National Credit Union Administration

Alison L. Clark, Chief Accountant
Examination & Insurance

NAFCU Annual Conference

June 21, 2019 New Orleans

Credit Losses . . .
Digesting New ASU

	Financial Instruments			
	Measured at Amortized Cost	Available-for-Sale Debt Securities	Other	Total Pages
Summary			6	6
Topic 326 Scope, Glossary, Measurement, Presentation, Disclosures	22	15	6	43
Topic 326 Implementation Guidance & Illustrations	25	4		29
Conforming Amendments & Other			163	163
Background & Basis for Conclusions	13	3	28	44
Total Pages	60	22	203	285

CECL's Fundamental Principle

Allowance for Credit Losses……..

- A valuation account
- Deducted from amortized cost basis of financial assets
- Used to present "net amount expected to be collected"
- Changes flow through net income

Book the difference as Allowance

$$A - B = C$$

326-20-30-1

Amortized cost . . . unpaid principal balance (UPB) lent to a member adjusted for loan fees and origination expenses, repayments, writeoffs, nonaccrual practices, accrued interest and certain hedging transactions

Amount expected to be Collected. . . remaining amounts expected to be collected from each loan

Credit Losses . . .
What's Not Changing?

Historical Loss

Total Losses

Credit Risk

Charge Off

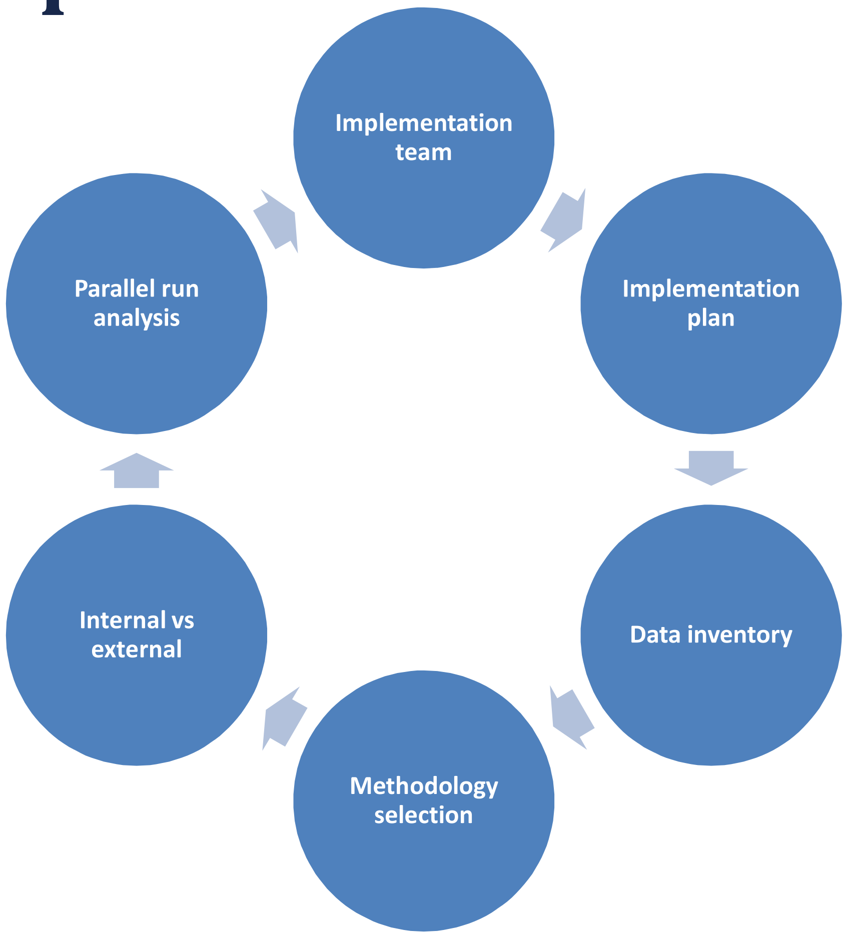
CU’s First Steps

Read the Standard

Read the FAQ

Form a Team

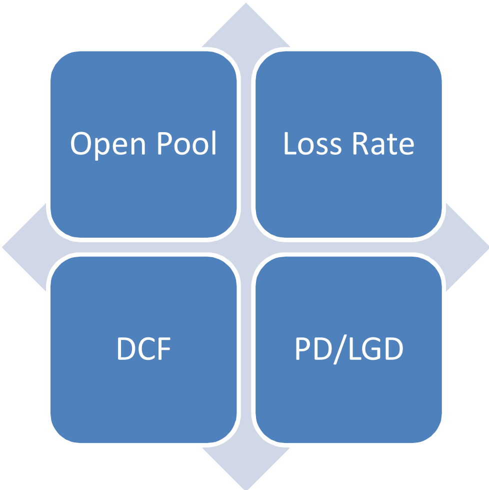
Implementation Process



Estimation Methods

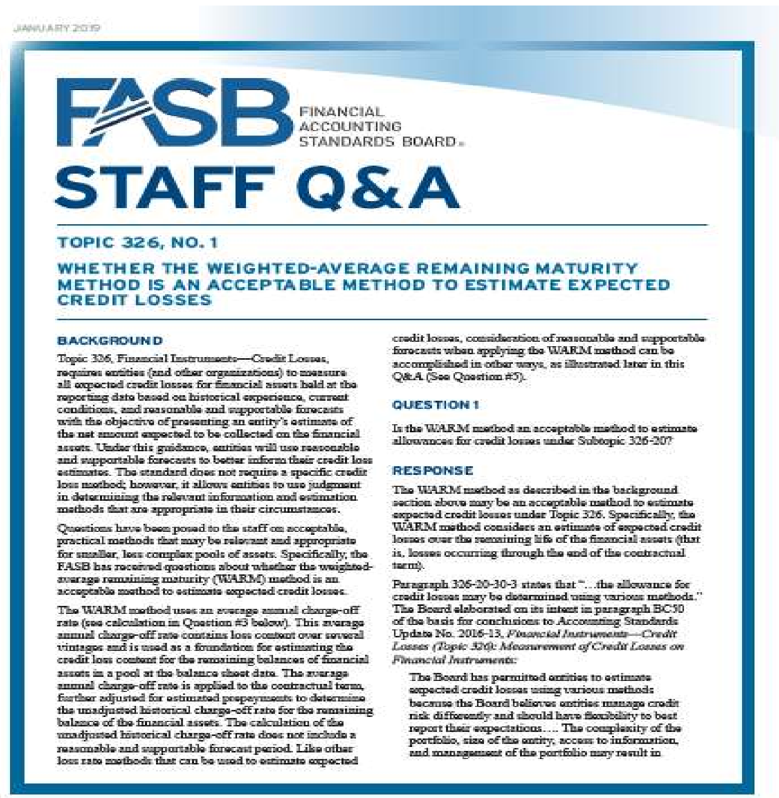
- CECL is scalable to size and complexity
- Does not specify single method
- Various Methods to Choose:

326-20-30-3



On January 10, 2019 FASB issued [Staff Q&A on WARM]

Weighted
Average
Remaining
Maturity



JANUARY 2019

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

STAFF Q&A

TOPIC 326, NO. 1

WHETHER THE WEIGHTED-AVERAGE REMAINING MATURITY METHOD IS AN ACCEPTABLE METHOD TO ESTIMATE EXPECTED CREDIT LOSSES

BACKGROUND

Topic 326, Financial Instruments—Credit Losses, requires entities (and other organizations) to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts with the objective of presenting an entity's estimate of the net amount expected to be collected on the financial assets. Under this guidance, entities will use reasonable and supportable forecasts to better inform their credit loss estimates. The standard does not require a specific credit loss method; however, it allows entities to use judgment in determining the relevant information and estimation methods that are appropriate in their circumstances.

Questions have been posed to the staff on acceptable, practical methods that may be relevant and appropriate for smaller, less complex pools of assets. Specifically, the FASB has received questions about whether the weighted-average remaining maturity (WARM) method is an acceptable method to estimate expected credit losses.

The WARM method uses an average annual charge-off rate (see calculation in Question #3 below). This average annual charge-off rate contains loss content over several vintages and is used as a foundation for estimating the credit loss content for the remaining balances of financial assets in a pool at the balance sheet date. The average annual charge-off rate is applied to the contractual term, further adjusted for estimated prepayments to determine the unadjusted historical charge-off rate for the remaining balance of the financial assets. The calculation of the unadjusted historical charge-off rate does not include a reasonable and supportable forecast period. Like other loss rate methods that can be used to estimate expected credit losses, consideration of reasonable and supportable forecasts when applying the WARM method can be accomplished in other ways, as illustrated later in this Q&A (See Question #5).

QUESTION 1

Is the WARM method an acceptable method to estimate allowances for credit losses under Subtopic 326-20?

RESPONSE

The WARM method as described in the background section above may be an acceptable method to estimate expected credit losses under Topic 326. Specifically, the WARM method considers an estimate of expected credit losses over the remaining life of the financial assets (that is, losses occurring through the end of the contractual term).

Paragraph 326-20-30-3 states that "…the allowance for credit losses may be determined using various methods." The Board elaborated on its intent in paragraph BC50 of the basis for conclusions to Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*:

> The Board has permitted entities to estimate expected credit losses using various methods because the Board believes entities manage credit risk differently and should have flexibility to best report their expectations…. The complexity of the portfolio, size of the entity, access to information, and management of the portfolio may result in

Loss Rate – Remaining Life/Maturity

What is Weighted Average Remaining Maturity Method? WARM?

AVERAGE ANNUAL CHARGE-OFF RATE × AMORTIZATION ADJUSTED REMAINING LIFE = *LIFETIME HISTORICAL CHARGE-OFF RATE*

WARM Method.....Estimating the Loss

Fact Pattern

- Estimate the allowance for credit losses as of 12/31/2020
- Pool of Loans with similar risk characteristics
    - Amortized cost basis of $10 million
    - 5-year loans – contractual term adjusted by prepayments
- Assume 0.25% qualitative adjustments to represent both current conditions and reasonable & supportable forecasts

Remaining Life (WARM) – Example

Step 1: Compute annual charge-off rate (just like today)

		A	B	C = B/A
Year End	**Amortized Cost**	**Average Balance**	**Annual Net C/O**	
2015	$9,350,000			
2016	9,398,000	9,374,000	32,000	0.34%
2017	10,779,000	10,088,000	33,000	0.33%
2018	11,050,000	10,914,000	50,000	0.46%
2019	10,738,000	10,894,000	42,000	0.39%
2020	10,000,000	10,369,000	31,000	0.30%
		Avg. Annual C/O rate		**0.36%**

Remaining Life –(WARM)– Example (con't.)

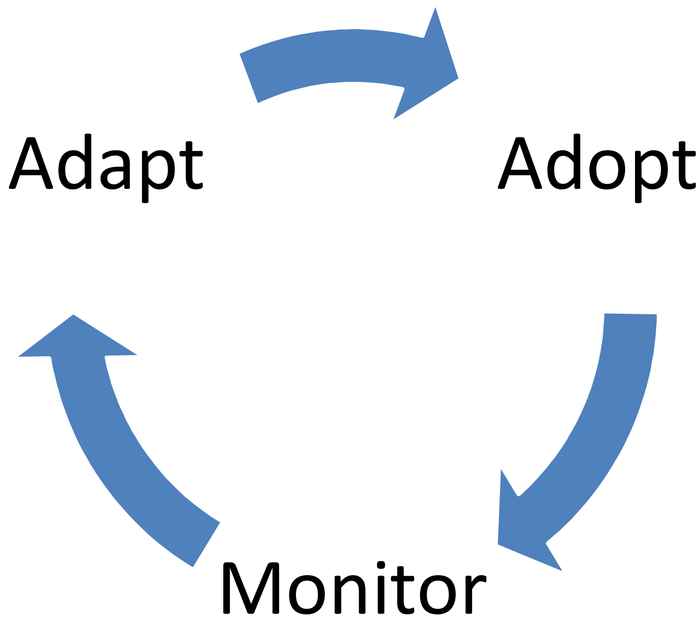
Step 2: Calculate the amortization- adjusted remaining life

	B	A	C	
Year End	**Est. paydown**	**Projected Amort Cost**	**Remaining life**	
2020		**10,000,000**	1.00	
2021	3,849,000	6,151,000	2.00	
2022	2,528,000	3,623,000	3.00	
2023	1,828,000	1,795,000	4.00	
2024	1,208,000	587,000	5.00	
2025	588,000	-		
Weighted avg amort adj remaining life			2.22	D
	Avg ann C/O rate		0.36%	E
Unadj lifetime historical C/O rate			0.80%	D x E
	Q factor		0.25%	
	Total ACL rate for 2020		1.05%	
Total ACL for 2020 ($10M x rate)			105,272.45	
2.22 = Sumproduct (Column C: Column B)/A1				

Use of Third-Party Vendors

- No requirement to use third-party service providers
- Use of third-party service providers does not absolve management of responsibility and ownership

Evolution



Exam Expectations

- 2019 – Open Dialogue - Questionnaire
- Today - Remains Incurred Loss = GAAP

Implementation . . . Various Resources

- 11 April 2019 Webinar
  - Joint Webinar: FED, FDIC, CSBS, FASB, SEC, and NCUA
- FASB Resources
  - FASB CECL Standard
  - Transition Resource Group (TRG)
  - TRG – Meeting Materials
  - Submit an Issue for Credit Losses
  - Technical Inquiry Service
- Interagency Guidance
  - "Interagency Guidance on the New Accounting Standard on Financial Instruments – Credit Losses"
  - "Frequently Asked Questions on the Current Expected Credit Losses Methodology (CECL)"
- CSBS Resources
- AICPA Accounting for Credit Losses Resources


THANK
YOU

Questions

Office Contact Page

Feel free to contact our office in E&I with questions or comments.

Primary Staff: Alison Clark, Chief Accountant
Aclark@ncua.gov

Secondary Staff: Scott Neat, DDOS
DSNeat@ncua.gov

Office Phone: 703-518-6611