



American
Bankers
Association

Current Expected Credit Loss (CECL) Accounting Standard:

An Introduction for Bank CEOs and their Board



The Change to CECL

FAS 5:

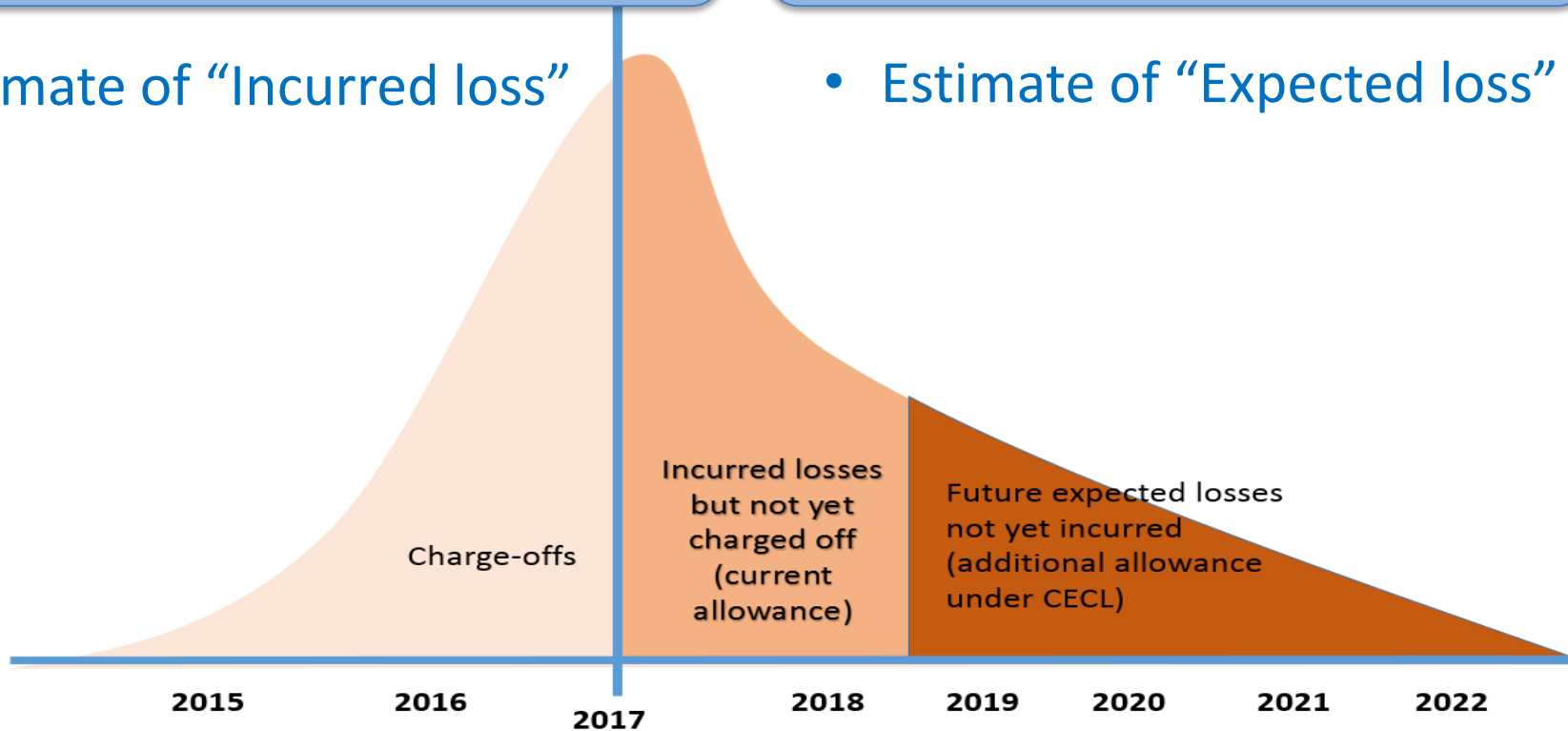
“Losses in the Portfolio”

- Estimate of “Incurred loss”

CECL:

“Risk in the Portfolio”

- Estimate of “Expected loss”



CECL: Expected credit losses over life of loan or portfolio

- Life of Loan (LOL) loss expectation (pool basis) effectively recorded at origination
- Forecast of the future to LOL required
- Historic averages of “life of loan” losses
 - Used as starting point for estimates
 - Applied to periods beyond “forecastable future.”

So what does this mean for me?

1. **Credit losses** will be recognized earlier in my financial statements
2. My **current process** to estimate my allowance will need to change
3. Periods of directional inconsistency between **performance metrics** and the **provision**

Where to start?

- Assess my current ALLL reserve process:
 - How do I currently estimate the reserve (data, model, governance)?
 - What additional information or modeling tools will I require to expand my estimate to estimate for life of loan?
- Communication:
 - Can I get out in front and share your assessments and pitch your solutions to your auditors/regulators to get them on board?
 - Can I involve other parts of the bank to ensure a consistent view between accounting, credit and others?
- Allocate resources:
 - Do the right people have the time needed to assess and implement the necessary changes?
 - Do I need external expertise or tools?
- Other considerations:
 - How will this impact my capital and do I need to start planning now to adjust?
 - Can I unlock value from the life of loan estimate to use in pricing or credit decisions?

Implementation considerations?

- Data to support life of loan loss, Q factor estimates
- Vintage information
- Further segmentation by credit risk characteristics
- Forecasting the future
- Governance:
 - Documentation
 - Internal controls

Biggest CECL Challenges

1. Investors/Mgmt – Communications

- Relationship of traditional metrics to provisions no longer continues
- New Metrics needed

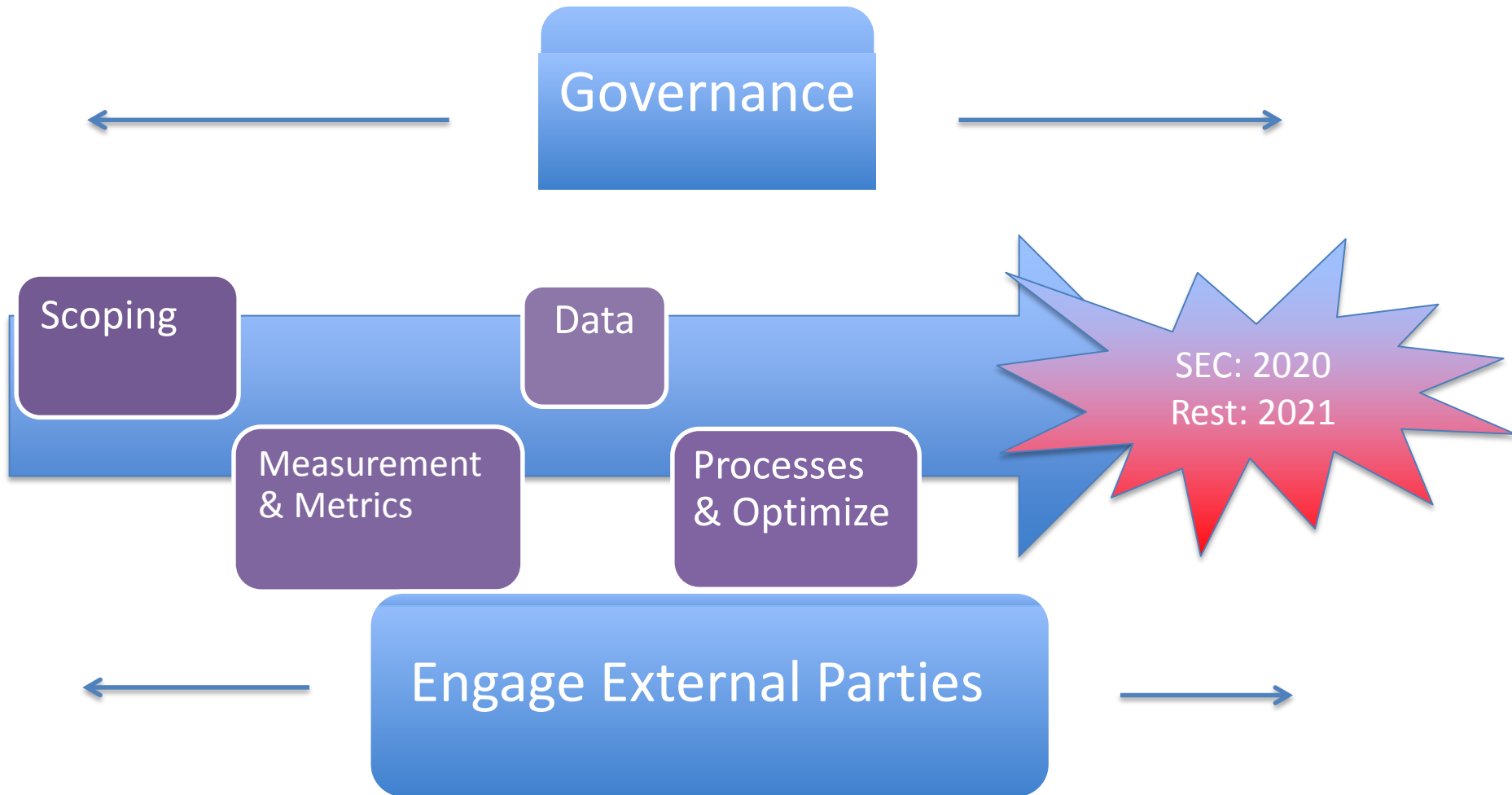
2. Auditors – Supporting documentation

- Life of loan, more granular data needed
- Quantifying forecasts of the future

3. Regulators – Aligning CECL

- To capital management, ALM, budgeting and planning

Transitioning to 2020/21



What to do now?

- Educate
- Communicate with your stakeholders
- Develop a plan