# How Will CECL Affect Your Institution’s Securities?

CECL risk management

**Summary:** CECL hasn’t been at the forefront of bankers’ minds given the pandemic. However, it is still happening and auditors and examiners will be asking questions about CECL. One area to think about is how CECL will affect your institution’s securities. We give you insight into CECL and HTM, AFS, and trading securities.

It has been estimated that on a clear night away from city lights, as many as 5K stars would be visible to the naked eye. Bankers are more likely to be looking at their loan loss estimates these days than up the stars. Still, we thought it was interesting nonetheless.

The financial press is full of news about CECL’s effect on loans, as well as how the effects of the coronavirus will affect CECL’s implementation. Yet, community financial institutions (CFIs) will need to understand and strategize around the effect the new standard will have on their institution’s investment securities too. These will need new accounting treatment as well. Different types of bank investment will require different accounting. Here are some considerations.

**HTM securities.** CFIs primarily use HTM securities to reduce capital volatility. These assets are currently accounted for monthly, on a book basis, and valuation changes aren’t recorded to capital or income. Right now, actual or anticipated losses that aren’t due to temporary impairment are recorded to income.

CECL will change how all financial institutions (FIs) account for HTM securities by requiring an allowance for lifetime expected credit losses, when FIs buy an HTM security. Institutions will figure that allowance by adjusting historical loss data for current conditions, plus reasonable and supportable forecasts, for pools of bonds with similar risk characteristics. In other words, they will need to guess at the asset’s history and future prospects, then account for anticipated problems at the time of purchase.

**Trading securities.** CECL won’t affect trading securities, a group of assets that get monthly accounting on a mark-to-market basis, with any value change recorded to income. Because the CFI would immediately account for credit losses, CECL doesn’t enter the picture.

**AFS securities.** At present, FIs account for AFS monthly on a book basis, recording valuation changes to capital, not income. They record losses when they know that one has or will take place, registering the income change as a reduction in the security’s loss basis. When the owner of an AFS security recovers previously recognized asset impairment, it records that recovery in interest income prospectively, over time.

CECL won’t apply to AFS debt securities. Under the new rules, FIs will recognize an allowance for credit losses, instead of a reduction in the asset’s cost basis. When a security’s credit quality improves or estimated credit losses improve, FIs will recognize these right away, as a reversal of the allowance recorded earlier. That aligns the recognition of credit losses on the income statement for the reporting period in which changes happen.

The new guidance does away with OTTI theory in favor of deciding whether an unrealized loss is due to credit problems or other issues. FIs will no longer use the amount of time a security has spent in a position of unrealized loss to determine credit loss. Instead, they will evaluate each security during every reporting period, comparing the present value of the asset's expected cash flows against the security's amortized cost basis.

Now is the time to start looking at all of the facets of CECL and its effects on your institution's securities. Get all your ducks in a row now as the auditors and examiners will likely be asking CECL-related questions in your next exam. If you need help, let us know. We can get you on track.

## THREE TIERS TO FIT YOUR CECL NEEDS

CECL is one of the biggest challenges these days. CECL FIT gives you options to fit your portfolio with a web-based intuitive solution, including as little or as much expert assistance needed. Plus, we include a 100% cancellation guarantee. Learn more about our CECL solution.