ASC 326-20 (CECL) FOR SPECIALTY FINANCE COMPANIES

May 19, 2022

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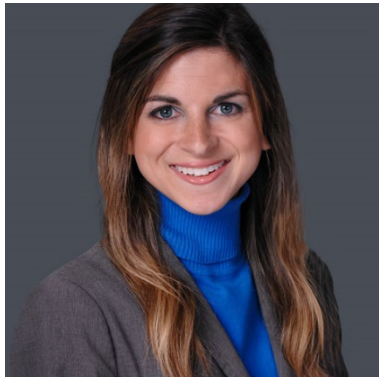
Today’s speakers



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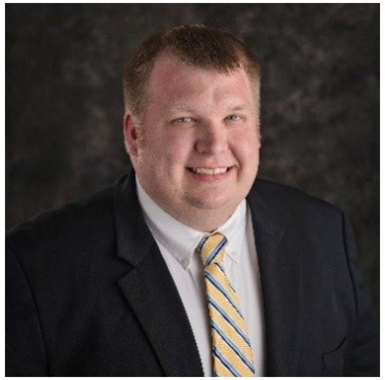

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Agenda

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Example methods	15
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Objectives

- By the end of this course, you will be able to:
  - Consider the implications of the new standard on credit losses (ASC 326-20) at your institution
  - Discuss relevant, available methodologies and models
  - Plan for implementation of ASC 326-20

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OVERVIEW OF THE CREDIT LOSSES STANDARD

ASU 2016-13

- ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, was issued in June 2016
- Includes significant changes to the determination of the allowance for credit losses on financial assets held at amortized cost basis (focus of this presentation)
  - Supersedes many of the provisions in ASC 310 and 450

Subsequent ASUs updating original standard

- 2018
  - Asu 2018-19, *codification improvements to topic 326, financial instruments – credit losses*
- 2019
  - ASU 2019-04, *codification improvements to topic 326, financial instruments – credit losses, topic 815, derivatives and hedging and topic 825, financial instruments*
  - ASU 2019-05, *financial instruments – credit losses (topic 326): targeted transition relief*
  - ASU 2019-10, *financial instruments—credit losses (topic 326), derivatives and hedging (topic 815), and leases (topic 842): effective dates*
  - ASU 2019-11, *codification improvements to topic 326, financial instruments—credit losses*
- 2020
  - ASU 2020-02, *financial instruments—credit losses (topic 326) and leases (topic 842)—amendments to SEC paragraphs pursuant to SEC staff accounting bulletin no. 119 and update to SEC section on effective date related to accounting standards update no. 2016-02, leases (topic 842) (SEC update)*
  - ASU 2020-03, *codification improvements to financial instruments*
- 2022
  - 2022-02, *financial instruments-credit losses (topic 326)-troubled debt restructurings and vintage disclosures*

ASU 2022-02 (TDRs and Vintage Disclosures)

TDRs recognition and measurement guidance	Modification-related disclosures	Vintage disclosures (only applicable to PBEs)
• TDRs no longer exist; • Account for all modifications in accordance with ASC 310-20, requiring determination at modification if the modification represents a new loan or a continuation of an existing loan	• Expansion of certain existing disclosures • New disclosure requirements • To include all modifications to borrowers experiencing financial difficulty where a modification forgave principal, reduced interest rate, caused an other-than-insignificant payment delay or extended term	Requirement to disclose current-year gross charge-offs by year of origination
Applied on a prospective basis, with an option for modified retrospective transition through a cumulative effect adjustment to opening retained earnings at the date of adoption	Applied on a prospective basis	Applied on a prospective basis

Early adoption permitted for those that have adopted CECL on a topical basis

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FASB project updates - 2022

- FASB agreed in February 2022 to undertake a project to consider adjustments to the accounting for purchased financial assets with credit deterioration (PCD financial assets)
  - Initial deliberations indicated that FASB would explore expanding the PCD accounting model for all assets acquired/purchased as opposed to just those experiencing credit deterioration
  - Continue to monitor RSM Insights/thought leadership and the FASB website for more details on a proposed exposure draft

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Revised effective dates (based on calendar year-end)

2022**

- PBEs that are SEC filers, except SRCs as defined by the SEC
- All interim periods within the calendar year

2023

- All others (PBEs that are SEC filers and SRCs, PBEs that are not SEC filers, Non-PBEs)
- All interim periods within the calendar year

***The CARES Act and Consolidated Appropriations Act deferred the original implementation dates for certain regulated financial institutions; however, regulators still allowed entities to adopt as of 1/1/2020, 1/1/2021, 12/31/2021 or 1/1/2022, if desired*

Implementation – financial statements

- Recorded through a cumulative effect adjustment to opening retained earnings in the period of adoption (January 1 for a calendar year end)
- Applicable purchased financial assets with credit deterioration ("PCD" financial assets) are accounted for on a prospective basis**
  - Adjust for the addition of the allowance for credit losses on these types of financial assets upon adoption ("gross up" method that adds initial allowance for credit losses to purchase price to set a new amortized cost; no initial income statement impact)
  - PCD applies to those with more-than-insignificant credit deterioration ***after*** the origination date (not *as of* the origination date; need to have a policy in place to define and assign PCD status)

APPLICABILITY AND MAJOR PROVISIONS

Subtopic 326-20, Financial assets measured at amortized cost

Applicability of CECL

- The following are in-scope:
  - Financial assets measured at amortized cost basis
    - ***Financing receivables (e.g., loans and net investments in leases recognized by the lessor in accordance with ASC 842 that are held for investment)***
      - ***Net investment in leases includes direct financing and sales-type; does not apply to operating leases***
    - Held-to-maturity debt securities
    - Receivables resulting from revenue transactions in the scope of Topic 606 (revenue from contracts with customers) or Topic 610 (other income)
    - ***Reinsurance receivables resulting from insurance transactions in the scope of Topic 944***
    - ***Receivables related to repurchase agreements and securities lending transactions in the scope of Topic 860***
  - Off-balance-sheet credit exposures not accounted for as insurance (e.g., loan commitments, standby letters of credit, financial guarantees not accounted for as insurance and similar instruments other than those in the scope of Topic 815 on derivatives and hedging)

Applicability of CECL (cont.)

- The following are generally **NOT** in-scope:
  - Loans held for sale
  - Financial assets measured at fair value or for which the fair value election has been taken
  - Available-for-sale debt securities
    - ASU 2016-13 did amend certain guidance relating to measurement of credit losses on AFS debt securities (formerly OTTI) - refer to the ASU and ASC 326-30 as not captured in this presentation
    - May apply for beneficial/residual interests in off-balance-sheet securitizations
  - Equity securities (measured at fair value in accordance with ASC 321)
  - Loans between entities under common control
  - Options and futures contracts

Major provisions of CECL

- Pre-adoption guidance – recognize incurred credit losses when probable and estimable
- CECL - Recognize expected credit losses at the time of origination/purchase of the financial asset
  - Through allowance for recognized financial assets
  - Results in day 1, life of asset expected loss recognition for recorded financial assets and off-balance-sheet exposures
  - Changes in the allowance (plus and minus) are recorded immediately through provision for credit losses

Amortized cost basis

DEFINITION
The amortized cost basis is the amount at which a financing receivable or investment is originated or acquired, adjusted for applicable accrued interest, accretion, or amortization of premium, discount, and net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments.
KEY ASPECTS OF THE DEFINITION
Inclusion of accrued interest, premium, discount and net deferred fees or costs. *For accrued interest, refer to the Practical Expedients and Policy Elections section that may allow for a policy election to not record an allowance for accrued interest.*
WHAT WILL THIS MEAN FOR YOUR ALLOWANCE?
The allowance for credit losses cannot be computed in a manner that only factors in unpaid principal balance. For example, if historical losses do not include losses on accrued interest, premiums, discounts and net deferred fees/costs, management must arrive at separate estimated losses for those components of amortized cost. *For accrued interest, refer to the Practical Expedients and Policy Elections section that may allow for a policy election to not record an allowance for accrued interest.*

Reserve + unamortized purchase discount ≠ allowance for credit losses

…In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses…"

ASC 326-20-30-5

Rationale is that expected lifetime losses are required to be recognized as of day one under CECL - waiting to "use up" the unamortized discount and then start recording required reserves would not be reflective of an appropriate day one allowance

Reserve + unamortized purchase discount ≠ allowance for credit losses (cont.)

- Entities should have a rational, systematic, and documented methodology for computing the allowance, independent of any consideration of the unamortized discount
- If the entity has historically combined the unamortized purchase discount and a calculated reserve to reflect an overall estimate of the allowance, this is no longer allowed
  - Compliance cannot be achieved by merely reducing the unamortized discount and adding that balance into the allowance day one; need to consider each independently
  - Unamortized discount is to be recognized over life of the loan using the interest method, whereas allowance is to be recognized day one (and adjusted as needed throughout the life)

How to estimate losses under ASC 326-20: Segmentation considerations

- Measure expected losses on a collective (pool) basis whenever similar risk characteristics exist
- Consider “loss drivers” when determining if similar risk characteristics exist
- Loan type is often a starting point, but to get the most accurate measure of expected credit losses, further consideration and bifurcation of similar risk characteristics may be appropriate
- When calculating expected losses, should include actual recoveries and an estimate of expected recoveries
  - Likely to be impactful for SF entities who have large volumes of recoveries based on charge-off policies employed

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How to estimate losses under ASC 326-20: Segmentation considerations (cont.)

- Examples of similar risk characteristics included in ASC 326-20 include the following:
  - Internal or external (third-party) credit score or credit ratings
  - Risk ratings or classifications
  - Financial asset type
  - Collateral type
  - Size
  - Effective interest rate
  - Term
  - Geographical location
  - Borrower’s industry or type
  - Vintage (year of origination)
- This is not an exhaustive list and management should consider other factors depending on nature of financial assets, borrower types, and methodology selected (e.g., delinquency status, bankruptcy status)

Example segmentation of finance receivables for a short-term lender

- ABC Lending provides short-term, unsecured financing to borrowers of multiple credit profiles through its online platform, with a focus on prime and sub-prime borrowers
- ABC Lending pools its finance receivables first by term, then by credit score, and then by aging as these factors have been determined to have the most impact on collectability

Product Term	Credit Score	Current	31-60	61-90	90+
1 month	Under 500	$ XXXX	$ XXXX	$ XXXX	$ XXXX
	500-600	$ XXXX	$ XXXX	$ XXXX	$ XXXX
	600-700	$ XXXX	$ XXXX	$ XXXX	$ XXXX
	700+	$ XXXX	$ XXXX	$ XXXX	$ XXXX
6 month	Under 500	$ XXXX	$ XXXX	$ XXXX	$ XXXX
	500-600	$ XXXX	$ XXXX	$ XXXX	$ XXXX
	600-700	$ XXXX	$ XXXX	$ XXXX	$ XXXX
	700+	$ XXXX	$ XXXX	$ XXXX	$ XXXX

How to estimate losses under ASC 326-20: Individually evaluated financial assets

- If a financial asset does not share similar risk characteristics with other financial assets, then that financial asset should be evaluated on an individual basis
  - Similar to the existing concept of “impaired”, but technically all impaired guidance and the term itself are superseded by ASC 326
- Under the incurred loss model, customers with bankruptcy-related restructurings that included a concession to the borrower were considered to be “impaired” since they were TDRs and required specific evaluation
  - With ASU 2022-02, TDRs no longer exist, but should still consider if modifications to borrowers experiencing financial difficulty should continue to be disaggregated based on similar risk characteristics, either as their own pool or as individual assets
  - If have same risk characteristics as other financial assets in a pool, then should be included in that pool

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Contractual term

- Estimate credit losses over the contractual term
  - Contractual term should be estimated for each pool of financial assets
  - Consider expected prepayments, if applicable
  - Do not extend for expected extensions, renewals or modifications unless:
    - The extension or renewal options are not unconditionally cancellable by the lender (i.e., the lender does not have the right to unconditionally cancel). If so, consider the likelihood that the financial asset will be extended or renewed
  - With ASU 2022-02 and required application of ASC 310-20 guidance for all modifications (i.e., is it a new loan or continuation of an existing loan), entities will need to consider how to track such initial origination and modification data to properly assess contractual term

Expected recoveries

- Entities should consider expected recoveries of amounts previously written off and expected to be written off when measuring the allowance for credit losses (i.e., net losses)

Credit card receivable considerations

- Unique considerations exist for any credit card receivables held by the entity
  - Segmentation
    - Revolvers vs. transactors
    - New vs. existing
    - Other as necessary based on loss drivers (e.g., credit score, balance)
  - Contractual term
    - Often have no stated maturity date or easily rolled into another term
    - Expected renewals/extensions not likely need to be factored in based on credit agreement being unconditionally cancellable by the lender
    - Balance considerations and how to estimate how long it will take to pay down/how to apply payments received (e.g., first in, first out; pro-rata/CARD Act)
  - Method

Qualitative factors and adjustments

- Consider relevant, reliable, and available information (internal and/or external) when estimating expected losses
- Should not rely solely on past events (i.e., historical loss calculation)
- Required to adjust historical loss information or the initially calculated allowance for:
  - Current conditions
    - Differences in risk characteristics (loss drivers) as compared to the period upon which historical losses were calculated
    - No change from previous standard
  - Asset-specific risk characteristics
- Required to incorporate adjustments for reasonable and supportable forecasted conditions
    - Significant change from previous standard

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“Give me a one-handed economist. All my economists say 'on one hand...', then 'but on the other...”

Harry Truman

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Adjustments for reasonable and supportable forecasts

- CECL is forward-looking in nature, a key change from the current incurred loss model
- CECL expands adjustments to also include reasonable and supportable future forecasts that affect expected collectability
  - May be economic data points, or other data points that impact collectability such as delinquency or credit quality migration
- Loss drivers identified in initial pooling/segmentation exercise may be a foundation for reasonable and supportable forecast data points
- Will require documentation to support establishment of the relevant data points, the direction and magnitude of the adjustments, the length of the forecasts and data sources

Adjustments for reasonable and supportable forecasts (cont.)

- Potential sources of information for a forecast include:
  - Publically available external forecasts
  - Internal experts
  - External experts
- Some companies that have already adopted are using external sources for this data, but this is not required under the standard and can be performed in-house

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Adjustments for reasonable and supportable forecasts (cont.)

- When a third-party service provider or source is used, consider the following:
  - Obtaining and maintaining a thorough understanding of how the third party obtained or derived the data and how it knows it is reliable, complete, and accurate as the third party's assumptions become management's assumptions
  - Relevance of the third-party data to the company - - information provided needs to be responsive (correlated) to the specific pools and characteristics of the client's portfolio

Adjustments for reasonable and supportable forecasts (cont.)

- Be mindful of local, regional, institutional, and asset-specific factors
  - For example, a known factory closure or government funding that will bring jobs to an area may have an impact on collectability and should be included, but may not have been in third party or more globally directed projections/publications
- Forecasting is at the input level, so an institution may be able to forecast one input for two years and another for three years
- Reasonable and supportable forecasts may change over time
  - In times of stability, may be able to forecast longer
  - In times of uncertainty, forecast period may be shorter

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Adjustments for reasonable and supportable forecasts (cont.)

- As part of management's estimation process, it is recommended to incorporate some form of regular validation for assumptions and inputs, specifically the reasonable and supportable forecasts
  - Audit expectation that management will have a process and control in place to continually go back and challenge its existing methodology, including how it arrives at significant assumptions such as expected recoveries and reasonable and supportable forecasts
  - Generally, would involve obtaining validation support from the source, SOC I Type II reports, and (or) independently comparing actual results to estimated or forecasted
  - Specifically, "backtesting" (retrospective review) may help the company evaluate its reasonable and supportable forecasts

Reversion period

- Reversion period refers to the time between the reasonable and supportable forecast period and the contractual term
- ASC 326-20 requires that the entity revert back to historical losses after the reasonable and supportable forecast period
  - May be less significant for SF entities if their contractual terms are short and they can forecast the entire period
- Need to consider the method(s) of reversion and the length of the reversion period(s)
  - Does not need to simply be a straight-line reversion over the remaining contractual term, but could be straight line over a period followed by an immediate reversion to historical losses or an immediate reversion
  - The reversion period may not be a singular period and may differ from portfolio segment to portfolio segment and year to year
- Consider the nature of the portfolio, the economic conditions and its loss history relative to its future expected losses when identifying the appropriate reversion period(s)

Zero expected losses

- There is a presumption that financial assets have a loss amount associated with them under the expected losses model
  - As a reminder, the unamortized discount associated with purchased receivables cannot be considered when establishing reserves
- Should include measure of expected risk of loss even if risk is remote or historical losses show no loss history over the contractual term
- May reach conclusion that expected credit loss is zero based on practical expedient or historical loss information adjusted for current conditions and reasonable and supportable forecasts
  - The latter is considered the exception, not the norm

PRACTICAL EXPEDIENTS AND POLICY ELECTIONS

Practical expedient: Collateral dependent financial assets

- Will only apply to secured financing receivables
- The fair value of the collateral at the reporting date may be used on a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity’s assessment as of the reporting date
- Fair value of collateral should be used when foreclosure is probable
- Factor in selling costs if expected to be repaid through sale
- One of few instances in which $0 allowance may be reasonable

Policy elections: Accrued interest

- Policy election 1 – allowance for accrued interest receivable
  - If an entity writes off accrued interest receivable in a timely manner and makes certain disclosures, the entity may elect to not measure an allowance for credit losses on accrued interest receivable
    - Election made at the class of financing receivable level
    - Note that “timely manner” is not defined and will require a certain level of judgment and supporting documentation when making this election
  - If no policy election is taken, will need to reflect the allowance for accrued interest receivable either as a separate calculation or as a component of the calculation of the allowance covering the total amortized cost
- Policy election 2 – write-offs of accrued interest receivable
  - By class of financing receivable, may make an election to write-off accrued interest by:
    1. Reversing interest income
    2. Recognizing credit loss expense
    3. Combination of both
  - Certain disclosures are required based on the policy elected

Policy elections: Accrued interest (cont.)

- Policy election 3 – disclosure of accrued interest receivable and associated allowance (as applicable)
  - Present net accrued interest receivable as either:
    - A separate line item in the balance sheet, or
    - Included in another line item with other balances, with separate note disclosure of where it is disclosed and the amount
  - If not elected, have to include in the line item that includes the remaining elements of amortized cost basis (i.e., line item with financing receivables)

Practical expedient: Accrued Interest

- May exclude applicable accrued interest included in the amortized cost basis for disclosures required under ASC 326
  - If applied, should disclose the total of accrued interest excluded from disclosed amortized cost basis as a single balance within the financials/notes

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FAIR VALUE OPTION

ASU 2019-05

- ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*, was issued in May 2019
- Provides an option for entities with certain financial instruments to ***irrevocably*** elect the fair value option (ASC 825-10) upon adoption of CECL
  - Can be elected on an instrument-by-instrument basis
  - Must be applied at adoption date and applied to financial assets previously held at amortized cost
  - Cannot be applied to held-to-maturity debt securities
- Most interest in this approach has been from those with short duration products, those that commonly lend to subprime borrowers, those in the auto finance industry, and those that purchase contracts at a significant discount
- Entities need to weigh the cost/benefit of this approach

Want to learn more about the fair value option and CECL?

Tune in to our webcast, *ASC 326-20 (CECL) and the Fair Value Option*, on May 26 for a deep dive into the topic

EXAMPLE METHODS

Methods overview

- No single method is suggested or required under ASC 326-20
- Multiple methods may be used
  - Many entities are finding that different methods work better for different portfolio segments
- Goal is to identify the method or combination of methods that best estimates expected credit losses based on the nature of the pools/segments, the relevant loss drivers and other factors

Possible methods

Loss rate approach**

- Snapshot
- Vintage
- Weighted-average remaining maturity (WARM)

Aging**

Discounted cash flow (DCF)

Roll-rate / migration

Probability of default / loss given default (PD/LGD)

Regression

Focus of today's presentation – please reach out with questions on other methods

Loss rate approach: Snapshot method

- Takes a snapshot of the portfolio at a point in time (e.g., as of a particular period end or date – current or past) and tracks performance of that portfolio until ultimate disposition
- Applies historical, lifetime charge-off rate associated with snapshot to amortized cost basis (or component of amortized cost basis to which it applies) as of measurement date

$$\frac{\text{Total charge-offs associated with snapshot}}{\text{Snapshot portfolio balance } \textit{(as of initial snapshot date)}} = \text{Historical lifetime charge-off rate associated with snapshot}$$

Loss rate approach: Snapshot method (cont.)

Year End	Amortized Cost	Charge-offs Associated with 2015 Snapshot Balance
2015	$ 9,350	
2016	9,398	$ 32
2017	10,779	32
2018	11,150	14
2019	10,738	9
2020	10,000	2
	2015 Pool's cumulative charge-offs (a)	$ 88
	2015 Amort cost (b)	$ 9,350
	Unadjusted lifetime historical charge-off rate (a)/(b)	0.94%
	Qualitative adjustments	0.25%
	Total allowance for credit losses ratio as of 2020 (c)	1.19%
	2020 Amort cost (d)	$ 10,000
	Total allowance for credit losses as of 2020 (c)x(d)	$ 119

Simplified for illustration purposes - the example above does not factor in any qualitative adjustments for current conditions or forecasted events.

Source: Ask the Regulators: CECL Teleconference for Bankers: Practical Examples of How Smaller, Less Complex Community Banks can Implement CECL

Loss rate approach: Vintage method

- Vintage = origination year
- Tracks charge-offs in each period associated with vintage and uses the average of those over a number of vintages to estimate future charge-offs for the respective period (e.g., use year 1 charge-off history for various vintages to estimate year 1 charge-offs for current portfolio)

Loss rate approach: Vintage method (cont.)

Origination		Charge-offs (%)					Remaining Lifetime	Remaining Lifetime
Amount	Date	Period 1	Period 2	Period 3	Period 4	Period 5	Charge-offs (%)	Charge-offs ($)
$ 5,500	2015	0.04%	0.35%	0.25%	0.15%	0.04%	N/A	N/A
$ 5,000	2016	0.04%	0.70%	0.30%	0.16%	0.04%		
$ 3,500	2017	0.00%	0.50%	0.23%	0.15%	0.04%		
$ 3,100	2018	0.04%	0.45%	0.26%	0.15%	0.04%		
$ 3,100	2019	0.02%	0.50%	0.26%	0.15%	0.04%		
$ 2,940	2020	0.03%	0.50%	0.26%	0.15%	0.04%		

($ in thousands)

	Period 1	Period 2	Period 3	Period 4	Period 5
Average charge-off rate	**0.03%**	**0.50%**	**0.26%**	**0.15%**	**0.04%**

Simplified for illustration purposes - the example above does not factor in any qualitative adjustments for current conditions or forecasted events.

Source: Ask the Regulators: CECL Teleconference for Bankers: Practical Examples of How Smaller, Less Complex Community Banks can Implement CECL

Loss rate approach: Weighted Average Remaining Maturity (WARM)

- Uses average annual loss rates and remaining life to estimate charge-offs
- Can likely leverage off existing methodology and continue to use average annual loss rates as do in the incurred loss model
  - Supported by the FASB as a potential option for smaller, less complex portfolios
- Apply the average annual loss rates to expected balances over the remaining life (contractual term)
  - Expected balances would reflect no new originations, expected prepayments and pay downs (i.e., estimate the amortized cost over remaining periods in the contractual term and apply average annual loss rate to each balance)
  - Entities will need sufficient documentation to support expected prepayments/paydowns

Loss rate approach: WARM (cont.)

Year End	*Est. Paydown*	Projected Amort Cost	Avg Annual Charge-off Rate	Allowance for Credit Losses
	2020 Actual Amortized Cost	*10,000*		
2021	*3,849*	6,151	0.36%	36
2022	*2,528*	3,623	0.36%	22
2023	*1,828*	1,796	0.36%	13
2024	*1,208*	588	0.36%	7
2025	*588*	-	0.36%	2
			Estimated unadjusted lifetime charge-off amount	$ 80
			Unadjusted lifetime historical charge-off rate	0.80%
			Qualitative adjustments	0.25%
			Total allowance for credit losses rate as of 2020	1.05%
			Total allowance of credit losses as of 2020 ($10,000 x 1.05%)	$ 105

Simplified for illustration purposes - the example above does not factor in any qualitative adjustments for current conditions or forecasted events.

Source: Ask the Regulators: CECL Webinar: Weighted-Average Remaining Maturity (WARM) Method

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Aging

- Relies on the tracking of historical loss data based on the past due status of the financial assets (i.e., losses that occur once a financial asset reaches a certain delinquency status)
- The credit loss rate associated with a specific past due bucket is applied to the amortized cost basis of that past due bucket as of the balance sheet date, then adjusted for qualitative factors (current and forecast)

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Estimating expected credit losses for trade receivables using an aging schedule (adapted from ASC 326-20-55-37 to 55-40)

Assigned an expected loss rate to all receivables, including those that are current. Some entities in the past may not have recognized an allowance on current receivables, but now may need to in light of the requirement to consider even remote risks of loss.

Aging	Amortized Cost Basis	Historical Losses	Expected Decrease	Projected Losses	Expected Credit Loss Estimate
Current	$ 5,984,698	0.3%	10.0%	0.27%	$ 16,159
1 - 30 days past due	8,272	8.0%	10.0%	7.20%	596
31 - 60 days past due	2,882	26.0%	10.0%	23.40%	674
61 - 90 days past due	842	58.0%	10.0%	52.20%	440
> 90 days past due	1,100	82.0%	10.0%	73.80%	812
	$ 5,997,794				$ 18,681

Current composition of receivables deemed consistent with historical period; however, current and forecasted economic conditions have improved, warranting 10% decrease to historical loss rates to arrive at projected losses

PLANNING FOR IMPLEMENTATION AND FINAL REMINDERS

Reminder: Steady build-up of reserves over time

- Continue to use the existing incurred loss model until CECL becomes effective
- Any unallocated reserves, changes in unamortized discounts or adjustments to historical losses that are in anticipation of adoption of CECL are <u>not</u> GAAP

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Planning for implementation - initial considerations

- Analyze standard/understand where you are versus where you need to be
- Identify a multidisciplinary implementation team and develop a detailed implementation plan
- Weigh benefits of modifications to existing approaches, systems, applications versus investing in new
- Identify resource needs (internal or external personnel / solutions)
- Decide how to obtain or develop reasonable and supportable forecasts and how to adjust historical information as a result
- Begin considering and gathering data by asset type such as:
  - Lifetime historical loss information
  - Vintage data
  - Contractual life and prepayment information
  - Correlation of historical losses to various economic environments, underwriting conditions, etc.

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Planning for implementation - documentation

- Prepare or modify existing allowance policy to document how the entity complies with the provisions of ASC 326
  - Document as you go, and document all items considered (not just those selected)
- Prepare or modify existing allowance procedures to document the approach for calculating and reviewing the allowance
- Prepare or enhance documentation surrounding adjustments to historical losses, including those for current conditions and reasonable and supportable forecasts
  - Documentation should focus on establishing the correlation between data points and expected losses and how the adjustments are established (i.e., how magnitude is determined)
  - If adjustments are not deemed necessary, provide documentation as to why
  - Note that this documentation should be prepared each time the allowance is calculated and should be part of the review process/controls
- Discuss plans with auditors and share documentation discussed above for initial reviews and feedback
  - The audit approach for CECL will generally involve getting behind management's estimate, so clear documentation supporting all decisions / assumptions made and compliance with ASC 326-20 will be critical

Planning for implementation - other

- Develop new processes and internal controls, particularly as they relate to elements not previously subject to internal controls (e.g., implementation specific matters, forecasts, certain data points)
  - Do not forget to consider changes to processes and controls related to modifications
- Consider running a parallel model for as many quarters as possible to see impact and to fine-tune the model
- Monitor regulatory and other developments in how the ASU is interpreted and applied, including implementation/disclosures of public companies
- Manage expectations and prepare to disclose the impact of adoption to investors/users
- Consider if any changes to credit extension or investment philosophy are warranted
- Consider impact on forecasting, budgeting and covenant compliance
  - Particularly relevant if electing the fair value option, which may increase income volatility

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RESOURCES

Resources

- RSM Thought Leadership
  - Financial Reporting Resource Center: Financial Institutions
    - http://rsmus.com/what-we-do/services/assurance/financial-reporting-resource-center/financial-reporting-resource-center-financial-institutions.html
  - *A guide to accounting for investments, loans and other receivables*
    - https://rsmus.com/what-we-do/services/assurance/a-guide-to-accounting-for-investments-loans-and-other-receivable.html
  - *Implementation and audit readiness for lenders: ASC 326*
    - *https://rsmus.com/our-insights/newsletters/financial-reporting-insights/implementation-and-audit-readiness-for-lenders-asc-326.html*

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Resources (cont.)

- FASB Accounting Standards Update
  - https://fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498
  - Lists Accounting Standards Updates Issued by year
- Interagency Joint Statements on CECL
  - https://www.fdic.gov/news/financial-institution-letters/2020/fil20054.html
  - See Related Topics section as bottom for links to series of joint statements
  - Though established by federal bank and credit union regulators, concepts are still relevant to those that may not be regulated by these parties
- AICPA Accounting for Credit Losses Resource Center
  - https://www.aicpa.org/interestareas/frc/accountingfinancialreporting/financialinstruments.html
- FASB Transition Resource Group for Credit Losses
  - https://www.fasb.org/page/index?pageId=standards/Transition.html

Resources (cont.)

- Webinar on practical methods for smaller institutions
  - Link to PDF slides and recorded webcast - https://www.webcaster4.com/Webcast/Page/583/24368
- Webinar on WARM method
  - Link to recorded webcast (slide deck in materials once registered) - https://www.webcaster4.com/Webcast/Page/583/29509
- FASB Staff Q&A – WARM
  - https://www.fasb.org/cs/ContentServer?c=Document_C&cid=1176171932989&d=&pagename=FASB%2FDocument_C%2FDocumentPage

Resources (cont.)

- FASB Staff Q&A – Developing an Estimate of Credit Losses
  - https://www.fasb.org/cs/Satellite?c=FASBContent_C&cid=1176172971977&pagename=FASB%2FFASBContent_C%2FGeneralContentDisplay
- CAQ Tool for Audit Committees
  - https://www.thecaq.org/preparing-for-the-new-credit-losses-standard-a-tool-for-audit-committees/
- Ask the Regulators: Applying Model Risk Management to CECL Models at Large Banks
  - Link to recorded webcast (slide deck in materials once registered) - https://www.webcaster4.com/Webcast/Page/583/31365

QUESTIONS AND ANSWERS

THANK YOU FOR YOUR TIME AND ATTENTION

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