CUNA 2019 Current Expected Credit Loss (CECL) eSchool

*Industry Data and Calibration Options*

**Sohini Chowdhury**
Director, Moody’s Analytics
Sohini.Chowdhury@moodys.com
610-235-5191

**John Toohig**
Managing Director, Raymond James
John.Toohig@RaymondJames.com
901-818-7651

In alliance with Raymond James
Agenda

1. The Case for Using Industry Data in CECL
2. The Case for Calibration to Lender-Specific Portfolios
3. Applying What We Learn to the Portfolio
CECL 101

CECL requires consideration of:

**Historical Losses X Current Conditions X Future Conditions**

Industry data can be leveraged for all 3 requirements!
The Case for Using Industry Data in CECL

1. When lender-specific data is not adequate to produce a CECL estimate

- Small number of defaults
- Lack of sensitivity to macro variables
- Lack of data for seasoned loans
- Lack of data for borrower attributes (like FICO)
- Small number of observations for LGD
- Volatile noisy data, no clear trends

Especially true for credit unions – they are small and have low to zero defaults.
2. To compare, benchmark individual lender’s performance to market to provide context.
The Case for Calibration

However, simply using industry data will not provide good CECL estimates if –

Individual lender’s historical performance has been significantly different from industry performance due to difference in portfolios, geo footprint, lending strategies etc.

Example: Small credit unions with localized footprint.
CU Losses vs Bank Losses

Net Charge-Off Rates

Sources: NCUA Call Report, FDIC Call Report

Credit Unions
Big Banks
Small Banks
**Calibration Options**

**Approach 1:** Estimate the relationship/multiplier between the lender-specific portfolio and the industry using available data.

Individual lender default rate = $\alpha + \beta \times \text{industry default rate}$

- Multiplier is analogous to the Beta concept in stock market returns
- Depending on data availability, perform this exercise at the account or cohort or portfolio level
- Apply the estimated parameters to the industry forecasts to obtain calibrated forecasts for an individual lender
Uncalibrated and Calibrated Loss Forecasts

Conditional loss rate, % of balance, annualized

Sources: Moody’s Analytics
Calibration Options

**Approach 2:** Industry Share Analysis

Estimate the individual lender’s losses based on *industry share.*
**Approach 3:** Peer Group Analysis

- Benchmark to a peer group’s performance, rather than to the industry’s

- Select peer group based on size, similar product and geo concentration, lending strategies etc.
Peer Group Selection

NOT controlling for credit score – less appropriate peer group

Controlling for credit score – more appropriate peer group

Conditional loss rates for HELOCs, % of balance

Conditional loss rates for HELOCs, % of balance, annualized

Source: Moody’s Analytics
Applying What We Learn

Prepare for the future

• Start capturing the necessary data / history – TODAY!

• Based on your CECL estimate, work with your lending team to better serve your member

• How might this data make you a better lender?
1) Let’s capture that “lender specific” historical data going forward
Applying What We Learn

2) Let’s apply it to your portfolio – better understand the risks
Applying What We Learn

3) Let’s monitor how the portfolio changes over time
Applying What We Learn

Apply this information to see where risk is in the portfolio. Work in concert with your lending team to adjust rate sheets over time with an eye towards ROA and growth. This knowledge will help you optimize your portfolio, safely and soundly.
Summary

• Industry data can be leveraged for CECL when lender-specific data is not complete

• Results from industry data can be calibrated to lender-specific portfolios

• Industry data combined with lender-specific data can help identify portfolio risks