Comparing Vintage Loss Rate Methodologies

How to Select the Right Method for Your Portfolio or Homogeneous Pool of Loans

By: Scott Blakeslee

Executive Summary

The Vintage method for collectively reviewing loans is a CECL-compliant loss rate method in which lifetime losses are captured as a percentage of total originations by vintage year. By comparing Vintage and Advanced Vintage methodologies, financial institutions are empowered to choose the best calculation method to ensure CECL compliance. The 2019 Financial Accounting Standards Board (FASB) issued a new account standard;

"Under the new accounting standard, disclosures of credit quality indicators of financing receivables and net investment in leases, such as loan-to-value ratios, credit scores, and risk ratings, need to be disaggregated by vintage (i.e., year of origination) to provide users of financial statements greater transparency regarding the credit quality trends within the portfolio from period to period."

Board of Governors of the Federal Reserve System, et al. (2019)

This whitepaper compares the Vintage and Advanced Vintage loss rate methods. It outlines the main differences between both methods, details the data requirement considerations, and summarizes the advantages and disadvantages.

Introduction

Vintage and Advanced Vintage methods are founded on similar principles and are both CECL-compliant loss rate methods. Compared to other CECL-compliant loss rate methods, the Vintage and Advanced Vintage methods stand out because they account for loan age. This is an important concept as seasoned loans generally carry less risk than newer loans, and the level of seasoning in a portfolio can change over time. There are many ways of accounting for loan age, but both Vintage and Advanced Vintage methods accomplish this by applying a unique loss rate to each vintage group (origination year) in the active portfolio.

Vintage Methods Comparison

While the Vintage and Advanced Vintage methods are founded on similar principles, there are some key differences to consider when deciding which method (if either) to use. The main differences stem from the fact that the Vintage method uses original balance as a baseline while the Advanced Vintage method uses current balance as its baseline. The details of this distinction are laid out in the respective Knowledge articles on the two methods, but the main takeaways are outlined below:

Vintage Methods Comparison

Vintage Method	Advanced Vintage Method
Uses original balance as a baseline	Uses current balance as a baseline
Allows segmentation by original credit quality	Allows segmentation by current credit quality
Only requires one "vintage" table to be constructed for each homogeneous pool (i.e. class)	Requires unique table construction for each active vintage group within the pool
Can only utilize charge-off data from vintages that have complete origination data	Incorporate charge-off data going back as far as it was recorded
Fewer Calculations	Better equipped to handle revolving loan types, such as HELOCs and credit cards

Analysis of Vintage Method's Advantages and Disadvantages

Advantages	Disadvantages
Uses simple calculations	Uses the state of the portfolio at the respective points of origination (original balance)
Good to use when acceptable historical data is available	Not ideal for revolving credits, such as lines of credit because it uses original balance
Similar to the traditional loss rate but CECL compliant	

Advanced Vintage Method

Advantages	Disadvantages
Uses current state of the portfolio as a baseline (current balance) and current credit quality	Uses complex calculations and data tables for each pool/class of loans
Better suited for revolving credits	Institutions must overhaul traditional historical loss rate methodology to migrate over
Good to use when origination data is limited	

Data Requirements

The minimum data requirements for using the Vintage method are at least one complete calendar year of charge-off data and original balance data going back at least to the term of the class. The minimum data requirements for using the Advanced Vintage method are at least one complete calendar year of charge-off data and active balance data.

When considering the minimum data requirements for both Vintage methods, if a financial institution can demonstrate that charge-offs do not occur after a certain number of years within the term of a particular class, they may be able to justify using the average term of the class instead of going back to the full term of the class. It is important to note that the longer the data history is, the more accurate and stable the estimates are.

In addition to the data required to accurately place each loan in the appropriate pool, such as origination date, loan type, and credit quality ratings, the following is a summary of the historical data requirements for each method:

Vintage:

- At least one complete calendar year of charge-off data.
- Original balances going back at least to the term of the class.
- Original balances for all loans, including pre-paid and matured loans.

Advanced Vintage:

- At least one complete calendar year of charge-off data and active balance data.

Final Takeaway

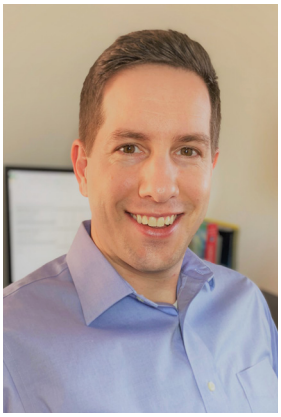
The Vintage and Advanced Vintage methods are founded on similar principles and are both CECL-compliant loss rate methods. Both methods account for loan age and offer a robust framework for institutions with strong historical data to use their own historical data in producing future loss estimates.

One of the main differences between these two methods is that they have different historical balance data requirements. Another difference is the level of complexity of the calculations involved for each method. Vintage involves relatively simple calculations and is based on original loan amounts. Advanced Vintage requires more complex calculations and is based on current balances.

When evaluating the Vintage methods, financial institutions should carefully consider:

- The advantages and disadvantages for each method.
- The data requirements, assumptions, and limitations for use.
- The sustainability of using the method.

About the Author



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