WHAT IS CECL AND WHY WAS IT CREATED?

Perspective of CECL

CECL FOUNDATION

MARCH 22, 2022

282:23:34:59

DAYS HOURS MINUTES SECONDS

By **Vinayak Shetty**

CECL COUNTDOWN SERIES

marcus.cree@greenpointglobal.com | sanjay@greenpointglobal.com

International Corporate Center, 555 Theodore Fremd Avenue, Suite A102 Rye, NY 10580

What is CECL?

Current Expected Credit Losses (CECL), issued by the Financial Accounting Standards Board (FASB), is a new methodology for calculating allowances for credit losses. It came into existence on June 16, 2016, and was formulated primarily to replace the Allowance for Loan and Lease Losses (ALLL) accounting standard.

The need to replace the Allowance for Loan and Lease Losses

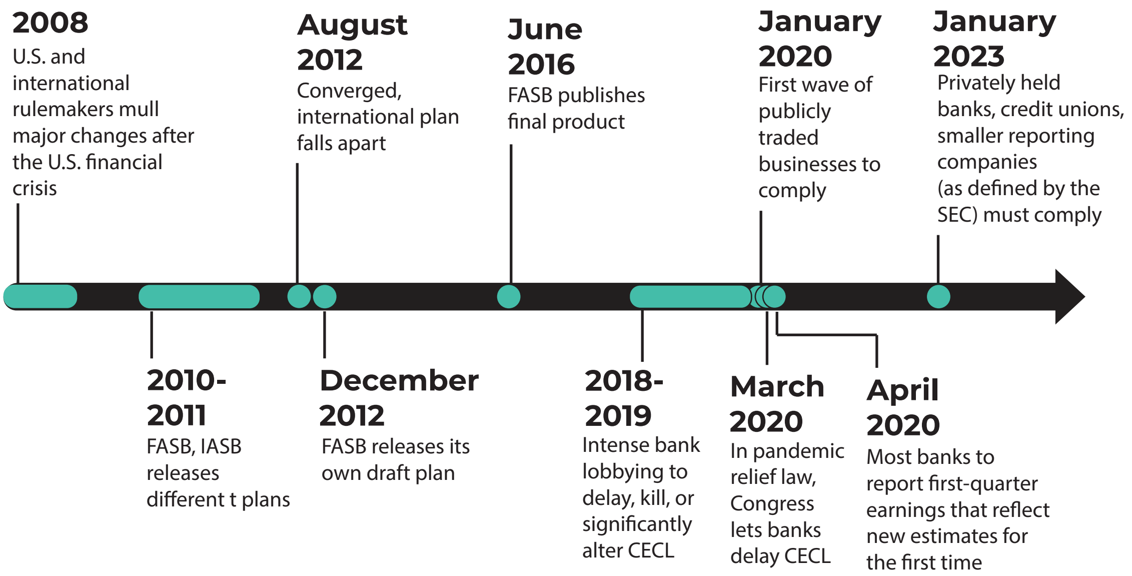
Every financial institution, including banks, encounters credit risk within its assets. In relation to this, ALLL is calculated as a reserve that these institutions need to establish. ALLL estimation posed its own set of challenges for financial institutions, including the significant amount of time taken for the reserve estimation process. Eventually, the FASB announced its plans to modify the manner in which banks account for impairment of assets by introducing the CECL model. CECL requires that companies include predictive, and forward-looking information while calculating their reserve for bad debts. As opposed to incurred losses, CECL requires an estimation of expected losses over the remaining life of loans.

THE 2007-2008 FINANCIAL CRISIS AND CREDIT LOSS ESTIMATION

The financial crisis of 2007-2008 demonstrated the inadequacy of existing methods, for adjustment of reserve levels of financial institutions when considering expectations of future market conditions. ALLL only relied on losses that were already incurred and did not factor in future cash flows that would end up uncollected. This resulted in disastrous errors in the adjustment of reserves for future expected losses. By mandating CECL, FASB hopes to improve the financial reporting of financial institutions through the estimation of future credit losses on various financial instruments and loans held by these institutions.

The Rollout of CECL

The long, winding road to the biggest ever change to bank accounting - the Current Expected Credit Losses (or CECL) standard.



How does CECL impact the banking industry?

Banks need to strategize and prepare for CECL implementation as soon as possible in order to meet critical deadlines. In 2020, at the onset of the pandemic, banks made changes to their financial reporting, specifically on how they account for loan losses. Several aspects of a bank's operations, including risk, accounting and finance, and IT, will be impacted by the CECL standards. Impairment estimates, data management, technology, governance, and capital ratios are other areas where the banking industry would need to consider CECL.

Although early indicators are positive, it remains to be seen if the CECL accounting standard has resulted in a better insight into lending practices within the bank industry. FASB is constantly on the lookout for any changes to the standard that will make it more effective. They want the banking industry to cover future losses by setting aside reserves when these losses become more likely, and not waiting until they are in a cash-strapped situation following a systemic default event. The pandemic saw CECL in action when some of the biggest consumer banks in the US set aside nearly $18 billion in reserves as businesses shut down. These banks saw their net income and earnings per share shrink, despite not having incurred losses yet. In late 2020, as COVID-19 cases stabilized and there were signs of economic recovery, banks released some of their reserves, which stabilized earnings.

However inconvenient the adjustment of reserves maybe for the banking industry, government intervention in the form of CECL has actually proved to be a blessing in disguise. It can be likened to resurfacing from a storm shelter after a hurricane and watching the clouds clear away.

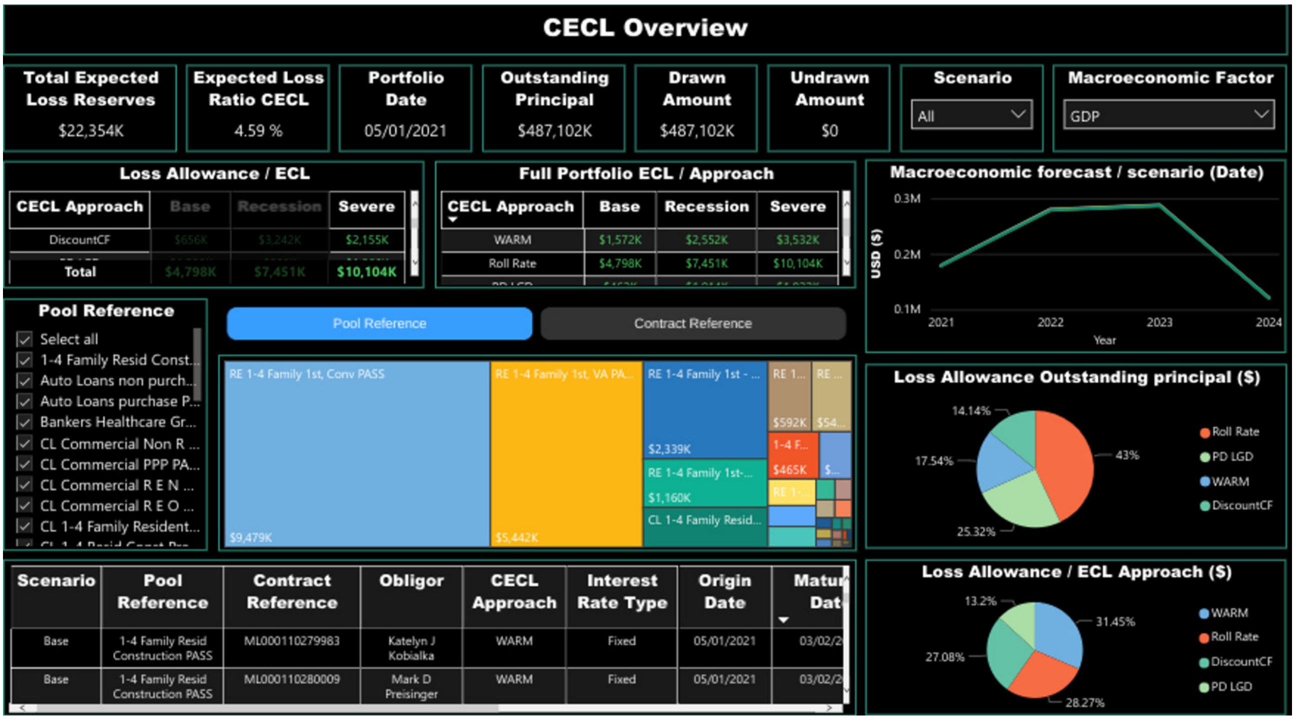
CECL Express can help...

CECL Express is a turnkey solution that fully satisfies all elements of the new CECL accounting standard. The system provides all non-loan data, including:

- Yield curves and Fed data
- Linked reports on losses from the FFIEC and NCUA
- PD and LGD curves
- Macroeconomic data

Banks and credit unions need to only provide the underlying loan details for the system to provide fully auditable ECL results for multiple calculation methods, including:

- Vintage
- Roll Rate
- Discounted Cashflow
- WARM
- PD/LGD



CECL Express provides more than valid ECL results. The system computes results for all methods and all loan pools, allowing the bank to optimize its CECL configuration and avoid the worst impacts of the new standard.

Visit ceclexpress.com for more information about the most efficient route to optimal CECL compliance.

ABOUT
CECL EXPRESS

- CECL Express is a turnkey, cloud-based solution, designed to provide banks and credit unions with optimized results and reporting that fully meet the 'Current Expected Credit Loss' accounting standards.
- CECL represents a major change in what is expected from financial institutions in their reporting of, and provisioning against potential credit losses.
- Smaller financial institutions are expected to implement forward-looking credit models to estimate losses they may experience.
- Selecting inappropriate 'Expected Credit Loss' (ECL) models will create a need to hold far more capital than is required, directly causing a loss of Profit and Loss (P&L). Data used within these models must also be reported for audit purposes.
- January 2023 will see the first official reporting period for the beginning of CECL. Banks and credit unions must have a framework in place, which is fully tested and reports results based on that data. In practice, this means selecting, implementing, and testing the system in the first half of 2022.
- For Finastra core systems, the integration has already been built. For customers with these systems, their CECL results are ready to be calculated and reported.

ABOUT
GREENPOINT FINANCIAL

- GreenPoint Financial is a division of GreenPoint Global, which provides software-enabled services, content, process and technology services, to financial institutions and related industry segments.
- GreenPoint is partnering with Finastra across multiple technology and services platforms.
- Founded in 2006, GreenPoint has grown to over 500 employees with a global footprint. Our production and management teams are in the US, India, and Israel with access to subject matter experts.
- GreenPoint has a stable client base that ranges from small and medium-sized organizations to Fortune 1000 companies worldwide. We serve our clients through our deep resource pool of subject matter experts and process specialists across several domains.
- As an ISO certified by TUV SUD South Asia, GreenPoint rigorously complies with ISO 9001:2015 and ISO 27001:2013 standards.

Marcus Cree

MANAGING DIRECTOR AND
CO-HEAD OF FINANCIAL TECHNOLOGY AND SERVICES

Marcus has spent 25 years in financial risk management, working on both the buy and sell side of the industry. He has also worked on risk management projects in over 50 countries, gaining a unique perspective on the nuances and differences across regulatory regimes around the world.

As Managing Director, Marcus co-heads GreenPoint Financial Technology and Services and has been central in the initial design of GreenPoint products in the loan book risk area, including CECL and sustainability risk. This follows his extensive experience in the Finastra Risk Practice and as US Head of Risk Solutions for FIS. Marcus has also been a prolific conference speaker and writer on risk management, principally market, credit and liquidity risk. More recently, he has written and published papers on sustainability and green finance.

Marcus graduated from Leicester University in the UK, after studing Pure Mathematics, Phycology and Astronomy. Since graduation, Marcus has continually gained risk specific qualifications including the FRM (GARP's Financial Risk Manager) and the SCR(GARP's Sustainability and Climate Risk). Marcus's latest academic initiative is creating and teaching a course on Green Finance and Risk Management at NYU Tandon School of Engineering.

Sanjay Sharma, PhD

FOUNDER AND CHAIRMAN

Sanjay provides strategic and tactical guidance to GreenPoint senior management and serves as client ombudsman. His career in the financial services industry spans three decades during which he has held investment banking and C-level risk management positions at Royal Bank of Canada (RBC) Goldman Sachs, Merrill Lynch, Citigroup, Moody's, and Natixis. Sanjay is the author of "Risk Transparency" (Risk Books, 2013), Data Privacy and GDPR Handbook (Wiley, 2019), and co-author of "The Fundamental Review of Trading Book (or FRTB) - Impact and Implementation" (Risk Books, 2018).

Sanjay was the Founding Director of the RBC/Hass Fellowship Program at the University of California at Berkeley and has served as an advisor and a member of the Board of Directors of UPS Capital (a Division of UPS). He has also served on the Global Board of Directors for Professional Risk International Association (PRMIA).

Sanjay holds a PhD in Finance and International Business from New York University and an MBA from the Wharton School of Business and has undergraduate degrees in Physics and Marine Engineering. As well as being a regular speaker at conferences, Sanjay actively teaches postgraduate level courses in business and quantitative finance at EDHEC (NICE, France), Fordham, and Columbia Universities.