How Community Bankers Can Launch CECL—
Successfully and On Time

Some good news for community banks, especially those with fewer than $1 billion in assets, is that the delayed implementation for Current Expected Credit Losses (CECL) provides time to be proactive. While CECL undoubtedly adds complexity to banking, if prepared for properly, the implementation can help institutions realize efficiencies and generate more informed strategies for growth—not just create an allowance forecast.

Changes in the accounting and reporting of credit risk have been in the works since the financial crisis, but that doesn't make adopting them a simple task. The Financial Accounting Standards Board (FASB) has issued the current expected credit loss (CECL) standard, and now financial institutions must start the work of adhering to it. These key steps will help you with a successful launch.

STEP 1

CHALLENGE YOUR INSTITUTION TO ADDRESS GAPS & MOVE QUICKLY

Begin your project with the end in mind. Despite the extension of CECL to January 2023, community banks need to begin making steadfast progress to add a forward-looking projection of losses to their allowance for loan and lease losses (ALLL) method.

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If your institution hasn't huddled its key stakeholders to discuss CECL—which is typically initiated by the CEO or CFO—you should do so as soon as possible. Unlike most accounting changes, this project will engage everyone from nearly every corner of the institution including your lenders, credit teams, controller, information technologists and internal audit team.

High-quality data is a known requisite for successfully implementing the new pronouncement. While most institutions have already been accumulating data, your first action may be to ensure that the vast information is actionable and relevant to your institution. We've found high-quality data requires examining both your people and data silos to consider how well they communicate with one another regarding loan performance.

STEP 2

ESTABLISH AN INTERNAL WORKING GROUP

Changing the way you calculate credit losses will affect many departments within your organization, and it's important to involve key players. The key stakeholders will vary depending on the organization, but senior management should spearhead the efforts.

Below is a list of others to consider including.

- Board members
- Finance and treasury
- Credit
- Risk
- Loan review
- IT

Each group will bring different perspectives to the discussion. Be prepared to gather insights into risk identification from credit personnel, for instance, and look to your IT leads for a discussion of how you'll automate any changes. Get everyone on board by expressing the importance of the change, be open to their expertise, and then work with them to set timelines for addressing key milestones as you go through the remaining steps.

STEP 3

IDENTIFY GAPS

There are likely certain aspects of your current process that you'll be able to leverage as you change to a new framework. The FASB has not prescribed specific methodologies for developing an estimate of expected credit losses. If you're currently using discounted cash flows, loss rate, probability of default, or provision matrix models when developing estimates, for example, you may be able to leverage them in developing an expected credit loss model. But there will also be areas you'll need to enhance. Key questions:

- How much data do you currently have access to? The new regulations will require a projection of credit risk over the life of the loan, including risk drivers that are relevant to your market and portfolio. Do you have the data necessary for the wider look, or do you need to explore new ways to collect and organize it?
- What resources do you need? Will additional tools or outside resources be needed to create an efficient, consistent, and repeatable process?
- Will your current infrastructure support the new process? Think about what you'll be asking your infrastructure to handle, and look for areas of weakness. What needs to be reinforced?

STEP 4

ESTIMATE YOUR CASH FLOW IMPACT AND PEOPLE IMPACT SOONER

When it comes to bridging your incurred loss models to the new CECL methodology, parallel runs are key to identifying how the new method may increase existing allowance balances.

With the support of automation, many community banks are able to facilitate a dynamic assessment and remove some of the risk associated with the inputs and data validation. Bankers should be mindful of the possibility that the "last minute" assessment of the allowance change may also be paired with an emergence of problem loans stemming from the COVID-19 pandemic.

STEP 5

MONITOR YOUR INPUTS & ASSUMPTIONS FOR BETTER GOVERNANCE

Be confident in your selected tool and governance processes. Knowing your calculations are reasonable and representative of your portfolio is fundamental. We know that each institution's model (or models) will be reviewed by regulators and external auditors, who recommend ongoing program monitoring to ensure data inputs and other qualitative adjustments remain supportable.

Whether you opt to pursue multiple models and granular segmentations or if a simpler approach is more suitable, it's important that you understand how your model works and how it can be modified to represent emerging trends and expectations.

Finally, it's necessary to take a holistic view to ensure a smooth transition, including:

- Build in testing for data integrity and method estimation validation
- Update other bank policies and reports so they are consistent with processes
- Consider running parallel with the ALLL to evaluate risks
- Back-test as part of supporting modifications and improvements. What are the implementation timelines?

WE CAN HELP

In the end, CECL will help banks develop a more disciplined information gathering process. The outcome will be better data, which management can use for improved decision-making. If you should have any questions, please contact 21 CFS.

This information is an excerpt from *Tips for Preparing for CECL*. Community Bankers Association of Illinois, July 2021

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