Frequently Asked Questions on Scaled CECL Allowance for Losses Estimator (SCALE)

1. **What is the SCALE method?**

    The SCALE method is a simple, spreadsheet-based method developed by the Federal Reserve to assist smaller community banks in calculating CECL compliant allowances for credit losses (ACLs) using proxy expected lifetime loss rates. The SCALE tool is a template that smaller community banks can use if they wish to use the SCALE method. This tool, developed by the Federal Reserve, uses publicly available data from Schedule RI-C of the Call Report to derive the initial proxy expected lifetime loss rates. If a bank uses the SCALE tool, bank management must use judgment to further adjust the proxy expected lifetime loss rates to reflect bank-specific facts and circumstances to arrive at their final ACLs estimate that adequately reflects their loss history and the credit risk in their portfolio.

2. **Why did the Federal Reserve develop the SCALE method?**

    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 banks of all sizes, and banks do not necessarily need to adopt complex modeling techniques for estimating credit losses or hire third-party vendors. However, some smaller banks continue to voice concerns about operational difficulties related to CECL implementation. Therefore, Federal Reserve staff developed the SCALE method and the SCALE tool to illustrate a simple and practical option that smaller community banks can use to estimate the ACLs under CECL.

    By utilizing industry or peer CECL ACL lifetime loss rate as the starting point, the SCALE method addresses potential concerns from smaller community banks about the operational challenge of capturing sufficient lifetime historical data and about the need to include reasonable and supportable forecasts.

3. **Is the SCALE method an acceptable method for estimating ACLs?**

    Yes. The SCALE method is one of many acceptable CECL methods that a bank may use to estimate ACLs. However, like all other acceptable CECL methods, bank management needs to determine whether the SCALE method is appropriate for the bank. CECL does not prescribe the use of specific estimation methods. Rather, ACLs may be determined using various methods that reasonably estimate the expected collectibility of financial assets and are applied consistently over time. Therefore, banks may use a method that is

appropriate for the bank's size and the nature, scope, and risk of its lending and investing activities, including the SCALE method.

4. **Is the SCALE method a regulator preferred method for estimating ACLs?**

No. The SCALE method is not a regulator preferred method for estimating ACLs. Further, the SCALE method does not ensure compliance with U.S. GAAP or any other regulatory requirement. Ultimately, bank management is responsible for maintaining ACLs at appropriate levels based on management's current judgments about the credit quality of the bank's financial assets. A bank should also consider known and expected relevant internal and external factors that significantly affect collectibility of the bank's financial assets over reasonable and supportable forecast periods.

Bank management is responsible for ensuring that the method(s) used in the loss estimation process is appropriate for the bank's size, complexity, and risk profile. A bank is permitted to utilize a different method for estimating its allowances. Further, bank management is not precluded from selecting a different method when a different method will result in a better estimate of its ACLs. The bank's use of any method for estimating ACLs should be well documented, with clear explanations of the supporting analyses and rationale. Management's evaluations are subject to review by examiners.

5. **Who can use the SCALE method?**

The SCALE method was developed to assist smaller community banks in estimating ACLs. The use of the SCALE method is optional and should be considered as one of many possible options available to bank management when implementing CECL.

The SCALE method was developed in recognition that many smaller community banks face operational difficulties in implementing CECL. Therefore, Federal Reserve staff developed this method with these banks in mind. Bank management must use judgment when determining whether the SCALE method is appropriate for their institution. While it may be suitable for small, noncomplex organizations that follow a traditional community banking business model, management should consider whether the bank's credit portfolio exhibits risk characteristics that may necessitate the use of a different method in estimating credit losses. Management is encouraged to discuss the suitability of the use of the SCALE method for their bank with their regulators.

The SCALE tool uses ACL data from Schedule RI-C and filing of this schedule is required for banks with assets greater than $1 billion. As such, it would be inappropriate for banks with total assets of $1 billion or more to use the SCALE tool in the calculation

of their ACLs. Banks using the SCALE tool that anticipate crossing this $1 billion threshold due to growth or acquisitions should incorporate the need for another CECL method into their strategic planning and due diligence efforts.

6. **Does the SCALE tool calculate the ACLs for a bank?**

No. The Federal Reserve's SCALE tool is simply a template that small community banks can use if they wish to use the SCALE method using publicly available data from the Call Report to derive proxy expected lifetime loss rates as a starting point in the ACLs calculation. Management is responsible for maintaining ACLs at appropriate levels. Management is also responsible for adjusting the starting proxy expected lifetime loss rates for facts and circumstances unique to its bank to better reflect the bank's own credit risk. Such adjustments rely on management judgment and existing credit risk management practices. Examiners will continue to evaluate management's problem loan identification processes and the reasonableness of management's assumptions, valuations, and judgments to determine whether the resulting estimates of expected credit losses are in conformity with U.S. GAAP and regulatory reporting instructions.

7. **Does the SCALE method require a bank to change credit risk management practices?**

No. The SCALE method does not change a bank's existing risk management practices. Management is responsible for evaluating credit risk using existing data, resources, and internal reports. Management should continue to review risk indicators such as volume and severity of past due financial assets, the volume of nonaccrual assets, and the volume and severity of adversely classified or graded assets, and historical write-offs when assessing credit risk. Ultimately, management is responsible for identifying concentrations of credit and establishing appropriate credit risk policies.

8. **Are qualitative factors still relevant when using the SCALE method 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 the financial asset when using the SCALE method to estimate ACLs under CECL. The SCALE method uses publicly available data as an initial proxy expected lifetime loss rate for calculating lifetime expected losses, which is then adjusted to reflect bank-specific facts and circumstances to arrive at a final ACLs estimate that adequately reflects loss history and the credit risk in a bank's portfolio. For example, while reasonable and supportable forecasts are incorporated into initial proxy expected lifetime loss rates (e.g., expected

loss rates reported on Schedule RI-C of the Call Report), management may believe that local economic conditions are expected to perform better or worse than the broader industry economic conditions. In this case, bank management should consider whether a qualitative adjustment should be applied to the initial proxy expected lifetime loss rates to better reflect the bank's local conditions.

Further guidance on the application of qualitative factors can be found in the Interagency Statement on Allowances for Credit Losses.[1]

9. **Are there timing issues that must be considered when using the SCALE method?**

Yes. The SCALE method relies on proxy expected lifetime loss rates (e.g., expected loss rates reported on Schedule RI-C of the Call Report). Since the proxy expected lifetime loss rates would typically be based on information from the previous reporting period, there would be a lag between the proxy data and the reporting date. Management is responsible for considering whether a qualitative adjustment is necessary to reflect any changes in economic and business conditions at the reporting date that affect the collectibility of bank's financial assets that were not present at the time the proxy expected lifetime loss rates were calculated. This is particularly important during periods in which the economic environment is rapidly changing.

10. **Is a bank that uses the SCALE tool limited to using the loan segments reported on Schedule RI-C of the Call Report?**

No. CECL permits banks to exercise judgment when segmenting their portfolios into pools of loans and small community banks may be able to use portfolio segments reported on Schedule RI-C of the Call Report. However, if management elects to further segment its portfolio, management will also need to identify an appropriate proxy expected lifetime loss rate for that segment. This rate can be developed based on internal bank data or may be obtained from external sources.

For purposes of calculating the ACLs using the SCALE tool, bank management may wish to aggregate portfolio segments that are evaluated on a more granular level under a bank's existing credit risk management practices into the segments reported on Schedule RI-C. In performing this analysis, a bank can perform a more granular level analysis based on concentration identification, risk tolerance threshold monitoring, and evaluation of performance metrics. This more granular analysis can be used by bank management to determine whether qualitative adjustments are needed to better reflect bank-specific credit risk exposure. If management concludes that the portfolio segments used in the

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[1] https://www.federalreserve.gov/supervisionreg/srletters/SR2012.htm

SCALE tool are not appropriate for the size, complexity, and risk profile of the bank, then another CECL method may be warranted.

11. How are the proxy expected lifetime loss rates used in the SCALE tool calculated?

Proxy expected lifetime loss rates used in the SCALE tool are derived from disaggregated data on the ACLs reported on Schedule RI-C of the Call Report. Management can assess this data from the FFIEC's Central Data Repository (https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx).

Schedule RI-C is required to be completed by institutions with $1 billion or more in total assets on a quarterly or semi-annual basis.[2] This schedule collects the amortized cost and associated allowance balance for certain loan segments. Proxy expected lifetime loss rates that can be used in the SCALE tool are derived by dividing the aggregated total ACL for a particular segment by the corresponding amount of the amortized cost for a group of industry or peer banks. Bank management is required to determine whether it would be appropriate to use an aggregated national rate or whether it would be more appropriate to segregate the information by a certain region, district or more customized peer group.

Schedule RI-C—Continued

Part II. Disaggregated Data on the Allowances for Credit Losses[1]

Schedule RI-C, Part II, is to be completed by institutions with $1 billion or more in total assets.[2]

Dollar Amounts in Thousands	(Column A) Amortized Cost		(Column B) Allowance Balance	
	RCON	Amount	RCON	Amount
Loans and Leases Held for Investment:				
1. Real estate loans:				
a. Construction loans	JJ04		JJ12	
b. Commercial real estate loans	JJ05		JJ13	
c. Residential real estate loans	JJ06		JJ14	
2. Commercial loans[3]	JJ07		JJ15	
3. Credit cards	JJ08		JJ16	
4. Other consumer loans	JJ09		JJ17	
5. Unallocated, if any			JJ18	
6. Total (sum of items 1.a through 5)[4]	JJ11		JJ19	

12. Does a bank that uses the SCALE tool have to use the national proxy expected lifetime loss rates?

No. Management is responsible for determining whether a certain proxy expected lifetime loss rate serves as a reasonable starting point in their ACL calculation.

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[2] Institutions with total assets of $1 billion or more but less than $5 billion that are eligible to file the FFIEC 051 Call Report complete Schedule RI-C semiannually in the June and December reports.

Management may choose to develop custom proxy expected lifetime loss rates that better reflect credit risks specific to their bank using a selection of peer banks rather than national expected lifetime loss rates. Management should document the proxy expected lifetime loss rates used with clear explanations of supporting analysis and rationale for the proxy expected lifetime loss rate chosen as a starting point.

13. What are the supervisory expectations for banks that elect to use the SCALE tool?

Supervisory expectations for banks that elect to use the SCALE tool remain the same. The use of the SCALE tool does not preclude any enforcement or supervisory actions from the Federal Reserve or other banking agencies. Examiners are expected to assess the appropriateness of management's loss estimation processes and the appropriateness of the bank's ACLs as part of their supervisory activities regardless of the CECL estimation method selected.

Refer to the Interagency Policy Statement on Allowances for Credit Losses for supervisory expectations on examiners' review of ACLs.

14. What are the documentation expectations for banks that elect to use SCALE?

Documentation expectations for banks that elect to use SCALE remain the same and are discussed in the Documentation Standards section of the Interagency Policy Statement on the Allowances for Credit Losses.

Management's policies, procedures, and documentation should reflect how SCALE is incorporated into management's overall ACLs methodology, including key judgments and assumptions. This may include documentation of how management determined the population and segmentation of RI-C data, the population of individually assessed loans, qualitative factor adjustments, and the final ACLs incorporated forward-looking information.

15. Where could institutions find aggregated Schedule RI-C data in order to determine the proxy expected lifetime loss rate?

Call Report data can be downloaded from the FFIEC's Central Data Repository Bulk Data Download page (https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx). To access the data, select "Call Reports – Single Period" and choose the appropriate reporting period date.

FFIEC bulk data is provided in tab delimited format and should be sorted and filtered to produce the relevant Schedule RI-C data fields needed to calculate the appropriate community bank expected loss rates. Banks may also download a version of this data

with limited processing performed on a pre-sorted spreadsheet prepared by the Federal Reserve and made available on the SCALE page of the CECL Resource Center's website (https://www.supervisionoutreach.org/cecl/scale). Each institution's management remains solely responsible for selecting and implementing an appropriate method to calculate the Allowances for Credit Losses given the unique facts and circumstances of their institution, including selecting appropriate external data sources.

16. **Does the SCALE method allow banks to incorporate institution-specific credit risk characteristics (sector concentrations, geographic footprint, etc.) when calculating the ACL?**

Yes. The SCALE method uses expected loss rates derived from external data as the *starting* point in the ACL calculation. Banks should then tailor their estimate of expected losses to better reflect an individual bank's credit risk profile. This can be accomplished through the use of qualitative adjustments that leverage existing credit risk management practices.

For example, a bank that has a credit concentration in agricultural production loans should evaluate whether a qualitative adjustment is needed to capture this risk. This will depend on the composition of the bank's chosen peer group. If the peer group is composed of similarly concentrated institutions, then the need for a qualitative adjustment may be reduced. However, if the peer group is composed of a wider selection of institutions that do not have a similar concentration, then management should determine whether an adjustment is needed.

17. **Why is the SCALE tool not appropriate for institutions with total assets greater than $1 billion?**

The SCALE tool utilizes proxy expected lifetime loss rates derived specifically from Schedule RI-C and this schedule is completed by institutions with total assets of $1 billion or greater. It would be inappropriate for institutions submitting data into Schedule RI-C to also use this data as proxy expected lifetime loss rates. Therefore, institutions with assets greater than $1 billion that are required to submit data into Schedule RI-C should not use the SCALE tool.