Leveraging CECL implementation plans into strategic transformation opportunities

For banks and other nondepository lending institutions (hereinafter referred to collectively as banks), reliable, complete, accurate, and timely data is critical for maintaining business operations, as well as meeting both financial and regulatory demands. This data dependency is especially true as certain banks prepare to comply with the Financial Accounting Standards Board’s (FASB) new CECL accounting standard for calculating expected credit losses over the life of the financial instrument. CECL implementation poses numerous data management challenges because banks of all sizes and levels of sophistication will need to assess and—for many, upgrade—their existing data sourcing, storage, aggregation, modeling, and reporting capabilities.

Planning and implementing an expected credit loss model will impact a bank’s lines of business, accounting, finance, credit risk, IT, and compliance. It is important, therefore, that banks take a holistic view of their risk data management practices and pursue opportunities to build a more coherent and scalable ecosystem. They might also consider automating certain credit loss provisioning processes to mitigate risk and reduce cost, especially for repeatable and time-consuming manual activities. This type of automation can be a cost-effective measure for all banks, regardless of size.

This perspective explores CECL’s data management implications and how affected banks can leverage compliance into a bigger strategic transformation.

Data and infrastructure readiness for Current Expected Credit Loss (CECL) implementation

One of the biggest concerns about implementing CECL is data: Do we have the right data, is there enough data, and is the data accurate? If not, how are we going to capture, collate, and consume it?

Data and infrastructure readiness for CECL implementation

CECL data readiness: Leverage current processes and technologies
CECL implementation will require a concerted effort by risk, finance, IT, and accounting policy departments. Fortunately, banks that can leverage existing processes and technologies may be able to save effort and cost on CECL planning and implementation. For example, banks that have mature credit risk modeling capabilities may be able to leverage their existing data sourcing process of capturing loan-level portfolio information from their risk systems. In addition, banks with internal stress-testing capabilities may gain a head start by using their historical and projected macroeconomic data, forecasting expertise, and a strong data governance framework. However, to estimate expected credit losses over the life of a financial asset, banks may need to source and retain a longer history of data than they do today to support the modeling effort and incorporate forward-looking macroeconomic trends into their expected loss calculations.

Banks, regardless of size, will need certain fundamental capabilities to meet the new CECL standard. It is important that affected institutions assess their current credit estimation processes (whether they are used for regulations or internal stress testing) and use the results as a baseline to map how these processes may be changed (or leveraged) to be CECL ready.

Those banks that are outside the purview of certain capital regulations (e.g., Basel/CCAR/DFAST) should not think they are at a disadvantage, as the CECL standard does not require advanced modeling techniques. It is our view that smaller and less complex organizations will be able to adjust their existing allowance methods to meet CECL requirements without using costly techniques. They should, however, consider CECL’s data requirements and available modeling techniques to determine what path to choose for capturing historical/macroeconomic data and building a strong data governance framework. These banks may not need an extensive overhaul of their risk infrastructure; in fact, they should view CECL as an opportunity to enhance their risk management systems and benefit from implementing more risk-sensitive models.

Four dimensions of CECL data readiness
Since CECL will require banks to handle larger volumes of data to forecast expected loss calculations, a sound implementation plan calls for a thorough review and enhancement of current data management capabilities. Further, these estimates will now incorporate the life of a financial asset, macroeconomic forward-looking indicators, and other inputs and decisions not factored into an incurred loss methodology.

This, in turn, makes a strong case for better data management capabilities across four dimensions:

Data sourcing
• CECL will require historical exposure data covering an entire credit cycle, which will involve intelligent backfilling and interpolation capabilities to cover for missing/unavailable data.
• Forward-looking information and macroeconomic factors could be applied to a pool of loans with shared credit risk characteristics and assessed collectively using a top-down approach. This will require banks to develop infrastructure for sourcing third-party/market data.
• Loss modeling using CECL would likely involve sourcing additional data attributes for predicting the loan losses: historical defaults, attrition, and recovery data; delinquency data; internal indicators of likelihood to pay; collateral information; estimates of loss severity and recoveries; prepayment data; macroeconomic variables; and forward-looking economic scenarios.

Data governance
• Considering the CECL estimates will be reported in the public domain, banks would need to ensure that the policies and decision making around data governance are firmly built to ensure completeness and accuracy.

The ability to control data quality and governance is essential for CECL compliance. If you have bad data, it results in bad loss estimates.

• Banks should assess their data architecture capabilities to accommodate CECL’s additional data requirements.
• Integrating data stored across business, risk, and finance systems may be a daunting challenge for some banks. A centrally controlled location integrating data from all sources could mitigate this issue.
• Banks should review their existing data governance capabilities to define clear ownership and quality expectations for all CECL calculation data.
• Banks should focus on data availability and quality across key data elements, traceability, issue management, remediation, and dashboard capabilities that meet regulatory requirements and are critical to operational efficiency.
• Banks should review their existing data security capabilities to maintain secure, end-to-end dataflow and access management.

Controls framework
• Banks should enhance a comprehensive controls framework that includes both preventive and detective controls to not only maintain data integrity, but also act as an early warning capability in case of greater potential risk.
Adapting robust SOX controls for new data sets and the related processes for expected loss calculations is critical to maintain compliance.

Automated systems with enhanced controls at every stage of the data lifecycle and well-documented manual adjustments and system plugs may provide a strong foundation to the control framework.

The overall governance and operating model will need to be well documented. Governance involves the structure, interaction, and relationships between a bank’s board, committees, and organizational units given its risk culture.

Technology considerations
- Banks assessing their technology systems and platforms based on CECL’s data requirements will have to decide whether to invest in tactical or strategic upgrades.
- Since CECL will require regular loss estimations at the exposure level, banks will need robust infrastructure supporting the data management, processing, and reporting engines. Banks could look to leverage robotic automation techniques where feasible so that manual processes are avoided or kept to a minimum.
- Workflow automation and business rules management systems can help banks employ a consistent and process-driven methodology across various silos.

How can banks get started?
Banks should take an integrated and holistic approach to CECL planning and implementation that, from a data perspective, encompasses granular-level analysis, technology, and data capabilities. As depicted in figure 1, organizations can begin by evaluating their existing risk and regulatory infrastructure (data, architecture, controls, reporting) to understand synergies with the CECL requirements, as well as potential data gaps. Importantly, since CECL will require historical data, banks should fast track their data collection exercise and collate historical data as early as possible rather than wait until project rollout.

Most banks are almost certain to encounter some challenges as they develop and progress their CECL implementation plans. The good news is that the transition to a CECL model can offer advantages beyond compliance: It is an opportunity to add strategic value by transforming the bank’s overall credit portfolio management data capabilities. Furthermore, coupling system and process automation with enhanced data warehousing and analytics capacity can positively impact operational efficiency.

Figure 1: Implementation approach

<table>
<thead>
<tr>
<th>Evaluate current state</th>
<th>Assess impact/effort</th>
<th>Build target state</th>
<th>Rollout</th>
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<tbody>
<tr>
<td>• Assess convergence with existing risk and regulatory infrastructure (data, architecture, controls, reporting)</td>
<td>• Define critical data elements</td>
<td>• Establish process and controls, reporting infrastructure</td>
<td>• Execute parallel run</td>
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<tr>
<td>• Perform data gap assessment</td>
<td>• Assess data availability and quality</td>
<td>• Source incremental data</td>
<td>• Document considerations and conclusions</td>
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<td>• Perform risk parameter assessment</td>
<td>• Identify system changes resulting from CECL—including data, process, and model</td>
<td>• Build/update models</td>
<td>• Conduct ad hoc analytics</td>
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<td></td>
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<td>• Implement IT solution</td>
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<td></td>
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<td>• Perform program and change management</td>
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Build process and data efficiencies
Benchmark against leading practices
Automate CECL calculation runs
Leverage predictive analytics
Data and infrastructure readiness for CECL implementation

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