PREPARING FOR PARALLEL RUNS

Perspective of CECL

CECL FOUNDATION

JULY 26, 2022

156	23	34	59
DAYS	HOURS	MINUTES	SECONDS

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CECL COUNTDOWN SERIES

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TIME FOR CECL PARALLEL RUNS

Financial institutions across the U.S. have been planning for the Current Expected Credit Loss (CECL) accounting standard for several years now. There is a general agreement among financial circles that implementing the Financial Accounting Standards Board's (FASB) CECL standard will be a challenge, especially for small banks and credit unions. Financial markets have only a few months now to prepare for and go live with CECL.

Data preparation, loan pooling, and model validation are just some of the procedures that need to be put into place as we move to a forward-looking credit loss estimation standard. Considerable planning needs to be done before implementing any major change, and CECL is no different. Most institutions plan to execute a parallel run for the CECL process. Understanding the right way to do this will go a long way in laying the groundwork on which the structure of CECL can be built.

The effective goal of a parallel run is to make sure that the institution is ready to review, calculate, and report on their CECL allowance for credit losses in 2023. This CECL result needs to satisfy the expectations of the management, external auditors, and regulators. Defining the objectives of the parallel run needs to be done early in the project planning phase.

The guiding principles that should define a parallel run for institutions in 2022 are as given below:

1. The 'business as usual' (BAU) process would run in tandem with the parallel run, and the resources needed for it have to be allocated accordingly
2. It is best practice to have at least two complete parallel run cycles that include governance, financial reporting, investor communications, and the external auditor
3. The parallel run and processes that surround it can be divided into the following stages:

   a) Stage 1 - Setting up a system

   b) Stage 2 - Refining and plugging data gapsa)

   c) Stage 3 - Initial results

   d) Stage 4 - Parallel run

   e) Stage 5 - Go Live

Data preparation and readiness are crucial aspects for each bank and credit union. Multiple models are used to calculate the required accounting provision under CECL, and each of them needs a comprehensive set of data to be used. Some examples of the data required are given below:

1. **External peer-group losses:** The Federal Financial Institutions Examination Council (FFIEC) or the National Credit Union Administration (NCUA) can provide detailed information about peer group losses
2. **Bank losses:** This would include any credit losses during the previous reporting periods
3. **Yield curves:** Internal rate of return (IRR) is needed for calculating discounting cash flows, and relevant yield curves are used for these calculations

The idea is to work backward from the CECL 'go live' phase, and make important choices regarding the CECL solution set-up. Various data options must be assessed at this point, and a number of models are needed to be selected. The requirement for each need to be understood, including:

1. Computation requirements
2. Data identification, cleansing, and storage
3. Model audit needs

After this stage, such reporting needs to be developed that can provide enough information to a bank audit team to show that Expected Credit Loss (ECL) calculations are based on relevant inputs and methods. This should be properly analyzed and must include:

1. Macro-economic scenario factors
2. Market data and credit loss curves
3. Obligor behavior scenarios (pre-payment speeds)
4. Peer group losses
5. Qualitative adjustments to reflect local factors

At this stage, the checking and audit reports need to be developed, and the final reporting can be perfected when the time to 'go live' comes closer. Before the first parallel run of the system can start, the entire process needs to be tested end-to-end.

A 'full dress' parallel run at this stage will ensure a smooth transition to the new standard. This will fix the remaining issues and test any new systems alongside the Allowances for Loan and Lease Losses (ALLL) processes that are established. This part of the process is crucial as it has to be a parallel run with no significant changes. This ensures that the CECL results that would be needed in 2023 would be as required. The ECL models will have to be put into place by now. CECL results will then have to be planned in a way that they can be defended during audits. To prepare for audits, reports and dashboards need to be created that allow auditors to:

1. See the results by pool
2. Analyze the data that has contributed to these results
3. View the overall result at a granular level (loan by loan)

The final stage is where the parallel run is executed in which the system needs to operate as if it were live. It has to provide meaningful results without too much intervention. For financial institutions, being prepared by executing a comprehensive parallel run process in 2022 should be well worth the effort.

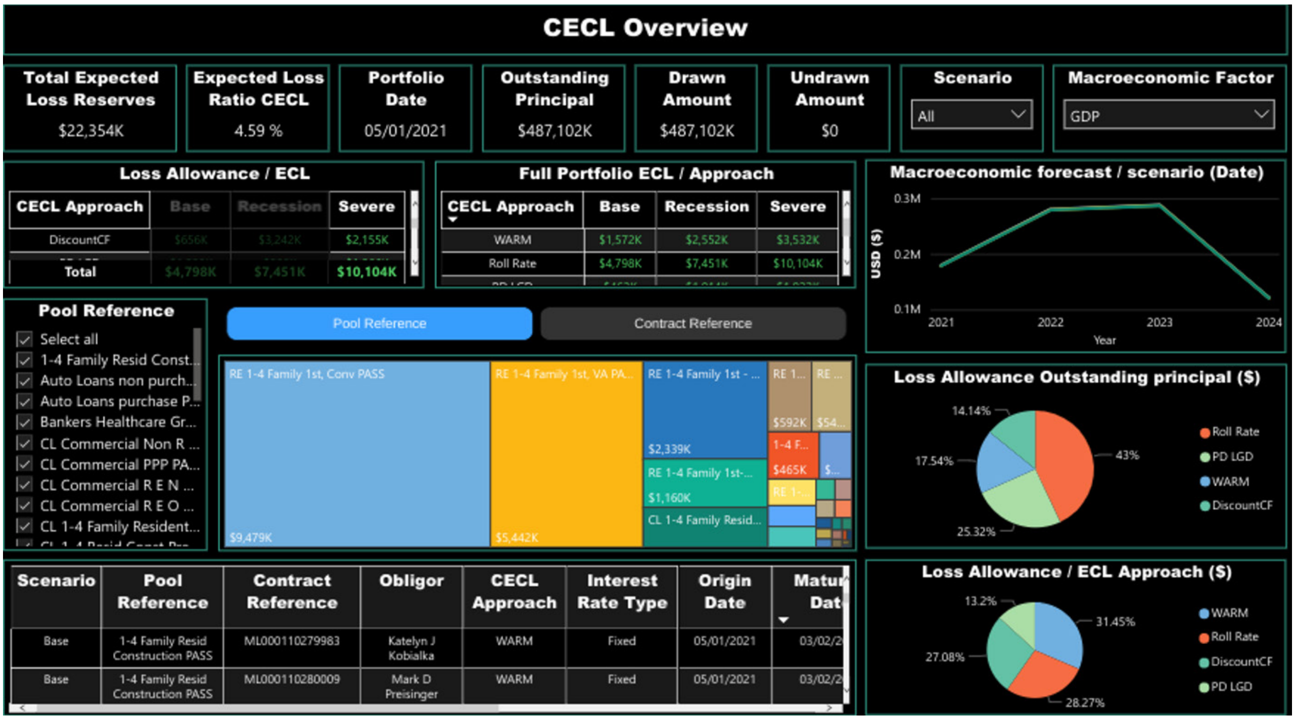
CECL Express can help...

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.