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Banks urged to begin CECL compliance following issuance of final standard

By Kiah Lau Haslett and Kevin Dobbs *June 16, 2016*

The issuance of the final credit loss rule moves the hotly debated accounting standard from proposal to reality, but the challenging journey to compliance and full implementation is just beginning.

The Financial Accounting Standards Board issued the final current expected credit loss standard, commonly called CECL, as well as the proposal's cost and benefits analysis on June 16, ending a six-month delay. The final standard, which goes into effect in 2020 for some institutions and 2021 for others, reiterated the board's stance that financial institution executives can use their best judgement and appropriate accounting approaches to calculate the life of loan losses at origination and increase their allowance for loan and lease losses. But some accounting experts say that the examples were not expansive enough and that the accommodative stance toward subjectivity will make implementation trickier.

The final standard clearly empowers bankers to use approaches and methods that work best for them, given the subjective nature of the life of loan loss estimate. The board "does not require specific approaches when developing the estimate of expected credit losses. Rather, an entity should use judgment" to develop techniques that it will consistently use to faithfully estimate a financial asset's collectability, the rule said.

"The good news is: It's more accommodative. Of course, that means it's much more subjective, and so that's going to put a bit more pressure on the implementation process," said Carol Larson, senior audit partner at Deloitte & Touche LLP. "Banks are really going to need to vet their process with the folks within the bank, to make sure everyone is in agreement with what they're doing. Their auditors [will be] good to vet it as well."

Accounting experts said the final standard closely mirrors the April draft that accompanied the FASB transition resource group meeting. The rule spanned nearly 300 pages and included 17 examples of how financial institutions should handle various calculations under CECL. But Randal Rabe, director at Credit Risk Management, said he was disappointed that the final standard did not include "meatier examples." For instance, he said the board simplified its credit quality disclosure example but did not include an example of how CECL would apply to held-to-maturity securities like municipal bonds instead of U.S. Treasurys. He also said some examples used a type of historical loss rate that is different than the loss rate community banks tend to use. He added that the final standard did not seem to appreciate that banks struggle with defending and explaining qualitative factors that are included in their assumptions to their auditors, an issue that could come up as banks try to create reasonable and supportable future forecasts under CECL.

Although banks have years to comply with the implementation date, experts cautioned against waiting. Larson said she worries that banks feel like they received a "hall pass" with the recent pushback in implementation. She argued that they will need to be "ready on Day 1" of the effective date to report their new ALLL numbers, with those wishing to run parallel modeling preparing now for execution. Small banks in particular will have to invest both time and money to figure out how best to make loss projections for multiyear loans, said Michael Gullette, vice president of accounting and financial management at the American Bankers Association.

"You need to get rolling," he said in an interview. "Get educated."

Gullette said the ABA already is working on training programs that it will soon make available to banks. "At the community bank level especially, there is still a lot of confusion about what this life-of-loan concept is and how to go about making the change in a manageable way."

To that end, FASB plans to offer resources in the coming weeks after financial institution executives have digested the rule's language. Spokeswoman Christine Klimek said the board will be offering a webcast where staff members will take a more in-depth look at the standard and will answer submitted questions. She said FASB will also meet with banks and industry groups to discuss their specific questions.

CECL

The current expected credit loss model is a forward-looking impairment approach that impacts the way banks and credit unions record losses on their assets. It requires institutions to book the expected lifetime losses of the loan on the first day of origination. It goes into effect in 2020 for some institutions and 2021 for others.

In contrast, the current system records losses when it becomes probable that a loan will be impaired. CECL will also impact the way financial institutions account for securities and assets such as purchase-impaired credits.

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