CECL Pulse check

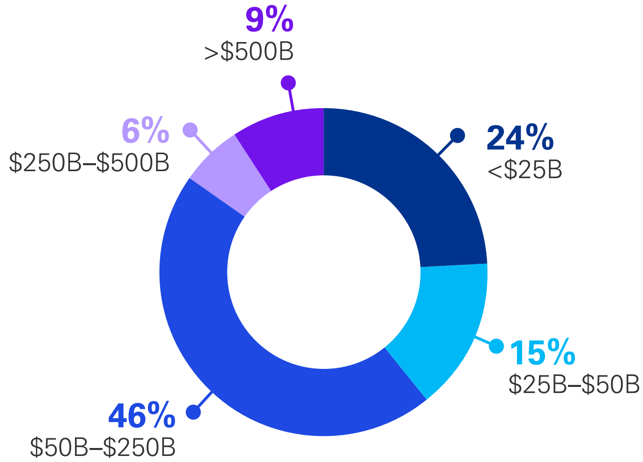
How companies are responding to economic impacts in their CECL estimates in Q3'23

We surveyed companies during the third 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 inflation-prone economy, where interest rates are expected to remain elevated for an extended period of time, on commercial and retail loan portfolios and how these forces are likely to affect CECL allowances.

Economic uncertainty continued in the third quarter of 2023 as market pressures persisted with rates to remain elevated through 2024. 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 estimates. The survey results were obtained between September 7 and September 21, 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

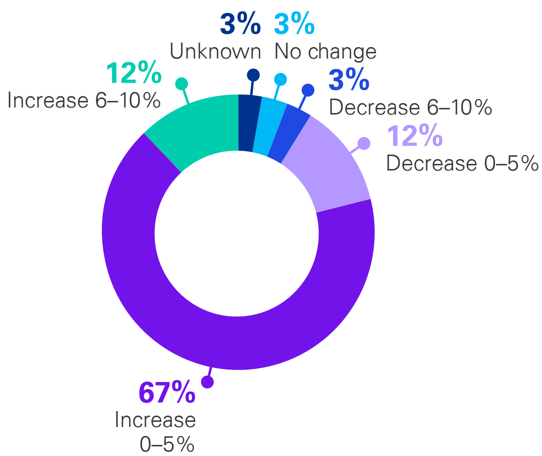
We surveyed **28 banks** and **5 consumer** companies. They range in asset size from less than $25 billion to more than $500 billion.



Responses for Q3'23 were obtained between September 7 and September 21, 2023, and reflect information known at that time.

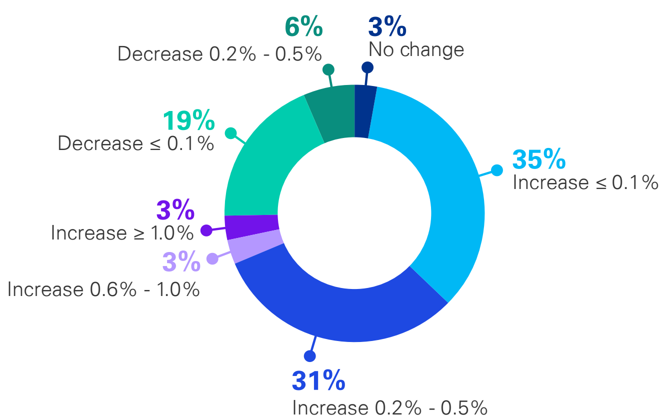
Expected impact of continued economic uncertainty on CECL methodology and results

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



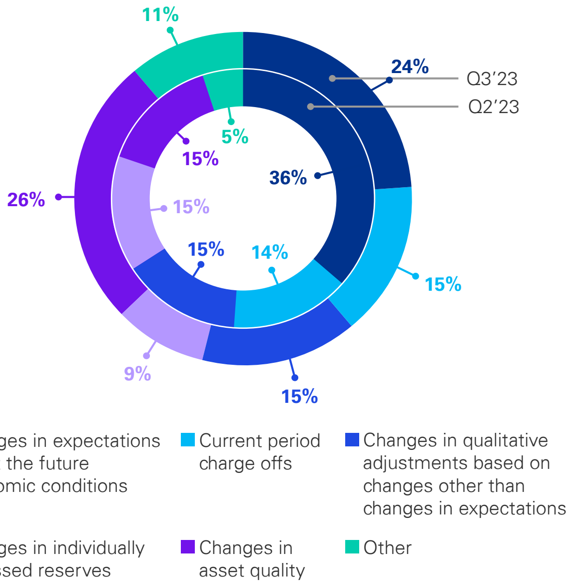
The majority of respondents (79 percent) expect the overall allowance for expected credit loss (ACL) to increase in Q3’23 compared with 78 percent in Q2’23. In contrast, 15 percent of respondents expect a decrease in their ACL in Q3’23 compared with 13 percent in Q2’23.

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 June 30, 2023 to September 30, 2023?



In Q3’23, approximately 35 percent of respondents who expect the overall ACL to increase expect the increase as a percentage of total receivables assessed for ACL to represent 0.1 percent or less and approximately 31 percent of respondents expect the increase to represent 0.2 percent to 0.5 percent. In contrast, 19 percent of respondents expect the decrease as a percentage of total receivables assessed for ACL to represent 0.1 percent or less and 6 percent of respondents expect the decrease to represent 0.2 percent to 0.5 percent.

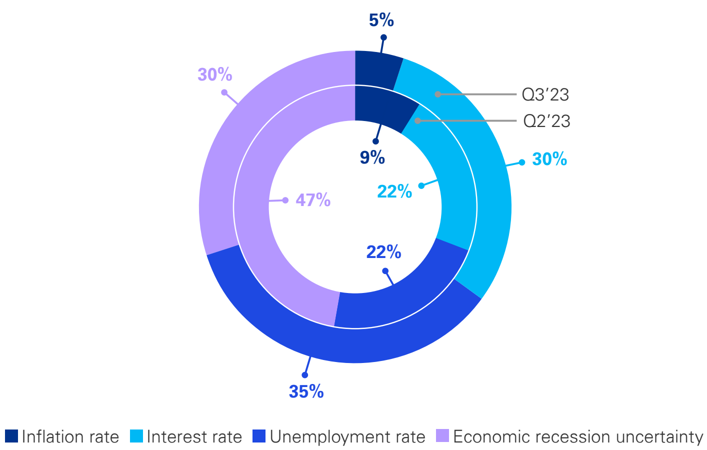
3. What do you expect the largest driver of change to be in the ACL balance excluding increases or decreases in loan volume from June 30, 2023 to September 30, 2023?



The largest driver of ACL change, excluding increases or decreases in loan volume, was changes in asset quality with 26 percent of respondents in Q3’23 selecting this driver as compared to 15 percent in Q2’23. Other drivers of ACL change included changes related to future economic conditions (24 percent in Q3’23 as compared to 36 percent in Q2’23), current period charge offs (15 percent in Q3’23 as compared to 14 percent in Q2’23), and changes in qualitative adjustments based on changes other than changes related to future economic conditions (15 percent in Q3’23 as compared to 15 percent in Q2’23).

The majority of respondents (68 percent) in Q3’23 cited no change in future economic conditions as compared to 71 percent in Q2’23. In contrast, 30 percent of respondents said their outlook on future economic conditions improved in Q3’23, compared to 0 percent in Q2’23.

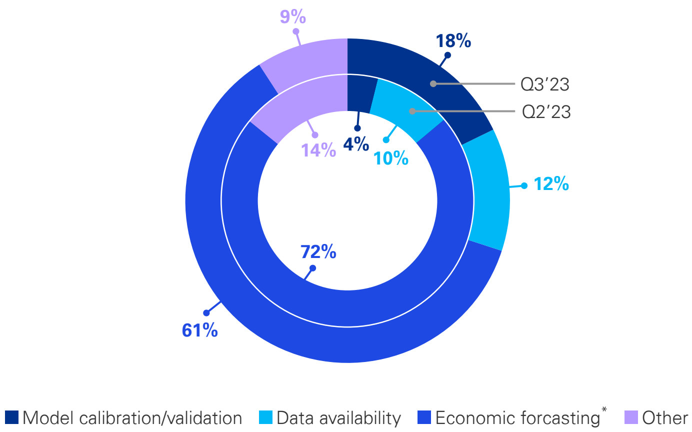
4. Which economic condition is having the greatest impact on your Company’s ACL estimate?



Responses for Q3’23 were obtained between September 7 and September 21, 2023, and reflect information known at that time. The economic conditions selected may not reflect the impact of more recent market events.

Approximately 35 percent of respondents in Q3’23 cited the unemployment rate as being the most significant economic concern as compared to 22 percent in Q2’23. Interest rate changes and economic recession uncertainty were the second and third most significant economic concerns with approximately 30 percent of respondents in Q3’23 selecting each of these conditions as compared to 22 percent and 47 percent respectively in Q2’23.

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

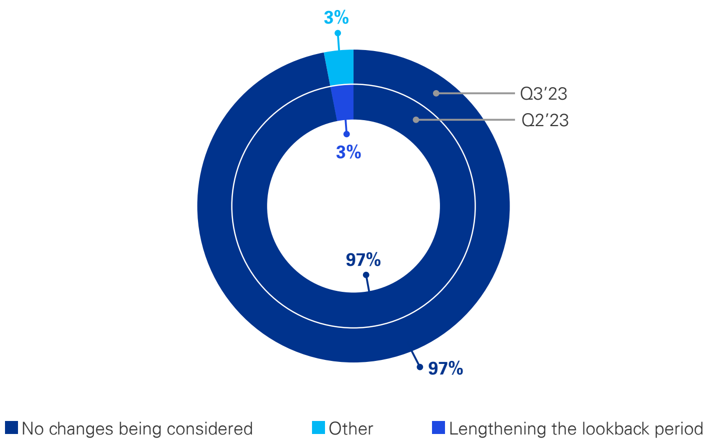


*Economic forecasting as a result of the inflation rate, interest rates, the unemployment rate and/or the potential of an economic recession.

Approximately 61 percent of respondents in Q3'23 stated that economic forecasting as a result of the inflation rate, interest rates, the unemployment rate and the potential of an economic recession, continues to be the greatest challenge in determining ACL estimates as compared to 72 percent in Q2'23. Approximately 18 percent of respondents in Q3'23, as compared to 4 percent in Q2'23, cited model calibration/validation 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 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 Q3'23 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 estimate which is consistent with Q2'23.

7. Is your Company using internally or externally derived economic forecasts?

The majority of respondents (84 percent) in Q3'23 cited economic forecasts used in determining ACL estimates are derived using external economic forecasts. In contrast, 16 percent of respondents utilize an internal economic forecast.

8. Is your Company currently considering changing its current economic forecasting source (e.g. from internal to external or from one external source to another external source)?

The majority of respondents (94 percent) in Q3'23 cited that no change is being contemplated or considered in relation to the sources of its current economic forecast used in determining ACL estimates.

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 and interest rate changes, and possible change in the unemployment rate.

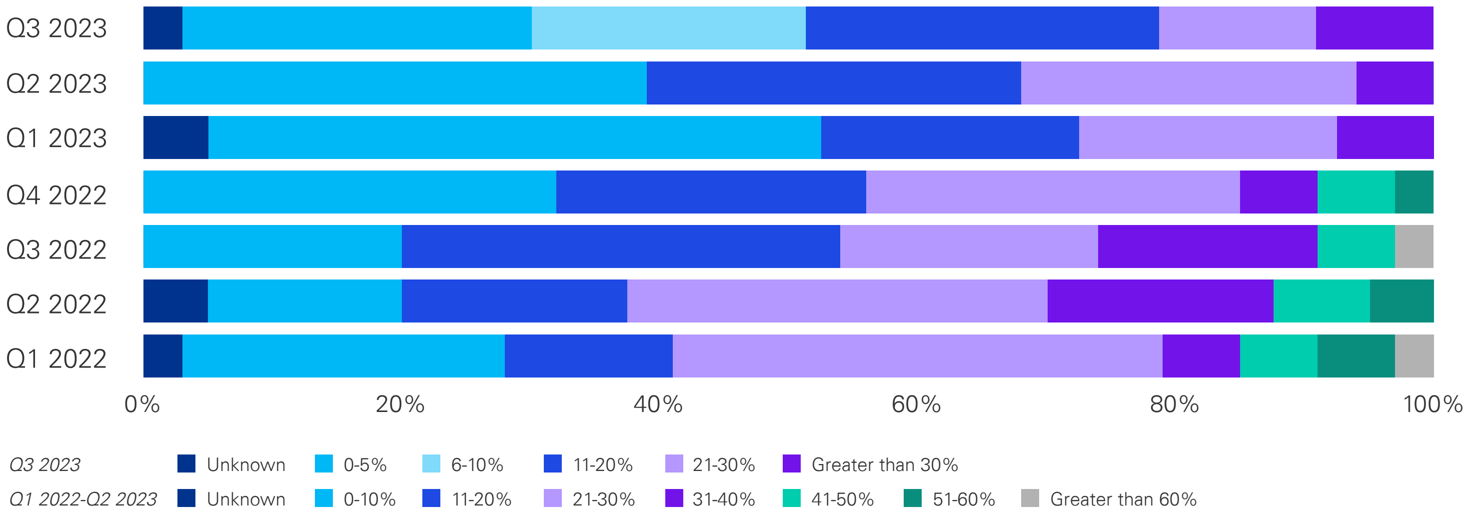
For those companies that utilize percentage probability weights in their macroeconomic scenarios as part of their methodology; we summarized the average percentage probability, where a percentage probability is applied, by scenario below. For example, for those respondents that applied a percentage other than zero percent to the base case scenario, the average was 58 percent in Q3'23.

	Base case	Upside	Downside	Moderate downside	Severe downside	Other
Q3'23[1]	58%	20%	30%	55%	15%	62%

Examples of where the "Other" scenario has been selected include specific adjustments to reflect current economic conditions and other alternate scenarios informing the loss estimate.

[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.

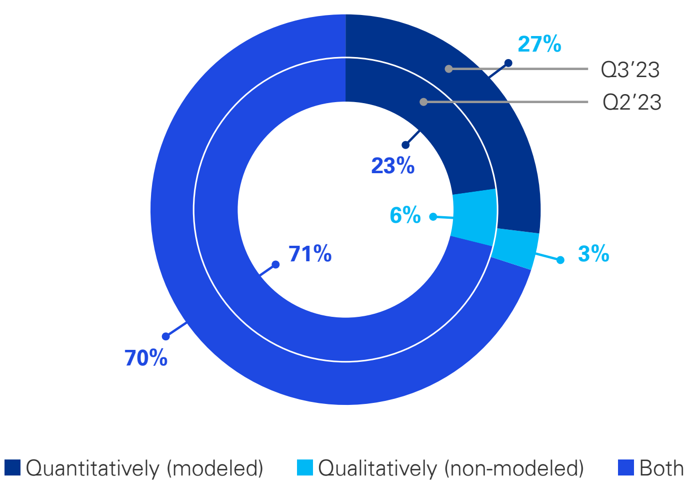
9. What percentage of your Company's ACL as of September 30, 2023 would you estimate to be based on qualitative factors?



Many companies incorporate qualitative adjustments into their ACL estimate to capture changes in expectations, and we understand they will continue to do so. Approximately 21 percent of respondents indicated they expect qualitative factors to comprise more than 20 percent of the total ACL estimate in Q3'23 as compared to 32 percent in Q2'23.

---

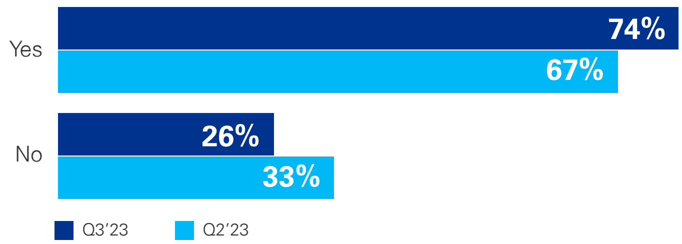
10. How are economic conditions such as the inflation rate, interest rates, unemployment rate and/or the potential of an economic recession being factored into your Company's ACL estimate?



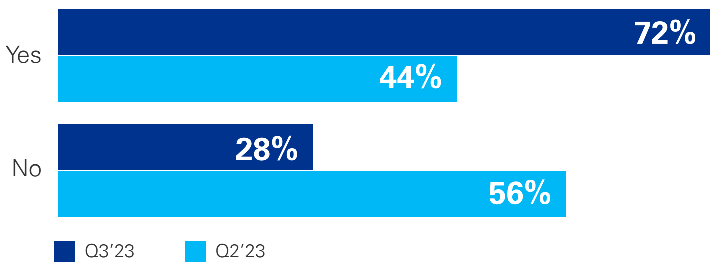
In Q3'23, approximately 70 percent of respondents are factoring in impacts from inflation rate and interest rate changes, the unemployment rate and a potential economic recession within their ACL estimate both quantitatively (modeled) and qualitatively (non-modeled) as compared to 71 percent in Q2'23. In contrast, 27 percent of respondents are factoring in these same impacts solely via the quantitative (modeled) component of the ACL estimate as compared to 23 percent in Q2'23.

Delinquencies and net charge-offs

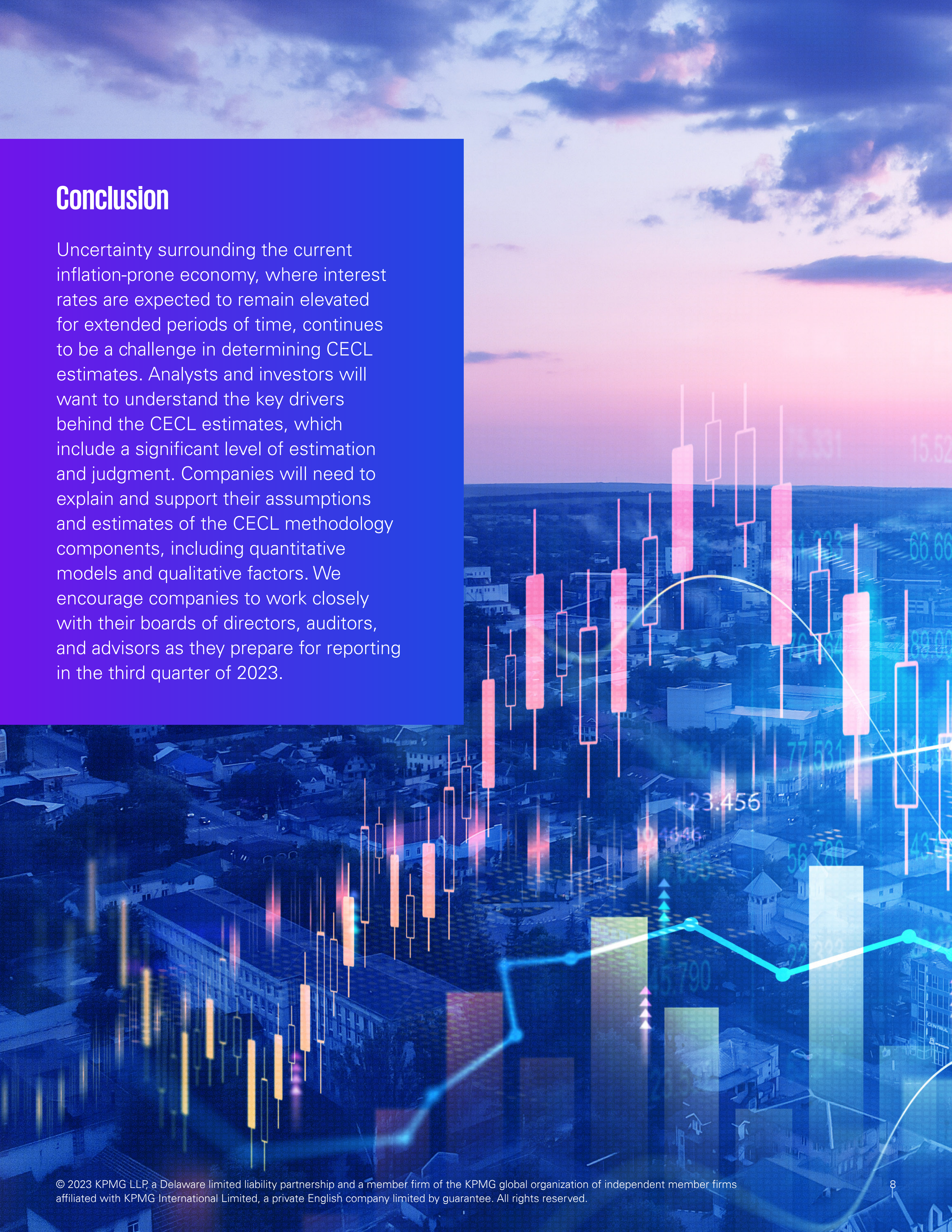
11. Have delinquencies increased from June 30, 2023?



12. Have net charge-offs increased from June 30, 2023?



We surveyed companies about delinquency and net charge-off trends and approximately 74 percent of respondents cited that delinquencies have increased in Q3'23 as compared to 67 percent in Q2'23. Approximately 72 percent of respondents cited net charge-offs have also increased in Q3'23 as compared to 44 percent in Q2'23. We expect net charge-offs to continue to increase in future quarters based on current delinquency trends and timing of net charge-offs following delinquencies.



Conclusion

Uncertainty surrounding the current inflation-prone economy, where interest rates are expected to remain elevated for extended periods of time, 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 third quarter of 2023.

Contact us

Patrick Davies-Griffith
Senior Manager, Audit
203-229-3323
pdaviesgriffith@kpmg.com

Natasha Boswell
Partner, Audit
212-909-5075
nboswell@kpmg.com

Alysha Horsley
Partner, Audit
704-370-4368
ahorsley@kpmg.com

Emily De Revere
Director, Accounting Advisory Services
617-988-5708
ederevere@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia