Summary of FASB "CECL" Model
to estimate the
Allowance for Loan and Lease Losses (ALLL)

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FASB’s Proposal on ALLL (the CECL model)

- Applies to loans AND debt securities
- Requires that all “expected” losses, over the entire lifetime of a loan or debt security, be estimated. Banks will begin with historical life of loan losses and justify adjustments from the lifetime averages.
- ABA believes:
  - CECL should exclude debt securities, as it represents no improvement from OTTI accounting
  - For loans – The proposal will:
    - Require overhaul of existing estimation systems.
    - Result in unreliable and volatile loss estimates beyond the foreseeable future
  - Roundtable discussions are needed *prior to issuing the final standard* to determine how CECL would be implemented. Bankers, investors, regulators and auditors should participate.
  - U.S. Banking Industry Model (BIM) represents a workable solution. Although it may result in higher levels of losses, it is built upon current systems and bankers’ understanding about impairment. BIM can be an efficient method to estimate all loss in a portfolio.

Comparison of Impairment Models on Unimpaired Loans

	1 Current U.S. Model	2 Banking Industry Model	3 FASB CECL Model
Standard	• Losses that are probable and reasonably estimable.	• All losses in the portfolio predictable with reasonable confidence. • Additional allowances are recorded, with adjustment for forecasts of future.	• Lifetime losses expected in the portfolio. • Forecasts of future included above.
Implementation	• Incurred But Not Reported amounts are recorded, based on annual charge-off rates. • Charge-off rates are adjusted to include existing and future considerations.	• Builds off current systems. • All foreseeable risks must be considered. • Reliability maintained.	• Big system changes required. • Higher ALLL at origination. • Lower Reliability=Volatility • Current delinquency/credit metrics will be irrelevant.
Notes	• ALLL levels currently consider charge-offs anticipated to be taken over next 1 to 2+ years.	• ALLL may be higher than current levels.	• OCC estimates 15% to 50% increase in ALLL levels industry-wide. Some bankers believe it will be even higher.

FASB's CECL Model Might Work If Modified…

FASB's CECL Model

Contractual Life of Loan Estimate

- Contractual life of loan analysis required.
- Loss is assumed at origination.

Debt Securities and Loans use CECL

- Losses recorded upon purchase.

Modified CECL Model

- All loss in the portfolio is estimated, but with reasonable level of confidence.
- "Foreseeable future" and "Loss emergence periods" can be acceptable methods.
- Macroeconomic conditions and contractual terms throughout the life of a loan are not ignored.
- Losses recorded when there are changes to loss expectations. (As opposed to when loss is probable, which is the current accounting.)
- Guidance provided on factors that may change loss expectations.
- Debt securities are excluded; instead, current OTTI accounting is maintained.