FINANCIAL SERVICES
COMMISSION

GUIDELINE No. 6

CREDIT RISK MANAGEMENT

This Guideline is issued by the Financial Services Commission ("the Commission") pursuant to section 53 of the Financial Services Commission Act 2010-21 ("Act") and comes into effect March 1, 2013.

This Guideline establishes out the standards of the Commission with respect to the management by credit unions of credit risk. Reference should be had to sections 198 to 202 of the Co-operative Societies Act (CSA) and to Regulations 22, 23 and 24 of the Co-operative Societies Regulations, 2008 ("Regulations").

Each credit union is required to implement a policy that addresses the following:

1. **Authorized types and classes of credit instruments** (as permitted by the Commission):

    1.1 Types of loans and classes (e.g. operating loans, term loans, mortgages etc.), eligible loan purposes, terms and amortization periods.

2. **Limits and prohibitions on credit exposures including concentration:**

    2.1 Limits on loans to any one borrower or group of connected persons[1];

    2.2 Loans in the aggregate for each loan type;

    2.3 Loans in the aggregate by industry;

    2.4 Limits on guarantees.

3. **Assessment criteria and security requirements for each authorized credit instrument:**

    3.1 Minimum debt coverage ratios and minimum security considerations for each type of security;

    3.2 Minimum loan and security documentation required to support the loan application;

    3.3 Process for security valuation, registration, insurance and renewal, and for appraisal for real estate loans;

[1] *"Connected people" means an officer, director, member of the Credit Committee, member of the Supervisory Committee or employee of a society and the spouse or children of any such person.*

3.4 Loan agreement and/or loan commitment letter.

4. Credit assessment and monitoring system.

An effective credit assessment system would include:

4.1 Investigation of borrower and guarantor information appropriate for the type of borrower (individual or commercial) and the type, size and nature of the loan, including, as appropriate:

4.1.1 Statement of net worth of individual borrowers and personal guarantors;

4.1.2 Credit bureau reports and major creditor/bank references;

4.1.3 Financial statements (3-5 years) and financial forecasts of commercial borrowers;

4.1.4 Determination of the borrower's ability to properly service the credit facility;

4.1.5 If applicable:

4.1.5.1 Business registration/incorporation documents, authorities, business insurance;
4.1.5.2 Management expertise.

4.1.6 Appropriate forms of security in real and personal property.

4.2 A loan checklist outlining required steps in the application, approval, security and disbursement process.

4.3 Standardized processes for each loan type

An effective credit monitoring system would include:

4.4 A risk rating/risk rating trend of all loans including regular reviews and monitoring for deteriorating trends.

4.5 Tax and insurance payments.

4.6 Identification of higher risk or "watch list" accounts for closer monitoring and follow-up action.

4.7 Timely review of all commercial loans including:

4.7.1 Regular confirmation of operating assets and liabilities;

4.7.2 Interim financial results;

4.7.3 Project status/real estate sales;

4.7.4 Rent and tenant rolls;

4.7.5 Regular exception reports.

5. Defined and prudent levels of decision making authority for approving credit exposures.

These would include:

5.1 Lender approval authorities, including escalating approval levels for large and complex loans, approval for loan write-offs and the required combination of experience, expertise and training for lending staff for the types of credit decision authority assigned.

5.2 Conditions for authorizing loan rewrites, loan postponements and formally restructured loans.

5.3 A process for approval on deviation from policy must be approved by the Board.

5.3.1 loans to restricted parties[2];

5.3.2 excess of lender or credit committee approval authorities where applicable.

6. Management of delinquent and doubtful loans.

This would include:

6.1 Active management of delinquent and doubtful loans including collection and legal activities.

6.2 Ensuring that staff responsible for managing delinquent commercial loans have the appropriate level of knowledge and expertise.

6.3 Appropriate recording and monitoring of rewritten and restructured loans.

6.4 Valuation of the allowance for doubtful loans.

6.5 Defined process for determining the level of non-specific allowance.

For purposes of this guideline loan types are defined as follows:

- ➢ Personal Loans: Consumer loans that are not loans to borrowers for private transport vehicles or that are not residential real estate loans.
- ➢ Private Transport: Consumer loans for private transport vehicles.
- ➢ Residential Real Estate: Consumer loans secured by a mortgage on real property.
- ➢ Commercial Loans: Loans for business purposes.
- ➢ Agricultural Loans: Loans for agricultural business purposes.

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[2] "Restricted parties" means an officer, director, member of the Credit or Supervisory Committees or employee of a society.