

SECTION IX
DELINQUENT LOAN CONTROL

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**Red Crown Federal Credit Union
Policy Manual
Section IX - Delinquent Loan Control**

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A. Philosophy

1. Red Crown Federal Credit Union must establish and maintain effective control over all loan and credit card accounts in order to safeguard the funds entrusted to it by its members.
2. The Credit Union philosophy of helping people to help themselves should be considered when the causes of delinquency are determined and collection can be implemented through adequate financial planning.
3. Every consideration should be given to retaining members when collecting loans. Red Crown will always consider the well being of the member as part of a sound collection policy.
4. Where responsible financial planning is exhibited by the member, satisfactory payment arrangements should be made in the best interest of Credit Union membership.
 - a. As a thrift institution, Red Crown will encourage regular payment; it will point out to its members the additional cost of using money through periods of neglected principal payments.
 - b. Red Crown will initiate vigorous collection action, within the limits of the Fair Debt Collection act, when it is indicated that the member has no intent of fulfilling his/her obligation.

B. Delinquent Loan Definition

Any loan or credit card account is considered delinquent if payment is not paid on or before the scheduled due date.

C. Delinquent Loan Committee

1. The Delinquent Loan Committee will be appointed by the Board as referenced in Section I, Appendix B.
2. This committee is responsible for:
 - a. Reviewing collection procedures developed by Management;
 - b. Reviewing, on a monthly basis, the report of delinquent loan/credit card accounts and the Internal Watch list.
 - c. Providing to the Board delinquent dollars, percents and end of month delinquent totals on all loans/credit card accounts.
 - d. Reviewing management reports of action taken, including legal action, repossessions, foreclosures, charge offs and any other special items of interest; and

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- e. Reviewing management reports of the reduction or cancellation of interest charges or the reduction of principal amounts in settlement of past due accounts.

D. Collections

1. The President/CEO and the *Head* of Lending or Collection Management are responsible for coordinating the collection efforts of Red Crown in accordance with the philosophy outlined in these policies.
2. Policy and procedures relating to the collection of delinquent loan/credit card accounts apply equally to all members.
3. One objective of the collection procedures will be the retention of members. These procedures will include provisions for determining the causes of delinquency and for cooperating with the member to the fullest extent possible without incurring a financial loss to Red Crown.
4. Management will proceed with repossession, foreclosure or other legal action as necessary to protect the interest of Red Crown. A list of such action taken will be reported monthly to the Delinquent Loan Committee and to the Board of Directors.
5. When a member exhibits the desire to fulfill his/her obligation, but is unable to meet the current terms of a loan, Red Crown will consider modifying a debt. Requirements for loan modifications are outlined in Red Crown's Loan Policy.
6. A report of loan/credit card accounts delinquent sixty (60) days or more will be submitted to the Delinquent Loan Committee each month for the Committee's review and approval of recommendations.
7. The President/CEO or *Head* of Lending or Collection Management is required to report to the Delinquent Loan Committee any Board member, committee member or staff who has an account delinquent more than thirty (30) days.
8. The status of a loan/credit card account will be reviewed with Management before legal action is taken.

E. Nonaccrual

1. Nonaccrual of Interest
Red Crown will cease accruing interest on a loan when it becomes 90 days or more past due; if it maintained on a cash (or cost recovery) basis due to the deterioration of the financial condition of the borrower; or, for which full payment is not expected.
2. Restoration to Accrual Status
In restoring all consumer loans to accrual status, if any interest payments received while the loan was in nonaccrual status were applied to reduce the recorded investment in the loan, the application of these payments to the loan's recorded investment may not be reversed (and

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interest income may not be credited). A nonaccrual loan may be returned to accrual status when:

- a. Its past due status is less than 90 days, Generally Accepted Accounting Principles (GAAP) does not require it to be maintained on the Cash or Cost Recovery basis, and Red Crown is plausibly assured of repayment of the remaining contractual principal and interest within a reasonable period;
 - b. When it otherwise becomes well-secured and in the process of collection;
 - c. The asset is a purchased impaired loan and it meets the criteria under GAAP for accrual of income under the interest method specified therein.
3. Restoration of Accrual Status on Member Business Loan Workouts
A member business loan workout will remain in nonaccrual status until the member has made a minimum of six consecutive timely payments under the restructured loan terms and Red Crown can document a current credit evaluation of the borrower's financial condition and prospects for repayment under the revised terms. The evaluation will consider the borrower's "sustained historical repayment performance" for a reasonable period prior to the date on which the loan is returned to accrual status (i.e., a minimum of six consecutive timely payments under the restructured loan's terms of principal and interest in cash or cash equivalents).
- a. In returning the member business loan workout to accrual status, Red Crown may take into account the sustained historical repayment performance for a reasonable time prior to the restructuring.
 - b. All identified losses will be charged off.

F. Charge offs

1. The Board of Directors delegates to management the authority to charge off loans.
2. Loans/credit card accounts presenting a high probability of loss will be charged off on a monthly basis. Management will use the following criteria to determine loans which should be charged off:
 - a. A non-performing loan/credit card account more than six months past due;
 - b. A delinquent loan/credit card account in the hands of an attorney or collection agency, unless there are extenuating circumstances to indicate the credit union will collect the loan;
 - c. A loan/credit card account where the credit union has been unable to contact the member for 90 days;
 - d. A loan/credit card account in bankruptcy, within 60 days of receipt of

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notification of filing from the bankruptcy court, unless the credit union can clearly demonstrate and document that repayment is likely to occur;

- e. A fraudulent loan/credit card account, no later than 90 days of discovery or when the loss is determined, whichever is shorter;
 - f. A loan where a deficiency balance remains after the sale or other disposition of collateral and where the credit union has received no payment and has no apparent course of action; and
 - g. A loan/credit card account deemed uncollectible, where additional collection efforts are non-productive regardless of the number of months delinquent.
3. The charge off of a loan/credit card account requires the approval of Management or a majority of the Board Executive Committee. Charge offs must not be approved by the loan officer that approved the loan/credit card account, or has any other conflict of interest regarding the loan, such as a loan to a family member.
 4. All charge offs will be reported to the Delinquent Loan Committee for review, and to the Board of Directors for ratification.

G. Sale of Repossessed Collateral

1. When Red Crown obtains ownership interest in any repossessed property, the estimated net realizable value of the repossessed collateral will be determined. The collateral will be transferred from the related loan account to the "**Assets Acquired in Liquidation**" general ledger account. Once repossessed property is liquidated the remaining balance is charged off.
2. The provisions of the Oklahoma Consumer Credit Act and Uniform Commercial Code, as well as any other laws or regulations that apply, will be followed with respect to the sale of all repossessed property.
3. Any repossessed property will be sold by written bid or auction, unless other arrangements are approved by Management and/or a majority of the Board Executive Committee.
4. Red Crown will retain the right to bid on the recovered item.
5. All recovered item(s) will be sold as is, with no warranties or guaranties given.
6. Once the repossessed item is sold, the member will be notified of any deficiency balance that is due and will be pursued for repayment of this balance, *if applicable*.
7. Any gain or loss on the sale of repossessed property will be recognized at the date of disposition.

H. Charged Off Loan/Accounts

1. Collection efforts will continue on all charged-off accounts either by the loan

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staff, attorney firm or collection agency. *Management has authority to accept a settlement offer.* A settlement offer, if accepted and paid, will classify the account as satisfied for credit reporting purposes only. Any reduction or cancellation of interest charges or the reduction of principal amounts in settlement of past due accounts will be reported to the Delinquent Loan Committee and to the Board of Directors.

2. Charged off accounts will be reported to the appropriate credit reporting agency indicating the date and amount of charge-off.
3. Records will be kept in the Collection Department of all recoveries made on the charged-off accounts. Any recoveries made will be reported monthly to the Delinquent Loan Committee.
4. Any charged-off account, which has been paid in full, will be reported to the credit bureau as charged-off/account paid.
5. Red Crown may deny services to a member who has caused a loss to Red Crown, either through default on a loan or through the filing of bankruptcy and the discharge of a debt to Red Crown through the bankruptcy.
6. The Federal Credit Union Act precludes Management from preventing a member from exercising the statutory rights of membership, i.e., maintaining a share account and voting at annual and special meetings. These rights can only be taken away through a formal expulsion. Red Crown will also ensure that any policy adopted does not breach a share account, share certificate or other contractual agreement between Red Crown and a member.

I. Determination of Allowance for Loan and Lease Loss (ALLL)

Red Crown will comply with FAS 5 - Allowance for Small Balance Homogeneous Pools of Loans and FAS 114 - Accounting for Impaired Loans when evaluating loans for potential loss.

1. **Loan Segment Identification - Various Pools of Loans**
Management will segment the loan portfolio into several broad categories of loans. Each category will demonstrate similar risk characteristics. The assignment of categories will be reviewed annually to insure that they are
2. **Estimating Loss on Loan Segments**
Management will apply a loss rate to each loan segment to determine an appropriate level of funding for that segment's Allowance for Loan and Lease Loss amount. That loss rate will be based on a 24-month rolling average historical loan loss ratio. Management will maintain supporting documentation for the technique used to develop their loss rates including the period of time over which they incurred the losses. If insufficient loss history is available (i.e. business loans) the loss rate will be based on other reasonable information such as loss history on similarly collateralized loans or industry conditions. In developing and maintaining loss measurements, management will consider the impact of current environmental factors and document which factors have been

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used in the analysis and how these factors affect the loss measurements. Management should also consider the following factors when developing loss measurements:

- a. Levels of trends in delinquencies and impaired loans;
- b. Levels of and trends in charge-offs and recoveries;
- c. Trends in volume and terms of loans;
- d. Effects of any changes in risk selection and underwriting standards, and other changes in lending products, policies, procedures and practices;
- e. Experience, ability and depth of lending management and other relevant staff;
- f. National and local economic trends and conditions;
- g. Industry conditions; and
- h. Effects of changes in credit concentrations.

3. Estimating Loss on Loans under FAS 114

Management will identify loans to be individually evaluated as defined by FAS 114. Loans to be evaluated individually will include but will not be limited to:

- a. Any loans having weaknesses that jeopardize full collection of the debt;
- b. Loans that are current according to their terms, but represent potential losses because of the payment terms or past practices;
- c. Workout loans in which Red Crown permanently amended the original terms of the note to lower payments or reduce interest rates;
- d. Any other loans as warranted.

The estimated losses on loans that are secured will be determined using the fair value of collateral. Fair value will be determined using an appropriate source such as the NADA publication or observable market price for similar assets. The estimated losses on impaired loans that are unsecured will be determined using the present value of expected future cash flows.

The estimated loss on individual loans will be added to the estimated loss on loan segments calculated under Item 2 above to determine the total Allowance for Loan Loss. Loans reviewed individually will be subtracted from the pools of loans used to estimate the loss on loan segments.

4. Oversight

Management should consider all known relevant internal and external factors that affect loan collectability during any given period. Management's current judgments about the credit quality of the loan portfolio should determine the balance of the Allowance for Loan Loss and provisions for loan losses and should include the following:

- a. The Board will review the ALLL and provision for loan losses reported each period;
- b. The Supervisory Committee should oversee and monitor the internal controls over the ALLL determination process;

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- c. The ALLL will be adjusted as needed through current earnings in accordance with GAAP.

5. **Summarization Reports**

Management will prepare a summary document supporting the amount of ALLL it reports on Red Crown's financial statements. This will verify that the ALLL is fairly presented in accordance with GAAP and is auditable. The Board or delegated committee will review this summary.

Common elements in the summary will include:

- a. An estimate of the probable loss incurred for each loan segment;
- b. An estimate of the probable loss incurred for individually reviewed loans;
- c. The aggregate probable loss estimated using Red Crown's methodology;
- d. The amount, if any, of the necessary ALLL adjustment; and
- e. Detailed sub-schedules of loss estimates that reconcile to the summary schedule if so warranted by the level of detail supporting the ALLL analysis.

J. Quality Control Review

Red Crown will regularly assess the risk in the loan portfolio and monitor potential future exposure. Management will maintain an internal watch list to monitor delinquent loans, problem credits and special mention loans. The internal watch list will include the following categories:

1. Watch – Loans in new loan programs, loans granted with significant policy exceptions, loans previously classified as problem credits and any other loans that require additional attention;
2. Special Mention – Loans that have potential weaknesses that may result in deterioration of the credit, loans with inadequate documentation, loans to borrowers who may be experiencing adverse economic or financial conditions and any other loans that warrant close attention;
3. Substandard – Loans that have been sixty days or more delinquent loans that have been re-financed or modified due to credit issues of the borrower, loans with questionable security and any other loans that represent a distinct possibility of loss to the credit union;
4. Doubtful – Loans that have been ninety days or more delinquent (sixty days if unsecured), loans where it is probable that the credit union will not collect all principal and interest (even though the borrower is making partial or irregular payments) and loans where, even if collected, the credit union would incur substantial collection costs. Loans in this category are considered impaired in the calculation for Allowance for Loan and Lease Loss.