**Credit Union Deposit Guarantee Corporation**

**Model Policy – Board Credit Risk Management**

The following is an outline of a comprehensive Credit Risk Management Policy, for Board approval and annual review. Any risk tolerance levels included within the model policy are for illustrative purposes only. This comprehensive model policy should be amended, or augmented to reflect the unique characteristics of the credit union, including the scope of credit risk activities, and the sophistication of risk management and technology.

***(Please delete this text box)***

***Board Credit Risk Management Policy***

***Month/Day/Year***

|  |
| --- |
| Policy Recommendation/Approval |
| Version | Original | Review | Responsibility | Date |
| 1.0 | X |  | Management Credit Committee |  |
| 1.0 | X |  | Board (Risk) Committee |  |
| 1.0 | X |  | Board of Directors |  |
| 1.0 |  | X |  |  |
| 2.0 | X |  |  |  |
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# Background

Credit risk is the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms. Settlement risk is the potential that completion of a financial transaction will fail to occur as intended and will be considered as a subcomponent of credit risk, where appropriate. A customer automated funds transfer (CAFT) facility, that is not pre-settled, is one example of settlement risk. will manage credit risk inherent in the portfolio, including concentration risk as well as individual, connected and related credit risk of loans, guarantees and transactions.

The Board Credit Risk Management Policy (CRMP) is the responsibility of the Credit Department, prepared with stakeholder input and recommended by the Management Credit Committee (MCC) for approval by the Board (Risk) Committee and the Board of Directors. The CRMP requires sound practices for the management of credit risk and applies to all lending and other activities that incur credit risk. CRMP exceptions, where allowed, are subject to exception approval guidelines, and regular reporting, in a time frame related to the materiality and severity of the exception.

Lending requirements may be restricted through other Board Risk Management Policies, including Non-members, Investment, Liquidity and Capital.

# Credit Risk Philosophy

The Board of Directors has the responsibility to establish an appropriate credit risk philosophy, including credit strategy and risk appetite. Senior Management has the responsibility to implement the philosophy, strategy, and appetite, including establishing an appropriate credit risk culture, throughout the organization. The Board has approved a conservative risk philosophy, that will encourage realizing opportunities for profit, while minimizing financial and reputational risk. This conservative philosophy is to be applied on an enterprise wide basis, and to be a prime focus of strategic and operational planning, ensuring the continued operations of the credit union, while sustaining brand and shareholder value.

## Regulatory Requirements

The CRMP must incorporate regulatory and legal requirements, including:

* The Credit Union Act – Alberta (The Act)
* The Credit Union Principal & Ministerial Regulations (The Regulations)
* Laws of the Province of Alberta and Government of Canada, as applicable, including Privacy, Anti-Money Laundering and Terrorist Financing, etc.

## Industry Best Practice

The CRMP must be materially consistent with Credit Union Deposit Guarantee Corporation (CUDGC) Lending Guidelines, Guidance and Standards of Sound Business and Financial Practices, which reflect Industry best practice/standards;

The CRMP will incorporate other industry best practice, where appropriate, such as credit risk management principles outlined by The Office of Superintendent of Financial Institutions Canada (OSFI), and Principles for the Management of Credit Risk outlined by The Bank for International Settlements, Basel Committee on Banking Supervision (Basel).

# Credit Risk Appetite

The Board of Directors has approved a conservative and balanced risk philosophy to include:

* Approval and annual review of prudent lending risk policies, supporting safety and soundness of the credit union.
* Management implementation of effective lending operating policies, and procedures, including appropriate internal controls, for monitoring and reporting on compliance and non-compliance with Board risk policies.
* Development and adherence to Board approved concentration limits, credit key risk indicators (KRI) and credit key performance indicators (KPI).
* Annual or multi-year business plans and business objectives, such as loan growth, are to be consistent with the CRMP, including risk strategy and risk appetite.
* will only participate in lending situations where sales and credit management have developed an appropriate level of knowledge and skills to assess and monitor the particular risk.
* Credit Department will review and approve credit risk embedded in new products, and may implement product concentration limits, monitoring and reporting.
* Delinquent loans 60-days and higher, are to be contained within a range of % to % of total loans.
* Impaired loans are to be contained within a range of % to % of total loans.
* Loan write-offs are to be contained within a range of % to % of total loans.

# Credit Authorization

discretionary lending limits for all borrowing classes are requested by the credit union board and confirmed, in writing, by CUDGC to the CU Board, who will then delegate appropriate limits and conditions to the CU Management Credit Committee (MCC).

The MCC, operating under their terms of reference, as per Appendix “E” attached, will approve a credit authority framework to be utilized by the CEO/Senior Credit Officer in delegating lending limits to credit adjudication and sales staff. Delegation of lending authorities will be based on the risk assessment competency and credit skill level of the individual, irrespective of the staffing position held.

The credit authority framework will include a periodic and regular review of a sample of loans approved within the delegated approval limits, to ensure that safe and sound underwriting practices and /CUDGC Lending Guidelines are applied with any allowed exceptions documented, mitigated and approved. This may be accomplished through a combination of periodic reviews by officers with higher lending limits and/or an internal loan review program.

# Risk Ratings

## Retail

Consumer lending will be adjudicated based on a credit score, (customized or Beacon) as developed by Retail Credit. Authority to extend exceptions outside the approved credit score ranges will be subject to an exception credit review and appropriate risk mitigation. Retail loan origination will be monitored by credit score bands and the credit score approval range adjusted where appropriate, based on historical delinquency, default and write-offs and the risk appetite.

## Commercial

Non-consumer loans will be subject to a Borrowers Risk Rating (BRR) model that grades the borrower based on risk characteristics outlined in CUDGC Business Lending Guidelines. Risk groupings include the following categories:

**BRR 1 through 4**  Excellent to Acceptable Risk

**BRR 5** Caution Risk

**BRR 6** Watch Monitoring

**BRR 7** Watch Concern

**BRR 8** Doubtful

**BRR 9** Impaired

The BRR is applied on a member basis on the whole credit relationship and will be downgraded when incremental risk is identified.

A status report will be provided covering Watch (BRR 6 & 7) and Doubtful (BRR 8 & 9) loans for review by the MCC and Board (Risk) Committee at least quarterly. A copy of the WATCH and Doubtful Loan report will be forward to CUDGC quarterly. will monitor and report on the distribution of BRR, including outstanding exposure and trending on a product basis (Agriculture and Commercial loans).

# Credit Risk Assessment and Adjudication

All requests for credit will be assessed based on the 5 C’s, including:

* **Character**: Management ability, financial strength(s)
* **Capacity:** Ability to pay
* **Collateral:** Appropriate security based on policy and guidelines, which will be consistent with CUDGC Lending Guidelines, where appropriate
* **Conditions**: Credit structure, credit environment, risk appetite
* **Credit:** Credit history.

All requests for credit must comply with policy and guidelines and where allowed, exceptions will be highlighted, mitigated, authorized and monitored.

Credit approval will be contained within assigned credit authorization limits, which will be subject to periodic review by the Credit department. All credits forward to Credit department for adjudication must have the support and full recommendation of the Commercial/Retail Sales Departments. The originating officers and those who recommend approval to higher authority levels maintain accountability for the ultimate credit decision.

Assigned credit authorization limits will be subject to connected account requirements within the Credit Union Act, Regulations and CUDGC Lending Guidelines.

Credit decline decisions, below the lending limit authorized for the Senior Credit Officer, will be subject to confirmation by a “one-up” level credit authority.

Syndication lending will be subject to a full credit assessment and due diligence investigation, independent of decisioning made by the syndication leader. The Credit Union Act requires CUDGC credit approval for syndications where the aggregate loan amounts exceed any one of the participating credit union's lending limits.

All non-consumer loans will be subject to a minimum annual review, as per the following policy section under “Credit Administration”, unless specifically exempted by the appropriate exception and BRR level for credit authority.

# Special Borrowing Classes

## Direct, Connected & Related Borrowings

Credit authorization limits will be applied to the aggregate direct and connected loan exposure as defined in the Credit Union Act, Regulations and CUDGC Lending Guidelines. **Maximum $X (X % Available Capital).** *The Board risk appetite should consider direct and connected exposure limits lower than the regulatory maximum.*

Group (Direct, Connected and Related) **Maximum $X (X % Available Capital).**

Residential Mortgage Loans: **Maximum $X (i.e. $1,000,000).**

## Directors & Related Parties

Loans to directors and their related parties, as defined by the Act, Regulations and CUDGC Lending Guidelines are subject to approval by the Board. The Board may pass a special resolution allowing management to approve loans to directors, and their related parties, subject to regular reporting to the Board. Loans approved under the special resolution are to be forward immediately on approval to CUDGC through the Loan Transaction Review Program.

Loans to Directors and their related parties are to be at fair market rate, not to exceed amounts prescribed by CUDGC and otherwise consistent with the Credit Union Act, Regulations and CUDGC Lending Guidelines.

Loans to directors in arrears exceeding 45 days are to be reported to CUDGC and the Alberta Superintendent of Financial Institutions. Should arrears exceed 60-days, the borrower is no longer eligible to sit as a Director of .

## Staff

* Loans to the President and CEO are subject to the Senior Credit Officer confirming the loans meet the approved policy and pre-approval by the Board, within the Credit Union’s discretionary lending limits.
* Loans to Senior Officers (Vice President and higher) are to be recommended by the Senior Credit Officer and approved by the President & CEO, within staff approval limits assigned by CUDGC.
* Loans to all other staff are to be approved within the approved credit authority framework and within staff approval limits assigned by CUDGC.
* All loans exceeding the staff approval limits, and within the (regular) discretionary limits assigned in writing by CUDGC require prior Board approval.
* All Senior Officer loans, including the president & CEO and all other employee loans aggregating more than $XXX,000 are to be reported to the Board at their next scheduled Board meeting.

# Market Service Area Exposure

 loan exposure is expected to be primarily within the Market Service Area (MSA), as defined by the Board (Risk) Committee. Non-consumer loan exposure, including Syndicated loans, outside of the MSA is to be limited to a maximum aggregate amount of % of available capital.

# Syndication Lending

Syndicated loans are to be consistent with CUDGC subject matter guidelines and subject to a maximum aggregate amount of % of available capital.

# Non-Member loan Exposure:

principal purpose is to provide loans to its members in alignment with the CU Act S 26 (1). Loans to non-members are restricted to conditions prescribed under the CU (Principal) Regulations.

Non-member loans may be considered to manage a temporary liquidity surplus, representing imbalances between member deposit and member loans. Board approval is required where the Loan/Deposit ratio exceeds 92.5% and will not be available if the loan/deposit ratio exceeds 95%. Exceptions require Board (Risk Committee) approval. Aggregate non-member loan exposure will be contained within a maximum of 15% of total loans, including the following loan programs, approved by CUDGC under a Special Loans Program:

* Residential Mortgage Pools maximum 10%  total loans
* Syndicate participations (excluding CU lead syndications) maximum 5% total loans
* Other Special Loan Programs maximum 5% total loans.

Note: The above limits are examples and should reflect the Board risk appetite. The limits may also be presented as a percentage of available capital.

# Real Estate Lending

## Retail

Residential mortgage lending represents a material loan exposure within the credit union’s loan mix. Mortgage lending practices are required to be prudent, take into account market developments and contain appropriate risk controls to support the safety and soundness of the credit union. Residential mortgage concentration should be a critical component within portfolio risk management activities and the Board risk appetite.

The Board will provide “high level” guidance and oversight relative to Management’s development of a Residential Mortgage Underwriting Policy (RMUP).

The RMUP, as a stand-alone management operational policy, or a compilation of mortgage policy and procedure documents, will reflect industry best practice, including consideration of the following fundamental principles for sound residential mortgage underwriting:

1. Residential mortgage practices and procedures will comply with the credit union’s comprehensive Residential Mortgage Underwriting Policy, with concentration limits approved within the Board Risk Appetite framework, and aligned with the Enterprise Risk Management framework.
2. Reasonable due diligence is required to confirm the mortgagee’s identity, background, employment and demonstrated willingness to service debt obligations on a timely basis.
3. will complete a diligent verification of the borrower’s income. Collateral values are not a substitution for income verification. Capacity to service debt obligations on a timely basis will be adequately assessed. Income should be calculated conservatively and resilience assessed appropriately, particularly for inclusion of rental income. The Gross Debt Service Ratio (GDSR) and Total Debt Service Ratio (TDSR) for uninsured mortgage and HELOC originations, is to be stressed, based on the greater of the contract rate plus 200 BPS or the Bank of Canada 5-year mortgage rate.
4. Sound collateral management and appraisal processes for the underlying mortgage properties. Maximum Loan-to-Value on all mortgage products is to be dynamic, relative to the value of the mortgage and local residential market conditions. The Standard Loan-to-Value is a maximum 65% for uninsured non-conforming mortgages and Home Equity Lines of Credit. Effective credit and counterparty risk management practices and procedures that support residential mortgage underwriting and credit portfolio management, including, as appropriate mortgage insurance.

Exceptions may be approved, if mitigated or warranted, documented within the mortgage application and approved under appropriate approval authorities. The aggregate number and amount of exceptions will be reported by exception type to the Board or Risk Committee at least annually for:

1. Stressed GDSR and TDSR that exceed maximum mortgage debt service capacity guidelines.
2. Loan-to-Value greater than 65% and less than 80% for unamortized Home Equity Lines of Credit and uninsured non-conforming mortgages.

The RMUP will apply to residential mortgages, home equity lines of credit and other consumer financial products that use residential property as security, including mortgage pool purchases where individual borrower credit risk belongs to the credit union.

Loans secured by residential mortgages must comply with quality mortgage loan requirements of the Credit Union Act and Regulations and be consistent with CUDGC Lending Guidelines, including the maximum prescribed fair market lending value, unless the excess is covered by a government guarantee or mortgage default insurance.

Maximum lending values for uninsured mortgages will be based on a sliding scale by discounting appraised values based on exposure over a specified amount and by geographical location, managed by the credit oversight function.

Uninsured non-conforming mortgage exposure will be contained within a maximum of 5% of the total residential consumer loan portfolio.

Residential mortgages in excess of 25-years, to a maximum of 30-years are to be monitored and contained within 15% of the total uninsured mortgage portfolio. 🡨 Note if allowed

Residential mortgage terms in excess of 5-years to 10-years, Are subject to aggregate exposure limits approved by Finance and Credit departments. 🡨 Note if allowed

Aggregate out of province and out of market service area mortgage loan exposure through direct loans, loan syndications or loan portfolio purchases (with credit risk exposure) will not exceed X% (e.g. 10%) of the total residential consumer loan portfolio.

Management will establish standard and exception maximum lending values by product, based on the risk characteristics of each mortgage product (sample table in appendix ``B`` attached).

The Board will require timely, accurate, independent and objective reporting on risks inherent in the residential mortgage business. Board reports will include, at a minimum, quarterly and year-to-date aggregate origination statistics by mortgage product, including segregation by material geographic exposure, lending value and amortization buckets. Management will monitor and report on total mortgage concentration by product and material geographic location, or by location determined to represent incremental risk.

Management will provide an annual declaration to the Board confirming the credit union’s residential mortgage underwriting and acquisition practices, risk management practices and procedures are materially in compliance with the Residential Mortgage Underwriting Policy, with any material exceptions and changes to the previous policy noted.

## Commercial

Loans against commercial or multi-family real estate are generally not to exceed 65% of the lower of cost or appraised value, although exceptions to a maximum of 75% as prescribed under CUDGC Lending Guidelines may be approved based on the merits and risk mitigation of the individual request. Exceptions are to be clearly outlined in the credit application, outlining mitigating factors, and where approved, included in aggregated exception reporting to the Board (Risk) Committee. Commercial mortgages exceeding 75% of the lower of cost or appraised value require CUDGC approval.

Loans against hospitality real estate are generally not to exceed the standard lending values prescribed in the following table, although the exception lending value may be approved, based on the merits and risk mitigation of the individual request. Exceptions are to be clearly outlined in the credit application, and if approved, included in risk exception reporting to the Board. The exception lending value is further subject to maximum lending values and terms approved by CUDGC, including the Corporation’s Hospitality Lending Guidelines. (Note: The following type of table could also be utilized to establish standard and exception lending values for commercial real estate, addressed in the previous paragraph)

|  |  |  |
| --- | --- | --- |
| Hotels | Standard Lending Value Value\* | Exception Lending Value  |
| Prime Market | 65% | 70% |
| Secondary Market | 60% | 65% |
| Tertiary Market | 55% | 60% |

## Total Commercial Real Estate

Aggregate loans to Commercial Mortgages, Construction and Hospitality will not exceed 150% of available capital, including:

* Commercial Mortgages 125% Available Capital
* Construction 25% Available Capital
* Hospitality 50% Available Capital

## Appraisals

 is to maintain a list of approved appraisers. Appraisals are to include valuations based on direct sales and net income capitalization and where the purpose is construction, an additional valuation for replacement cost. The lowest of the three methods should normally be considered for lending purposes; however, the Appraiser’s Final Value may be used, as an exception, if the other methods are reviewed, addressed within the credit application and the Appraisal final value is determined reasonable. Based on a review of the appraisal, including appraisal income, CAP rates and sales comparables, a lower Manager Valuation may be appropriate.

may require appraisals to be commissioned by the credit union, where borrowing risk is assessed as elevated. Where appraisals are commissioned by the borrower or not prepared for the credit union, the appraiser is to provide a conveyance letter. Appraisals are to be subject to lender due diligence, particularly relative to direct sales comparables, net operating income determination and capitalization rates. Where the internal review indicates a lower value may be appropriate, the lower manager’s valuation will be used for lending purposes.

## Environmental

Environmental conditions are to be addressed when lending against non-consumer real estate, with the exception of non-intensive farm property and appropriate documentation maintained, including an environmental indemnity agreement from the borrower. is to maintain a list of approved environmental engineers. Environmental assessments are to be subject to lender due diligence. Material environmental concerns are to be monitored and included in periodic Board reporting.

## Mechanical & Building Condition Reports

Mechanical and building conditions are to be addressed and documented when lending against non-consumer real estate, with the exception of non-intensive farm property. is to maintain a list of approved Engineers. Condition reports are to be subject to lender due diligence. A maintenance reserve may be required to fund material structural and maintenance concerns identified within the report.

# Credit Administration

 will establish and implement appropriate operating policies, guidelines and processes, supporting the Board’s credit risk strategy and appetite, promoting sound credit risk management for loan underwriting; loan approval; security preparation and registration; loan funding; amendments; annual reviews; security maintenance; collection of arrears and special debt management.

Segregation of duties for credit, sales, loan processing and special debts is required to promote independence and integrity of the loan system, where resources are available, and where not available mitigated by appropriately mitigating and compensating internal controls.

A pre-disbursement compliance audit will be completed prior to advancing funds with any material exceptions authorized prior to funding. An out-of-order report including expired loans, security deficiencies, and margin deficiencies is to be maintained, and actioned on a regular basis.

# Annual Reviews

Non-consumer loans will be subject to an annual review in a format commensurate with the risk of the individual exposure. Exemptions may be approved by the appropriate exception authority level. Commercial loan agreements will include appropriate conditions for an annual review, including provision of updated financial statements and covenant compliance.

Minimum annual review requirements typically include:

* Full review of corporate financial statements
* Full review for covenant compliance
* Updated BRR worksheet
* Members who have been provided inventory financing will be subject to at a minimum, an annual on-site review.

# Delinquent Loan Management

Management will establish a collections operating policy supporting a robust delinquency management program to reduce potential losses from delinquent loans. Collection activity should elevate from the Line of Business to Credit and subsequently to Special Debts based on the age of the delinquency, exposure amount or requirement for special handling to mitigate losses.

A Notice of Default should be issued to the borrower and guarantors when a default is material or when arrears exceed 90-days, unless an exception is approved by the “Vice President Credit”. Delinquency ratios and trends will be monitored relative to approved tolerance levels reported monthly to Senior Management and quarterly to the Board (Risk) Committee.

# Impaired Loan Management

Loans will be transferred to impaired status consistent with IFRS 9 standards, based on the occurrence of one of the following events, where there is a significant impact on expected repayment:

1. “Significant” financial difficulty
2. Breach of contract, including principal or interest delinquency 90-days or more in arears (Specialized financial instruments, such as Conditional Sales Contracts will be considered in default at 60-days in arrears).
3. Lender granting a concession that would otherwise have not been granted, other than due to financial difficulty
4. Probability of bankruptcy or financial reorganization
5. Disappearance of an active market for a financial asset because of financial difficulties or
6. Observable data supporting a measurable decrease in estimated future cash flows from a group of financial assets.

AND

There is objective evidence that an impairment loss is expected, based on the difference between the book value and the net present value of future recoveries.

Senior Management will develop a process to review and report impaired loan activity, including updated provisions to the Management Credit (Special Debts) Committee and Board (Risk) Committee at least quarterly.

# Loan Loss Allowances

 will prepare a separate Loan Loss Allowance policy for Board (Risk Committee) approval and annual review. The policy should address the following components:

* Board allowance strategy
* Guiding Principles
* Model description
* Model application
* Reporting and approval

## Collective Allowance (Provisions)

will develop and maintain a collective allowance model to establish an appropriate level of provisions, mitigating potential losses from loans that are impaired, however not yet specifically identified. The collective allowance model will be consistent with accounting and regulatory guidance and industry best practice, recalculated on a minimum quarterly basis and approved by the executive/management (credit) committee. Changes to collective model methodology require approval of the Board (Risk Committee). *(Note this will incorporate requirements of an expected loss model effective November 1, 2018)*

## Specific Allowance (Provisions)

Specific provisions will be established by the Credit Department for each impaired loan, based on the estimated loss after deducting the net realizable value of security held. Net realizable value will take into account costs of disposal. Where impaired loan exposure is greater than $1,000,000 and recovery is expected to be protracted more than 1-year, the net realizable value is to be reduced through a net present value calculation. Specific provisions will be approved by the Management Credit (Special Debts) Committee and reviewed at least quarterly.

# Write-offs

Loans will be written off when there is no reasonable expectation of further recovery. Credit cards and unsecured overdrafts will be written off when they reach 180-days in arrears.

The Management Credit Committee may delegate specific write-off limits, supported by appropriate reporting. The Management Credit Committee will provide a (minimum) quarterly summary write-off report to the Board (Risk) Committee. Loans written off will be reviewed periodically and records, including judgements, where applicable maintained to support the potential for future recovery.

# Risk Tolerance Levels

Senior Management has developed key credit risk indicators for Board approval, as per Appendix “A”. Key Risks include delinquencies, watch accounts, defaults, expired loans and loan losses on a product basis. Performance reporting will be provided to Management monthly and the Board (Risk/ERM Committee) at least quarterly.

# Concentration Limits

Management has developed credit concentration limits, including those required under CUDGC Lending Guidelines for Board approval, as per Appendix “B”. Concentration limits include line of business, industry exposure, including commercial real estate and hospitality, geographical exposure, direct and connected borrower exposure, and global exposure. Concentration reporting will be provided to Senior Management monthly and the Board (Risk Committee) at least quarterly.

# Counterparty Risk

Counterparty risk must be monitored and approved within assigned credit authorization limits, through a formal credit application process. Counterparty risk includes, for example aggregate credit exposure to a Financial Institution, including investments or derivative contracts sourced directly or through intermediaries, such as Credit Union Central of Alberta.

# Stress Testing

## ***Individual Stress Testing***

Risk analysis for credit applications in excess of $ million will include an interest sensitivity analysis that indicates the borrower produces sufficient cash flow (i.e. DSCR 1.00 or better) to meet scheduled payments incorporating an interest rate of basis points higher than the current 5-year fixed interest rate. Multi-scenario simulations should be considered, such as lower cash flow resulting from higher lease vacancy rates, combined with increased debt service requirements from higher interest rates, etc.

## ***Portfolio Stress Testing***

A credit stress testing program, as a component of the credit union’s ERM and ICAAP stress testing processes, will be maintained to assess the risk of default, on a portfolio basis with results and recommendations presented to the Board (Risk Committee). Stress testing should incorporate multi-scenario analysis where appropriate, including credit union specific and macro-economic default/loss drivers. The Commercial Real Estate sub portfolio will be subject to stress testing at least annually. Portfolio stress testing will be a component of ’s overall Enterprise Risk Management stress testing program.

# Early Warning Signals:

Early warning triggers will be developed for commercial borrowings in excess of $ million to indicate increased risk, requiring increased monitoring and initiating communication with the borrower, before a default condition is incurred. The BRR will be reviewed and downgraded, where warranted.

Portfolio early warning signals will be developed to trigger analysis, monitoring and reporting, including any recommended corrective action, and potentially result in a model review of collective allowances. Early warning signals could be based on internal indicators, such as a material increase in migration of BRR; increased migration of delinquencies between 30-60 or 90-days or a specified percentage of delinquency or default on a portfolio or product basis. Early warning signals will also be based on external events, such as a specified increase in the unemployment rate or increase in interest rates.

# Reporting

Monthly reporting to Senior Management and quarterly reporting to the Board (Risk) Committee will include quantitative data on current positions and trending, relative to stated risk tolerances as well as qualitative information, including corrective action, where appropriate. These reports include out of order, watch list, and impaired loans, with relative risk tolerance statistics and benchmarks.

# Effective Date

This Board Credit Risk Management Policy is effective upon approval by the Board of Directors and subject to annual review.

# References

The Credit Union Act - Alberta

The Credit Union (Principal) Regulations

The Credit Union (Ministerial) Regulations

Credit Union Deposit Guarantee Corporation Standards of Sound Business and Financial Practices

Credit Union Deposit Guarantee Corporation Lending Guidelines, including:

Connection Rule and Direct Obligations

Borrower Risk Rating

Higher Risk Loans

Loans to Directors and Employees

Nonperforming/Doubtful Loans

Syndication of Loans/ Loan Participation

Credit Reviews

Standard Terms and Conditions

Consumer lending Criteria and Debt Service Capacity Calculations

Office of the Superintendent of Financial Institutions:

OSFI B1 Prudent Person Approach

OSFI B2 Large Exposure Limits

OSFI B20 Residential Mortgage Underwriting Practices and Procedures

OSFI IFRS 9 Financial Instruments and Disclosures

Bank of International Settlements, Basel Committee on Banking Supervision:

BIS Principles for Management of Credit Risk (2000)

BIS Principles for Sound Stress Testing Practices and Supervision (2009)

# Abbreviations

Basel: Basel Committee on Banking Supervision

BIS: Bank for International Settlements

BP: Basis Point (100 BPS = 1%)

BRR: Borrowers Risk Rating

CAFT: Customer Automated Funds Transfer

CREA: Commercial Real Estate

CUDGC: Credit Union Deposit Guarantee Corporation

CRMP: Credit Risk Management Policy

CRMMP: Credit Risk Management Model Policy

ERM: Enterprise Risk Management

EWS: Early Warning Signals

GLLA: General Loan Loss Allowance

ICAAP: Internal Capital Adequacy Assessment Process

IFRS: International Financial Reporting Standards

KRI: Key Risk Indicator

KPI: Key Performance Indicator

MCC: Management Credit Committee

MSA: Market Service Area

OSFI: Office of the Superintendent of Financial Institutions

RMUP: Residential Mortgage Underwriting Policy

SLLA: Specific Loan Loss Allowance

TLLA: Total Loan Loss Allowance

# Glossary:

***Available Capital:*** Defined in the Regulations, as “total capital”, meaning primary capital plus secondary capital subject to restrictions and deductions as outlined in Schedule 2 of the Regulations. Note: For credit risk management purposes, Available Capital is based on year-end calculation.

***Default*:** A breach of contract, including conditions of lending, such as financial or non-financial covenants and principal or interest delinquency.

***Hospitality markets:***

* Prime Market: Franchised hotels with an effective age of 10-years or less, in the CU prime market service area (i.e. within 100 KM of a branch location).
* Secondary Market: Franchised hotels with an effective age of more than 10-years in CU prime market service area.
* Tertiary Market: Non-franchised hotels and hotels outside the CU prime or secondary hospitality markets.

***Materiality:***

1. For accounting purposes, materiality is usually quantified as a certain percentage, typically 5% of assets, revenues or expenses.
2. For market risk management purposes, materiality may be defined as a confidence interval, representing the relationship between the a distribution mean and it’s standard deviation.
3. For credit risk management purposes, although materially may be quantified, it is typically a judgmental view of the significance of an item relative to asset/liability concentration or impact on revenue/profitability.

***Non-conforming Residential Mortgage:*** Non-conforming mortgages are a subset of uninsured mortgage loans and are broadly defined as having higher-risk attributes or deficiencies, relative to other uninsured mortgages. Non-conforming characteristics can include non-income qualifying loans, loans to those with low credit scores or high debt service ratios, security values where attributes of the property cause the loan to carry elevated credit risk (e.g., illiquid properties) or any uninsured mortgage that has clear deficiencies relative to a conforming uninsured residential mortgage.

***Quality Mortgage:***

* A residential mortgage where the amount of the indebtedness, including prior charges does not exceed 80% of the fair market value, unless insured. Credit Union Principal Regulation 1(1)(m).
* A non-residential mortgage, including prior charges does not exceed 75% of the fair market value, without CUDGC approval.

***Risk Appetite:*** The amount of risk the Board is willing to accept on behalf of shareholders/stakeholders.

***Risk Tolerance:*** Quantification of risk appetite through risk positions or ranges.

***Sensitivity Analysis:*** Typically applies a constrained shock, such as a 2% interest rate increase to a single loan exposure, for the purpose of assessing a member’s repayment capacity under a potential, however realistic deterioration of economic conditions.

***Stress Testing:*** A simulation technique applying single or multiple shocks to a loan portfolio or portfolio segment to assess the potential cost to the institution, resulting from increased loan losses. Typical shocks for a loan portfolio could include a material increase in interest rates, unemployment rates and/or a material decrease in residential or commercial real estate prices. The shocks should represent a worst case event(s), to assess the maximum potential loss against available capital. Stress testing may be sometimes referred to as a multi-scenario analysis.

***Syndicated Loans:*** A credit facility structured by a lead bank and offered to select lenders under a participation agreement. Each participant is responsible to independently assess the credit risk and returns, while borrower contact is restricted to the lead bank.

Appendix “A” Risk Tolerance Levels

|  |
| --- |
| **Key Risk Indicators – Risk Matrix** |
| **Loan Type** | **Product** | **Condition** | **Delinquency** | **Defaults** | **Watch List** | **Expired** | **Write-Offs** |
| **Consumer** | **RML Conventional** | Acceptable | ≤ | ≤ | **Not Applicable** | ≤ |
| Caution |  |  |  |  |
| Concern | ≥ | ≥ |  | ≥ |
| **RML Insured** | Acceptable | ≤ | ≤ | ≤ |
| Caution | to | to | to |
| Concern | ≥ | ≥ | ≥ |
| **RML Total** | Acceptable | ≤ | ≤ | ≤ |
| Caution | to | to | to |
| Concern | ≥ | ≥ | ≥ |
| **HELOC** | Acceptable | ≤ | ≤ | ≤ |
| Caution | to | to | to |
| Concern | ≥ | ≥ | ≥ |
| **Other Consumer** | Acceptable | ≤ | ≤ | ≤ |
| Caution | to | to |  |
| Concern | ≥ | ≥ | ≥ |
| **Non Consumer** | **Small Business** | **Condition** | **Delinquency** | **Defaults** | **Watch List** | **Expired** | **Write-Offs** |
| Acceptable | ≤ | ≤ | ≤ | ≤ | ≤ |
| Caution | to | to | to | to | to |
| Concern | ≥ | ≥ | ≥ | ≥ | ≥ |
| **Commercial** | Acceptable | ≤ | ≤ | ≤ | ≤ | ≤ |
| Caution | to | to | to | to | to |
| Concern | ≥ | ≥ | ≥ | ≥ | ≥ |
| **Credit Card** | Acceptable | ≤ | ≤ | **Not Applicable** | ≤ |
| Caution | to | to | to |
| Concern | ≥ | ≥ | ≥ |
| **Total Loans** | Acceptable | ≤.75% | ≤.50% | ≤.25% |
| Caution | .76% to 1.24% | .51% to .99% | .26% to .49% |
| Concern | ≥1.25% | ≥1.00% | ≥.50% |
|  |

* Delinquencies: Percentage of loans with arrears 60-days or higher, relative to total loans. (Arrears between 30 days and 30 to 59 days should be monitored).
* Defaults: Percentage of Doubtful (BRR 8) and Impaired (BRR 9) to total loans.
* Watch List: Percentage BRR 6 & 7 loans and non-consumer loans expired more than 90-days, relative to total loans.
* Expired Loans: Percentage of loans expired 30-days or more relative to total loans.

Appendix “B” Concentration Limits

1. **Portfolio Limits**

|  |  |
| --- | --- |
| Line of Business | Target Range |
| RML, including | 40% | to | 50% |
|  RML Insured | 40% | to | 60% |
| RML Conventional | 40% | to | 60% |
| HELOC | 10% | to | 20% |
| Other Consumer | 5% | to | 10% |
|  Credit Card | 3% | to | 5% |
| Agriculture | 5% | to | 10% |
| Small Business | 20% | to | 30% |
| Commercial | 25% | to | 35% |

1. **Non-conforming Conventional RML and HELOC:** Maximum 5% of the RML & HELOC portfolio
2. **Aggregate RML exceeding 25-year amortization** 15% of conventional mortgages
3. **Industry Specific Limits**

Hospitality (Hotels & Motels): 14% of non-consumer loans (Note: CUDGC requirement maximum 15%)

Commercial Real Estate (Real Estate, Construction and Hospitality): 150% Total Available Capital

1. **Syndication loans**: 100% Total Available Capital
2. **Geographic Concentration:**

Out of Market Service Area: 50% total Available Capital

Special Geographical Exposures (i.e. Fort McMurrray) % Available Capital

In no instance will direct and connected exposure exceed the maximum limits allowed under Credit Union Regulations S54(1).

1. **Residential Mortgage Product Lending Values:**

|  |  |  |
| --- | --- | --- |
| **Product** | **Standard L/V Maximum** | **Exception L/V Maximum** |
| Conventional Mortgage (Purchase) | 80% | N/A |
| Conventional Mortgage (Refinancing) | 75% | 80% |
| Non-conforming Mortgage\* (Purchase) | 65% | 80% |
| Non-conforming Mortgage\* (Refinancing) | 60% | 75% |
| Recreational Property Mortgage | 70% | 75% |
| Non-owner occupied Mortgage | 70% | 75% |
| Home Equity Line of Credit | 65% | 75% |

*\*****See glossary***.

Exception parameters:

* The exception L/V must be authorized by designated credit approval authority, on a risk mitigated basis.
* Exception approvals are not to exceed 10% of aggregate mortgage/HELOC loans originated in the quarter.
* The Board is to receive quarterly aggregate exception reports.

Appendix “C” Delegated Credit Limits and Conditions

Appendix “D” Board Risk Committee Terms of Reference

*Note: Board committee terms of reference are included in the policy section of the Governance Manual. A* ***copy*** *of the terms of reference may be placed at this point to emphasise the committee’s direct link to the Credit Risk Management Policy. (If attached, please ensure the copy reflects the current terms of reference).*

Appendix “E” Management Credit Committee Terms of Reference