MOODY'S ANALYTICS

ARTICLE

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CECL Benchmark Q4 2021

A framework to understand the extent of your allowance (updated for Q4 2021)

In this paper, we continue the research analysis that we have been doing for more than a year, which lets us forecast whether banks will build, maintain, or release allowance into the next quarter. The analysis also shows where they stand on the range of preparedness compared with their peers in the context of an evolving economic outlook.

In this quarter, our analysis focuses on a couple of the asset classes that are experiencing the most volatility. Further analysis, including of other asset classes and alternative peer groups, is available upon request. Please contact the authors for details.

In Q4 2021, our new upper-bound index for the peer group is 1.85% and the lower-bound index is 0.37%. Q4 is the first quarter in which the upper bound has fallen below 2% overall, and the lower bound below 0.5%. This quarter also continues the downward trend in reserve balances for essentially all of 2021, which reflects the positive economic outlook throughout the year.

Volatility in all asset classes has resulted from the uncertainty of how quickly to release reserves that had been built at the onset of the COVID-19 pandemic. The other trend of note is that many of these banks are approaching their January 1, 2020 CECL day-1 reserve levels. In fact, a few of these banks have fallen below that initial percentage at a portfolio level.

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Figure 1 Bank reserve ratio over the midpoint benchmark ratio[1]

NAME	ACL Q1 %	RETAIL	COMMERCIAL	CONSTRUCTION	CRE	CREDIT CARD	OTHER	OVERALL
JPM	2.39%	72.20%	198.83%	333.03%	178.03%	176.02%	138.51%	190.54%
Wells	1.83%	113.01%	194.02%	230.42%	227.50%	159.48%	120.07%	171.23%
BoA	2.03%	57.82%	170.53%	161.72%	252.72%	176.59%	87.33%	151.09%
Citi	3.05%	65.62%	125.36%	39.40%	110.39%	133.45%	85.93%	122.23%
USB	2.15%	125.76%	236.55%	174.02%	349.53%	159.71%	154.53%	187.02%
Truist	1.66%	108.61%	190.83%	58.90%	188.32%	161.55%	165.91%	160.95%
PNC	2.00%	50.95%	232.99%	216.44%	305.09%	183.79%	209.77%	210.98%
Citizens	1.78%	117.76%	196.71%	230.00%	133.87%	118.23%	154.31%	156.49%
Regions	2.82%	123.07%	143.09%	29.22%	92.59%	151.38%	160.82%	123.63%
Huntington	2.03%	145.23%	189.25%	332.19%	286.35%	183.20%	176.09%	201.20%
Fifth Third	1.45%	160.97%	181.04%	118.44%	217.52%	145.37%	133.98%	164.26%
M&T	1.66%	250.49%	249.46%	358.89%	445.78%	163.17%	338.35%	346.90%
Key	2.33%	120.00%	120.55%	112.65%	136.45%	100.33%	70.22%	107.89%
Ally	2.13%	19.71%	305.13%	42.24%	340.39%		223.93%	219.35%

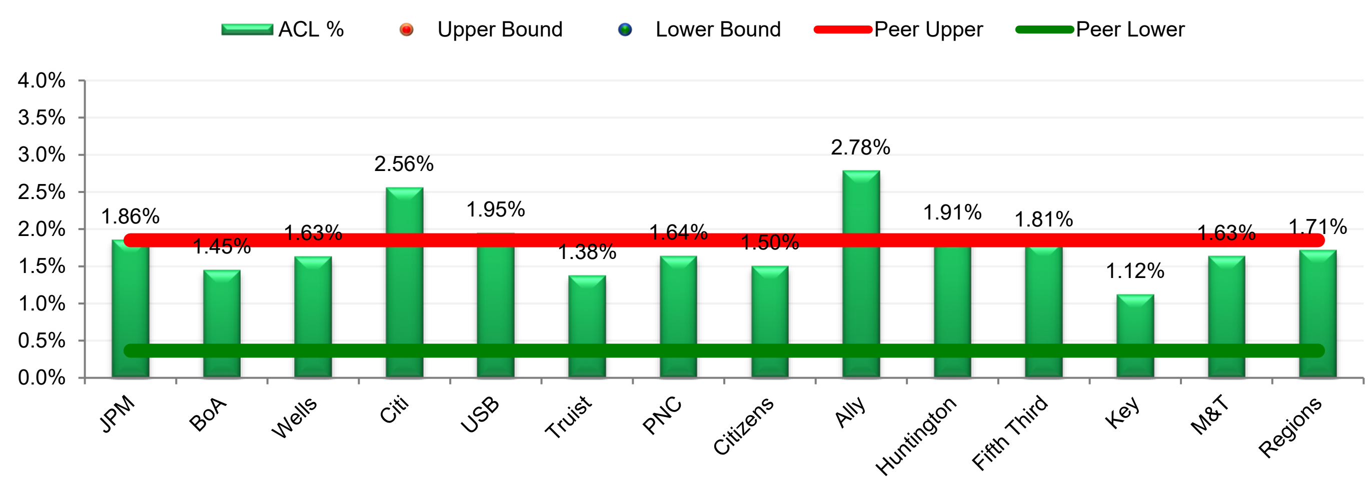
Source: Moody's Analytics and FDIC Call Report data

Introduction

Our benchmark analysis began on March 31, 2020 and has continued every quarter since then. As we complete 2021, the focus of the study remains at what level banks are releasing the reserves they built up in 2020. One factor affecting the level of reserves to be released is the stable economic outlook. Another factor to consider is the overall level of bank reserves prior of the pandemic. For example, three of the banks in the peer group are reserved at a portfolio level below their initial January 1, 2020 CECL adoption reserve (JPM, Key, and Truist). Three more (US Bank, Citibank, and Citizens) are less than 6% above their initial CECL reserve. As a result, even an improving economy may not lead to material releases for these banks.

That said, the story of this quarter is the continued stability of the economy and the economic outlook. That stability has led to banks slowly releasing some of the reserves they built up during the first two or three quarters of 2020 as the pandemic began. Within the benchmark analysis, this trend yields a movement toward the mid-point for many of the peer banks reviewed. Figures 2 and 3 illustrate this movement by showing that many of the banks are within the upper- and lower-bound limits for their overall reserving: 10 of the 14 banks are now reserved within our benchmark thresholds. As Figure 3 shows, all banks are continuing to decrease reserves.

Figure 2 Triangulation of ACL estimates



1 The higher the ratio, the more reserve coverage a given bank has with respect to its own midpoint benchmark—giving a relative view of the bank's reserve levels based on its own historical experience.

Figure 3 ACL metrics for peer group

NAME	ACL Q2 %	ACL Q3 %	Q2 TO Q3 % CHANGE	UPPER BOUND	MID-POINT	LOWER BOUND	% LOWER BOUND	MOST RESERVED / OVER RESERVED
JPM	$0	$0	-7.76%	$0	$0	$0	$5	190.54%
BoA	$0	$0	-7.17%	$0	$0	$0	$3	151.09%
Wells	$0	$0	-11.54%	$0	$0	$0	$6	171.23%
Citi	$0	$0	-5.30%	$0	$0	$0	$2	122.23%
USB	$0	$0	-4.10%	$0	$0	$0	$4	187.02%
Truist	$0	$0	-8.89%	$0	$0	$0	$6	160.95%
PNC	$0	$0	-5.93%	$0	$0	$0	$7	210.98%
Citizens	$0	$0	-5.29%	$0	$0	$0	$4	156.49%
Ally	$0	$0	-1.10%	$0	$0	$0	$7	219.35%
Huntington	$0	$0	-3.82%	$0	$0	$0	$5	201.20%
Fifth Third	$0	$0	-4.04%	$0	$0	$0	$5	164.26%
Key	$0	$0	-9.02%	$0	$0	$0	$3	107.89%
M&T	$0	$0	-0.21%	$0	$0	$0	$9	346.90%
Regions	$0	$0	-9.72%	$0	$0	$0	$4	123.63%

These trends are consistent across asset classes and banks. Given this consistency in the results and our benchmark outlook, we expect additional reserve releases in early 2022.

For a summary of the methodology used to generate this benchmark study, see our original whitepaper.[2]

Comparison of results – CRE loans and credit cards

This paper highlights two product classes that showed a particularly large change in the current quarter: commercial real estate loan portfolios and credit card portfolios. All asset classes are available for detailed analysis upon request (as well as alternative peer groups).

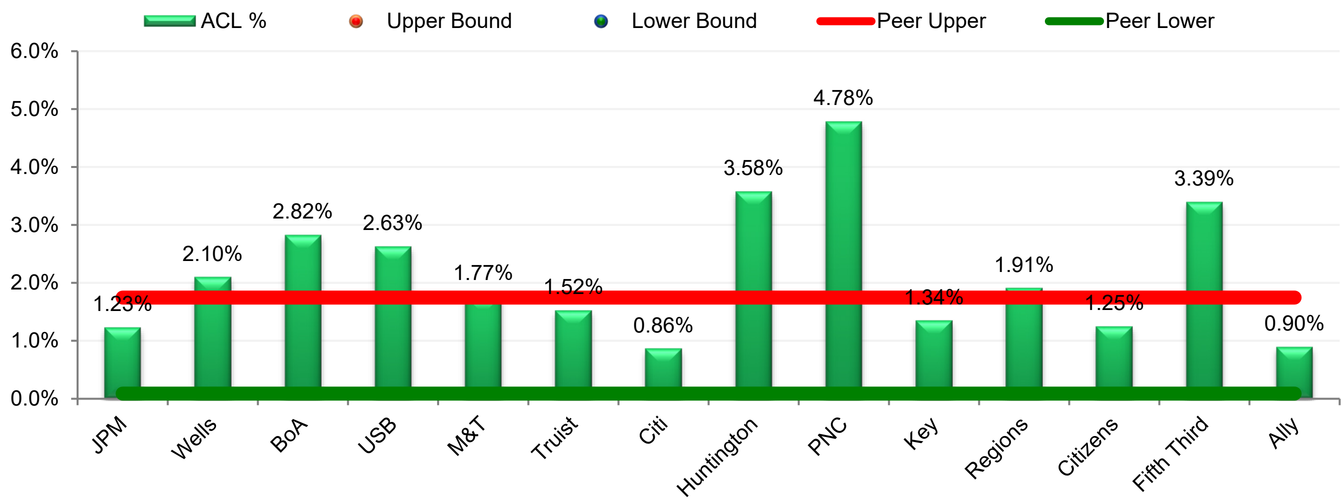
Commercial real estate

CRE portfolios have garnered a lot of attention over the past two years. Business closures, empty offices, and hotel shutdowns at the onset of the pandemic left investors in these portfolios with heightened concerns over credit deterioration. However, many property types and locations fared relatively well, and the US government provided much-needed support that trickled down to the net operating income of CRE properties. As a result, reserves for CRE portfolios slowly started to be released over 2021 as investors grew more comfortable that the worst may be behind them. However, the CRE portfolio remained one of the slowest to see releases.

In Q3 2021 releases began to pick up, and this asset class became one of the largest drivers in reserve releases in the peer group. Figures 4 and 5 paint a picture of how the peer group has begun to release these reserves more than previously seen. In particular, Figure 5 highlights the percentage change from the previous quarter. Even stronger evidence for reserve releases is how much the peer banks were over-reserved above the mid-point. In the previous study eight banks were reserved beyond this point by more than 300%; now only four are (see the final column of Figure 5). All signs in the economy point to reserve releases continuing.

[2] "CECL Build – Is it Enough?"

Figure 4 Q3 2021 peer benchmark for CRE portfolio



Source: Moody's Analytics and FDIC Call Report data

Figure 5 ACL metrics for peer group – CRE

NAME	ACL Q2 %	ACL Q3 %	Q2 TO Q3 % CHANGE	UPPER BOUND	MID-POINT	LOWER BOUND	% LOWER BOUND	MOST RESERVED / OVER RESERVED
JPM	$0	1.23%	$0	$0	$0	0.10%	1136.18%	178.03%
Wells	$0	2.10%	($0)	$0	$0	0.01%	16475.49%	227.50%
BoA	$0	2.82%	($0)	$0	$0	0.06%	4731.00%	252.72%
USB	$0	2.63%	($0)	$0	$0	0.04%	6110.70%	349.53%
M&T	$0	1.77%	($0)	$0	$0	0.06%	2703.49%	445.78%
Truist	$0	1.52%	($0)	$0	$0	0.16%	835.97%	188.32%
Citi	$0	0.86%	$0	$0	$0	0.26%	235.84%	110.39%
Huntington	$0	3.58%	$0	$0	$0	0.15%	2294.18%	286.35%
PNC	$0	4.78%	($0)	$0	$0	0.09%	5108.87%	305.09%
Key	$0	1.34%	($0)	$0	$0	0.14%	853.67%	136.45%
Regions	$0	1.91%	($0)	$0	$0	0.33%	482.34%	92.59%
Citizens	$0	1.25%	($0)	$0	$0	0.25%	397.78%	133.87%
Fifth Third	$0	3.39%	($0)	$0	$0	0.14%	2284.24%	217.52%
Ally	$0	0.90%	($0)	$0	$0	0.00%	50261.49%	340.39%

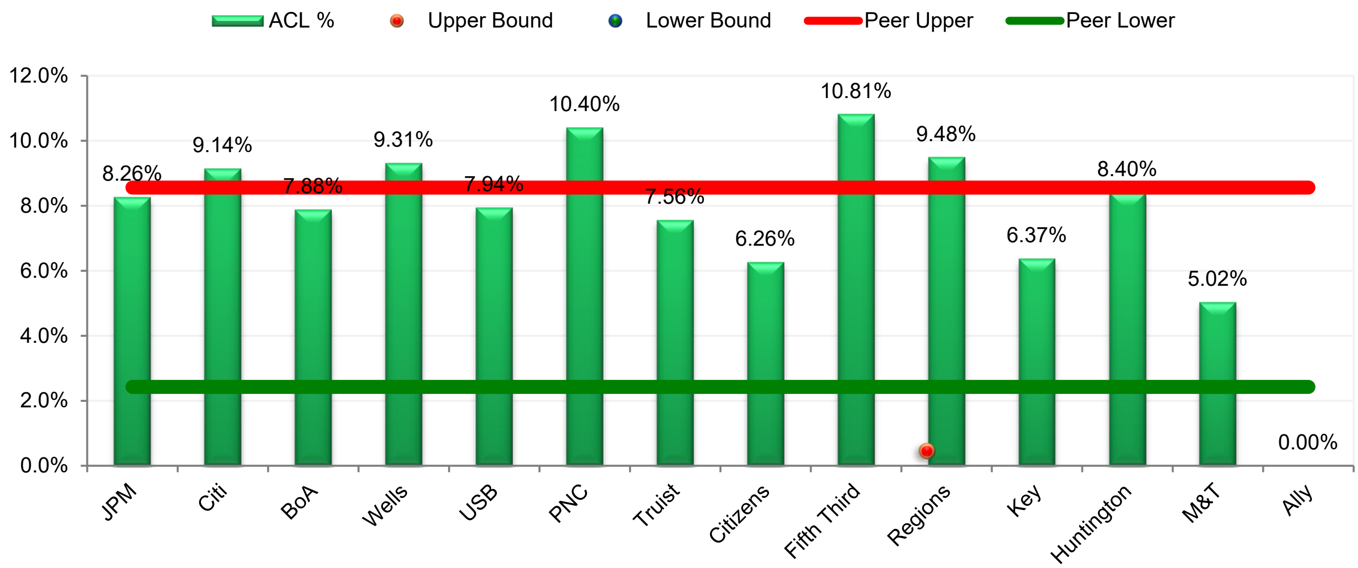
Source: Moody's Analytics and FDIC Call Report data

Credit cards

The credit card portfolio is another segment where reserves significantly increased early in the pandemic when unemployment skyrocketed. Because they are unsecured, credit cards usually experience much higher levels of defaults than other forms of credit—and we saw a reserve build commensurate with that expectation. As in the commercial real estate market, the losses did not reach the levels initially expected, owing to economic recovery and government stimulus. However, banks were reluctant to release too quickly and maintained reserves at a conservative level throughout the first half of 2021. From Q3 banks in the peer group began to release reserves at a much faster pace.

Figures 6 and 7 illustrate the peer group's current ACL reserve ratios for Q3 2021, as well as comparisons to their peer group's and their own upper and lower bounds. The faster reserve release levels are best shown in the change from one quarter to the next in Figure 7.

Figure 6 Q3 2021 peer benchmark for credit card portfolio



Source: Moody's Analytics and FDIC Call Report data

Figure 7 ACL metrics for peer group – credit cards

NAME	ACL Q2 %	ACL Q3 %	Q2 TO Q3 % CHANGE	UPPER BOUND	MID-POINT	LOWER BOUND	% LOWER BOUND	MOST RESERVED / OVER RESERVED
JPM	$0	8.26%	($0)	$0	$0	2.26%	265.60%	176.02%
Citi	$0	9.14%	($0)	$0	$0	2.63%	246.90%	133.45%
BoA	$0	7.88%	($0)	$0	$0	2.17%	262.55%	176.59%
Wells	$0	9.31%	($0)	$0	$0	2.45%	279.08%	159.48%
USB	$0	7.94%	($0)	$0	$0	2.83%	180.06%	159.71%
PNC	$0	10.40%	$0	$0	$0	2.72%	283.06%	183.79%
Truist	$0	7.56%	($0)	$0	$0	1.97%	282.78%	161.55%
Citizens	$0	6.26%	($0)	$0	$0	2.91%	115.39%	118.23%
Fifth Third	$0	10.81%	($0)	$0	$0	3.54%	205.52%	145.37%
Regions	$0	9.48%	($0)	$0	$0	2.41%	294.04%	151.38%
Key	$0	6.37%	($0)	$0	$0	2.70%	135.84%	100.33%
Huntington	$0	8.40%	($0)	$0	$0	3.10%	171.16%	183.20%
M&T	$0	5.02%	$0	$0	$0	2.53%	98.49%	163.17%
Ally	$0	0.00%		$0	$0	0.00%		

Source: Moody's Analytics and FDIC Call Report data

Summary and takeaways

We sought to produce in a practical way an upper- and lower-bound index that could reasonably indicate the level of reserves of a set of peer banks. This seventh paper in the benchmark series shows that a triangulation index built on heuristic measures for both a peer group and a bank can enable management to understand where they are relative to peers in their reserve practices.

Comparing ACLs from different call reports and historical experiences during the Great Recession is almost impossible, given the undisclosed underlying assumptions (weighted average portfolio life) and the difference in portfolio composition. Furthermore, economic uncertainty, unclear timing of net capital outflows, and government support affect banks in various ways. Thus, it is vital to understand the parameters of your allowance and know where you stand with respect to your peer group—whether you are above the upper bound or below the lower bound. Such knowledge is crucial for managers.

We have automated the process of building the triangulation index based on the outlined measures. We can therefore conduct this analysis on any peer group and at a portfolio level within days. If you have tried to find a reliable benchmark range for you and your peers, feel free to contact us. We offer executive management a view on the array of possible results, especially when internal model reliance is brought into question.

Additional resources from Moody's and Moody's Analytics

» Moody's Topic Page on COVID-19

» CECL Build – Is it Enough?

» CECL Benchmark Q2 2021

» CECL Benchmark Q1 2021

» CECL Benchmark Q4 2020

» CECL Benchmark Q3 2020

» CECL Benchmark Q2 2020

» CECL Adoption and Q1 Results Amid COVID-19

» Pre-COVID-19 Health of Small Businesses

» EDF Report September 2020 for North American Corporate Firms