Current Expected Credit Loss (CECL): Questions and Answers for Community Institutions

Speakers from:

- ► Board of Governors of the Federal Reserve System (FRB)
- ► Federal Deposit Insurance Corporation (FDIC)
- ► Office of the Comptroller of the Currency (OCC)
- ► U.S. Securities and Exchange Commission (SEC)
- ► Conference of State Bank Supervisors (CSBS)
- ► Financial Accounting Standards Board (FASB)

July 30, 2018

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Welcome everyone

- **Today's session**
- **Questions:**
  - Email your question to: rapid@stls.frb.org

    or
  - Use the "Ask Question" button in the webinar tool.
- **This call is being recorded and will be available immediately following the session.**
  - Archived recording can be accessed using the same link as today's webinar.
- **A survey will be delivered via email following the call. Let us know your thoughts or ideas for future sessions.**

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Today’s presenters

- **FRB**
  - **Joanne Wakim**, Chief Accountant
- **FDIC**
  - **Robert Storch**, Chief Accountant
  - **John Rieger**, Deputy Chief Accountant
- **OCC**
  - **Sydney Menefee**, Chief Accountant
- **SEC**
  - **Michael Berrigan**, Professional Accounting Fellow, Office of the Chief Accountant
- **CSBS**
  - **Jami Flynn**, Director, Supervisory Processes
- **FASB**
  - **Shayne Kuhaneck**, Assistant Director

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Goals of today's session

- Share the agencies' perspectives on questions asked by community institutions
- Demonstrate the consistency of views across the agencies
- Share common challenges faced by community institutions about implementing CECL
- Answer your questions

Questions and Answers (Q&A)

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Q&A

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?

2. **Supervisory expectations.** What can community institutions expect during 2018 examinations relating to CECL? Do examiners have a standard set of expectations for community institutions?

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Q&A (continued)

3. **Supervisory expectations.** How will the agencies evaluate the institution's process to determine allowance for credit losses (ACL) under CECL? Will examiners challenge institutions if their method results in a lower ACL under CECL than under the incurred loss model?

4. **Third-party vendors.** Do the agencies have a specific expectation regarding the use or purchase of third party vendor services to implement CECL?
   - FRB, Supervision and Regulation Letter 13-19/Consumer Affairs Letter 13-21, "Guidance on Managing Outsourcing Risk"
   - FDIC, Financial Institution Letter 44-2008, "Guidance for Managing Third-Party Risk"
   - OCC, Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance"

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Q&A (continued)

5. **Charge-offs and recoveries.** When determining historical loss rates to use in the calculation for ACL, how should recoveries be considered in the charge-offs (i.e., net or gross of recoveries)?

6. **Peer data.** Is it acceptable to use data from various regulatory reports (e.g., FFIEC Call Reports)? What types of peer data are available as a reference for historical loss experience?

7. **Historical data.** What is the minimum number of years of historical data required to calculate the ACL?

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Q&A (continued)

8. **Low historical loss experience.** What guidance is available for institutions with zero to extremely low historical loss experience? To what extent may institutions rely on qualitative adjustments to determine the appropriateness of the ACL?

9. **Qualitative factors.** What qualitative factors would be considered reasonable when using a loss rate method to calculate the ACL?

Q&A (continued)

10. **Reasonable and supportable forecast period.** 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?

11. **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?

Q&A (continued)

12. **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 FFIEC Call Report categories?

13. **Segmentation and life of loan.** Is it appropriate to pool loans with different maturities into one segment? For example, can a seven-year term commercial real estate (CRE) loan be pooled with a five-year CRE loan if the loan risk characteristics are similar? If yes, how is the average life of loan calculated for such pool?

Q&A (continued)

14. **Life of loan.** 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?

15. **Life of loan.** How is life of loan determined for lines of credit with a one year maturity?

16. **Renewals.** 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 five year period or should it remain in the original five year pool?

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Q&A (continued)

17. **Credit cards.** How are historical losses on open-ended credits (e.g., credit cards) determined under CECL?

18. **Methods**. Some have suggested that the vintage method will be the minimum standard required to implement CECL (i.e., other types of loss rate methods will not be acceptable). Is this accurate?

19. **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?

Q&A (continued)

20. **Transitioning methods over time.** Is it appropriate to use one loss rate method (e.g., open pool or WARM) and then transition to another loss rate method (e.g., vintage) at a later time when the institution has collected a sufficient amount of data?

21. **Supervisory expectations.** Will agencies object to institutions' use of the Weighted Average Remaining Maturity Methods, commonly referred to as WARM?

22. **Public company financial statement disclosure.** Is there a requirement to disclose the quantitative impact of the adoption of CECL on capital in the financial statements (e.g., Form 10-K)?

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Q&A (continued)

23. **Individual impairment.** What type of loans are required to be evaluated individually under CECL? Does CECL eliminate the need to identify and measure impaired loans?

24. **Troubled debt restructuring (TDR).** Does determination and measurement of expected losses on TDRs remain the same under CECL?

25. **Risk ratings.** How do loan risk ratings impact the calculation of the ACL under CECL?

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Q&A (continued)

26. **Revenue recognition.** How does CECL affect the revenue recognition and expense matching principle?

27. **Non-public business entity effective date.** Will there be a change in the effective date for non-public business entities?

To ask a question:

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Closing Remarks

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Resources (hyperlinks embedded)

- **FASB Resources**
  - FASB CECL Standard (core guidance p.101-123)
  - Transition Resource Group (TRG)
  - TRG – Meeting Materials
- **Interagency Resources**
  - "Interagency Guidance on the New Accounting Standard on Financial Instruments – Credit Losses"
  - "Frequently Asked Questions on the Current Expected Credit Losses Methodology (CECL)"
  - Community Bank Webinar: Implementation Examples for the Current Expected Credit Losses Methodology (CECL), February 27, 2018
- **Federal Reserve Resources (webinars)**
  - CECL Update: Frequently Asked Questions, October 3, 2017
  - Conversations with Industry Experts: Financial Accounting Standards Board (FASB) on Current Expected Credit Loss (CECL), July 28, 2016
  - Current Expected Credit Loss (CECL) Update: Current Supervisory Views, October 5, 2016

Resources (continued)

- **FDIC Resources**
- **OCC Resources**
  - CECL Homepage on BankNet
  - CECL Reference Guide for Bankers
  - CECL Call Report Effective Date Decision Tree
  - CECL Webinar Series
    - Part 1: Introducing CECL
    - Part 2: Implementation Considerations
    - Part 3: Debt Securities
    - Part 4: Data and Methods
    - Part 5: Third-Party Risk Management & CECL
    - Part 6: Purchased Credit Deteriorated Loans
  - Dedicated Mailbox: CECL@occ.treas.gov
- **CSBS Resources**
- **AICPA Accounting for Credit Losses Resources**

Acronyms

- ACL – Allowance for Credit Losses
- AICPA – American Institute of CPAs
- CECL – Current Expected Credit Loss
- CRE – Commercial Real Estate
- CSBS – Conference of State Bank Supervisors
- DCF – Discounted Cash Flow
- FASB – Financial Accounting Standards Board
- FDIC – Federal Deposit Insurance Corporation
- FFIEC – Federal Financial Institutions Examination Council
- FRB – Board of Governors of the Federal Reserve System
- OCC – Office of the Comptroller of the Currency
- SEC – U.S. Securities and Exchange Commission
- TDR - Troubled Debt Restructuring
- WARM - Weighted Average Remaining Maturity

Thanks for joining us.