Perspectives

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DATA NEEDED TO COMPLY WITH CECL

By Toby Lawrence, President, Lawrence Advisory Services and Owner, Platinum Risk Advisors

Having attended more than 20 different CECL seminars offered by accounting firms, software companies and industry regulators, one common question continues to come up time and time again.

What data is needed to comply with CECL?

Some of the speakers respond by listing everything except the kitchen sink to ensure they don't leave anything out, while others state that no additional data is needed because their solution relies only on the data within an institution's Call Report. One concern with these so-called "simple models" is that when we experience another economic slowdown, the adequacy of these models may come into question and/or may result in a small amount of losses tainting an institution's entire portfolio – resulting in a higher provision for the allowance for loan and lease losses (ALLL) than what is actually necessary.

Many institutions likely already have the data they need to calculate CECL in their current loan subsidiary ledgers (with the possible exception of the additional information needed to calculate prepayment percentages). For the actual CECL calculation, however, you need to be thinking about the following information.

Data needed for loans that are currently outstanding

- Customer / member number
- Loan number
- Loan type
- Ability to distinguish between term loans and line of credit loans
- Date the loan was originated
- Maturity date of the loan
- Original amount of the loan
- Current interest rate
- Unpaid balance at month-end
- Additional amount that can be draw on the loan (for line of credit loans)

For CECL, you may want to use more loan types than what are currently in your loan subsidiary ledger. This will help prevent significant losses in one loan type from tainting a large portion of your loan portfolio, leading to your institution having to record a higher ALLL balance than necessary. Additionally, the more collateral types you use, the better your ability to segment the loan portfolio and truly analyze the opportunities and risks within.

Data needed to calculate prepayment percentages for term loans

- Amount of contractually due principal payments received by vintage or year of origination
- Amount of total principal payments received by vintage year

Data needed for charge-offs

- Date of the charge-off or recovery
- Loan type
- Unpaid balance of the loan at the time of charge-off
- Estimated selling costs incurred to liquidate the related collateral
- Net proceeds received from the liquidation of the collateral
- Amount of the charge-off or recovery
- Year the loan was originated
- Amount of any remaining accrued interest
- If using migration analysis, the last risk rating (commercial loans) or FICO credit score (consumer loans) and the date the loan was assigned to that risk rating / FICO credit score
- Loan officer assigned to the loan
- If using the probability of default / severity of loss method, the number of net charge-offs and number of loans originated by each loan type and vintage year (year of origination)

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Additional data will be required to justify the subjective adjustments to the CECL historical charge-off percentages. To help with this, be prepared to segment your loan portfolio by:

- Collateral type
- Ranges of the loan-to-value ratio
- Ranges of the debt service coverage ratio for commercial loans and debt-to-income ratio for consumer loans
- Risk rating for commercial loans and FICO credit scores for consumer loans (assuming the institution doesn't risk consumer rate loans)
- Separating the loans located inside and outside of the normal trade area
- Loans acquired through participation
- Loan officer responsibility codes (to determine if there are any trends in loan officers' individually-managed portfolios)
- Delinquency status
- Spec versus presold loans for commercial construction one-to-four family loans
- Level of policy and technical exceptions

In order to segment a loan portfolio as noted above, lenders will need additional data for their loan subsidiary ledgers.

Data needed to justify subjective adjustments

- Collateral type (to do this correctly most lenders will need to add significantly more loan types to their loan subsidiary ledgers)
- Risk ratings for commercial loans
- FICO credit scores for consumer loans
- Cash flow generated from on-going operations (commercial loans)
- Principal and interest payments due to the institution (commercial loans)
- Principal and interest payments due to other lenders (commercial loans)
- Estimated market value of collateral pledged against the loan
- Debt-to-income ratio for consumer loans
- Number and type of policy exceptions
- Number and type of technical exceptions
- Zip code for real estate loans (this information is already in the loan subsidiary ledger)
- Whether the loan is on nonaccrual status or a TDR (this information is likely already in the loan subsidiary ledger)

The good news for most institutions is that their data processing systems are already set up to store this additional data. An interagency statement issued by the FDIC, OCC and the Federal Reserve Bank in 2006 required banks to segment their loans for major loan concentrations. This statement hasn't been enforced well to date, but regulators will be expecting institutions to do a better job of segmenting their loan portfolios going forward. These same types of data will also be needed to properly stress test a loan portfolio.

Getting this data for the current year will take some effort and will require a data scrub of all the loans currently in the loan portfolio. However, after the initial data scrub tracking this additional data should be relatively painless. The most challenging issue with implementing CECL will be obtaining this same level of data for prior years. To ensure you have enough data for your CECL calculation it is strongly recommended that institutions implement whatever model they're planning to use for CECL adoption as soon as possible, since at least 3 to 5 years of verifiable data will be needed to perform a proper CECL-compliant ALLL calculation.

Disclaimer: The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of the Financial Managers Society.

ABOUT THE AUTHOR
Toby Lawrence is the president of Lawrence Advisory Services and the co-founder and owner of Platinum Risk Advisors.

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FMS Financial Managers Society
1 North LaSalle St., Ste. 2225 | Chicago, IL 60602 | info@FMSinc.org
Contact: mloehrke@FMSinc.org | 312-578-1300
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