CECL AND COVID-19: IMPACTS ON CREDIT RISK MODELS AND METHODOLOGIES

Supporting financial institutions in transforming their credit risk management process and CECL methodology.

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MAZARS

THE NEW NORMAL IN BANKING

The current economic environment is uncertain, volatile and evolving at speed that is creating new market dynamics and ambiguity of the near future. As a result, institutions need to be agile and responsive to external environment, with changes needed on internal controls, processes and procedures. The “new normal” will have wide ranging implications for society and the business environment, necessitating both an accelerated response to external market conditions and creativity on how to deal with some of the imposed challenges.

The COVID-19 crisis has increased the volume of loans issued by financial institutions, with significant “draws” on existing liquidity lines coupled with the Federal stimulation package and associated liquidity injection to the financial market. In this context, new guidance and recommendations are issued frequently by both the regulators and industry authority bodies as to how institutions should reflect, amend or delay the financial and regulatory impacts of the COVID-19 economic trough.

This is placing a real focus on how there is a need to adapt procedures and policies to capture and measure credit risk, under the latest applicable CECL accounting standard (*FASB ASC Topic 326: Financial Instruments – Credit Losses*).

Credit Risk Monitoring

The way in which the pandemic and associated events will impact estimates of CECL reserves is a key consideration for institutions which are in the process of preparing the first application of the standard.

- The temporary relief measures are changing the rules and impacting how assets are classified between sound, TDR and defaulted, with direct side effects in model calibration to be considered when defining transition to default matrices.
- Institutions will also need to reflect the change in the economic environment by updating the parameters used for calculation, as the probability of default or the loss given default, as well as forward-looking information and the weighting allocated to multiple scenarios used to estimate the reserve.

Regulatory Compliance

Keeping the pace with the latest regulatory updates granting statutory and regulatory relieves and adjustments to the newly applicable CECL standard, such as:

- The CARES Act and CECL Interim Final Rule (IFR) of April 2020, with relieves granted to smooth the transition to CECL.
- Interagency Policy Statement on Allowances for Credit Losses Interagency Guidance on Credit Risk Review Systems, issued in May 2020.

Increased Operational Risk and Data Quality

CECL has placed new burdens on financial institutions to both collect and organize the relevant loan data supporting the developed methodologies. Managing the significant flow of new transactions, while addressing the related operational risks, is one of the most important challenges and institutions will need to ensure they have a strong data governance regime and gather the necessary information to compute CECL reserves.

Additional impacts that need to be managed include:

- Liquidity risk and relieves granted on prudential ratio (as leverage ratio).
- Compliance (anti money laundering but also consumer protection, information, mis-selling risk, conduct risk compliance).

KEY CHALLENGES

OUR SERVICES

Mazars has significant experience supporting financial institutions in developing expected credit loss models, both under international standards and US GAAP.

Our team combines the expertise of accounting and risk management professionals who understand the specific requirements of regulatory standards and their impact on your organization's structure, processes, procedures and financial statements, working together with our quantitative experts, capable of developing and assessing updated credit models and taking into consideration newly defined scenarios.

Credit Risk Management, Governance and Oversight

Establish a governance framework to manage how risks associated to this context are monitored and can impact your strategy and capital planning. Support the implementation of a systematic methodology to address the development, governance, and documentation underlying your CECL reserves. Ensure that existing credit risk process and policies are updated as necessary in the current context (covering emerging operational risks, defining new triggers for credit risk monitoring, TDR & default definition etc.).

Credit Risk Measurement: CECL Models and Mazars' CECL Solution

Use of CECL models and methodology, in compliance to the standard requirements, with supporting use of Mazars CECL solution : an easy to use and update solution which enables to compute up to 5 different scenarios, including updated 2020 macroeconomic scenarios and allows a point-in-time and forward-looking approach.

CECL Model Validation

A tested, comprehensive and independent approach, complying with US regulatory requirements (SR 11-7) and determining that your CECL models are performing as expected, in line with their design objectives and business uses, and conforming to regulatory requirements. This also allows you to identify potential limitations and assumptions, and to assess their possible impact on your financial statements.

Financial Reporting – CECL Disclosure

Update financial disclosures to comply with the SEC and FASB requirements and provide investors with the high-quality financial information they need to make decisions amid this uncertainty.

Regulatory Compliance and Capital Requirements

Ensure compliance with all the latest regulatory guidelines released by regulators and key authorities (e.g. Capital regulatory relief and scaling factor application as introduced by the CECL Interim Final Rule (IFR), or the updated concepts, practices and guidance on credit risk review systems issued in the Interagency Policy Statement in May 2020).

Data Governance and Advanced Data Analytics

Support your data management processes and ensure appropriate data governance (quality, integrity, data sourcing to complex merging of heterogeneous sources and data manipulation).
Rely on our Advanced Data analytics capacities to identify actual and potential credit weaknesses to strengthen credit quality, adjusting risk ratings as necessary, and identifying relevant trends that affect the quality of your portfolio.

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About Mazars USA
Mazars USA LLP is a client-centered, full-service accounting, auditing, tax, consulting and advisory firm with over 100 partners and 800 professionals in 12 U.S. offices. Mazars USA is the independent U.S. member firm of Mazars Group – a prominent international accounting, audit, tax and advisory services organization with nearly 24,000 professionals in 90+ countries.

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