NACUSAC 2025 Annual Conference | June 20, 2025

Life With CECL

Agenda

CECL Overview

Maintaining CECL Program

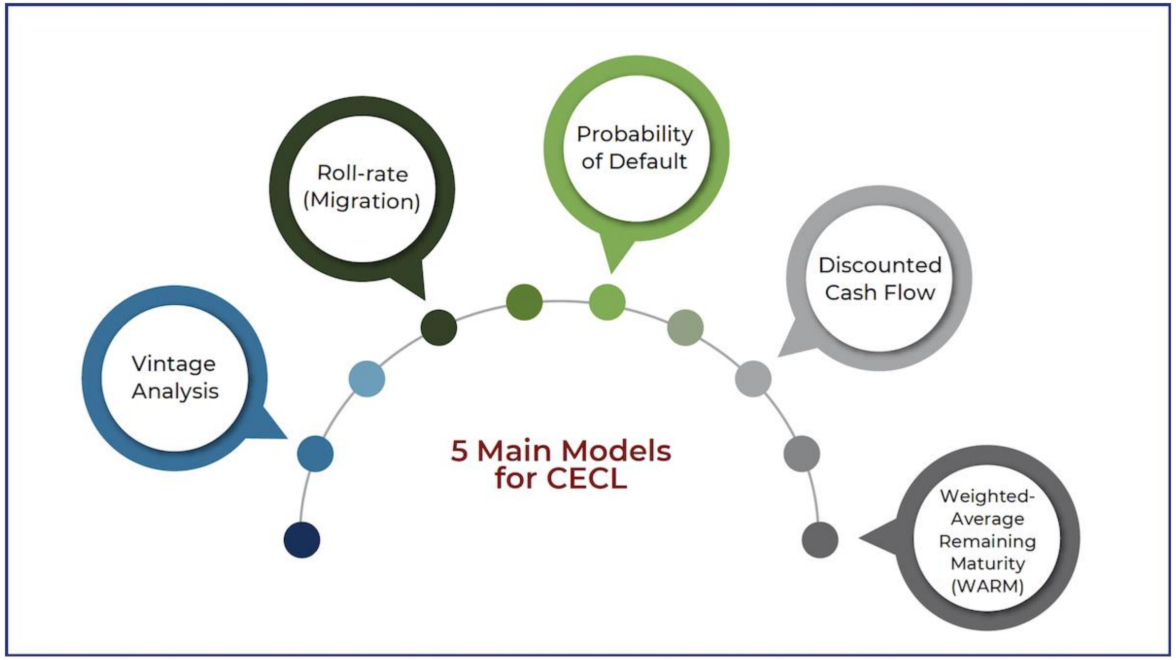
CECL Documentation & Audit Preparation

Supervisory Committee Roles & Responsibilities

CECL Overview

Current Expected Credit Loss (CECL) is the new methodology for estimating allowances for credit losses

- CECL requires a provision expense that estimates losses over the **lifetime of a loan**
- There are several loss estimation methods available
  - Historical-based methods
  - Regression methods



Source: FASB

A CECL model consists of the tools you use to analyze, make decisions, develop, and implement your CECL program

The end goal of your CECL program is to demonstrate that you are in compliance with regulatory guidelines

CECL Committee

Committee team members should come from different areas of the business

- Lending
- Credit/Risk/Collections
- Finance/Accounting
- Data/IT

Roles and responsibilities of each area should be documented

By Now, Your Financial Institution Should Be:

Reconciling historical data

Pooling loans based on risk characteristics

Assessing data for quality & relevance

Selecting methodologies for each loan pool

Calculating additional adjustments & other considerations

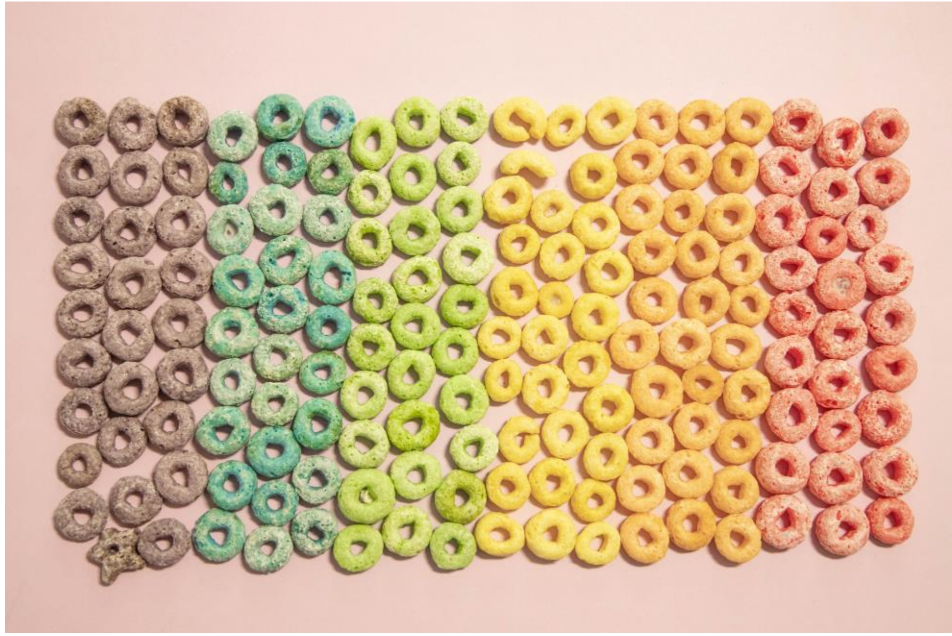
Loan Pools

Pooling structure for original ALLL may not be sufficient for CECL

CECL requires institutions to aggregate financial assets on the basis of similar risk characteristics

Examples of pooling considerations:

- Close-ended loans vs. lines of credit
- Secured vs. unsecured
- Direct vs. indirect
- Collateral positions
- Unfunded commitments that are conditionally cancellable vs. unconditionally cancellable
- Average life
- Performance (delinquencies & charge-offs)
- Pool size (individually review?)



Data Quality Assessment

There are different data requirements for each CECL methodology

Class	Months Reconciled History	W. Avg Term	Probability of Default Variables Available	Probability of Default	Discounted Cash Flow	Advanced Vintage	Static Pool	Vintage	WARM
Direct Auto	84	71	95%	Yes	Yes	Yes	Yes	Yes	Yes
Unsecured Consumer	84	52	4%	No	No	Yes	Yes	Yes	Yes
First Mortgage	84	279	92%	Yes	Yes	Yes	No	No	Yes
Student Loans	84	138	75%	Yes*	Yes*	Yes	No	No	Yes
Credit Cards	84	36	89%	Yes	Yes*	Yes	Yes	Yes*	Yes*

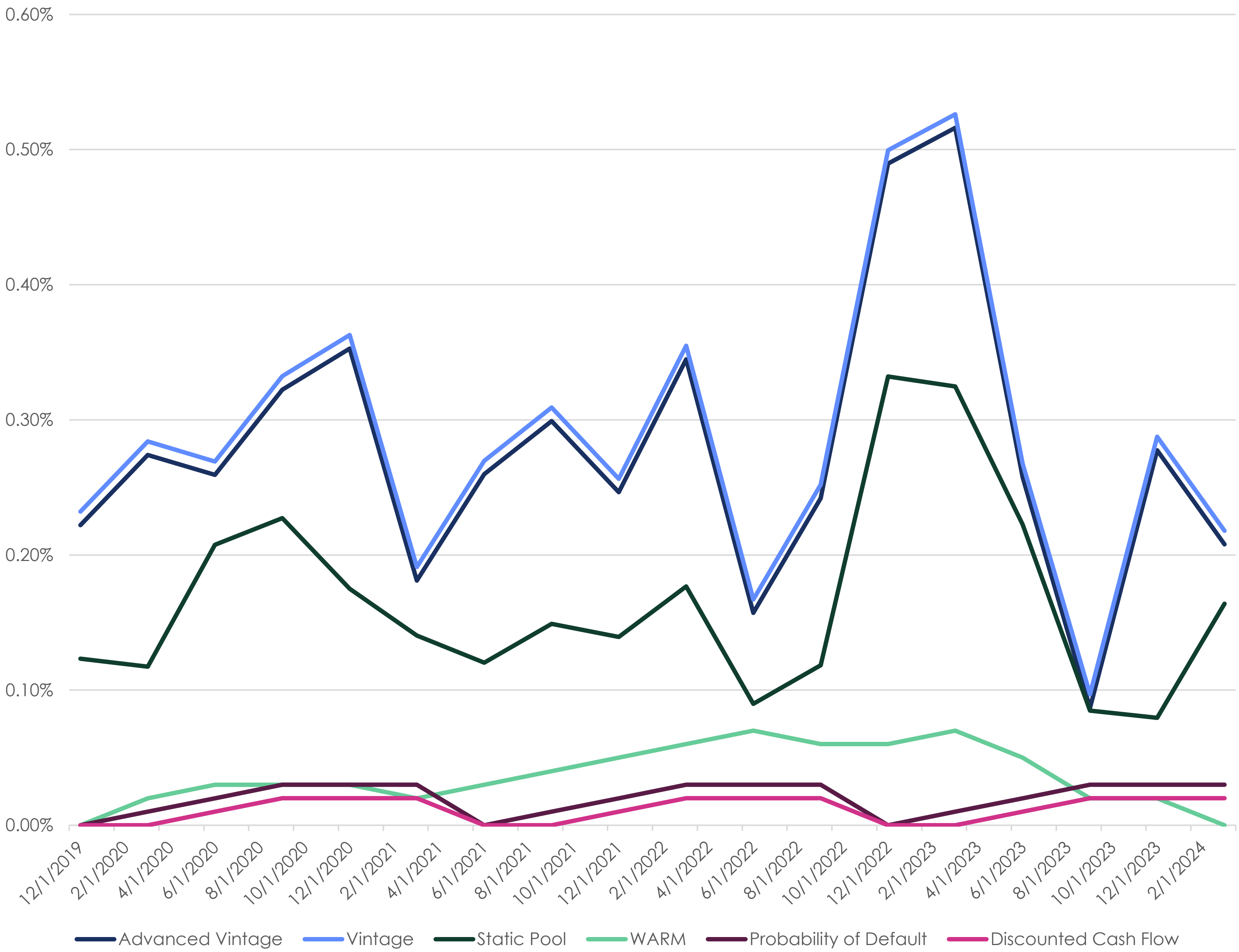
**Data considerations should be discussed*

Continuously check data requirements for each loan class, especially for the methodology that is selected for the final ACL calculation

Methodology Performance

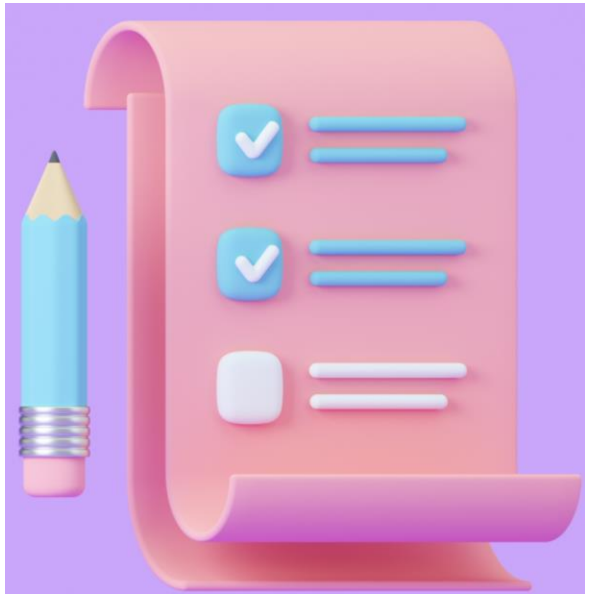
- Use historical data to monitor performance of all available CECL methodologies
- Measure performance based on
  - Historical loss comparisons/ back-testing*
  - Volatility
  - Assumptions used in the model
- Historical line graphs can visually show potential data issues

There will be variances between actual losses vs forecasted losses, as no model will provide 100% accuracy



Additional Adjustments & Considerations

- Individually reviewed loans
  - Common reasons to individually review:
    - New product
    - Discontinued product
    - Modified loan
- Forecast adjustments
  - "Calculation of loss provisions should consider past events, current conditions, and reasonable supportable forecasts"
  - Macro-economic factors
- Qualitative & environmental adjustments (AKA Q&E's or Q-factors)



Model Performance

Each institution should have a rigorous model risk management program (MRM)

During model testing:

- Ensure the model is stable, or spikes are reasonable/expected
- Assess for potential limitations
- Assess the impact of assumptions
- Identify situations where the model performs poorly or becomes unreliable
- Document results and review with CECL committee

Document the following:

Overview of test plans

Comparison of historical losses vs. CECL calculation

Volatility in the CECL calculation

Boundaries of model inputs and impact on model

Model deficiencies and adjustments made to the model because of it

Conclusions on model finalization & management summary explaining reasoning

CECL ACL Policy Content

Document procedures of CECL maintenance

- Roles & responsibilities for the allowance (Board of Directors, management, and any other parties involved with obtaining the final allowance calculation)
- Frequency of CECL calculation and accounting entry (monthly vs. quarterly)
- Determine if calculation is done in-house vs. third-party vendor
- Financial instruments to which CECL applies
- Guidelines for collateral-dependent assets
- Guidelines for loan modifications
- Sources of economic forecasts and qualitative factors used

Document due diligence of CECL program

- Description of process used to select vendor model (if applicable)
- Validation standards that must be met to put model into production & ongoing validation
- Standards for levels of discrepancy between forecasted & actual losses, and response to discrepancies
- Frequency of CECL ACL policy review
- Frequency of independent validation of CECL program and audit frequency

Updated ACL policy is then submitted to Board of Directors for approval

Audit/Regulatory Exam Prep

Documentation is key!

- Data Analysis
- Pooling Segmentation
- Model Selection
- Reasonable & Supportable Forecast
- Qualitative Factors
- Off-Balance Sheet Credit Exposures
- Individually Reviewed Loans
- Model Performance
- CECL Program Finalization
- CECL ACL Policy
- Procedures & Controls (user access, change management, software requirements, etc.)
- Verification on accuracy of CECL disclosures with reviewer approval & sign-off
- Discussions and decisions related to disclosures

What audit/exam questions have come up related to CECL?

Talk with your audit firm to determine expectations!

Helpful Reporting

Along with documenting the overall CECL program, different reports should supplement management decisions

- Executive summary reporting
- Collectively reviewed loan detail
- Individually reviewed loan detail
- Unfunded commitments
- GL activity summary/reconciliation reporting
- Data quality
- Trend reporting
  - Changes in base loss rate
  - Forecast and Q&E summary reporting

Supervisory Committee Roles & Responsibilities

- Ultimately, the Supervisory Committee oversees that management is adhering to guidelines as written in the CECL ACL policy
- Ensure assumptions used and management's estimate for credit losses is clearly disclosed in financial statements
- Familiarity with overall approach and execution of CECL program
- Understanding of how methodologies work, what was selected, calculated results, and reports used to monitor allowance
- Established protocol on how management will regularly inform supervisory committee and the cadence of these updates
- Ask questions!

What role have you served in your CECL committee?

Common Questions for CECL Committee

1. How far back is data reconciled and how is data integrity managed?
2. What criteria was used to determine loan pooling?
3. What CECL methodologies were available for evaluation and how were they ultimately selected? What assumptions are used in the model?
4. How are methodologies being monitored for performance? Have any adjustments been made since implementation?
5. How frequently will methodologies be reviewed for effectiveness and, if necessary, changed?
6. What additional adjustments are included in the final ACL calculation? How has this been documented?
7. When was the ALLL policy updated to a CECL ACL policy? How frequently is this being reviewed and, if necessary, revised?

What questions have come up during meetings?

Thank you.

Contact

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