CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

GUIDANCE

Business Case: Third Party Opportunities or Special Lending Programs

Reference: Standards of Sound Business and Financial Practices

G-8 Oversee Strategic Management
G-9 Oversee Risk Management
M-2 Risk Management Process
M-3 Credit Risk
M-4 Investment Risk

Standard G-8 Oversee Strategic Management requires the credit union board to establish business objectives, consider and approve business strategy and plans for significant operations, and review those at least annually to ensure they remain appropriate and prudent. The Board is to frequently evaluate actual operating and financial results against forecast results, in light of the credit union's business objectives, strategy and business plans.

Standard G-9 Oversee Risk Management requires the credit union board to establish appropriate and prudent risk management policies to mitigate risk exposures. The board is to obtain regular and reasonable assurance that there is an ongoing, appropriate and effective risk management process and that policies are being adhered to. The board is required to review risk management policies at least annually, to ensure they remain appropriate and prudent.

Standard M-2 Risk Management Process requires the Chief Executive Officer and Senior Management to ensure the credit union has an ongoing and effective risk management process.

Standard M-3 Credit Risk requires a credit union to have documented appropriate policies on the areas and type of credit in which the credit union is willing to engage and appropriate and prudent policies on exposure limits for a single risk, associated or connected borrowers, specific industries, geographic regions and other credit exposures warranting aggregation.

Standard M-4 Investment Risk requires a credit union to have documented appropriate policies on exposure limits for a single issuer, groups of associated issuers, types of financial instruments, industries or economic sectors, geographic regions and other market exposures warranting aggregation.

Introduction

Outlined below is a guideline for credit unions to consider in the development of their business case and related policies for third party opportunities or Special Lending Programs. A business case is required for submission to credit union boards, and the Corporation, where credit unions have or anticipate having a specific program outside normal lending or investment policy parameters, or where a counter party risk is evident.

Business Case: Third Party Opportunities or Special Lending Programs

Overview

- Credit unions that wish to be involved in third party products or special lending programs are to exercise caution and due care.
- Reputation, opportunity and financial risk should be clearly articulated in the business case, as well as the potential risk to capital.
- The credit union board should understand the contents of the business case and fully appreciate the associated risks prior to providing their approval. This discussion includes direct lending or indirect managed product through the investment portfolio of the credit union.
- The credit union must have a policy, approved by its board and reviewed by the Corporation, which specifically addresses its third party or special program lending. This policy would articulate constraints and typically be contained within an overarching board level Credit Risk Management Policy.

Business Case

Content	Comments
Background	Brief status of the credit union and its financial position. Identify the purpose of the business case.
Opportunity	Rationale for participating in the product and expected benefits. Identify the type of lending (e.g. mortgages, consumer loans, Dealer Plan, commercial loans) and establish a "cap" (maximum to be lent out, in aggregate, with these products) which is to be imposed.
Best Case, worse case, expected case scenarios	Define the profitability scenarios and the assumptions which are related to them.
Impact on Capital	Refer to comments below.
Alternatives	The alternative uses of capital and the potential rate of return and balanced risk assessment (pros and cons) for those alternatives.
Enterprise Risk Assessment	Likelihood and impact of risk. Assessment of risks including credit, market, liquidity, operational, reputation, opportunity and financial risk, and summary of risk to capital. The mitigating factors and tolerance level of these risks.
Compliance with legislative requirements	Address those legislative issues which affect the product and approvals required.
Controls	Explain the controls which will be in place. Include initial due diligence required (e.g. audit individual loans, credit risk assessment of third party) and ongoing requirements (e.g. periodic audits, annual credit risk assessment of third party).

Business Case: Third Party Opportunities or Special Lending Programs

Content	Comments
Reporting	Outline the requirements and frequency of reporting or monitoring, managing and mitigating the concentration risk against agreed policies and limits.
Investment in or loans granted by third parties	Full disclosure of the third party, the relationship with the credit union and their financial position and management ability. In the case of a loan purchase from a third party originator, a review of underwriting, collections, and portfolio performance to ensure risk and policies align with those of the credit union, or, to detail and mitigate material differences.
Policy	Refer to comments below. The policy related to the business case should be appended.

Capital

- The risk rating of assets for capital requirements is based on average losses for each asset category and does not take into account the actual portfolio composition.
- Adding or participating in a particular product requires an assessment of capital which would be considered adequate to offset potential above average risk.
- The assessment should be documented through an internal capital adequacy assessment process (ICAAP), or, if more appropriate to the size and complexity of the credit union, be part of a more informal active capital management procedure.

Policy	Documented Comments (as applicable for the proposed business opportunity)
Type	The type of third party product, investment, or special lending program.
Cap	The "cap" exposure expressed in dollars as well as a percentage of capital, taking into consideration legislative requirements.
Parameters/Criteria	For Special Loans Programs, distinct underwriting guidelines. The basis and rules for lending; security, TDSR, GDSR, credit history, type of business, tolerance levels, etc. For other counterparty risks or investments, specifics as to minimum investment rating or credit risk rating, etc.
Controls	For Special Loans Programs, early aggressive follow up on delinquent loans. For counter party risks and investments, action to be taken in the case of deteriorating ratings.

Business Case: Third Party Opportunities or Special Lending Programs

Policy	**Documented Comments** (as applicable for the proposed business opportunity)
Establishment of Specific Provision	Special Loans Programs, at 90 days, realization value assessment to be completed for mortgage secured products and balance to have a specific provision. For unsecured loans a full provision is to be applied. For counterparty risks and investments, individual assessment to determine the likelihood of full recovery, with provision for identified deficiency.
Segmentation	The portfolio or investment should be segmented for tracking purposes.
Management	Such programs should be centralized so that appropriate continuity in administration, accountability and control is ensured.
Approval Process	Step by step approval process for Special Loans Program loans.
Remuneration Expectations	Interest rate and fees. Premium pricing to offset the risk, if applicable.