Getting To Know CECL Better

CECL risk management

Summary: Regulators published their latest CECL FAQs. Check out our quick reference of this document.

It's Halloween so we thought we would bring you into the online dating world where terms such as benching (when you keep someone on the back burner as an option), submarining (person you are seeing disappears and then reappears randomly as if they had been just below the surface), ghosting (ceasing all communication with someone you are dating), stashing (person you are dating refuses to introduce you to anyone in their lives) and zombieing (when someone disappears from your life and then comes back from the dead with a text or social media interaction) can all happen.

When it comes to CECL (the current expected credit loss) promulgation from FASB, many may feel ghosted themselves. After all, with something as complicated and potentially impactful as these new rules, community bankers have been talking to anyone and everyone about CECL, and some are probably getting ditched by their friends as a result.

To help bankers get ready, regulators published their latest FAQs about the new rule. This document may serve as a handy way to review key changes, how they work, and what some of the implications may be. Here are some highlights.

For starters, it is important to note what the new standards do not affect. They do not apply to trading assets, loans held for sale, financial assets for which the fair value option has been elected, or loans and receivables between entities under common control. These exemptions from the standards can themselves be complicated and require the expertise of specialized accountants.

What CECL does impact is credit loss methodology. The new standard requires losses to be estimated when a loan is originated or acquired, and then updated over time. Under the changes, bankers must now consider not just current situations but also "reasonable and supportable" forecasts that could affect loan collections over the life of the loan. This may be difficult, but is definitely manageable with the right models.

While the changes are supposed to provide an informational cushion against huge loss surprises, like those that popped up in the last financial crisis, there is concern that the mechanics of complying will carry a steep price. One recent survey of bankers found that 80% said they would need to upgrade IT systems to enable the modeling required to estimate losses.

The FAQs continue through an extensive list of answers to questions bankers have been raising about the new standards. For instance, one of the questions is what information and data banks need to start collecting to carry out the loan loss projections. Regulators recommend banks review information they currently collect and then compare that to what might be needed to make loan loss projections. Particular attention should be paid to historical loan loss data. System changes may also be needed to collect and analyze the needed data.

Another important point that may be helpful to smaller community banks with less robust IT systems is that regulators will not require banks to reconstruct historical data, if it is not reasonably available without undue cost and effort. (Note: Auditors may differ in their opinion on this.) A bank that doesn't have access to historical data should nonetheless begin saving and maintaining current data for future use.

HEDGING SERVICES FOR COMMUNITY BANKS

Community bankers seeing long-term fixed rate demand from business clients can transform payments into a floating rate on their books using Borrowers' Loan Protection (BLP).