DRAFT Frequently Asked Questions on CECL Expected Loss Estimator (ELE) Tool

1. **What is the ELE tool and how does it work?**
   The ELE tool is an Excel-based tool that automates the Weighted-Average Remaining Maturity (WARM) method[1] using the Visual Basic for Applications (VBA) programming language. The tool relies on a financial institution's loan-level data and assumptions and automates the calculations for the WARM method as described in the FASB Staff Q&A.[2] The ELE tool is transparent in that it provides fully viewable code and formulas to allow financial institutions to independently understand and verify the ELE tool as well as adjust the tool as deemed necessary by their management.

   Financial institutions may layer on qualitative adjustments as deemed necessary by their management into the ELE tool to arrive at the final allowance for credit losses (ACLs). A financial institution's management is responsible for determining the appropriate data and assumptions to be entered into the ELE tool.

2. **Why did the Federal Reserve develop the ELE tool?**
   Similar to the incurred loss methodology, the CECL standard does not prescribe the use of specific estimation methods. Rather, ACLs may be determined using various methods that are operationally flexible and scalable to financial institutions of all sizes. Therefore, financial institutions do not necessarily need to adopt complex modeling techniques for estimating credit losses or hire third-party vendors. However, in response to concerns about operational difficulties related to CECL implementation, Federal Reserve staff developed the ELE tool to support institutions that have determined that the WARM method is appropriate for estimating the ACLs under CECL.

3. **Is the ELE tool a regulator preferred tool for estimating ACLs?**
   No. Financial institutions are not required to use the ELE tool or the WARM method for estimating ACLs, and the ELE tool is not a regulator preferred tool for estimating ACLs. Ultimately, the management of financial institutions are responsible for maintaining ACLs at appropriate levels based on their current judgments about the credit quality of their institution's financial assets. Financial institutions should also consider known and expected relevant internal and external factors that could significantly affect the collectibility of the financial institution's financial assets over reasonable and supportable forecast periods.

   Financial institution management is responsible for ensuring that the method(s) used in the loss estimation process is appropriate for the financial institution's size, complexity, and risk profile. Financial institutions are permitted to utilize a different method for estimating their allowances, and management is not precluded from selecting a different method. The financial institution's use of any method for estimating ACLs should be well documented, with clear explanations of

[1] The WARM method is one of many methods that could be used to estimate an allowance for credit losses for less complex financial asset pools.

[2] For additional information on the WARM method, refer to FASB Staff Q&A—Topic 326, No. 1—*Whether the Weighted-Average Remaining Maturity Method is an Acceptable Method to Estimate Expected Credit Losses* and *Ask the Regulators: CECL Webinar: Weighted-Average Remaining Maturity (WARM) Method* (April 11, 2019).

the supporting analyses and rationale. Management's evaluations are subject to review by examiners.

4. **Who can use the ELE tool?**
   Financial institutions that have determined the WARM method is an appropriate method to use to estimate their ACLs may choose to utilize the ELE tool. Each institution's management remains solely responsible for determining whether the use of the WARM method to calculate its ACLs is appropriate for its institution. Even after an institution concludes use of the WARM method is appropriate for that institution, the use of the ELE tool is one of multiple options available for implementing the WARM method. Financial institutions using the WARM method are not required to implement the WARM method using the ELE tool. Management is encouraged to discuss the suitability of the use of the ELE tool for their financial institution with their regulators.

5. **Are qualitative factors still relevant when using the WARM method and the ELE tool for estimating the ACLs?**
   Yes. Similar to practices under the incurred loss methodology, management must continue to consider qualitative factors that affect the collectibility of financial assets when using the WARM method to estimate ACLs under CECL. The ELE tool provides functionality for management to input qualitative factor adjustments as deemed appropriate by the institution. Financial institutions should maintain appropriate documentation, commensurate with their complexity and sophistication, to support their qualitative adjustments and the effect of the relevant qualitative factors on the measurement of expected credit losses.

   Further guidance on the application of qualitative factors can be found in the *Interagency Policy Statement on Allowances for Credit Losses*.[3]

6. **Are financial institutions that use the ELE tool limited to using the loan segments reported on the Call Report?**
   No. CECL permits financial institutions to exercise judgment when segmenting their loans into pools of loans. The ELE tool is able to process any loan segments identified by financial institution management officials. Loans in the same portfolio are expected to have the same payment frequency and amortization type and similar risk characteristics. However, the ELE tool is limited to 25 portfolios. If institutions have more than 25 portfolios, they will need to create separate ELE tool workbooks to accommodate additional portfolios.

7. **What are the supervisory and documentation expectations for financial institutions that elect to use the ELE tool?**
   Supervisory expectations for financial institutions that elect to use the ELE tool remain the same and are discussed in the "Examiner Review of ACLs" section of *SR Letter 20-12, Interagency Policy Statement on Allowance for Credit Losses*. The use of the ELE tool does not preclude any enforcement or supervisory actions from the Federal Reserve or another federal or state financial regulator. Examiners are expected to assess the appropriateness of management's loss estimation

[3] SR Letter 20-12, *Interagency Policy Statement on Allowance for Credit Losses* (May 8, 2020), available at: https://www.federalreserve.gov/supervisionreg/srletters/SR2012.htm.

processes and the appropriateness of the financial institution's ACLs as part of their supervisory activities regardless of the CECL estimation method selected.

Documentation expectations for financial institutions that elect to use ELE tool remain the same and are discussed in the "Documentation Standards" section of SR 20-12, *Interagency Policy Statement on the Allowances for Credit Losses*. Management's policies, procedures, and documentation should reflect how the WARM method and ELE tool are incorporated into management's overall ACLs methodology, including key judgments and assumptions. This may include documentation of the approach that management used to determine the population and segmentation data, the population of individually assessed loans, qualitative factor adjustments, and forward-looking information incorporated into the final ACLs.

8. Is the ELE tool different from the Scaled CECL Allowance for Losses Estimator (SCALE) tool?

Yes. Although both SCALE and ELE tools are simple spreadsheet-based tools developed by the Federal Reserve to assist community financial institutions with calculating the ACLs, the ELE tool is separate from SCALE. The ELE tool applies the WARM method and relies on data and assumptions supplied by financial institution management. The SCALE tool applies the SCALE method and uses publicly available data from Schedule RI-C of the Call Report to derive initial proxy expected lifetime loss rates. Additionally, the SCALE tool is only appropriate for financial institutions with total assets of less than $1 billion, while the ELE tool could potentially be appropriate for some community financial institutions over this threshold.