intelligence*

FACT Internal/external data are appropriate

FACT

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Road Hazards

MYTH

There is a right answer

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Road Hazards

MYTH There is a right answer

FACT Subjectivity is very high at many layers

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Road Hazards

MYTH There is a right answer

FACT Subjectivity is very high at many layers

FACT A consistent and well-reasoned process can be constructed and followed

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Road Hazards

MYTH Accurate forecasting is required

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FACT We must apply a forecast

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FACT No client criticized on forecast **inputs**

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Road Hazards

MYTH Accurate forecasting is required

FACT We must apply a forecast

FACT No client criticized on forecast **inputs**

FACT Clients have changed forecast **input** method after adoption with minimal scrutiny

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Road Hazards

MYTH

All methodologies must be examined

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Road Hazards

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FACT Allowable methodologies very broad

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FACT There are not “bright lines” between methodologies—more methodology “families”

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Road Hazards

MYTH All methodologies must be examined

FACT Allowable methodologies very broad

FACT There are not “bright lines” between methodologies—more methodology “families”

FACT Many methodologies are trivially inappropriate for an FI

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Hazards to Navigation

MYTH CECL is “higher”

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Hazards to Navigation

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FACT CECL practices are often more precise, and may be lower

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Hazards to Navigation

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CECL practices are often more precise,
and may be lower

FACT

Forecast expectations may exert pressure contrary to upward pressure of ‘life of loan’

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Hazards to Navigation

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FACT Forecast expectations may exert pressure contrary to upward pressure of ‘life of loan’

FACT Comparing outcomes of ACL vs. ALLL dependent on point in cycle

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Hazards to Navigation

MYTH CECL is “higher”

FACT CECL practices are often more precise, and may be lower

FACT Forecast expectations may exert pressure contrary to upward pressure of ‘life of loan’

FACT Comparing outcomes of ACL vs. ALLL dependent on point in cycle

FACT A 3-year loss rate is not 3x a 1-year loss rate

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Notes on SCALE

SCALE Background

- 'Ask the Fed' Webinar July 2021 – interagency with FASB representation
- Bank institutions < $1B assets
- Spreadsheet-based tool to assist as 'starting point' in computing ACL

SCALE Background

Acknowledges:

- Difficulty in establishing loss expectations for smaller FIs (lack of losses)
- “Internal information, external information, or a combination of both” black-letter requirement
- Data availability as productive constraint on segmentation
- Prudential regulatory expectations for small FI complexity

SCALE Theory

Peer ACL

Peer amortized cost = Peer lifetime loss expectation

+

Adjustments for peer group relevancy

+

Adjustments for expected conditions / Q factors

SCALE Theory

Peer ACL

Peer amortized cost = Peer lifetime loss expectation

+ Adjustments for peer group relevancy

+ Adjustments for expected conditions / Q factors

= Adjusted Loss Expectation

+ Individually Analyzed / 'Impairments'

+ Off Balance Sheet / Securities / etc.

=

Allowance for Credit Loss

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SCALE Theory

Peer ACL

Peer amortized cost = Peer lifetime loss expectation

SCALE Theory

Peer ACL

Peer amortized cost = Peer lifetime loss expectation

Schedule RI-C Part II - Disaggregated Data on the Allowances for Credit Losses(Form Type - 041)

Dollar amounts in thousands	(Column A) Amortized Cost		(Column B) Allowance Balance		
1. Real estate loans:					1.
a. Construction loans	RCONJJ04	**0**	RCONJJ12	**0**	1.a.
b. Commercial real estate loans	RCONJJ05	**1,423,897**	RCONJJ13	**22,093**	1.b.
c. Residential real estate loans	RCONJJ06	**1,349,607**	RCONJJ14	**5,270**	1.c.
2. Commercial loans[3]	RCONJJ07	**493,157**	RCONJJ15	**4,408**	2.
3. Credit cards	RCONJJ08	**0**	RCONJJ16	**0**	3.
4. Other consumer loans	RCONJJ09	**19,255**	RCONJJ17	**289**	4.
5. Unallocated, if any			RCONJJ18	**0**	5.
6. Total (sum of items 1.a. through 5)	RCONJJ11	**3,285,916**	RCONJJ19	**32,060**	6.

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SCALE Theory

Peer ACL

_____

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= Peer lifetime loss expectation

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Entered into SCALE…

Enter proxy expected lifetime loss rates here (e.g., Schedule RI-C)

↓

CECL ACL Lifetime Loss Rate		*From Tab 3* Adj. for Qualitative Factors		*Calculated* Life of Loan Loss Rate
0.0000%	+/-	0.0000%	=	0.0000%
1.5000%	+/-	0.0000%	=	1.5000%
0.3800%	+/-	0.0000%	=	0.3800%
0.8900%	+/-	0.0000%	=	0.8900%
0.0000%	+/-	0.0000%	=	0.0000%
1.4900%	+/-	0.0000%	=	1.4900%
0.0000%	+/-	0.0000%	=	0.0000%

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SCALE Theory

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6. Total (sum of items 1.a. through 5)	RCONJJ11	3,285,916	RCONJJ19	32,060	6.

This data includes the other FI's (from prior quarter):

- Qualitative adjustments
- Forecasted components
- Impaired reserve

SCALE Theory

Adjustments for peer group relevancy

SCALE Theory

Adjustments for peer group relevancy

Entered into SCALE…

Institution Net Loss to Average Total LNLS [from page 7 of UBPR]	
Year	**Ratio**
2007	0.0000%
2008	0.1000%
2009	0.4200%
2010	0.6500%
2011	0.3300%
2012	-0.3000%
2013	-0.5000%
2014	0.1800%
2015	0.0700%
2016	-0.0100%
2017	0.0350%
2018	0.0610%
2019	-0.3000%
2020	0.1500%
Average	0.0633%

SCALE Theory

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2018	0.0610%
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2020	0.1500%
Average	0.0633%

Peer Net Loss to Average Total LNLS [from page 7 of UBPR]	
Year	**Ratio**
2007	0.1000%
2008	0.3000%
2009	0.5000%
2010	1.9000%
2011	1.1000%
2012	-0.4300%
2013	0.2100%
2014	0.2500%
2015	0.1800%
2016	0.0500%
2017	0.0300%
2018	0.2300%
2019	0.2000%
2020	0.4000%
Average	0.3586%

Calculated

Adjustment
-0.2953%

SCALE Theory

Adjustments for peer group relevancy

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2020	0.4000%
Average	0.3586%

Calculated Adjustment
-0.2953%

SCALE Theory

Adjustments for peer group relevancy

Entered into SCALE…

	From Tab 2			*Calculated*			*From Tab 3*		*Calculated*		*Calculated*	
	Loans Assessed on Individual Basis			**Loans Assessed on Pooled Basis**		**CECL ACL Lifetime Loss Rate**		**Adj. for Qualitative Factors**		**Life of Loan Loss Rate**		**CECL ACL**
-	$ -	=	$	15,000		0.0000%	+/-	0.0000%	=	0.0000%	$	-
-	$ 3,700	=	$	71,300		1.5000%	+/-	0.0000%	=	1.5000%	$	1,070
-	$ 1,500	=	$	28,500		0.3800%	+/-	0.0000%	=	0.3800%	$	108
-	$ 2,000	=	$	38,000		0.8900%	+/-	0.0000%	=	0.8900%	$	338
-	$ -	=	$	-		0.0000%	+/-	0.0000%	=	0.0000%	$	-
-	$ 40	=	$	7,960		1.4900%	+/-	0.0000%	=	1.4900%	$	119
-	$ -	=	$	13,000		0.0000%	+/-	0.0000%	=	0.0000%	$	-
			$	173,760							$	1,635
								Adjustment for Historical Loss Experience		*From Tab 4*	$	(513)

SCALE Theory

Adjustments for expected conditions / Q factors

SCALE Theory

Adjustments for expected conditions / Q factors

Institutions are responsible for all inputs on this tab

Loan Segment	Adjustment	Comments
Real Estate - Construction	0.0000%	[Enter summary comments and source of supporting
Real Estate - Commercial	0.0000%	
Real Estate - Residential	0.0000%	
Commercial	0.0000%	
Credit Cards	0.0000%	
Other Consumer	0.0000%	
Additional Segments (1)	0.0000%	

Additional Narrative:

[Enter additional explanatory narrative if warranted]

SCALE Theory

Adjustments for expected conditions / Q factors

This is "old hat" for most… but consider existing incorporation of opaque forecast / Q factor / impaired amounts in the source data

Institutions are responsible for all inputs on this tab

Loan Segment	Adjustment	Comments
Real Estate - Construction	0.0000%	[Enter summary comments and source of supporting
Real Estate - Commercial	0.0000%	
Real Estate - Residential	0.0000%	
Commercial	0.0000%	
Credit Cards	0.0000%	
Other Consumer	0.0000%	
Additional Segments (1)	0.0000%	

Additional Narrative:

[Enter additional explanatory narrative if warranted]

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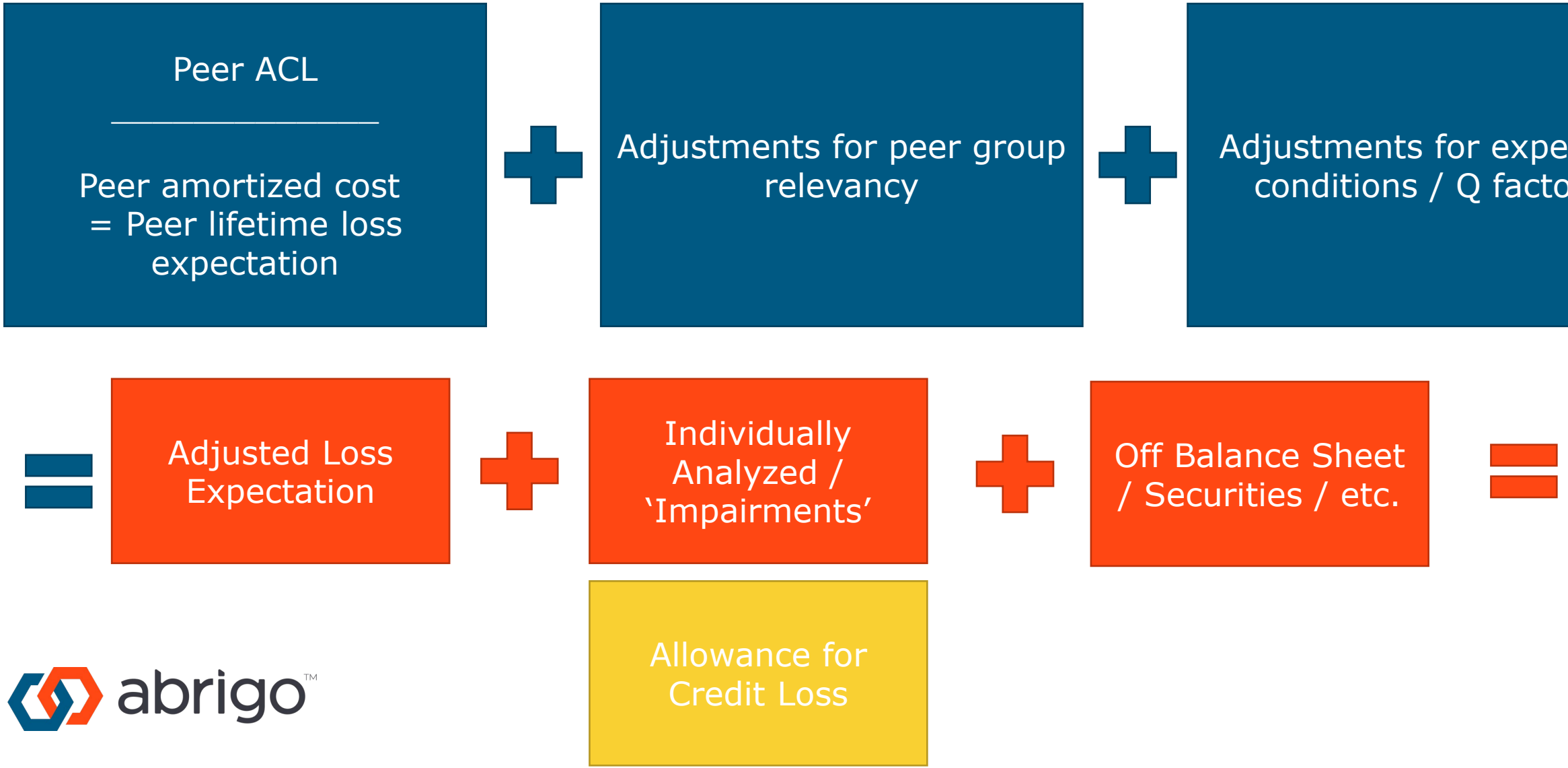
SCALE Theory



SCALE Considerations

- Relevancy of larger FIs in pool
- Future inclusion of smaller FIs in peer pool once they are live
- Time-shifting of information incorporated in call report estimates
- Defense of peer cohort
- Projectability – what will a SCALE allowance produce in e.g., Q2 2022?
- Defensibility risk for opaque components of peer ACL preparation (PPP, etc.)
- Purchased accounting considerations

SCALE Takeaways

- “Endorsement” of use of external data from prudential regulators – core new feature of CECL
- Signal of expected complexity, along with WARM webinar in ’18 (segmentation, for example)
- Good coverage for whatever direction you end up going

SCALE Takeaways

- "Endorsement" of use of external data from prudential regulators – core new feature of CECL
- Signal of expected complexity, along with WARM webinar in '18 (segmentation, for example)
- Good comparative coverage for whatever direction you end up going

Looking at what comparable public FIs have reported gives good "target" context

SCALE Takeaways

- "Endorsement" of use of external data from prudential regulators – core new feature of CECL
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- Good comparative coverage for whatever direction you end up going

Looking at what comparable public FIs have reported gives good "target" context

If planning to use this tool to prepare financial statements, ***start now***

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Proven Approaches – Theory

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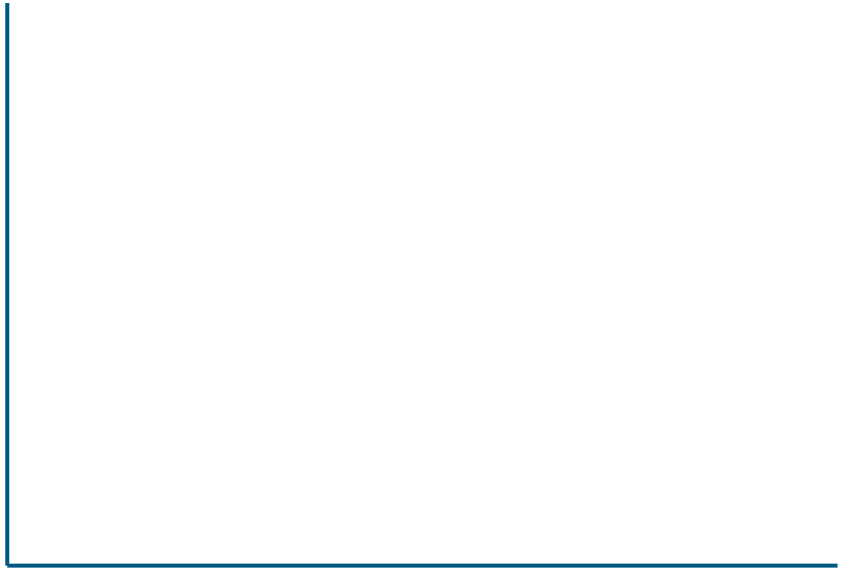

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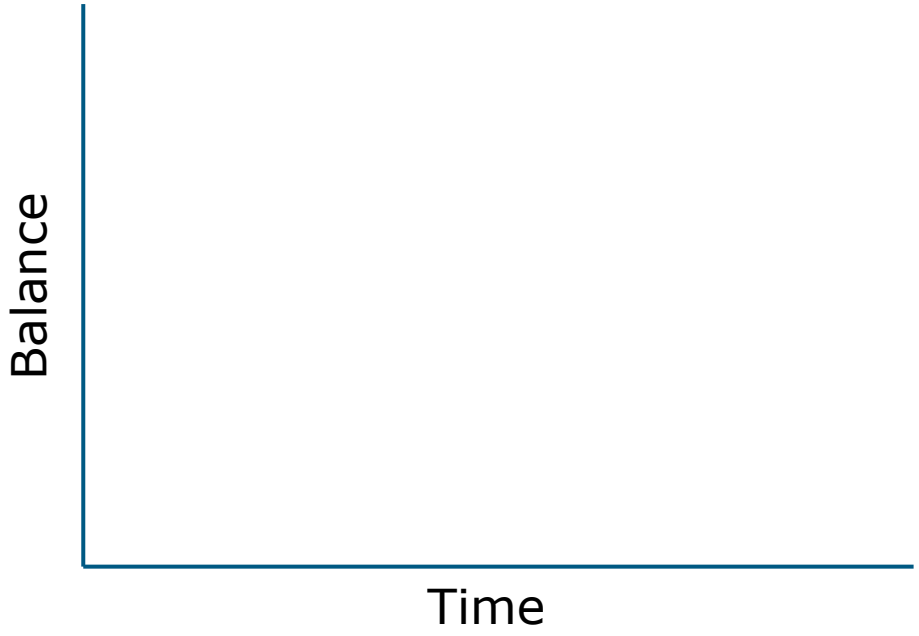
Proven Approaches – Theory



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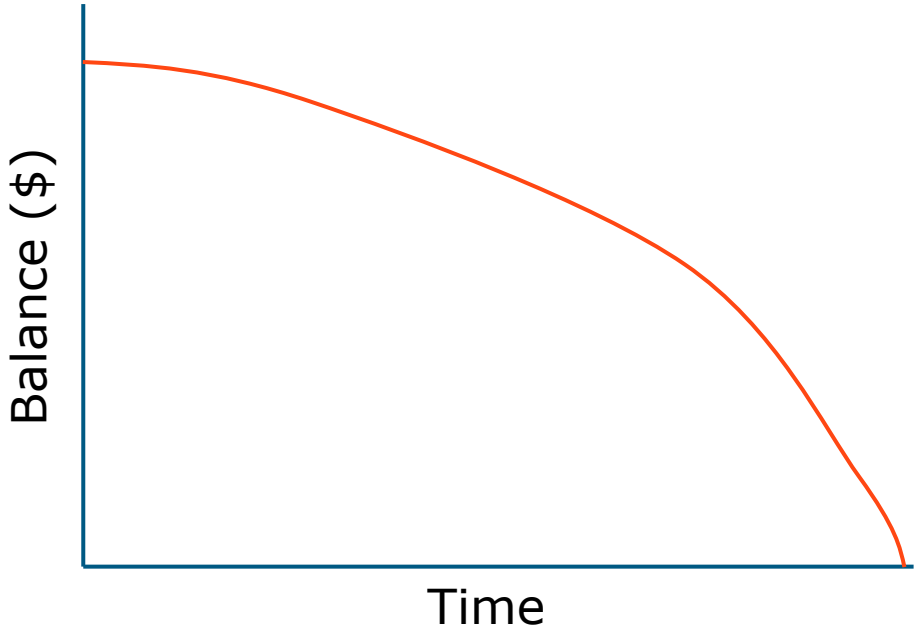

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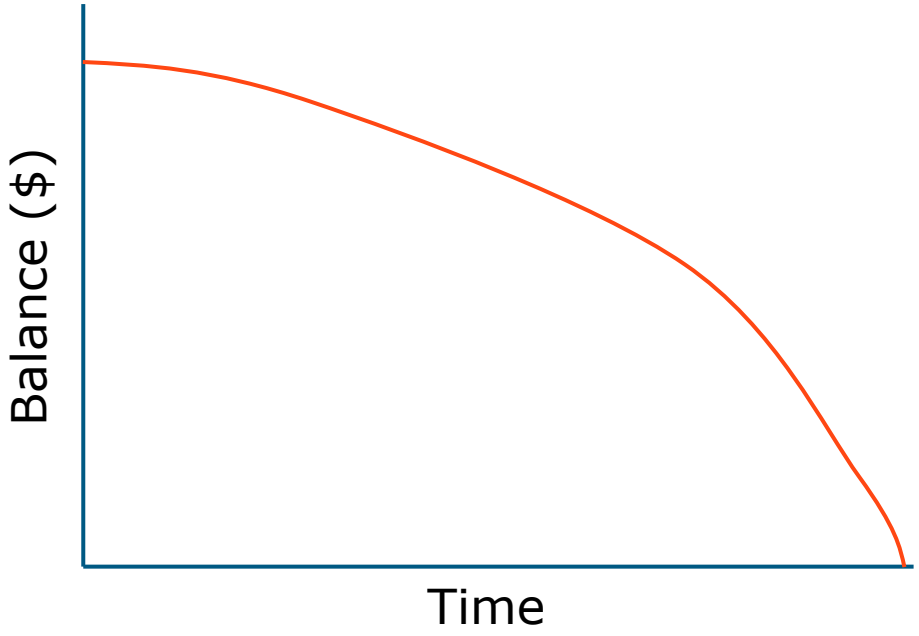

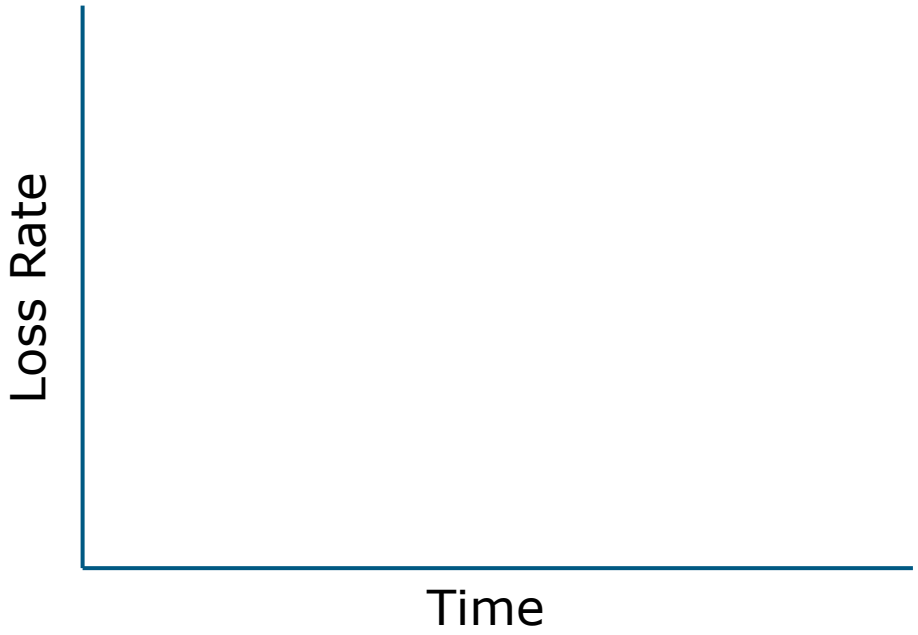

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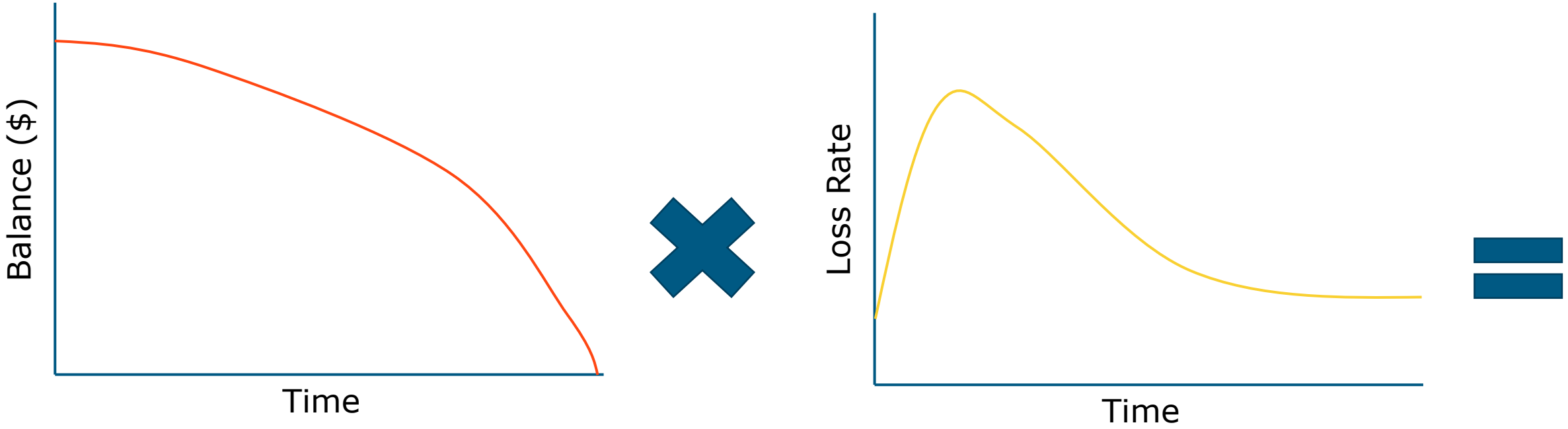

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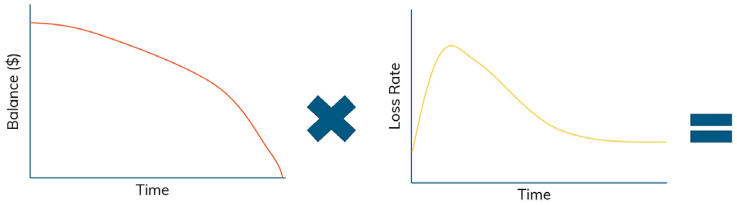

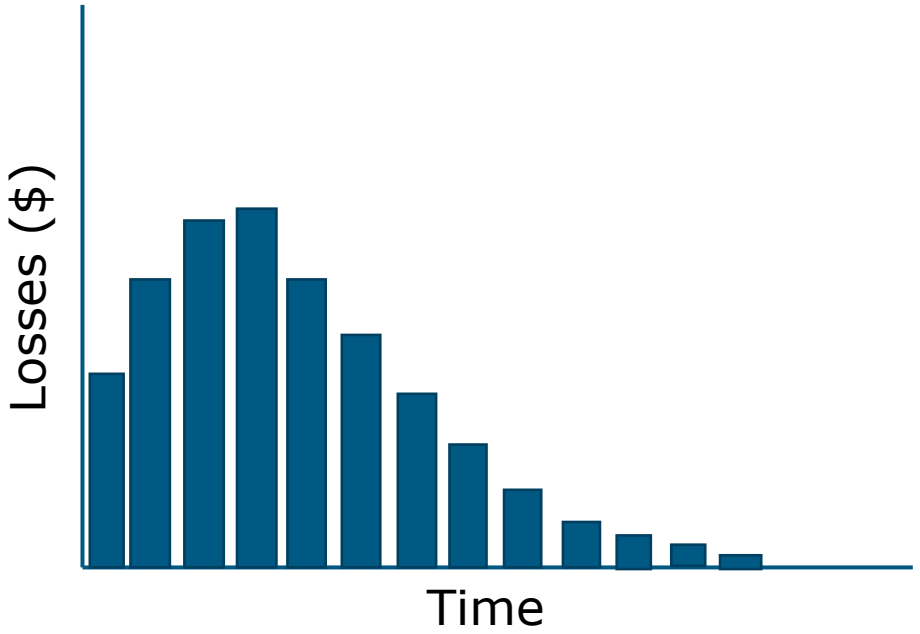

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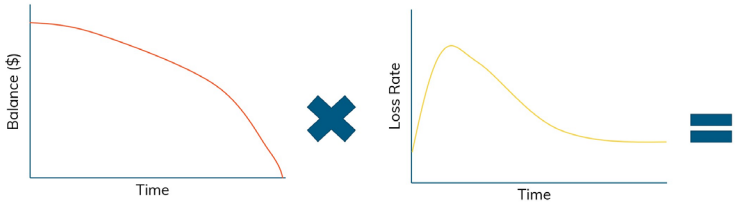
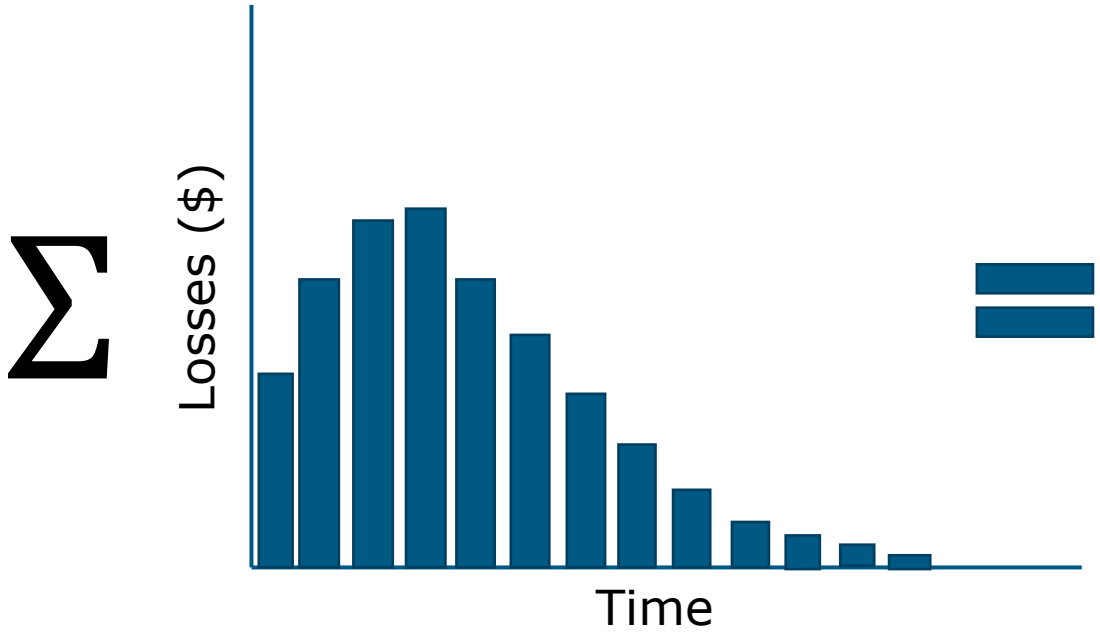
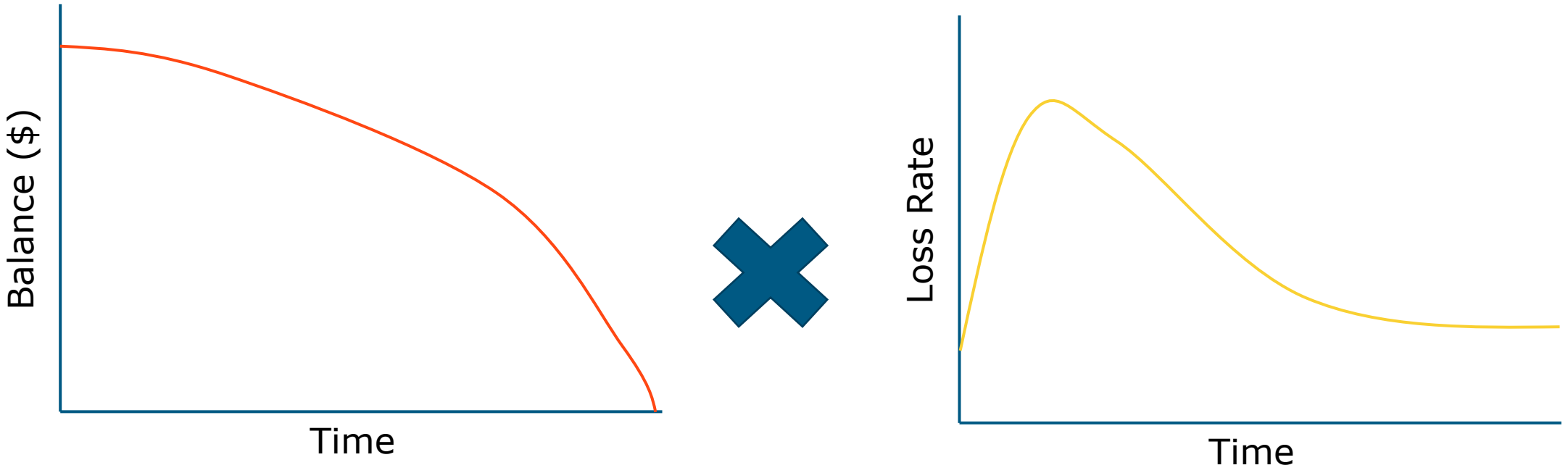


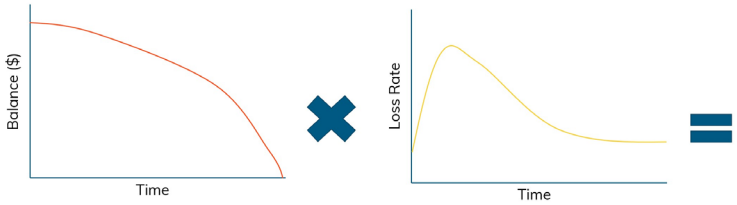


Lifetime Expected Loss

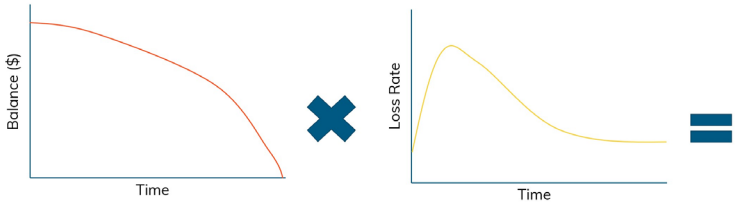
Proven Approaches – Theory

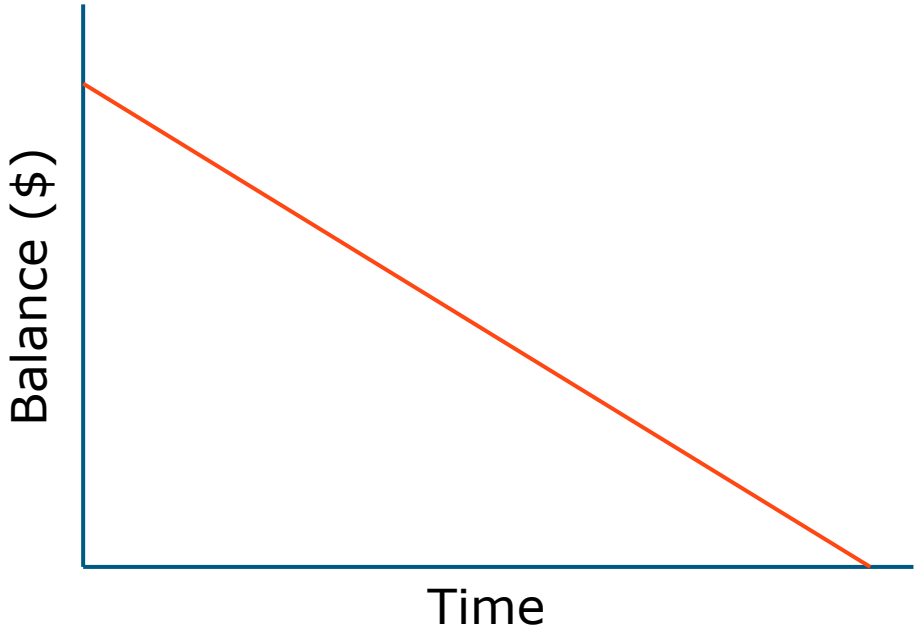


Proven Approaches – Simple



Simple Approaches (WARM/WARL)





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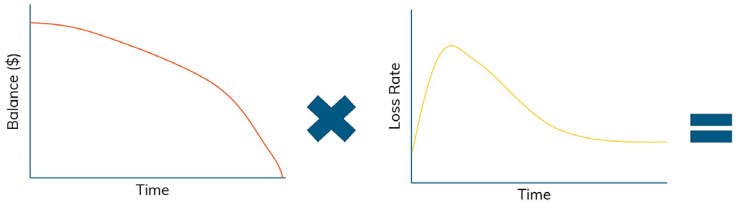

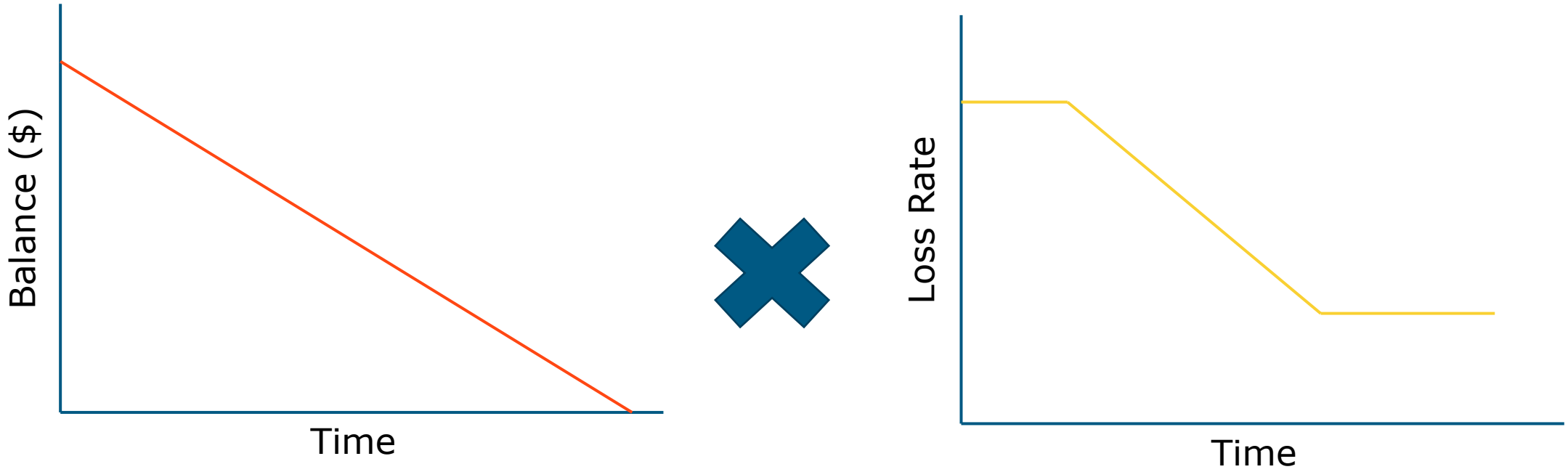

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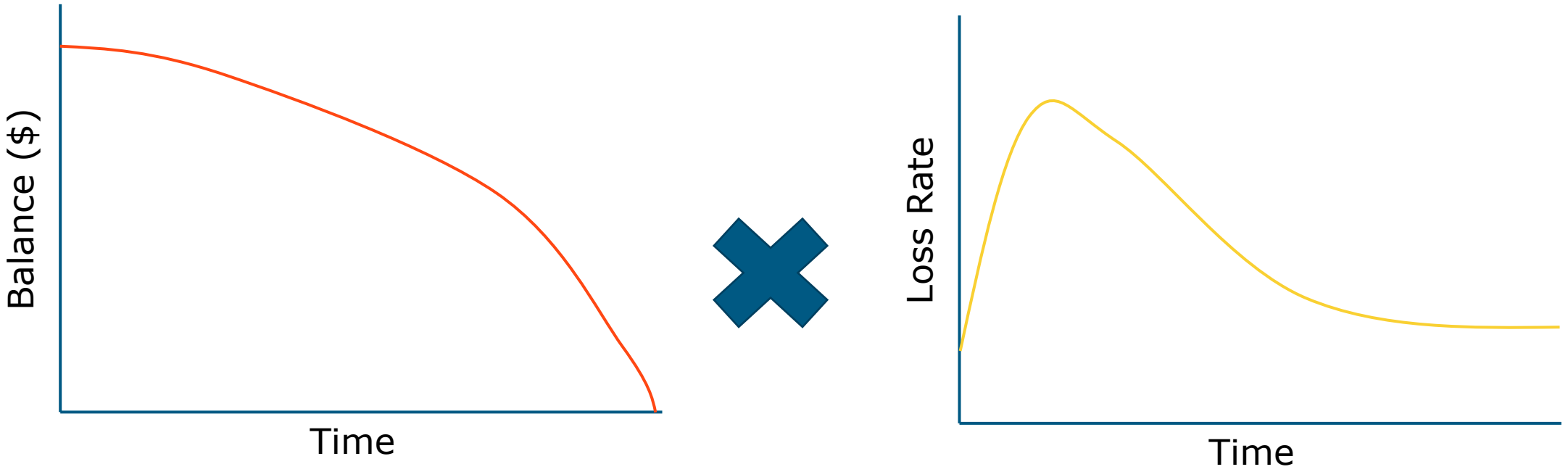
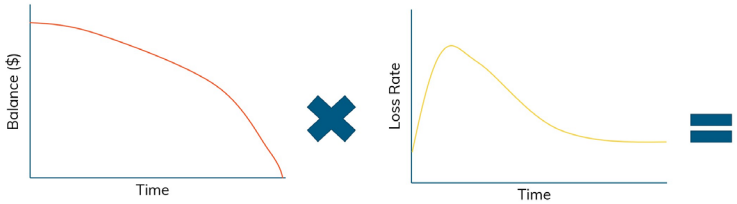
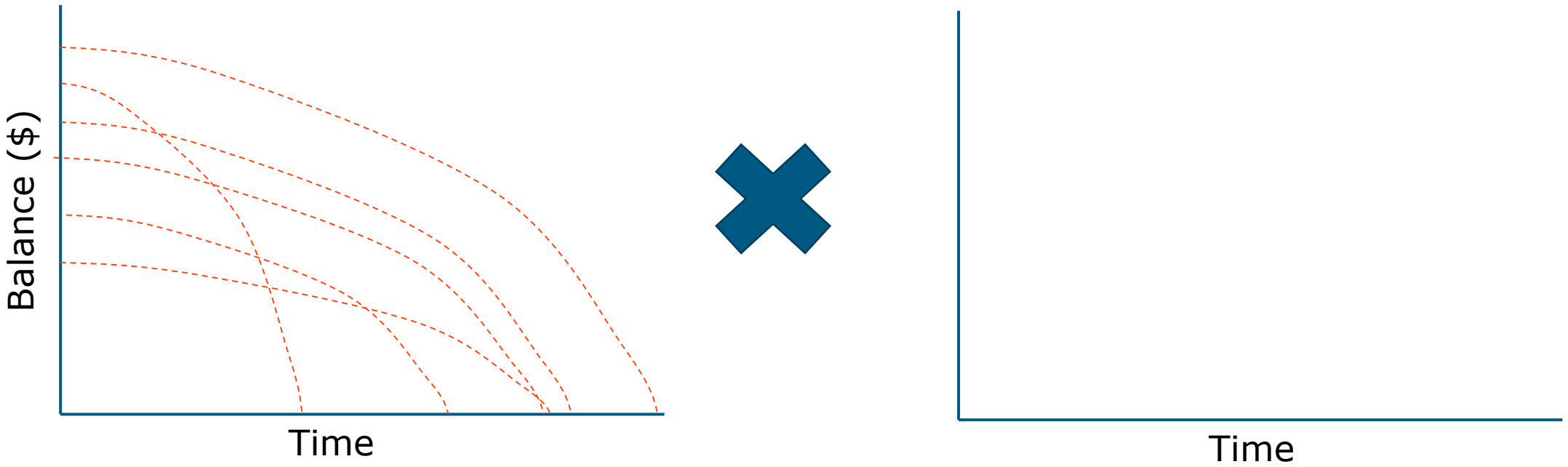


Closer to the Pin





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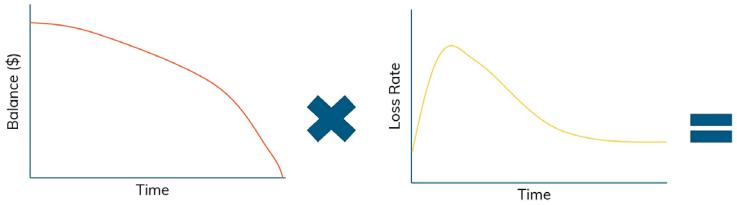

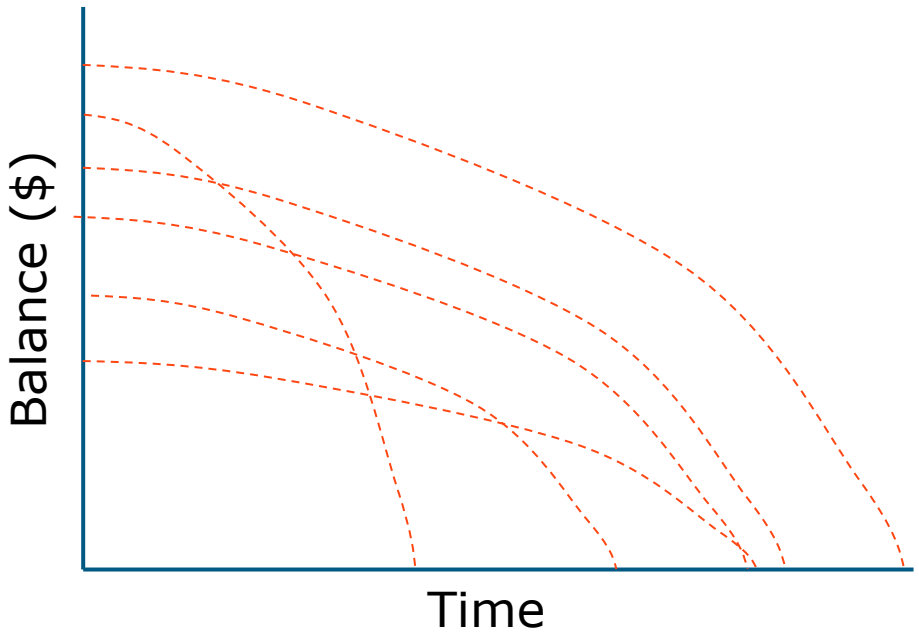

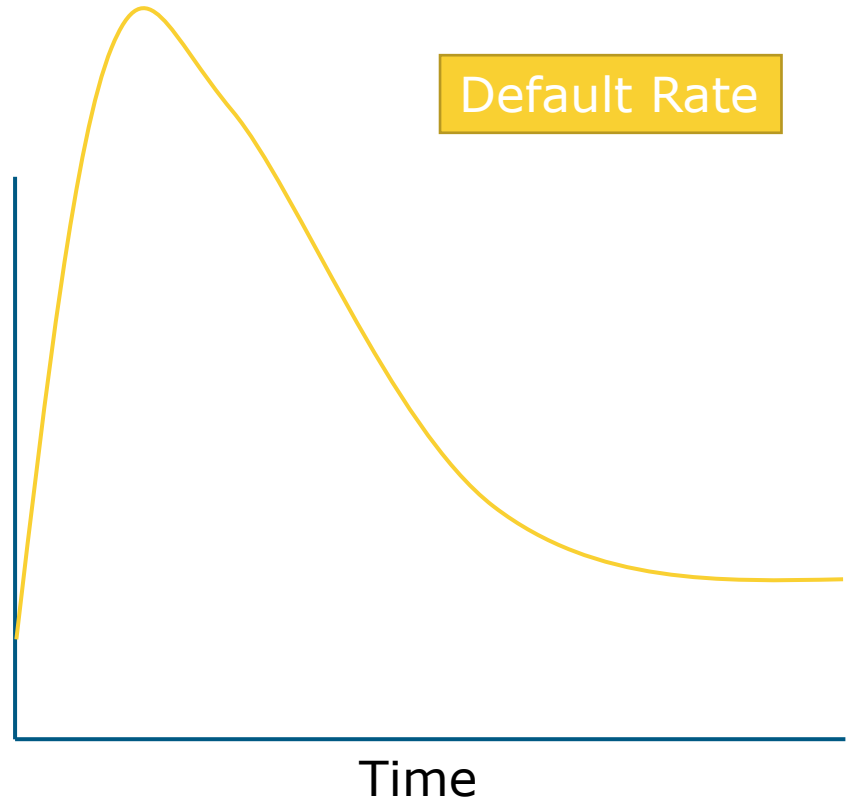

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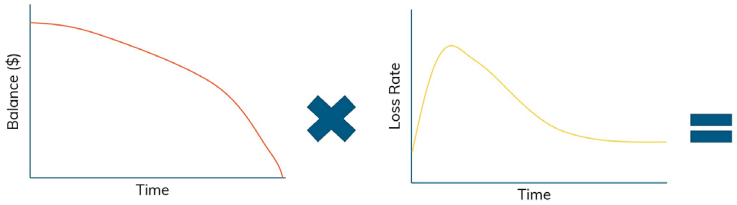

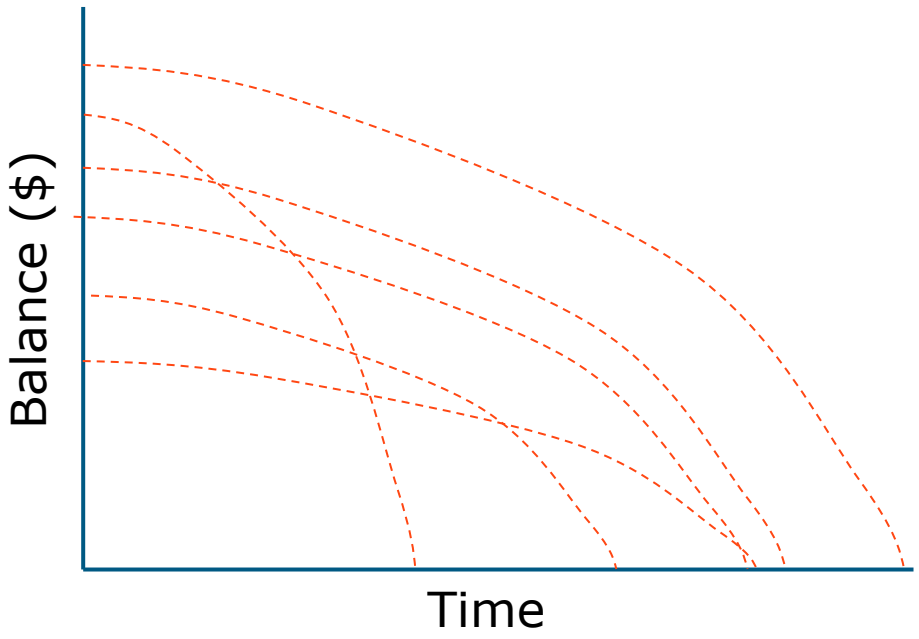

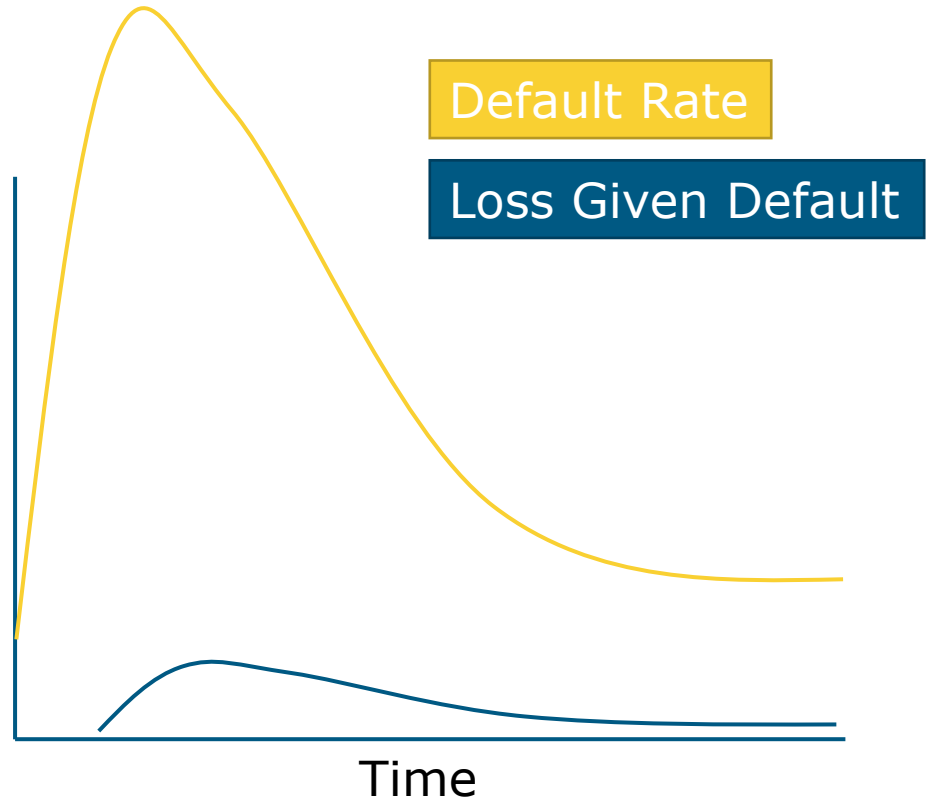

Questions?

Thank You

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