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Simplifying CECL Compliance:

Timing Is Everything

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Simplifying CECL Compliance:

Timing Is Everything.

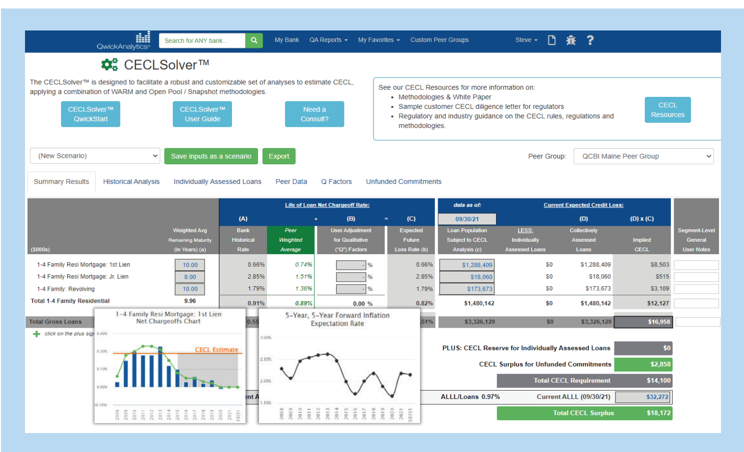
by Shawn O'Brien, President, QwickRate®

The CECL deadline is looming ever larger. Banks can't avoid regulatory compliance. But they can sidestep the stress of getting there.

Often the biggest challenge is simply getting over the hurdle of adopting an unfamiliar process for calculating reserves. Fortunately, regulators have helped by addressing many concerns head on.

Where should banks start?

Regulators expect different banks to use different solutions to calculate reserves, depending on the nature of their portfolios. For banks with fewer losses, overly engineered solutions add no value — a big reason solutions based on historical data from call reports are popular.



Process complexity can vary greatly among various CECL methodologies. When evaluating solutions, banks should know there's a tradeoff between precision and accuracy. Don't mistake one for the other.

For example, calculation models such as loss rate, remaining life, migration or vintages are less complex, but generally less precise. Other methodologies, including probability of default and discounted cash flows, are more precise, but also more difficult to develop. Is it worth the work to balance all these? Many banks say no. They prefer to continue using Q factors — both qualitative and quantitative — to support or defend CECL, as they did with ALLL.

Where to turn for practical assistance

Among the varying options for CECL compliance is a solution developed with community banks in mind. **QwickAnalytics® CECLSolver™ is easy to use and getting started is simple.**

Utilizing a weighted average remaining maturity (WARM) focus, CECLSolver automatically displays historical losses over WARM periods. Banks don't have to compile past information, and they can analyze different loss scenarios with ease. The tool also displays loss histories of selected peer groups (UPBR/state/custom) for identical periods. CECLSolver experts will help with WARM calculations, whether they're being prepared by the bank's team or the solution's support team.

Q factors are OK

No current or past losses to work with? If a bank doesn't have current or previous losses, more of its future loss forecasts will tend to come from qualitative adjustments, rather than from quantitative adjustments. Many banks now use Q factors to support their ALLL reserve. This will likely be true with CECL, too.

The qualitative perspective

In a 2019 FAQ, regulators noted, "When developing estimates of expected credit losses on financial assets, the institution should consider available information relevant to assessing the collectability of cash flows. This information may include internal information, external information, or a combination of both relating to past events, current conditions, and reasonable and supportable forecasts."

Regulatory statements regarding such assessments have caused many banks to stress — and there's no need to. Banks have successfully forecasted losses based on qualitative adjustments for years. They understand the process and know how it works. Plus, bankers and regulators alike believe in the method. It's not surprising that qualitative adjustments will continue to be part of the incurred loss calculation.

Questions & Answers

What banks are asking about CECLSolver.

Is it too late to get started with CECLSolver™ to meet the 2023 Q1 compliance date?

Absolutely not. Every week we consult with banks who are just now starting on CECL compliance — and assure them there is no need to panic. CECLSolver is easy to use and was built on regulatory guidance to make compliance as painless and efficient as possible for banks. And QwickRate's excellent customer service will guide and support you along the way.

What methodology does CECLSolver use?

CECLSolver mainly uses a Weighted Average Remaining Maturing (WARM) methodology, with elements of Open Pool/Snapshot — one of the more straightforward methodologies vetted and discussed by FASB and regulators for meeting CECL compliance. The tool automatically displays historical losses (by segment) and calculates lifetime loss rates over WARM periods. There's no need to compile past information, and analysis of different loss scenarios is quick and easy. CECLSolver also aggregates long-term peer loss data for standard or customized peer groups. Experts are standing by to help with WARM calculations, whether created by your team or ours.

Will regulators be receptive to this methodology?

Regulators continue to emphasize that "... for smaller, less complex community banks, complex modeling techniques are not required, and simple practical methods should work."* We're sensing an even greater acceptance of portfolio-based solutions and the WARM methodology, which is becoming the preferred choice of community banks. Regulators frequently note that bankers are constrained by the data they can access, making overly complex CECL methodologies a non-starter for many institutions. This is why a portfolio-based solution continues to be appropriate for helping more banks accomplish what their regulators look for — with very little work on their part.

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From a quantitative viewpoint

As for the CECL "forecasting" element, bankers should focus on what future circumstances might affect the ability to collect on loans, potentially causing losses in the credit portfolio. Banks should document these conditions and quantify their possible impact, considering the makeup of their portfolio and different economic scenarios that might have a bearing on specific segments — such as the effect of unemployment levels on home mortgage loans. It's important to understand how critical influences are trending and the possible negative results of reversals.

Designed for community banks

CECLSolver provides banks with a portfolio-level solution based on call report information — plus the ability to perform more complex loan-level analysis as required. From its inception the goal of the solution has been to help banks start, monitor and if necessary, adjust as they successfully accomplish CECL compliance.

CECL can be as complicated as banks want to make it — but delaying the inevitable isn't the wisest strategy. It's not too late. Let us know if we can help.

Request a demo with your data. Find out why hundreds of community banks are already using CECLSolver to address CECL compliance. Schedule at www.qwickrate.com or email info@qwickrate.com.

Shawn O'Brien is president of QwickRate, providing practical and affordable solutions for community banks for more than 30 years. An ICBA Preferred Service Provider.

What can a bank expect when they first log in to the tool?

Banks immediately see actionable results the first time they sign in to CECLSolver. We preload their historical call report data and the entire universe of historical data for peers at the segment level. It's a huge time saver when you can pull up a tool and instantaneously have an entire picture of your loss history, by segment, before you even change anything. Not only yours, but also your peers'. From there, you can edit the template, peer groups, Q factor adjustments and individually assessed loans, etc. as needed.

What advice do you have regarding the amount of detail auditors/regulators expect?

Auditors and regulators will definitely ask for the bank's model and the model results. They also ask for documentation of your thought process and justifications for your assumptions. This is a huge best practice banks should be aware of: document, document, document . . . your rationale for each assumption, any changes from your last run, etc. Multiple places throughout the tool allow you to add notes about your assumptions — all efficiently organized by loan segment — to build that narrative. Whenever you print or export the tool for auditors/examiners, those notes will be attached, walking them (and you) through your thought processes, which is really what they're looking for. An audit trail of this kind will be critical, especially the first year.

What can a customer expect in the future for CECLSolver?

As we help customers and meet with examiners and auditors, we identify enhancements to continually incorporate in the tool. A great example would be adding the Federal Reserve's SCALE tool as a second model or gut check. We also have a monthly Q&A Coffee Talk Session with customers and take their suggestions and requests back to our team. We will continue these efforts: listening and partnering with users, regulators and auditors; investing in the CECLSolver tool; and working hard to make CECL compliance a worry-free experience.

** From CECL Webinar for Bankers: Practical Examples of How Smaller, Less Complex Community Banks Can Implement CECL (by FDIC, FRB with the CSBS, the FASB, and SEC) February 27, 2018*