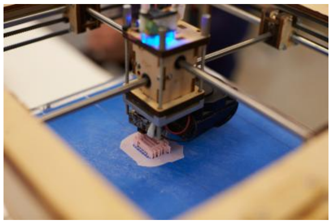

Of Futuristic Things & Regulations

by Steve Brown

Researchers at Harvard University have created a robot using 3D printing that is soft and squishy, wireless, does not need a battery and is powered by fluids. This first of its kind robot can be pumped out by machines quickly and for pennies on the dollar and it could have a large impact on society. As envisioned, it could be used for such things as rescue tasks, because it can swim and crawl. We find this very interesting.

While not as interesting perhaps as an Octobot (that's what they call it), the Financial Accounting Standards Board (FASB) has launched something new around loan loss reserves that is really shaking up bankers. It is known as the Current Expected Credit Loss (CECL) standard and industry experts have billed it as the single largest accounting change in US banking history. This is a huge deal because CECL promises to alter how all financial institutions perform their accounting for losses.

As things operate currently, impairments are based on incurred losses. That means loans are recognized as impaired when an event happened that makes it probable that future cash flows will not be collected in full under the original terms of a contract.

CECL replaces this approach and financial institutions must mix historical information, current economic conditions and "reasonable forecasts" to estimate an expected loss over the life of a loan. Basically, this change will lead to losses being reserved for sooner than under the existing model.

Public banks covered under the SEC are required to adopt the changeover for all accounting periods starting after Dec. 15, 2019. While there are way too many changes for us to go over here - briefly, there are new accounting practices around measurement, scalability, purchased credit-deteriorated assets and securities.

We bring all this up because even banks that will adopt after 2019 will have loans going on the books today that extend over that and will therefore be impacted by the ruling. This is not an easy problem to solve, so know that our team at PCBB is here to help you all along the way.

Our team has gained a fundamental understanding of the new CECL accounting model and we are beginning to share that with our customers, so everyone can better prepare.

We have a plan to help community bankers that covers such things as literature on the subject, expert assistance, alternative approach review and techniques to adequately segment risks in the loan portfolio.

Bankers should also be asking themselves whether they have proper historical data points, including historical prepayment experience. It is important to produce a list of key data which will be required for modeling, and take an inventory of data available. Missing data should also be collected going forward.

Once an implementation plan is adopted the work still isn't over. Bankers will need to continually assess plan status, discuss how it should be adopted and evolve over time. For instance, will the accounting be the same for different financial asset groups? How often will they be changed, if at all? What type of conditions might trigger a change in approach?

Other things to consider are how changes in different forward projections will impact cash flows related to prepayment speeds and collectability. Banks will have to take a closer look at the current rating system to identify risks associated with a given loan portfolio and to ensure it adequately tracks changes in risk (i.e. default vs. charge off).

While the start date remains in the future for banks, many loans that are going on the books today are likely to be impacted when you get there, so knowing more know is critical. While not as cool as a squishy moving octopus robot perhaps, give us a call if you want help with CECL and we can help your team get moving too.

BANK NEWS

Leadership Skills

Research by Deloitte and MIT on digital disruption finds the most important skill leaders should have to succeed in a digital workplace are: knowledge of market and trends, business acumen, problem solver (22%); clear vision, sound strategy, foresight (20%); preexisting experience, digital literacy (18%); open minded, adaptable, innovative (18%); and pragmatic, focused, decisive (11%).

ALLL by Size

The FDIC reported the loss allowance to loans and leases by size as follows: <$100mm (1.44%); $100mm to $1B (1.32%), $1B to $10B (1.17%), $10B to $250B (1.38%) and $250B or > (1.35%). The difference between the lowest and highest is 23%.

Biometric Risk

Wired reports hackers have found a way to trick facial recognition logins using photos from Facebook and 3D rendering.

IoT Risks

A Tripwire survey finds 30% of respondents say their company is prepared for the security risks tied to the Internet of Things (IoT), but 78% say they are concerned about IoT devices being used in distributed denial of service (DDoS) attacks.

DDoS Risks

Website security company Imperva reports the number of distributed denial of service (DDoS) attacks jumped 211% from Apr 2015 to Mar 2016.

Asset Size

A KPMG survey of executives at banks with assets between $1B and $20B finds respondents say the minimum asset level a community bank needs to be to remain independent is $1B (50%), $5B (41%), $500mm (8%) and $10B (1%).