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FASBs GUIDANCE ON CURRENT EXPECTED CREDIT LOSS CECL MODEL

Peter Barbera: In June of 2016, the FASB issued an accounting standards update that represents a dramatic change in the way institutions measure credit losses on financial instruments. The new guidelines, primarily referred to as the Current Expected Credit Loss Model, or CECL, are effective for fiscal years beginning after December 15th, 2019, for public business entities that file with the SEC.

Peter Barbera: CECL impacts a wide range of instruments from loans to held-to-maturity debt securities, net investments in leases, loan commitments, trade receivables, reinsurance receivables, and certain financial guarantees. And the key difference between CECL and current accounting is that current accounting requires credit losses to be recognized when it's probable a loss has been incurred whereas CECL requires companies to estimate the expected credit loss of an instrument over its lifetime using historical information, current conditions, as well as reasonable forecast.

Peter Barbera: As I mentioned, rather than recording credit losses as they are incurred currently, CECL require financial institutions to book estimates of credit losses much earlier, generally from day one when the asset is acquired or originated. This change in the timing of the credit loss recognition will result in additional volatility, both in earnings as well as capital levels. Given this, institutions will need to think about their lines of business, including product offerings and investments since the new approach to reserving may make some asset classes less profitable.

Peter Barbera: From an operational perspective, as a key component of the CECL assessment is a company's forecast of future economic conditions, existing models supporting the accounting process will most likely have to be enhanced or new models will have to be implemented. In addition, the data requirements to comply with CECL will be substantial.

Peter Barbera: CECL is one of the biggest changes in accounting for financial institution in years, and the impact of complying with the standard would be wide-ranging within an organization, requiring various business units ranging from accounting to human resources to be involved in the implementation effort. For example, accounting and the SEC regulatory reporting group given the change stems from an update to financial statement and disclosures and requirements. In the modeling and IT function, it will assist in deriving the credit loss estimate. The data management unit, we will provide historical losses by asset class and information supporting the qualitative adjustments.

Peter Barbera: Credit and underwriting will be critical to the extent it will be important to understand how the assumptions used for CECL purposes align with those used in the risk management, originations, and acquisition process. Internal audit and compliance will be critical in monitoring the operations and controls associated with the CECL process. And as I mentioned, human resources has a role to play to the extent that the change in credit loss recognition may impact employee incentive compensation.

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