A TIMELY BIMONTHLY INFORMATION AND IDEA STATEMENT

FINANCIAL INSTITUTIONS INSIGHTS

Delivering bimonthly information critical to community banking professionals while tackling issues ranging from IT security to regulatory compliance to operational improvements

In this issue:

Changes to revenue recognition for financial institutions

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In May 2014, the Financial Accounting Standards Board (FASB) issued new revenue recognition guidance that will, upon its effective date, replace almost all pre-existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. Implementation of the new guidance must occur no later than the quarter and year beginning January 1, 2018, for public entities (i.e., public business entities and certain not-for-profit entities and employee benefit plans) with a calendar year-end. For all other entities with a calendar year-end, implementation must occur no later than the year ending December 31, 2019.

As we discuss in our white paper, Changes to revenue recognition for financial institutions, we believe the major implementation challenge for financial institutions is determining which transactions are within the scope of the new guidance. While transactions within the scope of various sections of the FASB Accounting Standards Codification relevant to financial instruments are not in the scope of the new guidance, it may not always be obvious as to whether a financial instrument topic specifically addresses revenue recognition. Additionally, implementation challenges may arise in part from arrangements that are partially within the scope of financial instruments guidance and partially within the scope of the new guidance. In

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our white paper, we discuss the relevance of the new guidance for the following categories of revenue for financial institutions:

- Interest and dividend income and fee income on loans (including credit card fees)
- Service charges on deposit accounts
- Servicing and sub-servicing income
- Fees and commissions from fiduciary, securities brokerage and other activities
- Guarantee fees
- Insurance and investment contracts
- Sales of financial assets
- Sales of foreclosed property

All financial institutions will be impacted to varying degrees by the new guidance. Given that the effective dates are fast approaching, it is important for each institution to perform a complete evaluation of its various sources of revenue to determine the applicability of the new guidance and its impact on transactions within its scope.

New credit losses standard in a nutshell

Download white paper

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which introduced a new model for determining the allowance for credit losses known as CECL (current expected credit loss). While the new guidance is not effective for a few years, certain things should be focused on now given that it impacts nearly all entities and is believed to be the most significant fundamental accounting change financial institutions and other lenders have ever faced.

In our summary, New credit losses standard in a nutshell, we answer the following key questions:

- What do I need to know about the new standard on credit losses?
- When will the new standard be effective?
- What should management do now to prepare?
- What are the key aspects our governing body should focus on?

For additional information about the new credit losses standard refer to our high-level summary, FASB issues final standard on credit losses, and in-depth white paper, Financial instruments: In-depth analysis of new standard on credit losses.

How a 3-year technology plan helps control risk, drive growth

Aligning your board, your strategy and your technology

Regulators have required financial institutions to develop technology plans for several years. Unfortunately, many financial institutions have viewed this as primarily a regulatory compliance exercise and simply took an existing technology plan template and put their name on it. This satisfied regulatory compliance, but offered little value to the organization.

The lack of a true long-term strategy has become a bigger and bigger concern, especially as information technology (IT) spending continues to increase due to regulatory pressures and competitive necessities. For many financial institutions, IT spending has increased more quickly than profit margin growth, making it the largest budget line item for most financial institutions; nor is an increasing budget a board's only IT concern. Regulators expect boards to provide educated and active oversight over all areas, including IT. In addition, board members now face civil and criminal accountability regarding cybersecurity. Boards must now be more directly involved in IT planning to effectively address these risks and concerns, but it can be difficult for a board to meet these oversight expectations if the board is not tech savvy, or doesn't understand their role in the technology management process.

To read the complete article, go to: http://rsmus.com/what-we-do/services/technology/how-a-3-year-technology-plan-helps-control-risk-drive-growth.html

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To read the complete article, go to: http://rsmus.com/events/national_banking_conference_2017.htm

Is it time to review your core system?

Align core system with strategic goals to optimize technology

Optimization of the core processing environment is an essential component of maintaining your overall technology infrastructure to support current and future business needs. Across the financial institutions industry, a very competitive market in core processing software, services and emerging deployment options is helping financial institutions to control cost and align with the strategic direction of their organizations. Through an effective system selection process, you can identify business needs, assure integration with your technology infrastructure, and optimize the core evaluation and negotiation process.

Key components to consider as you review your core and consider conversion include:

- Alignment of the core and ancillary applications with the needs of your business
- Operating model
- Contract terms
- Resources to manage the vendor and implementation process
- Optimization of technology selected

A comprehensive selection approach includes the following phases:

- **Needs assessment** – Assess the available technology, including core systems, ancillary applications and outsourced services, and the future business needs of the organization. Identify key criteria, features, functions and integration requirements, and use these as the basis to develop a road map for where you want to go. Involve key leaders from all business lines and operational departments to ensure that key priorities from all stakeholders are addressed during the process.
- **Request for proposal (RFP)** – Develop a customized RFP that solicits specific, comprehensive proposals from selected vendors. The RFP requires vendors to propose total solutions and to address critical evaluation criteria, including features, limitations, growth needs, integration options, implementation, training, support, infrastructure and costs.
- **Due diligence and vendor review** – Schedule presentations with vendors. It's a good idea to use customized demonstration evaluation tools to assist the selection team in recording observations and scoring demonstrated system features against requirements.
- **Contract review and negotiation** – The negotiation process is critical in order to protect your financial institution's investment in the selected solution. Understand and negotiate pricing, term, service level, termination and price change triggers to avoid agreements that are one-sided in favor of the service provider. Both legal counsel and individuals familiar with the processing and business functions affected by the core system should participate in this process.
- **Implementation project management** – Complete the conversion to the new core system. Major system implementations are more successful when there is ownership and strong project management at the financial institution. A project manager who can coordinate efforts across your organization is a critical factor to a successful conversion. Note that most vendors offer project management but their focus is primarily on their data conversion requirements.

Financial institutions often choose to work with an independent consultant with broad experience in the financial institution industry to guide the organization through the evaluation and optimization process. A qualified consultant understands that there is no single best choice in the market and brings knowledge across the landscape of solutions and applications available in the market. An independent consultant provides unbiased guidance to determine the best match for your financial institution.

Financial institutions must understand affirmative action obligations

Many don't realize they need an affirmative action plan

Many financial institutions are unaware that they are required to maintain an affirmative action plan (AAP) to prove they are providing equal opportunities to protected classes (i.e., minorities, women, individuals with disabilities and veterans). Generally, employers with 50 or more employees and a government contract of $50,000 or more are required to maintain an AAP. Many financial institutions don't realize that having accounts insured through the Federal Deposit Insurance Corp. (FDIC) or the National Credit Union Administration (NCUA), serving as a depository of federal funds or serving as a paying agent for U.S. savings bonds creates a contractual relationship that triggers the AAP requirement.

Even absent a clear contractual relationship, it is in a financial institution's best interest to maintain a solid AAP. Not only will the plan satisfy requirements under the Department of Labor's Office of Federal Contract Compliance Programs (OFCCP), it can serve as valuable protection in the event that you are the subject of a discrimination lawsuit by a member of a protected class. In addition, there is increased cooperation among both federal and state agencies that enforce various nondiscrimination laws and regulations. If your financial institution comes to the attention of one of these agencies, it is increasingly likely that they will share their findings with other agencies; those agencies may also pursue enforcement actions.

Start by understanding what employment and related data you need to gather and ensuring that you have the systems and processes in place to collect and efficiently report that information for AAP purposes. An AAP typically includes:

- An analysis of applicant flow, current workforce information and employment-related activity that occurs over the period of a year
- Statistical reports and narrative information reflecting compliant policies and procedures
- Proactive affirmative action measures including training programs and outreach efforts

Many financial institutions choose to work with an outside vendor that is well-acquainted with equal opportunity rules and that also has experience coordinating the data and systems issues necessary to address them. Once you have the right AAP process in place, regularly updating your AAP is a relatively straightforward activity.

Financial institutions that fail to comply with AAP requirements can end up facing penalties and significant unwanted attention from federal and state regulators. Take the time now to understand your obligations and develop an appropriate AAP.

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