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Important Considerations for CECL Model Validation

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Learning Objectives

At the end of the session, you will be able to:

- Recognize the CECL model validation expectations by regulators and auditors
- Identify how to prepare for your institution's CECL model validation

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Today's Presenters

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Baltimore, MD

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Agenda

- Discussion of Current CECL Statistics
- Understand the key components of a CECL model validation
- Understand how to prepare for a CECL model validation
- Other items to be aware of in 2023 regarding CECL adoption

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Polling Questions

What is the expected impact to your allowance as a result of the adoption of CECL?

1) Minimal impact, less than 5% increase on the allowance
2) Between 5% and 20% increase in the allowance
3) Between 20% and 50% increase in the allowance
4) Between 50% and 100% increase in the allowance
5) Over a 100% increase in the allowance

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Polling Questions

Where are you in your CECL model validation journey?

1) Haven’t started
2) Started exploring options
3) Engaged a third party or intend on using internal personnel to complete in 2023
4) We have completed our first model validation already

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Current CECL Statistics

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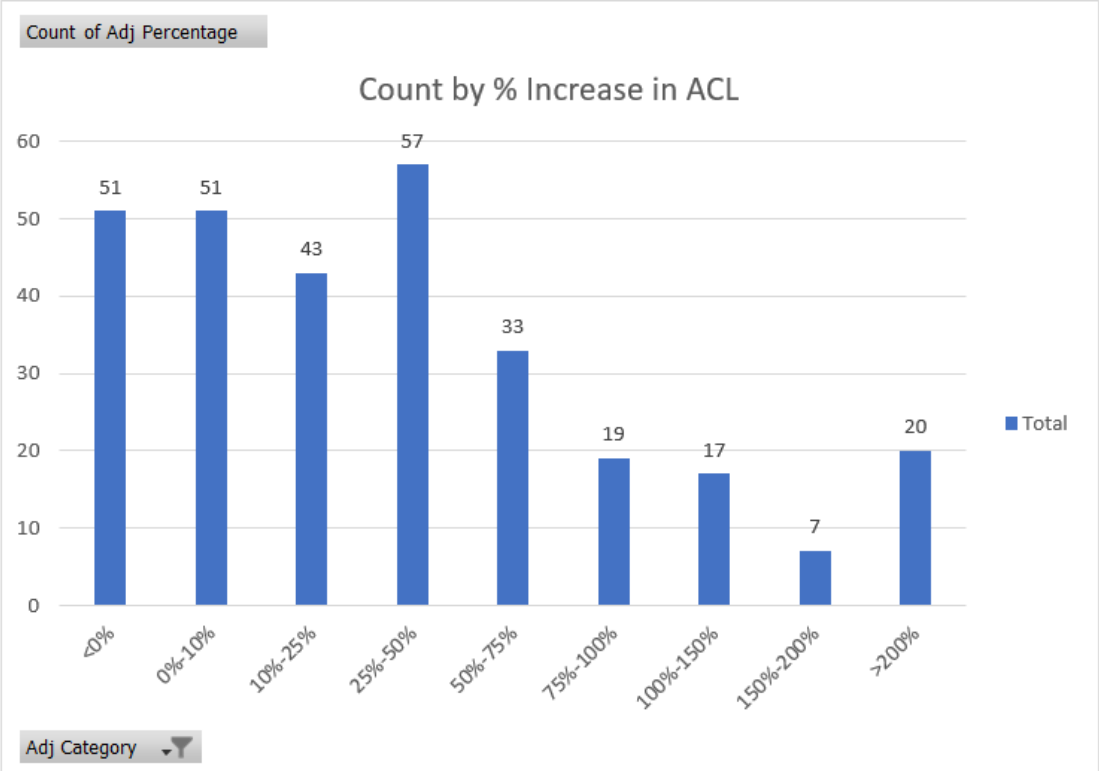
CECL Adoption Statistics



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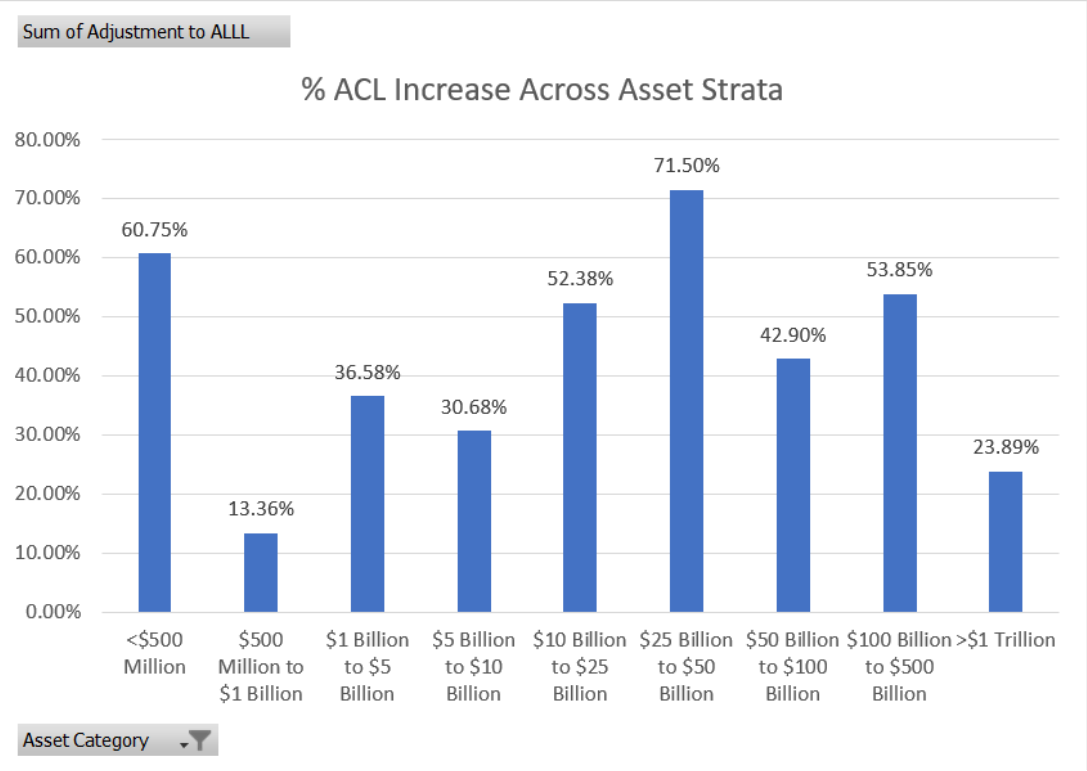
CECL Adoption Statistics



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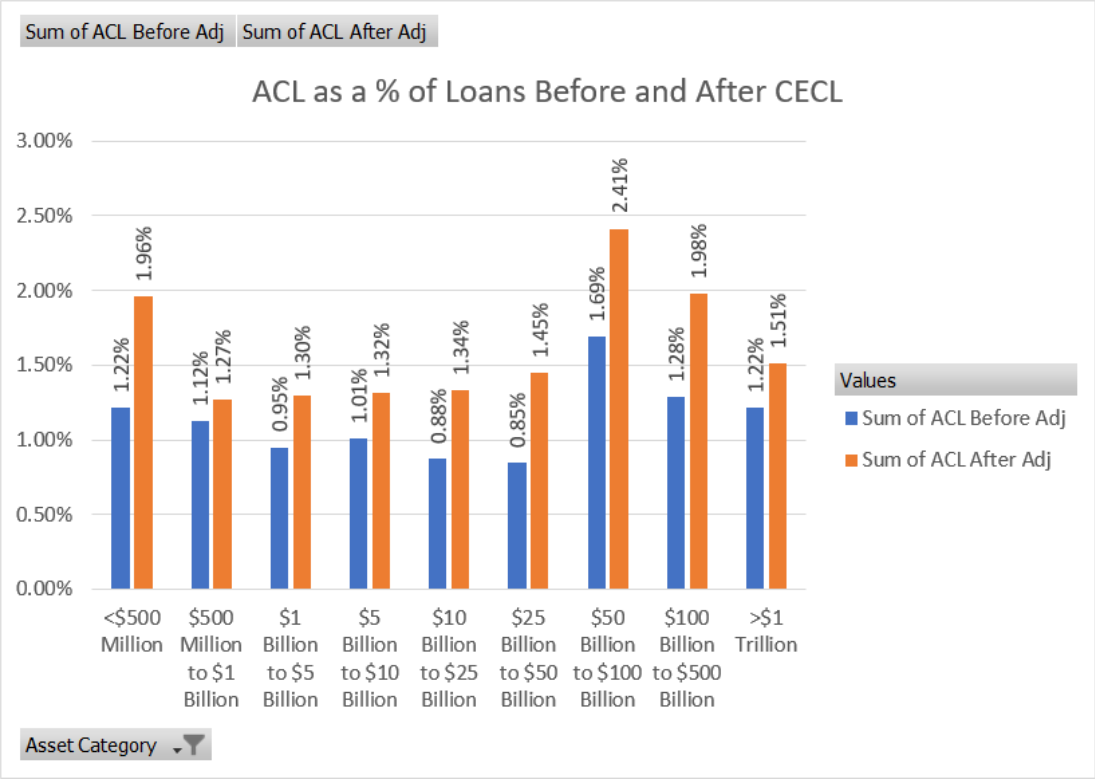
CECL Adoption Statistics



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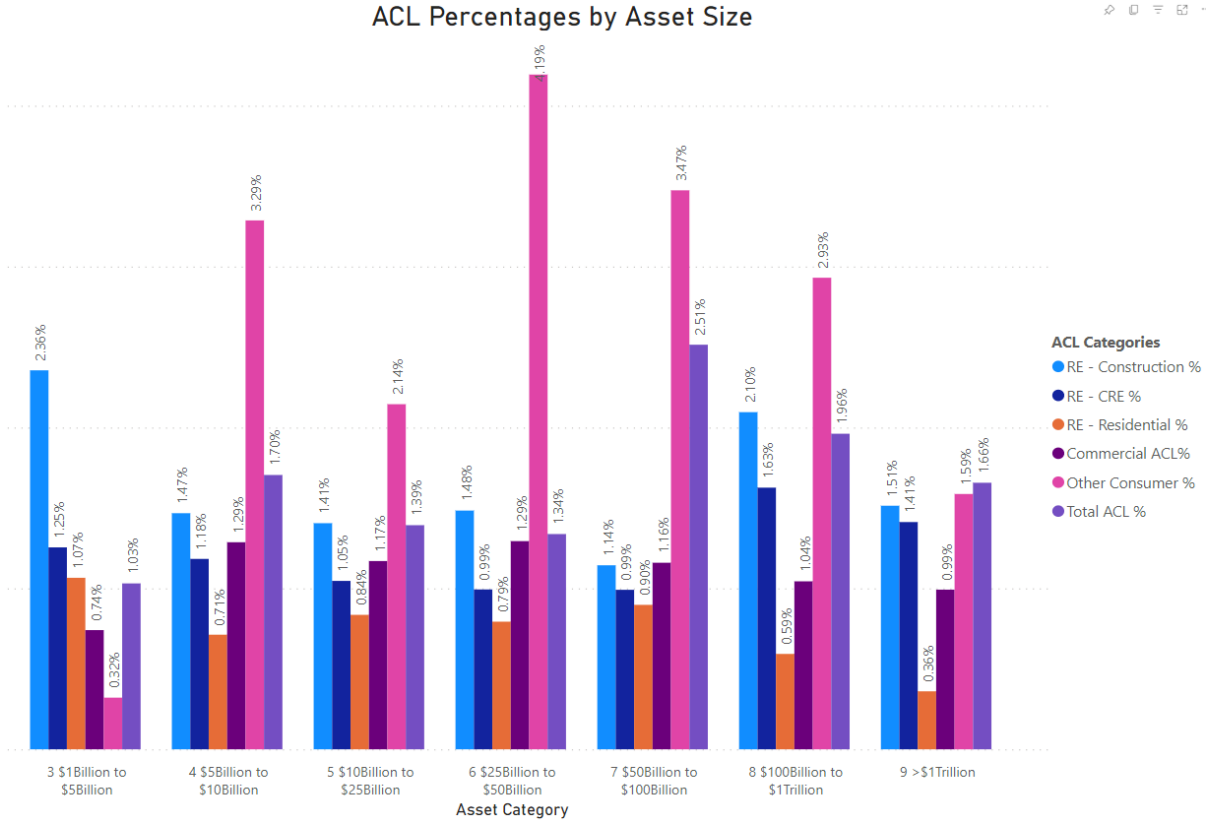
Current CECL Levels (12/31/2022)



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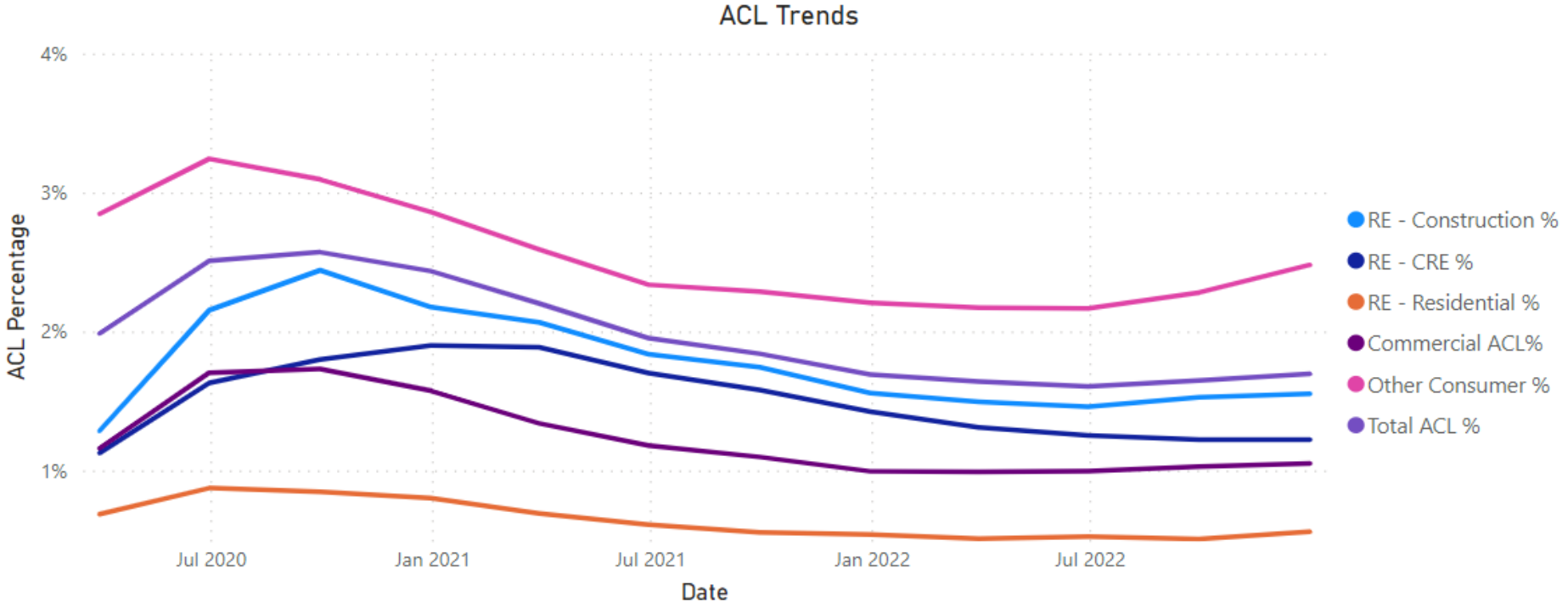
CECL Trends (12/31/2022)



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CECL Trends (12/31/2022)

Date1	RE - Construction %	RE - CRE %	RE - Residential %	Commercial ACL%	Other Consumer %	Total ACL %
3/31/2020	1.29%	1.13%	0.69%	1.16%	2.85%	1.99%
6/30/2020	2.15%	1.63%	0.87%	1.70%	3.24%	2.51%
9/30/2020	2.44%	1.80%	0.85%	1.73%	3.09%	2.57%
12/31/2020	2.18%	1.90%	0.80%	1.57%	2.86%	2.43%
3/31/2021	2.07%	1.89%	0.69%	1.34%	2.59%	2.20%
6/30/2021	1.84%	1.70%	0.61%	1.18%	2.34%	1.95%
9/30/2021	1.74%	1.58%	0.55%	1.10%	2.29%	1.84%
12/31/2021	1.56%	1.42%	0.54%	0.99%	2.21%	1.69%
3/31/2022	1.49%	1.31%	0.51%	0.99%	2.17%	1.64%
6/30/2022	1.46%	1.25%	0.52%	1.00%	2.17%	1.60%
9/30/2022	1.53%	1.22%	0.51%	1.03%	2.28%	1.65%
12/31/2022	1.55%	1.22%	0.56%	1.05%	2.48%	1.70%

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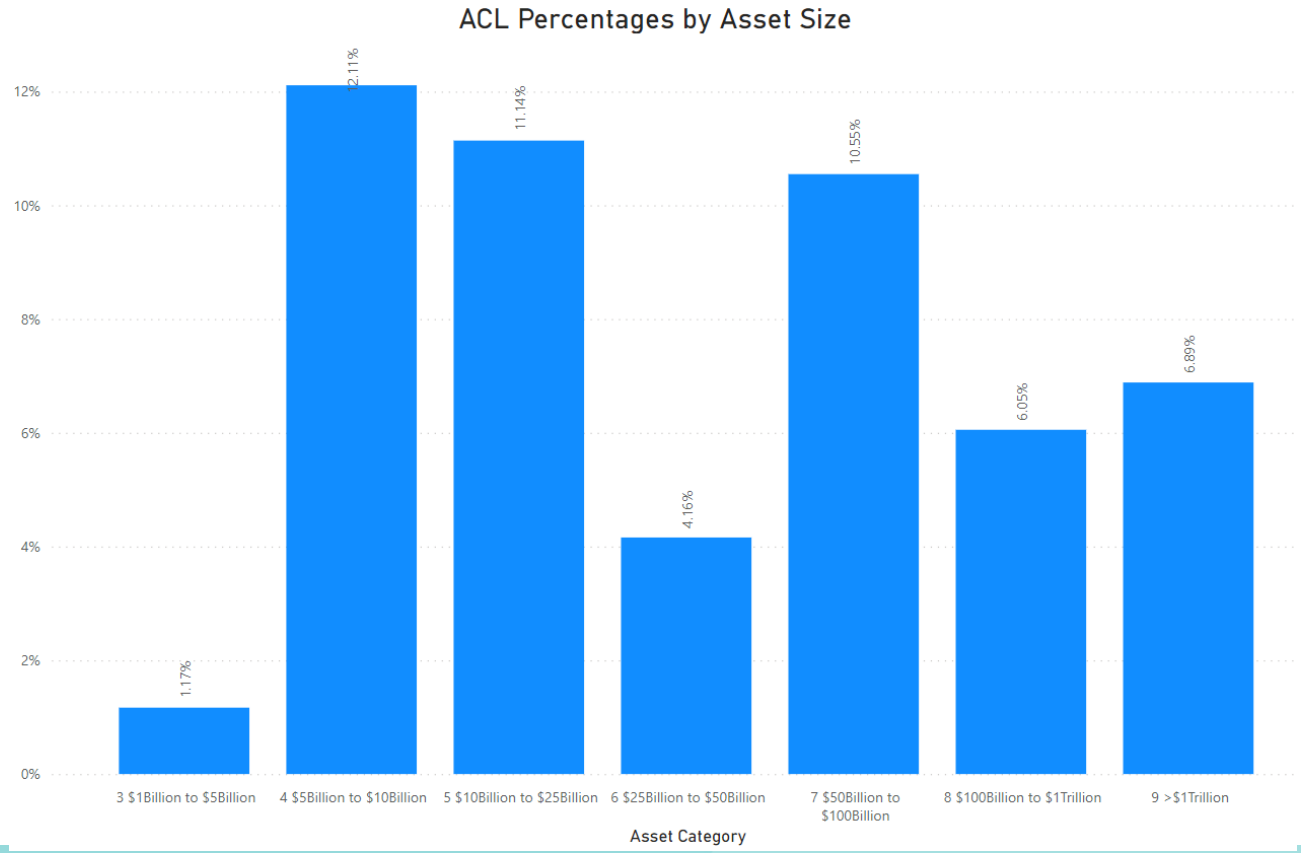
Current Credit Card CECL Levels



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Key Components of a CECL Model Validation

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Key Components

- Inspection of your Allowance for Credit Losses Policy
  - Compliance with regulations
  - Proper governance
  - Adequate detail
  - Evaluation of various methodologies
- Portfolio Segmentation
  - Similar risk characteristics
  - Reconciliation to loan data and review
  - Completeness and accuracy

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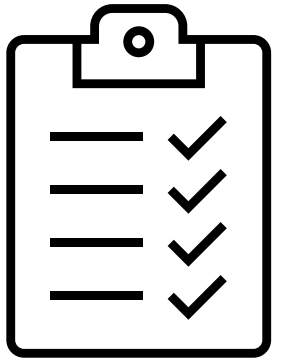
Key Components

- Historical Loss Calculation
  - Aggregation of charge-off and recovery information
  - Transfer procedures
  - Mathematical accuracy
  - Peer data
- Loan Data Validation
  - Loan level inputs



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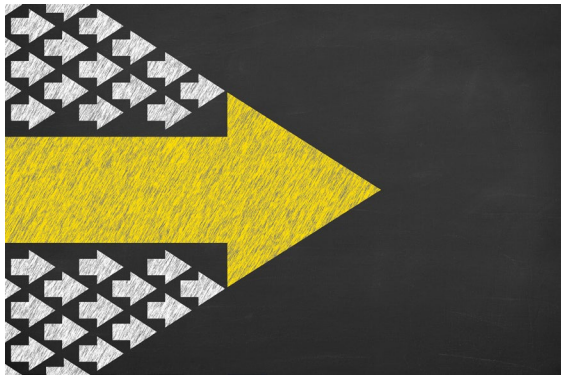
Key Components

- Forecast Period (Forward Looking)
  - Document of selection
  - Data elements and industry information
  - Reversion methodology
- Qualitative Factors (Current State)
  - Interagency guidance and SAB 119
  - Documentation
  - Data elements and industry information



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Key Components

Third Party

- Vendor Management
- Accuracy of data transfer
- Documentation and understanding of model
- User access

In House

- Mathematical accuracy
- Internal control
- User access
- Change management

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Key Components

- Backtesting
  - Evaluate estimate to actual results at a granular level
  - Key ratios and trends
- Unfunded Commitments and Investments
  - Documentation around methodology
  - Internal controls

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How to Prepare for a CECL Model Validation

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How to Prepare

Board Adopted Policy

Prepare a CECL Adoption "Package"

Third-Party Vendor Management

Documented Internal Controls and Processes

Governance Procedures

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Other 2023 Considerations

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Other 2023 Considerations

- Add to Internal Audit Plan
- Validation Frequency
- Talk to Your Auditors and Regulators
- Internal Backtesting
- Be Prepared to Adapt

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Thank You!

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