Budgeting for CECL

McQueen Financial Advisors

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In our daily work, clients from across the country share with us their opportunities and stress points. Often, we are asked thought provoking questions and we do our best to address each one of them. Just this week, a client asked us for guidance on how to estimate their CECL amount looking forward for 2023. Just two hours later, the question was asked again. The very next day, another client inquired about it. With budget season upon us, there is a clear need to review this important budget number with everyone. Projecting the CECL allowance for the upcoming year represents some challenges. We'd like to take this opportunity to share our thoughts on how to calculate and estimate the CECL allowance looking forward.

"Estimate the CECL allowance looking forward"

CECL Calculations

Calculating the CECL allowance for the current period is straightforward. We first look backwards and calculate an average net charge-off percentage. This is converted to a Projected Life Loss by carrying forward the historical average over the remaining life of each loan segment. Thereafter, the results may be adjusted higher or lower based on Current Conditions Adjustments and/or Forecast Adjustments. CECL Factors are simply the sum of Projected Life Losses, Current Condition Adjustments and Forecast Adjustments. The calculations are shown below, with CECL factors highlighted. This is a sample of the weighted average remaining maturity method used in McQueen's model.

September 30, 2022

Loan Segment	Balance	Projected Life Loss %	Current Conditions Adjustment	Forecast Adjustment	CECL Factor	CECL Calculated Reserve
Indirect Used Auto	30,039,225	0.268%	0.170%	0.141%	0.579%	173,916
Commercial	17,908,750	0.041%	0.000%	0.141%	0.182%	32,682
Mortgage 15 Yrs	12,101,487	0.000%	0.070%	0.141%	0.211%	25,537
Indirect RV	11,816,506	0.077%	0.250%	0.141%	0.468%	55,288
Used Auto	11,397,675	0.633%	0.000%	0.141%	0.774%	88,188
Indirect New Auto	7,283,059	0.559%	0.000%	0.141%	0.700%	50,996
		A	B	C	A+B+C	

Loan Growth Projections

The basics of creating a budget are similar for large and small financial institutions. Nearly everyone will use a combination of forecasting tools, economic projections, review of local opportunities and competition. Ultimately, loan growth projections are highly dependent on management's judgement. These activities are well established and familiar to each of us. After deciding on loan growth projections, the next logical step is to calculate the budgeted allowance. Prior to CECL, the forward-looking allowance budget considered only the upcoming year using the incurred loss method. In contrast, CECL uses the life-of-loan loss methodology which adds a layer of complexity to the calculations.

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CECL Budget Considerations

Using a very simple method, we could multiply the CECL factor by the expected loan growth for each segment. The Annual CECL Budget Amount below on the right is a rough approximation which could be used for budgeting purposes. This method may be appropriate for smaller and less complex pools where loan growth is expected to be gradual over the upcoming year. The CECL Budget amount could then be divided by 12 and included in the upcoming budget.

2023 Projections

Loan Segment	Balance	Expected Loan Growth %	Expected Loan Growth $	CECL Factor	Annual CECL Budget Amount
Indirect Used Auto	30,039,225	15%	4,505,884	0.579%	26,087
Commercial	17,908,750	7%	1,253,612	0.182%	2,288
Mortgage 15 Yrs	12,101,487	12%	1,452,178	0.211%	3,064
Indirect RV	11,816,506	15%	1,772,476	0.468%	8,293
Used Auto	11,397,675	22%	2,507,488	0.774%	19,401
Indirect New Auto	7,283,059	8%	582,645	0.700%	4,080

A More Robust Method

The simple method shown above considers only loan growth. Potential changes to other key CECL inputs are not captured. Specifically, the simplified method doesn't consider that current condition and forecast adjustments are likely to change over time. These two key model inputs may have a large impact on the CECL calculated allowance. Note that the Projected Change percentages below are for budgeting purposes, but not to be used in the CECL model. It's important to consider that the CECL allowance is calculated as of a snapshot in time and includes all known factors as well as reasonable and supportable forecasts. In contrast, the budget amount can include an estimate of unknown factors that may impact the allowance. As an example, a projected change to the current condition adjustment of 0.25% on the Indirect Used Auto segment may be appropriate if there is a concern that charge-offs will trend higher, even if there is no data to support this in the CECL model. Separately, the projected change in the Forecast Adjustment of 0.10% would be appropriate if there was a belief that the forecasted unemployment rate was inaccurate. This more robust method is appropriate where rapid growth or volatility are expected.

"Appropriate where rapid growth or volatility are expected"

2023 Projections

			Projected Change			
Loan Segment	Expected Loan Growth $	CECL Factor	Current Condition Adjustment	Forecast Adjustment	Projected CECL Factor	CECL Calculated Reserve
Indirect Used Auto	4,505,884	0.579%	0.250%	0.100%	0.929%	41,860
Commercial	1,253,612	0.182%	0.500%	0.100%	0.782%	9,803
Mortgage 15 Yrs	1,452,178	0.211%	0.000%	0.100%	0.311%	4,516
Indirect RV	1,772,476	0.468%	0.350%	0.100%	0.918%	16,271
Used Auto	2,507,488	0.774%	0.250%	0.100%	1.124%	28,184
Indirect New Auto	582,645	0.700%	0.250%	0.100%	1.050%	6,118
	A	B	C	D	E=B+C+D	A x E

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CECL Resources

McQueen's CECL model is a robust tool that removes all the burdensome tasks of crunching the numbers. At the end of each month, clients upload loan files to our secure portal. Thereafter, we provide a quick 2 to 3 day turn around. Periodically, it will be necessary to adjust the CECL results for a variety of reasons.

- Current Condition Adjustments: As one example, if the largest employer in your footprint announced large layoffs, it would be appropriate to boost the allowance. These entries are called current condition adjustments and are intentionally left up to management's judgement because there can be many variables unique to your institution.
- Individually Evaluated Loans: The process of updating the allowance for likely known losses is very similar to your pre-CECL method. As one example, if a borrower declares bankruptcy and has an outstanding unsecured loan, it will be necessary to adjust the allowance.

Updating current condition adjustments and individually evaluated loans is accomplished within our on-line CECL tool. Within minutes, clients can adjust their CECL results, print the changes and save the inputs for subsequent reports. Please contact your McQueen advisor for assistance with the on-line CECL tool.

Get In Touch

"We're here for all your CECL needs"

If you're facing a specific CECL issue and want to get the most out of resources available, we're here for all your CECL needs. Please feel free to reach out to us.

- CECL calculations made easy by outsourcing everything to us
- Regular webinars & written commentary
- McQueen's YouTube Channel includes many pre-recorded webinars
- Get answers quickly on how to use our on-line tool
- Ask us to help interpret reports
- Policy assistance
- Examiner Q&A