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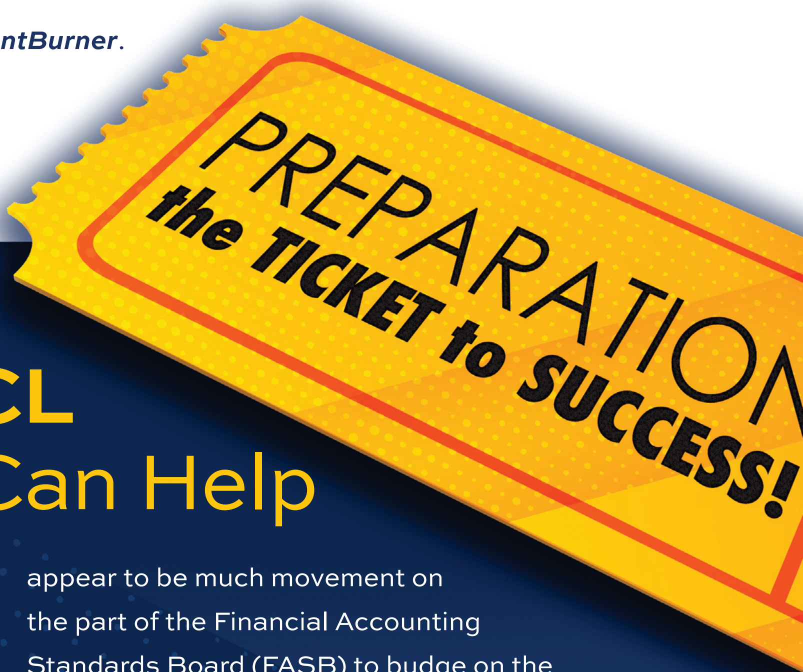
THE FRONTBURNER

Welcome to the January edition of ***The FrontBurner***! What a year 2021 was for so many, both personally and professionally. There is rarely ever a dull moment anymore either at work or at the Merry household, so I can only imagine what 2022 has in store for us all. It's hard to believe we are already looking at calendars that say 2022 on them, but we are. The year ahead promises to be busy, productive, rewarding, and probably fairly complicated, as they all are these days.

One thing we know is coming that adds to the complexities ahead are the regulatory changes regarding CECL. I know it seems as though this has been "coming" forever, but CECL really is getting closer by the day and we, here at VolCorp, want to help you be ready. Put on your seatbelts. The closer it gets, the faster it seems to be moving and we all have to get ready and go on the ride.

With that, I hope you enjoy this month's edition of ***The FrontBurner***.

Jeff Merry, President/CEO



The Coming of CECL
And How VolCorp Can Help

Happy New Year! While we can say we learned different lessons the past few years, there is one lesson we all learned. The unfortunate truth that CECL, Current Expected Current Loss methodology, is not a "who" but a "what." A "what" that some say will create an unnecessary burden upon the credit union industry. Not only time and expense to calculate the required funding amount and future monitoring, but some fear it will have a negative impact on the lending criteria for certain borrowers. The impact on lending goes against the reason credit unions were created in the first place—assisting people that other institutions may not.

In addition to the possible impact mentioned above, the Allowance for Loan and Lease Loss (ALLL) account will not exist going forward. Instead, the Allowance for Credit Losses (ACL) will take its place. This will be a difficult change for many to accept: a world without an ALLL!

While there is still some hope an exemption for CECL will be afforded to credit unions, there does not appear to be much movement on the part of the Financial Accounting Standards Board (FASB) to budge on the topic. At this point, the cold hard fact is all hope could be just a vapor as the clock quickly ticks to the required implementation date. For those credit unions who have not early adopted, compliance with CECL must begin at the fiscal year beginning after December 15, 2022. For a majority of credit unions, this would be January 1, 2023.

In June 2021, NCUA released their final rules for CECL. The rules provide an exemption for CECL to any federally-insured credit union (FICU) with less than $10 million in assets. These credit unions may use "any reasonable reserve methodology (incurred loss), provided it adequately covers known and probable loan losses." The rule will only apply if the credit union is federally-chartered. For state-charted credit unions, the credit union must comply with its state requirements for CECL and there could be a possibility the exemption would not apply.

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NCUA also finalized a rule allowing credit unions to calculate net worth under PCA (Prompt Corrective Action) rules with a phase-in approach once CECL is implemented. NCUA stated the final rule will "phase-in the day-one adverse effects on regulatory capital that may result from fully implementing the current expected credit losses (CECL) accounting methodology." This rule, commonly referred to as the "transition phase-in," will be available to credit unions who adopt CECL in the fiscal years beginning on or after December 15, 2022. It is expected NCUA will release additional guidance within the coming year on how this will be accounted for within the Call Report.

What does this mean for credit unions? For most credit unions, the implementation of CECL will require the current amount in the ALLL to be moved to the new ACL account. Then depending upon the CECL calculation, the account could require additional funding. The regulations state the first adjustment must be funded from Retained Earnings instead of flowing through an expense account. This entry will have an immediate impact on Net Worth and could possibly cause some credit unions to fall below Net Worth ratio requirements. The phase-in approach will allow for the recognition of a portion of the total funding over a three-year period. The phased-in recognition will provide time for a credit union to strategically implement a Net Worth restoration plan in order to comply with regulatory requirements by the end of the three-years.

It is important to note the phase-in approach only impacts the PCA calculations of Net Worth that is automatically calculated within the Call Report. It does not impact the credit union's actual account balances on the Balance Sheet. Credit unions will continue to calculate Net Worth using the balances stated on the Balance Sheet. Net Worth cannot be calculated using the phased-in approach when presenting to the Board of Directors, auditors and/or examiners.

While we still hold out hope CECL may never come to pass, credit unions cannot remain on the sidelines. CECL must be addressed now within each institution. If we can give some parting advice on this subject, it can be summed up in the following points:

1. CECL allows for several calculation methodologies depending on the complexity and needs of the credit unions. It also requires historical losses to be compiled. The research and data gathering can be a monumental task. Let VolCorp assist you with this by introducing you to our third-party vendor, CRF Advisors. CRF offers various options to comply with CECL to fit the needs of a credit union.

2. Be careful to not try to overfund your allowance in 2022 as a way to offset the impending impact of CECL. Typically, examiners will not allow a credit union to overfund the allowance account in a normal setting. It is anticipated examiners will be reviewing credit unions' assumptions in more detail to verify over-funding without justification is not occurring.

3. Some credit unions have had their Net Worth impacted negatively due to growth in shares since the beginning of the pandemic. The implementation of CECL could further negatively impact Net Worth. Keep this in mind as you are creating budgets and strategic plans for 2023 and beyond. Need assistance? VolCorp offers Strategic Planning Facilitation.

4. Finally, do not take a silo approach in strategy and only focus on the impact of CECL. Remember, strategy includes risk and risk requires monitoring and mitigation. This is extremely important when it comes to interest rate risk. VolCorp can assist with ALM modeling, what-ifs and validations to determine the interest rate risk within your Balance Sheet.

Do you have questions about CECL and how VolCorp can help you comply with the new regulations?

Please contact Marketing at **marketing@volcorp.org**, or 800-470-3444, extension 3.