



Why You Should Validate Your CECL Model

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MERCADIEN WEBINAR

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How to Earn CPE Credits

To earn CPE Credit, each attendee must:

- Login individually to the session using your own link as provided to you via email.
- Successfully complete at least 3 out of 5 of the polling questions.
- Respond to polling questions within the allotted 60-90 seconds.

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- Viewing a recording of this session (CPE is awarded only for live sessions).

Evaluation:

Upon completion of this program you will receive an event evaluation form, you must complete it & send back to us via email.

CPE Certificate:

Emailed to you within 2 weeks from the date of the webinar.

Agenda

- Model Methodologies
- Assumptions
- Documentation - MRM
- Model Governance & MRM
- Conceptual soundness
- Model Data
- Estimation
- Periodic calibration
- Why Validate?
- Questions



Model Methodologies

Governance/
Internal
Controls

Economic
Information

Model Methodologies

Data Fields Required for CECL Methodologies

DATA FIELDS		Weighted Avg. Rem. Maturity	Snapshot in Time	Historical Loss Method	Migration Analysis	Vintage Analysis	Discounted Cash Flow
Loan-level charge-offs	←	x	x	x	x	x	x
Loan-level recoveries	←	x	x	x	x	x	x
Loan-level balances	←	x	x	x	x	x	x
Match up by quarter from origination							
Dates of loan charge-off and recovery				x	x	x	x
Loan-level segmentation characteristics		x	x	x	x	x	x
Loan-level term/duration		x	x	x	x	x	x
Loan-level risk ratings/scores					x		
Loan-level migration of risk ratings/scores					x		
Loan origination dates						x	
Loan origination amounts						x	
Prepayment, attrition, and other assumptions							x
Qualitative factors		x	x	x	x	x	x

Assumption Management

Formal
Review

Set It &
Forget It?

Assumption Management – Validation Focus

Assess
Alignment -
MRM

Performance
Monitoring

Sensitivity
Framework

Polling Question 1

Where is your institution at in the CECL adoption timeline?

- a. Already adopted
- b. Running parallel models
- c. Have selected a method & working on implementation
- d. Deciding which method to use
- e. Haven't started - still hoping CECL goes way





Documentation

Documentation Standards

Testing

Regulatory
Guidance

Model Governance & MRM

Model
Documentation

Formalized
MRM

Preparing for
Validation

Insights Relative to CECL & MRM

Your auditors & examiners will expect your model to be validated prior to going live!

- Build validation into your roadmap & leave sufficient time for remediation

Be prepared to answer the 'tougher' questions during validation

- Effective challenge requires deeper assessment & testing vs. an audit

Anticipate annual validation

- CECL models will be rated as 'high-risk' in your model inventory requiring most frequent validation frequency (annual for most institutions)
- Your model will change as CECL modeling expectations will evolve

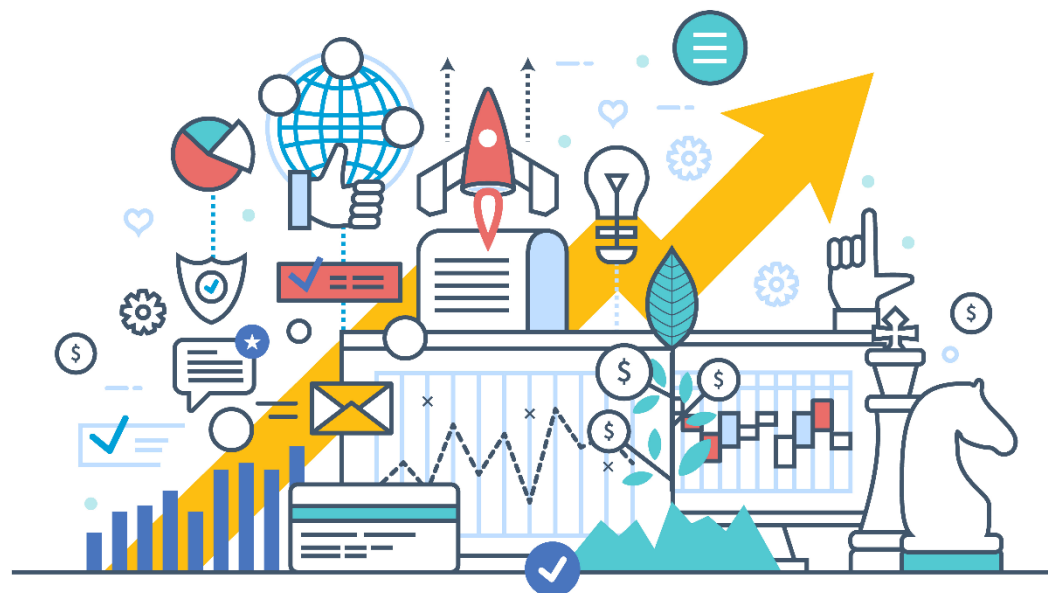
Vendor-provided documentation will not suffice for 'model documentation'

- Model documentation needs to read like a blueprint that would allow someone with reasonable intelligence to fully understand & replicate your model

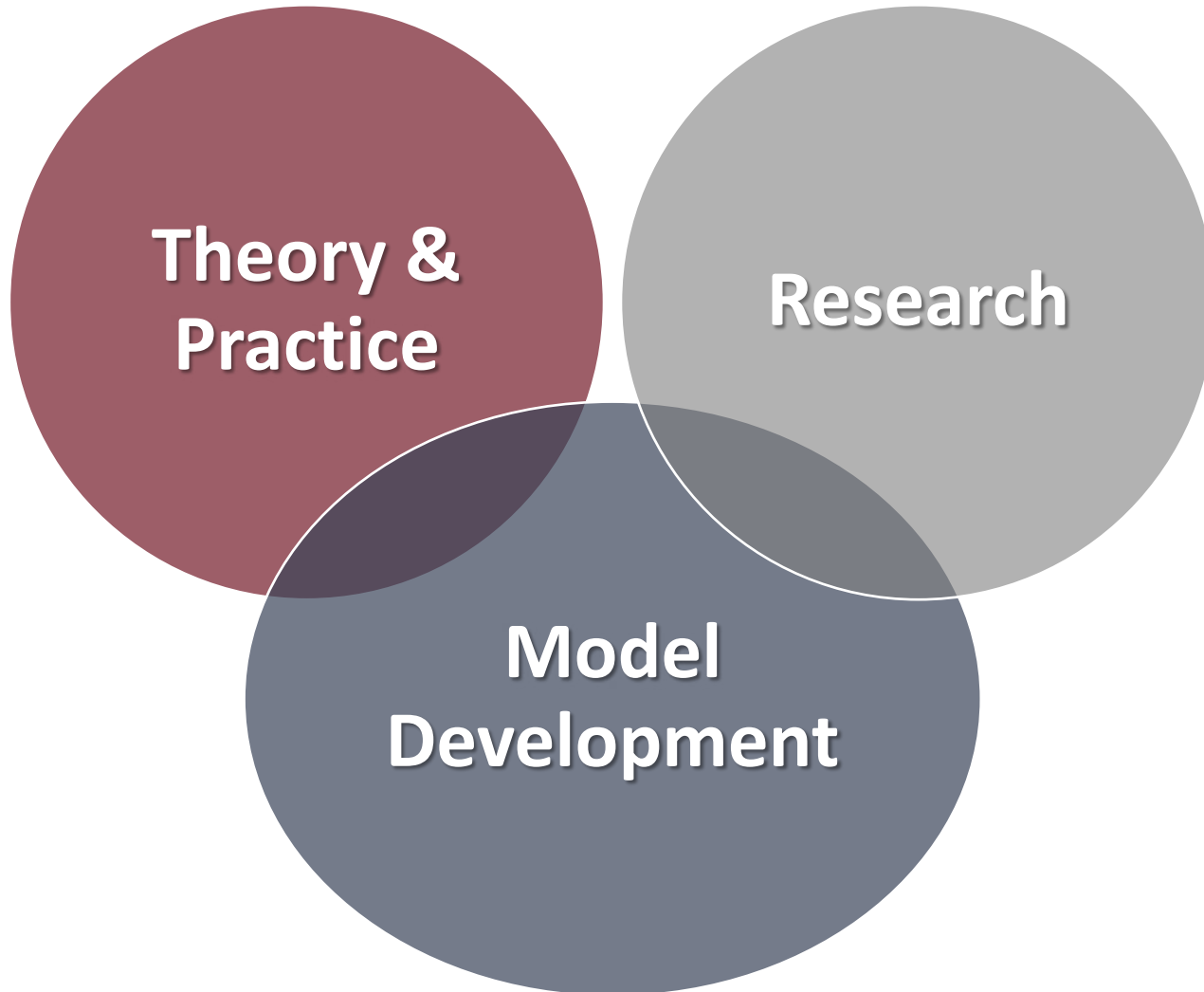
Polling Question 2

How will CECL adoption impact your F/S restatement?

- a. Increase reserves
- b. Decrease reserves
- c. Stay relatively the same
- d. I was hoping you would tell me the answer



Conceptual Soundness



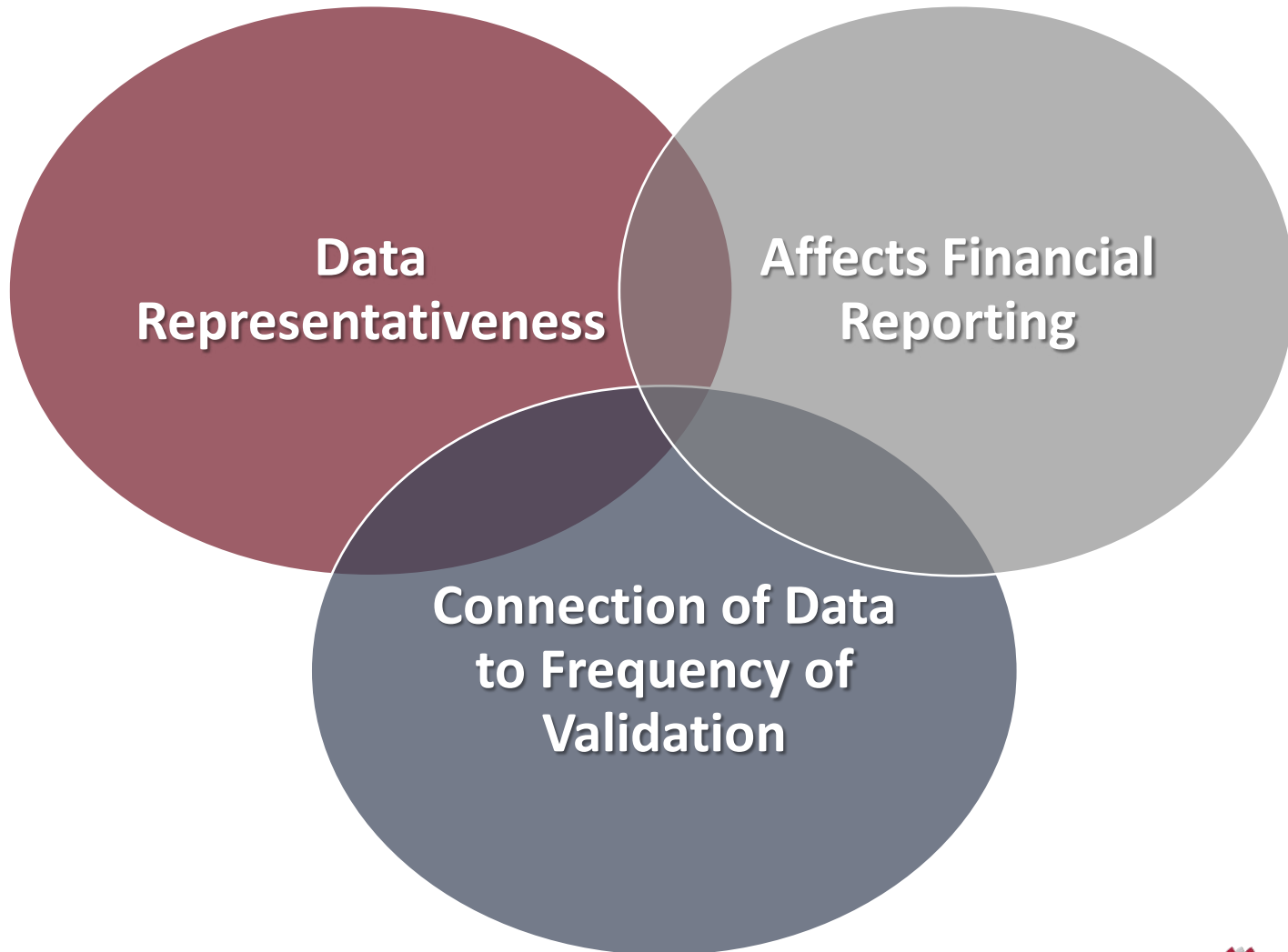
Polling Question 3

How confident are you in the conceptual soundness and data being used?

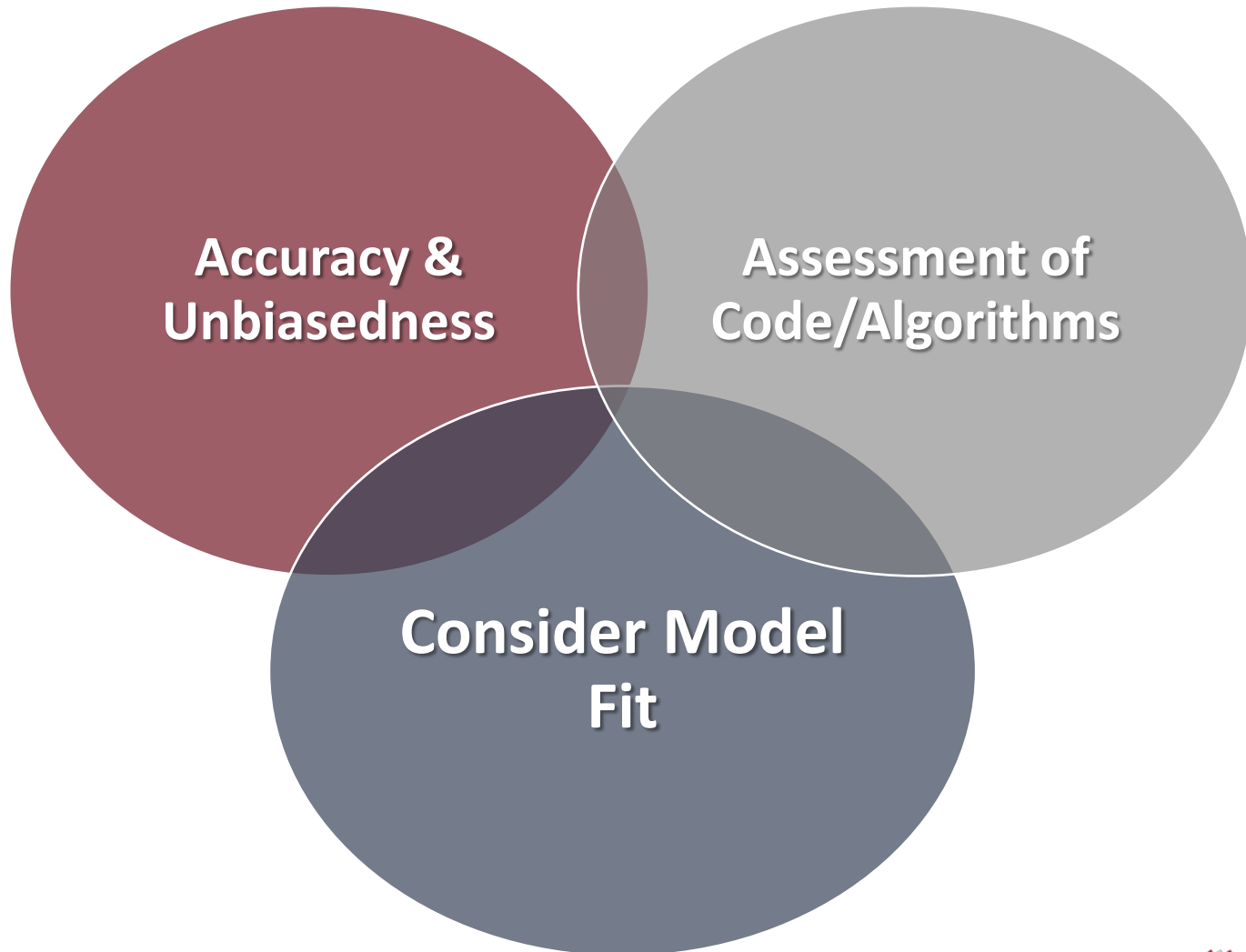
- a. Very Confident
- b. Confident
- c. Not Confident



Model Data



Estimation



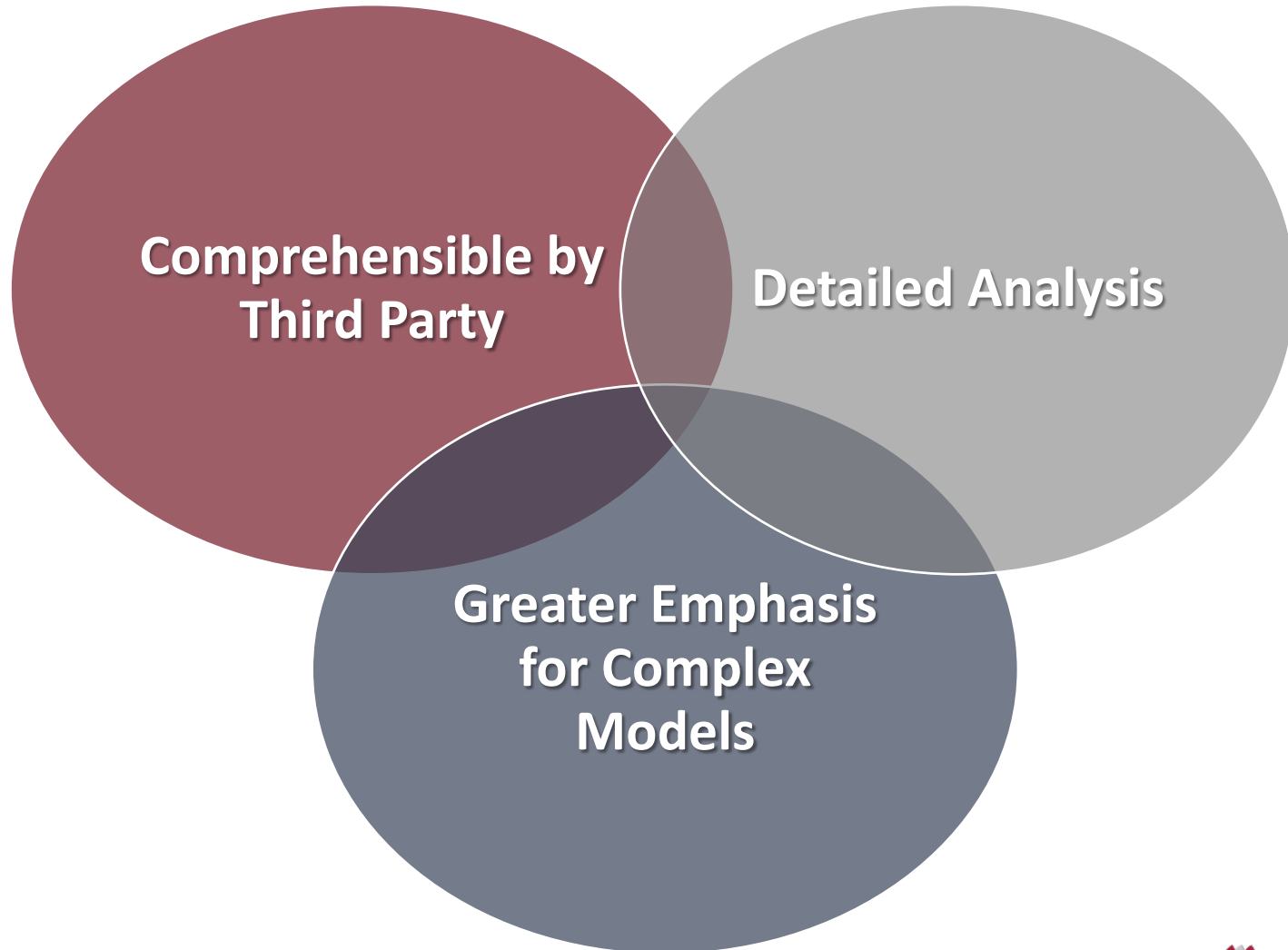
Polling Question 4

What is your plan for validating your CECL Model?

- a. Already validated
- b. Validate pre-implementation
- c. Validate post-implementation
- d. No plans to validate



Periodic Calibration



Why Validate?

- **Critical in short-term**
- **Improve/refine overall MRM & CECL governance** for long-term
- **Strategic opportunity** due to the nascent stage of CECL environment
- **BECAUSE WE DO NOT HAVE A CHOICE 😊**
 - The major regulatory agencies have explicitly stated (or adopted), “All model components, including input, processing, and reporting, should be subject to validation; this applies equally to models developed in-house and to those purchased from or developed by vendors or consultants.”

Polling Question 5

What does CECL stand for?

- a. Competitive Elderly Cycling League
- b. Current Expected Covenant Liquidity
- c. Corrupt Economic Collateral Luxuries
- d. Current Expected Credit Losses



Questions?



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