CECL for Credit Unions: Ready or Not

Harrison Powers, CPA - Principal
Steven Schiltz, CPA – Principal
Michele Cinciripino, CPA - Director

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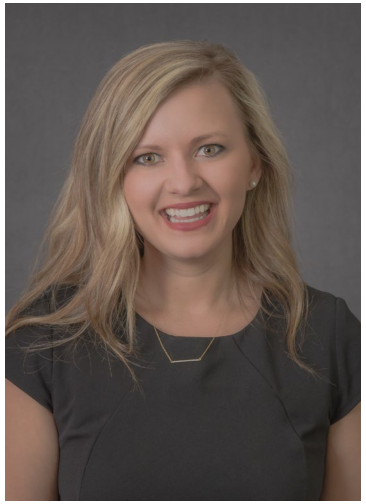
and our communities.

Today's Presenters

- Harrison Powers - Principal
  - Dallas, Texas
    Harrison.Powers@CLAconnect.com
- Steve Schiltz - Principal
  - Tucson, Arizona
    Stephen.Schiltz@CLAconnect.com
- Michele Cinciripino - Director
  - Philadelphia, Pennsylvania
    Michele.Cinciripino@CLAconnect.com



Learning Objectives

1. The purpose and impact of CECL on your institution
2. How - and when - to adopt the new standard
3. Expectations from regulators and auditors

A Refresher on CECL

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What is CECL?

Expected credit loss is an estimate of the present value of cash flows not expected to be collected based on quantitative and qualitative information

- Past events
- Historical loss experience
- Current conditions
- Borrower credit worthiness
- <u>Forecasts of expected credit losses</u>
- <u>Current point and forecast direction of economic cycle</u>

Calculating ASC 450 Today versus Tomorrow

Today

Average Annual Loss Rate

+

Qualitative Factors

=

Adjusted Annual Expected Loss Rate

×

Loan Principal

=

ASC 450 ALLL Amount

Tomorrow

1) Replaced by Historic Lifetime Loss Rate

2) Retained, but forecasting was added as a specific element to these adjustments

Calculating the ALL Today versus Tomorrow

Today

ASC 450 ALLL Amount

+

ASC 310-10 ALLL Amount (Impaired Loans)

+

ASC 310-30 ALLL (Purchased Impaired Loans)

=

Total ALLL Amount

Tomorrow

1) Replaced by Historic Lifetime Loss Calculation

2) Removed, could still calculate lifetime losses in a similar fashion

3) Removed, included in normal reserves

Summary of CECL Calculation

Step 1: What methodology are you going to use to calculate the number?

Step 2: How are we going to adjust our qualitative factors and narratives to the new standard?

Step 3: What is our forecast period and how are we going to adjust our history?

Historical Lifetime Loss Rate

+

Qualitative Factors

+

Forecast Adjustments

=

Current Expected Lifetime Loss Rate

We must start here, until we can compute our historic lifetime losses, we cannot start adjusting them to current expectations

Effective Dates

- Some private and all public entities have adopted
- Credit unions must adopt for annual reporting periods beginning after December 15, 2022, including interim periods within those fiscal years.

  - For many credit unions, this is January 1, 2023
  - You may follow your fiscal year – A September 30 year-end would adopt October 1, 2023

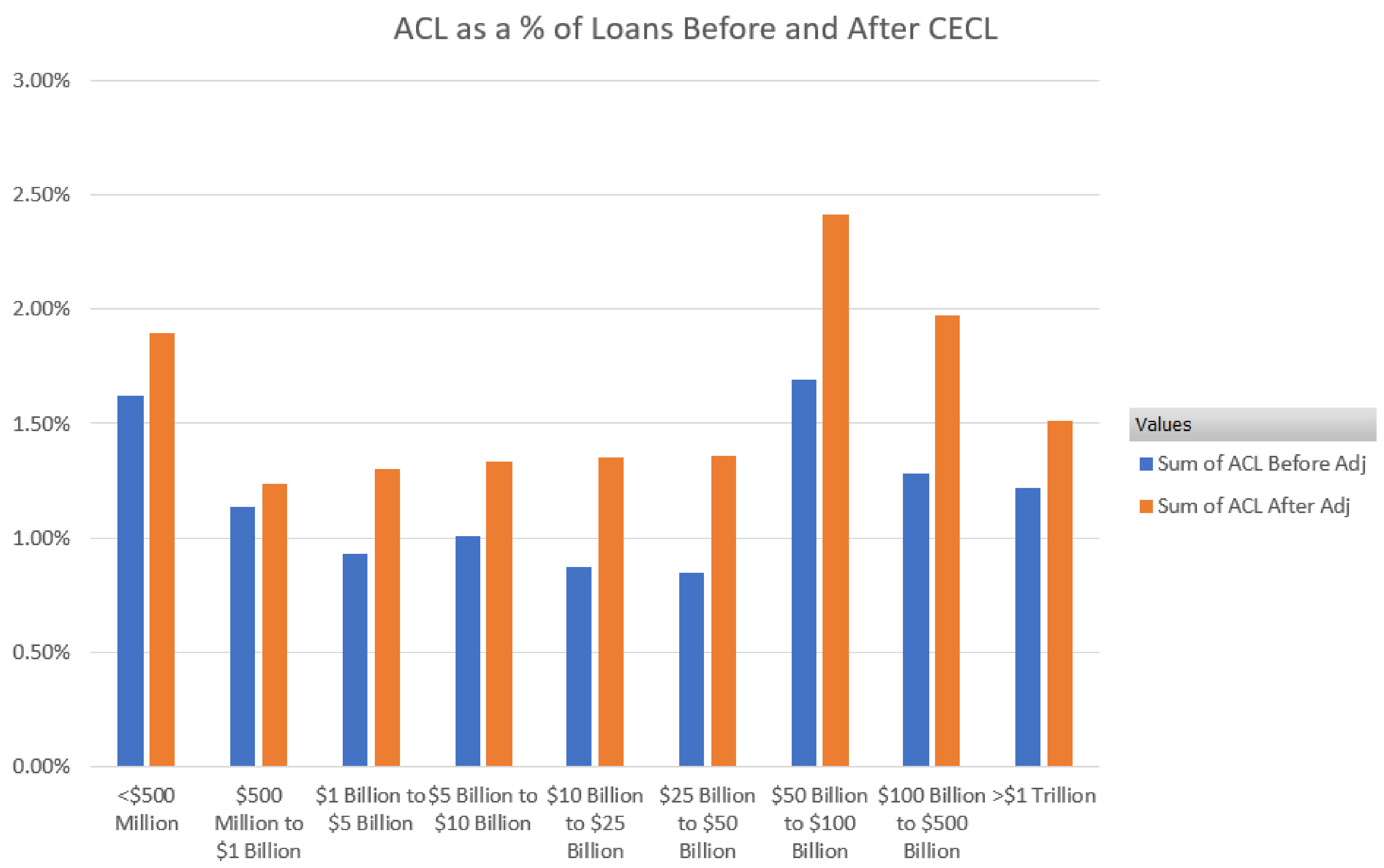
Capital Relief

- Credit unions may elect to "phase-in" the impact of CECL over three years for regulatory capital purposes

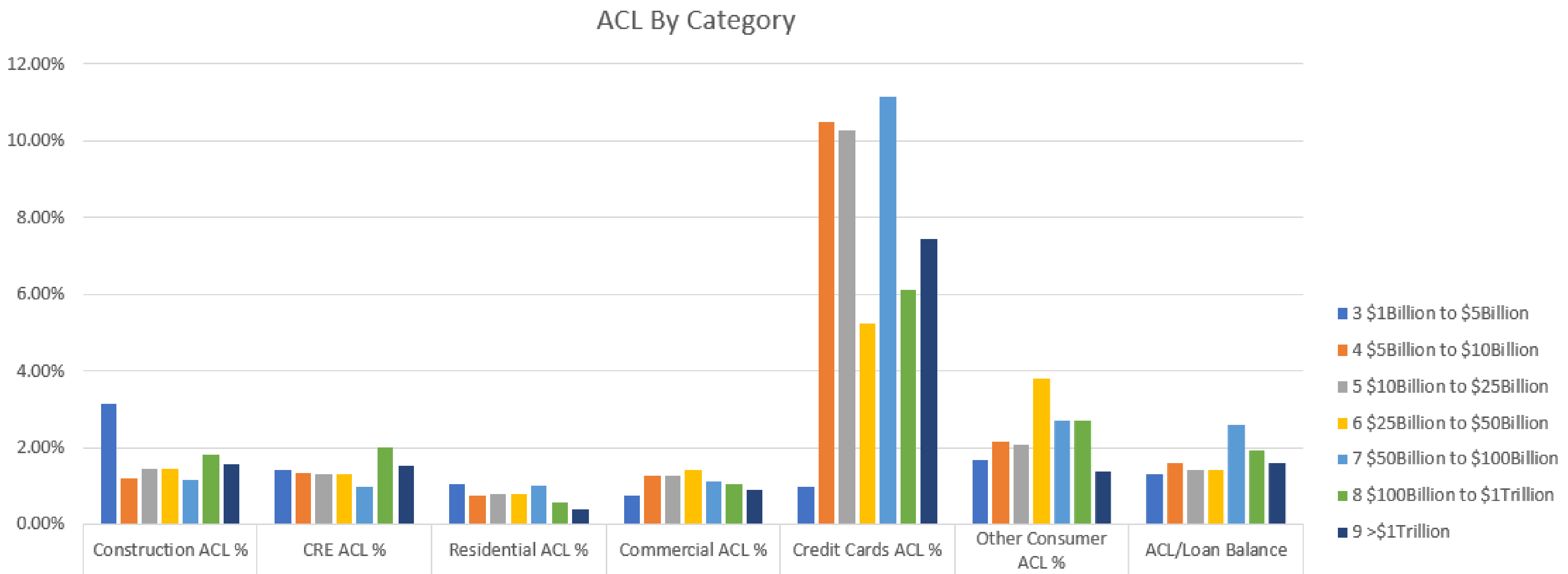
Transitional amounts	Transitional amounts applicable during each year of the transition period		
	Year 1 75%	Year 2 50%	Year 3 25%
$158,000	$118,500	$79,000	$39,500

- GAAP accounting is unchanged

Impact of CECL by Asset Size



Impact of CECL by Loan Type



	Construction ACL %	CRE ACL %	Residential ACL %	Commercial ACL %	Credit Cards ACL %	Other Consumer ACL %	ACL/Loan Balance
3 $1Billion to $5Billion	3.15%	1.43%	1.04%	0.77%	0.98%	1.68%	1.32%
4 $5Billion to $10Billion	1.18%	1.33%	0.74%	1.26%	10.47%	2.14%	1.62%
5 $10Billion to $25Billion	1.46%	1.30%	0.79%	1.27%	10.28%	2.07%	1.41%
6 $25Billion to $50Billion	1.46%	1.31%	0.79%	1.41%	5.22%	3.79%	1.43%
7 $50Billion to $100Billion	1.16%	0.96%	1.00%	1.13%	11.15%	2.71%	2.61%
8 $100Billion to $1Trillion	1.84%	2.00%	0.59%	1.07%	6.11%	2.70%	1.94%
9 >$1Trillion	1.55%	1.54%	0.38%	0.89%	7.43%	1.36%	1.62%

Too much to do.....
.....Too little time

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Ready, Set, Go!

- Steps to put CECL in perspective:

1. Understand your credit union's risk
2. Know the data you have
3. Select a model that fits
4. Document your approach

Understand Your Risk

CECL measures credit risk. Does your credit union:

High Risk

- Have significant losses
- Difficult to measure impairment
- Complex lending

Low Risk

- Infrequent losses
- Real estate and common collateral
- Routine loan structure

Know Your Data

CECL requires some degree of data. Is your credit union:

Data Rich

- Loan dashboards
- Data pools
- Complex risk modeling

Data Limited

- Excel driven
- Information is retained on paper or in data silos
- Less complex risk modeling

Select a Model

CECL is a financial model. Does your credit union need:

Complex Models

- Vintage
- Discounted cash flows
- Probability of loss given default

Simple Models

- Weighted average remaining maturity
- Snapshot / cumulative loss rate
- Migration analysis
- SCALE

Document Your Approach

- It is important to show auditors, regulators, and governance the "why" behind the model:

1. Model selected
2. Data relied upon
3. Assumptions used
4. Qualitative and environmental factors

Qualitative and Environmental Factor Examples

Changes in lending policies and procedures

Changes in international, national, regional, and local economic and business conditions

Changes in the nature and volume of the portfolio

Changes in the experience, ability, and depth of lending management

The existence and effect of any concentrations of credit

The effect of other external factors

Working with Examiners and Auditors

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Regulator Questions

- Are you familiar with CECL?
- Are you familiar with the interagency statement and FAQ?
- Do you have an implementation plan?
- Have you discussed CECL with your audit firm?

Regulator Questions

Have you formed an implementation committee?

Are you retaining data for the calculation (including data from third-party service providers)?

Do you plan to use a third-party to calculate CECL?

Have you determined the impact on capital?

Auditor Questions

Are inputs and outputs from the model complete and accurate?

Does management have support for their key assumptions?

Are financial statement disclosures appropriate?

Is the allowance sufficient?

Thank you for joining!

Harrison Powers
Harrison.Powers@CLAConnect.com
972-383-5776

Steve Schiltz
Stephen.Schiltz@CLAConnect.com
520-352-1259

Michele Cinciripino
Michele.Cinciripino@CLAconnect.com
972-383-5732

CLAconnect.com

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