

CECL Readiness August 2022

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- +Where should we be now?
- +CECL Observations during validations
- +SCALE and ELE thoughts
- +Unallocated reserves
- +Peer Analysis
- +Controls
- +Q&A

Agenda



Disclaimer

The opinions expressed in the presentations are statements of the speaker's opinion, are intended only for informational purposes, and are not formal opinions of, nor binding on, MCM CPAs & Advisors, LLP. Each participant is responsible for its own business, financial, investment or credit decisions.



Inspiration for the day

Do not quench your inspiration and your imagination; do not become the slave of your model.

- Vincent van Gogh



Where should we be now?

- + Complete?
- + Validated?
- + Running Parallel
- + How many parallel runs (quarters) did you run?
- + Still choosing a vendor?
- + Still working through methodologies?



Document, document, document

An anonymous quote from
March 2022

“We are almost ready with
the math, but we want to
spend more efforts on our
documentation before we
have everything validated.”





More vendors in 2021/2022

- +Sageworks / Abrigo
- +Valuant
- +Moody's
- +Plansmith
- +FedReporter
- +Banker's Caddy
- +Qwickrate
- +PCBB

Model interdependence

- + Doesn't necessarily mean it relies on another model
- + Models can share similar assumptions
- + Example: Prepayment speed assumptions
 - + CECL
 - + IRR



Through the Cycle

- + Document your own decisions
- + How far back to look for historical loss rates
- + Some institutions are using analysis period = estimated life of loan
- + Most going back farther than 5 years
 - + Common incurred loss period is 5 years
- + If you are going back 10 years, then pick up the recession by going back to 2009



Peer Data Use

- + Use your own
- + Use FFIEC Peer Data
- + Use Custom Peer Data
- + Use Blend of Peer Data and Own Data
- + Use Higher of Peer or Own Data
- + "No loss history" vs. "history of no losses"

- + Why is the peer data a better predictor of your losses than your own history?



Stress the model?

- + When did we have the highest losses?
 - + 2009 / 2010?
- + What was unemployment back then?
- + If unemployment goes back to that rate, what will our model tell us we need in the ACL?



Validation Bandwidth

Validation schedules started filling up rapidly in the 2nd quarter of 2022.

I got a call in mid-July. Client out west. Wanted to validate 3rd quarter 2022 model. Wanted the following

- + Fieldwork to occur after October 15
- + Final report in hand by December 1
- + Experience with the specific model they use, with clients who share the same auditor



Free is not always better...

+SCALE

+ELE

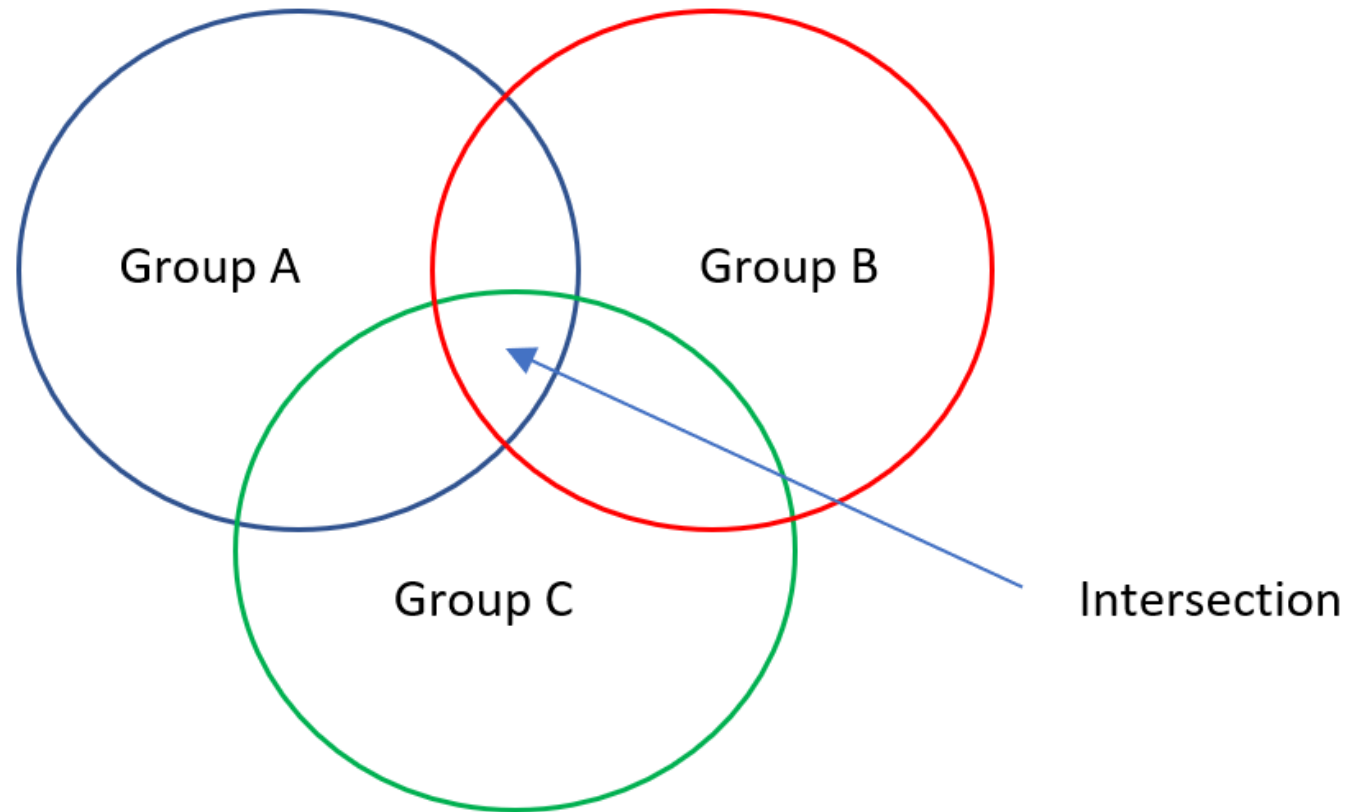


SCALE

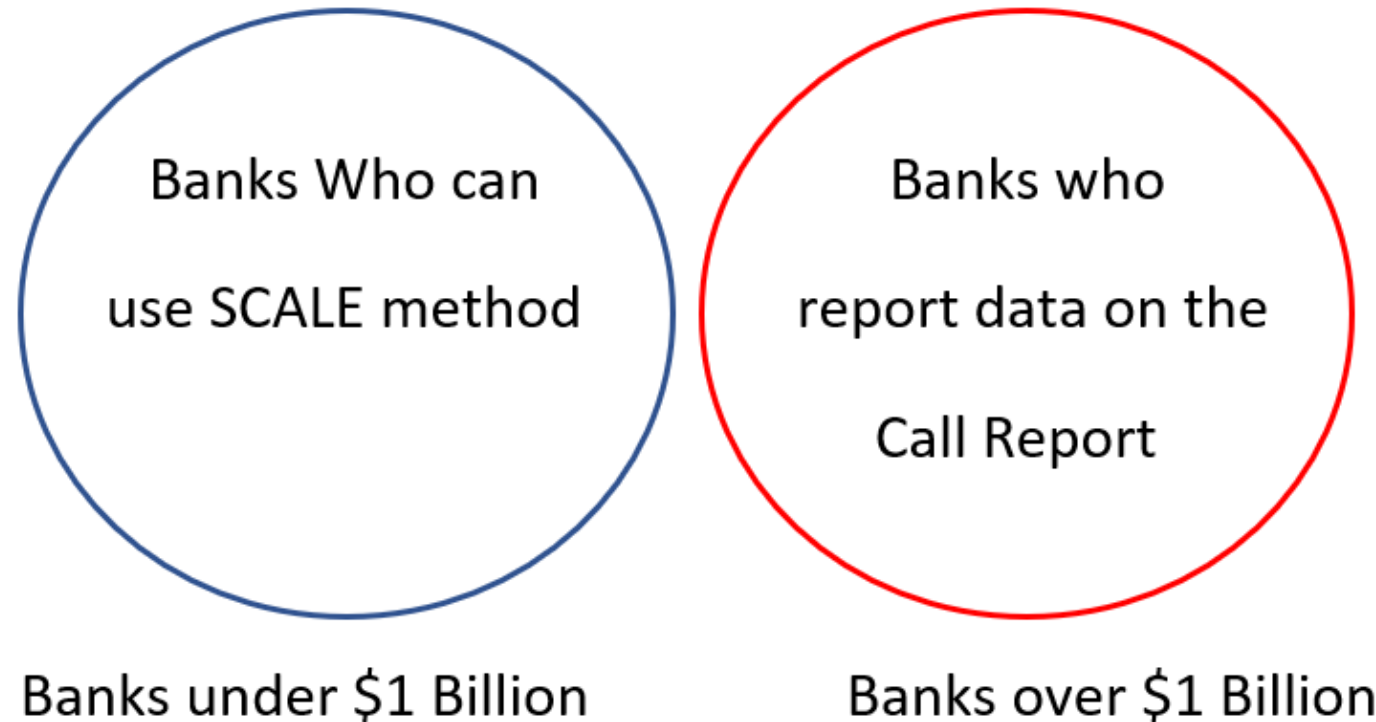
- + Scaled CECL Allowance for Losses Estimator
- + The Process
- + Only gets you to estimated loss rate
- + You still need to individually analyze loans
- + You still need to incorporate qualitative factors
- + Unfunded commitments
- + Securities



Venn Diagram



SCALE as a Venn Diagram



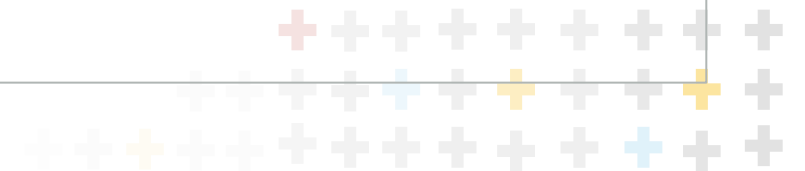
SCALE Statistics

December 2021 - reported


- +386 Banks
- + Total Loans
 - + Maximum \$74.8 Billion
 - + Average \$5.4 Billion
- +122 banks have unallocated up to \$12.7 million

December 2021 – not yet reported

- +520 banks with assets > \$1 Billion
- + Total Assets
 - + Minimum \$1 Billion
 - + Maximum \$121 Billion
 - + Average \$3.4 Billion



ELE

- + Expected Loss Estimator
 - + WARM Method approach
 - + Input portfolio data – 6 fields
 - + Portfolio
 - + Loan number
 - + Outstanding Balance
 - + Annualized interest rate
 - + Maturity Date
 - + Amortization Date
 - + Input assumptions of loss rate and prepayment rate
- 

ELE Thoughts

- + You still need to generate your own assumptions of loss rates and prepayment rates
- + Still need qualitative factors



Unallocated reserves

- + Unallocated = not supported by historical losses + Q factors
- + Several banks have had unallocated for a few years
- + Up to 25% of the ALLL has been unallocated
- + Should you have unallocated going forward under CECL?



Peer analysis / benchmarking

- + If your peer group members had an unallocated amount:
 - + How would you know?
- + It could look like they had a smaller increase when they transition to CECL
- + Skews the data
- + What if the peer group does not have unallocated, but you do?



Controls

- +What controls do you have in place for ALLL now?
- +Policies and Procedures
- +Data import and balancing
- +Reconciliation
- +Segregation of duties
- +Cross-training and backups





Questions?



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