The Fed's New CECL Tool

regulatory CECL

Summary: The Federal Reserve recently released its CECL tool, SCALE. Is this option right for your institution? We explain what it is, how it works, and provide you with considerations when reviewing it as an option, including its use of industry data, adjustments to expected loss rates, and no automatic linking with other solutions.

Today is National Chili Dog Day (the last Thursday in July). Since we find ourselves around the height of summer, this makes sense. Summers are filled with moments at the fair, the beach, and assorted barbeques with chili dogs, sausages, and hot dogs. Hot dog producers say that an average of almost 40% of all hot dogs are purchased during the summer months.

While enjoying a chili dog or just a regular hot dog, you may not be thinking about CECL. But, once you finish enjoying your taste of summer, you should give CECL your full attention.

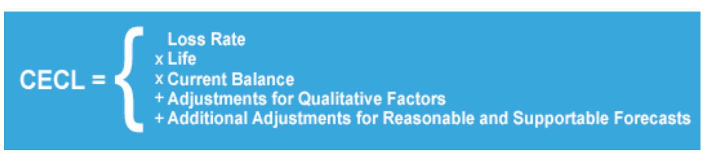
Among surveyed bankers, 25% said that they have selected a methodology for the current expected credit loss (CECL), which leaves 75% that haven't. Yet, it needs to be done soon. To provide another option for review, the Federal Reserve recently introduced a new tool to use for CECL. Let's discuss what this tool is, how it works, and some considerations in using it.

What is it?

This new tool is called SCALE, which stands for Scaled CECL Allowance for Losses Estimator. It is a spreadsheet-based tool developed by the Fed and released on July 15, 2021, to help non-complex community financial institutions (CFIs) under $1B in assets to implement the CECL standard.

How it works

SCALE is a spreadsheet model that is a starting point for calculating an institution's CECL allowance. At its most basic, the calculation for CECL is:



SCALE combines life, loss rates, and the reasonable and supportable forecast by using the expected lifetime loss rates from Schedule RI-C of the Call Report. This simplifies the process.

Features & limitations

1. **Use of industry data.** As a proxy for loss rates, SCALE uses expected lifetime loss rates from Schedule RI-C and allows for other data sources. Currently, 150 community financial institutions (CFIs) complete the Schedule RI-C. Expectations are that by the time CFIs are required to use CECL, over 700 institutions will be reporting data on RI-C, which is mandatory for all institutions over $1B in assets.

2. **Adjustments to expected loss rates.** Each institution is responsible for understanding how their loss history differs from the lifetime expected loss rates, including adjustments for loan categories not broken out in Schedule RI-C. So, the reasoning needs to be captured somewhere else for your auditors.
3. **No automatic linking with other solutions.** CECL calculations need to be supported by other risk solutions, like ALM. So, your institution will need to make sure that your assumptions are consistent among the different solutions. This documented linkage is not an automatic function of SCALE.

Q Factor details and more limitations

SCALE provides a starting point for one's qualitative or Q Factors. Institutions may compare their loss history to that of financial institutions nationwide and apply the difference as their qualitative adjustment. Other qualitative factor adjustments required today should also be applied, such as changes in credit administrative staff or lending policies.

SCALE does not calculate expected losses on individual loans. Loans requiring an individual reserve must be calculated separately when using SCALE. So, if you find you have enough individual loans that need their own reserves, this tool may not provide you with the functionality you need.

Caveats to consider

- Management remains fully responsible for supporting and documenting the institution's allowance estimates. So, in choosing the SCALE model, make sure you have this covered.
- The SCALE model comes "as is." What you see is what you get.
- SCALE doesn't apply to complex institutions or institutions over $1B in assets.
- It is not mandated and does not serve as a safe harbor for institutions choosing to use it.
- The Federal Reserve is not asserting its compliance with GAAP.

If you are part of the 75% that is still considering the right methodology to use for CECL, SCALE is one of the different approaches to review. However, make sure you assess its functionality and limitations carefully. Since time is of the essence, you may want assistance with your CECL decisions. Check out our CECL Resource Library or contact us today for additional information.

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ECONOMY & RATES

Rates As Of: 07/29/2021 05:54AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.05	0.00	-0.04
6M	0.05	-0.01	-0.04
1Y	0.07	-0.01	-0.04
2Y	0.21	-0.04	0.08
5Y	0.74	-0.15	0.38
10Y	1.28	-0.19	0.36

30Y	1.92	-0.17	0.27

FF Market	**FF Disc**	**IORB**
0.10	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.08