CECL Dominates AICPA Conference

Once a year, over 1,000 accountants, CPAs, regulators, standard setters, banking professionals, and auditors come together to discuss emerging issues at the AICPA National Conference on Banks & Savings Institutions. This year is even more unique as the conference is entirely virtual given the pandemic and national state of emergency. Over the past decade and since the last recession, the Conference has been dominated by the theme of how to account for credit losses in the loan portfolio. After all, loans are the fundamental earning asset of the banking industry (that is, when they are "performing"). Some have speculated over the past several years: "Wouldn't that be something if we were to experience an economic recession at the same time of implementing the new credit loss standard known as CECL?"

Well, here we are. We find ourselves in the middle of an economic recession, as Dr. Marci Rossell (AICPA Keynote speaker and former CNBC Chief Economist) stated, caused by forces from the outside in rather than from the inside out. Simultaneously, we as a banking industry are trying to implement one of the most controversial, most complex, and perhaps most comprehensive standards we have seen in a long time. As you might imagine, the conference has once again been dominated by this topic. Therefore, we have taken this opportunity to provide some high-level insights gathered over the past several days from comments shared by banks, auditors, regulators, and others at the conference:

Start early, run parallel models often, and backtest the results.

Most preparers noted that although the time horizon seems long until the next adoption date, now is the time to start (if you haven't already!). Most preparers and reporters should take advantage of the opportunity to gather additional data during this crisis in addition to perhaps the tail end of the prior financial crisis. All this information will help substantiate and support a full economic cycle as well as full life cycle of loan analysis as CECL nears.

Stress and intentionally break the models.

Recessions are unique, with the most recent two being driven by completely different economic scenarios – one with housing and now with the pandemic. Most of the models developed and calibrated today were built upon data and observations of the previous financial crisis during the Great Recession. As a result, these models "broke" when applied to the current recession. When the pandemic truly made its impact in March and economic forecasts were beginning to show its effects, many models went haywire.

The answer that many Banks' models calculated just didn't make logical sense. As a result, these institutions had to be flexible and agile in real time to develop overlays on top of the model, sometimes even revisiting the methods and calculations entirely based on the asset class.

Expect a seismic shift in the overall allowance composition from the qualitative component to the quantitative component.

Of the CECL preparers polled, less than 25% of the overall allowance is representative of the qualitative amount, and over 25% of respondents reported that qualitative reserves were less than 10% of the overall allowance composition. We believe this trend will continue as more banks move closer and closer towards CECL compliance.

Expect increases!

One thing is clear: CECL will produce an overall increase in your ALLL. In fact, according to OCC data, the average increase at transition was 34% in the overall ALLL. Even after neutralizing the impact of purchase accounting at some of the larger reporting banks in the sample, you should still expect an increase of over 20% of your ALLL in most cases when compared to the incurred loss model. If you are not seeing an increase in your preliminary calculations, you are encouraged to revisit your assumptions in both your incurred loss models as well as your CECL calculation.

Use all the tools in the toolbox.

One thing that was clear from the OCA regulatory panel was that although overall reserves will increase as part of CECL adoption, there are several tools that have been deployed that you can take advantage in order to offset the impact. Jeff Geer, Chief Accountant at the OCC, noted that from the time of the initial standard until final phase in of capital there is in essence a ten year adoption and transition period for CECL. In fact, only around half of all banks reporting have elected the transition period which further substantiates the amount of capital currently present in the banking system, even after the adoption of CECL.

CECL is not the only topic of conversation at this year's conference but it sure seems to take the cake for the most talked about. As you continue to think about your Bank's strategic plan during this upcoming budgeting and planning season, CECL will continue to be a topic that is front and center for your organization. Throughout your preparations for CECL, it is Valuant's goal to provide you with the insights, tools, and resources necessary to effectively transition and adopt the new standard.

*comments, views, and references above are related to the concepts presented at the 2020 AICPA National Conference on Banks and Savings Institutions.