

Family First Credit Union

Allowance for Loan Losses Policy

Purpose

It is the policy of Family First Credit Union to maintain a systematic, approved approach to estimate Allowance for Loan Losses to cover losses incurred in all loan categories within the portfolio and to emphasize to management its significant responsibility to maintain a satisfactory reserve account.

Objectives

The Allowance for Loan Losses should be sufficient to:

- Meet the requirements of full and fair disclosure.
- Cover estimated losses inherent in the total loan portfolio, both current and delinquent portions.

Review and Reporting

The Chief Financial Officer will prepare a worksheet monthly for analyzing the adequacy of Allowance for Loan Losses, which will be reviewed with the President. This worksheet will be used for funding recommendations and presented to the Board of Directors for approval each month.

Loan Review and Classification

Management will review the Credit Union's loan portfolio, both current and delinquent, in an effort to estimate the required balance in the Allowance for Loan Losses account. The credit union will use a combination of historical loss methodology and adversely classified (impaired) loans in the Allowance for Loan Losses Analysis.

Loan Segment Identification

Management will segment the loan portfolio into several categories (pools) of loans. Each category will demonstrate similar risk characteristics. The assignment of categories will be reviewed annually to insure that they are still appropriate. At this time the loan portfolio is segmented by loan type as follows:

- Unsecured
- New Vehicle
- Used Vehicle
- Other Collateral
- Share secured
- Home Equity
- 1st Mortgage
- 2nd Mortgage
- Business Mortgage
- Other Real Estate
- CUFS Mortgage

- CUFS Participation Loans
- CULS Participation Loans

Estimating Loss on Loan Segments

Management will apply an historical derived loss ratio to each loan segment to determine an appropriate level of funding for that segment's Loan Loss Reserve. Currently the loss ratio will be equal to the most recent two year average (calendar years).

Impaired (and Delinquent) Loans

Impaired loans will be evaluated based on value of collateral, external environmental factors and current status of the member. Impaired and delinquent loans will first be classified into categories, and assigned estimated loss ratios, as follows:

- Substandard – loss ratio 15%
- Doubtful – loss ratio 50%
- Probable Loss – loss ratio 100%
- Loans 1 month to less than 2 months delinquent and not classified in one of the historical loss ratio pools – loss ratio 10%

The impaired loans will then be evaluated by the CLO and assigned estimated loss percentages based on value of collateral, external environmental factors and current status of the member. Based on this evaluation, loans may remain in the categories listed above or may be assigned new loss percentages.

Trouble Debt Restructured (TDR) loans will be identified and evaluated separately as part of impaired loans. The amount to be included in the allowance for loan loss analysis will be determined per the TDR Policy. The calculation will compare the current loan balance to the present value of future cash flows, with the difference included as the estimated loss amount.

The total loan balances in each of these categories will be deducted from the "segment by loan types" categories and multiplied by the assigned loss ratios for impaired loans to determine the estimated amount required in Allowance for Loan Losses.

Determining Total Estimated Required Balance

The estimated loss on loan segments will be added to the estimated loss on impaired loans. The average recoveries (2 year average) will be subtracted from the total to determine the estimated required balance in Allowance for Loan Losses.

In developing and maintaining loss measurements, management will consider the impact of current environmental factors and document which factors have been used in the analysis, and how these factors affect the loss measurements. The following factors should be considered to develop environmental loss measurements:

- Levels of and trends in delinquencies and impaired loans
- Levels of and trends in charge-offs and recoveries
- Trends in volume and terms of loans
- Effects of any changes in risk selection and underwriting standards and other changes in lending policies, procedures, and practices
- Changes of the value of collateral
- Industry conditions
- Effects of changes in credit concentrations and changes of the level of such concentrations
- Effects of other external factors such as competition and legal and regulatory requirements.

Documentation of the Analysis

The analysis of the adequacy of the Allowance for Loan Losses will be prepared monthly and be reviewed and approved by the Board of Directors. The analysis will include:

- The amount of estimated loss in each category
- The aggregate estimated loss using the Credit Union's methodology
- The amount, if any, of the necessary adjustment to the Allowance for Loan Losses account
- Detailed documentation to support the loss estimates that reconcile to the analysis.

Authority / Oversight

Management should consider all known relevant internal and external factors that affect loan collectability during any given period. Management's judgments about the credit quality of the loan portfolio should determine the amounts of the Loan Valuation Reserve and Loan Write off Expense. The Board of Directors should review and approve the analysis of Allowance for Loan Losses and Loan Write off Expense monthly.

Accounting

The amount necessary to increase Allowance for Loan Losses will be recognized as a current period charge to operating expenses. The accounting treatment for the entire Loan Valuation Reserve will be determined on a consistent basis.

The Board of Directors has approved an allowable differentiation of 10%. Therefore, the Credit Union will meet full and fair disclosure if the balance in Allowance for Loan Losses is within 10% of the calculated amount required by the analysis.

Loans will be written off in accordance with the Charge-Off Policy. Recoveries on charged-off loans will be credited to Allowance for Loan Losses upon receipt.

Review

This policy must be reviewed at least annually by the Board of Directors.

Adopted _____

Date _____

Reviewed _____

Date _____