

Management Challenge:

A benchmark for CECL estimates

Today's Speakers



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Discussion

- » Benchmarking research
- » Q2 results overview
- » Interactive Q&A

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CECL Build – Is it Enough?

A framework to understand the extent of your allowance build

In this paper, we set out to estimate, based on 14 top financial institutions, a lower- and upper-bound current expected credit loss (CECL) estimate as of March 31, 2020. Using individual institutions' experiences and a few other heuristics measures, we seek a method that can help triangulate on a reasonable range of reserves as of March 31, and establish a methodology that can be used for future quarters. Given that CECL provides for a broad range of assumptions, we want to understand which institutions have built reserves aggressively (higher end of the range) versus those that will build over time (lower end of the range). We believe our methodology can be highly useful in times of uncertainty when events such as COVID-19 cloud the economic outlook.

The lower-bound index for the peer group as of March 31, 2020 sits at 1.64% and the upper-bound index for the peer group is 3.24%. Our expectation based on the research, the banks' current portfolios, and the evolution of the economic environment is that the lower-bound index will move well above 2% and the upper-bound index will move into the low 4% range, but time will tell. Based on our analysis, we expect a few banks in the peer group to ramp up reserve in Q2 more aggressively than the rest—namely Wells, Key, Fifth Third, CFC, and Regions (Figure 1). The latter three have a riskier loss profile than the peer group average and Wells relies perhaps too heavily on its expected recoveries forecast in Q1.

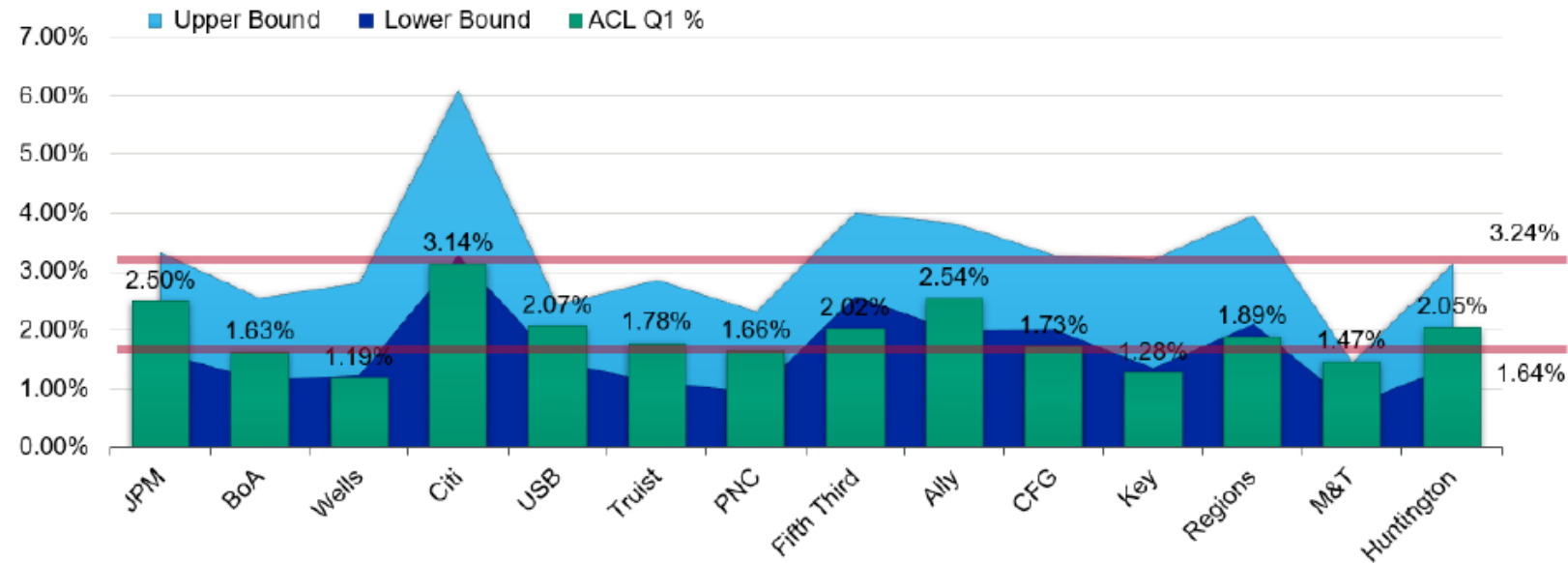
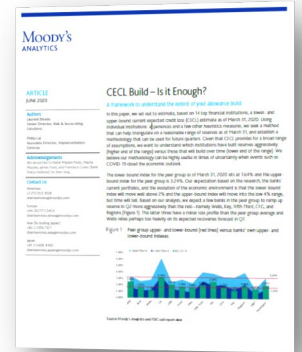
Figure 1 Peer group upper- and lower-bound (red lines) versus banks' own upper- and lower-bound indexes

Bank	Lower Bound (%)	Upper Bound (%)
JPM	1.64	2.88
BAC	1.64	1.89
Wells	1.64	5.16
Citi	1.64	2.82
USB	1.64	1.79
Truist	1.64	1.86
PNC	1.64	2.34
Sun Life	1.64	1.50
Key	1.64	3.24
CFC	1.64	1.89
Regions	1.64	3.24
M&T	1.64	1.89
Huntington	1.64	1.64

Source: Moody's Analytics and FDIC call report data

Published June 25th, 2020

Initial Results



Source: Moody's Analytics and FDIC call report data

*Peer group weighted average – 1.98%

Triangulation Index Creation

STEP 01

Gather data.

Define peer group and gather historical call report data and DFAST estimates. Review data for any anomalies and potential outlier issuers.

STEP 02

Review each methodology and Assumptions.

Select methodology and assumptions for each such that they reflect peer group realities and idiosyncrasies

STEP 04

Establish Index and weights.

Based on method selected assign weights to upper and lower bound metrics and determine which scaling factor to apply to make it a true range.

STEP 03

Determine which metrics to use.

Define which metrics would be used as quantitative metrics and which would serve best as qualitative and select what time period and scenarios to use.

STEP 05

Review results and apply qualitative judgment.

Review results, and define in the context of qualitative metrics which banks may be reserved appropriately and which may need to do more build. Review in context of next quarter's expected environment.



Framework Description - Triangulation



DFAST Stress testing results.

Gather stress testing results from customer and use peer group available or DFAST results averages.



NCO averages 2007-2010.

Customer and peers NCO during the financial crisis (GFC) period to derive coverage based on average and maximum loss experience.



NCO based scenario assumptions.

Historical NCO based scenario analysis (base and S4) to derive estimate of lifetime losses based on pure historical experience and high level assumptions



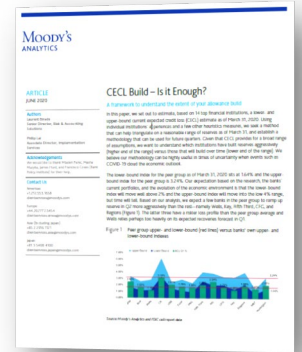
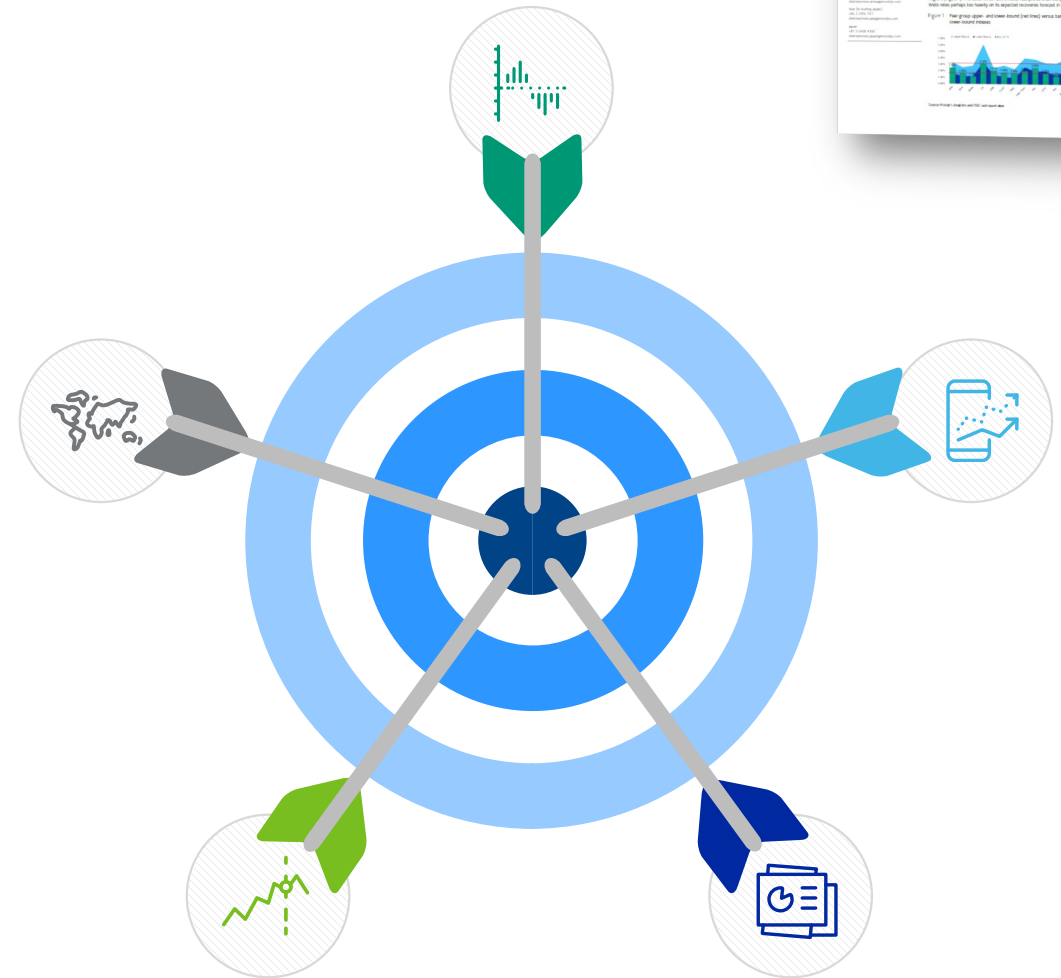
Historical CECL – full foresight.

Estimate derived using Historical Loss Analyzer based calculations for every historical quarter during the 2007-2010 period, could be extended to cover other period based on business cycle.



Top down CECL forecaster methodology.

Applying Capital Risk Analyzer CECL forecaster methodology to derive forecast estimate based on baseline and S4 scenario.



Framework Description - Weights

Establishing weights for each measure

- » Expert Judgment
- » Lower bound metrics
- » Upper bound metrics
- » Rational based on favored measures
- » Idiosyncrasies

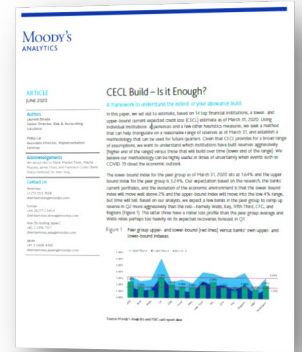


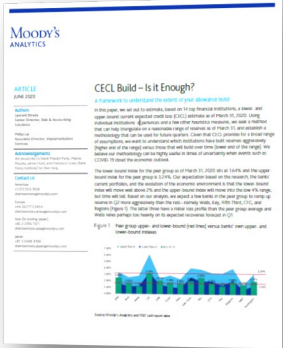
Figure 26 Lower- and upper-bound index weighting

ECL Range Indicators	Sample Set Weighted Averages	Weights	Upper Bound	Weights	Lower Bound
Macro UER Baseline March V2	2.11%			30.00%	0.63%
CECLFcast V1 base	2.49%			30.00%	0.69%
CECLFcast V2 base	2.48%			30.00%	0.71%
CECLFcast Avg 3y V1 base	2.09%			5.00%	0.09%
CECLFcast Avg 3y V2 base	2.04%			5.00%	0.12%
Macro UER S3 March V2	4.31%	10.00%	0.43%		
Macro UER S4 March V2	4.65%	10.00%	0.47%		
CECLFcast V1 S4	5.92%	10.00%	0.59%		
CECLFcast V2 S4	4.78%	10.00%	0.48%		
CECLFcast Avg 3y V2 S4	2.82%	10.00%	0.28%		
CECLFcast Avg 3y V1 S4	4.10%	10.00%	0.41%		
HLLA AVG only %	5.34%	10.00%	0.53%		
HLLA Min %	3.48%	10.00%	0.35%		
HLLA MAX only %	6.30%	10.00%	0.63%		
DFAST % Loss	5.63%	10.00%	0.56%		
		Upper Bound*	3.24%	Lower Bound*	1.64%

Source: Moody's Analytics

Q2 Results

Discussion and remarks



Source: Moody's Analytics and FDIC call report data

*Peer group weighted average – 2.59%

Management Challenge Benchmark for CECL

As a service or do it yourself...

The analysis presented today provides an overview of the Moody's Analytics view benchmarks to evaluate CECL estimates

- » Integrated tools to facilitate analysis
- » Key components:
 - Historical performance analysis
 - 5 top down methodologies
 - Incorporates idiosyncratic assumptions
 - Qualitative metrics for interpretation
 - Peer group benchmark and triangulation index



Benchmarking by
Moody's Analytics



Questions and Answers

Management Challenge: A benchmark for CECL estimates

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