



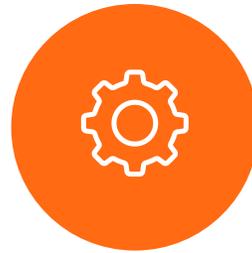
WEBINAR WILL BEGIN SOON...



NOVEMBER 14, 2023



WE ARE HERE
TO HELP!



HOUSEKEEPING

Thank you for trusting us to share our knowledge with you. Presentation is being recorded and will be available on our website. If you have a pop-up blocker, please disable it to participate in polling.



DETAILS IN DEVELOPMENT

We are presenting details as they stand *today*. Information presented could change in the future.



QUESTIONS

If you have a question, add it to the Q&A chat located at the bottom of your screen. We have turned off raising hands and anonymous questions.



CALL YOUR ADVISOR FOR ASSISTANCE

We will try to address questions at the end of the presentation. Please reach out to your professional for additional personalized assistance.

PRESENTERS



Allison Johnson, CPA, CMA
Senior Manager



Diane Nesbit, CPA
Partner



Available-for-sale Debt Securities ASC 326-30



While available for sale debt securities are not in the scope of CECL, ASU 2016-13 changed the guidance on how to account for them. The new guidance can be found in ASC 326-30.





Review current accounting



New guidance



Examples



Alternatives

Current Accounting Example

- Corporate bond treated as available for sale.
- Purchased for \$4,000,000 with PAR at \$5,000,000
- Bond pays 10% interest
- 10 Year maturity
- At the end of Year 1 - investment is valued at \$4,200,000
- Ignoring taxes for this example

- What would the entries be at purchase and the end of year 1?

Purchase and Recording Interest

| | | |
|-------|----|-------------|
| Bonds | \$ | 4,000,000 |
| Cash | \$ | (4,000,000) |

| | | |
|--------------------|----|-----------|
| Cash | \$ | 500,000 |
| Interest income | \$ | (500,000) |

Mark to Fair Value

| | | |
|-------|----|-----------|
| Bonds | \$ | 200,000 |
| OCI | \$ | (200,000) |

New Guidance

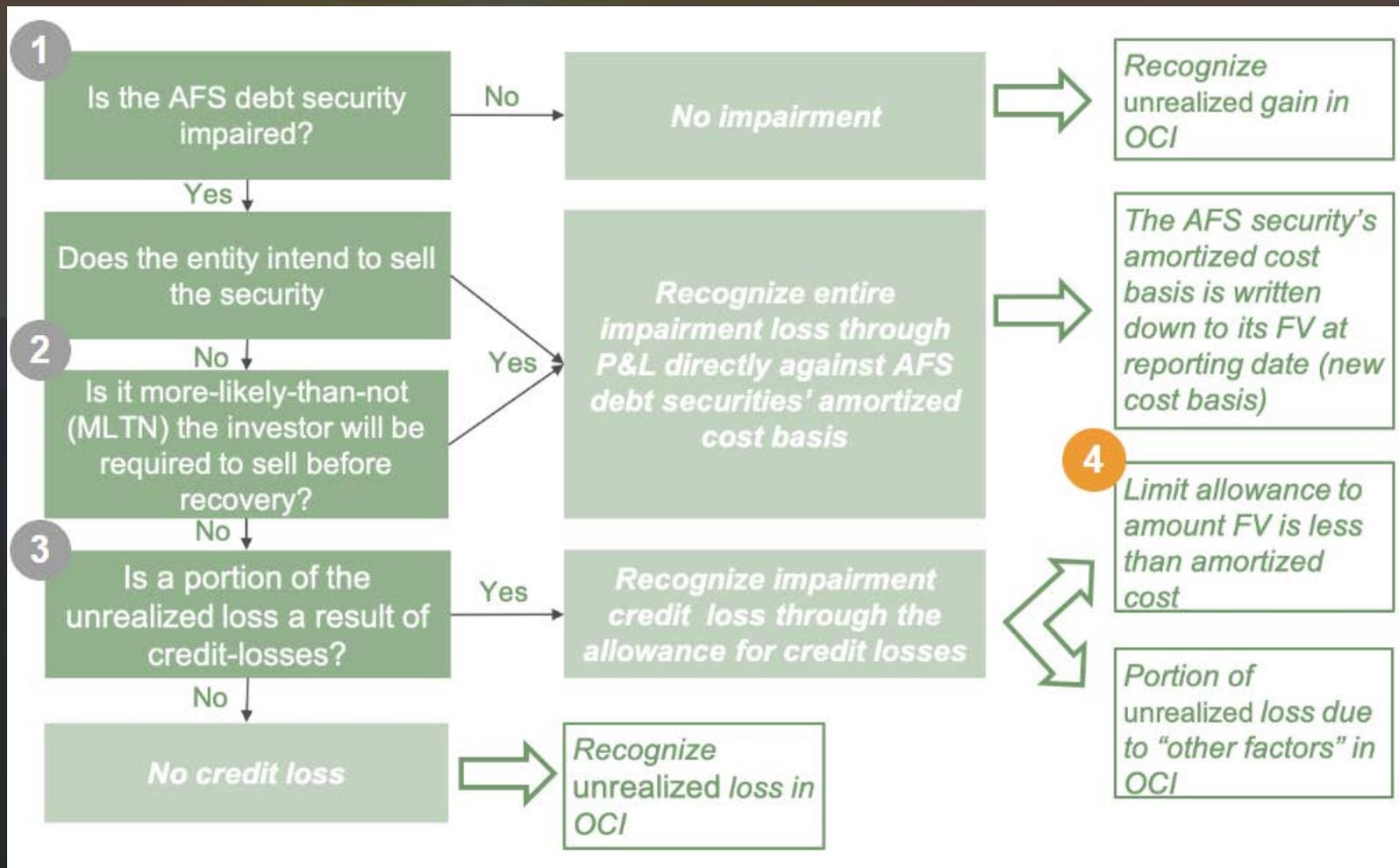
- Loss consideration needs to be assessed at an individual security level.
- When estimating potential credit losses, discounted cash flows must be used.
- The allowance for credit losses should be evaluated and changes reported in each reporting period.
- Impairment is broken out between credit-related risk and interest-related risk.
 - Credit related risk – change is recorded in the income statement
 - Interest-related risk – record in other comprehensive income

Differences Compared with CECL

- Impairment occurs when fair value is less than carrying value.
- Impairment is broken out between interest related risk and credit related risk.
- Different guidance because available for sale already required that the securities be marked to market and the difference run through OCI. Held to maturity and other non-fair value assets weren't required to.

POLLING QUESTION #1





How to determine if impairment is from credit loss?

Factors to consider

- Extent of impairment
- Adverse conditions related to the security
- Payment structure
- Market and industry changes
- Likelihood of future payments
- Failure of issuer to make payments
- Rating Changes

If you determine some of the impairment may be due to credit loss then a discounted cash flow analysis must be performed.

New Guidance Example

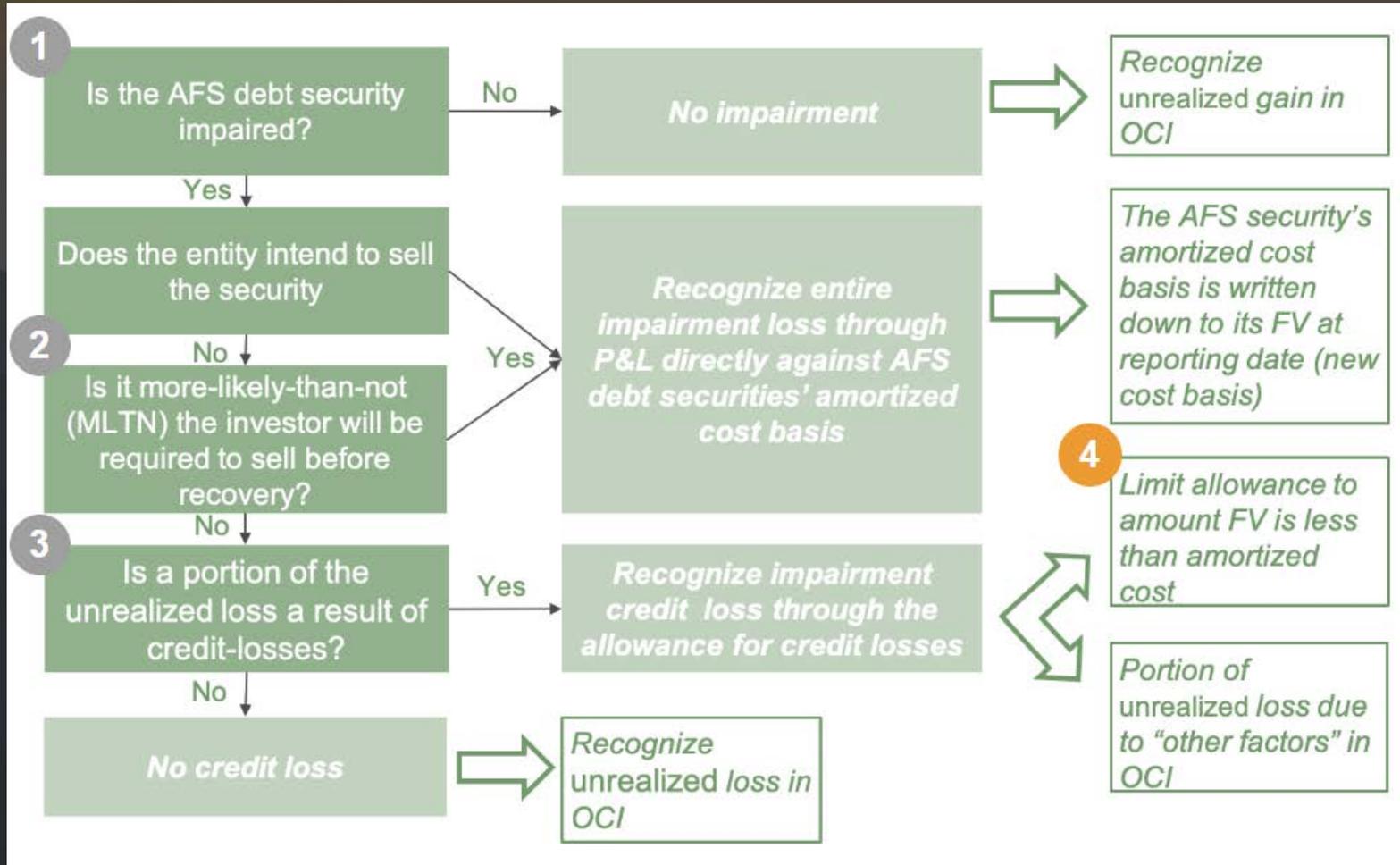
- Corporate bond treated as available for sale.
- Purchased for \$4,600,000 with PAR at \$5,000,000
- Bond pays 3% interest – paid monthly
- 4 Year maturity
- At the end of Year 1 – investment is valued at \$4,000,000, issuer credit rating was downgraded during the year
- Amortized cost at the end of Year 1 is \$4,700,000
- Ignoring taxes for this example
- Intend to continue to hold the instrument there are no indications that suggest a sale will be necessary to meet cash flow needs.
- We are evaluating the security at the end of year 1.

1: Yes
(\$700,000)
\$4m FMV - \$4.7 BACV

2: No

3: Yes
Credit rating downgrade suggest some may be credit related

Need to perform a discounted cash flow.





Discounted Cash Flow Analysis

- 1) Set up a schedule of contractual cash flows.
- 2) Using the schedule of cash flows, use the internal rate of return formula (IRR) in excel to calculate the implicit interest rate.
- 3) When evaluating a credit loss, prepare a schedule with updated anticipated cash flow. This is a management estimate.
- 4) Using updated anticipated cash flow, use net present value (NPV) formula in excel to calculate expected value of new cash flow stream.
- 5) Compare result of discounted cash flow to amortized cost.
 - 1) Difference between amortized cost and discounted cash flow is a credit loss and is recorded in the allowance account.
 - 2) Remaining difference from discounted cash flow down to fair value is run through other comprehensive income.

Example Results

As of 12/31/23

- Amortized Cost: \$4,700,000
- Discounted Cash Flow: \$4,344,249
- Fair value: \$4,000,000

Journal Entry:

| | |
|--|-----------|
| Investment - Allowance for credit loss | (355,751) |
| Allowance expense | 355,751 |
| Investment – Market value adjustment | (344,249) |
| OCI – Unrealized gain/loss | 344,249 |

New Guidance Example – Part 2

- Evaluating the security at the end of year 2.
- Credit quality of issuer improved slightly during the year.
- Fair value at the end of the year was \$4,500,000

Example Results

As of 12/31/24

- Amortized Cost: \$4,900,000
- Discounted Cash Flow: \$4,884,249
- Fair value: \$4,500,000
- Ending allowance: 15,751
- Beginning allowance: 355,751
- Ending OCI: 384,249
- Beginning OCI: 344,249

Journal Entry:

| | | |
|--|---------|-----------|
| Investment - Allowance for credit loss | 340,000 | |
| Allowance expense | | (340,000) |
| Investment – Market value adjustment | | (40,000) |
| OCI – Unrealized gain/loss | 40,000 | |

Example Results

As of 12/31/23

- Amortized Cost: \$4,900,000
- Discounted Cash Flow: \$4,950,000
- Fair value: \$4,500,000

In the example above, as the discounted cash flow is higher than the amortized cost, the full allowance would be removed and any write down to fair value would run through OCI.



Effective Dates



15 Dec. 2019

Public, excluding entities eligible to be SRCs as defined by the SEC - for fiscal years beginning after December 15, 2019.



15 Dec. 2022

Private and others - for fiscal years beginning after December 15, 2022.

Adoption Method

- Modified-retrospective Approach
 - Cumulative-effect adjustment to retained earnings at the beginning of the first reporting period in which the guidance is effective.
- Prospective Approach for debt securities with OTTI recognized before
 - Keep the previous adjusted cost basis and any additional impairment will use the new guidance

Alternatives

- Change classification from available-for-sale to trading
 - This should be documented in an investment policy
 - Would be treated as a change in accounting principle



Current Expected Credit Loss (CECL) ASC 326 (ASU 2016-13)





Effective Dates



15 Dec. 2019

Public, excluding entities eligible to be SRCs as defined by the SEC - for fiscal years beginning after December 15, 2019.



15 Dec. 2022

Private and others - for fiscal years beginning after December 15, 2022.

General Impact



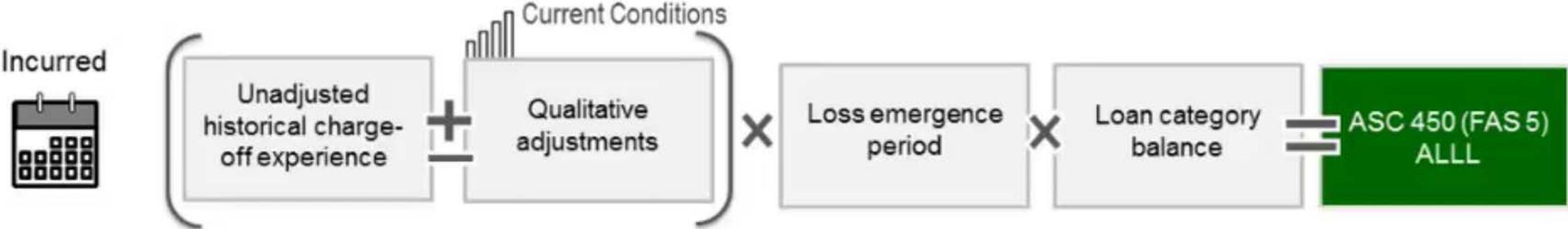
- Why the standard – Industry has always delayed the recognition of impairment losses until a recognizable event.
- Creates a model called Current Expected Loss model that is based on expected losses rather than incurred losses. Other impacts include:
 - Decreases number of credit impairment models
 - Eliminates barrier for time recognition
 - Adds requirement to recognize an allowance of lifetime expected credit losses
 - Does not prescribe a specific method for entities to use

Expected Losses vs. Incurred Losses

- Incurred losses model – when an event occurs (i.e. bankruptcy, overdue balances, etc.) the Company will then write-off related balances.
- Expected losses – entity will recognize an estimate of expected credit losses for financial assets as of the end of the reporting period. This is established using a contra-asset allowance account.

CECL Overview

Historical U.S. GAAP



CECL



POLLING QUESTION #2



Assets in Scope of CECL



- Amortized cost basis assets
- Held to maturity debt securities
- Financial assets (e.g. trade receivables, lease receivable, contract assets, etc.)
- Financing receivable
- Loans
- Loan commitments
- Freestanding contract
- Line-of-credit arrangement
- Standby letter of credit
- Insurance company reinsurance recoverable assets

Assets NOT in Scope of CECL



- Financial assets measured at fair value
- Available for sale debt securities
 - There is new applicable guidance for AFS securities that was discussed earlier in the presentation.
- Loans made to participants by defined contribution employee benefit plans
- Policy loan receivables of an insurance entity
- Promises to give (pledges receivable) of a not-for-profit entity
- Loans and receivables between entities under common control
- Receivables arising from operating leases accounted for in accordance with FASB ASC 842

Method for Establishing CECL Reserve

- FASB has no prescribed method
- ASU 2016-13 – “practical and relevant” methods
- May use different methods for different types of financial assets depending on the entity’s ability to predict the timing of cash flows and other information available to the entity.



Examples of models that are used for CECL

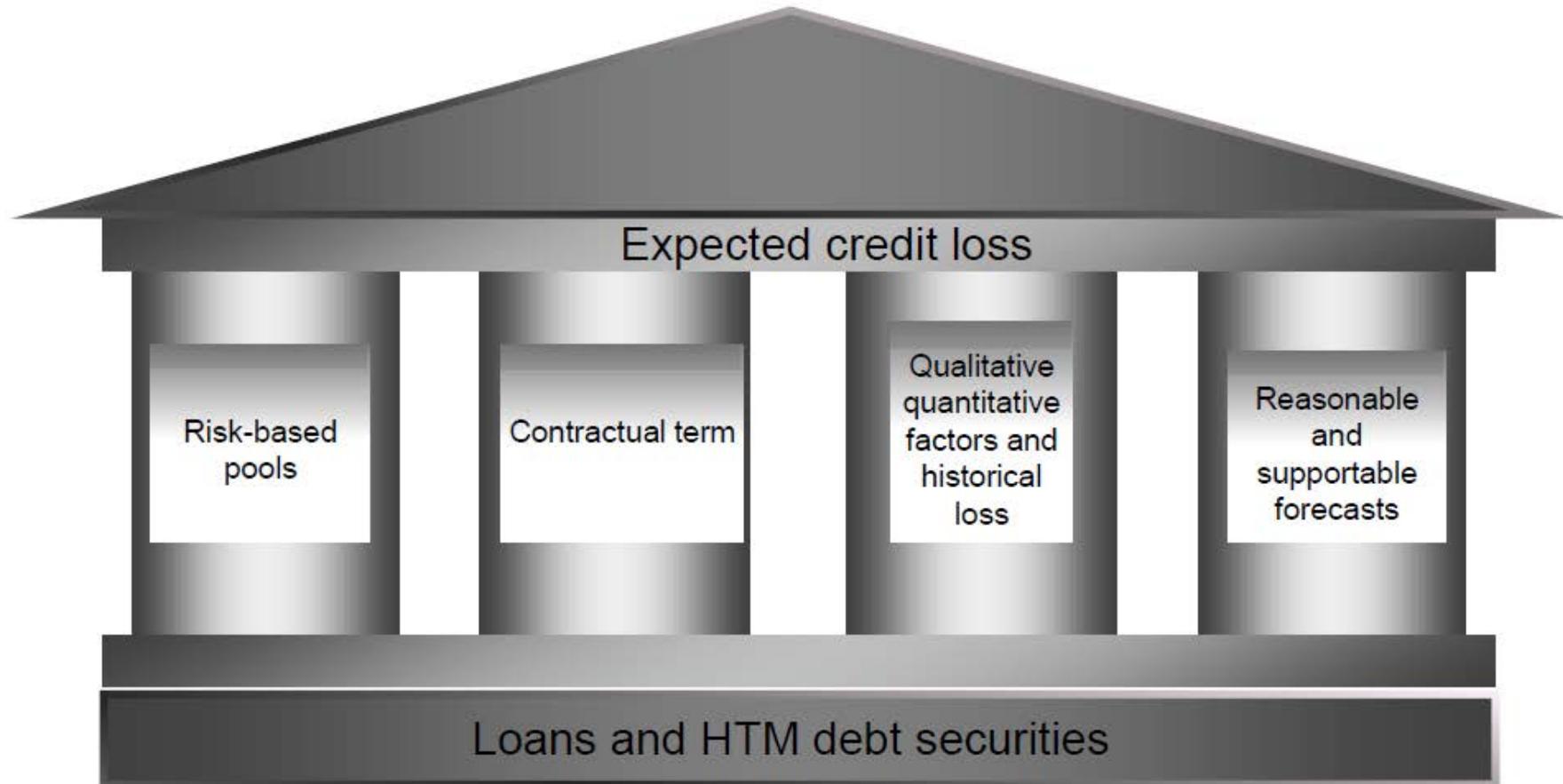
| Measurement Approach | Description |
|------------------------|---|
| DCF | Expected credit losses are determined by comparing the asset's amortized cost with the present value of the estimated future principal and interest cash flows. |
| Roll-rate | Expected credit losses are determined by applying an estimated loss rate to the asset's amortized cost basis. |
| Loss-rate | Expected credit losses are determined by using historical trends in credit quality indicators (e.g., delinquency, risk ratings). |
| Probability-of-default | Expected credit losses are determined by multiplying the probability of default (i.e., the probability the asset will default within the given time frame) by the loss given default (the percentage of the asset not expected to be collected because of default). |
| Aging Schedule | Expected credit losses are determined on the basis of how long a receivable has been outstanding (e.g., under 30 days, 31–60 days). This method is commonly used to estimate the allowance for bad debts on trade receivables. |



CECL Initial Measurement

- Allowance is a valuation account deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected on the financial asset
- At reporting date, record an allowance for credit losses on financial assets
- Report adjustment in net income (as a credit loss expense). Changes in estimate occurs through P&L in the period those estimates are updated.

Pillars of Expected Credit Loss



Considerations for Developing CECL Estimate

- available information relevant to assessing the collectability of cash flows should be considered
 - internal information, external information, or a combination of both relating to past events, current conditions, and reasonable and supportable forecasts
 - Relevant qualitative and quantitative factors should be considered that relate to the environment in which the entity operates and are specific to the borrower(s)



Considerations for Developing CECL Estimate (Continued)

- Historical credit loss experience of financial assets with similar risk characteristics generally provides a basis for an entity's assessment of expected credit losses
 - can be internal or external historical loss information (or a combination of both)
 - Adjustments to historical loss information should be considered for differences in current asset specific risk characteristics, such as differences in underwriting standards, portfolio mix, or asset term

Considerations for Developing CECL Estimate (Continued)

- Past events should not be solely relied on to estimate expected credit losses.
 - may need to adjust historical info to reflect the current conditions and reasonable and supportable forecasts which might differ from the conditions that existed historically
 - adjustments to historical loss information may be qualitative in nature and should reflect changes related to relevant data:
 - i.e. changes in unemployment rates, property values, commodity values, delinquency, or other factors that are associated with credit losses

Considerations for Developing CECL Estimate (Continued)

- Estimate should include a measure of the expected risk of credit loss *even if that risk is remote*, regardless of the method applied to estimate credit losses.
- not required to measure expected credit losses on a financial asset (or group of financial assets) where:
 - historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the amortized cost basis is zero



NO CECL RECORDED - EXAMPLE

Estimating Expected Credit Losses When Potential Default Is Greater Than Zero, but Expected Nonpayment Is Zero (This example is not intended to be only applicable to U.S. Treasury securities.)

- Entity J invests in U.S. Treasury securities with the intent to hold them to collect contractual cash flows to maturity. As a result, Entity J classifies its U.S. Treasury securities as held to maturity and measures the securities on an amortized cost basis.
 - Even with the highest credit rating by rating agencies at the end of the reporting period, Entity J's management still believes that there is a *possibility* of default, even if that risk is remote.
- 



NO CECL RECORDED – EXAMPLE - Continued

- Entity J considers the guidance in ASC paragraph 326-20-30-10 and concludes that the long history with no credit losses for U.S. Treasury securities indicates an expectation that *nonpayment* of the amortized cost basis is zero, even if the U.S. government were to technically default.
- Entity J notes the following about the securities:
 - explicitly fully guaranteed by a sovereign entity that can print its own currency;
 - that the sovereign entity's currency is routinely held by central banks and other major financial institutions;
 - is used in international commerce, and commonly is viewed as a reserve currency
- CONCLUSION: these factors qualitatively indicate that historical credit loss information should be minimally affected by current conditions and reasonable and supportable forecasts and as such no credit loss should be recorded.

ESTIMATING ON A POOL BASIS - SIMILAR CHARACTERISTICS EXIST

- Expected credit losses of financial assets should be measured on a collective (pool) basis when similar risk characteristic(s) exist.
- Similar risk characteristics may include any one or a combination of the following (the following list is not intended to be all inclusive):
 - Internal or external (third-party) credit score or credit ratings;
 - Risk ratings or classification;
 - Financial asset type;
 - Collateral type;
 - Size;
 - Effective interest rate;
 - Term;
 - Geographical location;
 - Industry of the borrower;
 - Vintage;
 - Historical or expected credit loss patterns; or
 - Reasonable and supportable forecast periods.

POOL BASIS - EXAMPLE

Estimating expected credit losses on a portfolio of loans with similar risk characteristics using a loss-rate approach.

- Community Bank A provides 10-year amortizing loans to customers. These loans are managed on a collective basis based on similar risk characteristics. The loans within the portfolio were originated over the last 10 years, and the portfolio has an **amortized cost basis of \$3 million**.
- After comparing historical information for similar financial assets with the current and forecasted direction of the economic environment, Community Bank A believes that its most recent 10-year period is a reasonable period on which to base its expected credit-loss-rate calculation.



POOL BASIS – EXAMPLE - Continued

- Community Bank A's historical lifetime credit loss rate (that is, a rate based on the sum of all credit losses for a similar pool) for the most recent 10-year period is **1.5 percent**.
 - The historical credit loss rate already factors in prepayment history, which it expects to remain unchanged.
- Community Bank A considered whether any adjustments to historical loss information for differences in current asset specific risk characteristics were needed before considering adjustments for current conditions and reasonable and supportable forecasts, **but determined none were necessary**.
 - Example of current differences could be underwriting standards, portfolio mix, or asset term



POOL BASIS – EXAMPLE - Continued

- Community Bank A considered significant factors that could affect the expected collectability of the amortized cost basis of the portfolio and determined that the **primary factors are real estate values and unemployment rates**. (see ASC 326-20-55-4 for list of potential factors)
 - Based on current conditions and reasonable and supportable forecasts, Community Bank A expects that there will be an additional **decrease in real estate values** over the next one to two years, and **unemployment rates are expected to increase further** over the next one to two years.
- 

POOL BASIS – EXAMPLE - Continued

- Estimates a **10-basis-point increase in credit losses** incremental to the 1.5 percent historical lifetime loss rate due to the expected decrease in real estate values.
- Estimates a **5-basis-point increase in credit losses** incremental to the historical lifetime loss rate due to expected deterioration in unemployment rates.
- Management estimates the incremental **15-basis-point increase** based on its knowledge of historical loss information during past years in which there were similar trends in real estate values and unemployment rates.

POOL BASIS – EXAMPLE - Continued

- Management is unable to support its estimate of expectations for real estate values and unemployment rates beyond the reasonable and supportable forecast period.
- Under this loss-rate method, the **15 basis points** are added to the **1.5 percent rate** that serves as the basis for the expected credit loss rate.
- No further reversion adjustments are needed because Community Bank A has applied a 1.65 percent loss rate where it has **immediately reverted into historical losses reflective of the contractual term**.
- This approach reflects an immediate reversion technique for the loss-rate method.

POOL BASIS – EXAMPLE - Continued

- **CONCLUSION:**
 - The expected loss rate to apply to the amortized cost basis of the loan portfolio would be 1.65 percent, the sum of the historical loss rate of 1.5 percent and the adjustment for the current conditions and reasonable and supportable forecast of 15 basis points.
 - The allowance for expected credit losses at the reporting date would be \$49,500 (\$3 million amortized cost basis x 1.65%).

Valuation Tool Example

- Federal Reserve Provided a Free Tool To Help
- This tool is meant for financial institutions with loans. May be something to consider if your entity holds a large number of non-related party loans.
- <https://www.supervisionoutreach.org/cecl>

POLLING QUESTION #3

ESTIMATING ON AN INDIVIDUAL BASIS

WHEN SIMILAR CHARACTERISTICS DO NOT EXIST

FOR EXAMPLE

01

A pool of homogeneous loans may initially use a loss-rate method, but certain individual loans no longer may have similar risk characteristics because of credit deterioration.

02

INDIVIDUAL BASIS

Expected credit losses of that financial asset should be measured individually if there are no similar risk characteristics with other loans.

03

INDIVIDUAL METHOD

A discounted cash flow approach is one method to estimate expected credit losses of individual loans, but it is not a required method.

Fair Value Election

- An entity may irrevocably elect the fair value option in accordance with ASC Subtopic 825-10 for financial instruments within the scope of ASC Subtopic 326-20, except for those financial assets in ASC paragraph 326-20-15-2(a)(2) {Held to Maturity Debt Securities}
- If elected – can use the modified retrospective approach:
 - adjustment to retained earnings at 1/1/2023 which means the loss for the asset held at 1/1/23 will not run through the P&L.



DISCLOSURES

Held to Maturity Disclosures on Credit Risk

- Credit Quality
 - Description of credit quality Indicators
 - Amortized cost basis by year of origination, or vintage, within each CQI
- Allowance for credit losses
 - Description of the methodology/estimate process including:
 - Factors considered to incorporate past events, current conditions, and future forecasts
 - Reversion method applied, if applicable
 - Rollforward of allowance for credit losses activity during the period
- Write-off policies
 - Entity's policies for recognizing write-offs.

Held to Maturity Disclosures on Credit Risk

- Past due status
 - Aging analysis disclosing amortized cost basis by portfolio segment or class of receivable
 - Entity's policies for determining delinquency status and when it considers an asset to be past due
- Non-accrual status
 - Entity's nonaccrual status policies
 - Amortized cost basis of assets on nonaccrual status and assets past due 90 days or more by not on nonaccrual status
 - Amount of interest income recognized during the period on nonaccrual assets
 - Amortized cost basis of nonaccrual assets for which there is no related ACL

AFS Debt Security Disclosures

- Parenthetically reflect amortized cost and allowance for credit losses on balance sheet
- Specific disclosure requirements related to:
 - AFS debt securities in an unrealized loss position for which no allowance for credit losses has been recognized
 - AFS debt securities with allowance for credit losses
 - Rollforward of the allowance for credit losses

POLLING QUESTION #4

Example of Disclosure (Allstate)

Adopted accounting standard

Effective January 1, 2020, we adopted the measurement of credit losses on financial instruments accounting standard that primarily affected mortgage loans, bank loans and reinsurance recoverables. Subsequent to the adoption, we measure credit losses on financial instruments, including losses related to mortgage loans, bank loans and reinsurance recoverables, using the expected credit loss model. This model requires us to recognize an estimate of expected credit losses for affected financial assets in a valuation allowance that when deducted from the amortized cost basis of the related financial assets results in a net carrying value at the amount expected to be collected.

See Note 2 of the consolidated financial statements for additional details on the adopted accounting standard.

Example of Disclosure (Allstate)

Adopted accounting standard

Measurement of Credit Losses on Financial Instruments Effective January 1, 2020, the Company adopted new Financial Accounting Standards Board (“FASB”) guidance related to the measurement of credit losses on financial instruments that primarily affected mortgage loans, bank loans and reinsurance recoverables.

Upon adoption of the guidance, the Company recorded a total allowance for expected credit losses of \$289 million, pre-tax. After consideration of existing valuation allowances maintained prior to adopting the new guidance, the Company increased its valuation allowances for credit losses to conform to the new requirements which resulted in recognizing a cumulative effect decrease in retained income of \$88 million, after-tax, at the date of adoption.

The measurement of credit losses for AFS fixed income securities measured at fair value is not affected except that credit losses recognized are limited to the amount by which fair value is below amortized cost and the credit loss adjustment is recognized through a valuation allowance which may change over time but once recorded cannot subsequently be reduced to an amount below zero. Previously these credit loss adjustments were recorded as other-than-temporary impairments and were not reversed once recorded.

Example of Disclosure (Allstate)

Credit losses recognized in net income ⁽¹⁾

| (\$ in millions) | For the years ended December 31, | | |
|---|----------------------------------|----------------|----------------|
| | 2020 | 2019 | 2018 |
| Assets | | | |
| Fixed income securities: | | | |
| Corporate | \$ (1) | \$ (7) | \$ (2) |
| ABS | (2) | (4) | (3) |
| MBS | (2) | (3) | (5) |
| Total fixed income securities | (5) | (14) | (10) |
| Mortgage loans | (39) | — | — |
| Limited partnership interests | (10) | (6) | (3) |
| Other investments | | | |
| Bank loans | (28) | (26) | — |
| Agent loans | — | (1) | (1) |
| Total credit losses by asset type | \$ (82) | \$ (47) | \$ (14) |
| Liabilities | | | |
| Commitments to fund commercial mortgage loans, bank loans and agent loans | 2 | — | — |
| Total | \$ (80) | \$ (47) | \$ (14) |

⁽¹⁾ Due to the adoption of the measurement of credit losses on financial instruments accounting standard, realized capital losses previously reported as other-than-temporary impairment write-downs are now presented as credit losses.

Example of Disclosure (Allstate)

Rollforward of credit loss allowance for fixed income securities

| | | For the year ended December 31, 2020 |
|---|-----------|---|
| (\$ in millions) | | |
| Beginning balance | \$ | — |
| Credit losses on securities for which credit losses not previously reported | | (5) |
| Reduction of allowance related to sales | | 2 |
| Write-offs | | — |
| Ending balance ⁽¹⁾ | \$ | (3) |

⁽¹⁾ Allowance for fixed income securities as of December 31, 2020 comprised \$1 million and \$2 million of corporate bonds and ABS, respectively.

Example of Disclosure

Gross unrealized losses and fair value by type and length of time held in a continuous unrealized loss position

| (\$ in millions) | Less than 12 months | | | 12 months or more | | | Total unrealized losses |
|--|---------------------|-----------------|-------------------|-------------------|---------------|-------------------|-------------------------|
| | Number of issues | Fair value | Unrealized losses | Number of issues | Fair value | Unrealized losses | |
| December 31, 2020 | | | | | | | |
| Fixed income securities | | | | | | | |
| U.S. government and agencies | 23 | \$ 185 | \$ (1) | — | \$ — | \$ — | \$ (1) |
| Municipal | 47 | 148 | (2) | — | — | — | (2) |
| Corporate | 127 | 1,229 | (39) | 27 | 187 | (26) | (65) |
| Foreign government | 7 | 7 | — | — | — | — | — |
| ABS | 22 | 160 | (2) | 13 | 49 | (3) | (5) |
| MBS | 14 | — | — | 67 | — | — | — |
| Total fixed income securities | 240 | \$ 1,729 | \$ (44) | 107 | \$ 236 | \$ (29) | \$ (73) |
| Investment grade fixed income securities | 163 | \$ 1,193 | \$ (13) | 84 | \$ 117 | \$ (17) | \$ (30) |
| Below investment grade fixed income securities | 77 | 536 | (31) | 23 | 119 | (12) | (43) |
| Total fixed income securities | 240 | \$ 1,729 | \$ (44) | 107 | \$ 236 | \$ (29) | \$ (73) |



Example of Disclosure

Gross unrealized losses by unrealized loss position and credit quality as of December 31, 2020

| (\$ in millions) | Investment grade | Below investment grade | Total |
|--|---------------------|------------------------|----------------|
| Fixed income securities with unrealized loss position less than 20% of amortized cost, net ^{(1) (2)} | \$ (15) | \$ (24) | \$ (39) |
| Fixed income securities with unrealized loss position greater than or equal to 20% of amortized cost, net ^{(3) (4)} | (15) | (19) | (34) |
| Total unrealized losses | \$ (30) | \$ (43) | \$ (73) |

⁽¹⁾ Below investment grade fixed income securities include \$17 million that have been in an unrealized loss position for less than twelve months.

⁽²⁾ Related to securities with an unrealized loss position less than 20% of amortized cost, net, the degree of which suggests that these securities do not pose a high risk of having credit losses.

⁽³⁾ No below investment grade fixed income securities have been in an unrealized loss position for a period of twelve or more consecutive months.

⁽⁴⁾ Evaluated based on factors such as discounted cash flows and the financial condition and near-term and long-term prospects of the issue or issuer and were determined to have adequate resources to fulfill contractual obligations

Example of Disclosure

Investment grade is defined as a security having a rating of Aaa, Aa, A or Baa from Moody's, a rating of AAA, AA, A or BBB from S&P Global Ratings ("S&P"), a comparable rating from another nationally recognized rating agency, or a comparable internal rating if an externally provided rating is not available. Market prices for certain securities may have credit spreads which imply higher or lower credit quality than the current third-party rating. Unrealized losses on investment grade securities are principally related to an increase in market yields which may include increased risk-free interest rates or wider credit spreads since the time of initial purchase. The unrealized losses are expected to reverse as the securities approach maturity.

ABS and MBS in an unrealized loss position were evaluated based on actual and projected collateral losses relative to the securities' positions in the respective securitization trusts, security specific expectations of cash flows, and credit ratings. This evaluation also takes into consideration credit enhancement, measured in terms of (i) subordination from other classes of securities in the trust that are contractually obligated to absorb losses before the class of security the Company owns, and (ii) the expected impact of other structural features embedded in the securitization trust beneficial to the class of securities the Company owns, such as overcollateralization and excess spread. Municipal bonds in an unrealized loss position were evaluated based on the underlying credit quality of the primary obligor, obligation type and quality of the underlying assets.

As of December 31, 2020, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed income securities with unrealized losses before recovery of the amortized cost basis.

Example of Disclosure

Loans The Company establishes a credit loss allowance for mortgage loans, bank loans and agent loans when they are originated or purchased, and for unfunded commitments unless they are unconditionally cancellable by the Company. The Company uses a probability of default and loss given default model for mortgage loans and bank loans to estimate current expected credit losses that considers all relevant information available including past events, current conditions, and reasonable and supportable forecasts over the life of an asset. The Company also considers such factors as historical losses, expected prepayments and various economic factors. For mortgage loans the Company considers origination vintage year and property level information such as debt service coverage, property type, property location and collateral value. For bank loans the Company considers the credit rating of the borrower, credit spreads and type of loan. After the reasonable and supportable forecast period, the Company's model reverts to historical loss trends. Given the less complex and homogenous nature of agent loans, the Company estimates current expected credit losses using historical loss experience over the estimated life of the loans, adjusted for current conditions, reasonable and supportable forecasts and expected prepayments.

Loans are evaluated on a pooled basis when they share similar risk characteristics. The Company monitors loans through a quarterly credit monitoring process to determine when they no longer share similar risk characteristics and are to be evaluated individually when estimating credit losses.

Loans are written off against their corresponding allowances when there is no reasonable expectation of recovery. If a loan recovers after a write-off, the estimate of expected credit losses includes the expected recovery.

Accrual of income is suspended for loans that are in default or when full and timely collection of principal and interest payments is not probable. Accrued income receivable is monitored for recoverability and when not expected to be collected is written off through net investment income. Cash receipts on



Example of Disclosure

Mortgage loans amortized cost by debt service coverage ratio distribution and year of origination

| (\$ in millions) | December 31, 2020 | | | | | | | December 31, 2019 |
|--|-------------------|---------------|---------------|---------------|---------------|---------------|-----------------|-------------------|
| | 2015 and prior | 2016 | 2017 | 2018 | 2019 | Current | Total | Total |
| Below 1.0 | \$ 15 | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 15 | \$ 56 |
| 1.0 - 1.25 | 133 | 27 | 36 | 70 | 48 | 24 | 338 | 225 |
| 1.26 - 1.50 | 378 | 41 | 144 | 187 | 333 | 6 | 1,089 | 1,237 |
| Above 1.50 | 1,037 | 396 | 283 | 373 | 499 | 112 | 2,700 | 3,302 |
| Amortized cost before allowance | \$ 1,563 | \$ 464 | \$ 463 | \$ 630 | \$ 880 | \$ 142 | \$ 4,142 | \$ 4,820 |
| Allowance ⁽¹⁾ | | | | | | | (67) | (3) |
| Amortized cost, net | | | | | | | \$ 4,075 | \$ 4,817 |

⁽¹⁾ Due to the adoption of the measurement of credit losses on financial instruments accounting standard, prior valuation allowance is now presented as an allowance for expected credit losses.

Example of Disclosure

Rollforward of credit loss allowance for mortgage loans

| (\$ in millions) | For the year ended December 31, 2020 |
|---|---|
| Beginning balance | \$ (3) |
| Cumulative effect of change in accounting principle | (42) |
| Net increases related to credit losses | (39) |
| Reduction of allowance related to sales | 17 |
| Write-offs | — |
| Ending balance | \$ (67) |

POLLING QUESTION #5



QUESTIONS?

