



CECL: Crossing the finish line, and then...

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Learning objectives

- ▲ Consider CECL's strategic implications for your institution
- ▲ Understand final stage key activities and decisions
- ▲ Build a plan for managing CECL long-term

Transitioning to CECL

Strategic Considerations

- ▲ **CECL is not prescriptive** – the industry is losing 45+ years of reserve comparability practices by regulators, auditors, and investors
- ▲ **New metrics will drive provisions** – traditional asset quality measures may not drive current period reserve levels or provision needs
- ▲ **Data quality and governance are crucial** – more data required, often outside of core systems, requires a higher degree of data discipline, transparency, and assurances
- ▲ **Evolution is inevitable** – just as the incurred model changed over time so too will CECL evolve, informed by experience, better data, auditor and regulator guidance
- ▲ **CECL may impact management and board committee composition** – new or different skills and perspectives may be needed to fulfill oversight responsibilities



Transitioning to CECL

Implications

- ▶ Testing, developing, and thoroughly documenting methodologies is expected
- ▶ Increased audit scrutiny, stronger oversight expectations, and evidence of alignment across major strategic functions: reserves, budgeting, and ALM
- ▶ Understanding capital impact and options prior to adoption (3-year phase in)
- ▶ Creating and implementing significant new and retrospective disclosures



Transitioning to CECL

Stages



Prep & Plan

- Study the standard
- Understand requirements
- Identify Executive sponsor
- Form working group
- Create Project Plan, Authority
- Identify resources needed to assess and execute
- Assess internal resource capabilities, skills

Decision: Vendor-model or self-developed model



Data

- Understand portfolio attributes, risk characteristics, and loss drivers
- Understand availability and quality of data, including reliability and accuracy
- Assess data limitations

Decision: Use of data assumptions and/or external enhancements



Later 2023 adopters



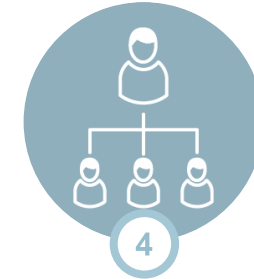
Model Development

- Clearly define model purpose
- Develop model(s)
- Integrate, map data
- Scenario and model testing
- Identify and address model deficiencies
- Create strong model documentation, including analysis, assumptions, limitations, decisions, and rationale

Decision: Model selection(s), overall methodology



1/1/23 adopters



Governance

- Understand and execute model risk management practices
- Define oversight roles and responsibilities
- Create policies, procedures, workflows, and controls
- Define on-going monitoring, validation, and reporting requirements, frequency
- Create disclosures

Decision: Authority, thresholds

Adoption Governance and Controls

Over model design, development, implementation, and use

- ▲ Board and Senior Management Oversight
- ▲ Policies
- ▲ Procedures
- ▲ Controls & Compliance
- ▲ Validation
- ▲ Monitoring
- ▲ Reporting

Source: *Interagency Supervisory Guidance on Model Risk Management*
(OCC 2011-12, FDIC FIL 22-2017, FRB SR 11-7)

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When management engages a specialist [third party, vendor], management is still responsible for the appropriateness of the specialist’s methodology, as well as both inputs and outputs relevant to the estimate.

AICPA Practice Aid

Board/Committee Oversight

Sample questions

- ▲ **1 Implementation plan:** Is the bank's CECL parallel run (including methods, models, assumptions, processes, and controls as if the standard were effective) on schedule?
- ▲ **2 Culture and resources:** Will significant judgments about implementation be made and approved centrally or within department(s)?
- ▲ **3 Systems and data:** Does the bank plan to use in its model any external or internal data not previously subject to internal controls? If so, how has management assessed the relevance and reliability of the data?
- ▲ **4 Controls:** Who is responsible for changing, updating, and reviewing processes, controls, and related documentation impacted by the new standard?
- ▲ **5 Policy and significant judgements:** Who has (or will) review, document, and communicate significant assumptions and judgments? What alternatives were considered, rejected, and why?
- ▲ **6 Modeling and assumptions:** Have specialists (internal, external) been identified to assist with developing the model? What controls are in place?
- ▲ **7 Involvement of stakeholders:** Are key decision-makers aware of the judgments and process/control changes that need to be made at a business-unit level?
- ▲ **8 External auditor:** Has the external auditor assessed the design and implementation of controls for data integrity, reasonableness of assumptions and modeling methodology? Has the external auditor reviewed significant judgments; what is their perspective?



Day 1 Impact

Entries

Allowance for Credit Losses

- Adjustment to reserves on funded loans (via provision)
- New reserve on HTM/AFS

Off-Balance Sheet

- Adjustment to reserves on unfunded commitments that are not unconditionally cancellable

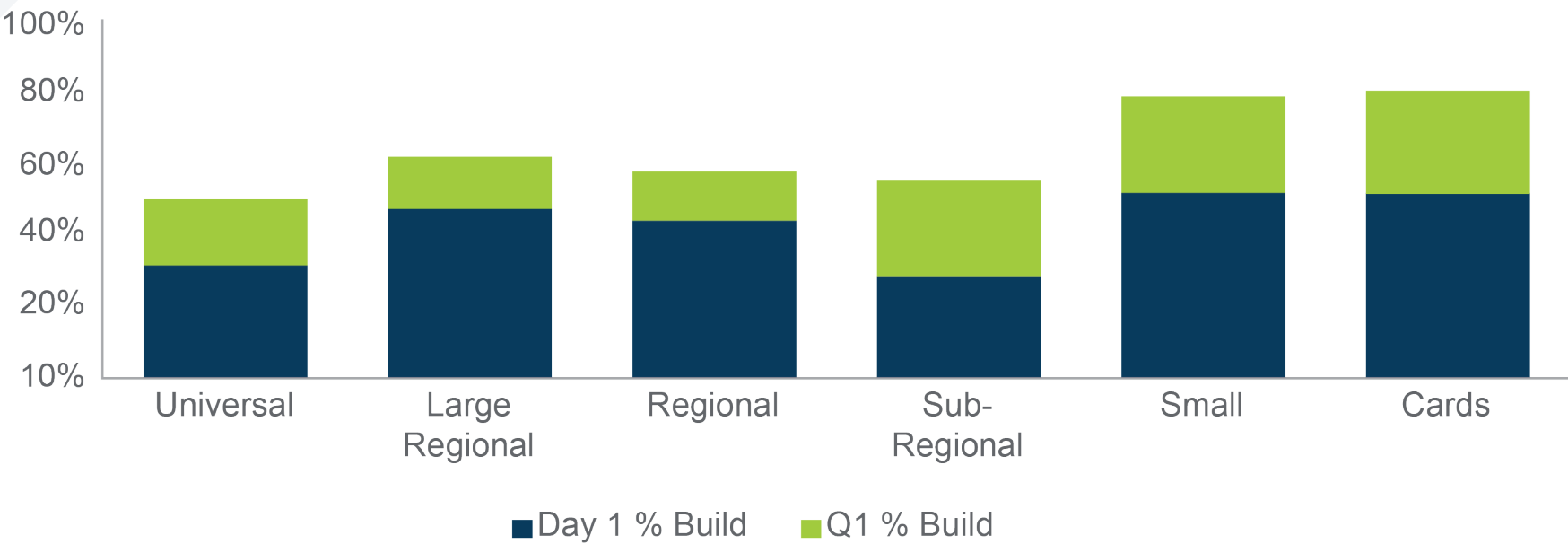
Related impacts to

- Shareholder's Equity
- Deferred taxes
- Regulatory capital ratios (regulatory phased-in relief?)

Day 1 Impact

2020 CECL Adopters

Figure 1 Percentage change in allowance



The actual “Small” bank range in Moody’s sample was -12.2% to +223.4%



2020 CECL Adopters

Transition and Pandemic

Loan Type	Percentage Change in Allowances Relative to Dec 31, 2019				
	On Jan 1, 2020	Jan 1, 2020 - June 30, 2020		June 30, 2020 - June 30, 2021	
	CECL Adopters	CECL Adopters	Non-Adopters	CECL Adopters	Non-Adopters
	1	2	3	4	5
Cards	48.4	71.3	33.6	-46.7	-19.5
Commercial	7.5	99.5	33.3	-70.9	-10.1
Other Consumer*	97.1	46.5	55.6	-44.2	-31.0
Commercial RE	33.3	55.5	29.4	11.9	28.8
Residential RE	27.6	81.9	19.9	-72.1	7.1
Construction	-13.9	75.3	24.6	-28.4	19.5
Total	37.4	75.9	32.3	-49.3	-0.8

Note: CECL adoption impact estimates by loan type are described in endnote 10. RE stands for real estate.

*Other consumer includes all consumer loans other than mortgage and credit cards, and primarily consists of student, auto, and installment loans.

Sources: FR Y-9C and FFIEC Call Reports.

- ▲ Average pandemic build was 2x CECL transition among adopters
- ▲ Significant reserve releases followed over 18 months, and continue
- ▲ 2023 CECL adopters reserve start-points may be pandemic-inflated



Assessing Reserve Reasonableness

Data source: UBPR (Uniform Banking Performance Report, FFIEC)

12/31/2021 ALLL	Bank Losses 2002-2021	ALLL Coverage (20 years, \$ Losses)	ALLL Coverage (20 years, % Loans*)
10,500	2,100	500% (5.00x)	285% (2.85x)

* % Loans on 12/31/21 balances





The three IZE's

1

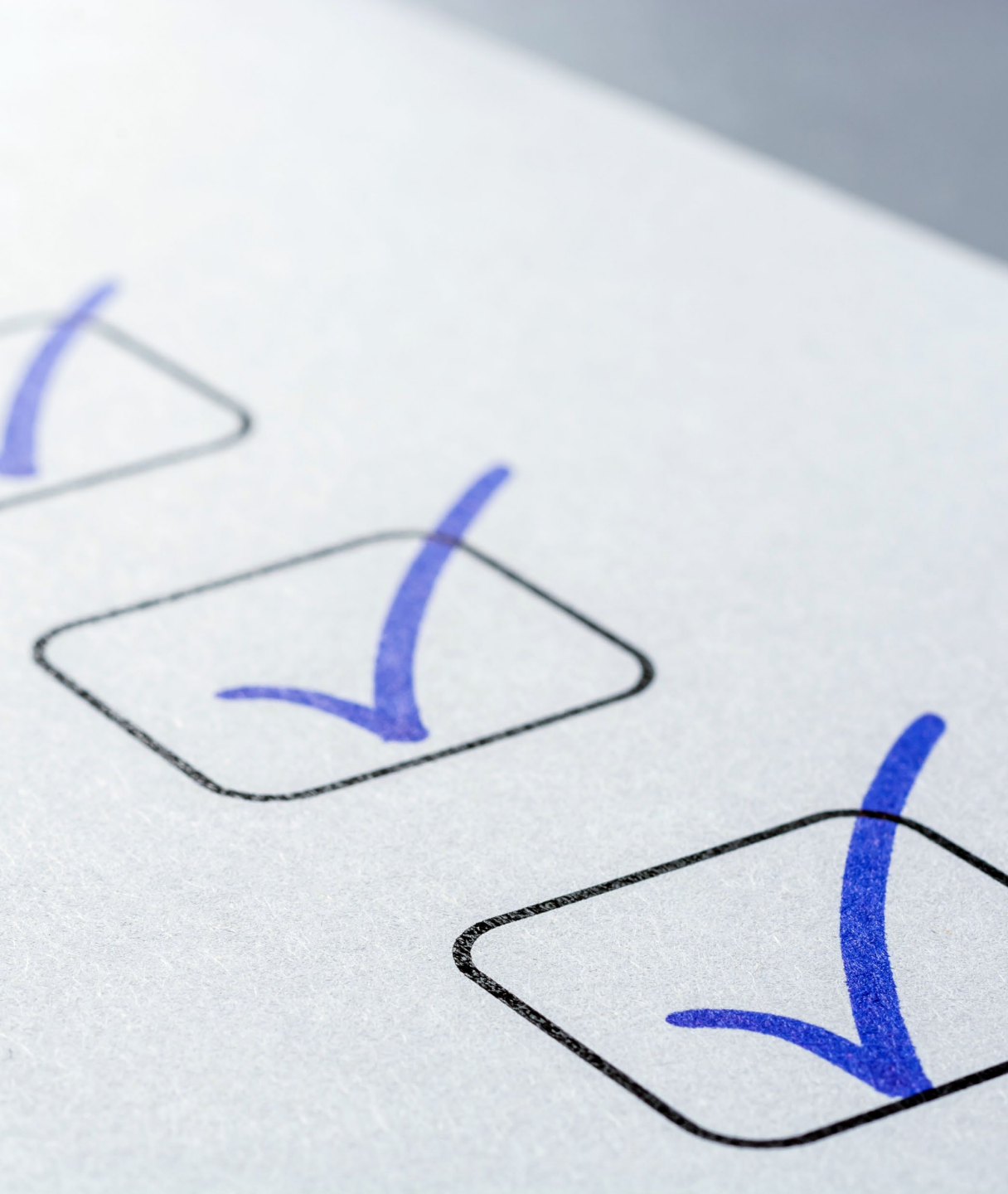
Standardize

2

Prioritize

3

Optimize



Standardize

- ▲ **What:** Production and reporting
- ▲ **How:** Design for ease, routine
- ▲ **Why:** Eliminate crazy, conserve energy
- ▲ **Benefit:** Consistent, repeatable, understandable

Risks and costs (if you don't)

- ▲ Human Capital
- ▲ Unpredictability
- ▲ Diverted attention and focus



Prioritize



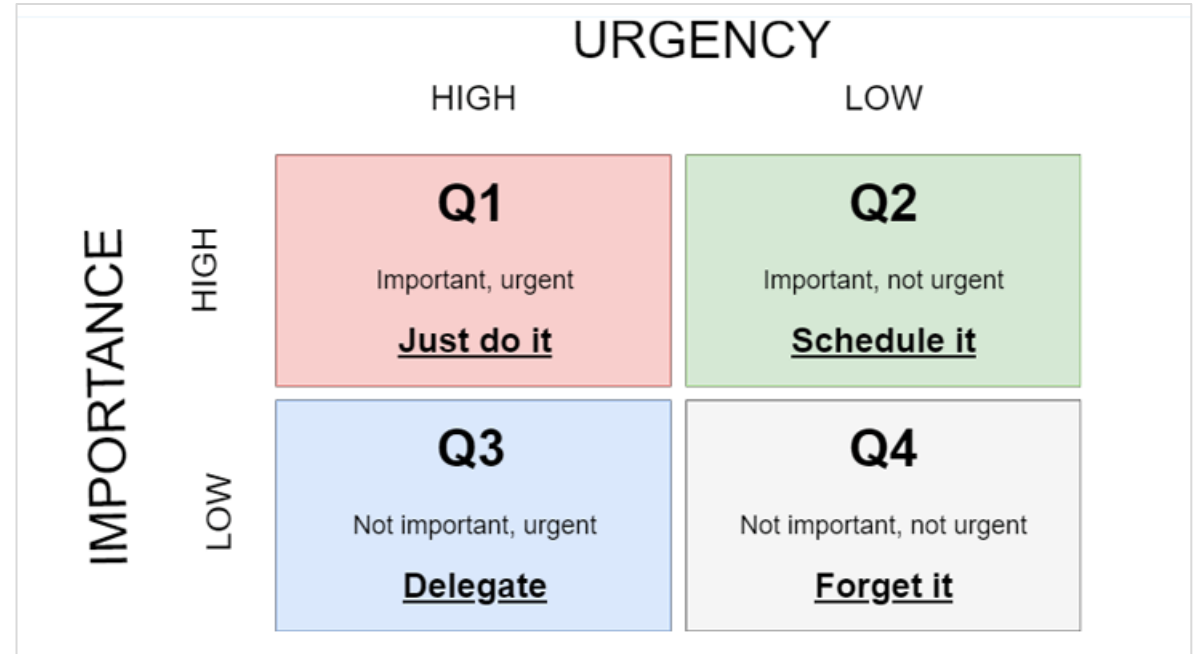
Red: Address immediately



Yellow: Closely monitor



Green: Schedule out



Reference: Eisenhower Matrix, Stephen Covey



Optimize

verb

1. to make as perfect, effective, or functional as possible
2. to make the most of
3. to take the full advantage of

Sources: Merriam-Webster, American Heritage Dictionary, Collins English Dictionary

Thank you

Access our CECL resources at
berrydunn.com/implement

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