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.

<u>Loan Segment Identification</u>
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 and CD secured
- Home Equity
- 1st Mortgage
- 2nd Mortgage
- Other Real Estate
- First Mortgage – CUFS & Member First Mortgage
- CUFS Participation Loans

- CULS Participation Loans
- MBL Participations

Estimating Loss on Loan Segments
Management will apply a 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
A loan is considered impaired when it is probable that the credit union will not collect all amounts due, including principal and interest, according to the terms of the loan agreement.

The impaired loans will be evaluated by the CFO, CEO, VP of Lending and Members Solution Manager and assigned estimated loss percentages based on value of collateral, external environmental factors and current status of the member. For secured loans, the estimated credit loss will be based on the value of the collateral. For unsecured loans, the base loss percentages will be 15% for sub-standard, 50% for doubtful and 100% for probable loss. These percentages may be adjusted based on the current status of the member and other external environmental factors. It is important to recognize that underlying assumptions require a substantial degree of judgement. Based on these evaluations, 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.

Qualitative and Environmental Factors
At least quarterly, management will consider the impact of current qualitative and environmental factors that are likely to cause adjustments to the estimate loss reserve. These factors will be considered for each pool (category) of loans. Any adjustments to the loss reserve for each pool will be entered in the "qualitative and environmental factors" column of the worksheet.

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
- Changes in management or staff (experience, ability and depth)
- Changes of quality in loan review system
- 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.

These factors will be considered for each pool of loans. The following scale will be used to adjust the percentage related to the qualitative and environmental factors.

- Low risk impact increase 0.25%
- Moderate risk impact increase 0.50%
- High risk impact increase 0.75%
- Extreme high risk impact increase 1.00%
- Low impact decrease -0.25%
- Moderate impact decrease -0.50%
- High impact decrease -0.75%
- Extreme impact decrease -1.00%

The reasons and factors used to adjust loss percentages for qualitative and environmental factors will be documented to support the adjustment.

Determining Total Estimated Required Balance
The estimated loss on loan segments will be added to the estimated loss on impaired loans, including any adjustments for qualitative and environmental factors. The average recoveries (2 year average) will be subtracted from the total to determine the estimated required balance in Allowance for Loan Losses.

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 Provision for Loan Losses 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 ____________________