KPMG

CECL Pulse check

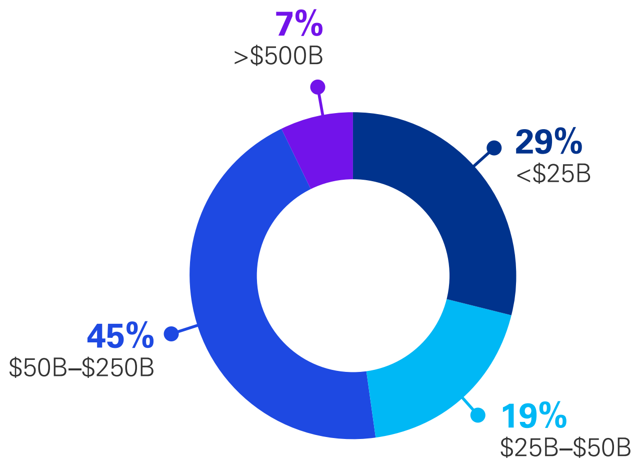
How companies are responding to economic impacts in their CECL estimates in Q2'23

We surveyed companies during the second quarter of 2023 to understand how current economic conditions are likely to impact their Current Expected Credit Losses (CECL) process. We asked about the continuing impacts of the current market uncertainty, including a potential recession, on commercial and retail loan portfolios—and how these forces are likely to affect CECL allowances.

Economic uncertainty continued in the second quarter of 2023 as market pressures persisted with rates to remain elevated through the spring of 2024 and the unemployment rate expected to worsen.[1] KPMG surveyed commercial and consumer lenders (including banks and finance companies) to understand how companies are reacting to and dealing with these issues and their impact on CECL reporting. The survey results were obtained between June 9 and June 22, 2023 and reflect information known at that time. As the economic situation continues to shift, we expect companies will continue to monitor and reassess assumptions used in their CECL estimates up to the reporting date.

Who we surveyed

We surveyed **24 banks** and **7 consumer** companies. They range in asset size from less than $25 billion to more than $500 billion.

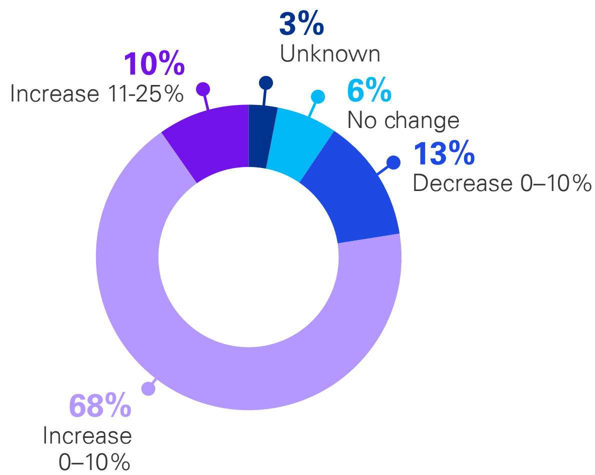


Responses were obtained between June 9 and June 22, 2023, and reflect information known at that time.

[1] "KPMG Economics Fire & ice… A global reckoning", KPMG, 2023.

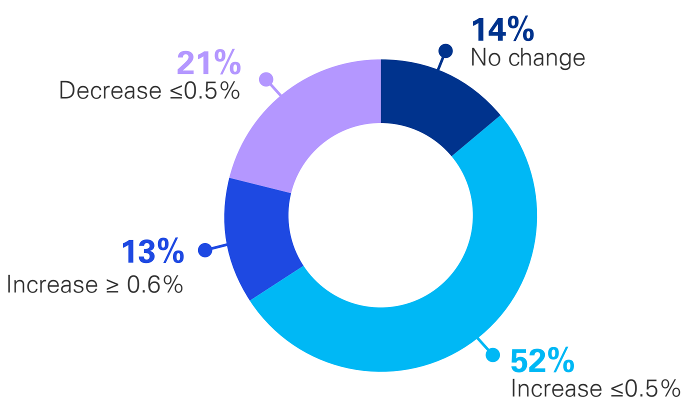
Expected impact of continued uncertainty on CECL methodology and results

1. How much do you expect the allowance for expected credit losses (ACL) to change from March 31, 2023 to June 30, 2023?



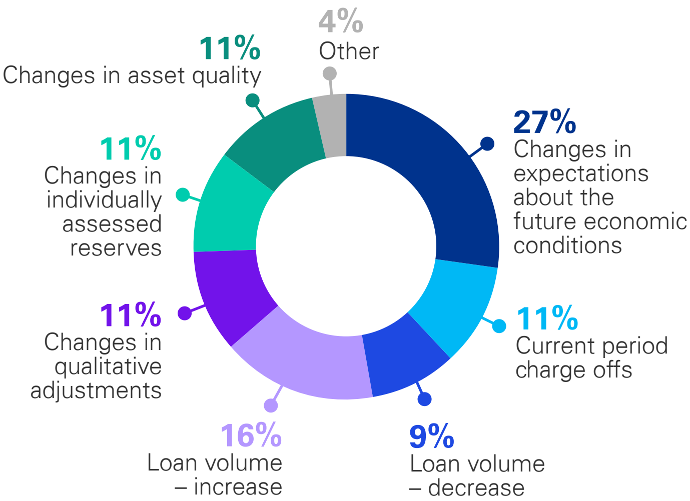
The majority of respondents (78 percent) expect the overall allowance for expected credit loss (ACL) to increase in Q2’23 compared with 80 percent in Q1’23. In contrast, 13 percent of respondents expect a decrease in their ACL in Q2’23 which is consistent with Q1’23.

2. How much do you expect the total allowance for expected credit losses (ACL) to change as a percentage of end of period receivables subject to ACL from March 31, 2023 to June 30, 2023?



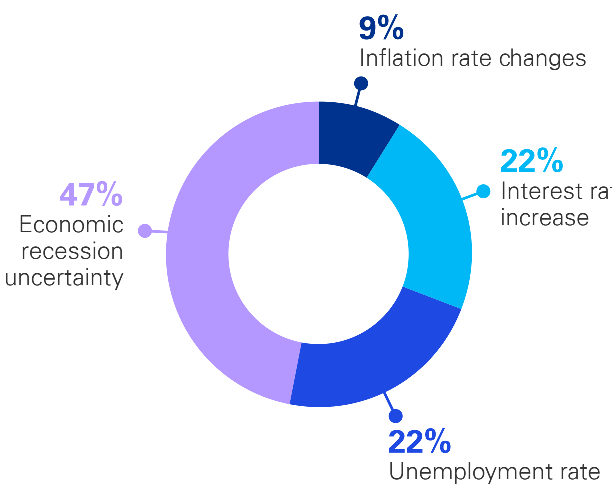
Approximately 52 percent of respondents who expect the overall ACL to increase in Q2’23 expect the increase to represent 0.5 percent or less as a percentage of total receivables assessed for ACL as compared to 60 percent in Q1’23. In contrast, 21 percent of respondents expect the decrease in their ACL to represent 0.5 percent or less as a percentage of total receivables assessed for ACL in Q2’23 as compared to 13 percent in Q1’23.

3. What do you expect the largest driver of change to be in the ACL balance from March 31, 2023 to June 30, 2023?



Approximately 29 percent of respondents said their outlook on future economic conditions deteriorated in Q2’23, compared to 38 percent in Q1’23. The majority of respondents (71 percent) in Q2’23 cited no change in future economic conditions as compared to 58 percent in Q1’23. The largest driver of ACL change cited was changes in expectations about future economic conditions (27 percent in Q2’23 as compared to 30 percent in Q1’23). Other drivers of ACL change included increase in loan volume (16 percent in Q2’23 as compared to 15 percent in Q1’23), current period charge offs (11 percent in Q2’23 as compared to 18 percent in Q1’23), changes in qualitative adjustments based on changes other than changes related to future economic conditions (11 percent in Q2’23 as compared to 13 percent in Q1’23), changes in individually assessed reserves (11 percent in Q2’23 as compared to 6 percent in Q1’23) and changes in asset quality (11 percent in Q2’23 as compared to 12 percent in Q1’23).

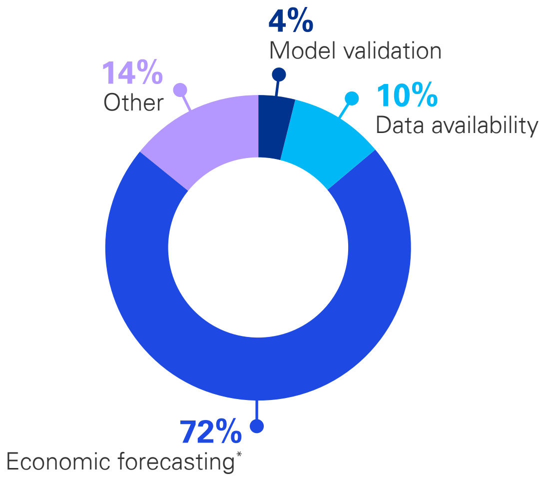
4. Which economic condition is having the greatest impact on your Company’s ACL estimate?



Responses were obtained between June 9 and June 22, 2023, and reflect information known at that time. The economic conditions selected may not reflect the impact of more recent market events.

Approximately 47 percent of respondents in Q2’23 cited economic recession uncertainty as being the most significant economic concern as compared to 25 percent in Q1’23. Interest rate increases and changes in unemployment rate were the second and third most significant economic concerns with approximately 22 percent of respondents in Q2’23 selecting each of these conditions as compared to 8 percent and 15 percent in Q1’23 respectively.

5. What is the greatest challenge you are experiencing in determining your Company's ACL estimate?

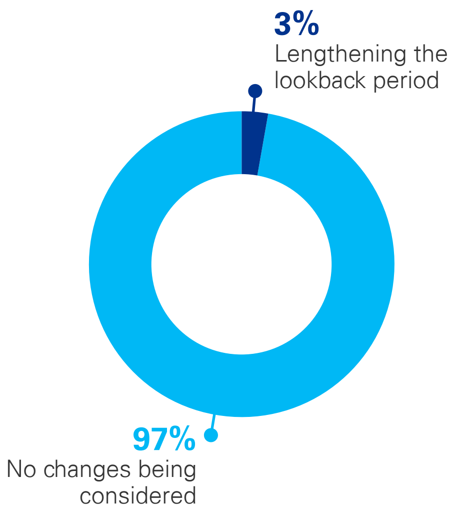


*Economic forecasting as a result of the inflation rate, increased interest rates, the unemployment rate and/or the potential of an economic recession.

The majority of respondents (72 percent in Q2'23) stated that economic forecasting as a result of the inflation rate, increased interest rates, the unemployment rate and the potential of an economic recession, continues to be the greatest challenge in determining ACL estimates as compared with 66 percent in Q1'23. Approximately 14 percent of respondents in Q2'23, as compared 15 percent in Q1'23, cited other factors including market instability as the greatest challenge in determining their ACL.

CECL methodology components

6. Is your Company currently considering making changes to one or more of the following key ACL assumptions or components either in response to the aforementioned challenges or as part of the assumption/component review?



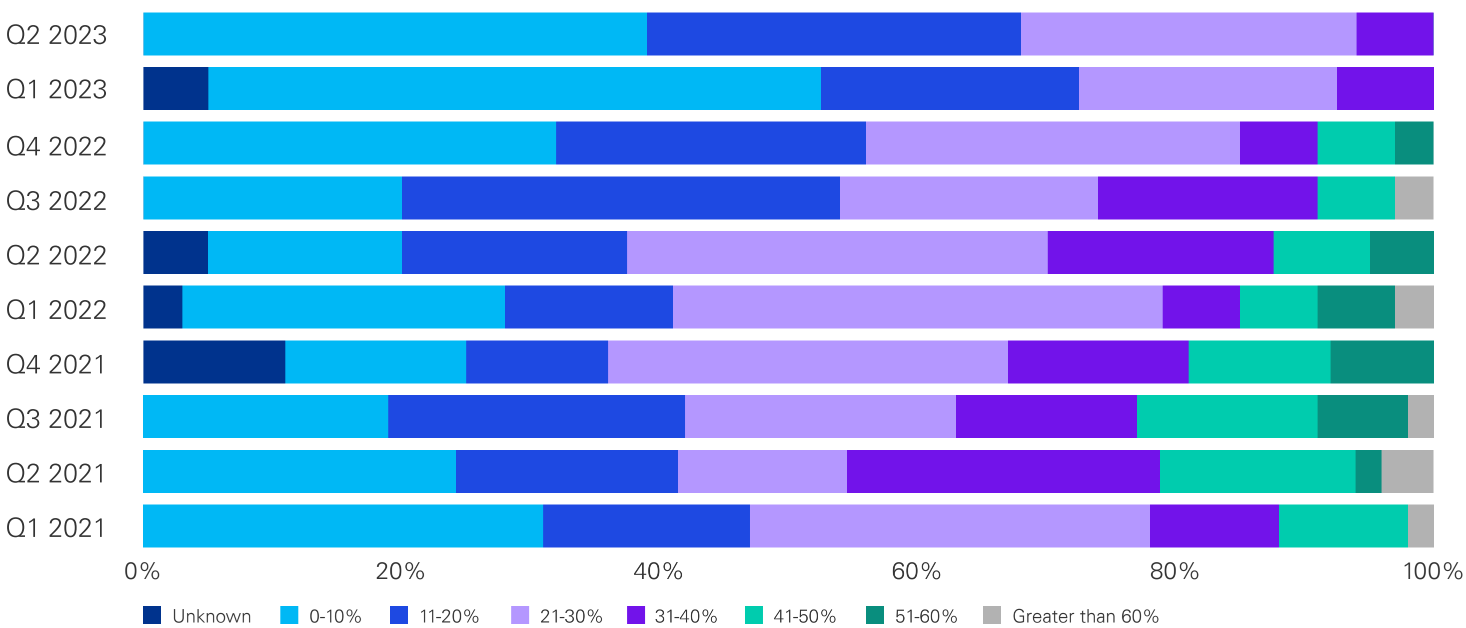
When asked whether changes to ACL assumptions are being considered in response to current challenges in determining the ACL estimate; 97 percent of respondents in Q2'23 cited they are not planning or considering making changes to the reasonable and supportable period, reversion period, or lookback period in response to current challenges in determining their ACL as compared to 88 percent in Q1'23.

To estimate losses over the reasonable and supportable forecast period, entities are permitted to incorporate one or more economic scenarios into their ACL estimate. Accordingly, many institutions have incorporated multiple economic scenarios into their ACL framework, particularly in response to economic recession uncertainty, inflation rate changes, interest rate increases, and possible change in the unemployment rate.

For those companies that utilize percentage probability weights in their macroeconomic scenarios as part of their methodology; we summarized the average percentage probability, where a percentage probability is applied, by scenario below. For example, for those respondents that applied a percentage other than zero percent to the base case scenario, the average was 55 percent in Q2'23.

	Base case	Upside	Downside	Severe downside	Other
Q2'23[1]	55%	24%	36%	7%	45%

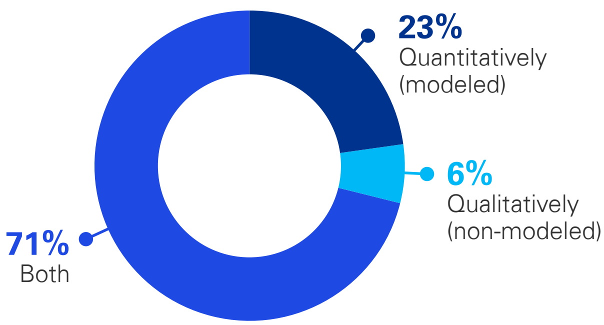
7. What percentage of your Company's ACL as of June 30, 2023 would you estimate to be based on qualitative factors?



Many companies incorporate qualitative adjustments into their ACL estimate to capture changes in expectations, and we understand they will continue to do so. Approximately 32 percent of respondents indicated they expect qualitative factors to comprise more than 20 percent of the total ACL estimate in Q2'23 as compared to 28 percent in Q1'23.

[1] The probability weights do not add to 100 percent given the table represents an average percentage probability by scenario where a percentage probability is applied other than zero percent.

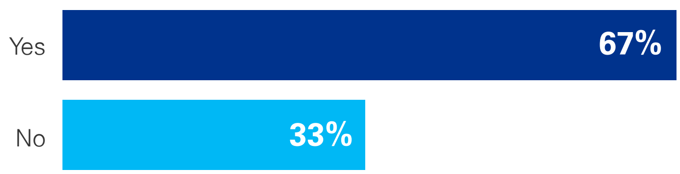
8. How are economic conditions such as the inflation rate, increased interest rates, unemployment rate and/or the potential of an economic recession being factored into your Company's ACL estimate?



In Q2'23, approximately 23 percent (27 percent in Q1'23) of respondents are factoring in impacts from inflation rate changes, increased interest rates, the unemployment rate and a potential economic recession within their ACL estimate quantitative (modeled) approach whilst 71 percent (66 percent in Q1'23) of respondents are factoring in these conditions both quantitatively (modeled) and qualitatively (non-modeled).

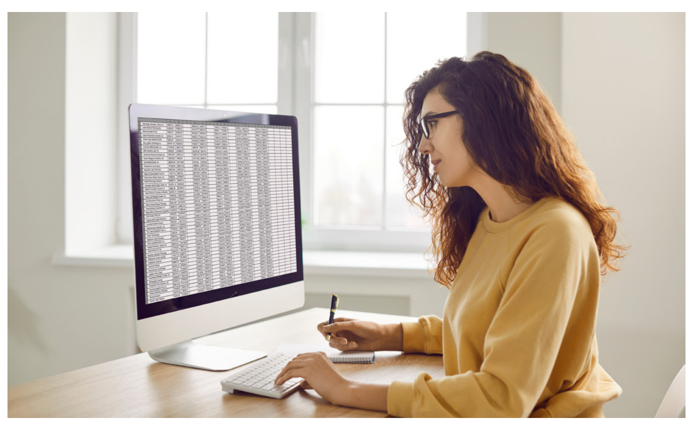
Delinquencies and net charge-offs

9. Have delinquencies increased from March 31, 2023?



10. Have net charge-offs increased from March 31, 2023?

We surveyed companies about delinquency and net charge-off trends and approximately 67 percent of respondents cited that delinquencies have increased as compared to Q1'23. In contrast, 56 percent of respondents cited net charge-offs had not increased as compared to Q1'23. Net charge-offs are expected to increase in future quarters based on current delinquency trends and timing of net charge-offs following delinquencies.



Conclusion

Uncertainty surrounding the economy, including concerns about the impact of inflation, high interest rates, and a potential economic recession, continues to be a challenge in determining CECL estimates. Analysts and investors will want to understand the key drivers behind the CECL estimates, which include a significant level of estimation and judgment. Companies will need to explain and support their assumptions and estimates of the CECL methodology components, including quantitative models and qualitative factors. We encourage companies to work closely with their boards of directors, auditors, and advisors as they prepare for reporting in the second quarter of 2023.

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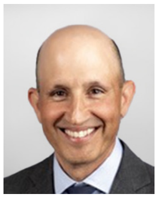

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