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The unintended consequences of CECL begin to surface

BY KIAH HASLETT AUGUST 16, 2016

One of the first unintended consequences of CECL has surfaced only a few months after the issuance of the final standard.

The current expected credit loss model, or CECL, is an accounting standard that will change the way banks account for losses on assets such as loans and securities. For loans, banks will move from an approach that books losses when they become likely to be incurred to one that books the expected lifetime of losses on the first day of origination. The standard may require banks to increase the amount of data they use in order to forecast loan performance and could cause some to change the way they model losses.

Sydney Garmong, managing partner at Crowe Horwath and chair of the American Institute of CPAs' depository institution expert panel, told a group of executives at the Crowe Horwath Bank Leadership and Profitability Improvement Conference on Aug. 15 that the credit loss change is the "biggest change in banking" in 40 years and promised it would be complicated. The change will also universally impact depository institutions.

"Unless you're the Treasury or Warren Buffett, you need to have an allowance," she said.

To date, much has been written about how CECL will impact the allowance for loan and lease losses. But the standard also applies to debt securities, a change that will require an allowance for bonds that can also be reversed. Bonds that are marked as held to maturity will follow CECL, while bonds marked as available for sale will use a different approach that is similar to the other-than-temporary-impairment model used today.

She said the approach will have the same first step for evaluation: A bank must take action if the security's fair value is less than the carrying amount. But she said a recent meeting of the AICPA's depository institution expert panel identified that banks will be required to utilize a discounted cash flow approach to calculate the impairment, based on the way the standard is written.

A discounted cash flow approach could require bankers to perform a calculation on these securities that could become complex, compared to the current approach of qualitative evaluations.

"I think this is an unintended consequence that hopefully the transition resource group will be able to address," she said. "If it's underwater and [available for sale] you will have to use a discounted cash flow approach. ... We've gotten more information and it seems like, yes, that is what FASB wanted. I don't know if they appreciated what that really means."

Garmong is a member of the transition resource group that FASB assembled to help navigate implementation issues that arise before it goes into effect. She said that the group may not be "as great" or effective as other transition groups have been for accounting changes such as revenue recognition. That group has identified a variety of unintended consequences that FASB has been able to address. But Garmong said the CECL transition group faces a different problem.

"I don't know what we're going to be able to offer. The FASB says record expected credit losses and that's where the complexity is coming from," she said. "I flagged the one about using discounted cash flows and I'm sure there will be a few others along the way. But I'm not thinking the transition resource group is going to be able to remove the complexity that will come along with [CECL]."

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