Perspectives

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CECL STATUS CHECK: HOW PREPARED IS YOUR FINANCIAL INSTITUTION?

By Rick Martin, Product Manager, Financial & Risk Management Solutions, Fiserv

It's already clear that the effect of CECL – the Financial Accounting Standards Board's (FASB) Current Expected Credit Loss standard – will be far-reaching. The CECL accounting standard, which requires banks and credit unions to record expected losses whenever they make a new loan (at the time of origination or purchase), is scheduled to go into effect as follows:

- Q1 2020 (March 31) for SEC-filing public organizations
- Q1 2021 (March 31) for non-SEC-filing public organizations
- Q1 2022 (March 31) for non-public business entities
- Q1 2022 (March 31) for credit unions

Despite these fast-approaching effective dates, many financial institutions do not have the historical data in place to calculate life-of-loan losses as required by this new credit loss model. Consequently, it may come as no surprise that financial institutions are working at a breakneck pace to prepare themselves for CECL. As financial institutions ramp up to this new standard, considering these following seven tasks will not only help them ensure they have the right data (and enough of it), but also save time and money down the road.

Driving CECL Implementation by Committee

By now, financial institutions should have implementation committees in place, with responsibilities assigned along the three main categories: operational, credit and compliance. These committees should include senior leaders from finance, accounting, lending, risk, operations/IT, compliance and retail.

Beyond the essential to-do lists, institutions should assign responsibility for integrating systems and processes across the organization and re-evaluating growth strategies.

Selecting a Methodology

Financial institutions have a great deal of flexibility when it comes to selecting a methodology for evaluating expected credit loss. In fact, the only requirement is to choose a method that is appropriate and practical – one that can reasonably estimate the expected collectability of financial assets and be applied consistently over time. The right choice depends on the type and size of loans issued by the institution (for instance, car loans versus mortgages) and other internal and external factors. In other words, different methods for different asset groups.

Compiling the Data

Compiling all of the data necessary to comply with CECL often represents the most challenging, time-consuming aspect of the process. For financial institutions, gathering the right historical data is a staggering task.

Begin by learning what data is required for CECL compliance and compare it to existing data to identify gaps. How will missing data be acquired to fill the gaps? Define how data from external or internal sources can be used. Look to external or aggregated sources from peer institutions. Institutions can also extrapolate through historical analysis of data within their organization. Determining how to put processes in place to capture the necessary data going forward is paramount.

Applying Economic Forecasts to Loans

Moving from the incurred-loss model to an expected-loss model will force financial institutions to consider how to apply economic forecasts to the valuation and protection of loan portfolios. Economic forecasts can provide valuable insight into future performance. For instance, unemployment rates could indicate shortfalls on car loan repayments or other short-term loans, while regional growth factors could positively affect repayment/refinancing of home loans, mortgages and longer-term loans.

Once the external data best suited to a loan portfolio has been assessed and gathered, forecasts can be developed to provide an advanced look at loan performance and reserve requirements.

Storing and Managing Data

Data management, retention and storage should also be considered when adapting to CECL standards, and many institutions are assessing their IT systems and planning investments to meet current and future requirements. Going forward, they'll also need to put the right systems in place to gather data, and develop governance strategies to ensure its retention. By combining data from financial accounting and risk management systems, it can be managed and analyzed in a meaningful way.

Gaining a Strategic Advantage

Fortunately, all of this data preparation can provide a competitive advantage for financial institutions. CECL requirements mark the first time this much data has been aggregated at the individual financial instrument level. And once that history – that instrument-level data – is captured, good things can happen. It can reveal valuable insights and trends that can help the institution improve decision-making around credit risk, interest rates and profitability.

For instance, look at demand for different types of loans over time, or other key factors. Data can be pooled and correlated by collateral or type – including mortgages, auto loans, credit cards and more – and further segmented by cost center, loan officer, FICO score or geography. Practical analysis of such a historical amount of instrument-level data provides a solid foundation for financial institutions to understand their markets and metrics. This includes how portfolios behave and where potential opportunities lie.

As it facilitates risk analysis into interest rates, liquidity, credit, market and regulatory capital, additional data for loans and credit helps forecast and reduce losses. In addition to generating more accurate budget projections, using this data to inform strategic decisions can help lead to lower overall risk and better managed return for every stakeholder, including borrowers.

Making Technology Do the Work for You

Making progress on CECL implementation is more urgent than ever considering the fast-approaching deadline. The best bet for financial institutions to meet the deadline and be positioned to strategically leverage all of that required data is to turn to a consultative vendor with the right CECL technology. Utilizing these resources can have a financial institution up and running with a CECL solution in as little as two months.

Consider these five factors when investigating CECL technologies: data management; methodology; reporting; technology integration; and strategic guidance and expertise. Having the right solution not only ensures compliance and minimizes reserve requirements, but also provides insight into data for strategic value over the long term.

Regardless of the ultimate choice, it is crucial for institutions to accelerate their implementation plans so they can approach the coming deadline with confidence.

Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of the Financial Managers Society.

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