Pulse check

How companies are responding to economic impacts in their CECL estimates in Q2'22

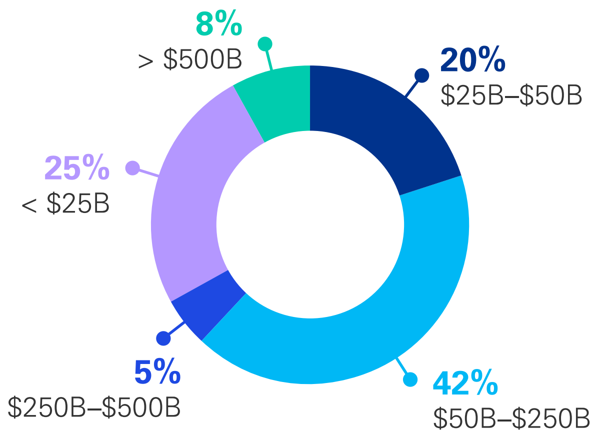
We surveyed companies during the second quarter of 2022 to understand how current economic conditions are likely to impact their Current Expected Credit Losses (CECL) process. We asked about the impacts of CECL on reported earnings—including commercial and retail loan portfolios—and to share their expectations regarding which economic conditions may have the greatest future impact on existing models. In addition, we asked them to describe recent challenges related to determining the estimate, methodology components, and FASB amendments.

Economic uncertainty increased in the second quarter of 2022 as inflationary pressures worsened and expectations of recession rose.[1] Similarly, supply chain disruptions persist and the ongoing Russia-Ukraine war continues to impacts global markets.

KPMG surveyed commercial and consumer lenders (including banks and finance companies) to understand how companies are reacting to and dealing with these issues and its subsequent impact on CECL reporting. The survey results were obtained between June 6, 2022 and June 17, 2022 and reflect information known at that time. With the ever changing global economic and political landscape, we expect companies will monitor and reassess the appropriateness of the assumptions used in their CECL estimate up to the reporting date.

Who we surveyed

We surveyed **33 banks** and **7 consumer finance** companies. They range in asset size from less than $25 billion to more than $500 billion.



Responses were obtained between June 6, 2022 and June 17, 2022, and reflect information known at that time.

[1] Source: "KPMG Global Economic Outlook", KPMG LLP, April, 2022.

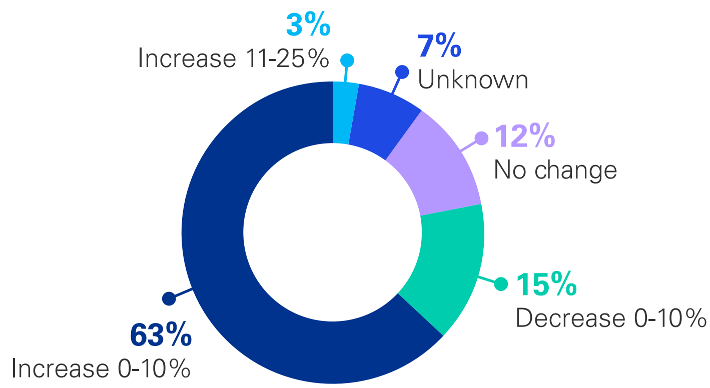
Expected impact of continued uncertainty on CECL methodology and results

The majority of respondents (66 percent) expect the overall allowance for expected credit loss (ACL) to increase in Q2’22 compared with 28 percent in Q1’22. In contrast, 15 percent of respondents expect a decrease in their ACL in Q2’22 compared with 50 percent in Q1’22.

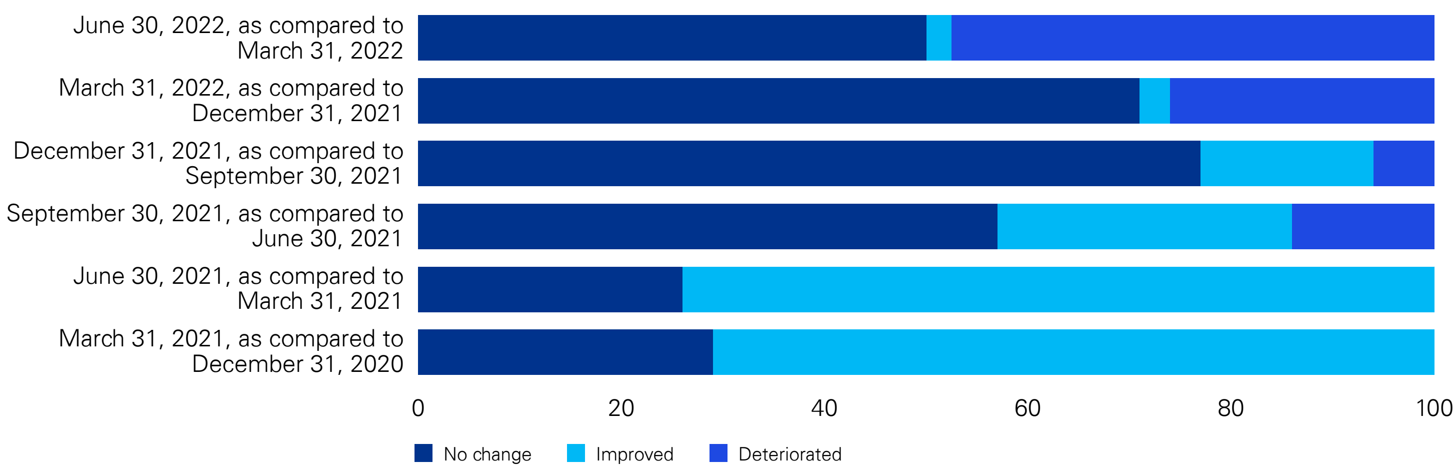
We also surveyed companies about their expectations of ACL changes disaggregated by commercial and retail portfolios. Approximately 50 percent of respondents expect an increase in the ACL for both commercial and retail loan portfolios compared with 22 percent and 25 percent, respectively, in Q1’22. In contrast, 18 percent and 15 percent of respondents expect a decrease in the ACL for commercial and retail loan portfolios, respectively, compared with 50 percent and 41 percent in Q1’22.

For the 66 percent of respondents who expect the ACL to increase, the most important factor cited was a change in future economic outlook (deterioration) compared to their outlook in Q1’22.

1. How much do you expect the allowance for expected credit losses (ACL) to change from March 31, 2022 to June 30, 2022?

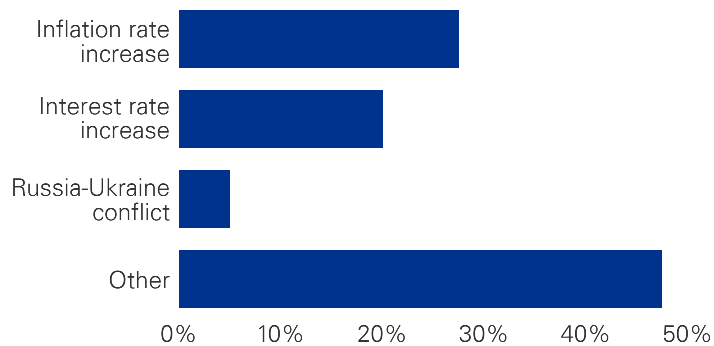


2. How has your Company’s outlook with regard to future economic conditions changed since the ACL estimate was derived on March 31, 2022?



Views regarding the future economic outlook have worsened as compared to Q1'22. Approximately 48 percent of respondents cited their future economic outlook had deteriorated in Q2'22 as compared to 26 percent in Q1'22. Factors leading to a deteriorated future economic outlook included increased inflation rate, increased interest rates and the ongoing Russia-Ukraine conflict. In contrast, 50 percent of respondents cited no change in their future economic outlook in Q2'22 as compared to 71 percent in Q1'22. Since December 31, 2021, approximately 92 percent of respondents cited that they have revised their macroeconomic forecast.

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

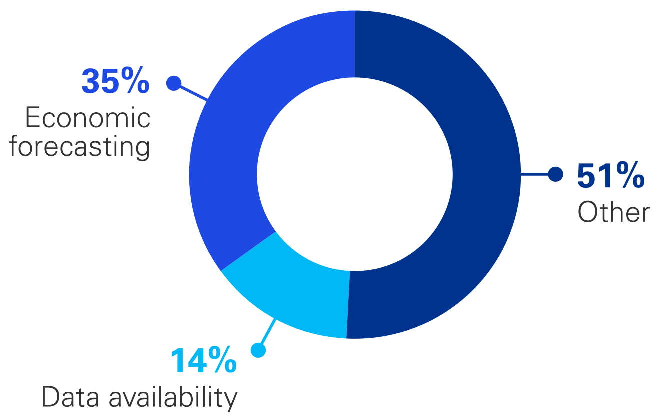


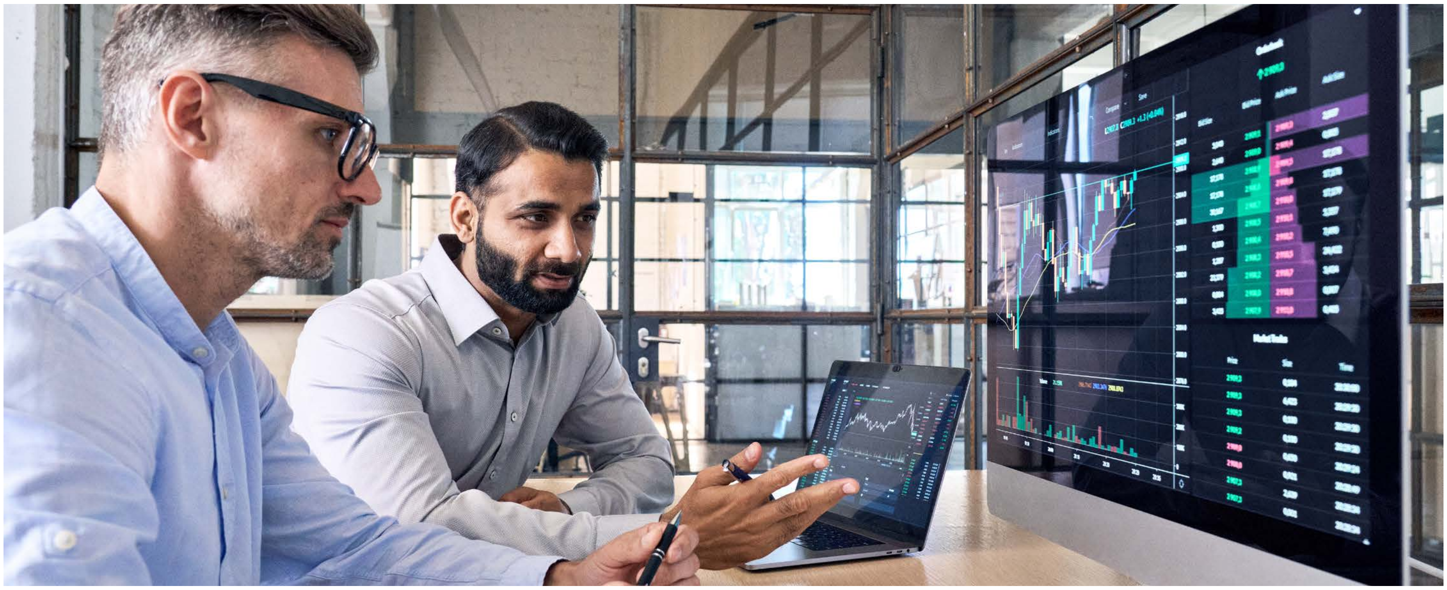
Responses were obtained between June 6, 2022 and June 17, 2022, and reflect information known at that time. The economic conditions selected may not reflect the impact of the Federal Reserve Bank's response to inflationary pressures.

Approximately 86 percent of respondents are experiencing challenges in determining their ACL due to economic forecasting in Q2'22 as compared to 59 percent in Q1'22. Respondents identified the following economic forecasting challenges:

- Difficulty in modelling multiple economic outcomes
- Constraints in calibrating model factors such as current levels of inflation
- Difficulty in modeling the impact of economic uncertainty and volatility

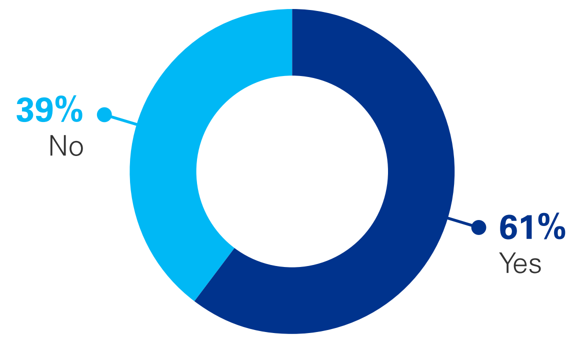
4. What challenges are you experiencing in determining your Company's ACL estimate?





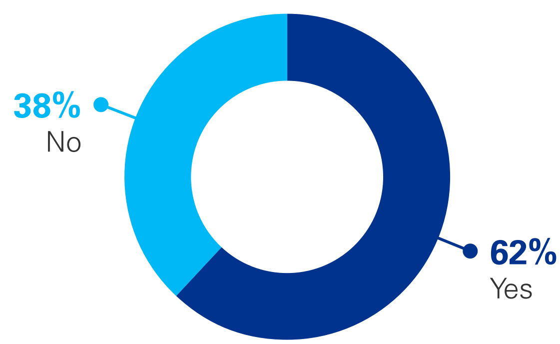
Approximately 61 percent of respondents stated that the challenges experienced in determining their ACL were a direct result of the higher inflation rate, increased interest rates and/ or the ongoing Russia-Ukraine conflict.

5. Are the aforementioned challenges a direct result of the higher inflation rate, increased interest rates and/ or the ongoing Russia-Ukraine conflict?



Although 83 percent of respondents indicated they do not intend to reassess and/ or recalibrate CECL quantitative models for recent experiences as a result of the higher inflation rate, increased interest rates and/ or the ongoing Russia-Ukraine conflict; 62 percent of respondents indicated there is an ongoing impact from the COVID-19 pandemic being factored into their ACL via qualitative adjustments.

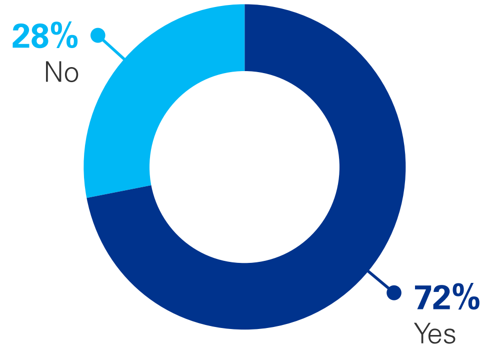
6. Is there any ongoing impact from the COVID-19 pandemic that is being factored into your Company's ACL estimate?



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 allowance estimate. Accordingly, many institutions have incorporated multiple economic scenarios into their allowance framework, particularly in response to economic uncertainty from higher inflation, increased interest rates, and the ongoing Russia-Ukraine conflict.

7. For your models that utilize macroeconomic inputs, do you leverage multiple economic scenarios to inform your ACL estimates?



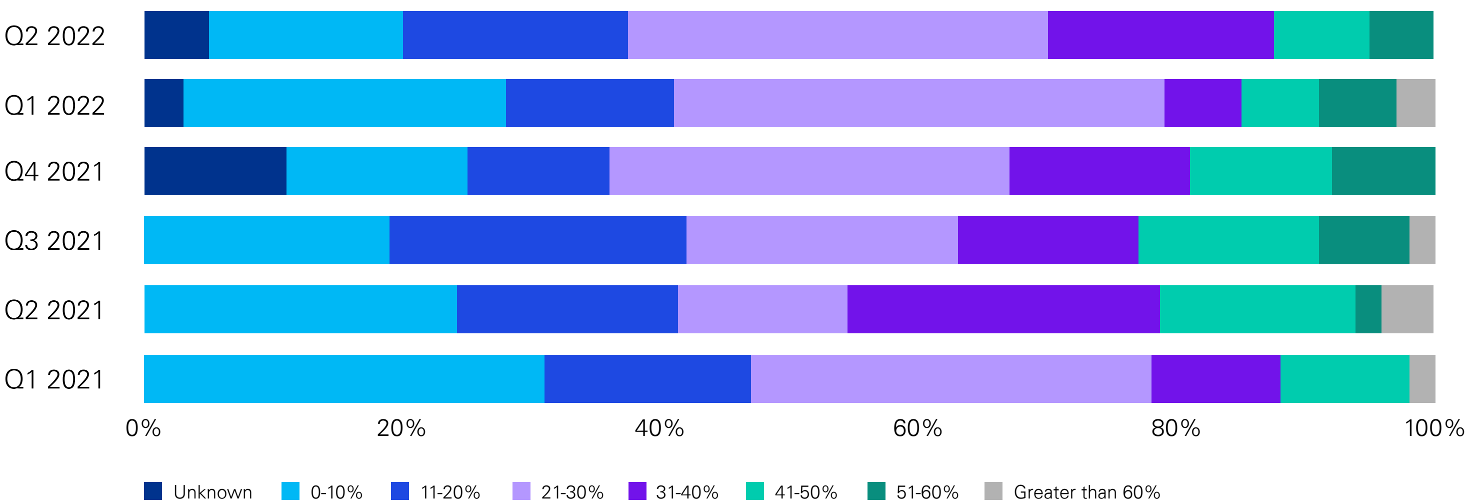
We also surveyed companies about their percentage probability weights used in their macroeconomic scenarios for both Q1’22 and Q2’22. We have summarized the average percentage probability by scenario below.

	Base case	Upside	Downside	Severe downside	Other
Q1’22[2]	66%	20%	28%	10%	53%
Q2’22	67%	20%	28%	13%	48%

Many companies incorporate qualitative adjustments into their allowance estimate to capture changes in expectations, and we believe they will continue to do so.

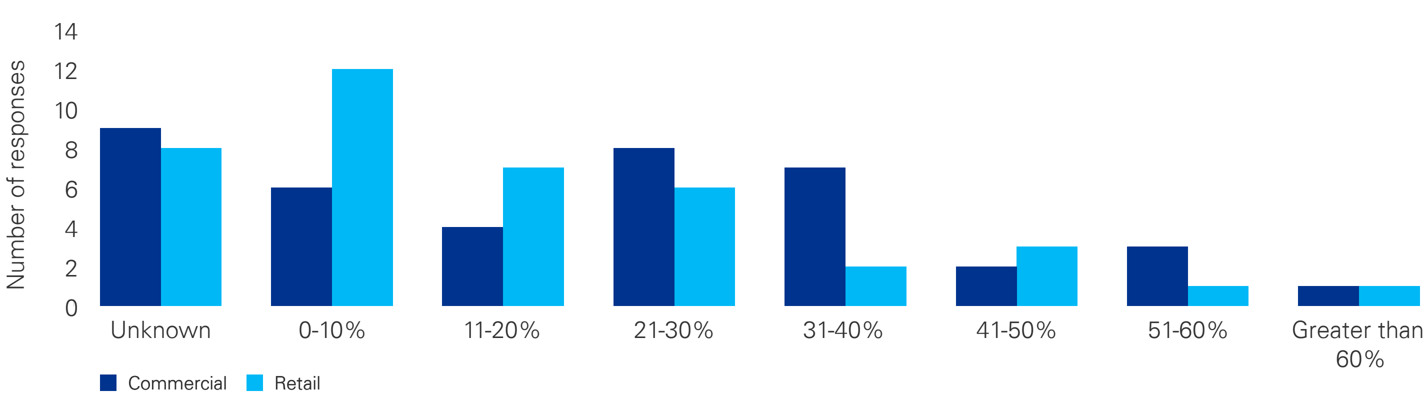
The qualitative component continues to be integral to the ACL estimate under CECL, as 63 percent of survey respondents indicated they expect qualitative factors to comprise more than 20 percent of the total allowance estimate in Q2’22 as compared to 59 percent in Q1’22.

8. What percentage of your Company’s ACL as of June 30, 2022 would you estimate to be based on qualitative factors?



We also surveyed lenders’ estimates of qualitative reserves specific to commercial and retail loan portfolios.

9. What percentage of your Company’s ACL as of June 30, 2022 would you estimate to be based on qualitative factors?

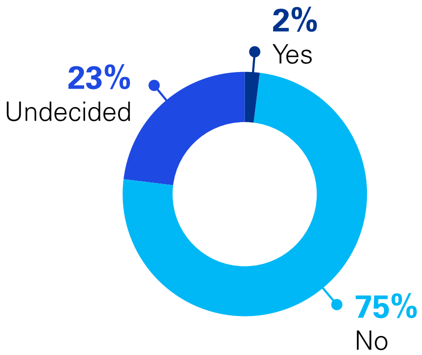


[2] The average percentage probability by scenario for Q1’22 is based on actuals for Q1’22 as provided by companies surveyed in Q2’22.

FASB amendments

This quarter we also surveyed companies as to whether they have adopted or plan to early adopt ASU 2022-02, which eliminates the accounting guidance for troubled debt restructurings (TDRs) by creditors in ASC 310-40, Receivables—Troubled Debt Restructurings by Creditors. Approximately 75 percent of respondents indicated that they do not plan to early adopt the amended guidance.

10. The FASB recently issued ASU 2022-02, which eliminates the accounting guidance for troubled debt restructurings (TDRs) by creditors in ASC 310-40, Receivables – Troubled Debt Restructurings by Creditors. Have you adopted or do you plan to early adopt the amended guidance?



Conclusion

The uncertainty surrounding the economy due to worsening inflationary pressures, persistent supply chain disruptions and continued unknowns in relation to geopolitical developments are anticipated to be a challenge in determining CECL estimates, particularly due to lack of similar historical events. 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 2022.

Contact us:

Patrick Davies-Griffith
Senior Manager, Audit
917-744-1923
pdaviesgriffith@kpmg.com

Mario Mastrantoni
Partner, Accounting Advisory Services
704-370-4362
mmastrantoni@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

DASD-2022-7433