The Language Of Banking - A Lost Translation

by Steve Brown

You may not know it, but JRR Tolkien, the renowned author of The Hobbit, also did a complete translation of the epic poem Beowulf. He finished it in the early 1930s just before he began work on The Hobbit, but put the translation aside and only recently has it been published. No one knows who wrote Beowulf originally, but it was most likely written during the 8th Century in Britain. As would make sense at the time, the poem was written in Old English, a language Tolkien was an expert at from an early age. Tolkien had a lifelong fascination with language and created several of his own, including "Elvish," which we find in the Lord of the Rings. So endeth' the literary lesson this morning.

For their part, community bankers have fluency in a number of languages, including "regulatory" and "audit." These strange languages permeate banking and their vocabulary has become part of the banking vernacular.

In like fashion, there is yet another language that is growing in importance that needs the attention of community bankers. This one is the language of accounting and more specifically, the dialects of FASB and the Current Expected Credit Loss (CECL) model. The CECL model was initially proposed by the FASB in Dec. 2012 and if it is adopted, CECL will bring about a number of significant changes to loan loss reserves, primarily because it stems from looking at the entire life of a loan when calculating allowance levels. Anyone involved in risk management knows that there is a necessity to predict the future, but what is becoming apparent in CECL, is that one version of possibilities is not enough. Once again, a variety of outcomes must be analyzed, so a stress test that looks at numerous possibilities (including adverse and severe case) is in order.

For now, CECL rules are not yet implemented, but banks can prepare by beefing up their data collection. Loan-specific data should be collected, as well as other data that can be correlated to loan losses, especially regional and local. Outsourcing the ALLL calculation may be a good choice for many banks that don't have the ability to collect the data and analyze it in such a robust form. In addition to the required analysis, most bankers also think the CECL model will require an increase in their allowance reserve. In fact, according to a 2013 poll by Sageworks, most bankers expect an increase in allowance of 10% to 50%, requiring a one-time capital adjustment, so this issue is very important and should be closely monitored by all bankers.

One further question worthy of thought as bankers consider all the implications of CECL, is who the primary driver of bank regulation will be? Rules like Dodd-Frank come from Congress, but it seems unlikely that any changes will be coming forth from that body any time soon. That means bank regulators and FASB may well become the primary drivers of rules and bank behavior. There are numerous differences, but one of the biggest is that regulations like Dodd Frank have made a serious effort to differentiate between large institutions and smaller ones. FASB for its part is quite indifferent to bank size and is truly a one-size-fits-all approach.

For bankers, as you tell the tale of your bank to regulators, be certain the information you are presenting is translated into the language understood best by who you are addressing. As with any language, a great deal can be lost in translation, so you have to be very careful. For banks that want help translating the implications of CECL and FASB in calculating the allowance, give us a call to learn more about PCBB's ALLL Quantifier.

BANK NEWS

Rate Hikes

Fed Dallas President Richard Fisher said stronger economic growth and signs of increased market excesses indicate the Fed will need to raise interest rates early in 2015 or potentially "even sooner".

Loan Growth

Fed data finds overall loans for the banking industry grew at a 7.7% annualized pace in Q2. This is well above the 5.5% level of Q1 and the 1.7% rate of Q2 2013. Further, it is also higher than the annual growth rates for 2009 through 2013.

More Saving

A report by Moebs Services finds the average balance for U.S. checking accounts was $4,436 at the end of 2013, more than double the $2,100 average of the past 25Ys.

Ridiculous

Despite heavy adoption of online, mobile, remote and video kiosk banking, the U.S. Postal Service continues to push to offer banking services saying rural and other communities are underserved. They point to branch closures and serving the unbanked as key drivers and have released a white paper that shows postal banking could bring in $8.9B per year. Credit unions and community banks stand to lose the most if this goes through and other revenue strapped government agencies would likely to follow suit.

Rising Risk

The Federal Housing Finance Agency's Office of Inspector General has released a report that nonbank mortgage lenders are increasing risks to FNMA and FHLMC due to low regulatory oversight and weaker finances than banks.

Reducing ALLL

Regulators indicate factors that may support recording a lower loan loss reserve (via a negative provision) include: A sustained reduction in watch list and classified loans; a sustained decline in delinquency and charge-off rates; steadily improving economic conditions supported by credible sources; reduction in high-risk segments from the loan portfolio (e.g., construction and land development) and an allowance estimate above the upper range of the allowance calculation when the estimate is based on a sound methodology.