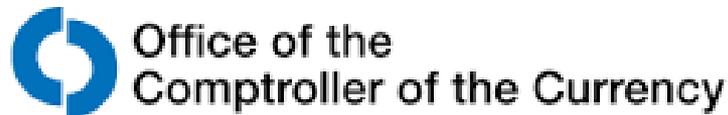


Webinar: Latest Developments on CECL and Upcoming Changes to the Allowance for Credit Losses



September 8, 2016



Topics

- An Introduction
- CECL
 - What's Changing?
 - What's not Changing?
 - Acceptable Methods
- Myths vs Facts
- Initial Supervisory Expectations
- Supervisory Preparation
- How to Prepare Now (Do's and Don'ts)
- Q&A

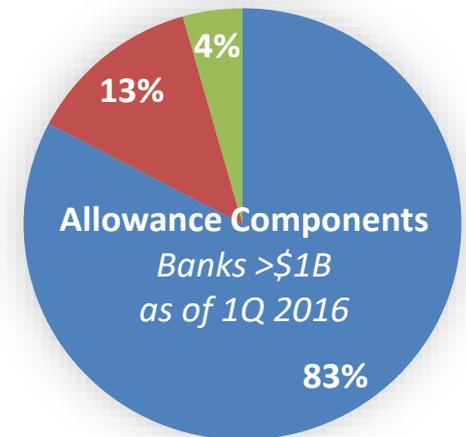
A link to the new standard:

http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176168232528

An Introduction: Incurred Loss Methodology

Under today's incurred loss methodology, the ALLL...

- Includes probable incurred losses as of the balance sheet date
 - Does not consider the effect of future, expected events
 - An “incurred loss” for accounting purposes precedes a Loss Classification/charge-off
 - Applies exclusively to financing receivables
- Is comprised of:
 - ASC 310-10: Individually evaluated loans deemed impaired
 - ASC 310-30: Purchased credit impaired loans
 - ASC 450-20: All other loans not included in the buckets above



■ ASC 450-20 ■ ASC 310-10 ■ ASC 310-30

An Introduction: CECL... easy as A B C

- A valuation account
- Deducted from amortized cost basis of financial assets
- Used to present “net amount expected to be collected”
- Adjustments flow through net income

$$A - B = C$$

Amortized cost . . . unpaid principal balance (UPB) lent to a customer adjusted for net deferred fees or costs, repayments, writeoffs, nonaccrual practices, and certain hedging transactions

Amount expected to be
Collected . . . remaining amounts expected to be collected from each loan

An Introduction: CECL Scope

Loans		Debt Securities	
Held for Investment	CECL	Held to Maturity	CECL
Held for Sale	Lower of amortized cost or fair value **	Available for Sale	AFS credit loss model*
		Trading	FV-NI **

* In developing a new credit-loss methodology for AFS, the Board decided that the “other-than-temporary” concept should no longer exist and that an allowance for credit losses on AFS is limited by the amount that the fair value of an AFS debt security is less than its amortized cost basis. In addition, if an institution decides to sell an AFS debt security, the amortized cost basis must be written down to fair value and any allowance for the security written off.

** No change to current U.S. GAAP.

An Introduction: Effective Dates

CECL Effective Dates

Entity Type	U.S. GAAP Effective Date	Call Report Effective Date*
Public Business Entities (PBEs) that are SEC Filers	Fiscal years beginning after 15 December 2019, including interim periods within those fiscal years	Q1 2020 (31 March 2020)
Other PBEs** (Non-SEC Filers)	Fiscal years beginning after 15 December 2020, including interim periods within those fiscal years	Q1 2021 (31 March 2021)
Non-PBEs	Fiscal years beginning after 15 December 2020, including interim periods beginning after 15 December 2021	Q4 2021 (31 Dec. 2021)
Early Application	Early application permitted for fiscal years beginning after 15 December 2018, including interim periods within those fiscal years	Permissible No earlier than 31 March 2019

* For institutions with calendar year ends.

** A public business entity that is not an SEC filer would include (1) an entity that has issued securities that are traded, listed, or quoted on an over-the-counter market, and (2) an entity that has issued one or more securities that are not subject to contractual restrictions on transfer and is required by law, contract, or regulation to prepare U.S. GAAP financial statements and make them publicly available periodically (e.g., pursuant to Section 36 of the Federal Deposit Insurance Act and Part 363 of the FDIC's regulations).

CECL: What's Changing

	Current US GAAP	CECL
When are Losses Recognized?	When it is “ probable ” a loss has been “incurred” (+ four other methodologies)	No recognition threshold , current expectations are updated at each reporting date
How Much Loss is Recognized?	Recognize the amount of loss that has already been incurred	Recognize an allowance to reduce the net carrying value to the amount expected to be collected
What Information is Used in Determining Loss?	<ul style="list-style-type: none"> • Past events • Current conditions 	<ul style="list-style-type: none"> • Past events • Current conditions • Reasonable & supportable forecasts that affect collectibility

CECL: What's Changing

- Reduces the number of credit impairment models
- Introduces a “lifetime” concept for estimating the allowance for credit losses
- Requires collective or pool basis assessment of credit losses
- Requires an allowance on HTM securities
- Enhances credit quality disclosure requirements for public business entities
- Accounting for purchased credit impaired loans

EARLIER RECOGNITION OF CREDIT LOSSES!

CECL: What's Not Changing

- Ability to choose an estimation method most appropriate for the bank. CECL is *scalable*.
- **Total amount of losses** recognized over time
- Credit risk review/management processes
- Consideration of historical loss experience on similar assets and current conditions
- Consideration of qualitative factors affecting collectability
- Interest income recognition and nonaccrual policies
- Write-off (i.e., charge-off) policies
- Accounting treatment for loans held for sale

Small Banks Don't Need Big Models!

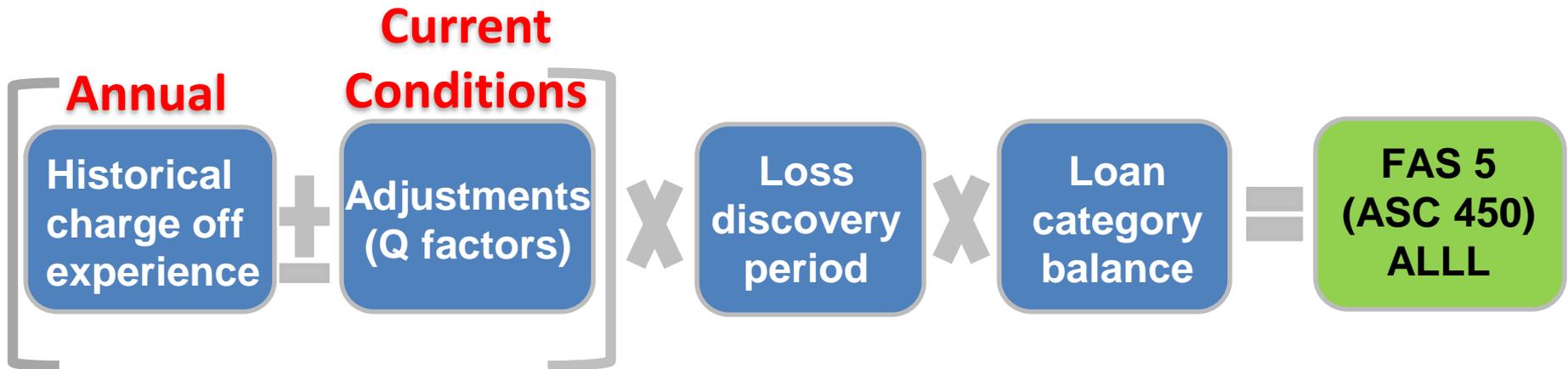
CECL: Acceptable Methods

Expected credit losses may be determined using . . .

- Various methods including loss rate, vintage, roll rate/migration, probability of default, discounted cash flow (DCF)
- Not required to
 - Utilize DCF method or vintage method
 - Reconcile estimation technique with DCF method
 - Discount for time value of money unless using DCF
 - For DCF, use effective interest rate

CECL: Loss Rate Methods—Today & Future

Current US GAAP



CECL



CECL: FASB's Loss Rate Method Example

<p>Fact Pattern: Year end 20X5 Amortized Cost Basis = \$3,000,000 Term: 10 year amortizing Historical lifetime credit loss rate = 1.50%</p>	<p><u>Management expects in 20X6 and 20X7:</u></p> <ul style="list-style-type: none"> • Fall in real estate values • Rise in unemployment <p>Management cannot reasonably forecast beyond 20X7</p>
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Allowance Calculation	
Historical lifetime credit loss rate	1.50%
Adjustment for expected decrease in real estate values	+0.10%
Adjustment for expected increase in unemployment rates	<u>+0.05%</u>
Lifetime expected loss rate	1.65%
CECL Allowance (\$3,000,000 x 1.65%)	\$49,500

CECL:



#	Myths	Facts
1	CECL requires big, complex models.	CECL is scalable , just like the incurred loss methodology today.
2	Regulators will require benchmark increases in allowance levels.	Although allowance levels are expected to increase, upon adoption of CECL regulators will <u>not</u> look for benchmark increases in allowance levels.
3	FASB did not consult with stakeholders when drafting CECL.	FASB developed the CECL methodology based on extensive feedback from stakeholders.*
4	Institutions must develop loss forecasts for the entire life of loan , including long term forecasts (e.g., 30-year mortgages).	Institutions should revert to historical loss experience for periods beyond which they are able to reasonably forecast.
5	The accountants can handle implementing CECL.	CECL implementation should involve various functional areas within an institution.

* FASB met with 200+ users of financial statements and hosted 15 preparer workshops, 8 public roundtables, and 25 fieldwork meetings.

Initial Supervisory Expectations

- Joint Statement on the New Accounting Standard on Financial Instruments – Credit Losses was issued by the agencies on June 17, 2016
 - Provides initial information about the FASB’s new standard
 - Provides initial supervisory views regarding the implementation of the CECL methodology by supervised institutions
 - Available at <https://www.fdic.gov/news/news/press/2016/pr16051a.pdf>

Regulatory Agencies' Preparation



- Established an interagency steering committee
- Conduct outreach with bankers and auditors
- Develop internal and external training and communication plans
- Inventory existing supervisory guidance to be updated
- Develop additional guidance and tools
 - Call Report changes
 - Transition-specific and ongoing accounting considerations

How to Prepare Now (Do's)

- Become familiar with the standard
- Develop an implementation plan and timeline
- Discuss the new standard with the board of directors, external auditors, industry peers, and your banking regulators
- Involve bank staff who perform relevant functions in preparation for implementation
- Review current allowance and credit risk management practices to identify existing processes & methodologies that can be leveraged
- Consider data availability (e.g., origination, maturity dates, loan losses by type of loan, charge-off dates, lifetime loss amounts)
- Use available industry resources
- Consider potential impact on capital
- Keep your examination team up to date



How to Prepare Now (Don'ts)

- No early incorporation of “expected loss” concepts or “soft adoption”
- No artificial inflation of the ALLL before effective date to smooth impact
- Don't wait to prepare
- Don't overload at adoption
 - Record initial effect of CECL adoption on the effective date through retained earnings, not P&L
 - No “cookie jar” reserves



