As CECL Preparation Morphs into CECL Implementation, Shortfalls and Strategies Are Beginning to Emerge

Many institutions are beginning to move from the preparation phase to the implementation phase, and as those preparations transform into reality, some common mistakes and helpful lessons are emerging.

This isn’t to say that financial institutions aren’t making positive headway. According to FMS research, executives at community banks and credit unions are feeling better about CECL than they were last year—more than half (58%) of the 400 leaders surveyed deemed their CECL preparations to be on track and on time. So it seemed like a good time to check in to find out about some of the common implementation issues they’re having—and to come up with some tips for how to fine-tune an institution’s CECL plans as they move into the next phase.

MISTAKE 1

More Data, More Problems

To absolutely nobody’s surprise, most of the issues institutions are running into as they implement CECL are related to data.

“Institutions have not had to manage data in the same way they will have to under CECL,” says Brett Schwantes, a senior manager at Wipfli LLP. “If certain data points are not as clear as they were hoping they would be, they may have to change some processes and controls to collect the data in a different way going forward in order to implement their desired CECL methodology.”

When it comes to those data issues, they can run the gamut. Some institutions are finding that the data isn’t as clean and straightforward as they had hoped, and will require more upwork than they had planned for. For instance, some institutions have found that their loan renewal information is more difficult to pull than they had imagined.

“Sometimes institutions have found that the loan origination fields, such as date and balance, are overwritten every time a loan is renewed,” says Schwantes. “Or else they find they have to look at two different fields—the origination date and the last renewal date—to determine the ‘beginning’ date of a loan, and if a loan has been renewed more than once, the institution ends up missing the loan information for previous loan renewals.”

While some of these were issues that reared their ugly heads as soon as institutions started preparing for CECL, it’s likely there will continue to be more data-specific challenges that pop up over the next few years.

“With hindsight, it is easy to see these problems will exist, but when institutions didn’t have to use certain data and estimate lifetime loan losses, they didn’t have processes or controls in place to manage data the way they will need to in the future,” Schwantes explains. “I’m not surprised institutions have and will continue to run into issues like these, which is why we’re telling our financial institution clients to start early and be ready to run into issues like these that will have to be addressed.”

MISTAKE 2

Failing the History Test

Institutions are also proving the truth of a classic proverb—those who don’t learn from the past are doomed to repeat it. To wit, some are making the same mistakes they saw their international peers make during the IFRS 9 adoption.

“These mistakes are largely related to process and decision-making delays that pushed back the ultimate implementation of IFRS 9,” says Mike Riechers, a director at KPMG LLP. “Specifically, decisions around modeling, controls and reporting infrastructures may have delayed many institutions from leveraging a parallel-run period for as long as they would have liked. They may not have their entire loss forecasting mechanism built in time.”

Another history test that some community institutions in particular are struggling with is the absence of recent loan losses.

“Without actual loss history, it will be challenging to estimate future lifetime losses, and many institutions will be unable to obtain loss history from historical periods with more losses because they had no reason to keep this data prior to the new accounting standard,” Schwantes says. “In these cases, they’ll likely have to rely more on peer data or other data until they’ve been able to accumulate a sufficient loss history of their own.”

MISTAKE 3

The Uncertainty Principle

Many institutions are finding the shifting balances of demand loan estimates a challenge. With Americans running up a record high of over $1 trillion in revolving balance debt last year, this relatively obscure issue has become a recurring problem for CECL implementation.

“A rising issue involves lines of credit and other demand loans,” Schwantes says. “Although the loan documents may indicate a term for the loan, the balance of the loan fluctuates over time and may pay down to $0 multiple times over the stated term. So institutions are struggling with how to determine what the term of such a loan is and how to estimate lifetime losses when the balance fluctuates so significantly.”

This concern echoes several other data issues (like faulty loan origination fields), in that something that may have sounded simple to calculate is in practice causing a significant amount of work for implementers.

MISTAKE 4

The Spirit of the Law

Many banks that had already built CCAR or DFAST infrastructures probably hoped to leverage those statistical models and mechanisms to implement CECL, but they were met with a nasty surprise.

“Therefore efforts may not produce results in line with the principle of CECL as a best estimate of future loss reporting,” says Riechers.

CECL is meant to predict a steady-state performance under normal conditions rather than losses at times of duress—a fundamental difference that may have been hard to anticipate. However, now that these institutions have seen their error, they have to start over from scratch. For institutions that thought their existing work would give them a head start on CECL, this is bound to push back their implementation timetable.
Some of the CECL recommendations that institutions have heard from the beginning still represent the best advice as implementation gets underway in earnest, while others have emerged from the hands-on experience of actually doing the work and learning from mistakes. Along the way, these four solutions have emerged as clear and actionable steps in the right direction.

**SOLUTION #1: GAP ANALYSIS**

Even in the midst of implementation, it’s never too late to undertake a gap analysis – an in-depth look at the space between where you are now and where you hope to end up, as well as how to get there.

“A comprehensive gap analysis should help document and quantify the impact of all transition criteria and give you a solid road map to work from as you complete your CECL transition,” Riechers says.

He highly recommends an independent gap analysis, especially if your institution is already deep in the CECL process.

“Sometimes unless you’ve really dug in and gotten independent eyes on it, you don’t know what you’re getting until you get there,” he says.

No matter where you are in your CECL process, an independent gap analysis will highlight your blind spots and help you find a way to close the holes in your plan. If you’re just getting started, it will help you create an effective strategy; if you’re deep in the implementation phase, on the other hand, it can find errors before they really start to count against you. Think of it as being able to check your work before you have to turn it in.

**SOLUTION #2: EFFECTIVE LEADERSHIP**

Perhaps the biggest difference between institutions that are still floundering in the shallow end of the CECL pool and those who have seen relative success is the quality of their leadership. Like most major undertakings, CECL implementation tends to be much more difficult and much less effective without a strong leader.

“The common thread success stories share is a single strong leader backed by a cross-functional steering committee,” says Riechers. “When there’s decision by committee, that’s where issues may arise.”

Trying to implement CECL by group consensus is a recipe for infighting at worst and a drawn-out and ineffective decision-making process at best.

“Those who have made the most progress in the CECL implementation process have management teams that have made it a priority and dedicated resources to the implementation,” says Schwantes. “For example, the institutions that I think of as further along regarding CECL implementation have had a member of the management team holding the CECL implementation team members accountable.”

When the institution appoints an effective point person and the process itself gets meaningful buy-in from the organization’s leaders, CECL implementation tends to prosper.

**SOLUTION #3: INVESTING TIME**

Time is the greatest gift you can give your CECL implementation team. So with the hard deadline still two years away, the earlier you start the better.

“I would advise institutions to start early and be prepared to run into issues,” Schwantes says. “If certain tasks were not as easy as we were hoping they would be, we may have to change processes and controls and collect data going forward until we have what we need for the CECL methodology. The earlier we evaluate our data needs and the necessary changes, the likelier we are to have enough clean data by the time we need to estimate credit losses under CECL.”

In other words, use solutions #1 and #2 above to help your institution make the most of the time you have left.

“Every transition should have an independent gap analysis, strong leadership and a focus on process and controls – those are the lessons learned from CCAR, DFAST, IFRS 9 and other recent accounting change projects,” Riechers says. “This is what keeps these projects on track and on time, and not having one of these components can lead to unforeseen delays and unexpected effort.”

**SOLUTION #4: STAYING FLEXIBLE**

The truth is that while most of these recommendations have been around since the beginning of the CECL discussion, there were plenty of curve balls that couldn’t have been foreseen.

“The changes to Dodd-Frank, for instance, were not predictable even as recently as six months ago,” Riechers says. “It’s possible that we may start to see the repercussions of that in the mid-market space in a way that may not have been foreseeable prior to that change.”

Even now, as best practices begin to emerge, there is no one-size-fits-all CECL solution for every institution. The key is to find the method that best fits one’s needs and give it the best effort possible.

“Each institution has the flexibility to adopt CECL in a way that suits it,” says Schwantes.