# Financial Manager's Society Meeting

## *CECL Overview & Capital Update*

May 9, 2018

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Office of the Comptroller of the Currency

# *Agenda*

- CECL Overview
- Regulatory Capital Issues

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# CECL 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).*

# Impairment . . . Comparison of Models

| | Current US GAAP | CECL |
|---|---|---|
| When are Losses Recognized? | When it is "probable" a loss has been "incurred" (+ four other models) | 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? | • Past events<br>• Current conditions | • Past events<br>• Current conditions<br>• Reasonable & supportable expectations about future |

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# CECL: Components of Expected Loss

| | |
|---|---|
| Historical loss information | Relevant and supportable internal and external loss information assigned to pools of loans with common risk characteristics |
| Current conditions | Adjustments to historical loss rates to fit current conditions consistent with asset-specific risk characteristics via quantitative or qualitative allocation |
| Reasonable and supportable forecasts | Adjustments to historical loss to represent the economic forecast impact on the loan pool via quantitative or qualitative allocation at the individual asset level or overall pool level |
| Reversion to historical loss | Unadjusted historical loss applied for periods in which a reasonable and supportable forecast cannot be applied at the individual asset level or overall pool level |
| Expected loss | ALLL represents expected loss over the loan contractual maturity which reduces the loan balance to the net amount the bank expects to collect |

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# Introduces "Life-of-loan" Concept


1) Calculate time between CECL calculation date and contractual maturity of loan
   - CECL calculation on December 31, 2021
   - Contractual maturity of loan is June 30, 2024
2) Determine if prepayments are expected
   - For shorter contractual term or prepayment penalties, an estimate of prepayments may not be necessary
   - For longer term loans, bank may use its own experience to estimate prepayments or obtain third-party information
3) Banks generally precluded from considering renewals, extensions, or modifications in determining contractual life
   - When TDR expected, impact of renewal, extension, or modification considered
   - Topic heavily debated within the industry

# Earlier Recognition of Provision Expense

- Not more provision expense, but earlier recognition of provision expense
- Charge-off guidance has not changed under CECL, but timing of provisioning will be earlier

# Accounting for PCI Loans

PCI Loans

- PCI = PCD under CECL
- Shortcomings of current PCI model
  - Accounting complexities
  - Lack of financial statement comparability
- CECL requires estimate of allowance for credit losses at time of purchase
  - Added to purchase price rather than reported as credit loss expense
- Under CECL, no separate allowance for PCD loans and non-PCD loans

# More Judgment Requires More Oversight

- Allowance under CECL will incorporate more judgments

- CECL adds requirement to consider “reasonable and supportable forecasts”

- Judgments generally applied over longer time horizons—increasing potential impact

- Because of increased risk, more oversight and stronger controls important to ensuring allowance is accurate

# General Areas That Will Not Change

- 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**
- Consideration of **qualitative factors** affecting collectability
- **Nonaccrual and charge-off** policies

**Not Changing**

# CECL Methodologies

- ✓ Loss rate, vintage, discounted cash flow (DCF), roll rate/migration, PD x LGD
- ✓ Any method may be applied to TDRs
- ✓ Scaled for the size and complexity of the bank, so long as it meets CECL objectives
- ✓ Discounted for time value of money ONLY if using DCF

# Loss Rate Method – Today & Future

## Current U.S. GAAP

[ Annual: Historical charge-off experience ± Current Conditions: Adjustments (Q factors) ] x Loss discovery period x Loan category balance = FAS 5 (ASC 450) ALLL

## CECL

[ Lifetime: Historical charge-off experience ± Current & Forecast: Adjustments (Q Factors) ] x ~~Loss discovery period~~ x Loan category balance = CECL ALLL

# Interagency CECL FAQs – issued 12/19/16
# OCC Bulletin 2016-45

- #1-3 Overview
- #4-6 Scope and effective date
- #7 Methods
- #8, 10-12 Securities
- #9, 13-16 Specific application issues
- #17-23 Regulatory impact and expectations

# CECL: FAQs

## Interagency CECL FAQs – issued 9/7/17
## OCC Bulletin 2017-34

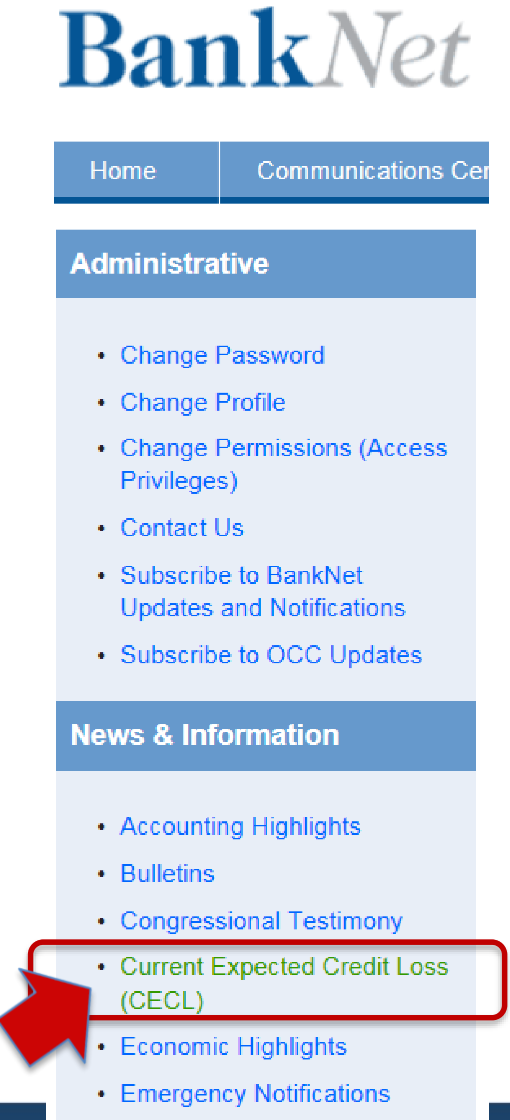
- #24 Qualitative factors
- #25-26 Data
- #27 Purchased credit deteriorated
- #28-36 Public business entity (PBE)
- #37  Collateral dependent fair value measurement

# CECL: FAQ #19 (OCC Bulletin 2016-45)

**19. Can institutions build their allowance levels in anticipation of adopting CECL? [December 2016]**

- No. Institutions must continue to use the existing U.S. GAAP incurred loss methodology until CECL becomes effective. It is not appropriate to begin increasing allowance levels beyond those appropriate under existing U.S. GAAP in advance of CECL's effective date.
- When estimating allowance levels before CECL's effective date, the implementation of the CECL methodology is a future event. It is therefore inappropriate to treat CECL as a basis for qualitatively adjusting allowances measured under the existing incurred loss methodology.

# CECL: Resources




- CECL Homepage
- Accounting Standard – ASU 2013-16
- Frequently Asked Questions
- Joint Statement
- CECL Reference Guide for Bankers
- CECL Webinar Series Registration Information
- Dedicated Mailbox:

**CECL@occ.treas.gov**

# CECL: Webinar Series

BankNet

- CECL Webinar Series – Part 1 – March 23, 2017 _ Introduction
  - Key elements of the new accounting standard, including scope and effective dates
  - Initial supervisory expectations for implementation
  - OCC implementation plans, including ongoing initiatives and resources
- CECL Webinar Series – Part 2 – May 23, 2017 - Implementation
  - Developing an implementation plan – steps, resources, and timing
  - Data estimation methodology considerations
  - Internal control considerations
  - Initial supervisory expectations
- CECL Webinar Series – Part 3 – August 22, 2017 – Debt Securities
  - CECL's impact on HTM securities
  - Targeted changes to accounting for AFS securities
- CECL Webinar Series – Part 4 – February 15, 2018 –Data & Methods
  - Why data is important
  - Conducting a data inventory
  - Data quality considerations
  - Data requirements for various CECL methodologies
- CECL Webinar Series – Part 5 - April 26, 2018 – 3rd Party Risk Management
  - Third-party risk management in implementing CECL
  - Provides OCC guidance for institutions engaging with and managing third-party relationships

# Capital Issues

- Proposed Regulatory Capital Changes
  - Proposed Transition Provisions - CECL
  - Simplification of Capital Rule

# Questions