STATE OF MICHIGAN

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GOVERNOR

DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES
OFFICE OF CREDIT UNIONS

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TO: Credit Union CEOs and Board Chairpersons
All Credit Union Examination Staff

SUBJECT: Credit Union Information & Safety/Soundness Considerations

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As discussions continue on how to best serve members during these challenging times, the following additional guidance is being provided, that we may all have a common understanding for examinations and in our endeavors to ensure members' financial needs are being met while preserving the safety and soundness of our credit unions and the industry. The Office of Credit Unions supports your efforts to provide needed financial services to your members in a prudent and sound manner. As many new and/or customized products are presently being offered and considered by many institutions in order to meet members' needs during the present state of emergency, I offer the following information and suggestions to help credit union management in considering and managing general risks.

As discussed with many individuals in the industry and in previous correspondences, several institutions quickly began offering customized products to aid members in the present extraordinary times. Such reported products have included:

Lending

1. Skip-a-pay/extension products 1+ months
2. Waived fees for loan applications
3. Small emergency loans
4. Loans with reduced interest rates
5. Short term real estate payment deferments
6. New loans - no payment due for X months
7. Waiving application/modification fees
8. Waiving loan late fees
9. PPP loans (SBA guaranteed payroll loans)

Other

10. Early deposit withdrawal with no penalty
11. Promoting debit card issuance/usage
12. Promoting online/mobile banking
13. Promoting online loan applications
14. Policy changes to permit e-signatures etc.
15. Increasing drive-through service hours/days
16. Increasing withdrawal limits
17. Increasing frequency of ATM stocking

General

Appropriate products may include these and others if implemented in a prudent manner, and within your institution's financial and operational ability to manage and control the related risks. It is critical in these challenging times that your risk management systems and magnitude of such offerings are appropriately sophisticated and commensurate with your institution's short and long-term capacity to withstand the related costs (or foregone revenues) without prejudicing your credit union's safety and soundness.

OCU does not express an opinion on any individual product an institution may choose to offer; credit union boards and management must determine what is appropriate for their institution. It must be recognized that these extraordinary circumstances may result in negative changes for several key ratios; it will be vital for credit union management to understand the risks, their short and long term effect on the credit union, and be able to measure, monitor and control them. Management must implement risk management processes that incorporate these steps and be able to demonstrate the institution will return to stable/positive performance without jeopardizing overall safety and soundness. The following fundamental concepts will continue to be applied to examination reviews.

Financial Trends/Capacity:

Offering a variety of services benefiting members during extraordinary times may result in temporarily increased expenses and/or diminished revenues. It is the responsibility of credit union management to balance any negative financial effects with the benefit to members, with the preservation of the institution's long-term soundness being of foremost importance. Management must be able to demonstrate:

- Exposure to net worth is not excessive, and is reasonably controlled by management
- The impact to earnings is anticipated and controlled by management – supported by reasonable projections illustrating a timely return to stability/profitability
- Reasonably foreseeable loan losses are being reserved for appropriately in the ALLL pursuant to GAAP and the reported net value of loans is fairly stated
- Financial projections and managerial strategies consider potential impacts from current and reasonably anticipated:
  - Decreased investment yield/income and values
  - Decreased loan income from refinance activity or increased non-performing loans
  - Decreased income from increase in cash assets (to meet liquidity needs)
  - Narrowed margins
  - Tightened liquidity
  - Decreased revenues (fees waived or decreased from a decline in usage)
  - Other spikes in loan delinquency/losses/ALLL reserve
  - Under-collateralization of loans which may result from deferred payments and/or market decline
  - Future strains on liquidity from prolonged payment deferments, additional loan demands, etal.
- Ensure performance and projections are frequently reviewed to determine what contingency plans may need to be readied, in the event unforeseen threats to the institution's safety and soundness do emerge

Operational Capacity:

There must be sufficient staff and systems in place and operating effectively, to monitor and manage the products and services being offered. Management must be able to evaluate how the segments of the balance sheet are performing. These will include, but not be limited to:

- Effective systems to accurately identify and report modified loans and delinquent loans
- Skilled and knowledgeable staff necessary to underwrite loan products, administer accounts appropriately and ensure compliance with regulations, and sound business practices

- Effective controls over customer identification and account security. As more services may be handled remotely, strong controls over file maintenance and changes to member contact/identification fields become increasingly essential (phone numbers, email addresses, security questions, etc.)
- Ensure systems are in place which recognize when modification terms expire, normal payments are to resume, and recognize when to reinstate collection efforts
- Ensure undue reliance is not placed on third parties engaged to assist in lending activities. Credit union staff/management must be sufficiently knowledgeable to ensure the credit union's interests are protected and any collateral/guarantee are protected

Payment Modifications/ Loan Products:

Extensions, skip-pays, deferments, forbearances and other modification types can be useful tools to give members additional time to recover from extraordinary circumstances. Important considerations and basic risk management tools include:

- Clear processes for applications, underwriting and approval which are free of discrimination
- Supplying borrowers with clear and compliant disclosures, which can easily be understood by the borrower. Borrowers should be able to fully understand where they will stand at the end of the modification period
- Establishing concentration limits for the portfolio and for each product type, to manage overall risk exposure, and prevent undue liquidity risk and/or undue financial stress from interest rate risk
- Evaluate and control potential liquidity risk associated with a significant decrease in payment in-flows
- Evaluate which modified loans qualify as TDRs, to ensure proper tracking, reporting and accounting for such
- Anticipate situations where negative amortization may result from skipped payments, and have reasonable solutions for borrowers to resume normal payments
- Ensure staff are appropriately trained and knowledgeable in making sound credit decisions which do not disguise existing collection problems or underreport classified assets
- Ensure collateral/guarantees are preserved wherever applicable. Ensure the credit union's contractual obligations (loan covenants, collateral agreements, and guaranty requirements) are satisfied and evidence/documentation of such is maintained at all times (regardless of whether granted internally or through a third party)

While these concepts are not new nor applicable only to these extraordinary circumstances, all examiners and credit unions must be familiar with the basic tenets of safety and soundness. I encourage credit union executive management to strive to keep your Regional Supervisor informed of any material changes in the credit union's operations, product offerings, financial condition, or strategic direction. I expect examiners to evaluate the condition of each institution based upon its individual merits, management's effectiveness, compliance with consumer protection standards, and its long-term prospects for viability, safety and soundness.

This guidance may be updated periodically. Nothing herein modifies or supersedes any existing law or regulation.

If you have any questions, please feel free to contact this office or your Regional Supervisor.

Sincerely,

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