Five Things to Do Now for CECL

It is three years before the first banks will estimate their allowances based on the new FASB accounting standard, Current Expected Credit Losses, already better known as “CECL.” But according to regulators, auditors and accountants, it’s going to take at least that long for banks to ready themselves for CECL. Banks need to begin planning, taking the preparatory steps that will reveal their commitments when implementation is at hand.

Here are five things you can do to get ready, each progressively more involved and demanding:

1. Learn

Start by reading FASB’s CECL Accounting Standards Update (ASU) from December 2012. It might not include all the nuances and details of a final ASU expected in the first quarter of 2016, but it will give you the essentials. Most basic to your preparations is knowing what the standard requires, what it doesn’t and what’s unclear to you. You will also benefit from reading some of many comment letters from the industry to FASB and FASB’s responses. That will give you a sense of what might be different in the final from the initial ASU. Review the analyses from industry groups, such as the American Bankers Association and the major accounting firms, especially the accounting firm that serves your bank. As well, the Federal Reserve has offered conference call seminars on CECL and will continue to schedule those calls.

It is important to know that you won’t simply be able to copy what another bank is doing, that each bank will be required to develop its own tactical approach to CECL. Taking opportunities to learn about CECL will help you understand specifically what your institution will need to do.

2. Share

As you learn about CECL and how you might model to include future losses in your allowance estimating, discuss your findings and concerns with your internal stakeholders – your board and senior management; your risk, finance and credit personnel. Share what you are learning and get their input on how CECL will impact your ALLL. Also discuss CECL with your external auditors and regulators. They are going through the same learning curve and will be comfortable discussing their thoughts on what to expect and how to prepare. That will put you, your auditors and regulators on the same page; a worst-case scenario is committing extensive time and expense to developing a model that proves ineffective.
3. Hoard

All indications are that modeling for expected losses will require more depth and breadth of data than any incurred loss model. How much data will you need? Over what period of time? Which data fields will you need beyond what you currently use in estimating using your incurred loss model? The data stored in your core system might not be sufficient. In fact, if you do nothing else, you need to start gathering data – and with implementation three years from now, you can only fall further behind the curve if you wait. In determining what kind of data you will need, you will find that different data fields are required for different types of modeling, including:

- Loan balance data – a wide range of information to accommodate whatever CECL model you decide on
- Segmentation information – similar to your current pools and based on what types of lending you do
- Risk information – historical loss data including risk ratings, risk grades and other types of scores
- Loan origination information – when loans have been originated and where they are in their life cycles
- Transaction level data – loss recovery information that ties back to those loans
- Defaults and pre-payments – for estimating the remaining lives of those loans

4. Forecast

CECL will require you to look to the future, how prospective economic conditions as well as internal circumstances impact your portfolio. Key to looking at the future is using “reasonable and supportable” forecasts. You can use such resources as the Federal Reserve FOMC ("The Fed") or Conference Board or Congressional Budget Office. When you choose a resource make sure it has a history of accuracy, then use it consistently. Economic factors are similar to Q factors, but more forward-looking. It is important to understand how your forecast correlates with your particular experience: your losses, defaults, prepayments.

5. Model

Perhaps the most useful, if also most complex and demanding, way to prepare for CECL is to develop a sample CECL model. You can start by booking historical lifetime losses and determining the timing of those losses. Your goal is not to develop the perfect model, but to generate modeling strategies that will be useful in developing a functional model. And don’t be concerned if your sample model produces drastically higher reserves; it might simply mean you need to adjust or reexamine assumptions. **Most importantly, do not book losses according to CECL before the CECL implementation date.** You are required to book your allowance according to the incurred loss standard until CECL implementation.

**MST** (MainStreet Technologies of Atlanta, Ga.) provides financial institutions throughout the United States with software solutions for estimating the ALLL, analyzing and mitigating loan portfolio risk and preparing for CECL. MST solutions are configured for each institution, integrate with core systems, deliver greater adherence to policy, consider data security and exponentially improve efficiencies.