



Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

During July 2010 the FASB issued Accounting Standards Update 2010-20 "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses" (ASU 2010-20). For nonpublic entities, this requirement is effective for annual reporting periods ending on or after December 15, 2011.

This update set forth requirements for additional disaggregated information regarding the credit quality and nature of credit risk inherent in the entity's portfolio, along with how the allowance for credit losses was derived from this information, to be disclosed in annual financial statements. Not only will balances need to be additionally disaggregated, but the related allowance for credit losses will also need to be presented at these disaggregated levels. The update requires two levels of disaggregation. They are defined as follows:

- **Portfolio Segment** - "The level at which an entity develops and documents a systematic methodology to determine its allowance for credit losses." Examples include real estate, auto and consumer loans. The following information should be presented by portfolio segment:
 - Allowance for loan losses
 - An entity must also disclose how historical losses and existing economic conditions affected management's judgment and a discussion of the risk characteristics relevant to each portfolio segment.
 - Significant purchases and sales of loans
- **Class of Financing Receivable** – "A group of financing receivables determined on the initial measurement attribute (for example, amortized cost or purchased credit impaired), risk characteristic of the financing receivable and an entity's method for monitoring and assessing credit risk." The following information should be presented by class of financing receivable:
 - Impaired loans that are individually evaluated for impairment
 - An entity must also disclose the factors considered in determining impairment.
 - Non-accrual and past-due loans
 - An entity must also disclose the policy for recognizing interest income and how cash receipts are recorded.
 - Credit Quality Information
 - An entity must also disclose a description of the credit quality indicator(s) used by the institution in assessing the credit quality of its loans (e.g. credit scores, loan to value, etc...) and the date or range of dates in which the information was updated.
 - Modifications
 - An entity must also disclose how the financing receivables were modified and the financial impact of the modifications, by **Class**.
 - An entity must also disclose qualitative information about how such modifications are factored into the determination of the allowance for credit losses, by **Segment**.

The following example illustrates the update's reporting requirements:



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Consumer Credit Exposure

Credit Risk Profile by Internally Assigned Grade

To assign a credit risk profile, ABC Credit Union utilized the work of a third party to perform a multidimensional portfolio analysis as of December 31, 20X1 and 20X0. A score was assigned on an individual loan basis using FICO score, past due status, change in FICO score from the previous scoring, whether or not the loan was collateralized and whether or not there was a co-borrower account. Based on the combination of these credit quality indicators, which were all evaluated as of the balance sheet dates, a Risk Grade of Low, Medium or High was assigned. Assigned Risk Grade as of December 31, 20X1 and 20X0¹ were as follows:

	R/E - Prime		R/E - Subprime		R/E - Commercial		Auto - New		Auto - Used	
	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0
Risk Grade:										
Low	194,744,326	187,239,673	76,310,186	81,560,471	27,188,970	31,102,993	16,921,666	24,832,155	15,847,461	22,727,883
Medium	48,184,294	51,763,133	14,041,470	13,316,275	7,844,471	8,235,421	5,342,480	7,891,879	6,553,148	9,761,045
High	45,980,794	36,737,263	5,658,459	4,948,446	4,929,166	5,983,033	1,921,439	3,148,136	2,150,189	3,809,836
Total	288,909,414	275,740,069	96,010,115	99,825,192	39,962,607	45,321,447	24,185,585	35,872,170	24,550,798	36,298,764

	Cons - Credit Card		Cons - LOC		Cons - Rec Vehicle		Cons - Unsecured		Total	
	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0
Risk Grade:										
Low	43,673,991	36,525,933	3,639,794	3,274,311	1,665,225	1,492,991	1,175,674	1,130,900	381,167,293	389,887,310
Medium	32,734,016	35,646,825	3,793,849	4,315,090	1,082,084	1,563,064	1,339,970	1,499,563	120,915,782	133,992,295
High	10,043,051	10,952,815	1,882,465	2,396,403	235,316	475,078	589,379	781,839	73,390,258	69,232,849
Total	86,451,058	83,125,573	9,316,108	9,985,804	2,982,625	3,531,133	3,105,023	3,412,302	575,473,333	593,112,454

It has been our historical experience that the likelihood of charge offs is significantly greater in High Risk loans as compared to other loans and Medium Risk loans as compared to Low Risk Loans. However, historical performance is not necessarily indicative of future results.

¹ In this example, balances are comparative. For the first year of implementation, it will be encouraged, but not required to report comparatively. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.



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Consumer Credit Exposure - Continued

Credit Risk Profile Based on Payment Activity

In assessing performance of financing receivables, ABC Credit Union utilized the Financial Accounting Standards Board's definition of "A performing financing receivable is a category of financing receivables that are current in regards to payments made on the financing receivables." ABC Credit Union considers financing receivables less than 15 days past due to be current. Performing and nonperforming financing receivables by portfolio segment as of December 31, 20X1 and 20X0¹ are as follows:

	R/E - Prime		R/E - Subprime		R/E - Commercial		Auto - New		Auto - Used	
	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0
Performing	252,380,321	243,515,839	88,364,585	94,904,311	36,195,471	39,348,873	23,090,552	33,594,984	22,825,663	33,359,409
Nonperforming	36,529,093	32,224,230	7,645,530	4,920,881	3,767,136	5,972,574	1,095,033	2,277,186	1,725,135	2,939,355
Total	288,909,414	275,740,069	96,010,115	99,825,192	39,962,607	45,321,447	24,185,585	35,872,170	24,550,798	36,298,764

	Cons - Credit Card		Cons - LOC		Cons - Rec Vehicle		Cons - Unsecured		Total	
	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0
Performing	81,315,769	79,250,034	8,513,474	9,022,641	2,856,568	3,272,678	2,910,393	3,003,914	518,452,796	539,272,683
Nonperforming	5,135,289	3,875,539	802,634	963,163	126,057	258,455	194,630	408,388	57,020,537	53,839,771
Total	86,451,058	83,125,573	9,316,108	9,985,804	2,982,625	3,531,133	3,105,023	3,412,302	575,473,333	593,112,454

It has been our historical experience that the likelihood of charge offs is significantly greater for Nonperforming loans than Performing loans. However, historical performance is not necessarily indicative of future results.

¹ In this example, balances are comparative. For the first year of implementation, it will be encouraged, but not required to report comparatively. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.



ABC Credit Union
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Allowance for Credit Losses and Recorded Investment in Financing Receivables

Management formed its estimate of the allowance for credit losses based on historical losses as well as the risk characteristics relevant to each portfolio segment, which are as follows:

- Nonperforming real estate loans increased approximately 11.1%, or \$4.8 million and High Risk Real Estate loans increased by approximately 18.7%, or \$8.8 million from December 31, 20X0 to December 31, 20X1.
- Nonperforming auto loans have decreased approximately 45.9%, or \$2.4 million and High Risk auto loans have decreased approximately 41.5%, or \$2.9 million.
- Nonperforming consumer loans have increased approximately 19.0%, or \$1 million and High Risk consumer loans have decreased approximately 12.0%, or \$1.7 million.

Based on historical losses as well as the risk characteristics noted above, management has developed the following estimate of allowance for credit losses as of December 31, 20X1².

	Real Estate	Auto	Consumer	Total
Allowance for credit losses:				
Beginning balance	6,417,613	848,960	6,844,540	14,111,113
Charge-offs	7,836,258	512,178	6,352,664	14,701,100
Recoveries	135,033	7,765	216,654	359,452
Provision	9,275,807	318,902	5,874,109	15,468,818
Ending balance	<u>7,992,195</u>	<u>663,449</u>	<u>6,582,639</u>	<u>15,238,283</u>
Ending balance: individually evaluated for impairment ³	<u>3,411,870</u>	<u>283,227</u>	<u>2,810,130</u>	<u>6,505,227</u>
Ending balance: collectively evaluated for impairment	<u>4,580,325</u>	<u>380,222</u>	<u>3,772,509</u>	<u>8,733,056</u>
Financing Receivables:				
Ending balance	<u>424,882,136</u>	<u>48,736,383</u>	<u>101,854,814</u>	<u>575,473,333</u>
Ending balance: individually evaluated for impairment ³	<u>23,548,198</u>	<u>2,701,111</u>	<u>5,645,089</u>	<u>31,894,398</u>
Ending balance: collectively evaluated for impairment	<u>401,333,938</u>	<u>46,035,272</u>	<u>96,209,725</u>	<u>543,578,935</u>

² For simplicity of presentation, this information is disclosed only as of December 31, 20X1. This is adequate for first year implementation. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.

³ Twenty Twenty Analytics has worked with several credit unions to incorporate loans individually evaluated for impairment by the credit union into our allowance validation calculation.



ABC Credit Union
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Impaired Loans³

Loans are identified as impaired when it is determined that payment of interest or principal is doubtful or when interest or principal is 90 days past due. The following loans were impaired as of December 31, 20X1²:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
R/E - Prime	8,006,098	6,404,878	0	120,153	64,049
R/E - Subprime	2,660,579	2,128,463	0	84,888	21,285
R/E - Commercial	1,107,422	885,937	0	92,546	8,859
Auto - New	589,791	536,174	0	12,081	3,324
Auto - Used	598,697	544,270	0	6,222	3,374
Cons - Credit Card	1,916,547	1,916,547	0	1,403	11,883
Cons - LOC	206,530	206,530	0	2,654	1,280
Cons - Rec Vehicle	72,735	66,122	0	4,897	410
Cons - Unsecured	75,719	68,836	0	5,643	427
With an allowance recorded:					
R/E - Prime	12,009,147	9,607,318	2,319,988	119,265	96,073
R/E - Subprime	3,990,869	3,192,695	770,976	84,000	31,927
R/E - Commercial	1,661,133	1,328,906	320,906	91,658	13,289
Auto - New	884,687	804,261	140,552	11,193	4,986
Auto - Used	898,046	816,406	142,675	5,334	5,062
Cons - Credit Card	2,874,821	2,874,821	2,385,147	515	17,824
Cons - LOC	309,795	309,795	257,027	1,766	1,921
Cons - Rec Vehicle	109,102	99,183	82,289	4,009	615
Cons - Unsecured	113,579	103,254	85,666	4,755	640
Total:					
Real Estate	29,435,248	23,548,198	3,411,870	98,752	235,482
Auto	2,971,221	2,701,111	283,227	8,708	16,747
Consumer	5,678,829	5,645,089	2,810,130	3,205	35,000

² For simplicity of presentation, this information is disclosed only as of December 31, 20X1. This is adequate for first year implementation. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.

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Age Analysis of Past Due Financing Receivables²

Management considers a receivable to be current if it is less than 15 days past due. Recorded investments greater than 90 days and accruing represents loans that are well collateralized and in the process of collection. The following table analyzes the aging of our financing receivables as of December 31, 20X1:

	15 - 30 Days	30 - 60 Days	60 - 90 Days	90 + Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Real Estate								
R/E - Prime	14,210,615	2,940,748	2,057,379	17,320,351	36,529,093	252,380,320	288,909,413	2,165,044
R/E - Subprime	4,436,845	1,130,203	493,570	1,584,913	7,645,530	88,364,585	96,010,115	198,114
R/E - Commercial	1,770,396	838,101	244,001	914,638	3,767,136	36,195,471	39,962,608	114,330
Auto								
Auto - New	888,085	206,948	0	0	1,095,033	23,090,553	24,185,585	0
Auto - Used	1,047,024	538,090	111,743	28,279	1,725,135	22,825,663	24,550,798	3,535
Consumer								
Cons - Credit Card	2,711,069	998,339	333,433	1,092,449	5,135,289	81,315,770	86,451,059	136,556
Cons - LOC	422,520	196,616	10,551	172,946	802,634	8,513,474	9,316,108	21,618
Cons - Rec								
Vehicle								
Cons - Unsecured	58,719	67,339	0	0	126,058	2,856,568	2,982,625	0
	84,025	73,948	10,469	26,191	194,632	2,910,393	3,105,025	3,274
Total	<u>25,629,297</u>	<u>6,990,330</u>	<u>3,261,145</u>	<u>21,139,766</u>	<u>57,020,538</u>	<u>518,452,795</u>	<u>575,473,333</u>	<u>2,642,471</u>

² For simplicity of presentation, this information is disclosed only as of December 31, 20X1. This is adequate for first year implementation. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.



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Financing Receivables on Nonaccrual Status¹

Loans are placed on a cash (non-accrual) basis when it is determined that payment of interest or principal is doubtful or when interest or principal is 90 days past due, except when the loan is well collateralized and in the process of collection. Any interest accrued on these loans is reversed at 90 days and charged against current interest, and interest is thereafter included in earnings only to the extent actually received in cash. The following loans were on non-accrual status as of December 31, 20X1 and 20X0:

	<u>20X1</u>	<u>20X0</u>
Real Estate		
R/E - Prime	15,155,307	15,619,840
R/E - Subprime	1,386,798	1,429,306
R/E - Commercial	800,308	824,838
Auto		
Auto - New	0	0
Auto - Used	24,744	25,502
Consumer		
Cons - Credit Card	955,893	985,192
Cons - LOC	151,328	155,966
Cons - Rec Vehicle	0	0
Cons - Unsecured	22,917	23,620
Total	<u>18,497,295</u>	<u>19,064,264</u>

¹ In this example, balances are comparative. For the first year of implementation, it is encouraged, but not required to report comparatively. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.



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Modifications^{2,3}

In some instances, to prevent default of its financing receivables, ABC Credit Union has modified the terms of its Prime, Subprime and Commercial positions. Modifications include extended payment terms, reduction of interest payments or reduction of principal amounts. Modified financing receivables are reduced to fair market value, the amount ABC Credit Union expects to collect on the contract, at the time of modification. Reduction in principal amounts are charged off as loan and lease loss expense in the statement of income and expenses for the year ended December 31, 20X1. Other modifications are evaluated individually based on modification type and class of financing receivable, including historical defaults and additional modifications and reserved for in its allowance for credit losses in the accompanying statement of financial conditions as of December 31, 20X1. The following tables illustrate current troubled debt restructurings as of December 31, 20X1 and defaulted debt restructurings for the year ended December 31, 20X1:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
R/E - Prime	46	22,412,545	18,198,987
R/E - Subprime	8	510,335	414,392
R/E - Commercial	18	2,466,291	2,002,628
Total	72	25,389,171	20,616,007
	Number of Contracts	Recorded Investment	
Troubled Debt Restructurings That Subsequently Defaulted			
R/E - Prime	8	1,948,917	
R/E - Subprime	1	36,453	
R/E - Commercial	3	360,921	
Total	12	2,346,290	

² For simplicity of presentation, this information is disclosed only as of December 31, 20X1. This is adequate for first year implementation. In succeeding years (e.g. presenting as of December 31, 2012 and 2011) this information will need to be presented comparatively.

³ Twenty Twenty Analytics has worked with several credit unions to incorporate TDR Loans into our allowance validation calculation.