AMERICAN BANKER

BankThink Community banks still aren't ready for CECL

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Published **February 05 2019, 10:20am EST**

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The Financial Accounting Standards Board held a much-anticipated meeting of its "transition resource group" for the Current Expected Credit Losses accounting standard on Jan. 28, featuring a presentation of an alternative CECL proposal made by a group of regional banks. A few days before, the American Bankers Association published a strident white paper calling for delays to CECL until its impact can be fully understood and suggested replacing the controversial "life of loan loss calculation" with an easier "through the cycle" loss rate. Add to this, the week before, members of Congress criticized CECL publicly in a hearing. It appeared that momentum was building to delay the implementation of the new accounting standard.

But, to the chagrin of most bankers, the ABA and the legislature, FASB's transition resource group didn't suggest that it had any plan to slow down the pace of the CECL implementation in coming years. In fact, the proposal by the regional banks was rejected as adding more complexity and needing additional audit review.

All of this recent noise had added to the sense of paralysis that most of the community banking market feels when it comes to implementing CECL. Recent polls published by vendors and industry groups suggest that more than 50% of community banks have not done anything about CECL except collecting more data in anticipation of needing it.

So, if FASB holds fast to its deadlines, that would mean that there are hundreds or perhaps more community banks who will suddenly realize that they need help meeting the deadline. For the vast majority of community banks that are public business entities facing a 2020

deadline (others will have to comply by 2022), this March will represent the one-year mark before they have to perform their first formal CECL calculation filing.

Industry best practices suggest that banks need to understand their CECL implementation strategy and run parallel at least two quarterly cycles before the deadline. There remain major tasks that loom for these banks: accelerated loan data collection, review of portfolio segmentation, testing of the different loss rate methodologies and consideration of the use of peer data and establishment of a future loss projection methodology.

The American Bankers Association puts it bluntly in a recently published white paper, noting that beyond discussing a credit loss estimation known as the weighted average remaining maturity, or WARM, method, regulators have done little to help smaller banks prepare for this transition.

"In the two and a half years since the CECL standard has been issued, the only guidance from FASB or the banking agencies to community banks has been to say that the questionable 'WARM' method 'may be an appropriate method,' " the paper states. "There has been no guidance related to the critical Q factor analysis, how to satisfy disclosure requirements, or how to discuss changes in lifetime credit risk with their boards of directors in a competent fashion."

The fact is that smaller financial institutions that are public business entities are running out of time — and they are all going to be looking for help with CECL simultaneously. Now is when regulators and accounting firms should step out of the shadows and offer practical guidance to help jumpstart the slumbering industry before it is too late.

Smaller institutions with fewer resources need helpful, practical guidance to help them answer questions about how to perform the basic CECL compliance tasks like creating a "reasonable, justifiable" life of loan loss calculation with little or no internal historical losses to work with. They need to understand what is expected when they need to create loss projections using the rudimentary peer loss data from public sources. They are looking for leadership from regulators to help them move forward to create and explain the new life of loan qualitative factors that are needed to make the CECL allowance for credit losses calculation actually work for the bank.

But regulators so far are simply not giving the message clearly to bankers as to what they expect and how they want things done at smaller institutions with scarce resources. Bankers don't know what to do — and so they do nothing.

Based on recent reaction from regulators, audit firms and FASB, there will be no implementation delay and many community banks will have exactly one year to become compliant, or they risk significant criticism from their examiners and external audit firms, penalties or worse. That is not how any bank wants to start the new decade.

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