Credit Risk Management Basics as Financial Institutions Gear Up for CECL

With CECL (Current Expected Credit Losses) creeping around the corner, consumer credit risk management is a top priority for community financial institutions. It's critical for originations, scoring, profit and loss forecasting and strategic planning, among many other concerns.

Key factors in credit risk management include delinquency rates, interest and fee income, prepayments, probability of default, loss given default, exposure at default and recoveries. The factors impacting credit risk management are not limited to internal factors. It's important to understand the general economy and particularly the local economy or, for some credit unions, the status of your select employee groups.

Community financial institutions have a distinct advantage in knowing their customers. Not only is your data lake overflowing with information to help detect patterns and make predictions, but you often *actually* know your customers and members. A report from the Risk Management Association reads, "The information you gather and the relationships you establish are critical to positioning yourself as a valued financial consultant and provider of financial products and services. Establishing a good relationship can bring a long stream of equity to your institution."

Ser Tech's ProAct has the data you need for managing your portfolio. Learn more here!

Knowing your customers and members, also covers understanding their numbers. With a car loan, this is obvious, but it's also important to know whether that home equity loan your institution is considering will be used to make improvements to the home or pay for a child's college tuition. One provides enhancements to the underlying asset, while the other could create a liability. Additionally, knowing the customer thoroughly allows your institution to better understand their ability to repay, and how you may want to structure and price the loan.

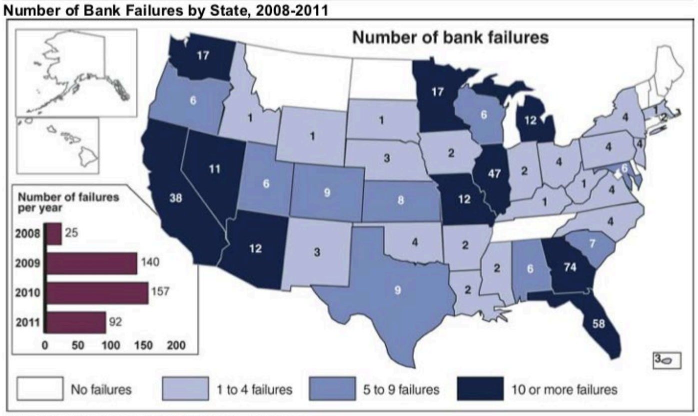
The Office of the Comptroller of the Currency notes that practicality dictates the most rigorous credit analysis is typically when a loan is made but with subsequent monitoring to check payment performance, credit migration and updated collateral valuations.

The board of directors should regularly question the appropriateness of strategic initiatives, staffing and management decisions, and the balance between risk taking and profitability, including establishing a risk management framework calibrated to the size and complexity of the institution.

Basic characteristics of a well-managed retail credit portfolio, according to the OCC, include:

- structured oversight by the board and senior management
- clear and consistent policies and operating procedures
- a well-established risk appetite
- structured risk assessments
- well-defined processes for policy exceptions
- effective monitoring reports
- well-designed strategies, business plans, and product testing

Number of Bank Failures by State, 2008-2011



Source: GAO analysis of FDIC data: Map Resources (map).

According to the [Government Accountability Office](), 10 states that led in bank failures during the Great Recession experienced strong housing growth in the years leading up to the crisis, as well as losses in the aftermath due to aggressive growth strategies riskier funding sources and employed weak underwriting and credit administration practices. No financial institution, nor the nation, can afford to see another Great Recession anytime soon. Financial Accounting Standards Board’s CECL was a consequence on every bank as a result of some reckless dealers. Let’s make the most of it to shore up credit risk management overall.

Click here to contact Ser Tech about setting up a ProAct analytics demo today!