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RESUMING CECL COMPLIANCE PLANNING

By Jay Kenney, PCBB

Community banks that put current expected credit loss (CECL) standard work on the back burner during the pandemic are finding the need to bring it to the front burner once again and begin planning and implementation steps.

As many bankers are discovering, CECL can be more than a straightforward change in accounting methods. It has the potential to create material changes in the capital and reserve amounts needed to backstop expected credit losses.

The new CECL rules require institutions to be more forward-looking and utilize predictive forecasting models to estimate potential losses. Although community banks have enjoyed a more extended grace period than the large banks that have already implemented CECL, steps are needed to prepare for the Jan. 1, 2023 start date.

Understanding key differences

It is easy to get stuck in the weeds in the details of CECL. From a high-level view, CECL has some crucial differences compared to the incurred loss. Dun & Bradstreet groups these differences into three essential changes for bankers to recognize.

- Focus on forward-looking data versus past performance
- Group or cluster HTM securities and loans by risk profiles
- Provide consistent assumptions for losses for monitoring, auditing and for all other forward-looking solutions

Tips to get started with CECL

The focal point of CECL is developing and validating a forecasting model, which will need to consider the size and complexity of an institution's credit and security portfolios. Those models need to be transparent and defendable.

Another significant piece will be managing the data inputs for those models. Community banks need to start gathering data internally and determine what external or third-party data sources they need to access.

Additionally, it would help if you thought about managing, storing and updating data. Below are **six simple steps** to help you resume your CECL compliance preparedness.

1. **Form a CECL preparedness team.** There will be a lot of heavy lifting ahead in preparing and implementing this new strategy. Include a good cross-section of disciplines, perspectives, and expertise to make sure all issues are addressed, such as credit (loans), accounting (reserves & securities), technology (data & new tools), and compliance (audit and regulatory expectations). These issues are a key component to ensure your implementation runs smoothly. Also, do not forget to include Board training.
2. **Create a realistic timeline.** The American Institute of CPAs (AICPA) recommends running one year in parallel. To accomplish this, you will need to have your model configured by the end of this year.
3. **Look for third-party expertise.** This type of project can be daunting and time-consuming, even with the best-laid plans. Consider working with third-party experts to help put you on a path to success. Consultants can bring expertise and resources to help create a more efficient transition to CECL compliance.
4. **Evaluate ALM and stress test.** Although often more applicable to large banks, a Loan & Capital Stress Test also can be a valuable tool to assess CECL readiness for community banks. Such tests help account for different potential loss rate scenarios. Additionally, you will need to review the assumptions in your asset liability management (ALM) solution and other solutions using similar forward-looking assumptions to ensure that these are consistent and defendable throughout your institution.

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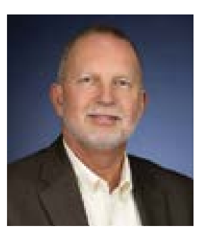
5. **Review lessons learned.** Community banks can gain some insight into the process and impact of CECL from the big banks, specifically the public disclosures, earnings calls, and reports from publicly traded companies. The AICPA is another resource tracking known CECL issues. Currently that list includes more than 40 topics that range from appropriate considerations for a forecast period to how to account for troubled debt restructurings.
6. **Utilize available resources.** There are a variety of resources ranging from FAQs to webinars and audio presentations. Besides the AICPA website, you might want to check out PCBB's CECL Resource Library.

CECL is coming and preparing now is crucial. The steps above will get you on the right path. But, if you find you need extra help, we are here to assist you. For more information or to continue the discussion, please contact Jay Kenney.



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