STATE OF MICHIGAN
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES

Bulletin 2014-14-CU

In the matter of

Allowance and Reserve Accounts
_______________________________________/

Issued and entered
this 21st day of July, 2014
By Annette Flood
Director

This bulletin supersedes OFIR Bulletin No. 2005-09-CU, dated June 2005.

The purpose of this bulletin is to clarify the various reserves covered in Section 386 of the Michigan Credit Union Act (MCUA), 2003 PA 215, as amended, MCL 490.386, and to set forth reserve requirements for safe and sound operation of domestic credit unions.

Allowance for Loan and Lease Loss Account

Section 386(2) of the MCUA, MCL 490.386(2), requires credit unions to establish an allowance for loan and lease loss (ALLL) account based on reasonably foreseeable losses in accordance with generally accepted accounting principles (GAAP). Statement of Financial Accounting Standards No. 5 requires individual impairment if loan losses are probable and the amount of loss can be reasonably estimated and states accruals for general contingencies would no longer be permitted.

An adequate determination of loan losses must include both an individual appraisal of specifically identified loans and an estimate of losses inherent in the remaining loan portfolio based upon historical loan loss and environmental experience.

The ALLL analysis must reflect appropriate consideration of the institution's credit risk management systems. This interaction may be simplistic relative to homogeneous retail credit pools and rely primarily on delinquency status and loan-to-value (See OCU Letter 2010-CU-01), or may require more robust, individual credit analysis in the case of non-homogeneous pools, such as commercial loan portfolios.

An appropriate credit risk management system, and relatedly the ALLL, should always include recognition of individually impaired loans. Factors to consider when determining collectability include delinquency status, the borrower's documented capacity to service the debt and the liquidation value of collateral securing the loan.

Someone other than the responsible loan officer should perform the appraisal of individual loans. In situations where internal controls are not sufficient, the institution should ensure an appropriate, regularly scheduled independent loan review.

The experience component of the methodology should be based upon a historical average net loss ratio that management can support with appropriate documentation and independently reviewed as part of the financial audit. Newly initiated loan programs, without historical perspective, must include a reasonable estimate of predicted losses until appropriate statistics become available.

The ALLL calculation must comply with GAAP and be supported in writing as part of the audit process. Relatedly, the audit should include appropriate review of internal controls over the modification of due dates, loan-to-value data and other information used in the ALLL methodology.

As prescribed by GAAP, all amounts recovered from charged-off loans shall be placed in the ALLL account until the amount charged has been replenished.

Special Reserves
Section 386(3) of the MCUA, MCL 490.386(3), may require credit unions to establish special reserves. Upon resolution recorded in its minutes, the Board may establish, change, rescind or initiate charges against a special reserve.

Any questions regarding this bulletin should be directed to:

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