CECL Implementation:
What You Need to Know

August 6, 2019

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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- **Q&A session will be held at the end of the presentation.**
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- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 6,100 employees
- Offices coast to coast
- Serving 1,500+ financial institutions
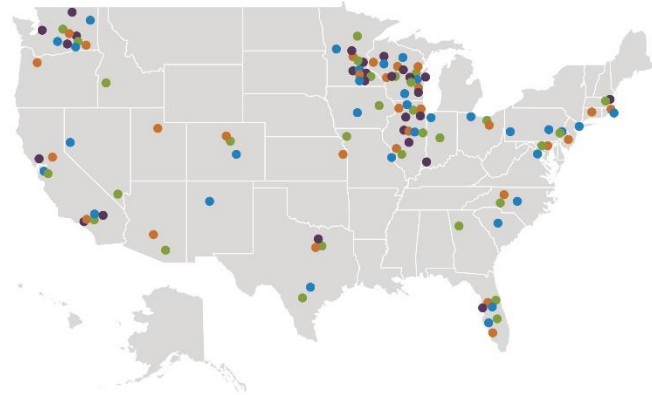
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Speaker Introduction

- David Heneke and Josh Juergensen are principals within CLA's financial institutions practice, working with financial institutions across the country. They both focus 100 percent of their time on certified audits, internal audits, and other consulting services for financial institutions.

Recent Developments

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Proposed Extension

- July 17 FASB Meeting
  - Proposed dividing implementation into two buckets
    - ◊ Publically Traded, excluding small reporting companies
    - ◊ Everyone else (implementation would be 2023)

ASU 2019-04

- Accrued Interest
  - Accounting policy election, several options
- Recoveries
  - Should be included when estimating the allowance for credit loss

ASU 2019-04

- Selling Costs on Probable Foreclosures
  - Specifically requires an entity consider the estimated costs to sell if it intends to sell

- Contractual Extensions and Renewals
  - An entity should consider extension options that are included in the original or modified contract and are not unconditionally cancellable by the entity

ASU 2019-05

- Provides an option to irrevocably elect the fair value option on an instrument-by-instrument basis for eligible instruments

Current Allowance Levels and CECL Expectations

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Current Allowance Levels (As of March 31, 2019)

Loan Type	Impaired ALLL as % of Loans	Collective Allowance as % of Loans	Purchased Impaired Allowance as % of Loans	Total Allowance as % of Loans
Real Estate Construction	3.57%	1.05%	1.72%	1.07%
Commercial Real Estate	4.49%	0.76%	0.90%	0.79%
Residential Real Estate	4.61%	0.45%	1.59%	0.51%
Commercial Loans	11.56%	1.06%	1.11%	1.19%
Credit Cards	39.63%	6.02%	30.15%	6.42%
Other Consumer Loans	8.33%	1.04%	2.51%	1.11%
Unallocated	N/A	N/A	N/A	N/A
Total	9.25%	1.10%	1.34%	1.18%

# Industry Wide Net Charge-Off Data (12/31/18)

| Gross Loan Call Code	Description	12/31/2018	12/31/2017	12/31/2016	12/31/2015	12/31/2014
RCONF158	LN SECURED BY 1-4 FAM RES CONSTRUCTI	-0.01%	-0.02%	-0.08%	-0.01%	0.12%
RCONF159	LN SECURED BY OTHR CNSTRCTN LN & LA	-0.02%	-0.02%	-0.02%	-0.06%	0.00%
RCON1420	R.E. LOANS-FARMLAND	0.04%	0.04%	0.02%	0.02%	0.04%
RCON1797	REVOLVING, OPEN-END LNS SECD BY 1-4F	0.03%	0.14%	0.27%	0.39%	0.59%
RCON5367	ALL OTH LNS SECD BY 1-4FMLY-1ST LIEN	0.01%	0.02%	0.05%	0.13%	0.16%
RCON5368	ALL OTH LNS SECD BY 1-4FMLY-JR LIENS	-0.19%	0.03%	0.23%	0.64%	1.01%
RCON1460	R.E. LOANS MULTI-FAMILY	0.00%	-0.01%	0.00%	0.00%	0.02%
RCONF160	LN SECURED BY OWNER OCCPD NONFARM NO	0.04%	0.05%	0.04%	0.08%	0.15%
RCONF161	LN SECURED BY OTHR NONFARM NONRES PR	0.03%	0.03%	0.00%	0.07%	0.06%
RCON1766	C&I LOANS	0.31%	0.42%	0.49%	0.29%	0.27%
RCON1590	LOANS TO FINANCE AGRICULTURAL PROD	0.25%	0.23%	0.24%	0.08%	0.04%
RCONB538	CREDIT CARDS LOANS	3.88%	3.74%	3.33%	3.11%	3.36%
RCONK137	AUTO LOANS	0.85%	0.87%	0.71%	0.58%	0.55%
RCONK207	OTHER CONSUMER LOANS	1.00%	1.02%	0.94%	0.88%	1.11%
RCON2081	LNS TO FGN GOVTS & OFFICIAL INST	0.00%	0.00%	0.00%	0.00%	0.01%
RCONJ464	OTHER LOANS	0.13%	0.18%	0.13%	0.16%	0.15%
RCON2165	LEASE FINANCING RECEIVABLES	0.18%	0.18%	0.26%	0.18%	0.10%
	Total	0.51%	0.52%	0.49%	0.46%	0.52%
	3 Year Average	0.51%				
	5 Year Average	0.50%				
	13 Year Average	1.08%				

Large Institution Charge-Off Curve
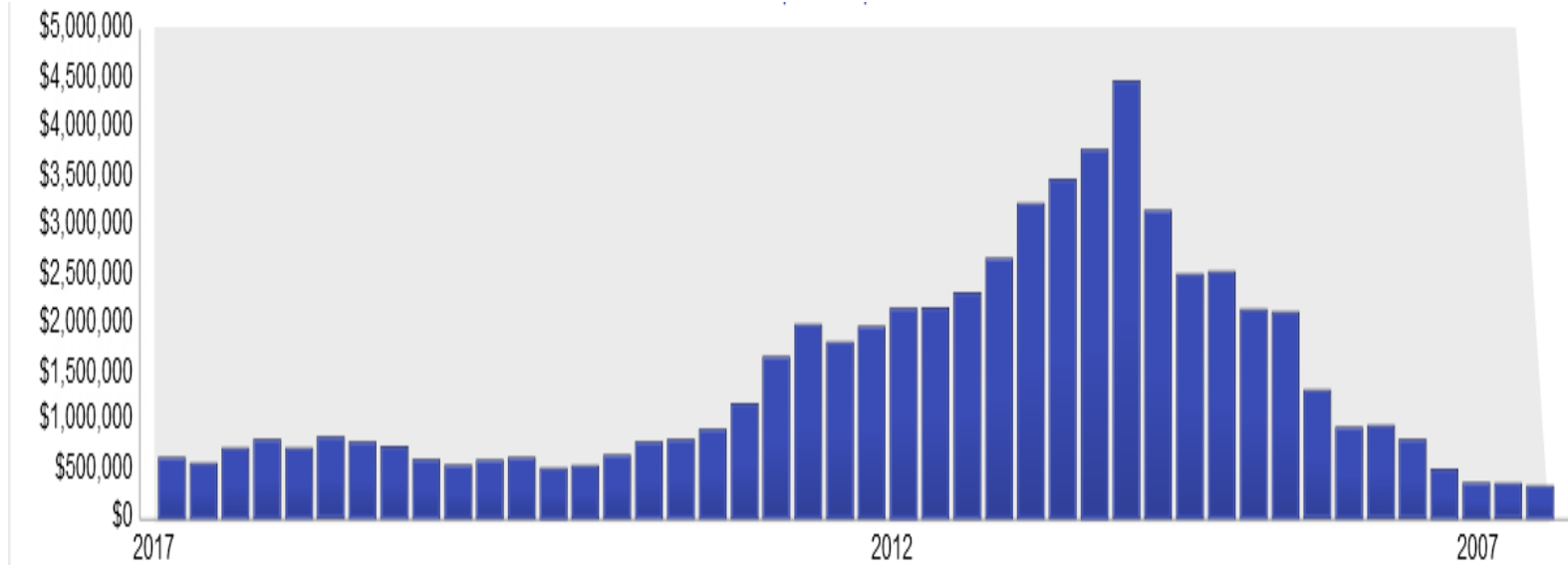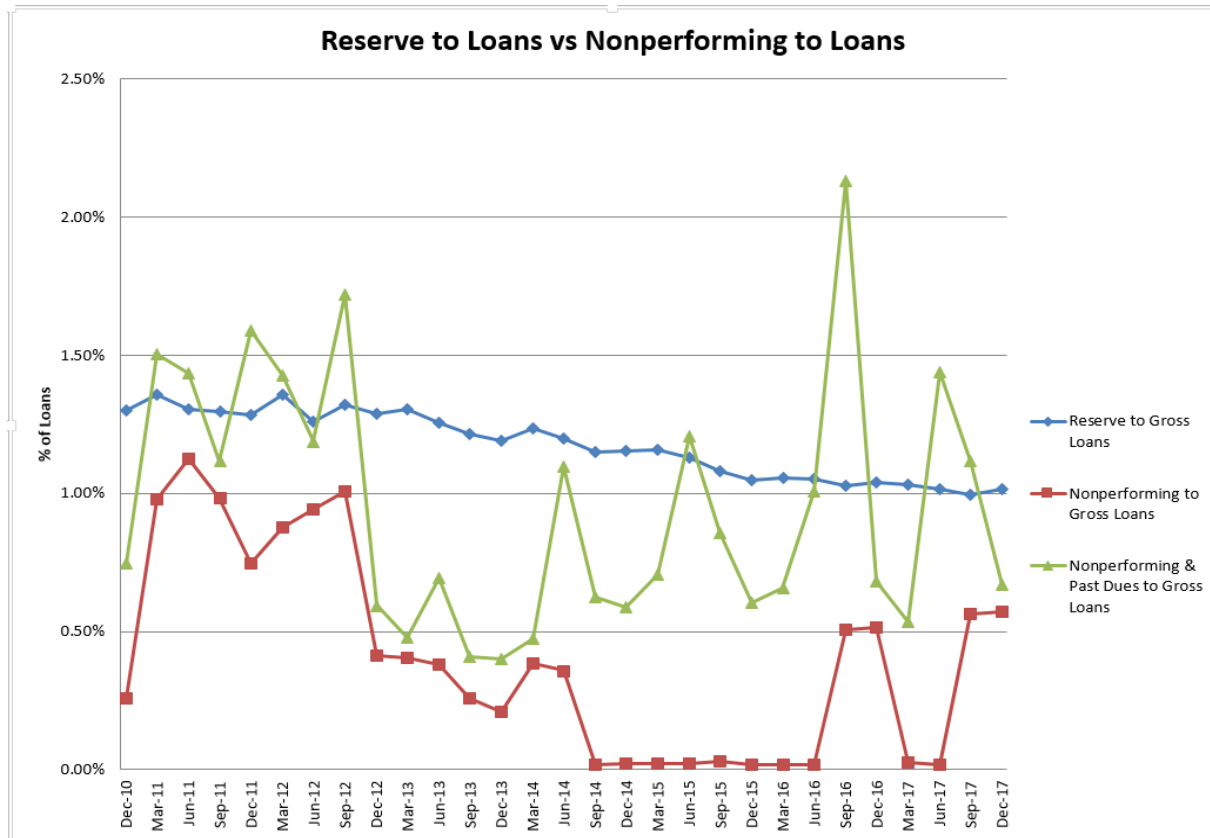
Large Institution Trend Analysis
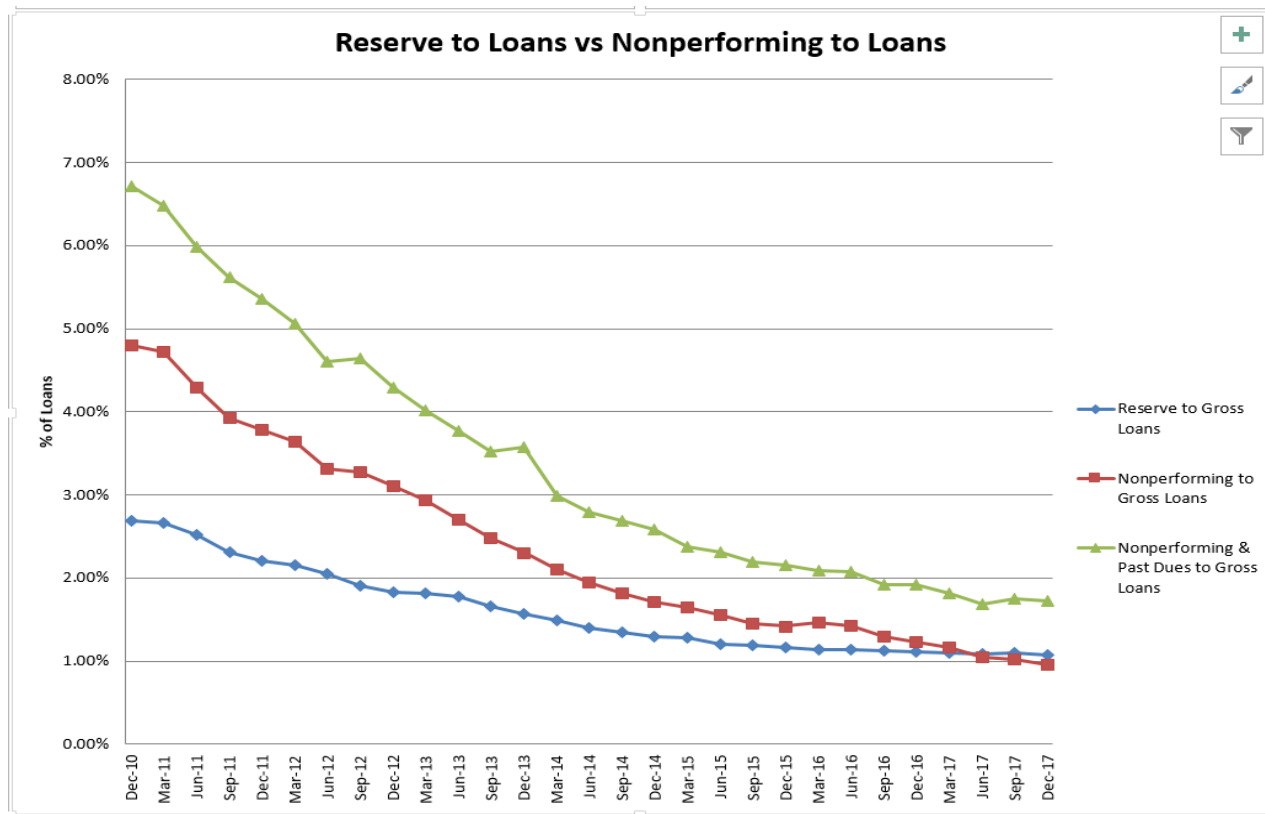
Community Institution Charge-Off Curve
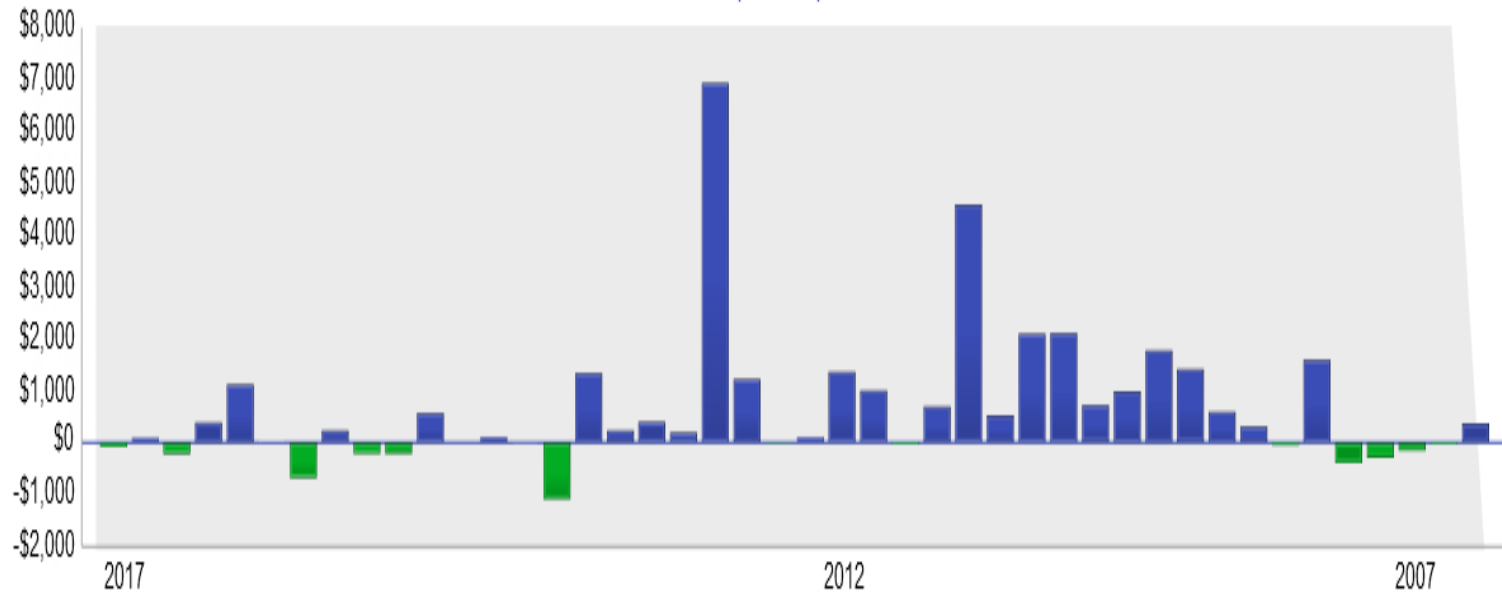
Community Institution Trend Analysis

CECL Assumptions

- Allowance will go up

- Reserve for life instead of incurred

- Reasonable and supportable forecast period

CECL Versus Incurred Comparison

Principal:	$ 100,000					
Term:	5					
Interest Rate:	5.00%					
Payment:	$ 23,097					
	Beginning	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Balance	$ 100,000	$ 81,903	$ 62,900	$ 42,948	$ 35,095	$ 20,000
Payment		$ 23,097	$ 23,097	$ 23,097	$ 10,000	$ 16,850
Principal		$ 18,097	$ 19,002	$ 19,952	$ 7,853	$ 15,095
Interest		$ 5,000	$ 4,095	$ 3,145	$ 2,147	$ 1,755
Net Book Value		$ 76,903	$ 57,900	$ 17,948	$ 10,095	$ (0)
Chargeoffs		$ -	$ -	$ 20,000	$ -	$ (5,000)
Incurred Losses						
ALLL	$ -	$ -	$ 20,000	$ -	$ -	$ -
Provision		$ -	$ 20,000	$ -	$ -	$ (5,000)
Chargeoffs		$ -	$ -	$ 20,000	$ -	$ (5,000)
Lifetime Losses						
ALLL	$ 20,000	$ 20,000	$ 20,000	$ -	$ -	$ -
Provision	$ 20,000	$ -	$ -	$ -	$ -	$ (5,000)
Chargeoffs		$ -	$ -	$ 20,000	$ -	$ (5,000)

Qualitative Factors/Industry Data Analysis

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Qualitative Factors/Forecasting

- Historical loss rates will continue to be adjusted for qualitative factors and forecasting

- Select a reasonable and supportable forecast period and adjust historical information

- Federal Reserve data can assist with this analysis

https://cdr.ffiec.gov/public/

https://research.stlouisfed.org/fred-addin/

https://fred.stlouisfed.org/graph/?g=4VT

https://www.ncua.gov/analysis/credit-union-corporate-call-report-data/quarterly-data

Qualitative Factors/Forecasting

- Mathematically support qualitative factor adjustments.

- Regression analysis.

- Are there any correlations between your data and an economic data point?

- Level of sophistication will depend on if your data can be correlated.

Qualitative Factors/Forecasting

- Use of industry data
- Correlate economic items to industry data

Correlations/Forecasting

Unemployment Rate vs Chargeoff Rate
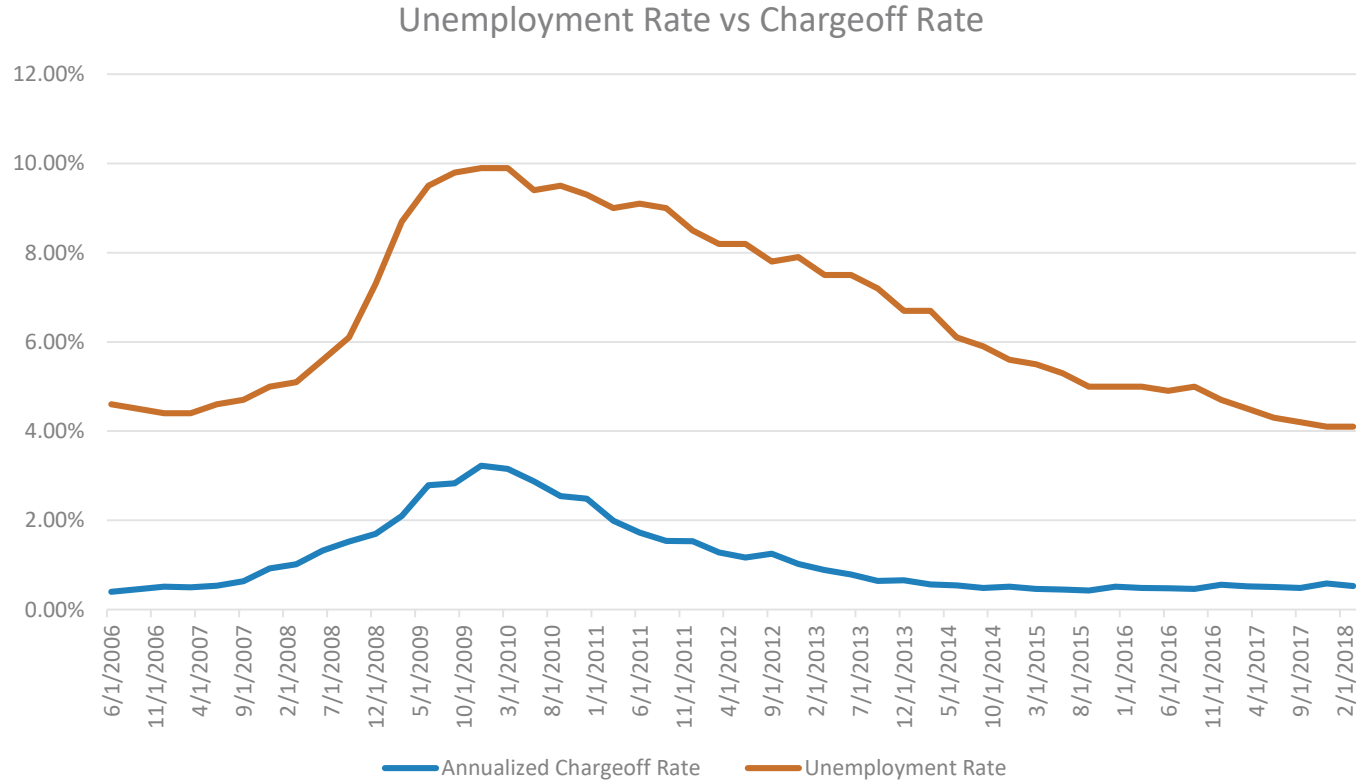
Correlations/Forecasting

SUMMARY OUTPUT	
Regression Statistics	
Multiple R	0.869813913
R Square	0.756576244
Adjusted R Square	0.751284423
Standard Error	0.004223703
Observations	48

=-0.013229451+0.374851244*Unemployment Rate		
Unemployment Rate	5.00%	
	0.55%	Chargeoff Rate

Screen Share

Data

Model Selection

- Complexity versus accuracy of utilizing multiple methodologies
- Importance of risk rating accuracy, timely update and tracking
- Changes to policies, procedures, and process controls
- Consistency of assumptions across models

Data Elements

- Note Number

- Purpose Code

- Original Amount

- Current Principal Balance

- Origination Date

- Renewal/Extension Date

- Maturity Date

- Risk Rating

- Charge-off and Recovery Data (with date and note)

Data Elements

- Interest Rate

- Payment Amount

- Payment Frequency

- Prepayment Expectations

- Narrative to Support Inputs

Data Collection

- Additional data collection may be necessary depending on how granular you want to get

- Other elements may include loan to value, debt service coverage, credit scores, etc.

- You do not want to get too granular, as you may end up with very small pools that will not be statistically relevant

- Verify you can obtain the elements mentioned above at various points in time

Closing Thoughts

- Statistically supporting qualitative factors will be a challenge for community institutions

- Tools are available to assist with forecasts

- Qualitative and forecasting adjustments are going to continue to be a significant component of the allowance calculation

Questions?

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Thank you!

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