



## The Mathematics Of Finding The Right CECL Vendor

CECL risk management

**Summary:** CECL is coming and community banks may need to look for outside assistance. What key attributes should your bank use to assess CECL vendors?

Bankers love numbers and math. After all, how else do you count all that money in the vault? To get your number wheels going this morning we point out that 3 quarters, 4 dimes and 4 pennies is the largest amount of coins you can have without being able to make change for a dollar. If that doesn't get you going, we note that back in 1830 an eagle swooped into the US Mint building in Philadelphia and was used as a model for coin engravings for years; the TSA collects about \$775,000 in loose change at airport security checkpoints each year; the lifespan of a \$10 bill is a short 4.5Ys and paper money isn't paper at all but is rather cotton and linen.

Community bankers will need to do some additional math when it comes to looking for the right vendor around the current expected credit loss (CECL) rule that takes effect for SEC banks in 2020 and all others in 2021. To help you better assess your vendors, we share this partial list of key vendor attributes.

**Data is critical so be sure you own and control it.** CECL forces banks to spend more time and money to prepare and audit ALLL. To do that you will need to collect, maintain and analyze historical and current loan data.

Unfortunately, most core systems don't contain all the data required. A bank might have changed its core system, with old data lost or prohibitively expensive to recover. Also, some banks have purchased others but not received the loan history as part of the transaction. The core system may also only keep 5Ys of data, even though a bank has loans that mature over 20Ys.

Those gaps aren't the end of the world, but you'll want to have all the data on loans you originate going forward. A good vendor should help ensure that, by storing your historical data and providing it to you as needed.

**Deep understanding of optionality - a huge driver for loan loss reserves now.** Real estate loans generally have a maturity of 5Ys to 30ys and a prepayment option for the borrower. Prepayment rates fluctuate with interest rates. So, assumptions regarding the loan's likely prepayment rate are important in determining the option's value and in turn, the expected loss estimate. Vendors must be able to demonstrate deep expertise in this area, so be very careful here.

**Things change so the model needs to be flexible.** Different loans use different methods in different economic conditions. You will need to choose methods that suit your current conditions for each loan and then shift over time as conditions change. Be sure any vendors you consider can handle that easily and simply.

**Provide total data transparency for all calculations.** A bank's staff needs to understand data clearly in order to properly group loans. It's also important to show auditors and examiners how you arrived at a result. Data transparency helps you accomplish both goals. You should expect this quality from any vendor and they should demonstrate this in advance.

**Provide both finance and credit expertise.** The accounting and credit departments can be in two different orbits around the bank. To be compliant under the rule, vendors should understand the needs of both and be able to explain what is changing and why from both points of perspective.

**Choose carefully and prudently.** The rule adds complexity, is different than historical methods, is subjective, can significantly change the reserve and is susceptible to management biases and misstatements that can be catastrophic. Be sure methodologies make sense, are easily explained and easily supported by subject matter experts to avoid trouble.

Choosing a CECL vendor can be a daunting process and there are plenty of other criteria to think about, so be cautious. You still have time to figure it all out so don't panic either. For more information or help doing the math, feel free to contact us or check out our [CECL product page](#).

## CECL SOLUTION - BUILT BY OUR BANK FOR YOUR BANK

CECL is one of the biggest challenges for community bankers these days. Our experts are ready to guide you every step of the way through this integration with no software to maintain. Learn more about our [CECL Solution](#).

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