CECL Pulse check

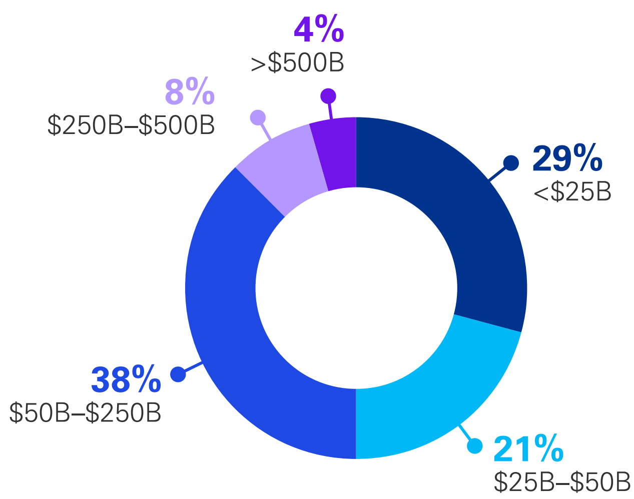
How companies are responding to economic impacts in their CECL estimates in Q2'24

We surveyed companies during the second 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 second quarter of 2024 as market pressures persisted, with rates to remain elevated through the end of the year. KPMG LLP (KPMG) surveyed commercial and consumer lenders, including banks and finance companies, to understand how companies are dealing with these issues and their impact on CECL estimates. The survey results were obtained between June 18 and June 24, 2024 and reflect information known at that time. As the economic situation evolves, we expect companies will continue to monitor and reassess the assumptions used in their CECL estimates up to the reporting date.

Who we surveyed

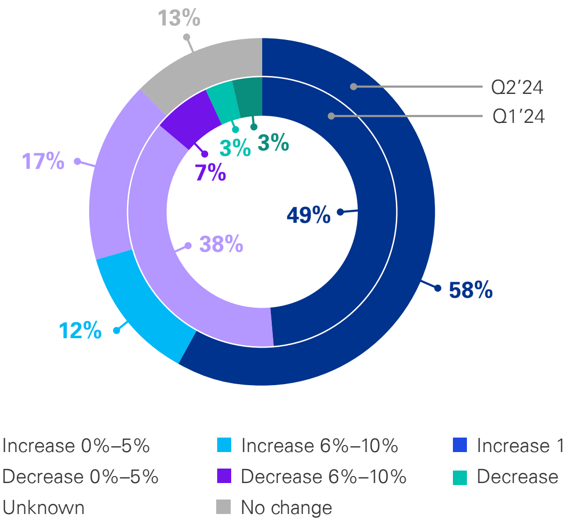
We surveyed **19 banks** and **5 finance companies** with a wide range of asset sizes.



Responses for Q2'24 were obtained between June 18 and June 24, 2024, and reflect information known at that time.

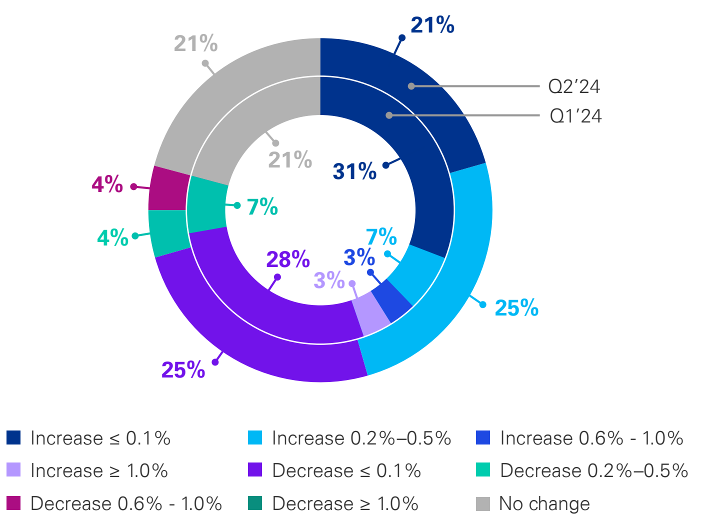
Expected impact of continued economic uncertainty on CECL methodology and results

1. How much do you expect the allowance for expected credit losses (ACL) to change from March 31, 2024 to June 30, 2024?



In Q2'24, approximately 70 percent of respondents expect the overall allowance for expected credit loss (ACL) to increase, compared with 49 percent in Q1'24. In contrast, 17 percent of respondents expect a decrease in their ACL in Q2'24, compared with 48 percent in Q1'24.

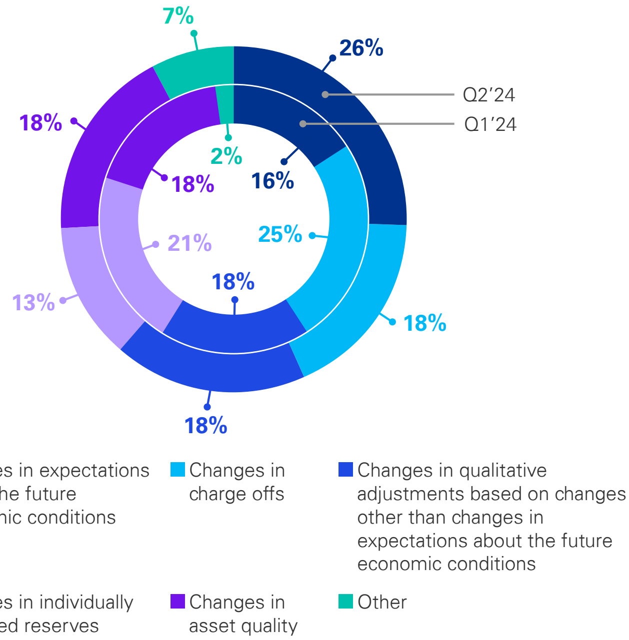
2. How much do you expect the total allowance for expected credit losses (ACL) to change as a percentage of end of period receivables subject to ACL from March 31, 2024 to June 30, 2024?



In Q2'24, approximately 21 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 (as compared to 31 percent in Q1'24). Approximately 25 percent of respondents expect the increase to represent 0.2 percent to 0.5 percent (as compared to 7 percent in Q1'24). In contrast, 25 percent of respondents expect the decrease as a percentage of total receivables assessed for ACL to represent 0.1 percent or less (as compared to 28 percent in Q1'24). Approximately 4 percent of respondents expect the decrease to represent 0.2 percent to 0.5 percent (as compared to 7 percent in Q1'24).

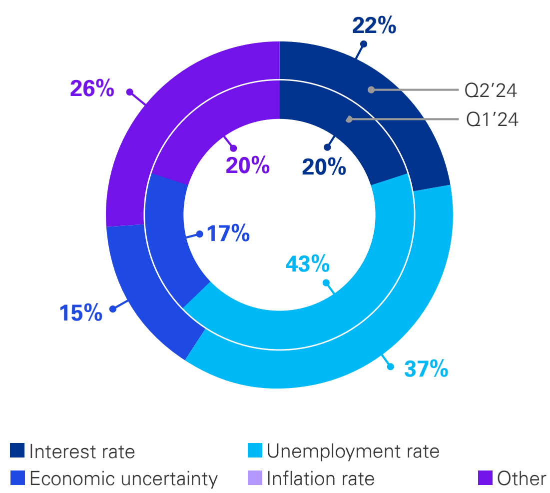
Approximately 21 percent of respondents in Q2'24 expect no change in the overall ACL as a percentage of total receivables assessed for ACL, which is consistent with Q1'24.

3. What do you expect the largest driver of change to be in the ACL balance excluding increases or decreases in loan volume from March 31, 2024 to June 30, 2024?



The largest driver of ACL change, excluding increases or decreases in loan volume, was changes in expectations about future economic conditions. Approximately 26 percent of respondents in Q2'24 selected this driver as compared to 16 percent in Q1'24. Other drivers of ACL change included changes in charge offs, with 18 percent of respondents in Q2'24 selecting this driver, as compared to 25 percent in Q1'24. This was followed by changes in qualitative adjustments based on changes other than changes in expectations related to future economic conditions (18 percent in Q2'24 which is consistent with Q1'24), changes in asset quality (18 percent in Q2'24 which is consistent with Q1'24), and changes in individually assessed reserves (13 percent in Q2'24 as compared to 21 percent in Q1'24).

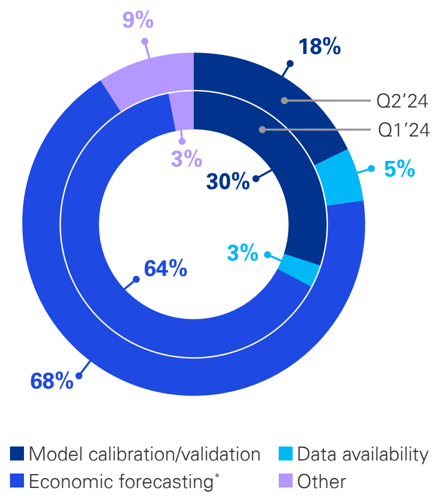
4. Which economic condition is having the greatest impact on your Company's ACL estimate?



Responses for Q2'24 were obtained between June 18 and June 24, 2024, and reflect information known at that time. The economic conditions selected may not reflect the impact of more recent market events.

Approximately 37 percent of respondents in Q2'24 cited the unemployment rate as the economic condition expected to have the greatest impact on ACL, as compared to 43 percent in Q1'24. Other economic conditions such as changes in commercial real estate values was the second most significant economic concern in Q2'24, with approximately 26 percent of respondents selecting this economic condition, as compared to 20 percent in Q1'24. Interest rate changes was the third most significant economic concern, with approximately 22 percent of respondents selecting this economic condition in Q2'24, as compared to 20 percent in Q1'24.

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, economic uncertainty, and/ or other economic factors.

Approximately 68 percent of respondents in Q2'24 stated that economic forecasting as a result of changes in interest rates, unemployment rate, economic uncertainty, and/ or other economic factors continue to be the greatest challenge in determining ACL estimates (as compared to 64 percent in Q1'24). Approximately 18 percent of respondents in Q2'24, as compared to 30 percent in Q1'24, 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.

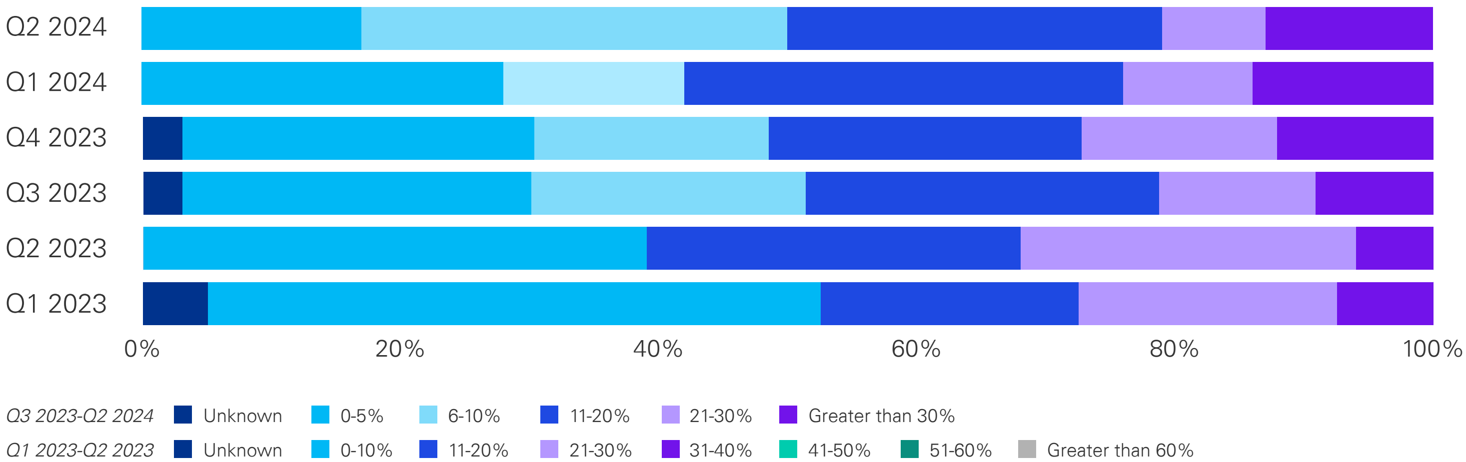
For companies that utilize percentage probability weights in their macroeconomic scenarios as part of their methodology; we summarized the average percentage probability, where a percentage probability is applied, by the scenario below. For example, for those respondents that applied a percentage other than zero percent to the base case scenario, the average was 64 percent in Q2'24.

	Base case	Upside	Downside	Moderate downside	Severe downside	Other
Q2'24[1]	64%	17%	37%	27%	20%	25%

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.

6. What percentage of your Company's ACL as of June 30, 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 21 percent of respondents indicated they expect qualitative factors to comprise more than 20 percent of the total ACL estimate in Q2'24 as compared to 24 percent in Q1'24.

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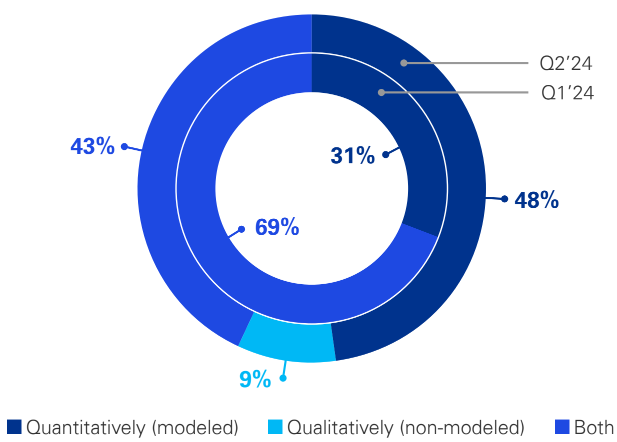
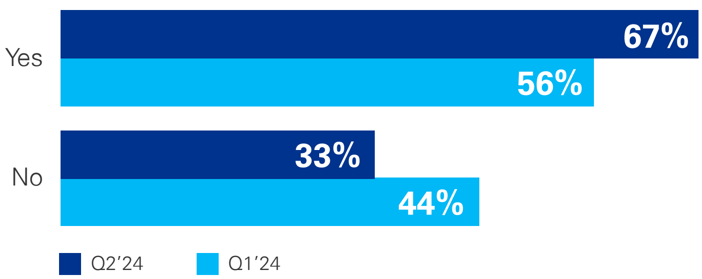
7. How are economic conditions such as changes in interest rates, unemployment rate, economic uncertainty, and/ or other economic factors being factored into your Company's ACL estimate?



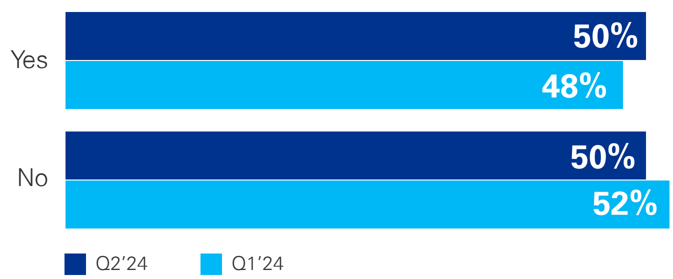
In Q2'24, approximately 43 percent of respondents are factoring in impacts from interest rate changes, the unemployment rate, economic uncertainty, and/ or other economic factors within their ACL estimate, both quantitatively (modeled) and qualitatively (non-modeled) as compared to 69 percent in Q1'24. In contrast, 48 percent of respondents in Q2'24 are factoring in these same impacts solely via the quantitative (modeled) component of the ACL estimate (as compared to 31 percent in Q1'24).

Delinquencies and net charge-offs

8. Have delinquencies increased from March 31, 2024 from prior quarter end?

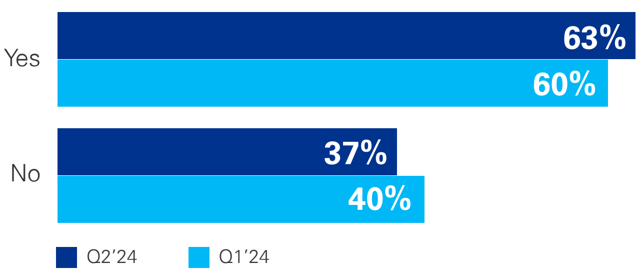


9. Have net charge-offs increased from March 31, 2024 from prior quarter end?



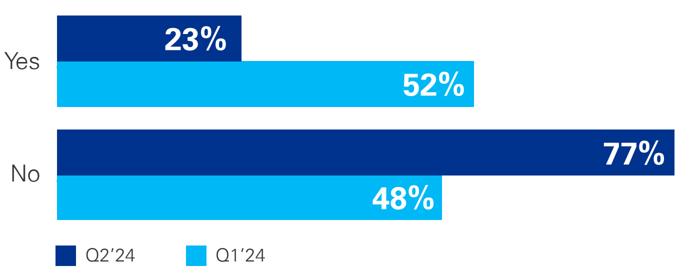
We surveyed companies about delinquency and net charge-off trends and approximately 67 percent of respondents cited that delinquencies have increased in Q2'24 as compared to 56 percent in Q1'24. Approximately 50 percent of respondents cited net charge-offs also increased in Q2'24, as compared to 48 percent in Q1'24.

10. Have non-performing commercial loans increased from March 31, 2024 to June 30, 2024 from prior quarter end?



Approximately 63 percent of respondents cited that non-performing commercial loans have increased in Q2'24 as compared to 60 percent in Q1'24. Of those who responded, 47 percent in Q2'24 identified commercial real estate-office loans as being the primary non-performing commercial loan type (as compared to 25 percent in Q1'24).

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



Approximately 77 percent of respondents in Q2'24 have not identified new trends in the most recent delinquency and net-charge off rates as compared to 48 percent in Q1'24.

For those respondents with a commercial real estate portfolio, approximatively 33 percent of respondents expect the ACL to loan reserve coverage ratio to be greater than 2.50 basis points in Q2'24.

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 second quarter of 2024.

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