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I N C O R P O R A T E D

CECL

**WHAT YOU ACTUALLY NEED TO KNOW:
A PRACTICAL DISCUSSION**

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COMMON CONCERNS

- Still a lot of unease about:
 - What is CECL?
 - What will be the capital impact?
 - What data do I need?
 - What model is right for my credit union?
 - Other concerns?

WHAT IS CECL?

Current allowance method

- Recent historical loss rates are utilized to determine the ALLL account
Example: 36 mth. Historical loss rate rolling average
- ALLL account covers current losses for the next 12 to 18 months based on current actual losses
- It is not a forecast
- Criticism – not forward looking, but backward looking (too little, too late)

WHAT IS CECL?

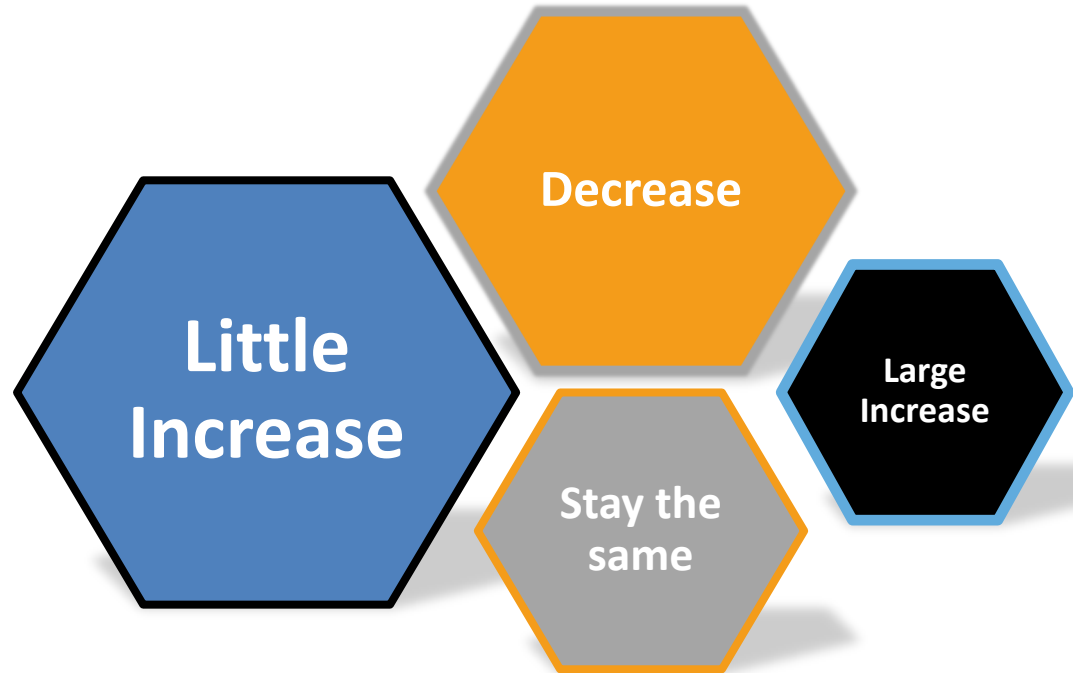
- It is an actual forecast
- Current expected credit losses (CECL) for the remaining life of the current loan portfolio
- As if no new loan originations occur and the portfolio is just left to run off. What will the total estimated losses be for the current loan portfolio?
- Expected loan cash flow runoff (i.e. prepayment speed adjusted)
- CU effective date of January 1, 2023

WHAT IS CECL?

- Askthefed.org – Webinar April 11, 2019
<https://www.webcaster4.com/Webcast/ListenPage?companyId=583&webcastId=29509>
- FASB Staff Q & A – Topic 326, No. 1 – January 2019 www.fasb.org
- FASB Staff Q & A – Topic 326, No. 2 – July 2019 Developing an Estimate of Expected Credit Losses on Financial Assets www.fasb.org
- October 7, 2019 CU Journal Opinion by J Mark McWatters
<https://www.cujournal.com/opinion/ncua-can-ease-credit-unions'-cecl-burden>
- More coming

CAPITAL IMPACT

Many credit unions may not see a large change in their ALLL. In some cases it could actually stay about the same or decrease.



What we have learned completing over 250 CECL Reports

CAPITAL IMPACT

- Initial adjustment – one-time charge to capital and the ALLL account.
- Subsequent entries will be through the income statement.

**AT LEAST A ONE YEAR PARALLEL RUN FOR
PLANNING AND TRENDING ANALYSIS**

DATA CONSIDERATIONS

“Institutions should collect and maintain relevant data to support its estimates of lifetime expected credit losses in a way that aligns with the method or methods it will use to estimate its allowances for credit losses” *Federal Reserve Website*

IN OUR WORDS

- Pick a model/methodology that uses data you already have or can easily obtain. Do NOT pick a model and THEN determine what data is needed.
- The model you select should consider the data you can get AND are willing to spend the time getting (time is money).
- Data requirements vary widely depending on the methodology and particular model.

DATA CONSIDERATIONS

Credit union own data

Full Economic Cycle

Regional, Industry,
peer data

Q Factor-Qualitative

MODEL SELECTION

FASB CONSIDERATION

- FASB does not prescribe a specific model
- Practical and scalable
- Reasonable and supportable
 - Model/methodology
 - Assumptions
 - Forecast
- Assumed quarterly assessment

MODEL SELECTION

“agencies expect the new accounting standard will be scalable to institutions of all sizes.”

<https://www.ncua.gov/files/press-releases-news/interagency-joint-statement-accounting-standard-financial-instruments-06-17-16.pdf>

IT IS NOT A ONE SIZED
FITS ALL SELECTION!

MODEL SELECTION

A solution that is too complex for the credit union or heavily data intensive may result in unnecessary resource utilization and even increase the possibility of error.

Example:

Over-segmenting could potentially result in increased error for small to medium sized credit unions.

EXAMPLE

Use peer data or another methodology for categories where you do not have enough credit union specific data

CECL Model & Scenario Builder

Please use the following dropdowns to build your customized CECL model & scenario for each category

| Category | Current Balance | Methodology | Scenario | Expected Net Losses |
|---------------|-------------------|-------------------------------|------------------------------|---------------------|
| 1st Lien | 2,291,878 | Remaining Life | Reversion to Long-Term Rates | - |
| Commercial | - | Remaining Life | Reversion to Long-Term Rates | - |
| Commercial RE | - | Remaining Life State Rates | Reversion to Long-Term Rates | - |
| Credit Card | - | Remaining Life National Rates | Reversion to Long-Term Rates | - |
| Jr. Lien | 8,994,243 | Remaining Life | Economic Forecast - Standard | 5,640 |
| New Auto | 8,372,327 | Remaining Life State Rates | Reversion to Long-Term Rates | 29,895 |
| Other Secured | 3,320,645 | Remaining Life | Economic Forecast - Low | 28,544 |
| Payday | - | Remaining Life | Reversion to Long-Term Rates | - |
| Share Secured | 329,249 | Remaining Life | Reversion to Long-Term Rates | - |
| Student | 2,840,344 | Probability of Default | Reversion to Long-Term Rates | 42,530 |
| Unsecured | 3,615,751 | Remaining Life | Economic Forecast - High | 58,753 |
| Used Auto | 24,398,461 | Remaining Life | Reversion to Long-Term Rates | 178,422 |
| Total | 64,019,335 | | | 343,784 |

MODEL SELECTION

Historical data
(economic cycle)

Sensitivity /Stress
Testing

Multiple
Methodologies

Peer Data

ALL-IN COST CONSIDERATIONS

**Personnel
Allocation**

**Proper Controls
Assurance – input & output**

**Software
(if applicable)**

**Including
Backup**

Model Accuracy

Other IT

**Data
Integrity**

Consistency and accuracy

**Data
Storage**

**Periodic method
and assumption
approval**

Back-testing

Model Validation

MODEL SELECTION

- Don't just assume that all in-house or outsourced solutions are all the same so I might as well just pick one.
- Out of pocket costs vary widely.
- Resources required by the credit union varies widely.
- Make sure you select the model that is right for your credit union!

WHAT IS THE RIGHT SOLUTION FOR YOUR CREDIT UNION

What we have learned completing over 250 CECL Reports for smaller credit unions

- CECL compliance can be comfortable, easy, and affordable with the right solution
- Choose a model that incorporates applicable data you already have available and limits resources expended
 - CU's own loss data and compliment with industry data
 - Full economic cycle (~15 years)
 - Alternative methodologies

SPEND TIME AND ENERGY ON SERVICES TO HELP YOUR MEMBERS



Mark H. Smith
I N C O R P O R A T E D

WOULD YOU LIKE TO KNOW MORE?

Easy and affordable CECL Solution

IRR/ALM Outsourced Solution

Third Party Review/Validations

Interactive Peer Analysis

PLEASE CONTACT US

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