CECL Pulse check

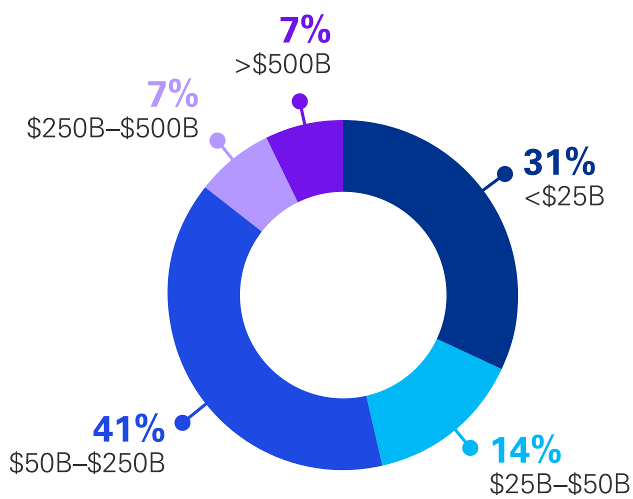
How companies are responding to economic impacts in their CECL estimates in Q1'24

We surveyed companies during the first quarter of 2024 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 first quarter of 2024 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 March 14 and March 21, 2024 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

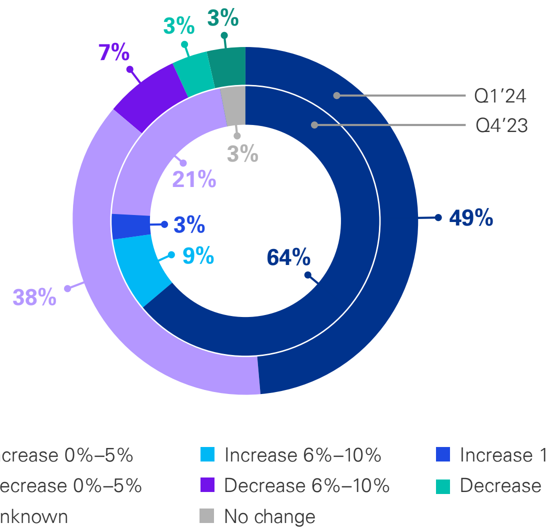
We surveyed **22 banks** and **7 finance companies**. They range in asset size from less than $25 billion to more than $500 billion.



Responses for Q1'24 were obtained between March 14 and March 21, 2024 and reflect information known at that time.

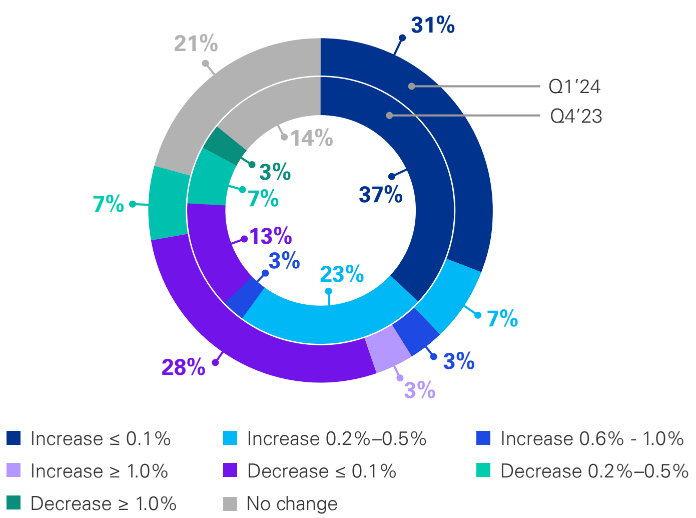
Expected impact of continued economic uncertainty on CECL methodology and results

1. How much do you expect the allowance for expected credit losses (ACL) to change from December 31, 2023 to March 31, 2024?



In Q1'24, approximately 49 percent of respondents expect the overall allowance for expected credit loss (ACL) to increase compared with 76 percent in Q4'23. In contrast, 48 percent of respondents expect a decrease in their ACL in Q1'24 compared with 21 percent in Q4'23.

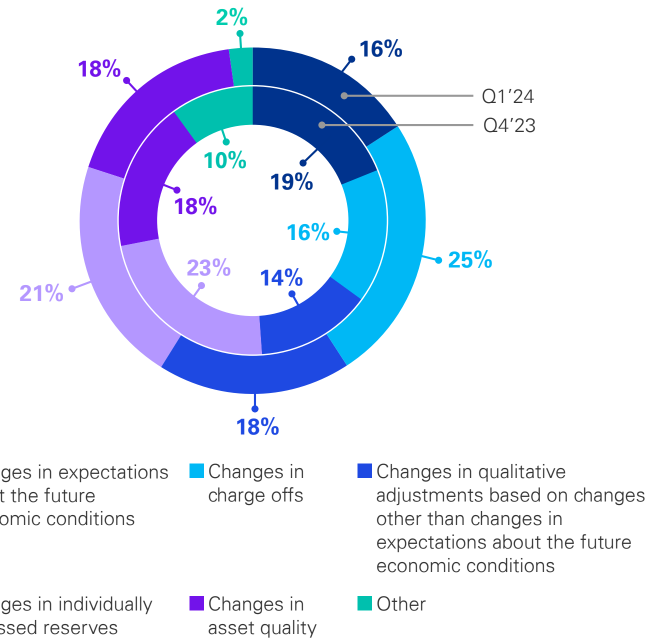
2. How much do you expect the total allowance for expected credit losses (ACL) to change as a percentage of end of period receivables subject to ACL from December 31, 2023 to March 31, 2024?



In Q1'24, approximately 31 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 7 percent of respondents expect the increase to represent 0.2 percent to 0.5 percent as compared to 37 percent and 23 percent, respectively, in Q4'23. In contrast, 28 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 13 percent and 7 percent, respectively, in Q4'23.

Approximately 21 percent of respondents in Q1'24 expect no change in the overall ACL as a percentage of total receivables assessed for ACL as compared to 14 percent in Q4'23.

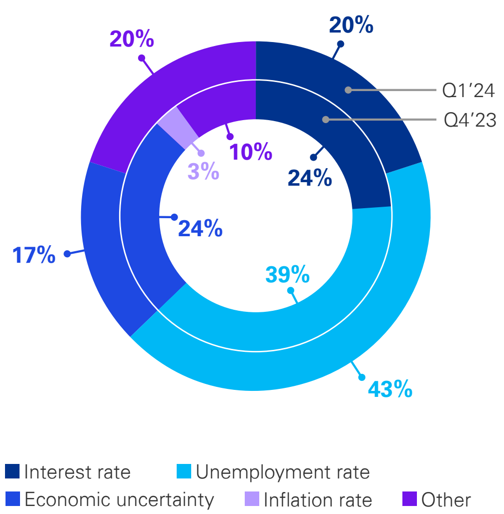
3. What do you expect the largest driver of change to be in the ACL balance excluding increases or decreases in loan volume from December 31, 2023 to March 31, 2024?



The largest driver of ACL change, excluding increases or decreases in loan volume, was changes in charge offs with 25 percent of respondents in Q1'24 selecting this driver as compared to 16 percent in Q4'23. Other drivers of ACL change included changes in individually assessed reserves (21 percent in Q1'24 as compared to 23 percent in Q4'23), changes in qualitative adjustments based on changes other than changes in expectations related to future economic conditions (18 percent in Q1'24 as compared to 14 percent in Q4'23), and changes in asset quality (18 percent in Q1'24 as compared 18 percent in Q4'23).

The majority of respondents (62 percent) in Q1'24 cited no change in future economic conditions as compared to 76 percent in Q4'23. In contrast, 35 percent of respondents said their outlook on future economic conditions improved in Q1'24, compared to 18 percent in Q4'23.

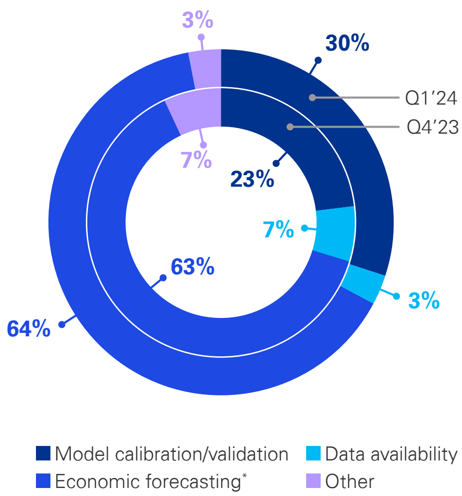
4. Which economic condition is having the greatest impact on your Company's ACL estimate?



Responses for Q1'24 were obtained between March 14 and March 21, 2024 and reflect information known at that time. The economic conditions selected may not reflect the impact of more recent market events.

Approximately 43 percent of respondents in Q1'24 cited the unemployment rate as being the most significant economic condition as compared to 39 percent in Q4'23. Interest rate changes was the second most significant economic concern with approximately 20 percent of respondents selecting this economic condition in Q1'24 as compared to 24 percent in Q4'23. Other economic conditions such as changes in commercial real estate values was the third most significant economic concern with approximately 20 percent of respondents selecting this economic condition in Q1'24 as compared to 10 percent in Q4'23.

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



*Economic forecasting as a result of changes in interest rates, unemployment rate and/ or other economic uncertainty.

Approximately 64 percent of respondents in Q1'24 stated that economic forecasting as a result of changes in interest rates, unemployment rate and/ or other economic uncertainty, continues to be the greatest challenge in determining ACL estimates as compared to 63 percent in Q4'23. Approximately 30 percent of respondents in Q1'24, as compared to 23 percent in Q4'23, cited model calibration/validation as the greatest challenge in determining their ACL.

CECL methodology components

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

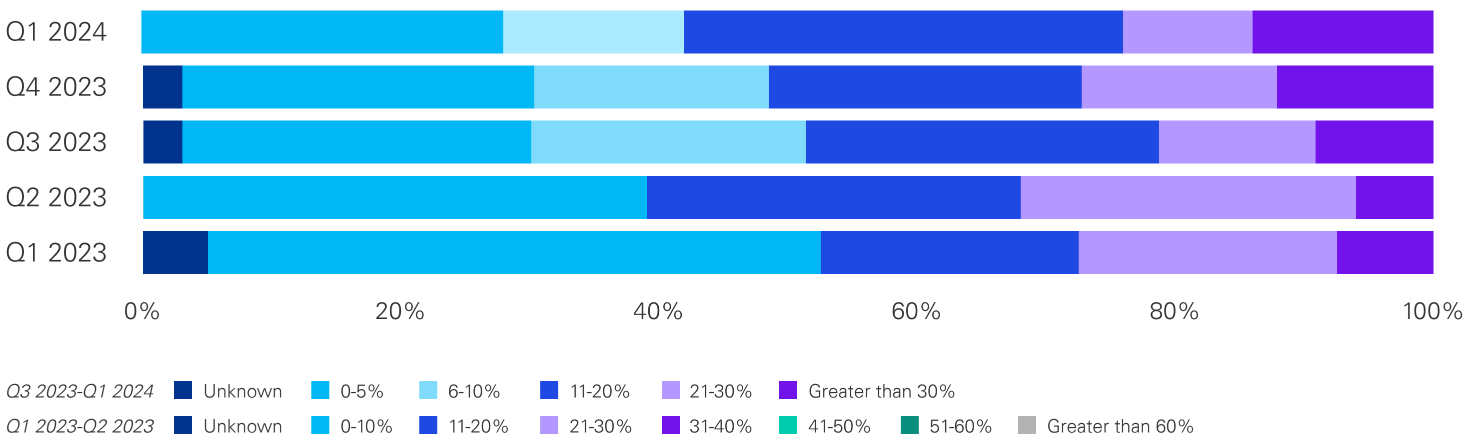
For those companies that utilize percentage probability weights in their macroeconomic scenarios as part of their methodology; we summarized the average percentage probability, where a percentage probability is applied, by scenario below. For example, for those respondents that applied a percentage other than zero percent to the base case scenario, the average was 61 percent in Q1'24.

	Base case	Upside	Downside	Moderate downside	Severe downside	Other
Q1'24[1]	61%	20%	29%	34%	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.

[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 0 percent.

6. What percentage of your Company's ACL as of March 31, 2024 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 24 percent of respondents indicated they expect qualitative factors to comprise more than 20 percent of the total ACL estimate in Q1'24 as compared to 27 percent in Q4'23.

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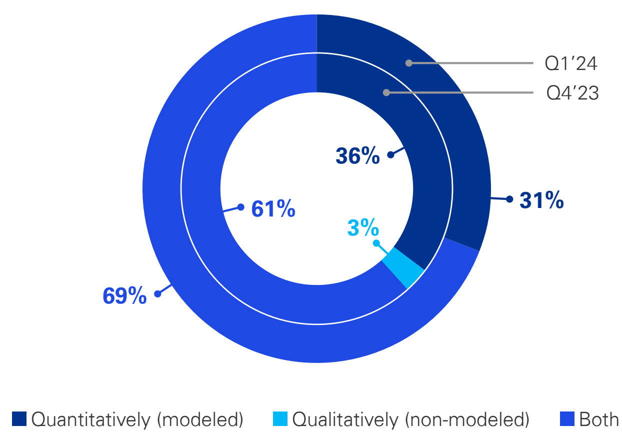
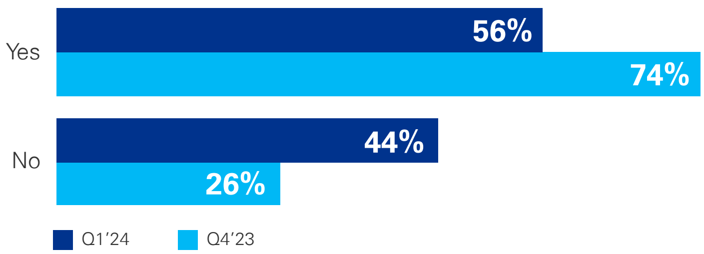
7. How are economic conditions such as changes in interest rates, unemployment rate, and/ or other economic uncertainty being factored into your Company's ACL estimate?



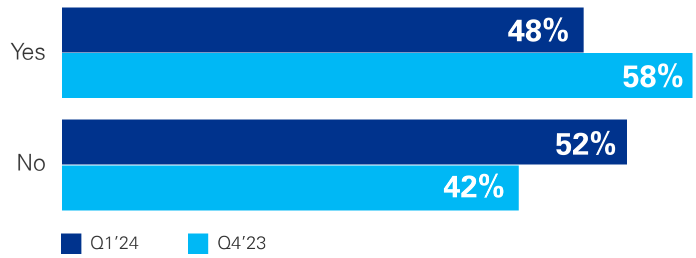
In Q1'24, approximately 69 percent of respondents are factoring in impacts from interest rate changes, the unemployment rate and other economic uncertainty within their ACL estimate both quantitatively (modeled) and qualitatively (non-modeled) as compared to 61 percent in Q4'23. In contrast, 31 percent of respondents are factoring in these same impacts solely via the quantitative (modeled) component of the ACL estimate as compared to 36 percent in Q4'23.

Delinquencies and net charge-offs

8. Have delinquencies increased from December 31, 2023?

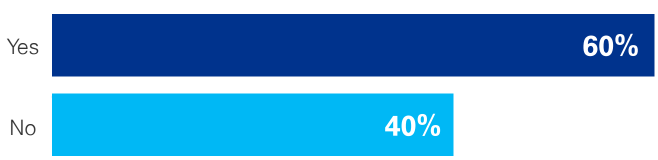


9. Have net charge-offs increased from December 31, 2023?



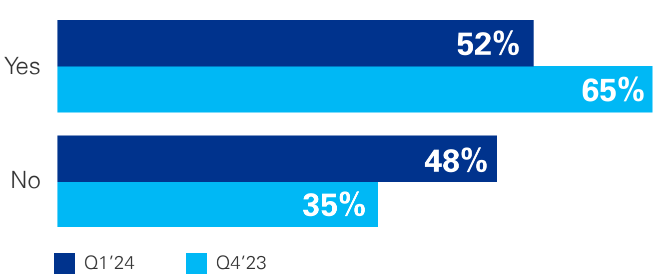
We surveyed companies about delinquency and net charge-off trends and approximately 56 percent of respondents cited that delinquencies have increased in Q1’24 as compared to 74 percent in Q4’23. Approximately 48 percent of respondents cited net charge-offs have also increased in Q1’24 as compared to 58 percent in Q4’23.

10. Have non-performing commercial loans increased from December 31, 2023 to March 31, 2024?

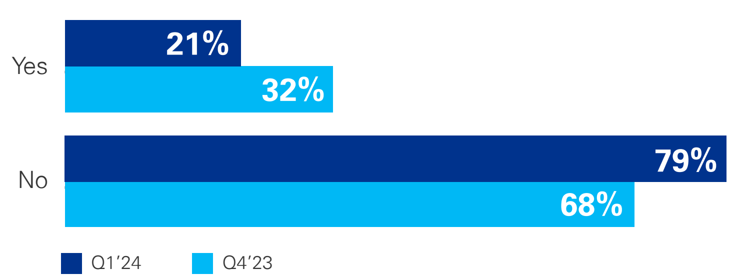


Approximately 60 percent of respondents cited that non-performing commercial loans have increased in Q1’24 and of those who responded 63 percent identified commercial and industrial loans as being the primary non-performing commercial loan type.

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 52 percent of respondents in Q1’24 cited current delinquency and net charge-off rates are consistent with pre-pandemic levels as compared to 65 percent in Q4’23 and of those who responded 79 percent have not identified new trends in the most recent delinquency and net-charge off rates as compared to 68 percent in Q4’23.

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 first quarter of 2024.

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