Allowance for Loan and Lease Losses
(ALLL)
Agenda

- Key observations during the financial crisis
- What are the current conditions out in the field
- Key asset quality indicators
- Exam related issues
- Proposed changes to the ALLL
Key Observations During the Financial Crisis

- ALLL levels not commensurate with the overall risk in the portfolio
- Charge offs over a short compressed timeframe
- Provision requirements led to a significant erosion of capital and in some cases bank failures
What are the Current Conditions Out in the Field?

- Improving economic indicators leading to a reduction in past due and nonaccrual loans
- Charge offs have reduced significantly
- Minimal provision requirements and in some cases reverse provisions.
National Charge-off Ratio

Source: Bank Call Reports
National Nonperforming Assets

Source: Bank Call Reports
Sixth District Net Charge-Offs

Source: Bank Call Reports
Sixth District Noncurrent Loans

Source: Bank Call Reports
Sixth District Loan Loss Reserves

Source: Bank Call Reports
Sixth District Reserve Adequacy

Reserves/ Nonaccrual Loans (X)

Source: Bank Call Reports
Building/Releasing Reserves

Building Reserves > 0%, Releasing Reserves < 0%

Source: Bank Call Reports
Sixth District CBG Median ALLL Coverage Trends

Source: Bank Call Reports
Exam Related Issues

- Loss periods need to transition back to normal time periods
- Support Unallocated portfolio
- Documentation
- Validation
Proposed Changes to Accounting for Credit Losses

- Reasons for change in accounting for credit losses
- Summary of proposed changes
- Improvements over existing model
Crisis led to calls for improvement in accounting for credit losses
  • In April 2009, G20 requested that standard setters “strengthen accounting recognition of loan-loss provisions...”

Weaknesses in current credit loss accounting model:
  ◦ Delayed recognition of credit losses until losses are probable.
  ◦ Inability to factor in expectations of future conditions
What are the main provisions of the FASB model?

- Requires an estimate of losses expected over the remaining life of a financial asset
  - Lifetime loss estimate now only used in FAS 114 and SOP 03–3
- Incorporate information about past events, current conditions, and reasonable and supportable forecasts of the future.
Proposal: Improvements over Existing Model

- Will lead to early recognition of credit losses
  - By recognizing credit losses expected over the life rather than just losses that have been incurred as of the balance sheet date.
- Will incorporate “reasonable and supportable” forecasts of the future.
- Simple in concept but possibly not in application.
Challenge Community Banks Face: Estimation of Expected Credit Losses

- The proposal does not require the use of any specific method
- The proposal will require data on historical lifetime loss experience that most banks may not have
  - Will require banks to track new data
  - May require new systems to track lifetime loss experience
Regulatory Views

- Regulators have pushed for long transition period
- Regulators have pushed for practical expedients to be allowed
- Regulatory guidance will be robust
- Regulators understand the challenge this will present to community banks.