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The domino effect: Current Expected Credit Losses (CECL) technology impacts

Moving forward with the right structure, capabilities, and governance

Implementing the Financial Accounting Standards Board's (FASB) new CECL standard is going to place greater demands on banks' and other nondepository lending institutions' (collectively, "institutions") requirements for additional internal and external data, and potentially its storage. The significant increase in required data will magnify how frequently the data is updated and the complexity of analytics to be performed. These additional data requirements will put added pressure on an institution's information technology (IT) infrastructure.

CECL guidance is principles-based; the standard's implementation will evolve based on regulatory points of view and industry practice. Some things, however, should be considered givens: transparency, traceability, governance, and accountability will be the watchwords for modeling and reporting. More internal stakeholders will be involved—including accounting, finance, risk, compliance, and legal—and other functions will potentially utilize the respective system outputs. While an institution's reporting frequency (monthly or quarterly) likely won't change, the amount of data analysis and processing that will need to be done in the same timeframe will be significantly greater and put pressure on meeting internal and external reporting requirements. These and other challenges will make implementing and managing CECL considerably more complex than today's allowance and impairment estimation process.

CECL's many moving parts and the new allowance process's role in supporting business decisions are driving institutions of all sizes to consider replacing their traditional spreadsheets and legacy IT solutions with a more responsive, configurable platform—one with enabling tools and credit model options to sustain a CECL framework.

Technology solutions, specifically off-the-shelf solutions, cannot, in isolation, make your institution CECL-compliant. Instead, a technology solution should help facilitate your institution in developing its own end-to-end CECL platform.

Additionally, these new IT solutions can help auditors and examiners by enabling them to document, validate, defend, and support an institution's reserve levels, as well as put controls in place around the model and its outputs.

This article explores CECL's impact on an institution's technology needs, approaches, and investments as they determine how to move forward with the right IT structure, capabilities, and governance.

What's the impact?

Identifying which types of data to capture is an important part of the CECL process. Equally important—if not more so—is looking closely at the data volume, scope, and characteristics to help your institution better understand how the standard could impact its current IT infrastructure and future technology needs. Under CECL:

- The number of data attributes needed will likely expand.
- The level of granularity will increase and likely change over time.
- The frequency of data updates and changes may place greater stress on the processing time to complete credit loss estimates.
- Institutions may see greater application and relevance of the allowance in supporting business decisions and pre-transaction support.
- Allowance process owners may receive multiple requests for what-if scenarios, as well as wider report distribution; both may increase IT processing time.
- Measuring the accuracy of the credit loss estimates over time may help support an institution's risk management process in evaluating its credit loss model.

Does an institution's current IT infrastructure provide a sustainable platform that can effectively and efficiently manage the consumption, access, and distribution of frequently changing assessment data? Could a new technology platform improve processing time and enable the institution to be more responsive to CECL's requirements? To answer these and other questions, the institution's finance/accounting and IT functions should work collaboratively to plan and develop the structure, capabilities, and governance of its ideal solution.

Although allowance processing under the CECL standard will place more stress on an institution's accounting and IT functions, the outputs will be more forward-looking and likely used more broadly within the institution than today's loss estimates. Commencing with CECL's effective date, institutions that utilize a responsive, configurable platform with enabling tools should be able to:

- Produce more timely updates
- Identify and proactively analyze changes in their assets' risk behavior between allowance periods
- Better evaluate the sensitivity of model estimates to changes in assumptions

CECL technology investments: A platform approach

Because the CECL standard has both business and technology impacts, its implementation and ongoing management should be viewed holistically. For optimal results, institutions may consider investing in a single technology platform that will house all enabling technologies and provide data transparency, traceability, and accountability.

This single-source platform—which could be hosted or installed on premise—would function as a system of record for the institution's end-to-end CECL process and house all related data, credit models, and credit loss estimates. It should allow users from accounting, risk, and other functions to quickly change model parameters and assumptions, reference data, loan segmentation, and system settings without requiring IT or vendor support. In addition, the platform should provide appropriate internal controls. And because CECL is expected to evolve over the next few years, it is critical that the platform be flexible.

Desirable features of the platform include:

- The ability to modify quantitative and qualitative inputs and obtain prompt results
- A sandbox environment to deliver results of what-if scenarios using actual data
- Real-time ad hoc reporting to provide timely analysis to support decision making
- A process to track changes and provide clear audit trails to support transparency
- The ability to layer multiple attributes to support an institution's evolving product mix and segmentation needs

How can an institution get started?

Whether management continues with its current process or determines that a new technology solution is the preferred approach, the platform should be holistic in design, promote integration across multiple business units, and support what is likely to be an evolving CECL process. An institution should consider the following steps to begin the platform design and development process.

- Assess the potential technology and organizational impacts of CECL needs stemming from data volume, scope, and attributes. Identify enabling tools that can address these needs and support the allowance process.
- Conduct thorough due diligence when selecting solution vendors. Beyond basic software functionality, look at the vendor's long-term viability. Can it provide the technical thought leadership around this accounting topic? Does it have the necessary capabilities to sustain and support its solution, especially as the implementation of the CECL standard evolves?
- Get comfortable with the CECL process before the effective date. Solution planning, design, and implementation may take as long as a year, and will have wide-ranging technology and business impacts. Consider running pro forma analyses prior to going live.

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