CURRENT EXPECTED CREDIT LOSS

EXL

FAQ SHEET

Frequently Asked Questions

1. What is CECL?

CECL, or Current Expected Credit Loss, is a new accounting standard issued by Financial Accounting Standards Board (FASB) that will change how Financial Institutions (FI) account for credit losses for loans and debt securities. This is in alignment with IFRS9 - Financial Instruments issued by International Accounting Standards Board (IASB) in 2014 which requires entities to determine their loss provisioning using Expected Credit Losses model.

2. What are the major changes in CECL compared to existing standards?

The key changes introduced by CECL standard are:

- **Forward Looking Approach**: CECL requires FIs to consider not only past events and current conditions, but also reasonable and supportable forecasts that affect future losses. CECL replaces the current “incurred loss” approach with an “expected loss” approach.
- **Lifetime Credit Loss Allowance**: CECL requires FIs to estimate expected credit losses over the entire life of the asset. While current rules require an allowance for credit losses only expected to incur over the next 12 months, CECL removes this probable loss threshold and requires lifetime credit loss allowance.

- **Single Impairment Model**: CECL requires transition from multiple impairment models to a single impairment model for all financial instruments subject to impairment assessment.

3. When will the CECL standards take effect?

The new standards will be effective for fiscal years beginning after December 15, 2019 for Public Business Entities (PBEs) which are SEC filers, and fiscal year beginning after December 15, 2020 for other PBEs. For all other entities, the standard will be effective for fiscal years beginning after December 15, 2021. However, early adoption is permitted for all entities for fiscal years beginning after December 15, 2018.

4. Who is impacted by the change in standards?

Regardless of size, all banks, savings associations, credit unions, and financial institution holding companies – both public and private – whose regulatory reports are required to conform to US GAAP are impacted by the new CECL standards.

5. Which assets are covered under the purview of CECL?

The CECL amendment affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash.

6. Which approaches are allowed for modeling expected losses?

CECL standard does not require Financial Institutions (FIs) to use complex modeling systems or prescribe any specific methodology to be followed to estimate expected credit losses. The entities need to develop their own modeling approaches that work best for them based on their data availability and existing model inventory.

7. What kind of a segmentation strategy needs to be followed for estimating losses?

CECL requires entities to estimate expected credit losses on assets on a collective basis where similar risk characteristics exist. The segmentation practices used under incurred loss methodology may also be appropriate under CECL after some refinement. If an asset however, does not exhibit risk characteristics similar to other assets, expected credit losses will have to estimated individually for such asset.

8. How does CECL takes care of Troubled Debt Restructurings (TDRs)?

CECL requires the recognition of all future losses on both TDRs and non-TDRs. However, FASB requires FIs to use the same methodology for TDRs that is applied to other assets. CECL retains the TDR disclosure requirements, hence the procedures to identify and monitor TDRs will continue.

9. Are qualitative factors still needed for CECL?

Yes, similar to the current methodology, FIs will still need to use qualitative factors while estimating the credit losses, and should not rely solely on output from statistical models. Analysis to identify Q-factors will become more granular and important under CECL due to long term nature of the forecast.

10. Which macro-economic scenarios will be used for CECL Models?

The macro-economic forecasts for future will not be provided by FASB and have to be determined by individual FIs based on their understanding of macro economy and its impact on various assets under management.