

# ARE YOU READY FOR CECL?

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**A RECENT INFORMAL POLL PERFORMED BY MAZARS USA LLP OF OVER A DOZEN COMMUNITY BANKS IN THE NEW YORK/NEW JERSEY METROPOLITAN AREA SHOWS WIDE DISPARITY IN THE IMPLEMENTATION OF TOPIC 326, FINANCIAL INSTRUMENTS – CREDIT LOSSES (“CECL”), BOTH IN IMPLEMENTATION STAGE AND PROCESS. NEWS ARTICLES, MEDIA POSTS AND RECENT ACTIONS BY REGULATORS AND STANDARD SETTING BODIES ALL POINT TO SIMILAR LARGE DISPARITIES IN CECL IMPLEMENTATION ACROSS THE NATION. FORTUNATELY, THE FINANCIAL ACCOUNTING STANDARDS BOARD (“FASB”) HAS NOTED THE CHALLENGES THAT SMALLER BANKS ARE FACING AND, ON JULY 17, 2019, VOTED TO ISSUE A PROPOSAL FOR PUBLIC COMMENT WHICH WOULD DELAY THE EFFECTIVE DATE FOR CECL.**



CURRENTLY, SEC FILERS, EXCLUDING SMALLER REPORTING COMPANIES (“SRCS”), ARE REQUIRED TO IMPLEMENT CECL FOR FISCAL YEARS BEGINNING AFTER DECEMBER 15, 2019 INCLUDING INTERIM PERIODS WITHIN THOSE YEARS. ALL OTHER ENTITIES (INCLUDING PUBLIC BUSINESS ENTITIES (“PBES”) OTHER THAN SEC FILERS – EXCLUDING SRC) ARE REQUIRED TO IMPLEMENT CECL FOR FISCAL YEARS BEGINNING AFTER DECEMBER 15, 2022, INCLUDING INTERIM PERIODS WITHIN THOSE YEARS. EARLY ADOPTION IS PERMITTED FOR FISCAL YEARS BEGINNING AFTER DECEMBER 15, 2018 AND INTERIM PERIODS WITHIN THAT FISCAL YEAR.

THE CURRENT FASB PROPOSAL TO DEFER THE IMPLEMENTATION WOULD GIVE NO RELIEF TO NON-SRC SEC FILERS, BUT WOULD GIVE ALL OTHER ENTITIES AN ADDITIONAL THREE YEARS. AS A RESULT, THE STANDARD WOULD NOT BE FULLY IMPLEMENTED BY ALL ENTITIES UNTIL THE JANUARY 1, 2023 CALENDAR YEAR. THE FASB HAS ALSO ISSUED ITS SECOND STAFF Q&A ON THE TOPIC ENTITLED “TOPIC 326, NO. 2, DEVELOPING AN ESTIMATE OF EXPECTED CREDIT LOSSES ON FINANCIAL ASSETS.” MUCH OF THIS STAFF Q&A REVOLVES AROUND THE TOPIC OF DEVELOPING REASONABLE FORECASTS AND THE TOOLS INVOLVED IN DOING SO.

“FORECASTING” ECONOMIC SCENARIOS SEEMS TO BE ONE OF THE LARGEST HURDLES BANKS ARE FACING WITH CECL. BECAUSE CECL REQUIRES AN ESTIMATE OF EXPECTED CREDIT LOSSES FOR THE LIFETIME OF ALL ASSETS ACCOUNTED FOR AT AMORTIZED COST, IDENTIFYING THE APPROPRIATE SOURCES TO SUPPORT SUCH AN EFFORT IS CUMBERSOME. WHILE REGULATORS HAVE SAID THEY DO NOT EXPECT BANKS TO REFER TO

ALL AVAILABLE SOURCES AND SPECIFIC MODELING IS NOT REQUIRED, EACH PRODUCT MUST BE SUPPORTED BY ITS OWN QUALITATIVE AND HISTORICAL FACTORS. THESE WILL DIFFER PRODUCT TO PRODUCT IN TERMS OF AVAILABLE HISTORICAL INFORMATION, AVAILABILITY OF EXTERNAL BENCHMARK FACTORS OR FORECAST PERIOD DURATION, WHICH NEEDS TO BE REASONABLE, PRIOR TO GOING BACK TO HISTORICAL OBSERVATIONS. BANKS WILL NEED TO ADEQUATELY DOCUMENT THEIR METHODOLOGY BY PRODUCT AND PORTFOLIO, AS AUDITORS AND REGULATORS ALIKE WILL NEED TO BE ABLE TO VERIFY SUCH INFORMATION IS ACCURATE.

TO THAT END, MANY OF THE RESPONDENTS IN THE INFORMAL MAZARS POLL NOTED THAT THEY WILL, OR HAVE, HIRED EXTERNAL CONSULTANTS TO VALIDATE THEIR MODELS. WHILE MOST ADMIT THAT THE “MATHEMATICAL” COMPONENT IS NOT COMPLEX, THE VALIDATION OF THE ASSUMPTIONS BY PRODUCT AND PORTFOLIO REQUIRES SIGNIFICANT EFFORT. “GARBAGE IN; GARBAGE OUT” IS NOT A POSITION BANKS WANT TO BE IN. DATA QUALITY IS KEY TO SUCCESSFUL IMPLEMENTATION AND MUST BE A KEY FOCUS AREA.

FURTHER, IT WAS NOTED THAT MOST SMALLER INSTITUTIONS WERE NOT ACQUIRING NEW SOFTWARE TO ACCOMMODATE CECL. INSTEAD, THEY FELT THAT THEIR EXISTING TECHNOLOGY PLATFORMS, WITH SOME UPGRADES OR ADDED MODULES, COULD ACCOMMODATE THE CECL REQUIREMENTS. THIS COST SAVINGS WAS A POSITIVE BUT OFFSET BY THE SIGNIFICANT TIME REQUIRED BY THEIR INTERNAL IMPLEMENTATION TEAMS TO ACCUMULATE ACCURATE AND QUALITY DATA POOLS (WHETHER INTERNALLY

OR FROM EXTERNAL DATA PROVIDER WHEN RELEVANT) AND BY THE COSTS OF EXTERNAL TEAMS FOR VALIDATION. ALSO KEY IS CONSISTENCY IN THE APPLICATION METHODOLOGY. WHILE DIFFERENT PRODUCTS AND PORTFOLIOS WILL HAVE DIFFERENT QUALITATIVE AND HISTORICAL FACTORS, WHERE THERE IS ANY CROSSOVER IN EXTERNAL FACTORS, REGULATORS HAVE INDICATED THOSE ITEMS MUST BE APPLIED CONSISTENTLY ACROSS THE BANK’S CECL METHODOLOGY.

THE DEFERRAL OF THE IMPLEMENTATION DATES FOR CECL FOR MANY INSTITUTIONS PROVIDES A MUCH NEEDED OPPORTUNITY FOR A MORE SEAMLESS TRANSITION. SMALLER INSTITUTIONS WILL BE ABLE TO REFER TO THE IMPLEMENTATION DISCLOSURES OF LARGER ONES AND REVIEW WHATEVER PUBLIC INFORMATION MAY BECOME AVAILABLE REGARDING IMPLEMENTATION HURDLES AND LESSONS LEARNED. IMPLEMENTATION TOOLS CAN BE FURTHER REFINED, AND INTERNAL CONTROL PROCESSES CAN BE DEVELOPED REGARDING ASSUMPTION DEVELOPMENT, CHANGES TO DATA, AND MANAGEMENT AND BOARD REVIEWS OF ESTIMATES AND OUTCOMES. CECL MAY NOT BE COMING TO YOUR DOORSTEP AS SOON AS ORIGINALLY EXPECTED; BUT IT IS COMING... TIME TO GET PREPARED!

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