NEW IMPAIRMENT GUIDANCE (CECL)

- Incurred/Probable
- Expected/Lifetime
Included

- Financing receivables
- Held to maturity debt (no more OTTI)
- Loan commitments, guarantees, standby letters of credit
- Lease receivables
- Reinsurance receivables
- Receivables on repurchase & securities lending agreements

Excluded

- Financial assets at fair value
- Available for sale debt (updated model)
- Participant loans defined contribution benefit plans
- Insurance policy loans
- NFP pledges receivable
CECL KEY HIGHLIGHTS

- Recognize an estimate of expected credit losses over remaining contractual life based on:
  - Historical experience
  - Adjustment for current conditions
  - Adjustments for reasonable & supportable forecasts

- Contractual life considers expected prepayments, but excludes:
  - Expected extensions
  - Renewals & modifications unless expected to happen in a troubled debt restructuring
CECL KEY HIGHLIGHTS

Shall be measured on a collective pool basis using similar risk characteristics unless assets do not share similar risk characteristics, for example:

- Credit score or credit ratings
- Collateral type
- Size
- Term

For future periods where forecasts are not supportable, an entity shall revert to historical loss information either:

- Immediately
- On a straight-line basis
- Using another rational or systematic basis
CECL KEY HIGHLIGHTS

- Collateral-dependent practical expedient & TDR remains
  - Collateral-dependent = repayment expected substantially through operation or sale of collateral when borrower is experiencing financial difficulty

- Estimate of expected credit losses shall include a measure of expected risk of credit loss even if that risk is remote

- Does not prescribe a specific model or method to be used
  - FASB believes models do not need to be “unnecessarily complex”
CECL CALCULATION

Historical Lifetime Credit Loss + Current conditions adjustment + Forecast adjustment = Current expected credit loss
# ASU 2016-13 IMPLEMENTATION DATES

## Effective Date (for Entities with Calendar Year-Ends)

<table>
<thead>
<tr>
<th>Type</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
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<tbody>
<tr>
<td><strong>ASU 2016-13 Impairment (CECL)</strong> *</td>
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<tr>
<td>PBE – SEC filers</td>
<td>Interim &amp; annual</td>
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<td>PBE – small</td>
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<td>Interim &amp; annual</td>
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<tr>
<td>All others</td>
<td></td>
<td>Annual</td>
<td>Interim</td>
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* Early adoption permitted for all entities for periods beginning after December 15, 2018
FORMAL REGULATORY GUIDANCE

- Joint Statement on the New Accounting Standard on Financial Instruments - Credit Losses (June 2016)
- Frequently Asked Questions on CECL (September 2017)
KEY TAKEAWAYS

New standard will be scalable to all institutions

Smaller & less complex institutions will be able to adjust their existing allowance methods to meet the requirements of the new standard without the use of costly &/or complex modeling techniques

Inputs to allowance estimation methods currently used will need to change to properly implement CECL requirements

Institutions can continue to leverage credit risk management practices in their qualitative & quantitative factors

Institutions may apply different estimation models to different groups of financial assets or loan pools

Won’t require institutions to engage third-party vendors to assist in implementing & calculating allowances within CECL

Institutions may need to capture additional data & retain data longer to meet CECL data requirements
CECL READINESS & IMPLEMENTATION PROCESS

Create committee & timeline
Pool segmentation & credit risk identification
Data inventory & gap analysis
Model(s) selection & development
Model(s) finalization & parallel run
Modify policies, procedures, controls & disclosures
EXAMPLE IMPLEMENTATION TIMELINE – NON-SEC PBE

- **2018**: Create timeline & committee
- **2019**: Data assessment & pool & risk analysis complete
- **2020**: Finalization of planning process & model selection complete
- **2021**: Model finalization & parallel run, including testing controls for year leading up to implementation
- **2022**: Test run of required annual disclosures
- **2022**: Finalize annual disclosures

Implementation
## POOL SEGMENTATION & CREDIT RISK IDENTIFICATION

### Document the appropriateness of loan pools based on common risk characteristics under:

- Consider if current pooling can be leveraged
- How homogenous are current pools and how CECL may impact this given:
  - Differences in payment structure, term, prepayment risk, etc.
  - May result in more or less granularity
- Document key risk indicators and loss driver for each pool

### Use this time to perform the following:

- Inventory all current policies, procedures, processes and controls over the incurred loss rate model
- Determine lives of pools (contractual adjusted for prepayment)
- Create a preliminary list of models you will consider for each pool
DATA INVENTORY & GAP ANALYSIS

- Create an inventory of where all historic loan information is maintained
  - Detailed loan trial balances
  - Loan level charge-off & recovery activity
  - Loan origination activity

- Consider sources for historic data
  - Loan applications (core systems)
  - ALLL spreadsheets/software
  - ALM software

- Determine what gaps are present
  - Data needs are highly dependent on model selection
  - Conclude on whether you have appropriate historical data
MODEL SELECTION

- Specific model approach is not mandated; however, start by considering what is used currently
- Different models will work better for certain portfolios
  - Consumer v. commercial
  - Amortizing v. non-amortizing
  - Amount of loss experience
  - Population size
- Determine which loans will be analyzed individually
  - TDRs
  - Collateral dependent loans
  - Other loans not having similar risk characteristics
MODEL SELECTION

Open pool loss rate models
- Open pool at segment level

Probability of Default/Loss Given Default
- More significant data needs to determine event of default over loan life

Discounted cash flow
- More significant data needs such as prepayment rates & default rates

Closed (static) pool loss rate models
- Vintage model (sub-segment by origination)
PANEL DISCUSSION
QUESTIONS?
THANK YOU!