CECL Pulse check

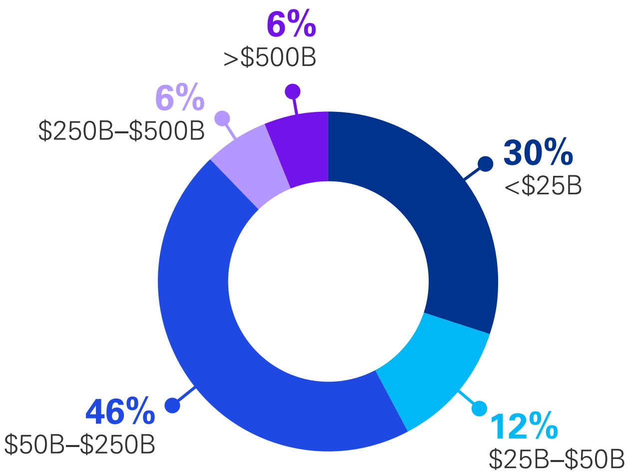
How companies are responding to economic impacts in their CECL estimates in Q4'23

We surveyed companies during the fourth 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 economic impacts of the current macroeconomic environment and how these forces are likely to affect CECL allowances.

Economic uncertainty continued in the fourth 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 December 7 and December 19, 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

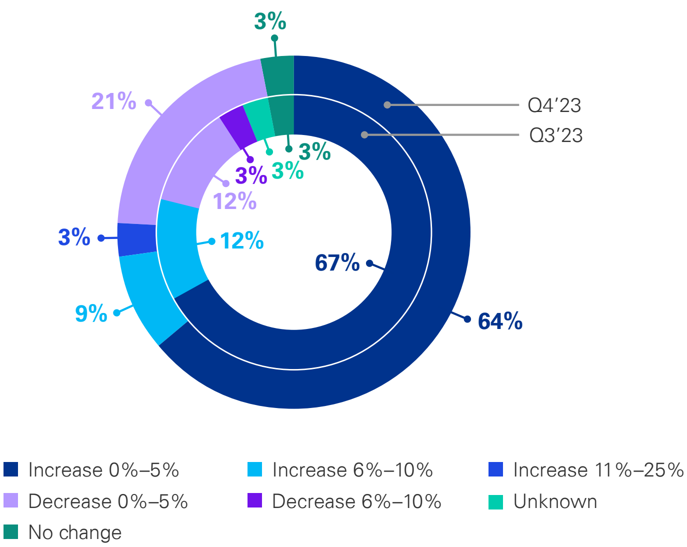
We surveyed **26 banks** and **7 consumer** companies. They range in asset size from less than $25 billion to more than $500 billion.



Responses for Q4'23 were obtained between December 7 and December 19, 2023 and reflect information known at that time

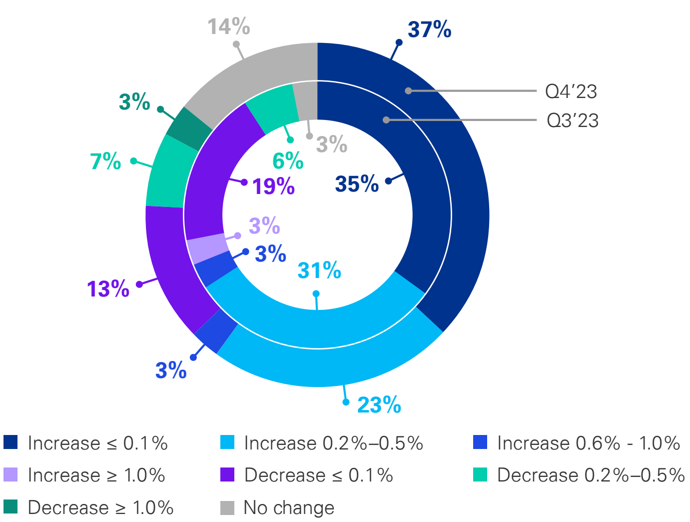
Expected impact of continued economic uncertainty on CECL methodology and results

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



The majority of respondents (76 percent) expect the overall allowance for expected credit losses (ACL) to increase in Q4'23 compared with 79 percent in Q3'23. In contrast, 21 percent of respondents expect a decrease in their ACL in Q4'23 compared with 15 percent in Q3'23.

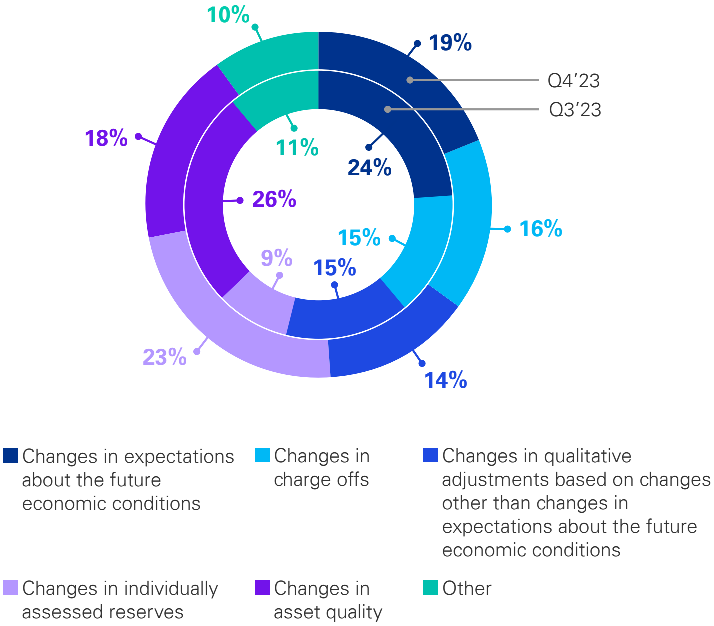
2. How much do you expect the total allowance for expected credit losses (ACL) to change as a percentage of end of period receivables subject to ACL from September 30, 2023 to December 31, 2023?



In Q4'23, approximately 37 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 23 percent of respondents expect the increase to represent 0.2 percent to 0.5 percent as compared to 35 percent and 31 percent, respectively, in Q3'23. In contrast, 13 percent of respondents expect the decrease as a percentage of total receivables assessed for ACL to represent 0.1 percent or less and 7 percent of respondents expect the decrease to represent 0.2 percent to 0.5 percent as compared to 19 percent and 6 percent, respectively in Q3'23.

Approximately 14 percent of respondents in Q4'23 expect no change in the overall ACL as a percentage of total receivables assessed for ACL as compared to 3 percent in Q3'23.

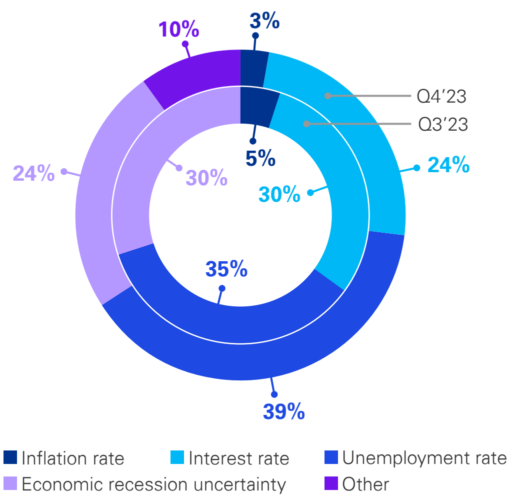
3. What do you expect the largest driver of change to be in the ACL balance excluding increases or decreases in loan volume from September 30, 2023 to December 31, 2023?



The largest driver of ACL change, excluding increases or decreases in loan volume, was changes in individually assessed reserves with 23 percent of respondents in Q4’23 selecting this driver as compared to 9 percent in Q3’23. Other drivers of ACL change included changes related to future economic conditions (19 percent in Q4’23 as compared to 24 percent in Q3’23), changes in asset quality (18 percent in Q4’23 as compared to 26 percent in Q3’23), changes in charge offs (16 percent in Q4’23 as compared to 15 percent in Q3’23), and changes in qualitative adjustments based on changes other than changes in expectations related to future economic conditions (14 percent in Q4’23 as compared to 15 percent in Q3’23).

The majority of respondents (76 percent) in Q4’23 cited no change in future economic conditions as compared to 68 percent in Q3’23. In contrast, 18 percent of respondents said their outlook on future economic conditions improved in Q4’23, compared to 30 percent in Q3’23.

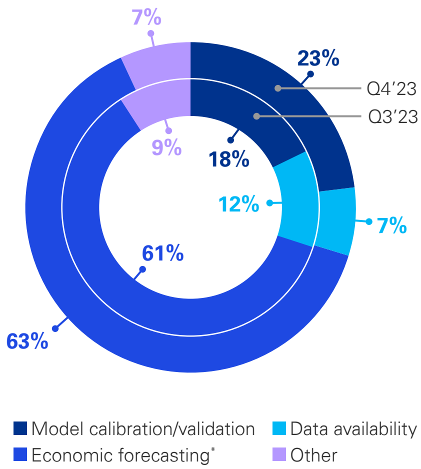
4. Which economic condition is having the greatest impact on your Company’s ACL estimate?



Responses for Q4’23 were obtained between December 7 and December 19, 2023 and reflect information known at that time. The economic conditions selected may not reflect the impact of more recent market events.

Approximately 39 percent of respondents in Q4’23 cited the unemployment rate as being the most significant economic concern as compared to 35 percent in Q3’23. Interest rate changes and economic recession uncertainty were the second and third most significant economic concerns with approximately 24 percent of respondents in Q4’23 selecting each of these conditions as compared to 30 percent for each of these conditions in Q3’23.

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

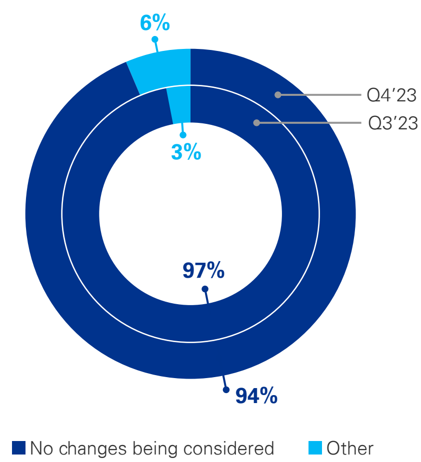


*Economic forecasting as a result of the inflation rate, interest rate, the unemployment rate and/or the potential of an economic recession.

Approximately 63 percent of respondents in Q4'23 stated that economic forecasting as a result of the inflation rate, interest rate, the unemployment rate and the potential of an economic recession, continues to be the greatest challenge in determining ACL estimates as compared to 61 percent in Q3'23. Approximately 23 percent of respondents in Q4'23, as compared to 18 percent in Q3'23, 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 challenges detailed in Question 5 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; 94 percent of respondents in Q4'23 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 as compared to 97 percent in Q3'23. Approximately 6 percent of respondents in Q4'23 are considering other changes to the ACL assumptions and components including applying model overlays related to prepayment trends and other trends considered non-recurring.

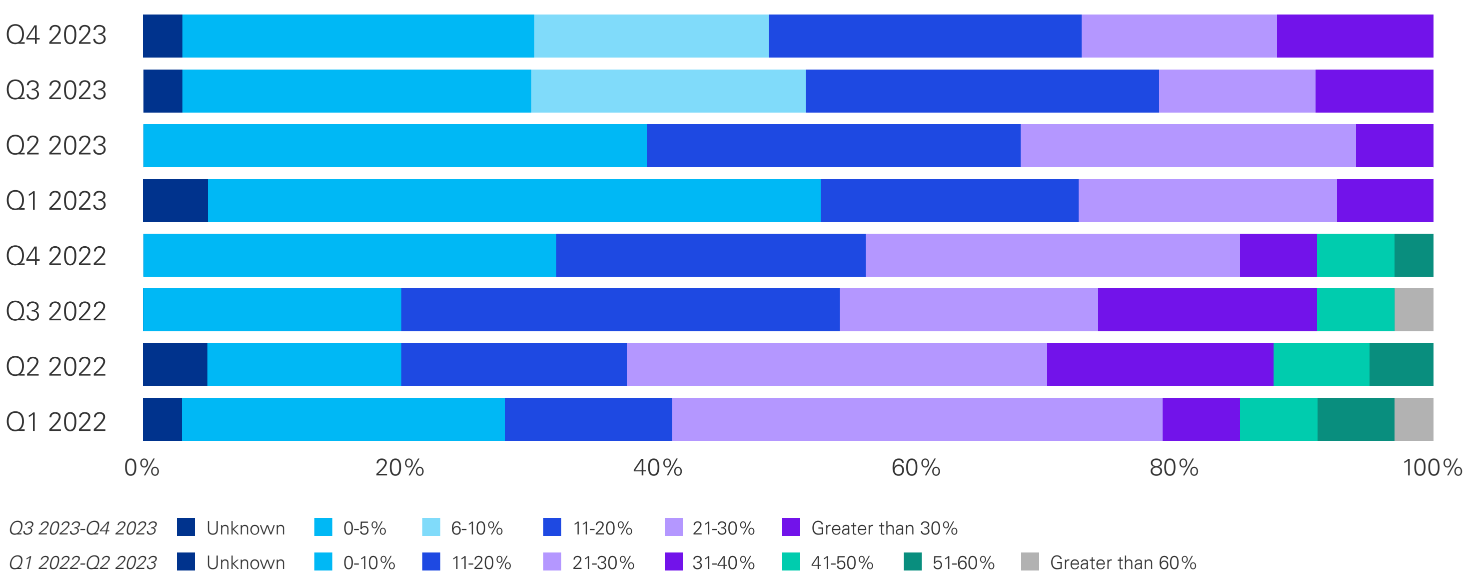
To estimate losses over the reasonable and supportable forecast period, entities are permitted to incorporate one or more economic scenarios into their ACL estimate. Accordingly, many institutions have incorporated multiple economic scenarios into their ACL framework, particularly in response to economic 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 61 percent in Q4’23.

	Base case	Upside	Downside	Moderate downside	Severe downside	Other
Q4’23[1]	61%	21%	27%	35%	11%	58%

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.

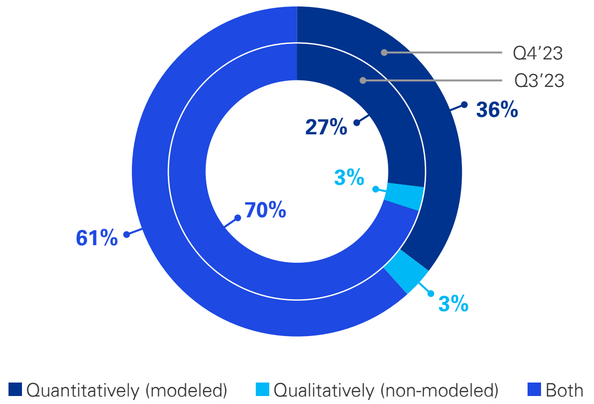
7. What percentage of your Company’s ACL as of December 31, 2023 would you estimate to be based on qualitative factors?



Many companies incorporate qualitative adjustments into their ACL estimate to capture changes in expectations, and we understand they will continue to do so. Approximately 27 percent of respondents indicated they expect qualitative factors to comprise more than 20 percent of the total ACL estimate in Q4’23 as compared to 21 percent in Q3’23.

[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.

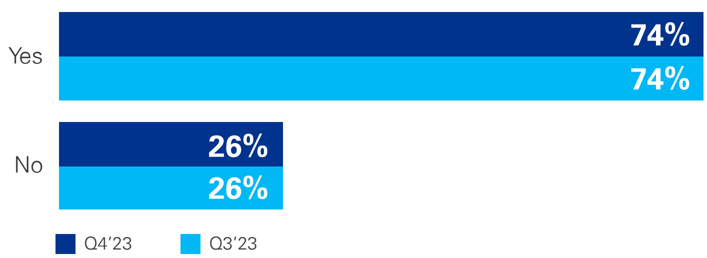
8. How are economic conditions such as the inflation rate, interest rates, unemployment rate and/or the potential of an economic recession being factored into your Company's ACL estimate?



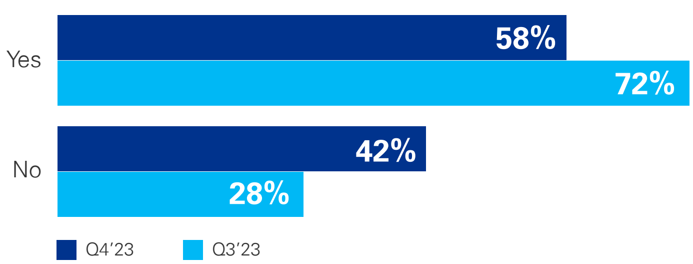
In Q4'23, approximately 61 percent of respondents are factoring in impacts from inflation rate and interest rate changes, the unemployment rate and a potential economic recession within their ACL estimate both quantitatively (modeled) and qualitatively (non-modeled) as compared to 70 percent in Q3'23. In contrast, 36 percent of respondents are factoring in these same impacts solely via the quantitative (modeled) component of the ACL estimate as compared to 27 percent in Q3'23.

Delinquencies and net charge-offs

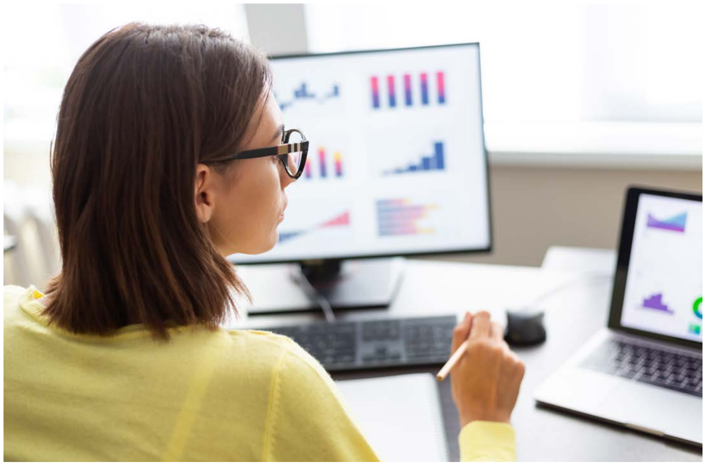
9. Have delinquencies increased from September 30, 2023?



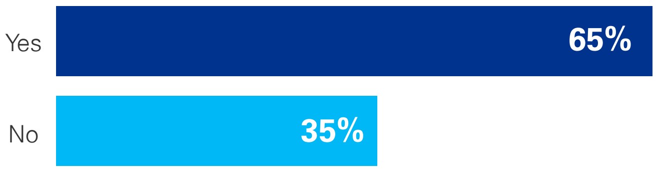
10. Have net charge-offs increased from September 30, 2023?



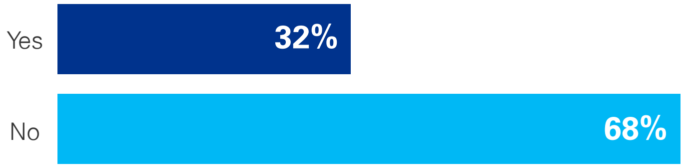
We surveyed companies about delinquency and net charge-off trends and approximately 74 percent of respondents cited that delinquencies have increased in Q4'23 which is consistent with Q3'23. Approximately 58 percent of respondents cited net charge-offs have also increased in Q4'23 as compared to 72 percent in Q3'23.



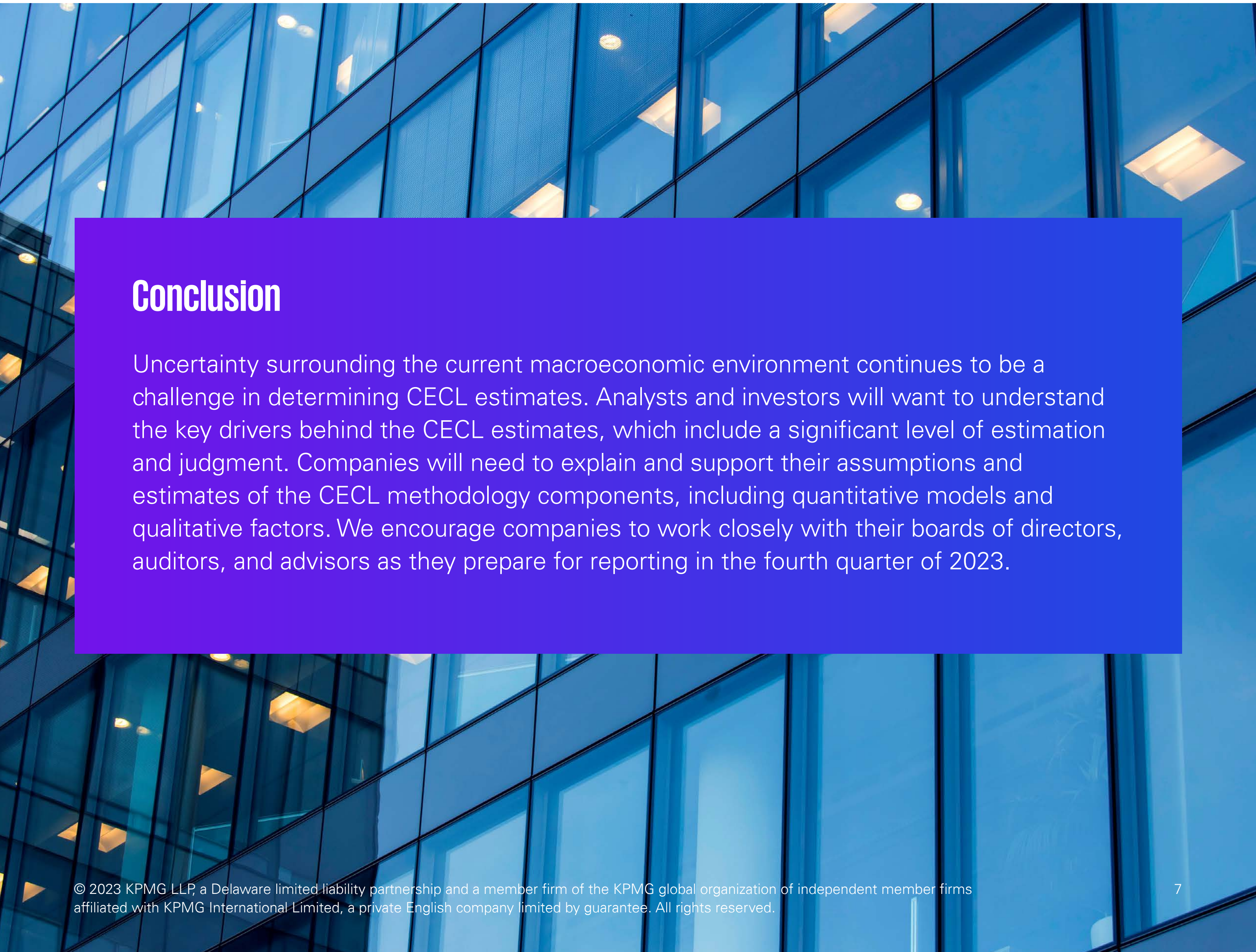
11. Are current delinquency and net charge-off rates considered to be consistent with pre-pandemic levels?



12. Are current delinquency and net charge-off rates indicating new portfolio trends as compared to historical experience?



Approximately 65 percent of respondents in Q4'23 cited current delinquency and net charge-off rates are consistent with pre-pandemic levels and of those who responded 32 percent have identified new trends in the most recent delinquency and net-charge off rates. Potential new portfolio trends may continue to emerge as delinquencies and net charge-offs increase beyond pre-pandemic levels in combination with other impacts on borrower behavior such as changing interest rates.



Conclusion

Uncertainty surrounding the current macroeconomic environment 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 fourth quarter of 2023.

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