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BULLETIN: **2019-KDCU-CUB-2**

TO: **Kansas Chartered Credit Unions**

SUBJECT: **Allowance for Loan and Lease Losses**

ALLOWANCE FOR LOAN AND LEASE LOSS GUIDANCE

The purpose of the Allowance for Loan and Lease Losses (ALLL) is to reflect estimated credit losses within your portfolio of loans and leases. Estimated credit losses are estimates of the current amount of loans that are probable to be uncollectable given the facts and circumstances. These represent net charge-offs that are likely to be realized for a loan or group of loans (probable but unconfirmed). This calculation reduces the amount of the loan portfolio on the balance sheet.

Staff for the Kansas Department of Credit Unions (KDCU) have received numerous questions related to ALLL and will attempt to provide some guidance. An examiner is tasked with determining if management has a sound methodology, with supporting documentation, for estimating the amount of probable existing losses in its loan and lease portfolio. It is also important that management understand the purpose of the ALLL. This process requires management judgment and is inevitably imprecise. All decisions should be supported by documentation and clear explanation.

Credit union management and boards must also understand the risks associated with improperly calculating the ALLL – compliance, transaction and reputation. Boards of directors bear responsibility for ensuring their credit unions have controls in place to maintain the ALLL in accordance with the credit union's policies and procedures, generally accepted accounting principles (GAAP) and ALLL supervisory guidance. Supervisory committees provide oversight.

NCUA Rules and Regulations, Part §702.402(d)(2), states the "allowance for loan and lease losses (ALL) established for loans must fairly present the probable losses for all categories of loans and the proper valuation of loans. The valuation allowance must encompass specifically identified loans, as well as estimated losses inherent in the loan portfolio, such as loans and pools of loans for which losses have been incurred but are not identifiable on a specific loan-by-loan basis."

A credit union's size, organizational structure, business environment and strategy, management style, loan portfolio characteristics, loan procedures, field of membership, and management information systems will influence its ALLL methodology.

Generally, a credit union's methodology should include, among other things, a regular analysis of the loan portfolio, consideration of all loans, collectability and current collateral values.

The NCUA, in Part §702.402(b), requires the financial statements of a credit union to provide full and fair disclosure of all assets and liabilities. Accurately calculating and reporting ALLL is part of that requirement.

Credit unions should also be aware that the above process will be replaced by CECL (Current Expected Credit Losses) methodology, with a regulatory reporting effective date of December 31, 2021.