

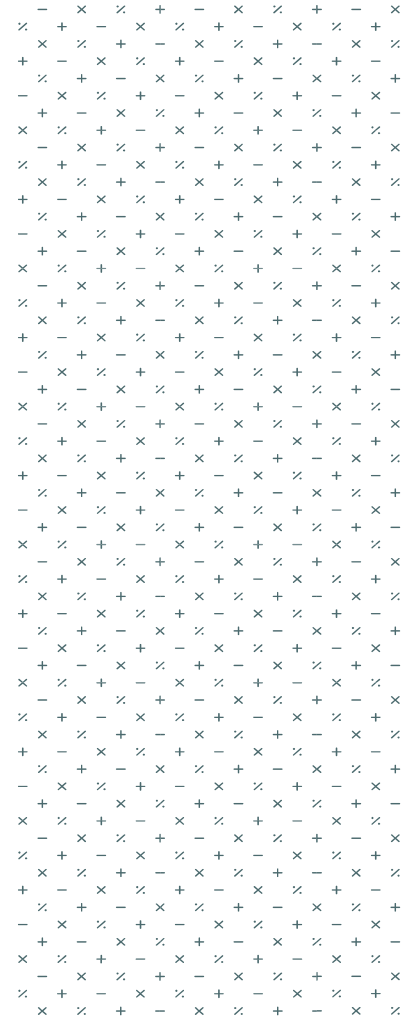


# Managing Lending Risks

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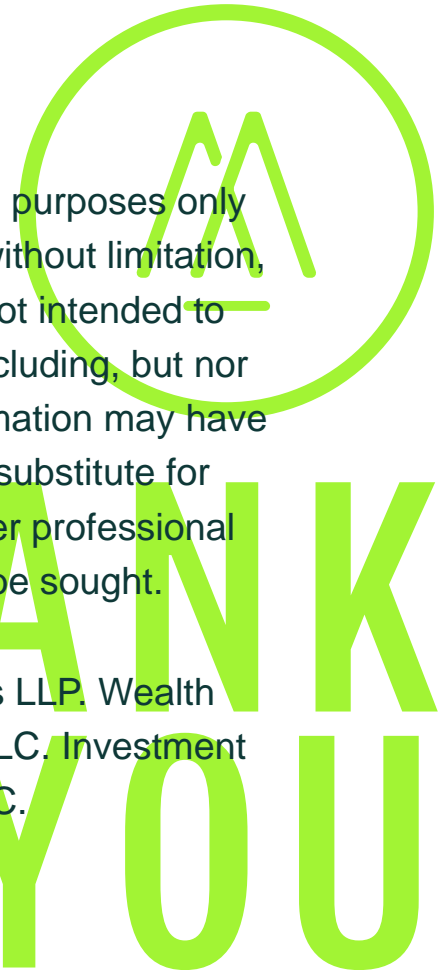
Katherine Hart, Senior Manager

Aran Loftus, Senior Manager



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# Presentation Takeaways

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Lending Update– “*Update on the current lending environment*”

Governance – “*Governance and control considerations*”

Audit and Regulatory Perspectives – “*Key audit considerations and regulatory updates*”

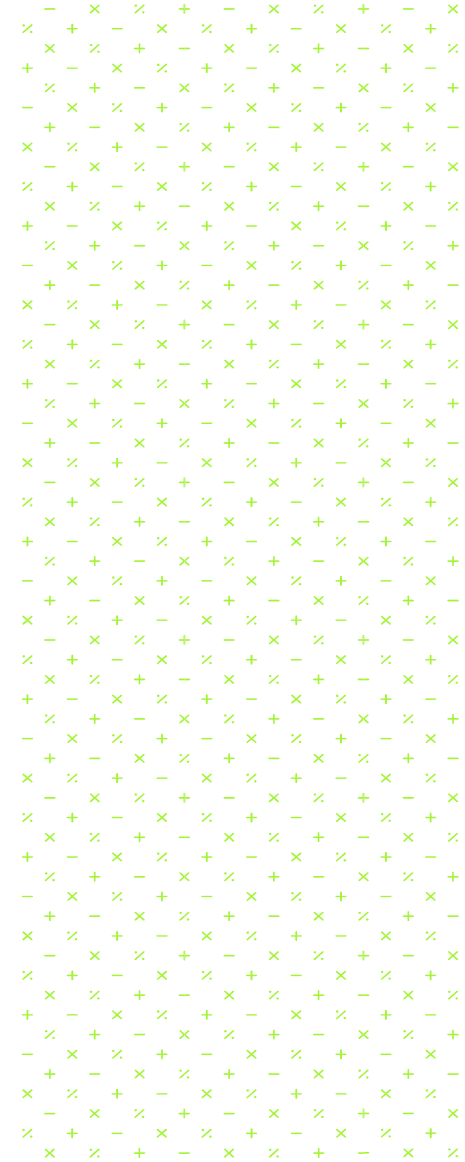


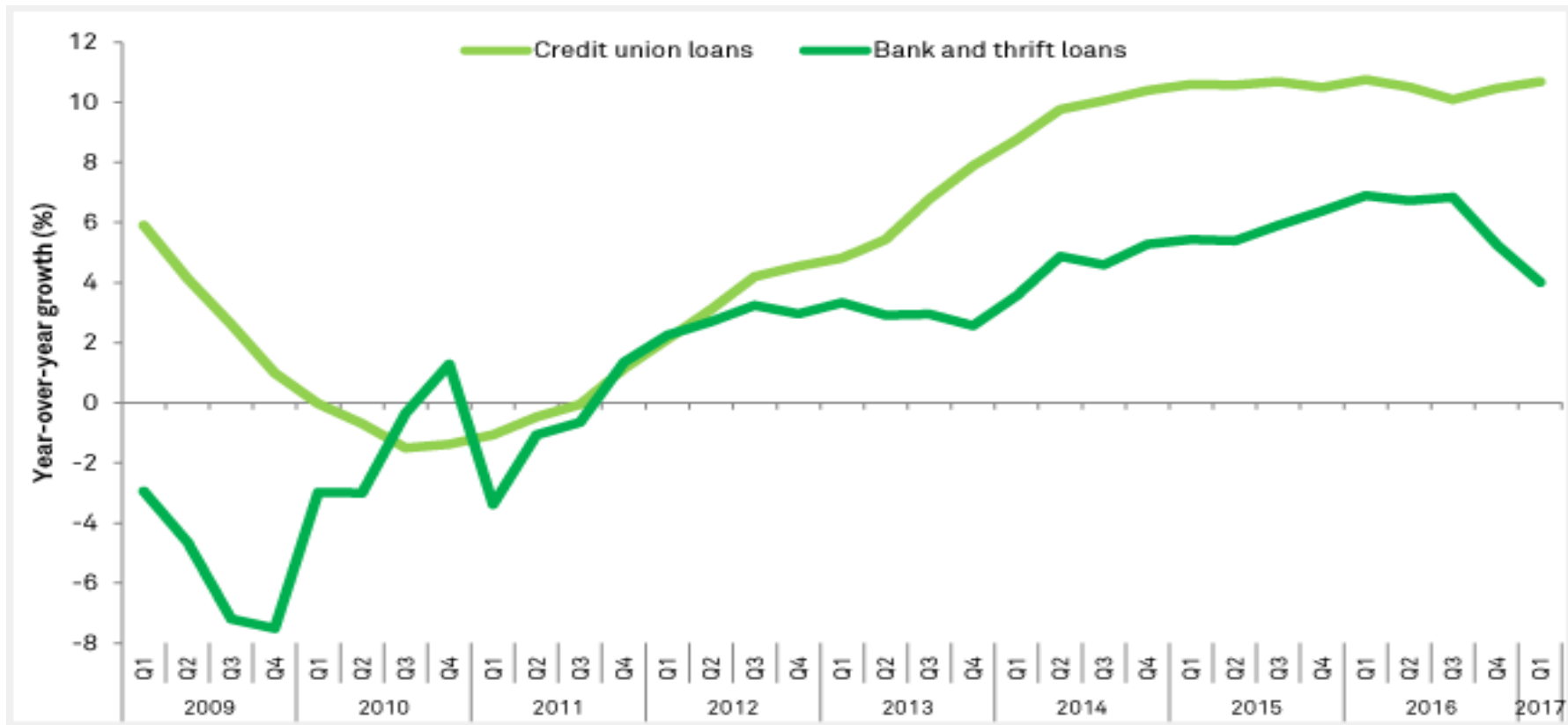


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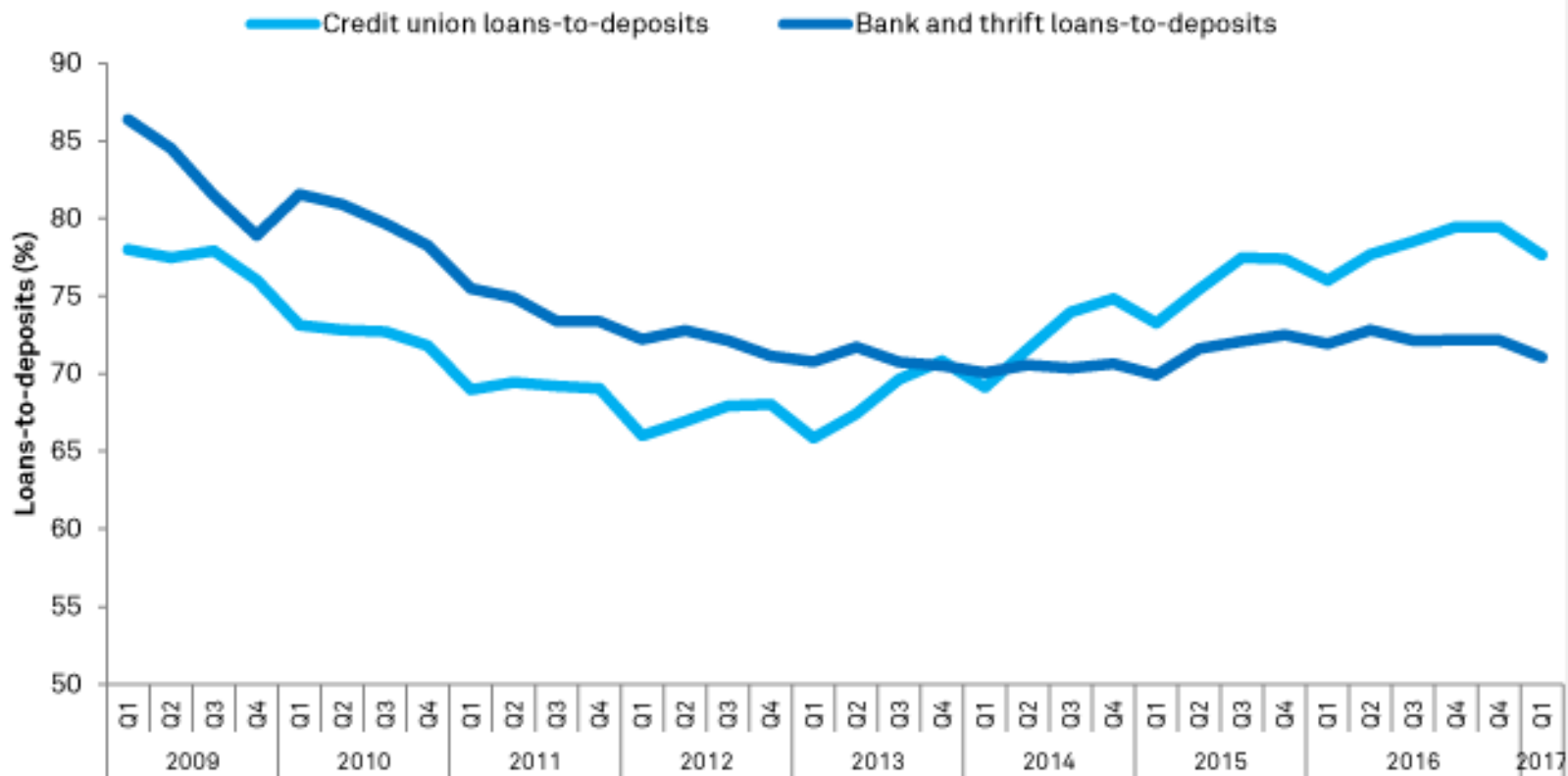
# Lending Update

*SCTW Las Vegas 2017*



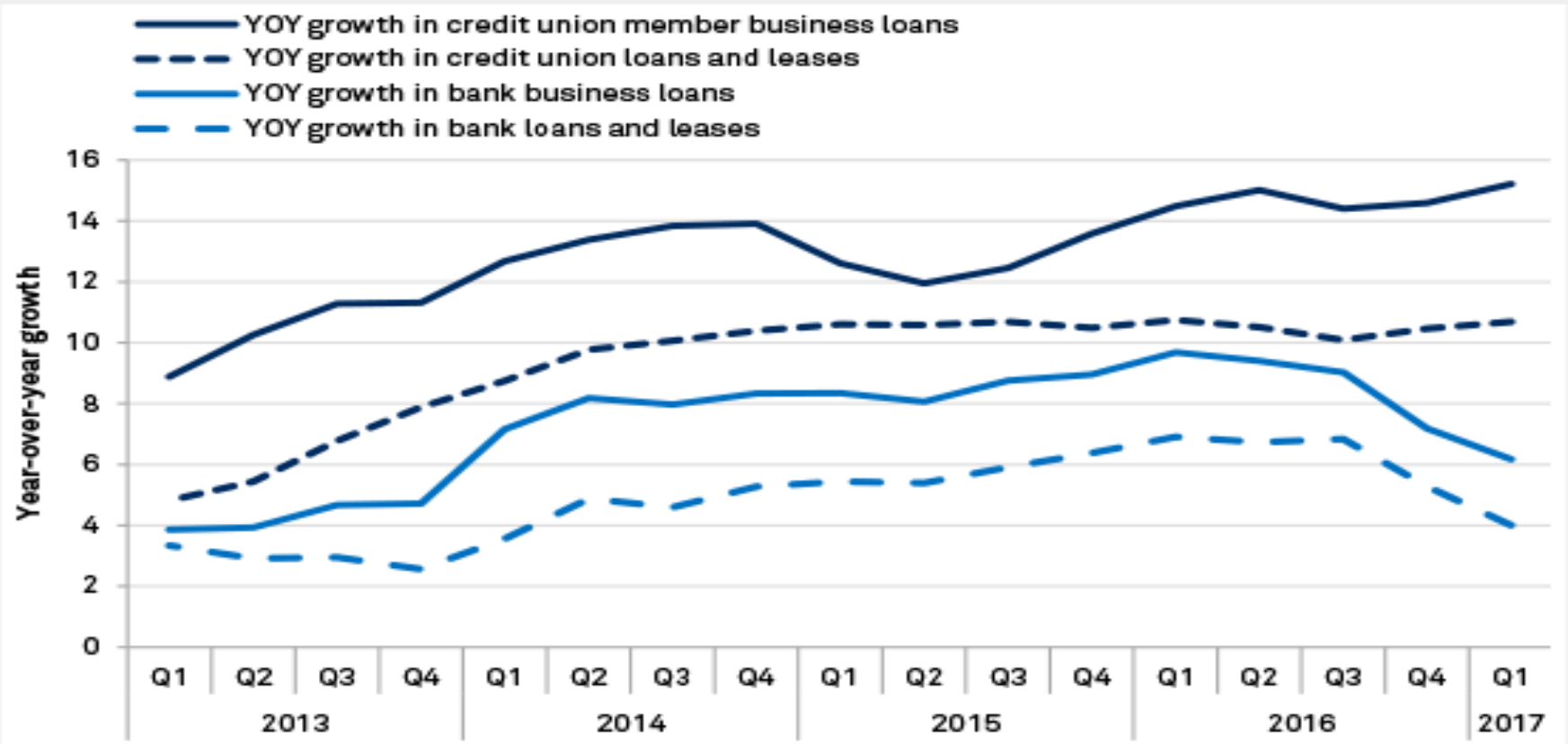


- Source: SNL Financial



Data compiled May 31, 2017.  
Based on regulatory filings by U.S. commercial banks, savings banks, savings and loan associations and credit unions.  
Source: S&P Global Market Intelligence

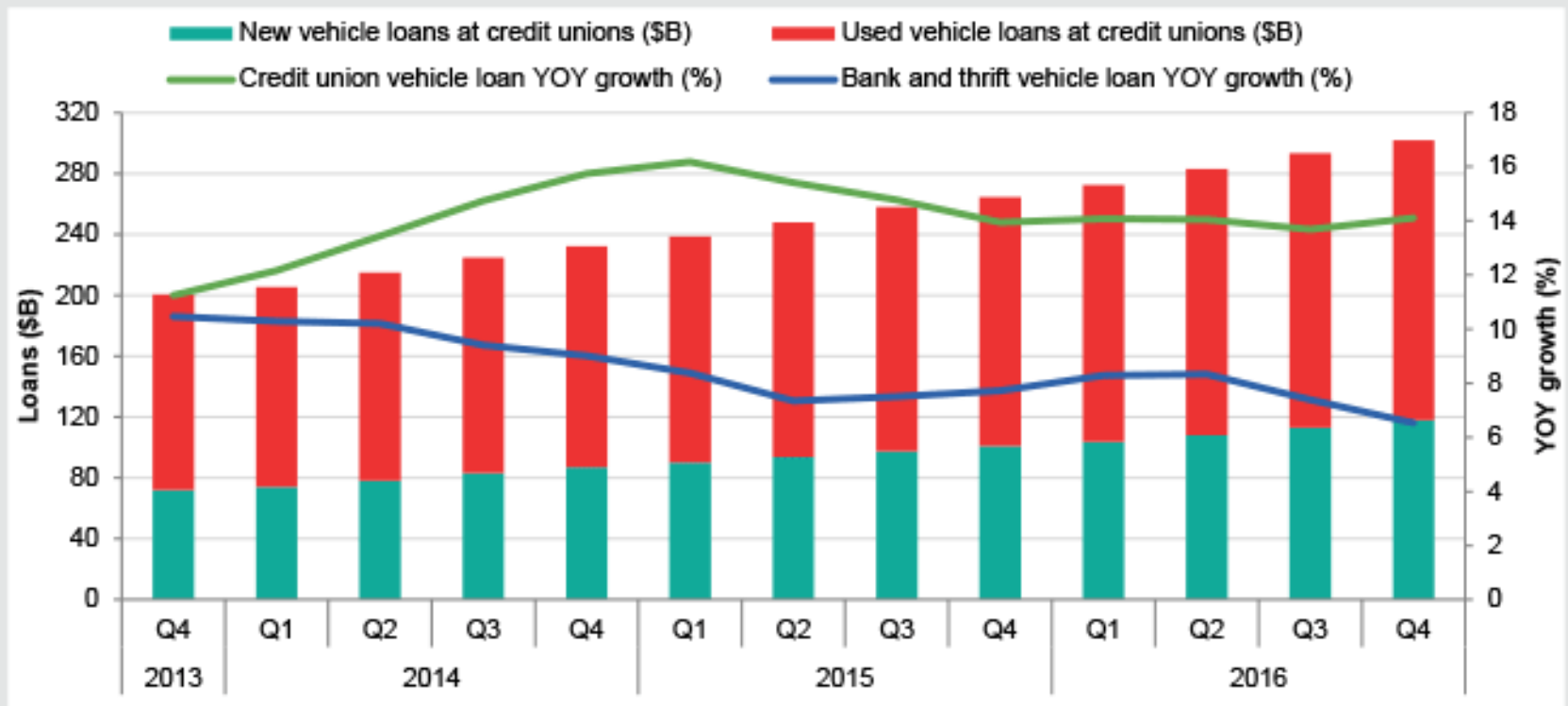
## Credit unions outpacing banks in business loan growth (%)



Data compiled May 31, 2017.  
Based on regulatory filings.



## Credit union vehicle loan growth



Data compiled March 1, 2017.

Based on regulatory filings by U.S. commercial banks, credit unions, savings banks and savings & loan associations.

Credit union year-over-year growth includes both new and used vehicle loans.

Bank and thrift year-over-year growth includes both new and used vehicle loans at U.S. offices.

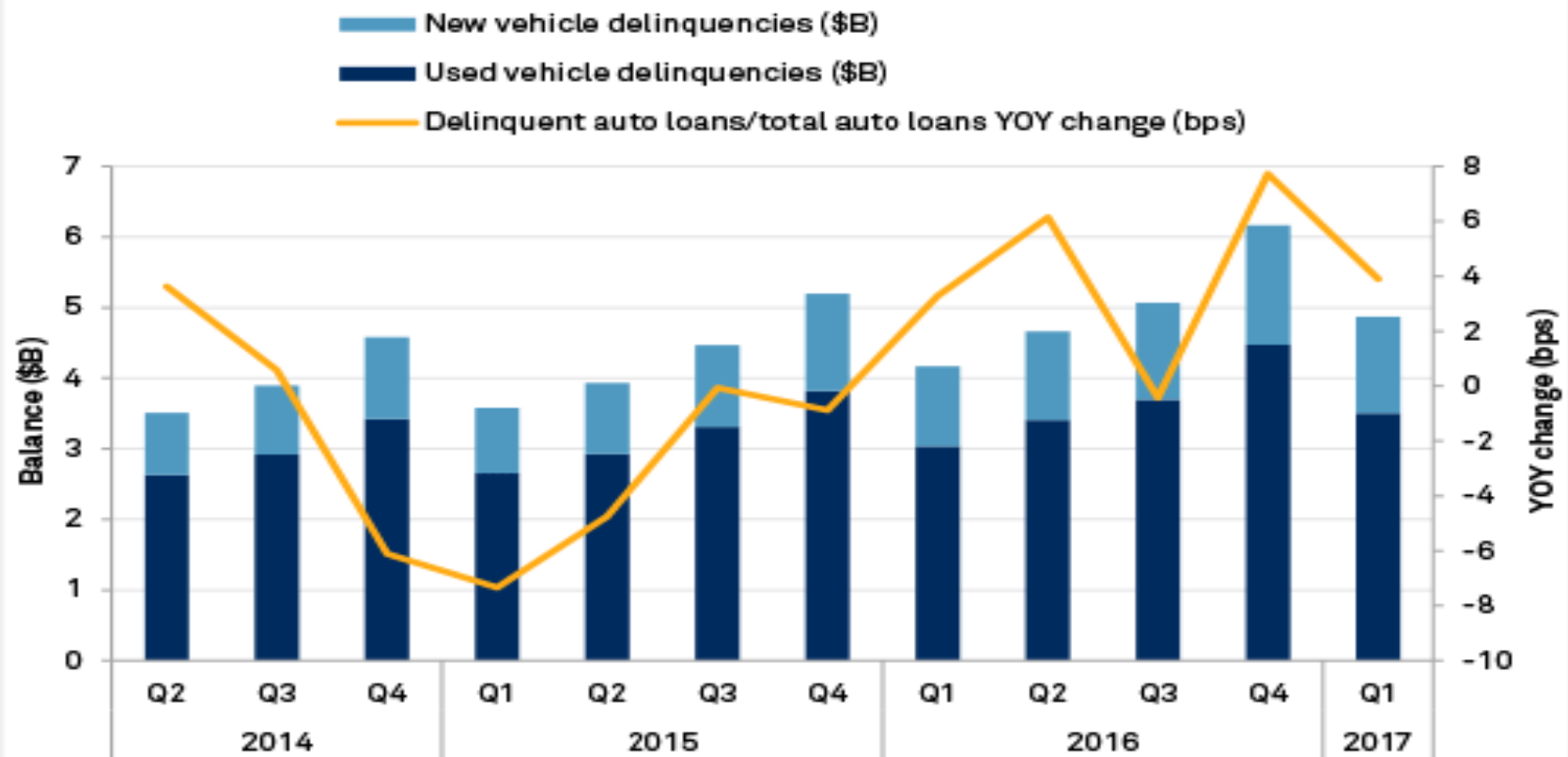
YOY = year-over-year

Source: SNL Financial, an offering of S&P Global Market Intelligence





## Vehicle loan delinquencies at US credit unions



Data compiled June 19, 2017.  
 Data based on regulatory filings by credit unions.  
 Delinquencies include loans 30 days or more past due.  
 Source: S&P Global Market Intelligence

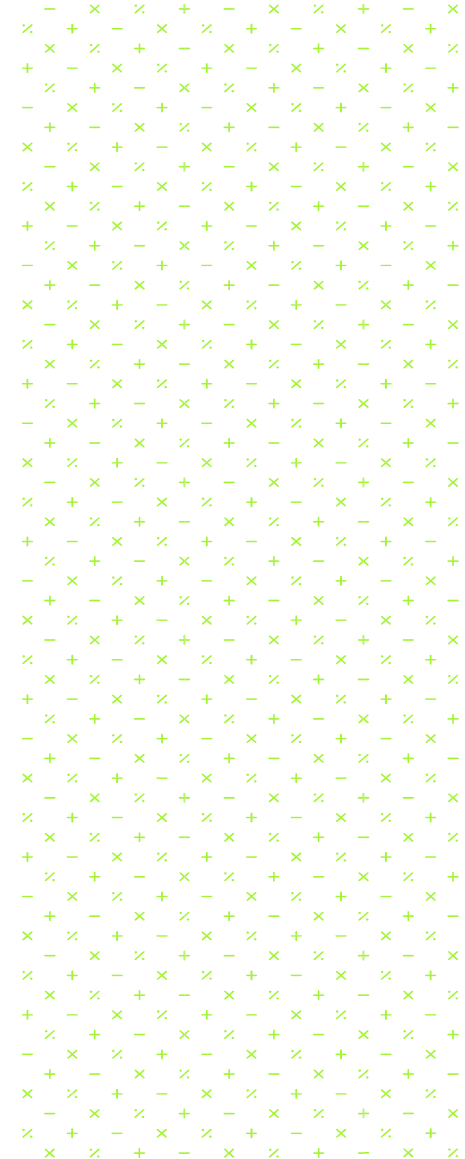




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# Governance

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# Common Definitions

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- CRE – Commercial Real Estate
- C&I – Commercial and Industrial
- Owner occupied – the purchaser occupies the property and uses it for their business. Ex: Auto repair shop
- Non-owner occupied – the owner rents to third parties. Ex: Shopping center
- SBA Loans - loans guaranteed by the Small Business Administration and subject to the specific requirements as defined by the SBA.
- Revolving lines of credit – loans used for short term cash flow needs and require periodic repayment. Ex. Credit cards





# Strategy

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**Who do we want to lend to?**

**How are we best able to serve our members?**

**Do we have the right management team?**

**What happens when a loan goes bad?**

**How strong is our relationship with regulators?**

# Policies – Key Elements

Maintained by management and approved by the Board

“Living Document”

Outlines basic elements of strategy

Dovetails into accounting and reporting

Detailed underwriting approach and limits

Provides practical guidance to lending staff





# Monitoring

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## RESPONSIBILITIES

- **Management – borrowers, staff, reporting**
- **Board – Totals, new loan originations, charge offs, delinquency, exceptions, a summarized watch report, 5300 call report and audited financial statements**
- **Supervisory Committee – audited financials, control exceptions, internal auditor reports**



# Monitoring

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## COMMON MONITORING REPORTS:

- Loans by risk rating
- Loans by type and collateral
- Loans by branch and/or officer
- Delinquency reporting
- Charge-off and recovery reporting
- Watch list – this is a key report!

# Monitoring

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## SUPERVISORY COMMITTEE MONITORING

- Periodic audits of loan terms, file completeness and compliance
- Periodic audits of key member business lending controls
- Review of findings reported to the committee
- Coordinate independent loan file review engagement
- Coordinate independent allowance for loan losses validation





# Control Discussion and Common Gaps

**Outdated Policy**

**Lack of qualified  
lenders**

**Lack of clearly defined  
strategy**

**Boarding controls non-  
existent**

**Lack of file  
maintenance reviews**

**Annual reviews not  
timely**

**Policy exceptions not  
tracked**

**Tickler reviews not  
occurring**

**Lack of well-defined  
workout strategy**



## CHALLENGES IMPLEMENTING LENDING CONTROLS

# Challenges

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- ***Not enough staff*** – each different lending cycle requires separate controls and creates segregation of duties issues
- ***Too expensive*** – consider the costs of a breakdown
- ***Trust of employees*** – trustworthy employees are not a good reason to limit the amount of controls



# Implications of Control Findings

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**REGULATORY DOCUMENTS OF RESOLUTION AND  
HIGHER CAMELS RATINGS**

**INABILITY TO FUND NEW MEMBER BUSINESS  
LOANS**

**EXCESSIVE RISK LEVELS IN THE PORTFOLIO**

**REPUTATIONAL AND ECONOMIC COSTS DUE TO  
ERRORS IN THE FUNDING AND SERVICING  
PROCESS**



# Common Problem Areas

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## **PARTICIPATIONS AND LOAN POOLS – LOANS FUNDED WITH OTHER CREDIT UNIONS**

- Participation sold – the credit union sells a portion of the loan to another credit union
- Participation purchased – the credit union purchases a portion of a loan from another credit union
- Loan pools – A grouping of similar loans purchased from, or sold to, another credit union.
- These may be brokered deals

**TAKE AWAY** – If your Credit Union is involved in these activities or considering these transactions, we recommend having a conversation with your auditor and management regarding accounting requirements.



# Common Problem Areas

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## COMMERCIAL LOANS (NON-REAL ESTATE)

- Commonly called C&I Loans (Commercial and Industrial)
- May be collateralized by business assets or not at all!
- Generally require increased levels of monitoring
- Interest rate risk associated with variable rates

**TAKE AWAY** – If your Credit Union is developing a C&I portfolio: specific policies, procedures and controls should be documented and implemented

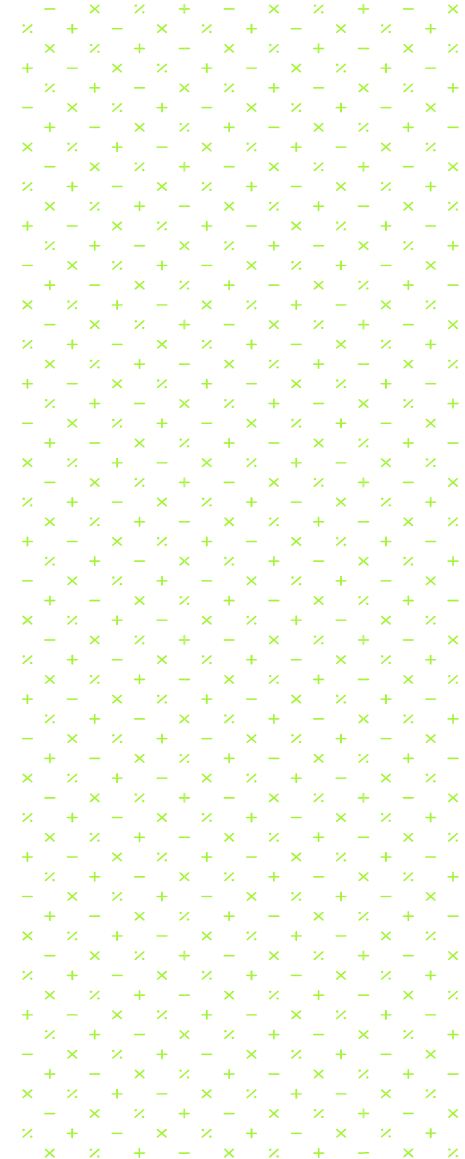




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# Regulatory Perspectives

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# Regulatory

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- **MBL Concentration: Limited to 12.25% of assets and 175% of capital**
- **New MBL rules for 2017:**
  - Principles based lending
  - Lifts limits on construction and development
  - May waiver personal guarantees
  - Removes restrictions on loan-to-value
- **Risk Based Capital applies in 2019**
- **CECL in 2021!!!**

# Questions?

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