What to Do Now to Prepare for CECL

by Tom Caragher, Director, Product Management, ZM Financial Systems

Industry experts agree a significant amount of historical data is needed for financial institutions to prepare for CECL. With slightly more than two years until the new standard becomes effective, have you started to prepare?

Beginning in 2020 and being phased in until 2022, financial institutions will be required to use historical information, current conditions and reasonable forecasts to estimate the expected loss over the life of a loan, under the new FASB accounting standard, Current Expected Credit Losses (CECL). The multiyear implementation period is intentionally provided to give institutions enough time to prepare themselves to adhere to the new standards, but many institutions have just begun or haven't even started to take any necessary action.

Financial institutions need to begin collecting data, forecasting, modeling and reporting now. Here are six things you should keep in mind about CECL to keep pace with the rollout:

Build a team to support this process. Understanding the process and identifying the data needs is not something that should be done by one person. It should involve stakeholders from across the institution for transparency and visibility. Consider ensuring a representative from the C-suite is part of the team.

Identify the data need. Each of the team members involved should have a unique perspective and understanding of data within the organization. Begin by identifying internal data components. What are the aspects that allow aggregation of various types of loans and investments? Then within each category, what additional elements allow for subpools?

Select your methodology for calculating ALLL. Decide what methodology you will use to quantify historic loan losses and how you will use that methodology to calculate current ALLL (Allowance for Loan and Lease Losses). Part of the calculation will involve a qualitative adjustment to loss levels, which can be a subjective level or can be determined using regression analysis.

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CECL with forecasting and stress testing may allow your institution to improve and optimize long-term performance. With different forecasts in different stressed environments, forecasted ALLL may change. Understanding those changes and implications may enable better strategic and contingency planning to maximize profitability.

Gathering your data is just a starting point. One of the most difficult and time consuming parts of CECL compliance will be the data exploration, gathering and organization. Once that process is established on an ongoing basis, the process should be less onerous. However, it is important to continually review the loan loss evaluation methodologies, including how to utilize them to optimize performance.

If you haven't started preparing for CECL, now is the time to catch up. Your financial institution may benefit from beginning the data collection step soon to keep pace with the CECL rollout.

Financial institutions will need as much time as possible to develop a holistic understanding of their data and their data strategy, and determine how to manage the new process efficiently. Use this time to gather your institutions' historical data and begin regression and forecasting, and determine the tools needed to be successful. Having the right data – and enough data – will be key to implementing the new standards. And, it may save time and money down the road.

About the Author

Thomas (Tom) Caragher is the Director of Product Management at ZM Financial Systems. He is responsible for the overall direction and strategy for the company's Online CECL solution. Before joining ZM Financial Systems he spent 12 years as the Sr. Product Manager for the risk products at a financial software company.

Prior to that position, Tom spent five years as an interest rate risk consultant, as well as several years at the Chicago Board of Trade in back office operations and as a credit analyst for GreenTree Financial.

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