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What Credit Unions Need to Know About the Implications of the New Exam

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Discussion Topics

- Background
- Modifications: procedures and documentation
- Portfolio analysis and the ALL
- Examiner perspective
- Looking ahead

Background

- CARES Act, Sec 4013
 - Relief from reporting requirements that apply to accounting for TDRs
 - Basis for Interagency Guidance
- Interagency Guidance
 - April 7, 2020: Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)
 - June 2020: Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions

Background

NCUA Letters to Credit Unions

- March 2020, Letter 20-CU-02
 - Working with members and FAQs
- April 2020, Letter 20-CU-09
 - Regulatory relief
- April 2020, Letter 20-CU-12
 - COVID outreach questions



Loan Modifications

- Policies and procedures
- Risk assessments
- Documentation
- Internal controls
- Reporting and monitoring



Loan Modifications and the ALLL

- Communicate regularly with lending and operational teams
- Establish consistent documentation for all modifications
 - Create a tool / checklist for modifications as a best practice
- Be familiar with recent interagency guidance on loan modifications and the CARES Act

Loan Modifications and the ALLL

- Use flex / data fields in your core system to track all modifications made as a result of COVID-19
- Modifications need to be tracked and reported – NCUA focus
- COVID modifications will be on future Call Reports
- Commercial loan workout procedures should be developed to ensure prudent and safe and sound decisions
- Be proactive with participation loan lead partners to understand decisions for loan modifications
- What % of loan portfolios are being modified?

Regulatory Reporting Considerations of COVID-19 Related Loan Modifications

- Potential challenges that may arise:
 - Loan needs to be remodified within the CARES Act window
 - Accrued interest considerations
 - Clarity of internal policies and procedures for remodifying a loan
 - Ensuring lenders are informed
 - Perform risk assessments by type of loan



Regulatory Reporting Considerations of COVID-19 Related Loan Modifications

- Credit risk:
 - Agencies continue to stress prudence and safe and sound practices
 - Credit score migration - monitoring is important
 - Evaluation of credit card balances and limits
 - LTVs
- Past due reporting:
 - Deferment of loans due to COVID-19 aren't expected to be reported as past due
 - Potentially, modifications won't hit until statutory delinquency until November

Regulatory Reporting Considerations of COVID-19 Related Loan Modifications

- Nonaccrual status and charge-offs:
 - Refer to regulatory reporting instructions and their internal policies
 - Missed first payment after 3- or 6-month deferral - reverse accrual?
 - Accrual related to COVID-19; any reversal will be larger (potentially 9 months vs. 3 months)

Portfolio Analysis and ALL

- Incurred Cost Model
 - Homogeneous pools +
 - Individually evaluated (impaired, commercial) +
 - Qualitative and Environmental factors (Q&E) =
 - ALL funding levels
- Q&E should incorporate COVID-19



Q&E Factors in the ALLL

- Q&E factors will likely be in the spotlight for 2020 reporting
 - Times of uncertainty are the reason for these factors
 - Recent earnings announcements from large publicly traded financial institutions indicate increases in their ALLL due to COVID-19
 - Examiners will be looking for Q&E (rational and consistently applied)
 - Banking industry Q1 adjustments to the ALLL

Q&E Factors in the ALLL

- **Documentation** of Q&E factors will be critical to support your ALLL
 - Unemployment trends
 - Economic (Macro, Micro)
 - 2008 crisis as a baseline
 - Others
- Unwinding the ALLL due to COVID-19 (hopefully)
 - Credit unions will need a documented basis in which to do this

Q&E Factors in the ALLL

Seven factors should be present*

Factor	Comments
Portfolio trends	Changes to portfolio that introduce risk
Portfolio concentrations	Related members, industry, geography, etc.
Economic and market trends	Trends in GDP, unemployment, etc.
Changes in lending practices	Changes in procedures, staffing, etc.

Factor	Comments
Changes in loan review system	Quality of loan review
Geographical considerations	Unique matters (i.e., major employer closing)
Other factors	National emergencies, etc.

*Per the [July 2006 Interagency Policy Statement on the Allowance for Loan and Lease Losses](#)

Q&E Factors in the ALLL

- Consider adjusting Q&E factors, appropriately, for different portfolio segments or the credit union's risk profile
- Establish ranges that can be adjusted as economic situation evolves
- Use available data that supports trends in your portfolio
 - Federal Reserve's Beige Book, U.S. Bureau of Labor Statistics Reports, local economic reports

Examiner Focus

- CARES Act, Sec 4013 and Interagency Guidance
- Examiner considerations
 - Asset size
 - Complexity
 - Risk profile
 - Sponsor industry and members
 - Written documentation by the credit union



Examiner Perspective

- Supervisory exam
 - Risk management
 - Response to COVID-19 impact
 - Composite rating will incorporate management's assessment of COVID-19's impact
 - Written documentation



Examiner Perspective

- Overall supervisory assessment
 - Initial risk assessment and ongoing relating to COVID-19
 - Management's documented understanding of impact on:
 - Projected earnings
 - Funding
 - Operations
 - Capital
 - Liquidity
 - Market risk
 - Risk assessment will be considered in CAMEL ratings

Examiner Perspective

- Component ratings
 - Capital adequacy
 - Asset quality
 - Classification of credits
 - Credit risk review
 - New loans
 - Paycheck Protection Program (PPP)
 - Modifications
 - Nonaccrual
 - ALL funding
 - Real estate values (LTV) and appraisals

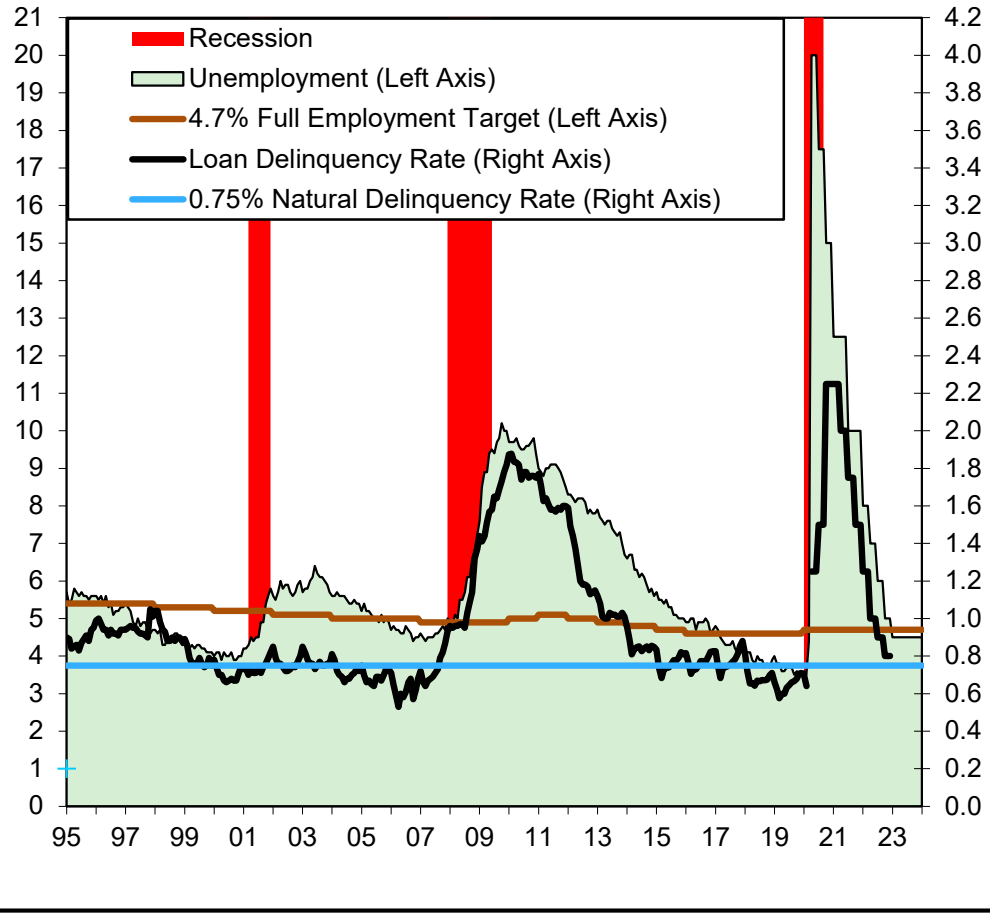


Examiner Perspective

- Component ratings
 - Management
 - Operational risk
 - Independent risk assessment and audits
 - Earnings
 - Liquidity
 - Market risk

Looking Ahead: CUNA Forecasts

CU Delinquency Rate
vs.
Unemployment Rate



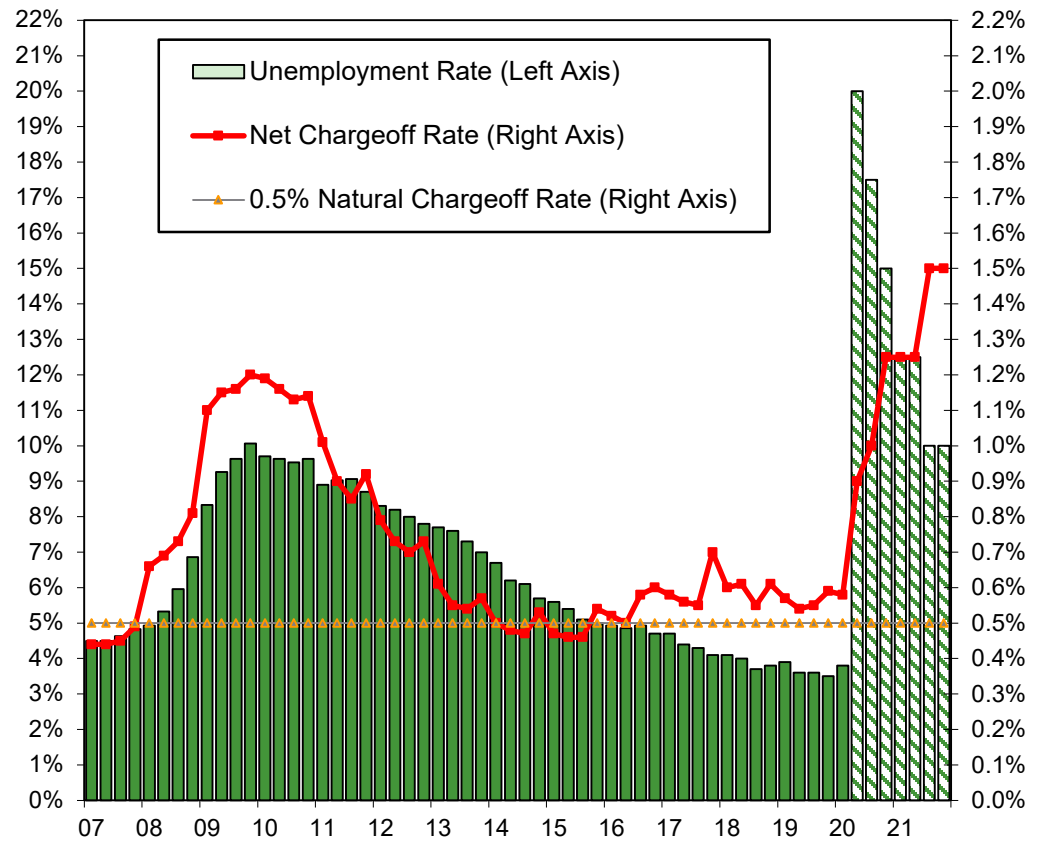
Loan delinquency rate rising to 2.25%.

Current delinquency = 0.63%



Looking Ahead: CUNA Forecasts

CU Net Charge-Off Rate
vs.
Unemployment Rate



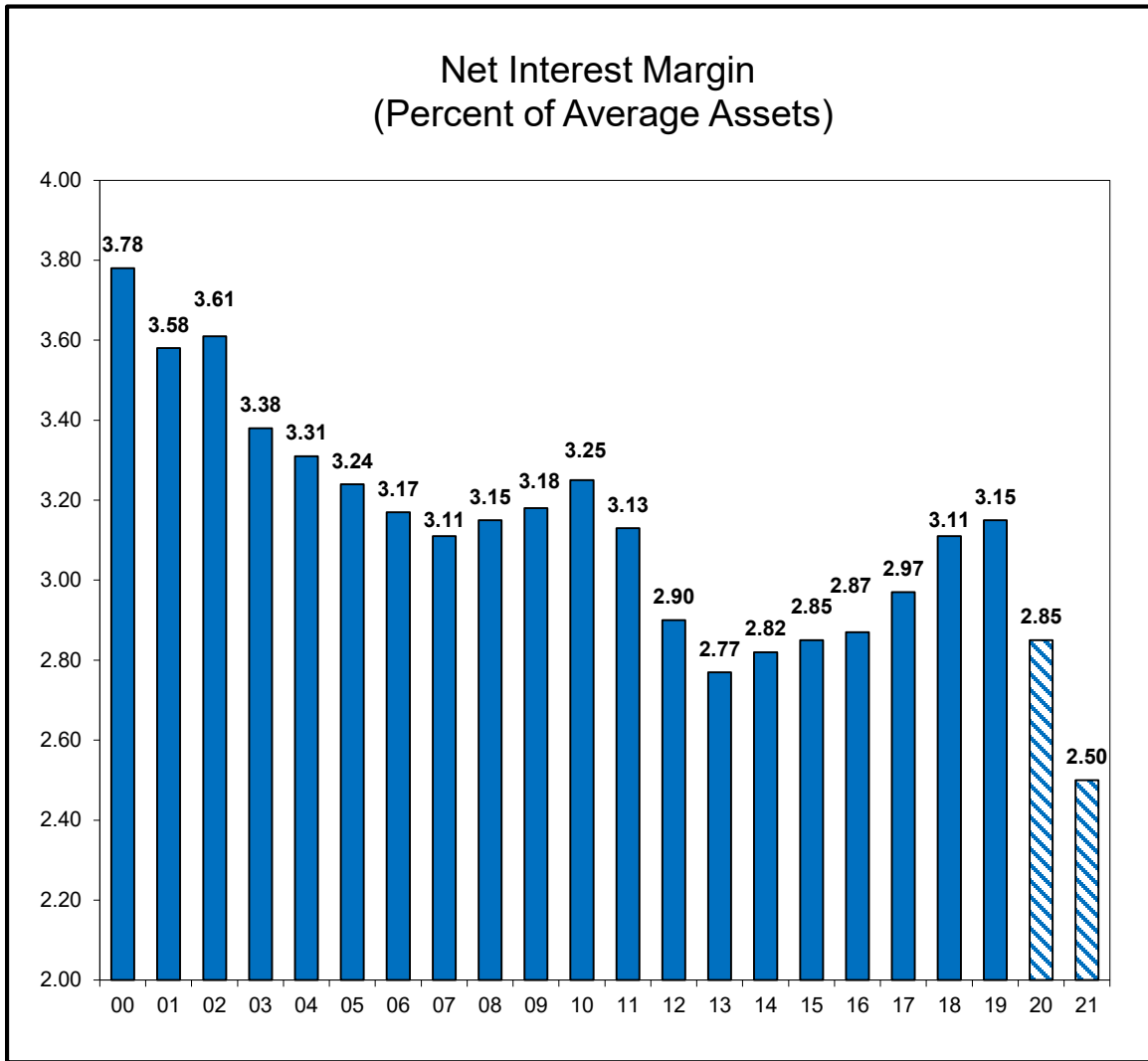
Source: Department of Labor, NCUA, CUNA

Loan charge-off rates rising to 1.5%.

Current Net C/O = 0.58%



Looking Ahead: CUNA Forecasts

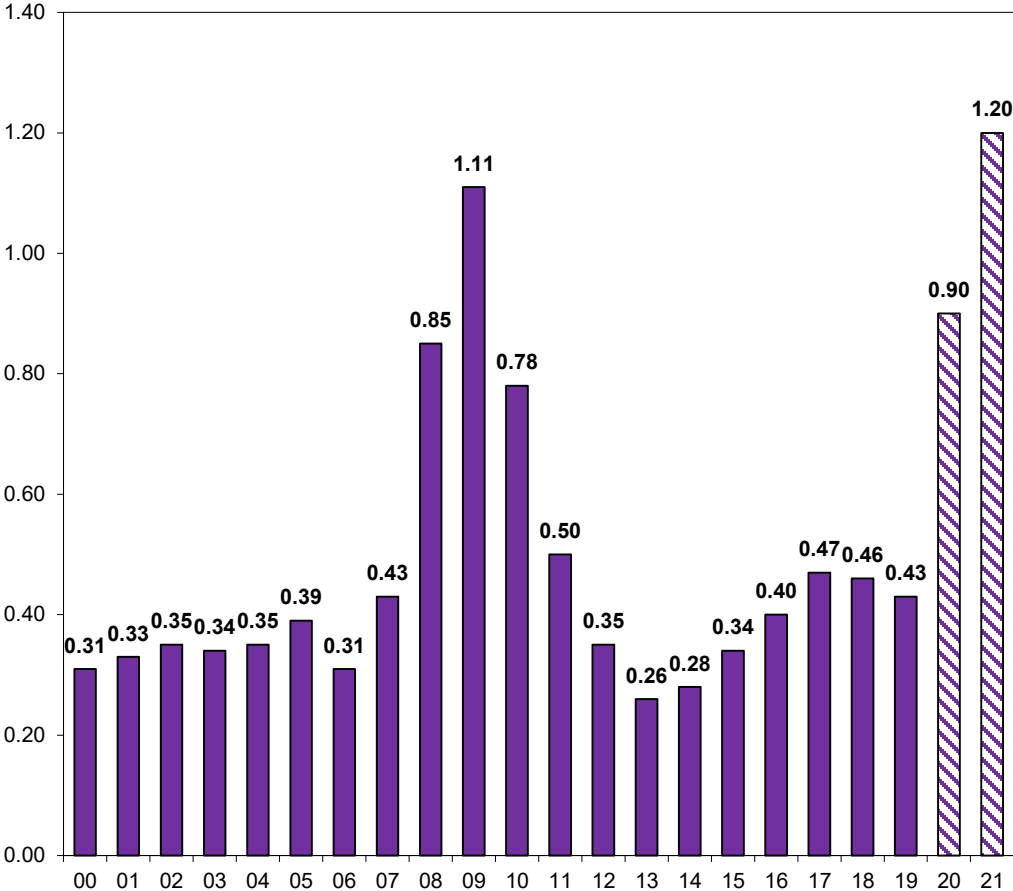


NIM expected to fall to record lows



Looking Ahead: CUNA Forecasts

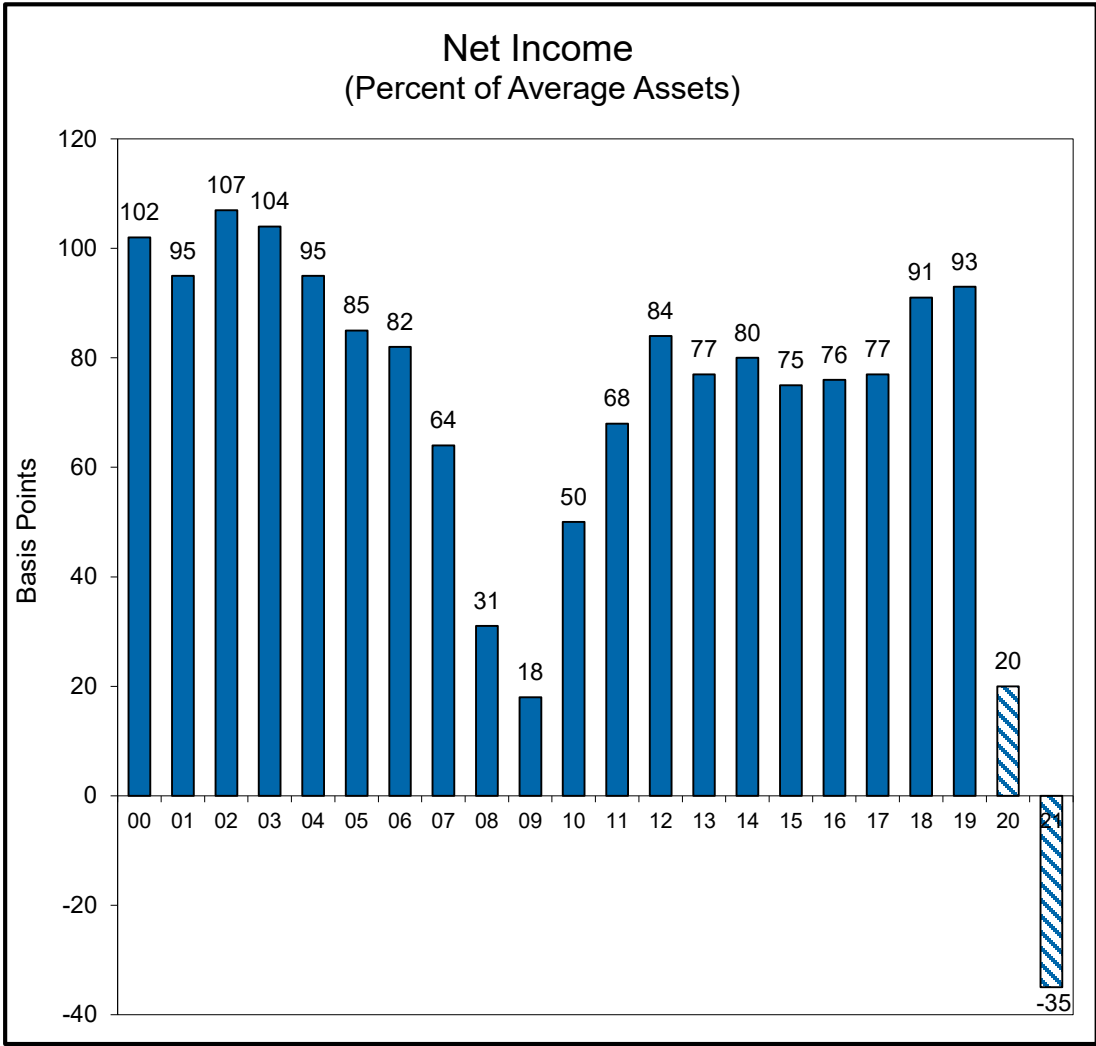
Provisions for Loan Losses
(Percent of Average Assets)



Rising PLL expense



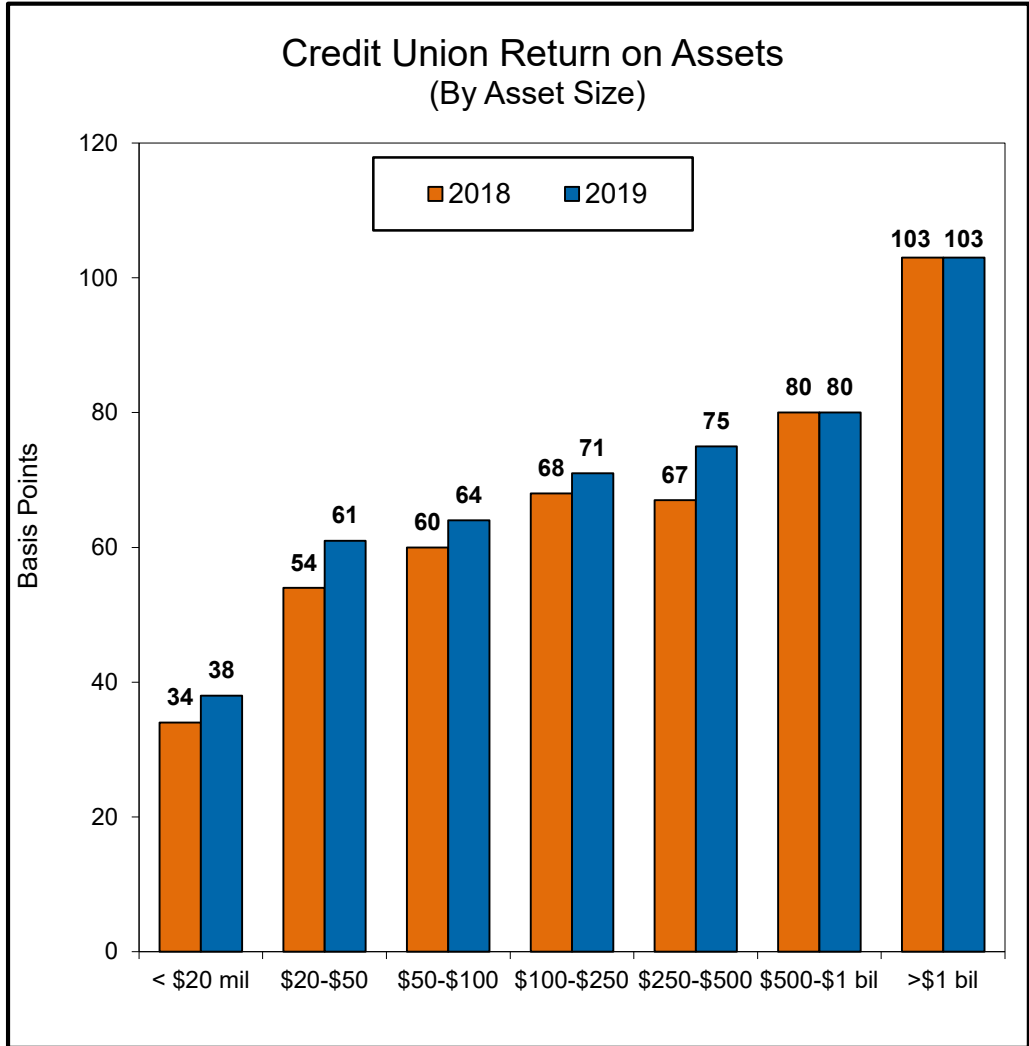
Looking Ahead: CUNA Forecasts



Net income 2021:
Losses projected



Looking Ahead: CUNA Forecasts



ROA large vs. small credit unions

Increased merger activity



Resources



<https://www.ncua.gov/coronavirus>

COVID-19

[For Federally Insured Credit Unions](#)

[FAQs for Federally Insured Credit Unions](#)

[For Credit Union Members](#)

[FAQs for Credit Union Members](#)

[Other COVID-19 Resources](#)



Credit Union National Association

<https://www.cuna.org/COVID19/Resources/>



National Association of
Federally-Insured Credit Unions





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Thank you

