Current Expected Credit Loss (CECL)

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Turning the Tide

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Today's Learning Conversations

- What is CECL?
- When does it go into effect?
- What are the components of CECL?
- What methodologies are used for the historical component?
- What expected external and internal factors may affect your CECL?
- How do you calculate expected components of CECL?

What is CECL - Current Expected Credit Loss?

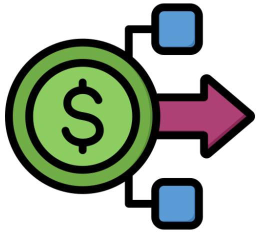
- Loss Reserve that replaces Loan Loss Reserve (LLR).
- Must be **forward-looking** and **historical**.
- Must consider both **external** and **internal** factors.
- Must consider both **quantitative** and **qualitative** factors.
- Assets must be grouped by risk profiles.

When Does CECL Go into Effect?

- CECL applies to every organization with a loan portfolio.
- Native CDFIs have until the first reporting period following **December 16, 2022** to have a CECL model developed and implemented.

What are the components of CECL?


Historical


Expected


External

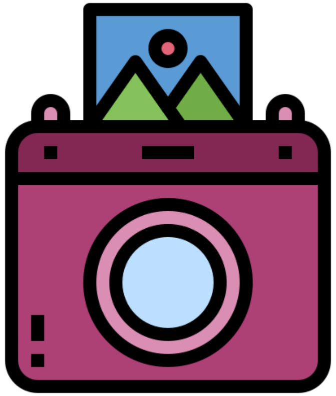

Internal


Quantitative

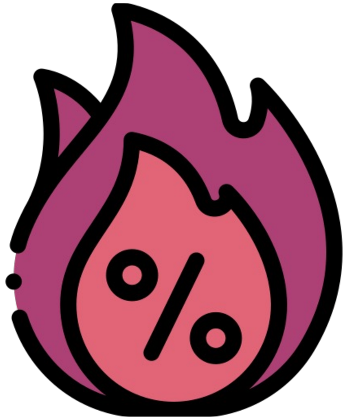

Qualitative

Historical Component of CECL

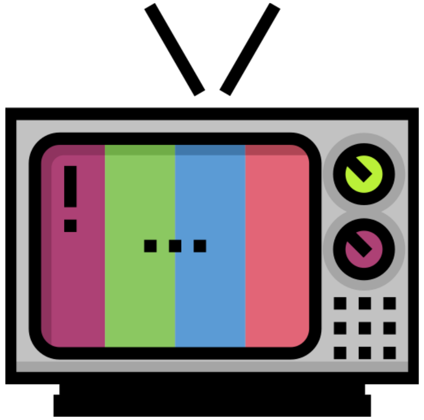
Common Historical Methodologies



Snapshot or Open Pool Method



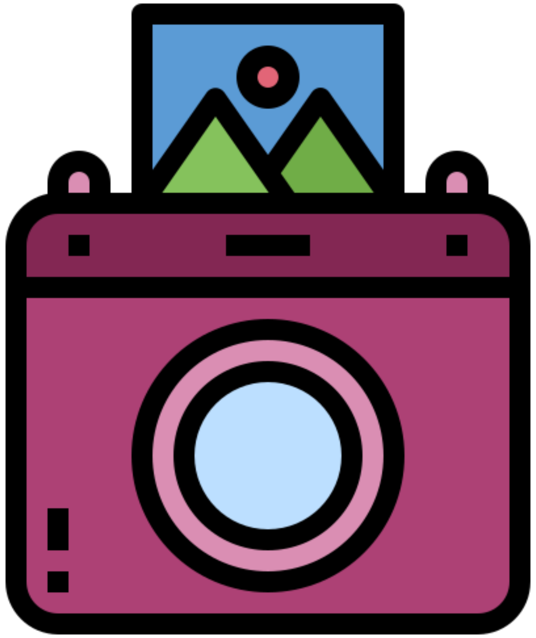
Remaining Life or Weighted Average Interest Remaining (WARM)



Vintage Method

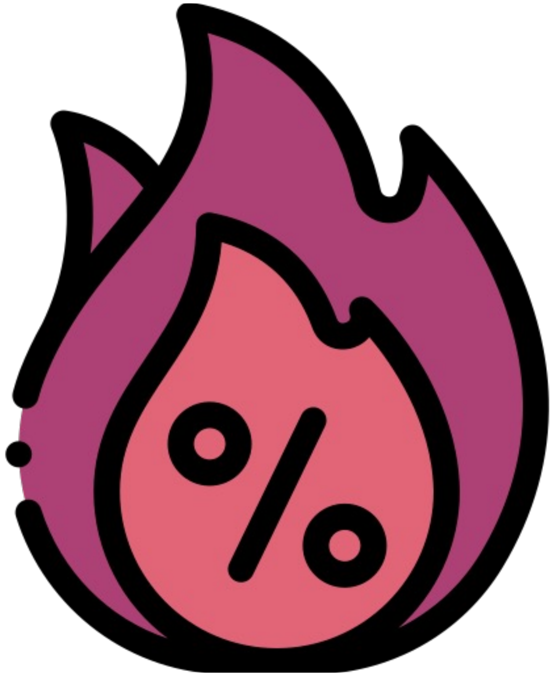
Snapshot or Open Pool Method

- Takes a snapshot of a loan portfolio at a point in time in history and tracks the loan portfolio's performance in the subsequent periods until its ultimate disposition.



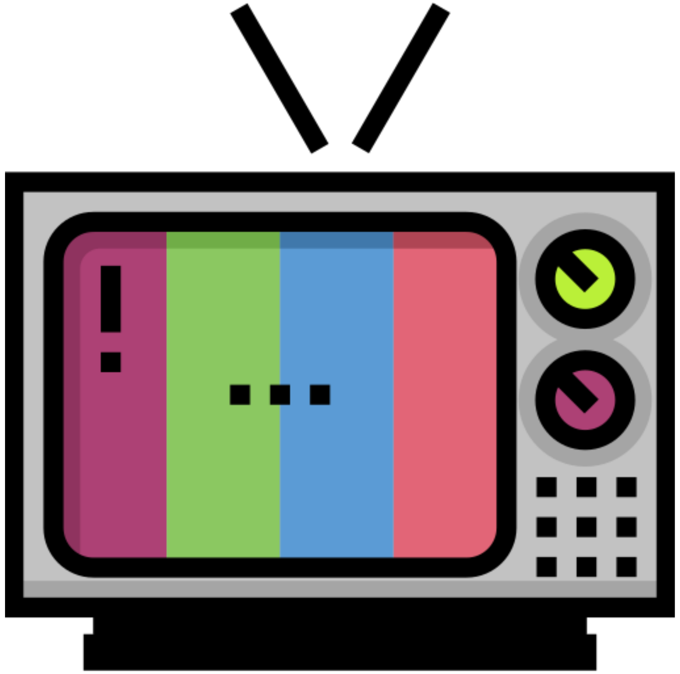
Remaining Life or Weighted Average Remaining Maturity (WARM) Method

- Uses the average annual charge-off rates and the remaining life of the loan to estimate the allowance for credit losses.



Vintage Method

- Tracks all charge-offs associated with a specific vintage—origination year.



Link to Historical Methodology Models

- www.supervisionoutreach.org/cecl/methodologies-and-examples

Expected Component of CECL

What are External Factors?

- External conditions outside of the organization that have potential of causing credit loss.

Peer-Sharing – External Factors

- What are some External Factors that may affect your loan portfolio?

Examples of External Factors

- External Factors – Chosen for Oweesta
    - National Inflation Rate
    - Unemployment Rate
    - Recession Officially Declared by US Government
    - Heath Pandemic, Natural Disaster, War
    - Federal Funds Interest Rate
    - Political Risk to Funding

What are Internal Factors?

- Internal conditions inside the organization that have potential of causing credit loss.

Peer-Sharing – Internal Factors

- What are some Internal Factors that may affect your loan portfolio?

Examples of Internal Factors

- Internal Factors – Chosen for Oweesta
  - Median Size of All Loans
  - Median Size of First In Loans
  - Median Size of Loan Risk Rated 3
  - Percentage of Portfolio with Loans Risk Rated 3
  - Median Size of Loan Risk Rated 2
  - Median Size of Balloon Loans

How to Weight External & Internal Factors

How to Weight External Factors

1. Identify an event that caused your Native CDFI to experience a loss in the past and how your Native CDFI responded to it.
2. Determine the value of the loss.
3. Compare the value of the loss to the value of the portfolio or the section of the portfolio the loss affected.
4. Determine if this is a reasonable and supportable assumption of how your Native CDFI will respond to such an event in the future.

Oweesta Case Study – Weight of External

1. During the COVID 19 Oweesta chose to forego interest payment on its loans.
2. That loss of interest income totaled $677,446 of a loan portfolio size of $49,812,250.
3. From this, Oweesta can reasonably project that should another health pandemic arise it can expect to lose up to three quarters of interest.
4. Thus, a factor value of 1.36% of the amortized cost have been established for this factor.

How to Weight Internal Factors

1. Identify internal factors that may negatively affect your loan portfolio.
2. Identify baseline values.
3. Identify any modifier to these baselines values that may add to the negative affect of the internal factors.

Oweesta Case Study – Weight of Internal

1. Oweesta chose to establish a base line from the industry average for loss reserve for Intermediary lenders as reported in the OFN annual Side by Side report.

2. Oweesta established modifiers based on various median loan amounts and portfolio concentrations.

3. This was to ensure that should Oweesta experience the loss of the median of its borrower's loans in any of these categories, the loan amounts will be covered by the loss reserve or CECL value.

Determining Degrees of Factors

How to Determine Degrees of Factors

1. Identify if the factors being considered are all or nothing or if they will increase by stages.
2. If factor will increase by stages, determine the number of divisions that would be prudent.
   - Look at historical maximum and minimum economic affects of the chosen factors.
   - Look at percentage of your borrowers the chosen factor affects.
3. Determine desired level of delineation of the external factors' effect.
4. Using the most reasonable and supportable estimates, choose a degree the factor can potentially affect the loan portfolio.

Oweesta Case Study – Degrees of Factors

1. Oweesta determined it was necessary to weight each of the External Factors according to the likelihood of it increasing to its maximum potential.
2. Oweesta incorporated a Condition Weight ranging from no effect to the maximum level of effect for the factor.
3. The number of levels of increase was based on historical economic affects of the chosen external factors and the desired level of delineation of the external factors' effect.
4. The values in between the maximum and minimum are determined by the judgement of management using the most reasonable and supportable estimates.

Talking Circle – Storytelling

1) Discuss what external or internal factors your Native CDFI is considering to be included in it CECL.

2) Discuss a method your NCDFI may choose to weight each of these external factors.

CECL Clinic

- Registration will be in early July.
- Clinic to build a CECL model from a provided template.

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