Are You Ready for CECL?

FASB's Current Expected Credit Loss Standard (CECL) will impact financial institutions' end-to-end reserving process. Primatics makes the transition a non-event.

Experts agree that CECL will result in an increase in reserves across the banking industry. The OCC estimates that the reserve would increase anywhere from 30% to 50%.[1]

The Proposed Standard

The FASB is reviewing and refining the Proposed Accounting Standards Update ASC 825-15, Financial Instruments: Credit Losses, more commonly known as the Current Expected Credit Loss model, or CECL.

The proposed standard establishes a single reserve method for all financial instruments measured at amortized cost. This update will require financial institutions to change the way they approach their reserve process. Financial institutions will have to replace the current incurred loss approach with a lifetime expected loss estimate. The new impairment model eliminates ASC 310-30 (formerly SOP 03-3) and alters some of ASC 310-10-35 (formerly FAS 114).

This methodology change requires a significant shift in mindset, operations, and more importantly, a financial institutions' reporting and disclosures which will be more complex than ever. Financial institutions will need a more holistic understanding of the reserve and an automated and controlled approach to manage the entire process and explain changes in the reserve over time. Will you be prepared to answer questions from investors and regulators?

The Major Impacts

The most significant challenges the new standard will pose are:

- **Complex Reporting and Analytics:** Since the allowance will likely be a larger component of the financial statement results, financial institutions will be more reliant than ever on detailed analytics to gain insight into the drivers of assumption changes between periods. Changes in the factors leading to an increase or decrease in the loss expectations and the reason for the change must be disclosed at the portfolio level. Documentation and transparency will be critical in order to adequately support the estimate. A manual approach to compiling this information is unlikely to meet the requirements in the time available during the reporting period.

[1]Source: http://www.occ.gov/news-issuances/speeches/2013/pub-speech-2013-136.pdf

The Major Impacts (cont'd)

- **A Forward-looking Reserving Process:** Financial institutions will not only have to understand and incorporate historical loss rates into the reserving process, but also include forward looking assumptions in the calculation. Consider the forecast of future economic circumstances; forecasts are highly judgmental, and the potential for expected credit loss volatility is high. These assumptions will need to be developed and supported by a consistent methodology and sound data. Financial institutions will have to substantiate the assumption changes they make over time, and their impacts on the reserve.

- **Deeper Integration Between Accounting and Credit:** The new standard will further require these two groups to collaborate effectively. Both the accounting and credit views will be necessary to determine the method and information used to calculate the reserve. Collaboration between accounting and credit will also be critical to providing a comprehensive explanation of how the current and projected forecasts drive the estimate. Changes in credit quality leading to an increase or decrease in the loss expectations must be understood by both accounting and credit. Automation and controls will be essential to information exchange and creating one view of the reserve.

The EVOLV® Approach to CECL

EVOLV is the only software system that seamlessly integrates a robust accounting system with a model execution platform that is capable of generating lifetime expected cash flows. EVOLV is built on a flexible, extensible platform, designed from the ground up to adapt to change. Primatics delivers EVOLV through a state-of-the-art SaaS model, which means financial institutions will never be out of date with the standard.

Integrate Accounting and Credit

- Make better business decisions driven by a unified accounting and valuation view
- Analyze accounting scenarios and portfolio sensitivity to changing macroeconomic and credit variables at the instrument level
- Take advantage of flexible and customized analytics and reporting capabilities

Streamline End-to-End Processes

- Automate the aggregation and transformation of data into GAAP-compliant entries
- Realize efficiencies in operations with robust reporting; staff spends time analyzing and understanding results rather than compiling and reconciling datasets
- Integrate key controls within the process, ensuring SOX compliance and reducing the audit time
- Access to a scalable and secure framework that anticipates changes to regulatory guidance

Services

Primatics Professional Services team is ready to help financial institutions successfully address the challenges of the conversion, and implement an efficient cost effective end-to-end process in support of CECL.

EVOLV is supported by over 350 industry experts with accounting and credit experience to guide you through this transformation of your business processes. The Primatics team provides support across conversion, operation, and analytics. Primatics Professional Services team has the technical expertise to interpret the standard as well as assist in policy writing and implementation. These experts have a deep understanding of accounting and valuation operations, and can help redesign end-to-end processes; ensuring proper controls exist to support SOX compliance. The Primatics team, leveraging EVOLV, will help financial institutions deliver the powerful analysis necessary to understand changes in the allowance and answer questions from investors and regulators.