The Countdown To CECL Has Begun

Future losses will soon be part of the equation for calculating reserves, and there's much work to be done.

By Marc Rapport

Credit unions are counting down to an accounting sea change.

New current expected credit loss (CECL) standards will take effect at the end of 2021 for all financial institutions. Credit unions, however, have the option to adopt the new standards in 2019.

After the financial crisis of 2008-2009, the Financial Accounting Standards Board approved changes that require institutions to reserve for future losses over the life of a loan rather than at the current incurred loss model.

"The new model turns the loss reserve estimate from something you can predict in the short term into something that's difficult to predict over the long term," says Tim Green, executive vice president and chief financial officer at KeyPoint Credit Union ($1.3B, Santa Clara, CA).

Tim Green, EVP & CFO, KeyPoint Credit Union

Under the new CECL standards, planning for credit risk and loan losses will be an enterprise-wide affair.

manager at Moss Adams. “It likely will take a full institutional effort to implement.”

A first step toward that end is to pull together a team that includes accounting, lending, credit administration, internal audit, risk, and treasury as well as staffers not typically involved in accounting standards, such as IT and marketing.

Before that, though, credit unions need to recognize that they all must adhere to the new CECL standards.

CU QUICK FACTS

KeyPoint Credit Union
DATA AS OF 03.31.18

HQ: Santa Clara, CA
ASSETS: $1.3B
MEMBERS: 57,893
BRANCHES: 8
12-MO SHARE GROWTH: 8.4%
12-MO LOAN GROWTH: 7.6%
ROA: 0.50%

“Credit unions are all over the map in their understanding of CECL,” says Yvonne Stelpflug, a vice president at CO-OP Financial Services. “Some are under the impression that CECL does not apply to them, which is not true.”

Next Year? Or Next Decade?

The first decision a credit union must make is not whether to comply, but when.

John Dalton, director of product strategy at Fiserv, says he’s only aware of one client that intends to go with next year’s early adoption date. The rest of Fiserv’s 1,400 clients will wait until the end of 2021. In the meantime, they’ll be identifying gaps in historical data, developing models of expected losses, and assessing how much more money they should divert to reserves.

And as credit unions divert more money to reserves, their lendable net worth will drop.

“KPCU has been growing rapidly over the past five years,” Green says. “We’ve already considered doubling the reserves in the year of adoption and will likely slow our growth to allocate more capital to reserves.”

Jason Stretch, manager of finance at Ent Credit Union ($5.2B, Colorado Springs, CO), also anticipates increasing the credit union’s loan loss reserves but doesn’t expect that to impact Ent’s ability to lend.

Jason Stretch, Manager of Finance, Ent Credit Union

When, And How, To Begin

According to Porter at Moss Adams, the firm advises credit unions to begin fixing inaccurate data today.

“Good internal data from now until implementation is clearly better than old, inaccurate data,” the senior manager says.

CECL requires institutions to segment based on risk characteristics. If a credit union’s data isn’t accurate, it could result in inappropriately grouped loans and inaccurate loss rates applied to inaccurate loan pools.

CU QUICK FACTS

Ent Credit Union
DATA AS OF 03.31.18

HQ: Colorado Springs, CO
ASSETS: $5.2B
MEMBERS: 313,563
BRANCHES: 29
12-MO SHARE GROWTH: 7.8%
12-MO LOAN GROWTH: 12.3%
ROA: 0.93%

“You’ll have garbage in, garbage out,” Porter says.

To ensure it’s working with good data and assumptions, Ent plans to run its current loss calculation models parallel to its new CECL model for at least a full year prior to official implementation at the end of 2021.

Credit unions waiting until 2021 might consider following this timeline provided by Vikas Sharma, practice lead for banking analytics at EXL Service:

- Assess readiness and create a roadmap by the end of 2018.
- Test vendor solutions and select one by mid-2019.
- Prepare data and infrastructure by the end of 2019.
- Learn from the big banks along the way through mid-2020.

After that, it’s time for final preparations to deploy the new loss calculations models.

Mira Ness won't be looking to the big banks for CECL guidance as much as sharing insight with her peers about how to account for possible future losses.

"We're working with other small credit unions to figure out which method is best for us," says the CEO of New York University Federal Credit Union ($24.2M, New York, NY).

Mira Ness, CEO, NYU FCU

Her small credit union's portfolio and data store are so much less complex than her large counterparts that Ness can adopt CECL standards next year to get an idea of what it will be working with. She says she'll be working with her core processor to secure the data needed to properly segment her portfolio into the required pools of loan types.

Ness also wants to get a head start on satisfying regulators.

"Since we'll be using the life of all loans, I think examinations will be less pleasant than in the past," the CEO says. "We plan to start early to make sure we have an idea of what our examiners are looking for."

Don't Reinvent The Wheel

CU QUICK FACTS

NYU FCU
DATA AS OF 03.31.18

HQ: New York, NY
ASSETS: $24.2M
MEMBERS: 5,227
BRANCHES: 1
12-MO SHARE GROWTH: 12.6%
12-MO LOAN GROWTH: 16.7%
ROA: 1.14%

Segmenting loans will be a big deal under CECL because of the different nature of loans, and predicting future losses in revolving lines of credit might be particularly tricky because of fluctuating balances and terms.

Unlike current GAAP standards, CECL requires loss provisioning for current exposure only.

"This creates unique challenges for credit cards and other revolving products as financial institutions have to attribute future losses to current snapshot balances," says Manish Jain, a vice president at EXL.

But in the search for inside expertise and outside help, don't throw the baby out the with the bathwater.

them more readily access more data and demonstrate to regulators that they're taking a scientific approach to CECL."

Plus, the teamwork required to meet the CECL standards can break down the silos that exist between departments and skill sets.

"This new aggregation of data will allow credit unions to glean insights to better serve members," says Dalton at Fiserv.

Ness at NYU FCU would agree.

"We'll have all this data we can use to analyze where we're doing well and where we need to tighten up," she says.

Want more credit union strategies? Sign up for the CreditUnions.com free newsletter.

July 30, 2018

CALLAHAN & ASSOCIATES
1001 Connecticut Ave. NW Suite 1001
Washington, DC 20036
P: 800-446-7453 F: 800-878-4712