CECL Prep: Implementation.

Crafting a project plan and timeline

IN THIS GUIDE

- Forming an implementation committee
- Crafting a project plan
    - » 5 Categories for consideration
- Example implementation timelines
- Example timeline: SEC-filing institution

INTRODUCTION

In 2012, the FASB introduced proposed guidance on the allowance for loan and lease losses (ALLL) that could profoundly change the calculation and the way some institutions manage loan data to support the reserve. The final guidance has yet to be released, so it is not currently possible to say with confidence what institutions will be impacted and to what degree.

The proposal, known as the current expected credit loss (CECL) model, moves away from the incurred loss model, which has a simple one-year horizon. The CECL model will be a forward-looking calculation that will estimate expected, rather than probable, losses for loans over each loan's estimated life. The reason for the change, according to the Federal Reserve, will be quicker recognition of losses and an ALLL that will better reflect changes and credit quality. The challenge for institutions is that the CECL calculation, if the final guidance is similar to proposed versions, will likely require multiple years of granular information for each loan in the portfolio.

The CECL model will likely be implemented as early as December 15, 2018, but that should not give institutions reason for delaying preparation. It is important that bankers determine how CECL may affect their institution and identify resources for implementation. The first step is to form an implementation committee whose task is to develop an implementation project plan.

This guide details the basics for CECL implementation, based on information from the current exposure draft of the *FASB Project on Accounting for Financial Instruments: Impairment.*

Implementation Committee.

An implementation committee should be formed under the direction of either senior management or the board of directors. Members should include senior employees from several departments of the institution, including finance, credit, risk, operations, IT and audit. These committee members may not realize today how the existing ALLL affects their department, but it will be important that they know how CECL may impact them upon implementation.

Once the committee is formed, initial objectives and timelines should be developed. This requires that responsibilities be assigned and resources identified. There should be enough diversity among resources to provide guidance for the three main categories of a CECL implementation project plan: Operational, Credit and Legal/Compliance.

CECL IMPLEMENTATION SCOPE

Operational	• IT Systems • Vendor management
Credit	• Credit business lines • Mergers & acquisitions • Counter-parties
Legal/Compliance	• Regulatory reporting • Tax • Financial reporting

RESOURCES TO CONSIDER

Auditors	**Regulators**	**Peer Institutions**
In-house Experts	**Outside Consultants**	**Vendors**

Once the objectives and timelines are developed, the next step is to generate a detailed project plan in which roles are assigned. From there, the committee must meet regularly and provide updates to various leadership at the institution and the board of directors.

Implementation Project Plan.

The first step in the project plan is the evaluation of the current ALLL methodology and the processes used to determine the current reserve. Things to evaluate include processes for data gathering, the platform used to perform the calculation and the efficiency of the process. Transitioning to the new CECL model is an opportunity to improve ALLL processes and implement a data integrity and stress testing program that will benefit the institution. Among the many topics the committee and plan should address, many of which will be unique to each institution, there are five major categories to consider.

5 CATEGORIES FOR CONSIDERATION

1. **Methodology changes**
   CECL will be a calculation that determines lifetime expected losses based on "reasonable and supportable forecasts". This calculation has the potential to be more sophisticated, using models such as migration analysis, vintage analysis or PD/LGD. If your institution considers moving to a more robust methodology, any new model that is developed internally will need validated by an external authority, and internal controls must be developed. If internal development is not feasible, the committee could explore an external software provider or consultant.
2. **Data requirements**
   Due to the potentially complex changes to the ALLL and the need to predict extended periods of losses, proactive institutions will gather and store a few years of quarterly or monthly, loan-level data. This can be challenging even for large institutions with more IT resources. If the institution's current data capturing and storage solutions are insufficient, consider (a) contacting the institution's core provider to inquire about data archiving, (b) working with the IT department to create an in-house storage solution or (c) partnering with a trusted, third-party vendor for capturing and archiving loan-level data. For more information about potential CECL data requirements, see the CECL Data Prep Guide.
3. **Capital adjustment**
   The CECL model may require a one-time adjustment to capital to account for changes in the allowance. Capital is not cheap, and a process to acquire that capital should be identified early enough to raise additional capital on or before the CECL implementation date. For those institutions that are publicly traded, a process of providing any relevant information to shareholders and securities regulators should be identified as well.
4. **Communication**
   Keep the board and senior management abreast of any known or anticipated impact of CECL. Consider regular updates to keep them apprised of the committee's progress. Any meetings with the board should have updates read into the minutes as an official memorialization of the committee's progress.
5. **Projected impact**
   CECL can potentially affect many parts of the bank. Many industry experts believe CECL may result in higher reserves and potentially fluctuation provisions. Because provision affects net income, earnings projections may be impacted. Institutions may also find that their peer comparisons may change, possibly dramatically, due to the unique application of the non-prescriptive model across different types of portfolios. Conversely, in some cases CECL may result in a reduction of ALLL levels.

The CECL model is an extension of a broader risk management framework developed by Basel with the help of FASB and regulators. The goal is to have institutions properly identify, mitigate and reserve for risk in their portfolios. Along with an ALLL that complies with CECL, institutions should consider developing a stress testing program that tests both the institution and concentrations of its portfolio.

Implementation Timelines.

Timelines will need to be managed in order to ensure the institution meets the desired date for implementation. In the current FASB exposure draft, institutions fall into one of three categories, which will determine the date for required CECL implementation.

THREE IMPLEMENTATION DATE CATEGORIES

1 **SEC-Filing Institutions**
December 15, 2018

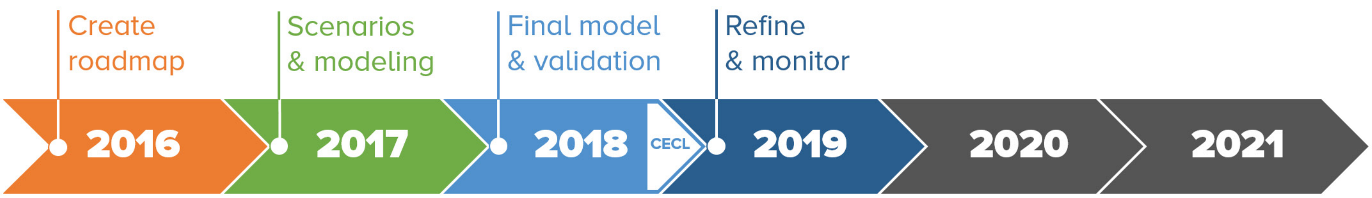
2 **PBE Non-Filers**
December 15, 2019

3 **Others**
December 15, 2020

Example timelines

The following timelines illustrate how the implementation committee may design the project plan and the objectives for each year leading up to implementation.

1. SEC-Filing institutions



2. PBE Non-Filers

3. Others

Example Timeline: SEC-Filer.

***Implementation is likely to be unique at each institution.*

Timeline example: Description by year

2016: Create roadmap

Creating a roadmap includes forming a committee and developing a project plan. Once completed, the task of reviewing the CECL language and identifying data requirements can begin. Necessary activities include identifying data requirements, checking for data adequacy and addressing any needed data-archiving improvements. Data should be gathered and stored each month according to the projected need of the institution, and potential loss methodologies should be reviewed against available data to evaluate feasibility. Lastly, an institution can begin modeling potential CECL scenarios.

2017: Scenarios and modeling

The institution should continue to develop and refine multiple, potential CECL scenarios in parallel with the current ALLL calculation. Keep trying the models and the data for deficiencies, and begin the process of identifying potential, final models. While testing, consider the impact each scenario will have on capital. Finally, provide management with comparisons of the current ALLL against proposed CECL scenarios and their impact on the provision and capital.

2018: Final model and validation

This is the final year before implementation for most institutions, and it is also likely the most critical. The final CECL model must be approved by the board of directors and external auditors, and it should take into account any regulatory feedback received by the institution. Final scenarios should be tested and presented to management and shareholders showing the projected impact on ratios, earnings and capital. As CECL is being finalized, this is the right time to introduce more robust stress testing, underwriting and loan pricing programs.

2019: Refine and monitor

In 2019 and years following CECL implementation, it will be important to fine-tune the new ALLL process as well as other related processes. ALLL levels should be monitored under the new model to ensure accuracy. Risk ratings and loan pricing adjustments should be fine-tuned to minimize risk. Management and the board should continue to receive updates on the progress and impact of changes on the institution.

Additional Information.

About Sageworks

Sageworks provides credit and risk management software solutions to thousands of financial institutions, helping them grow profitably, while mitigating risk. Sageworks is trusted by more financial institutions for the ALLL than any other solution.

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