Running CECL In Parallel – What You Should Know

regulatory CECL risk management

Summary: While most big and mid-sized banks have already implemented the new CECL standard, many community financial institutions are waiting until their deadline of January 1, 2023. Yet, there is a lot to do this year to ensure you are compliant, including running CECL in parallel. Here are three guiding principles that we recommend to keep you on track as you perform your parallel runs.

Over 67MM years ago, the pterosaur Quetzalcoatlus northropi lived in North America. The Quetzalcoatlus was a mix between a giraffe and a heron with a wingspan of up to 36 ft, weighing up to 550 lbs, and standing up to 36 ft tall. It is considered the largest flying animal ever. That is a record that will likely stand in the history books.

Turning from big flying dinosaurs to big banks, the Federal Reserve reports that "*on January 1, 2020, most large and mid-sized US banks adopted Current Expected Credit Losses (CECL)*." As a result, about 80% of all US bank loans are now under the new accounting standard. Community financial institutions (CFIs) have the option of adopting CECL now, but few are interested in climbing aboard before their deadline on January 1, 2023. Still, most are following AICPA recommendations and are taking the time to run parallel CECL systems, to make sure they're ready. Through our work with our customers, we have uncovered these **three guiding principles** and some pointers to help your institution stay on track, as you perform your parallel runs.

A parallel run requires extra effort, because it compels bankers to assemble resources. But it's a good way to make sure that your institution is genuinely prepared to operate under CECL. After all, it's important to think through all the eventualities. It's better to take the time for two or more dry runs that cover what you need when you go live, such as additional data, adjusted Q Factors, your procedures, documentation, etc. Through these parallel runs, you may find related issues that your planning didn't reveal.

1. **Don't let the parallel process run on autopilot.** Running in parallel is a time to make sure things are running as they should. Executives need to stay hands-on, ensuring that the bank has necessary processes in place, including ongoing assumption documentation. You'll probably need to adjust your assumptions. Downstream changes are likely to affect both your model and your documentation, so plan to share these with examiners as well.

Our expertise has shown that these four categories should be addressed to keep things running smoothly, while giving you vital feedback to incorporate into the model.

- **Accessing and deploying resources.** Who will build and run your parallel CECL process? Will the effort involve vendors? Identify your team, whether internal or external.
- **Using the appropriate technical functions.** Determine how you'll select a modeling approach, as well as your resources, and then schedule for conducting system integration testing and user acceptance testing. Plan to run quality assurance testing throughout the parallel run. You're essentially testing the functionality you'll need for processing the allowance for credit losses and related disclosures.
- **Setting up operations.** With technical issues resolved, you'll move to following the target operating model design sequence, with the goal of producing an allowance for credit losses and external quantitative

reporting disclosures.

- **Defining the process for approving credit-loss allowances.** Run this process for two to four quarters, with your credit-losses approval committee. Take an especially careful look at what they feel caused allowance changes between one period and the next, as well as considering the qualitative overlays included in the credit-loss allowance.

2. **Talk with auditors and your regulatory agencies.** Get their early feedback and support for your CECL assumptions. Your chosen model should be in harmony with your projected growth, as well as in line with whatever strategic initiatives you've planned for 2022. Auditors and regulators may see your situation as more or less complex in light of even small changes to your growth or strategy. Be prepared by getting this input, before it is too late to make any adjustments.

3. **Let the data guide you.** Make sure that you pick the right supplemental data and then let that data guide you. Supplemental data needs to be reliable, consistent, and relevant to your institution's situation. Once you've chosen your data, pay attention and respond accordingly. Don't needlessly overcomplicate your compliance process, but be diligent.

CECL is here within a matter of months. Is your institution on track? If not, let us know. We have helped many CFI customers implement CECL and run in parallel. We can help you too, so that you can keep moving on other matters at hand.

CECL: THREE TIERS TO FIT YOUR NEEDS

ECONOMY & RATES

Rates As Of: 02/07/2022 06:42AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.23	0.01	0.17
6M	0.56	0.07	0.37
1Y	0.88	0.09	0.49
2Y	1.30	0.12	0.56
5Y	1.77	0.16	0.50
10Y	1.93	0.14	0.41
30Y	2.22	0.11	0.31

FF Market	FF Disc	IORB
0.08	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.07