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Preparing for CECL implementation

Facts to know and tips to follow for a smooth transition

On June 16, 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments, also known as the current expected credit loss (CECL) model. While financial institutions have several years to prepare for the implementation of this significant standard, there are steps and information to consider today to ensure a seamless and successful adoption.

Changes required under CECL

CECL has a significant impact on how financial institutions calculate credit impairment. The standard replaces the current "incurred loss" approach with an "expected loss" model. It requires the estimation of the lifetime of expected credit losses over the contractual life of financial instruments. Essentially, this removes the current GAAP restriction of the ability to record credit losses that are expected but do not yet meet the "probable" threshold.

Areas impacted by this guidance include loans, leases, guarantees, loan commitments and debt securities. Financial institutions will need to modify their current processes for establishing allowances and other-than-temporary impairments. Compliance with the standard may require changes to systems or operations associated with credit data aggregation and modeling, capital planning and regulatory and financial reporting.

An institution is also required to consider other relevant information under CECL, including the collectability of cash flows based upon past events such as historical experience, current conditions, and reasonable and supportable forecasts. CECL eliminates the current accounting treatment for purchased credit impaired loans and requires additional disclosures, including further disaggregation of information currently disclosed about credit quality indicators to include the year of the asset's origination (i.e. vintage).

Calendar for implementation

Financial institutions should begin preparations today, as the effective dates are as follows:

- Securities and Exchange Commission (SEC) filers: Effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
- Public business entities (non-SEC filers): Effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years
- All other entities: Effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years beginning after December 15, 2021

Financial institutions are permitted to adopt the new guidance early for fiscal years beginning after December 15, 2018, including interim periods within the year.

How to prepare for CECL

The most effective way to prepare for CECL is to be proactive. Here are two steps to begin the process:

- Define what data is required to measure expected credit losses for the financial instruments impacted. For an institution's lending portfolio, this may include collecting and retaining data such as loan balance, date of origination, credit characteristics at origination (i.e. loan-to-value, debt-to-income, credit score, etc.), loan segment, risk rating, charge-offs and recoveries associated with the loan (partial and full), and the actual length of the life of the loan.
- Assess the current risk management, accounting and operational policies and procedures, as well as information technology system capabilities. Existing processes and controls will also need to be evaluated and tailored to align with the new environment.

For more information on CECL implementation, contact Rehmann's Financial Institutions Group today.

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