IDENTIFYING ISSUES – HISTORIC COMPARISONS BETWEEN REPORTING PERIODS

Perspective of CECL

CECL FOUNDATION

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177 : 23 : 34 : 59
DAYS HOURS MINUTES SECONDS

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CECL
COUNTDOWN
SERIES

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CECL IMPLEMENTATION

In June 2016, the Financial Accounting Standards Board (FASB) issued the Current Expected Credit Losses (CECL) accounting standard. CECL focuses on estimating expected losses over the life of the loan. CECL's effective date has been rescheduled from January 2022 to January 2023 for non-public companies, and from January 2021 to January 2023 for smaller reporting companies. Many financial institutions have already implemented CECL and are well into the process of fine-tuning the standard to adjust to their organizations' framework. Those that have adopted the standard can now focus on their historical data and aligning it for auditing purposes. For those that have just adopted the standard or are about to do it, much can be learned from the experiences and mistakes of those pioneering institutions that have already tested the waters of CECL.

Source: GAAP Gynamics

CECL data and historic comparisons

Historical loan data may be difficult to obtain. Banks can calculate historical loss rates based on this information. CECL also takes into account reasonable forecasted economic conditions and current economic conditions. Under CECL, historical loss experience cannot be calculated using the annual loss rate. When institutions finally have their CECL data in place and have implemented it, they need to make better use of this data. As a best practice, banks and credit unions can use this data and compare it between reporting periods. The benefits of these historic comparisons are listed below:

1. When there is any discrepancy between data belonging to two different reporting periods, banks need to dig deep and investigate the cause of this anomaly.

2. When institutions adopt best practice of comparing their CECL results from two different reporting periods, they can move to the next step, which involves using the data to solidify their organization's accounting framework.

3. Even if the economic conditions are relatively stable in any economy, there is a chance that CECL results can still undergo a swing

between reporting periods. When this happens, institutions need to be prompt to investigate the source to stabilize their expected credit loss allowance and reserves.

4. When institutions focus on historic comparisons of their CECL data, they ensure that they are ready with answers to any challenging auditing questions that may arise in the future. A good best practice would be to do the audit work before the auditor reaches there.

Rectifying CECL result deviations between reporting periods

As discussed earlier, when economic conditions are favorable and most macroeconomic factors are constant, any swings in CECL results should alert the risk management team of institutions. They can investigate these data deviations by:

1. Checking market data and the performance of stock exchanges and financial instruments they deal in
2. Digging deeper into loan portfolios and, if required, into the historic data of a loan itself to understand how it is being affected by factors such as unexpected losses, interest rates, credit risk, profitability, and liquidity
3. The loan book of a bank or finance company shows the value of the loans it holds. In event of any CECL data deviations between reporting periods, banks can open their loan books and check them for their size, principal and interest amounts and data, and the balance sheet details.
4. Investigating how market data fluctuations may be affecting the credit profile of a loan pool as these changes can become more pronounced over time if not checked early and rectified
5. Making it a practice to compare CECL results between two quarters and identifying issues that may arise

The importance of storing each and every piece of data through reporting periods cannot be stressed enough. Documenting this data is equally important as it is the backbone of every institution's audit reporting effort. A well-planned data store, supported by documentation that is meticulously put together will impress the most hardened auditors. To meet the expectations of auditors and regulatory bodies, preparers have to increase their documentation efforts and implement incremental controls. The five areas where auditors are expected to focus are:

1. Models and methods used
2. Qualitative adjustments
3. Data
4. Controls/Governance
5. Assumptions

Auditors of accounting estimates need to do a high-level lookback analysis to understand the difference between previous estimates and actual results. This is one way for them to judge the management's process reliability.

Frameworks put into place by adopting the above-discussed best practices can help institutions avoid any audit-related shocks and pass those audits without glitches. These frameworks can then be put into auto mode to check and verify historic comparisons of CECL data using methods such as trend and stress analysis.

Making historic comparisons between reporting periods has often been an area that has been neglected by financial institutions. CECL implementation and the associated auditing requirements will go a long way in ensuring that these valuable results and data are no longer neglected.

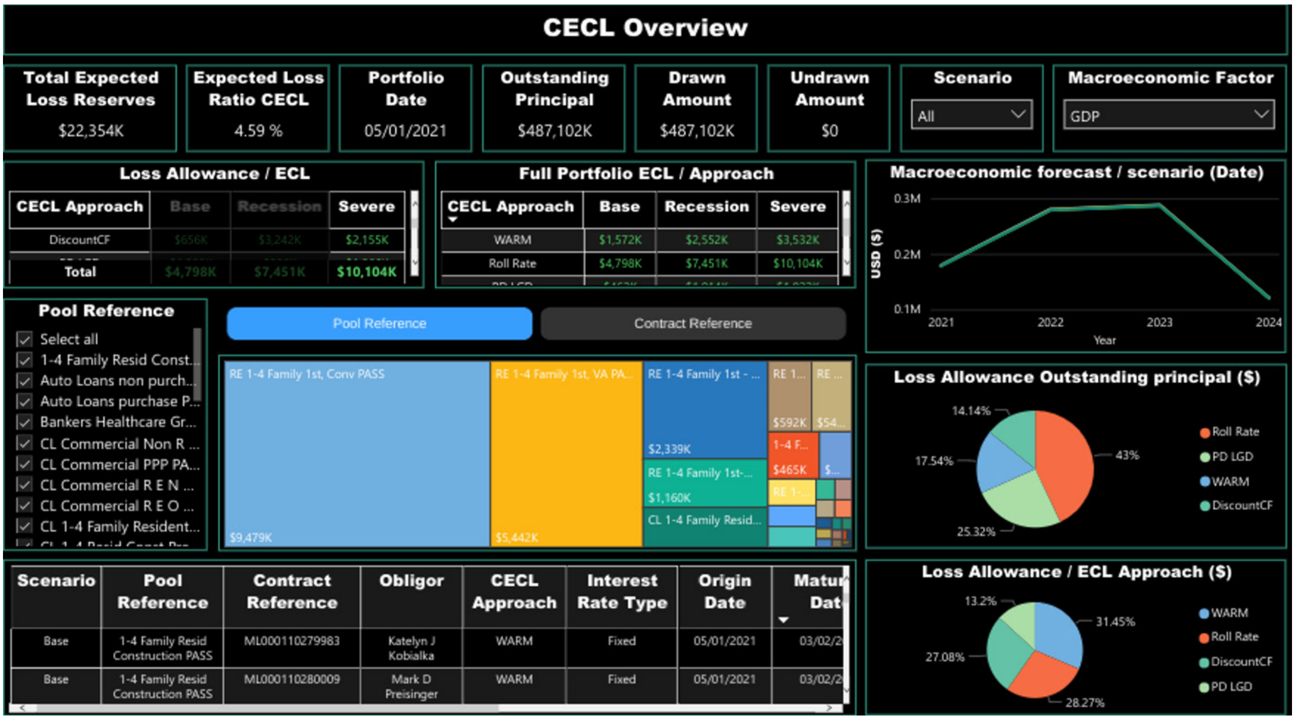
CECL Express can help...

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 company by TÜV Nord, GreenPoint rigorously complies with ISO 9001:2015, ISO 27001:2013, and ISO 27701:2019 standards.

Marcus Cree

MANAGING DIRECTOR AND
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 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.