

# 5 STEPS FOR AN ON TIME CECL LAUNCH

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As a community banker, you know the importance of getting the numbers right and fully understanding your bank's loan relationships. The good news for community banks, especially those with fewer than \$1 billion in assets, is that the delayed implementation for Current Expected Credit Losses (CECL) provides time to be proactive on both. While CECL undoubtedly adds complexity to banking, if prepared for properly, the implementation can help institutions realize efficiencies and generate more informed strategies for growth – not just create an allowance forecast.

Asset Quality Manager (AQM) is running in banks like yours and was designed to be affordable, quickly implemented and more comprehensive than Excel and Call Report based approaches. We've gathered key takeaways from our direct banking experience and programmed them into software to help you navigate the short runway for CECL readiness. Here are the highlights from what we learned that may help your unique implementation timeline.

## 5 STEP CECL LAUNCH CHECKLIST

1. Challenge your institution to address gaps & move quickly.
2. Assess your CECL tools against your known gaps and possible opportunities.
3. Pick an analysis tool best suited for your portfolios.
4. Estimate your cash flow impact and people impact sooner.
5. Monitor your inputs & assumptions for better governance.



# 1

## **STEP 1 CHALLENGE YOUR INSTITUTION TO ADDRESS GAPS & MOVE QUICKLY.**

Begin your project with the end in mind. Despite the extension of CECL to January 2023, community banks need to begin making steadfast progress to add a forward-looking projection of losses to their allowance for loan and lease losses (ALLL) method.

If your institution hasn't huddled its key stakeholders to discuss CECL – which is typically initiated by the CEO or CFO – you should do so as soon as possible. Unlike most accounting changes, this project will engage everyone from nearly every corner of the institution including your lenders, credit teams, controller, information technologists and internal audit team.

High-quality data is a known requisite for successfully implementing the new pronouncement. While most institutions have already been accumulating data, your first action may be to ensure that the vast information is actionable and relevant to your institution. We've found high-quality data requires examining both your people and data silos to consider how well they communicate with one another regarding loan performance.

While your community bank will possess much of the data needed, building workable database files is a frequent challenge. Whether you're challenged by the vastness, completeness, reliability or accessibility of your data, a CECL analysis tool solution should unify and simplify those data points. We're providing questions on each point to challenge your CECL launch. These will help you ensure you CECL implementation is beneficial for your team and well-timed.



### **CHALLENGE QUESTIONS:**

- Have we utilized the extended deadline?
- What have we learned from early adopters?
  - Have we adequately challenged our portfolio segmentation strategy?
  - What risk indicators are accessible, and what risks are most significant to our portfolios?
  - Is our data aligned to be relevant and sufficient going forward?
  - What gaps do we have in our early warning systems and our expected loss modeling goals?
  - To what extent are our systems able to analyze early warnings and prompt tests for impairment and other needs related to creating specific reserves?



**Estimated Time for Community Banks:**  
2 – 4 months



### **Indicators of Success:**

- CECL implementation team assembled monthly
- Deadlines established with clear conditions of satisfaction
- Loan workout processes tested for readiness

# 2

## **STEP 2 ASSESS YOUR CECL TOOLS AGAINST YOUR KNOWN GAPS AND POSSIBLE OPPORTUNITIES.**

After challenging your existing gaps and confirming your data warehouses, you can prioritize which methodology tool fits your needs. Our solution was built by bankers and for bankers, which means we've studied the various alternatives to complying with CECL.

Below we've provided our framework to guide your journey.



### **CHALLENGE QUESTIONS:**

Are we comfortable with our ability to allocate the time needed to analyze and/or create complex forecasting models?

What are the data analytic capabilities inside the bank? Do our partners have time to fill the gap?

How much time are we willing to allocate to adhere to the standard going forward?

How much time do we commit to creating reports of ALLL, delinquency and watch list loans? Do we anticipate this time commitment to increase with our adoption of CECL?



### **Estimated Time for Community Banks:**

3 – 6 months



### **Indicators of Success:**

- Data collection methods and reliability confirmed
- Availability and quality of data confirmed
- Methodologies understood and tools identified
- "Fit-for-purpose" modeling needs debated and decided

# TOOL COMPARISONS

## ASSET QUALITY MANAGER

### PROS

- + Designed alongside a Top 50 CPA firm and attested to comply to standard by a Top 100 CPA firm
- + Works with any core system
- + Quick to implement and maintain
- + Provides multiple levels of segmentation based on your data and needs
- + Creates a collaborative platform as a “single source of truth” for troubled loans
- + Deploys multiple, defensible CECL methodologies and can change methods with a click, choosing between four dynamic models that include WARM+ and Vintage
- + Functionality beyond CECL computations include Incurred Loss Method, Early Warning & Delinquency Management, Impairment Testing, Watch Lists and Reporting
- + Supports parallel runs for incurred and CECL in a single platform
- + Accommodates user inputs to customize to your needs
- + Dedicated onboarding team
- + Built-in auditable change logs

## EXCEL-BASED MODEL

### PROS

- + Uses existing technology stack
- + Regulators are okay with banks using a vendor OR not using a vendor

### CONS

- Internal control challenges
- Single-purpose tool
- May require 3rd party development support
- Time consuming to create (6-18 months) and maintain (up to 15 hours per run)
- Static models
- Siloed / isolated analyses of loans

## CALL REPORT MODELS

### PROS

- + May be acceptable for less complex portfolios
- + Good for estimating impact up front
- + Lower cost to implement than sophisticated models

### CONS

- May not reflect accurate portfolios segmentation
- Not scalable or dynamic with limited data use resulting in a narrower approach
- Delay between data availability and model run dates
- Risk if method not satisfactory
- May overstate or understate expected losses depending on peer data (akin to ALM models)

## SOPHISTICATED MODELS

### PROS

- + Robust modeling capabilities
- + Capable onboarding support
- + Engaged content creation

### CONS

- Designed for “large and highly complex” institutions
- Expensive or requires addendums to existing contracts
- Sometimes single purpose
- Built by vendors (think “private equity owned”, core providers, consultants) commonly resulting in upsells and hiding future price increases
- May require more data points than available and separate “analytic” engagements to tailor to your needs
- Long implementation queues

# 3

## STEP 3 PICK AN ANALYSIS TOOL BEST SUITED FOR YOUR PORTFOLIOS.

Most institutions that are considered less than the FDIC’s threshold for “large and highly complex” institutions are evaluating for CECL readiness – not CECL compliance at this time. That said, the takeaway we are learning from early adopters and recent exit interviews is that CECL models need to be scalable, not just in implementation but in methodology as well. While the accounting standards do not prescribe a specific methodology, regulators and bank auditors have consistently encouraged banks to prepare for changing inputs, assumptions and methodologies when preparing.

You know your portfolio the best. A great benefit of an integrated solution like AQM is that it provides insight as to whether each model is properly estimating based on the perceived risks within each portfolio pool.

### Asset Quality Manager’s Four Models to Forecast Future Losses

Stratman Solutions’ Asset Quality Manager (AQM) runs multiple models simultaneously, unifies and facilitates collaboration to incorporate feedback from throughout your organization and provides a platform to document allowance rationale for clear explanations of supporting analyses.

- **Vintage Model** identifies and creates vintages for each loan in your portfolio and ties losses back to year of origination
- **Snapshot Model** looks at a particular point in time and follows the chargeoff history over the life of the pool
- **Weighted Average Remaining Maturity (WARM+) Model** estimates loan balances and applies loss rates to the forecast with adjustments specific to your institution’s portfolios
- **Loss Rate Model** computes losses based on the chargeoffs experienced each year relative to the amount of originations in that period



### CHALLENGE QUESTIONS:

Do we feel comfortable with the systems and controls that support the maintenance of our allowance for credit losses?

Are we capturing loan pools and segmentations completely including data conflicts?

Is our allowance methodology repeatable and conforming to our grading systems and processes?

Is our allowance easily summarized and are the rationale for adjustments clear?

Have we validated the allowance methodology and are we able to make adjustments to the process, as necessary?



### Estimated Time for Community Banks:

2 – 4 months



### Indicators of Success:

- Model tool installed
- Teams trained on functionality and process
- New systems, controls, methodology and adjustment rationale by portfolio are documented
- Model results are validated

# 4

## **STEP 4 ESTIMATE YOUR CASH FLOW IMPACT AND PEOPLE IMPACT SOONER.**

When it comes to bridging your incurred loss models to the new CECL methodology, parallel runs are key to identifying how the new method may increase existing allowance balances. With the support of automation, many community banks are able to facilitate a dynamic assessment and remove some of the risk associated with the inputs and data validation. Bankers should be mindful of the possibility that the “last minute” assessment of the allowance change may also be paired with an emergence of problem loans stemming from the COVID-19 pandemic. These potential expenses and distractions could threaten earnings, introduce capital stress and draw scrutiny from stakeholders.

Further, streamlining your asset quality management process in advance of the implementation window positions your bank to deploy its talent more effectively, creating more time for strategic actions, rather than tedious data assembly. Accumulated nonperforming loans during the parallel run period could exhaust already strained implementation teams when fine-tuning your CECL readiness is at its peak.

An integrated solution such as AQM allows you and your management team to quickly understand how this impacts the current estimate for the allowance for loan losses while saving input and calculation time. By leading with a collaborative platform, you can spend less time chasing credit commentary and more time assessing your risks and modifying adjustments.



### **CHALLENGE QUESTIONS:**

How much of an allowance change will we be able to accommodate in a given period?

How will the potential change impact our capital expectations? Will it require dividend expectations for shareholders?

What is the messaging behind a meaningful change due to CECL implementation?

How has the pandemic affected pool level performance?

Is the new methodology supported with historical loss experience and can qualitative factors be utilized to supplement the historical data?

What is our preferred range for a “reasonable and supportable forecast” period?



### **Estimated Time for Community Banks:**

2 – 3 months (ideally two quarters before effective date)



### **Indicators of Success:**

- Reserve processes updated
- Potential impact on earnings & capital determined
- Impact on workforce determined
- Strategies developed to minimize effects of methodology changeover

# 5

## STEP 5 MONITOR YOUR INPUTS & ASSUMPTIONS FOR BETTER GOVERNANCE.

Be confident in your selected tool and governance processes. Knowing your calculations are reasonable and representative of your portfolio is fundamental. We know that each institution's model (or models) will be reviewed by regulators and external auditors, who recommend ongoing program monitoring to ensure data inputs and other qualitative adjustments remain supportable.

Whether you opt to pursue multiple models and granular segmentations or if a simpler approach is more suitable, it's important that you understand how your model works and how it can be modified to represent emerging trends and expectations.

Another key benefit after the implementation of AQM is visibility. Additional visibility is critical to tracking trends and responding quickly and sufficiently. As we continue to see the potentially delayed effects of COVID- 19 in communities across the country, you will want to begin watching for trends in your loan pools. Because you're using a tool, you'll have the flexibility to see things easily and make adjustments. You can be confident in your choice and rest assured that you're preparing for CECL and ready to back up your selection.



### CHALLENGE QUESTIONS:

Have we established procedures to monitor internal and external changes to the portfolio?

Do we have a consistent process for modifying our methods?

Are we able to adjust our assumptions in a timely fashion?

Are we prepared to ensure compliance after implementation?



**Estimated Time for Community Banks:**  
1 month & not less than annually thereafter



### Indicators of Success:

- Internal controls established
- Post-implementation ownership of program determined
- Policies and procedures finalized
- Monitoring of internal and external changes planned



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AQM is a cost-effective partner for a better asset management system because it creates a collaborative platform for both automated and user-led identification of current borrower risks to create and communicate troubled asset action plans, not just loss forecasts. With easy, navigable settings, AQM enables you to process forward-looking forecasts, set early warning systems and generate troubled asset action plans without the distractions and expenses associated with do-it-yourself Excel models and a single-purposed Call Report estimator or

high-priced, under-utilized alternative solutions. It's a feature-rich, affordable solution that will save your team time and enhance your ability to strategize and forecast, so you can better serve your customers.

With these five steps in mind, you should be CECL launch-ready. And with Asset Quality Manager as your tool, you can take comfort knowing you have a tested solution that provides a dynamic validated model that is right-sized for your needs and provides more than just a calculation. ■



**Asset Quality Manager™**  
*Every detail. Every delinquency. Done.*

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Stratman Solutions has led the banking software industry since 1996 with innovations hundreds of financial institutions across the country rely on to maximize efficiency.

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