NYU Stern’s Ross and Salomon Roundtable on CECL: Transparency or Opacity? Implementation and Effects on Lending and Pro-Cyclicality

October 28, 2019
CECL: Transparency or Opacity?
Implementation and Effects on Lending

Hal Schroeder
FASB Member
October 28, 2019

The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.
Recent . . .
Stop & Study?

Opinion: A new accounting rule on loan losses could be disastrous for the economy

FASB’s new rule will find losses where none exist.

A broken accounting system in need of repair

BankThink CECL spells trouble for small banks, consumers

‘Absolutely devastating’ to small lenders: Lawmakers lay into CECL

New bill sits on Senate agenda to block, study CECL

Congressman Introduces Bill Requiring FASB to Study New Standards

Proposal follows lawmakers’ efforts in recent months to delay and further study a controversial rule on credit losses.

ABA’s Guillet: CECL Could Imperil Credit in Economic Downturn

The Wall Street Journal

Banks Take Fight Against New Loan-Loss Rule to Washington

Both House and Senate craft proposals to delay CECL implementation
Transparency . . .
Markets (Investors)

Price-to-Book
Non-financials

Price-to-Book
Financials

Price-to-Book
Difference

What did investors know?

2007 - 2009
Great Recession

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Transparency... Investors Estimate, Regardless

<table>
<thead>
<tr>
<th>Year</th>
<th>Significant Increase in Credit Risk</th>
<th>Before</th>
<th>Great Recession</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
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</tbody>
</table>

Devaluation of US commercial banks begins & peaks before recession.

Risk rises... Loan $ + 35%
But reserves hit multi-decade lows
LLR $ - 10%
LLR % 1.15%

During recession...
Loan $ - 2%
But reserves hit historic highs...
LLR $ +140%
LLR % 3.29%

... as valuations head toward normal.
## Transparency . . . Alternatives Considered

<table>
<thead>
<tr>
<th>Ignore Losses</th>
<th>CECL—Day 1</th>
<th>CECL—Split 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Results in ever-increasing pool of “non-bankable assets” (i.e., no value)</td>
<td>• Focus on amounts lent &amp; expected to collect; difference is allowance with changes in NI</td>
<td>• “CECL-compliant” reserve, with next 12-months NCOs expensed in NI &amp; remainder in OCI</td>
</tr>
<tr>
<td>Defer &amp; Amortize</td>
<td>Hybrid—Lower Threshold or Period</td>
<td>CECL—Spread</td>
</tr>
<tr>
<td>• Amortize pool of “non-bankable assets’ similar to S&amp;L “supervisory goodwill” used in 1980s</td>
<td>• “more likely than not” threshold or “reasonable &amp; supportable” time period</td>
<td>• “CECL-compliant” reserve, offset by likely “non-bankable asset” amortized over time</td>
</tr>
<tr>
<td>Defer Until Loans Charged Off</td>
<td>Incurred—Probable</td>
<td>Fair Value</td>
</tr>
<tr>
<td>• Aligns book &amp; tax accounting; eliminates DTA, but delays losses</td>
<td>• Current model investors ignored starting roughly two years before crisis</td>
<td>• Considers all cashflows including interest income; rejected in 2010 by banks and investors</td>
</tr>
</tbody>
</table>

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1) Alternative mentioned by a few regional banks in 2018 comment letters to Federal Reserve regarding regulatory capital; modified in 11/5/18 agenda request sent to FASB. Investors also have strongly supported separating the provision expense between newly originated loans and revisions to prior estimates. During CECL deliberations the Board considered such alternatives, however banks strongly opposed any separation citing various cost and complexities concerns. Based on this feedback, the Board didn’t require any separation of the provision expense.
Transparency . . . Comparability

Contractual + Renewals

How much?

Risk Exposure

12 months

Contractual Life

Allowance by Period

Current US GAAP [as written]
Current US GAAP [as applied]
CECL

Current

Initial

Revised

Actual

"Day 1"
EOP 1
EOP 2
EOP 3
EOP 4
EOP 5

Day 1

"Probable" Threshold

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Transparency . . . Enhanced Disclosures

Current GAAP

<table>
<thead>
<tr>
<th>Term Loans</th>
<th>20X5</th>
<th>20X4</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of December 31,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential Mortgage:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk Rating:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 – 2 internal grade</td>
<td>34,614</td>
<td>37,122</td>
</tr>
<tr>
<td>3 – 4 internal grade</td>
<td>23,076</td>
<td>24,748</td>
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<tr>
<td>5 internal grade</td>
<td>43,477</td>
<td>44,651</td>
</tr>
<tr>
<td>6 internal grade</td>
<td>2,385</td>
<td>2,636</td>
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<tr>
<td>7 internal grade</td>
<td>294</td>
<td>708</td>
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<tr>
<td>Total residential mortgage loans</td>
<td>103,846</td>
<td>109,865</td>
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<tr>
<td>Residential Mortgage loans:</td>
<td></td>
<td></td>
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<tr>
<td>Current-period gross writeoffs</td>
<td>110</td>
<td>220</td>
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<tr>
<td>Current-period recoveries</td>
<td>11</td>
<td>8</td>
</tr>
<tr>
<td>Current-period net writeoffs</td>
<td>99</td>
<td>212</td>
</tr>
</tbody>
</table>

Future GAAP

<table>
<thead>
<tr>
<th>Term Loans</th>
<th>Amortized Cost Basis by Origination Year</th>
<th>20X5</th>
<th>20X4</th>
</tr>
</thead>
<tbody>
<tr>
<td>As of December 31,</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential Mortgage:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk Rating:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 – 2 internal grade</td>
<td>8,313</td>
<td>7,784</td>
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<tr>
<td>3 – 4 internal grade</td>
<td>5,542</td>
<td>5,190</td>
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<tr>
<td>5 internal grade</td>
<td>12,673</td>
<td>9,117</td>
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</tr>
<tr>
<td>6 internal grade</td>
<td>695</td>
<td>500</td>
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</tr>
<tr>
<td>7 internal grade</td>
<td>86</td>
<td>62</td>
<td></td>
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<tr>
<td>Total residential mortgage loans</td>
<td>27,309</td>
<td>22,653</td>
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</tr>
<tr>
<td>Residential Mortgage loans:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current-period gross writeoffs</td>
<td>29</td>
<td>21</td>
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</tr>
<tr>
<td>Current-period recoveries</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Current-period net writeoffs</td>
<td>99</td>
<td>212</td>
<td></td>
</tr>
</tbody>
</table>

Trust, but verify!

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Provision Expense as % of Gross Loans

NBER Recessions in Gray

<table>
<thead>
<tr>
<th>Timing</th>
<th>Qtr</th>
<th>Average Incurred</th>
<th>Average CECL</th>
<th>Incurred vs CECL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher Risk (2004 to 2006)</td>
<td>12</td>
<td>0.14%</td>
<td>0.26%</td>
<td>-0.12%</td>
</tr>
<tr>
<td>Year before Recession (2007)</td>
<td>4</td>
<td>0.29%</td>
<td>0.56%</td>
<td>-0.27%</td>
</tr>
<tr>
<td>Recession (2008 to 1H2009)</td>
<td>6</td>
<td>0.80%</td>
<td>0.68%</td>
<td>+0.12%</td>
</tr>
<tr>
<td>%Change from 2004 to 2006</td>
<td></td>
<td>+470%</td>
<td>+163%</td>
<td></td>
</tr>
<tr>
<td>Post-Recession (2H2009 to 2010)</td>
<td>6</td>
<td>0.72%</td>
<td>0.41%</td>
<td>+0.31%</td>
</tr>
<tr>
<td>%Change from 2004 to 2006</td>
<td></td>
<td>+415%</td>
<td>+59%</td>
<td></td>
</tr>
<tr>
<td>Normalized Risk (2011 to 2013)</td>
<td>12</td>
<td>0.21%</td>
<td>0.22%</td>
<td>-0.01%</td>
</tr>
<tr>
<td>Full Cycle (2003 to 2013)</td>
<td>40</td>
<td>0.36%</td>
<td>0.36%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

Source: Analysis based on quarterly Federal Reserve Bank Y9C data.

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Lending . . . Pro-cyclicality

Rises 29% from beginning of recession to reach peak

Rises 264% from beginning of recession to reach peak

Peaks in 1Q2009 5 quarters after recession begins

Peaks in 1Q2010 9 quarters after recession begins

“. . . we observe a greater reduction in lending during recessions by banks that delay expected loss recognition more compared with banks that delay less.”

Beatty & Liao (2011)


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Lending . . . Less Loans vs Buybacks

Source: Analysis based on loan data for all FDIC-insured commercial banks and buyback data provided by KBW.
Implementation . . . Benefits Justify Costs

What we’re hearing . . .

“Business Approach” versus “Compliance Exercise”?

Time to . . .
- Clean up data
- Improve internal controls
- Enhance estimation processes

Improvements in . . .
- Risk Management
- Pricing
- Capital Allocation
- Credit Decisions

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Notable Events . . .

Regulation . . .

October 2018, trade associations’ letter sent to Financial Stability Oversight Council chair seeking “delay in implementation until such a study can be completed.”

September 2018, CECL focus of roundtable hosted by three congressmen to facilitate discussion of “regional bank proposal.”

December 2018, FSOC discussed CECL, minutes state “the OCC believes CECL is an improvement.”

“Stop-and-Study” movement seeks a “legislative fix” with bills proposed in both the House and the Senate.

Legislation . . .

August 2019, CECL and the Credit Cycle study, published in Federal Reserve’s Finance and Economics Discussion Series, “shows that a disproportionate share of the associated provision expenses occurs prior to the recession under CECL, rather than during it.”

Proposed House bill to require FASB “to consider, in adopting accounting principles, the impact such principles will have on the broader U.S. economy, market stability, and availability of credit.

Study-only directives attached to both the House and the Senate appropriations bills. Requests directed toward others including the SEC and the U.S. Treasury, but not to the FASB. Senate version seeks study to assess need for a change to regulatory capital; not to CECL.

Possible release of studies responsive to directives attached to any final appropriations bills?

FASB staff meet with financial and nonfinancial entities, other stakeholders. Views heard very consistent with comments at January 2019 public roundtable—splitting provision, with a portion flowing through net income and the remainder in OCI, was not operational. No surprise; banks—large and small—provided same feedback in 2013, when Board explored same idea.

August 2019, FASB considers change in philosophy to extend and simplify how effective dates are staggered between larger public companies and all other entities.

2H18

November 2018, modified version of “regional bank proposal” formally submitted to FASB.

1Q19

April 2019, FASB declined further consideration of “regional bank proposal.”

2Q19

October 2019, FASB vote whether to delay CECL until 2023 for smaller public and all private entities; roughly 90% by number, but only 10% of industry assets.

3Q19

1Q20, CECL required for larger public banks . . . the 10% / 90%.

4Q19

1Q23, CECL required for remaining 90% / 10%.

2020

Passage of appropriations bill? Reconciliation process? Continuing resolution?

2023

Proposed House bill to require FASB “to consider, in adopting accounting principles, the impact such principles will have on the broader U.S. economy, market stability, and availability of credit.

August 2019, FASB considers change in philosophy to extend and simplify how effective dates are staggered between larger public companies and all other entities.

Possible release of studies responsive to directives attached to any final appropriations bills?
Michael Gullette
Senior Vice President

October 28, 2019
CECL thru Financial Crisis: Resi Mtg.

Reserve Analysis - Mortgage
"CECL" Modeled Historical vs Actual Reserves

L/T Economic Forecast
Perfect Foresight
Incurred

“Perfect Foresight”
CECL thru Econ Cycle: 70% C&I
## CECL Preliminary Estimates

<table>
<thead>
<tr>
<th>Category</th>
<th>Current</th>
<th>As Of May 2019</th>
<th>“ABA Snapshot”</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Banks $1-10B</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-4 family 1st</td>
<td>70</td>
<td></td>
<td>103-132</td>
</tr>
<tr>
<td>CRE no-own</td>
<td>88</td>
<td></td>
<td>112-119</td>
</tr>
<tr>
<td>C&amp;I</td>
<td>157</td>
<td></td>
<td>95-105</td>
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<tr>
<td>CC</td>
<td>448</td>
<td></td>
<td>560-610</td>
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<td>Auto</td>
<td>128</td>
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<td>155-159</td>
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<td></td>
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<td>High Stress</td>
<td>Low Stress</td>
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<td></td>
<td>380-470</td>
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<td>417-559</td>
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<td>314-347</td>
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<td>800-823</td>
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<tr>
<td></td>
<td></td>
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<td>391-438</td>
</tr>
</tbody>
</table>

CECL Roundtable

Joshua Ronen

October 28, 2019
CECL

Loss on Origination

CECL requires recognition of full lifetime expected credit losses upon initial recognition of an asset
Discounted Cash Flow Method Uses the Contractual Rate, not the Hurdle Rate

The entity shall discount expected cash flows at the financial asset’s effective interest rate.

When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows.

The effective interest rate is defined in the standard as the contractual rate: “the rate of return implicit in the financial asset, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset”
Rational Lenders will Avoid Losses

The standard ignores that lenders will rationally increase interest rates to compensate for whatever default risk and consequent non-payment of principal and/or interest they anticipate over the lifetime of the loan.

Hence, rational lenders expect not to incur economic losses upon origination.
Hypothetical Loan Example

Loan of $1000 with 3-year maturity, a face value of $1000 and annual interest payments:

- Hurdle rate assuming no expected non-collections: 10%
- Expect non-collection of $100 of principal on maturity
- Contractual rate: 13.0213% to make lender whole
- Annual interest expected to be fully received over the 3 years

PV at 10% discount rate = $1000, the amount of loan extended.
Use of Contractual Rate Creates Fake Losses

PV at 13.0213% as required by the Standard = $930.73

Reported credit loss = $69.27, about 7% of the loan.

Economic loss = $0

*Fake loss* = $69.27.

* To avoid a loss, lender would need to charge an interest rate of 4.694% !!!
What if the Lender Does not Make Itself Whole?

Irrational lenders or those who for business reasons purposefully fail to cover expected losses will properly suffer accounting losses that equal the economic losses by using the hurdle rate.

- PV of expected cash collections at 10% = $924.87
- Reported credit loss = Economic loss = $1000 - $924.87 = $75.13

How to estimate the hurdle rate? Use the rate charged on loans with no expected losses.

Implication for regulation: use the hurdle rate.
Conclusion

- CECL penalizes rational lenders who cover themselves against credit losses by requiring the discount rate to be the contractual rate.
- CECL creates accounting losses on origination when there is no economic loss. This is not transparent accounting.
- Loan growth will increase recorded credit loss over time.
- This will adversely affect capital, hence reducing lending, especially to poorer, high credit risk borrowers.
- Cure: Change the estimation method such that only economic losses are reflected as accounting losses upon origination. This can be done by using the hurdle rate.
- When lenders do not adjust for expected losses, requiring them to use the hurdle rate will give rise to accounting losses that equal the economic loss. This will induce them to be prudent.
- If GAAP is not amended, regulators should require the change into a hurdle rate.
CECL Model

Current Expected Credit Losses (CECL)

Lifetime Expected Credit Losses recorded at origination

EARLIER RESERVE RECOGNITION

- Good for bond holders
- Mismatch to income recognition

HIGHER VOLATILITY

- Consider reasonable and supportable forecasts

- No specific required methodology
  - DCF, PD/LGD, roll rates
  - Significant optionality (e.g. credit card paydown assumptions)

REDUCED COMPARABILITY
Moody’s Banking Methodology – Financial Profile

Schematic of Financial Profile

RISKS

Asset Risk
Weight: 25%

Capital
Weight: 25%

Profitability
Weight: 15%

Solvency
Total Weight: 65%

RISK MITIGANTS

RISKS

Funding Structure
Weight: 20%

Liquid Resources
Weight: 15%

Liquidity
Total Weight: 35%

Financial Profile

Source: Moody’s Investors Service
CECL – Impact on Rating Methodology

» No change to our rating methodology – historically we have not seen accounting changes impacting the rating methodology
  - Unless the accounting change results in a change in business practices
  - Which we will monitor closely subsequent to implementation

» Capital scores will generally go down on day 1 for US banks

» However, we do not expect to change the scorecard as a result of CECL implementation
  - These are global metrics that should not change when accounting in one jurisdiction changes
  - We have had a similar change under IFRS 9 recently

» Moody’s scorecard capital metrics
  - Are based on USGAAP amounts without regulatory phase-in adjustments
  - Are just the starting point of our analysis – analytical judgement is applied to arrive to final assigned scores
The underlying economics do not change so we do not expect ratings to change solely as a result of the CECL implementation

Ratings are relative and all issuers will be impacted

Outliers with a larger impact than peers will have to be analyzed

Determine if the forward looking capital position has changed

- We will inquire and consider capital actions the company plans to take

Determine if the new accounting provides information that we had already considered analytically in the assigned score

- Fast growth or higher risk portfolios - qualitative factors already considered in assigned ratings
- Forward looking information already considered as part of our assessment

OR – this brings out new information that we were not aware about the issuer AND it has a potentially significant impact on the credit assessment
Access is everything™

Expertise
A comprehensive view of the global markets through our ratings and research.

Credibility
Over 100 years of experience delivering forward-looking, independent, stable and transparent opinions.

Engagement
Meaningful interactions across multiple channels between our analysts and market participants.
US Current Expected Credit Losses (CECL) Industry Benchmark Study

Project review for NYU
Nathaniel Royal, Global Credit Data
The hypothetical portfolio is composed of a set of loans chosen to provide coverage of various types of asset classes/borrowers, exposures and facilities, fit to the US market.

<table>
<thead>
<tr>
<th>ASSET CLASS / BORROWER TYPE</th>
<th>ASSET CLASS / BORROWER TYPE</th>
<th>ASSET CLASS / BORROWER TYPE</th>
<th>ASSET CLASS / BORROWER TYPE</th>
<th>ASSET CLASS / BORROWER TYPE</th>
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### Illustrative (Large Corporates)

<table>
<thead>
<tr>
<th>Obs#</th>
<th>Geography</th>
<th>Credit Quality</th>
<th>Loan Term</th>
<th>Secured Type</th>
<th>Origination Exposure</th>
<th>Revolver Utilization</th>
<th>Loan Type</th>
<th>Amortization Method</th>
<th>Interest Rate Type</th>
<th>Reference Curve</th>
<th>Interest Rate</th>
<th>Historical Loss Rate</th>
<th>Annualized Prepayment Rate</th>
<th>Loss Estimate</th>
<th>Lifetime ECL</th>
<th>R&amp;S Period ECL</th>
<th>Mean Reversion Period</th>
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<td>U.S. A</td>
<td>1</td>
<td>1</td>
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<td>0.5</td>
<td>Revolving</td>
<td>Revolving</td>
<td>Floating</td>
<td>LIBOR</td>
<td>2.75%+50bps</td>
<td>5 bps</td>
<td>0.5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>U.S. BB</td>
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<td>Secured</td>
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<td>Revolving</td>
<td>Revolving</td>
<td>Floating</td>
<td>LIBOR</td>
<td>2.75%+100bps</td>
<td>30 bps</td>
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<td>Fixed</td>
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<td>LIBOR</td>
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<td>30 bps</td>
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Project Returns Example: Focused Insights

The considerable variability in the initial benchmarking results suggests that some banks can improve significantly the level and variability of their ALLL and PLLL estimates through targeted changes.

Variability of CECL at Borrower Level

- In the study we also focus on the variability for the various hypothetical borrowers for different portfolios, characterized by the various risk drivers.
- For the sample in hand, the variability of the ECL changes with the risk drivers. The riskier the exposure, the lesser the consensus on the ECL.
- The value of a particular bank is displayed as an orange dot/line, helping the bank understand their models better.

Variability in Model Components over the Life of the Product

- Variability in PD (EAD, LGD) Models is an important driver in explaining variability in CECL among banks.
- Banks vary in the 1-year PiT (starting point) as well as in the “steepness” of the curve.
- The value of a particular bank is displayed as an orange dot, helping the bank understand their models over the time.
The News

- There is variability amongst banks on their losses; sometimes a great deal
  - So what
  - Oh no!
- The overall effect CECL will have on banks bottom lines
  - No sure
  - Modelers and their models
    - But will the models be effective?
      - Model use will depend on bank management.
      - Are the parameters and scenarios used close enough to enough?
- Outlook: A post CECL returns future: examining each bank’s the methodology
  - Who did it “better”
    - Will cross-evaluation be effective in achieving better models?
The Effect of the Current Expected Credit Loss Standard (CECL) on the Timing and Comparability of Reserves

Sarah Chae, Robert Sarama, Cindy Vojtech, and James Wang

New York University, Stern School of Business

October 28, 2019
The views expressed in this presentation represent those of the authors, and are not necessarily those of the Federal Reserve Board or the Federal Reserve System.
Figure: Delinquencies, ALLL, and Provisions as a Percent of Total Loans

Empirical Design - Overview

Compare CECL to incurred in a simple stylized model

- When and how fast are reserves built under CECL vs incurred?
  - Examine the timing of peaks and the volatility of provisioning

- What is the impact of different forecast assumptions on CECL?
  - Ideal: Perfect forecast of the HPI path
  - Optimist: Constant 0.5% monthly HPI growth
  - AR: HPI forecast using an autoregressive trend
  - Hybrid: 6 months of perfect forecast and then revert to flat

- What is the impact of more frequently updating macro forecasts?
  - 24, 12, 6, 3 month scenario update cycles
Empirical Design - Implementing CECL

- **Data**
  - 30-yr fixed, first-lien mortgages
  - Originated in California 2002 - 2015
  - 1% sample from McDash servicer data

- **CECL guidance: a “reasonable and supportable” forecast period**
  - Point in Time: Condition on forecasted HPI for 2 years
  - Through the Cycle: Afterwards, revert to long run HPI

- **Flexible econometric model for default and prepayment**
  - Specification includes seasoning, LTV, and FICO
  - Update LTV following HPI forecasts
  - CECL = EL for the current loans + losses for defaulted loans assuming constant LGD

- Changing the HPI forecasts is the driver of the various scenarios
Interpolated Reserves and Idealized CECL - Perfect Foresight

Reserves under CECL are less procyclical and less volatile.

What if forecasts are not perfect?

Chae, Sarama, Vojtech, and Wang (FRB) 10/28/19
Optimistic Forecasts at Varying Cycles

![Graphs showing forecasts revised at different cycles](image)

Key:
- **CECL with Perfect Foresight**
- **CECL with Optimistic Fcast**
- **CA HPI (right axis)**
- **HPI with Optimistic Fcast**
AR Forecasts at Varying Cycles
CECL with Limited Perfect Foresight - 6 months
Forecast Comparison

Not too surprisingly, the optimistic forecast leads to the most delayed ALLL build.
Forecast Comparison - Different Forecast Window

- **Forecast HPI for 3 years**
  - CECL with Perfect Foresight
  - CECL with Optimistic Fcast
  - CECL with LF Fcast

- **Forecast HPI for 2 years**

- **Forecast HPI for 1 year**

- **Forecast HPI for 6 months**
  - ALLL under Incurred
  - CECL with AR Fcast
Big Picture

- When setting provisions under CECL, risk managers need to be cognizant of the importance of the scenario projections, models, and update cycles
  - With inaccurate forecasts (optimistic), CECL can lead to undesired reserve buildup behavior even at frequent update frequencies
  - If forecasts are relatively accurate, CECL seems to be less procyclical and less volatile than ALLL under incurred losses

Caveats

- Mortgages have a fairly long loss emergence window, results may differ for loan losses that are quicker to deteriorate given stress
- Model was estimated through the cycle i.e. sensitivities based on more information than risk managers would have had in 2006
- Results on procyclicality have ignored the impact on loan originations
- Loss given default was assumed constant
CECL Roundtable

Jason Jacobs
Head of Office of Accounting Policy
AIG
October 28, 2019
CECL Roundtable

Robert Hetu
Head of US Private Debt

Caisse de dépôt et placement du Québec

October 28, 2019