MOSSADAMS

Loan Payment Relief Due to COVID-19: Audit and Risk Considerations

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With You Today

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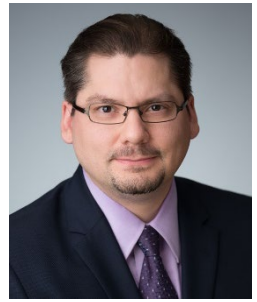

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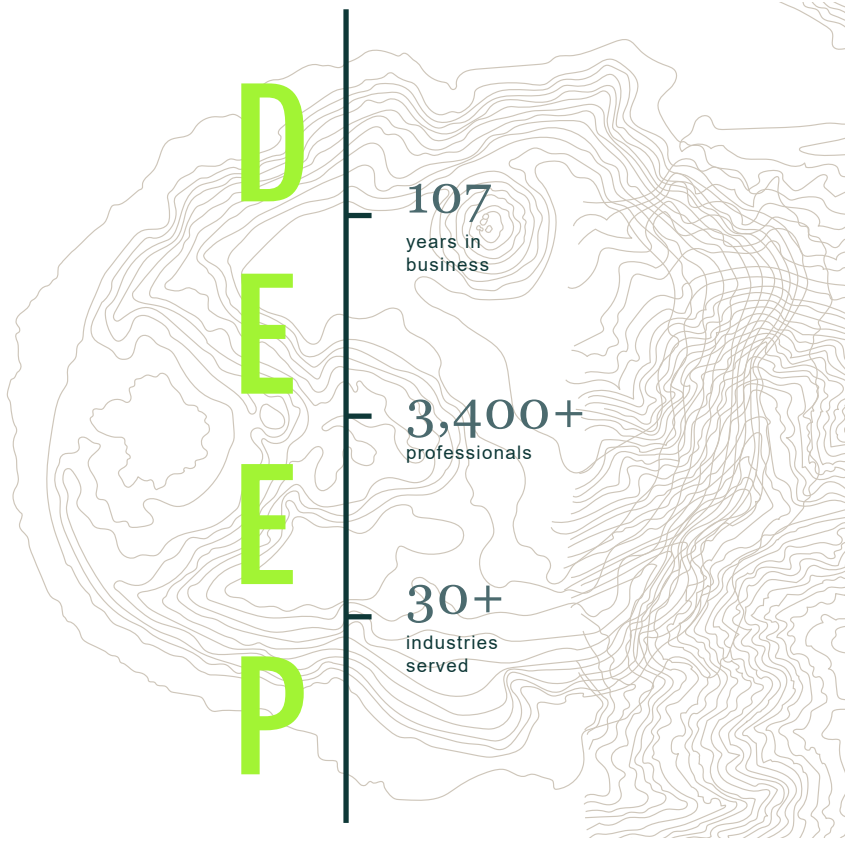
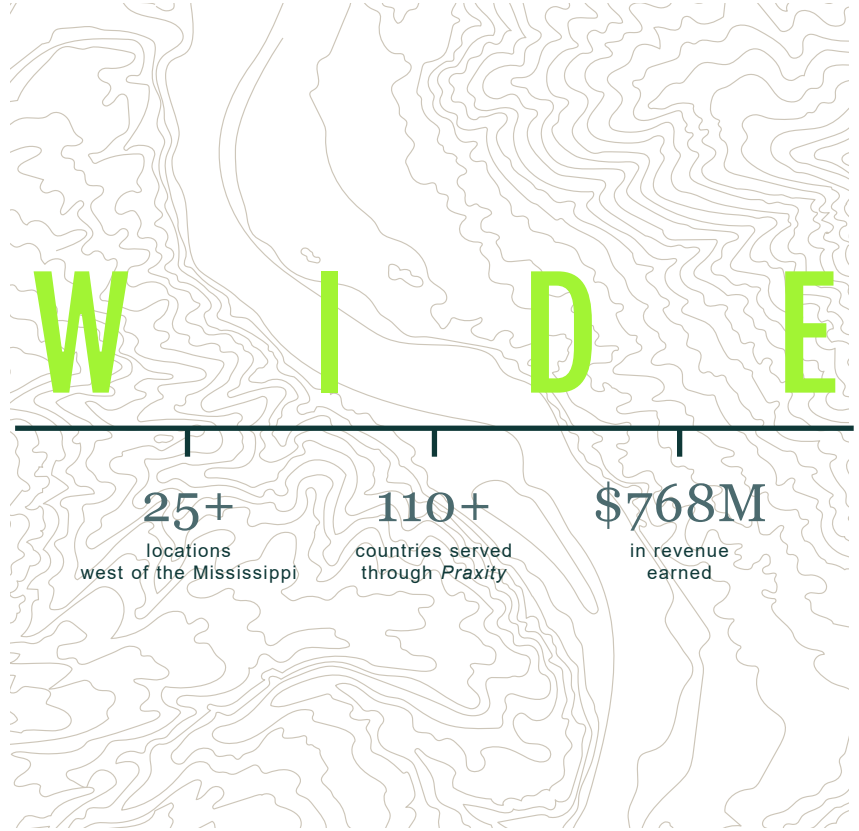
Expertise



Crater Lake—
A monument to perseverance, North America's deepest lake filled to 1,949 feet over 720 years.

Reach



Grand Canyon—
At 277 miles long and up to 18 miles wide, this icon serves as a testament to determination and time.

Data as of January 2020

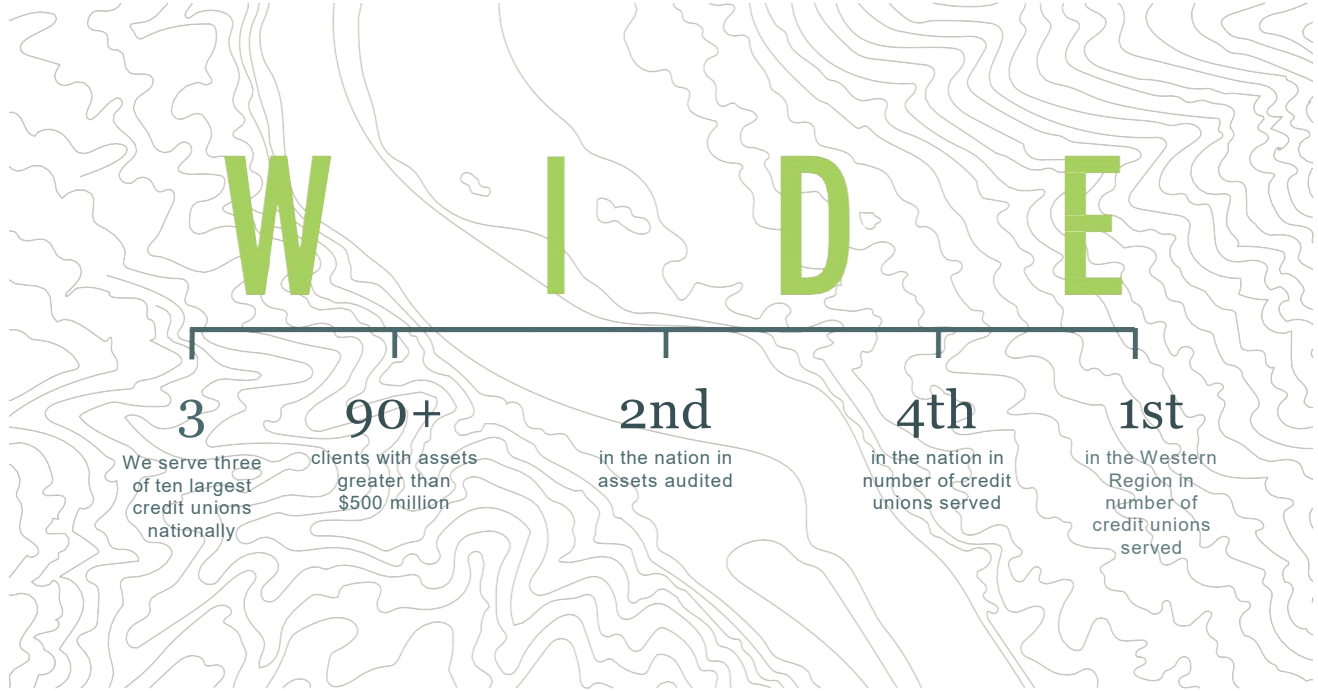
Credit Union Experience

Staying current on financial reporting standards, ensuring senior executives and supervisory committee members understand their roles, maintaining regulatory compliance and IT security, and finding ways to reduce risk throughout the organization are some of the most effective ways to help your credit union succeed.

Our professionals are well-versed in the complexities of your industry—we serve over 400 credit unions and other financial institutions, that range in size from less than $1 billion to $20 billion in assets with multibranch operations.

By engaging a team that's intimately familiar with the challenges you face, your institution can be well positioned to seek out best lending practices, manage interest-rate- risk, and grow its membership.

Reach



[1]Callahan and Associates, *2020 Guide to Credit Union CPA Auditors*

Grand Canyon—
At 277 miles long and up to 18 miles wide, this icon serves as a testament to determination and time.

Polling Question 1

Back when we all traveled, did you take unused items from hotel bathrooms? (shampoo, soap, sewing kit, etc.)

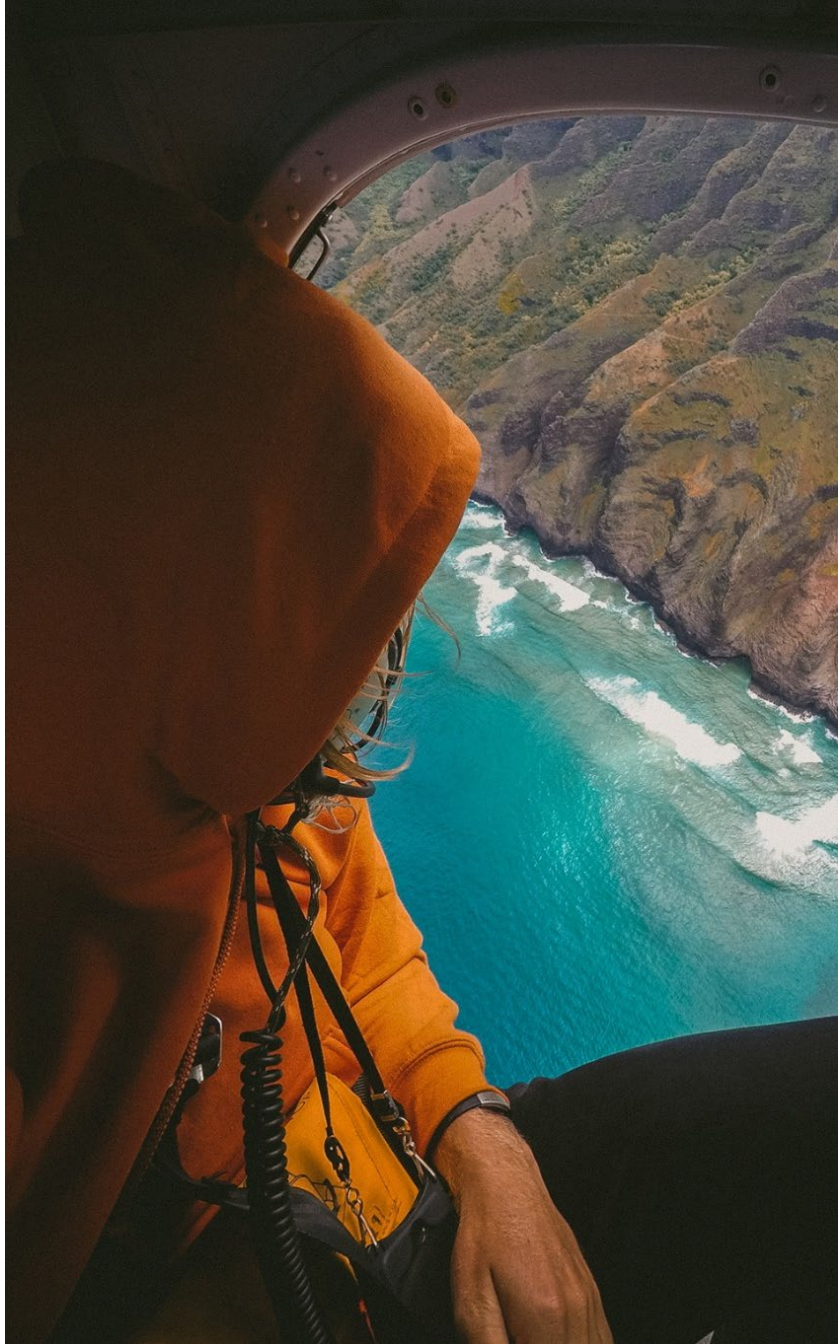
A Yes

B Sometimes

C No

Goals For Today:

- Understand CARES Act vs. Interagency Guidance
- Industry Trends – Loans and Credit Loss
- Allowance and Financial Reporting Considerations
- Audit considerations



Loan Modifications

Polling Question 2

What percentage of loans has your Credit Union modified?

A less than 1%

B less than 5%

C greater than 5%

D Unsure

Loan Modifications – Interagency Guidance

- Issued March 22, 2020, prior to the signing of the CARES act, in response to the COVID-19 pandemic
- FASB issued a statement of agreement with the interagency guidance
- Encourages working with borrowers to modify loans
- Includes detailed examples of modifications along with regulatory expectations
- Guidance refers to modifications of up to 6 months potentially not being considered troubled debt restructurings (TDRs) if pandemic related
- Delinquency reporting eased in this area
- https://mossadams.com/articles/2020/03/financial-institution-guidance-covid-19

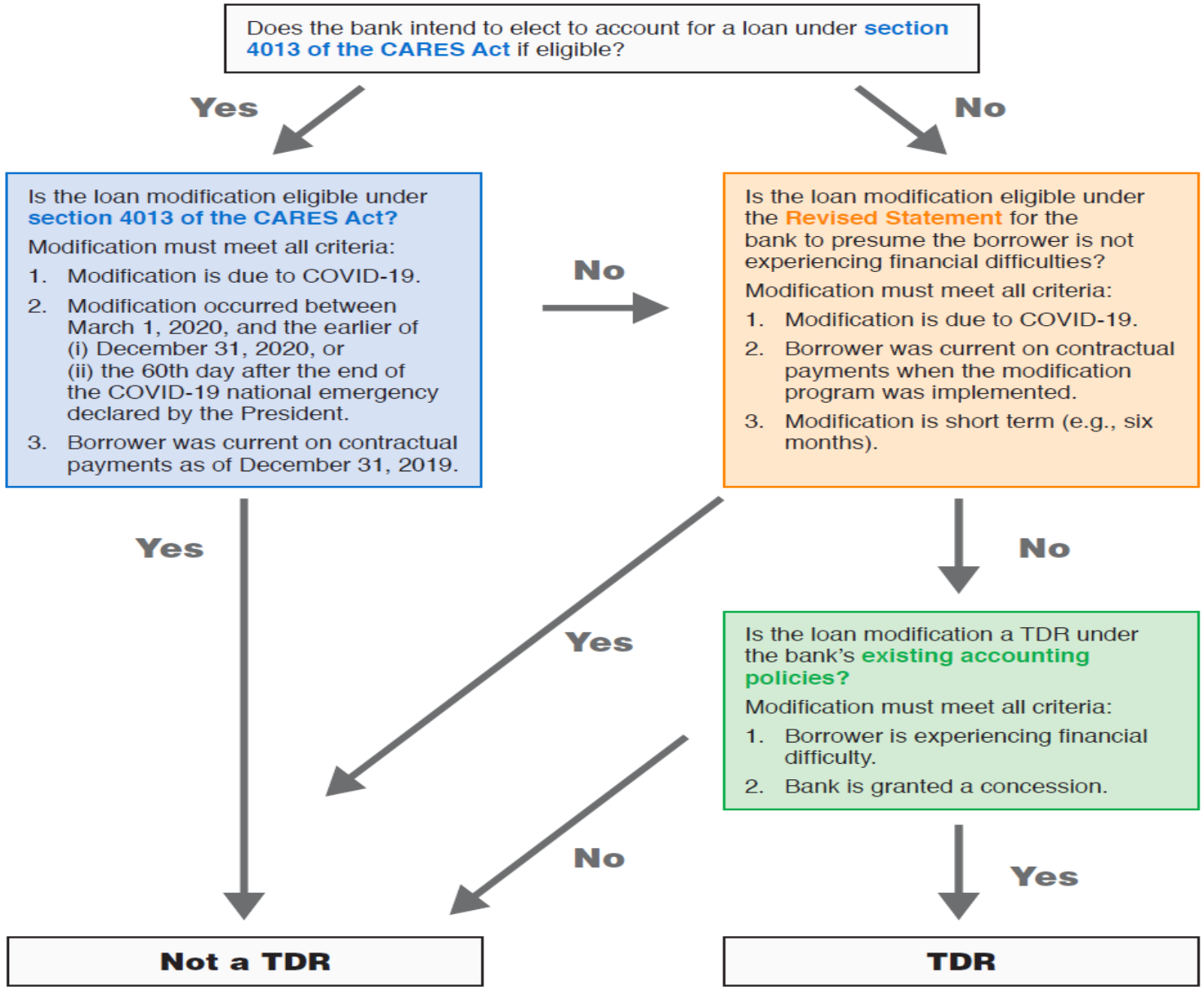
Loan Modifications – CARES Act

- Option to suspend requirements under US GAAP for loan modifications related to the pandemic that potentially would have otherwise been considered troubled debt restructurings.
- Must be current at December 31, 2019 (under 30 days past due) and the modification performed due to the pandemic to qualify.
- Includes modifications such as forbearance agreements, interest-rate modifications, repayment plans, or other arrangements that defer principal and interest payments.
- Election may begin on March 1, 2020 and last no later than the earlier of December 31, 2020 or 60 days after lifting of the coronavirus national health emergency.
- https://mossadams.com/articles/2020/03/cares-act-includes-cecl-and-tdr-relief

	Section 4013 of the CARES Act	Non-Section 4013 Loan Modifications (Revised Statement)
Evaluation date of whether borrower was current (< 30 days past due)	December 31, 2019	No earlier than when the modification program is implemented
Modifications terms allowed (safety and soundness principles still apply)	Any modification	Short term (e.g., six months)
Time period of when the modification occurs	Between March 1, 2020, and the earlier of (i) December 31, 2020, or (ii) the 60th day after the end of the COVID-19 national emergency declared by the President.	Management should use judgment to determine if the modification is related to COVID-19.
Duration of non-TDR designation	Remaining life of the loan. Subsequent modifications must be evaluated if they are not also eligible under the criteria.	Remaining life of the loan. Subsequent modifications must be re-evaluated.
Why is it not a TDR?	By law, the bank is not required to designate the loan as a TDR.	The bank may presume that the borrower is not experiencing financial difficulty.

If neither section 4013 of the CARES Act nor the Revised Statement criteria are met, the bank should follow its existing accounting policies to determine whether the modification should be accounted for as a TDR.

Is the COVID-19 Loan Modification a TDR?



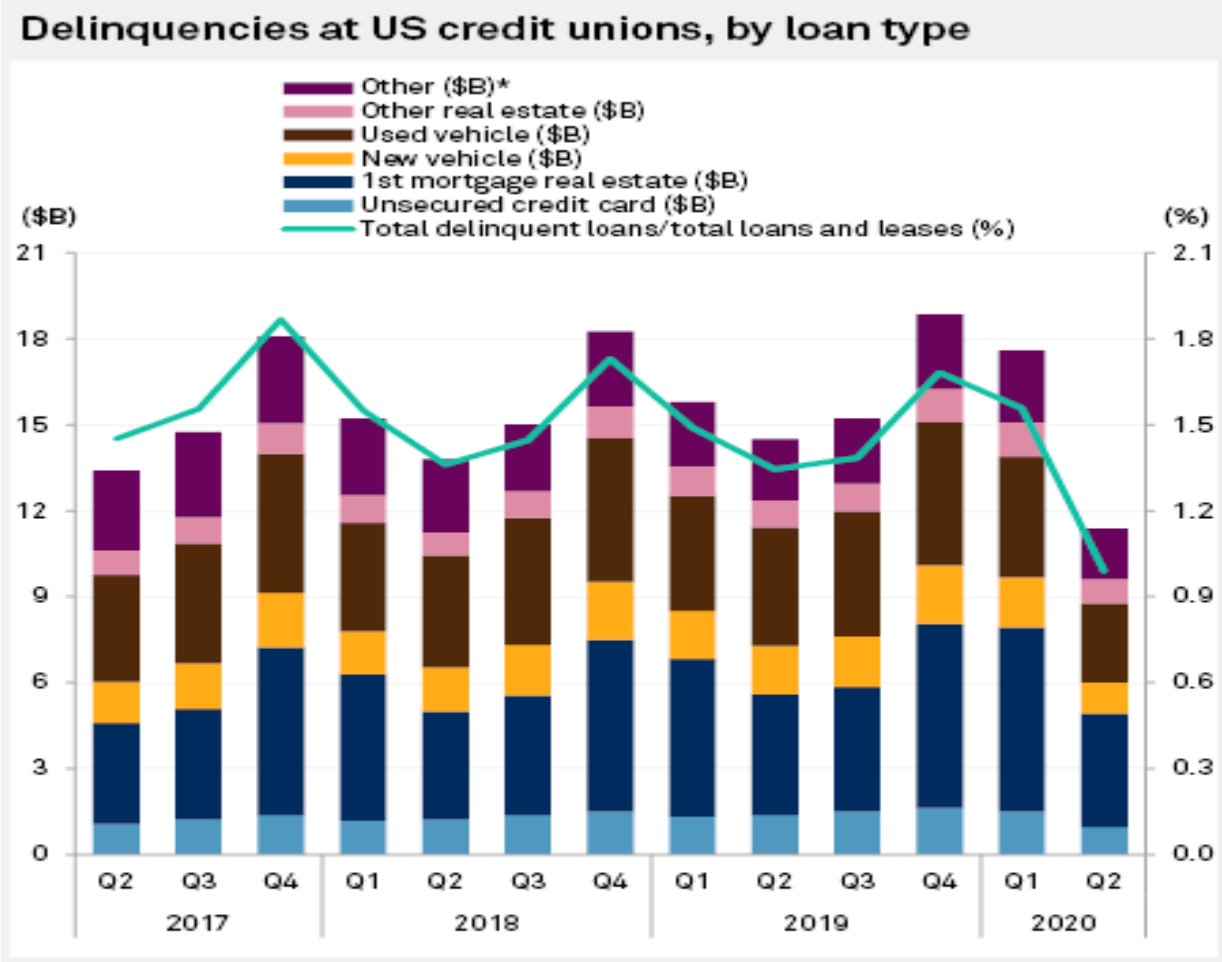
Modification Considerations

- What are the controls in place to ensure proper documentation and classification of the modifications under policy, Interagency guidance or CARES ACT?
- What are the flagging/tracking mechanisms in place? Are they automatic or manual given multiple loan systems in play?
- Will regulators be critical if modifications are outside the six month deferral period as mentioned in the Interagency guidance?
- What documentation will be required to prove modifications are pandemic related?
- How will the Credit Union prepare for processing additional modifications?
- How should we be treating interest recognition (accrue or not) given varying modification programs?
- Loan Payment Deferral Accounting Considerations During COVID-19

Industry Trends

Delinquencies Decrease!

- ✓ Compared to March 31, 2019, over 30 day delinquencies have decreased to 0.99% of total loans compared to 1.34% a year ago
- ✓ Delinquencies are being somewhat masked due to modification efforts and CARES Act relief efforts
- ✓ With some modifications expiring, Q3 & Q4 will be interesting!



Asset quality generally strong

- ✓ Non-performing loans and net charge offs generally decreasing
- ✓ However; reserves are increasing across the board and credit unions as a whole have an average reserve of 1% on the total loan portfolio, an increase of 10bps over Q1 2020.

Asset quality at 20 largest US credit unions by loans and leases, Q2'20

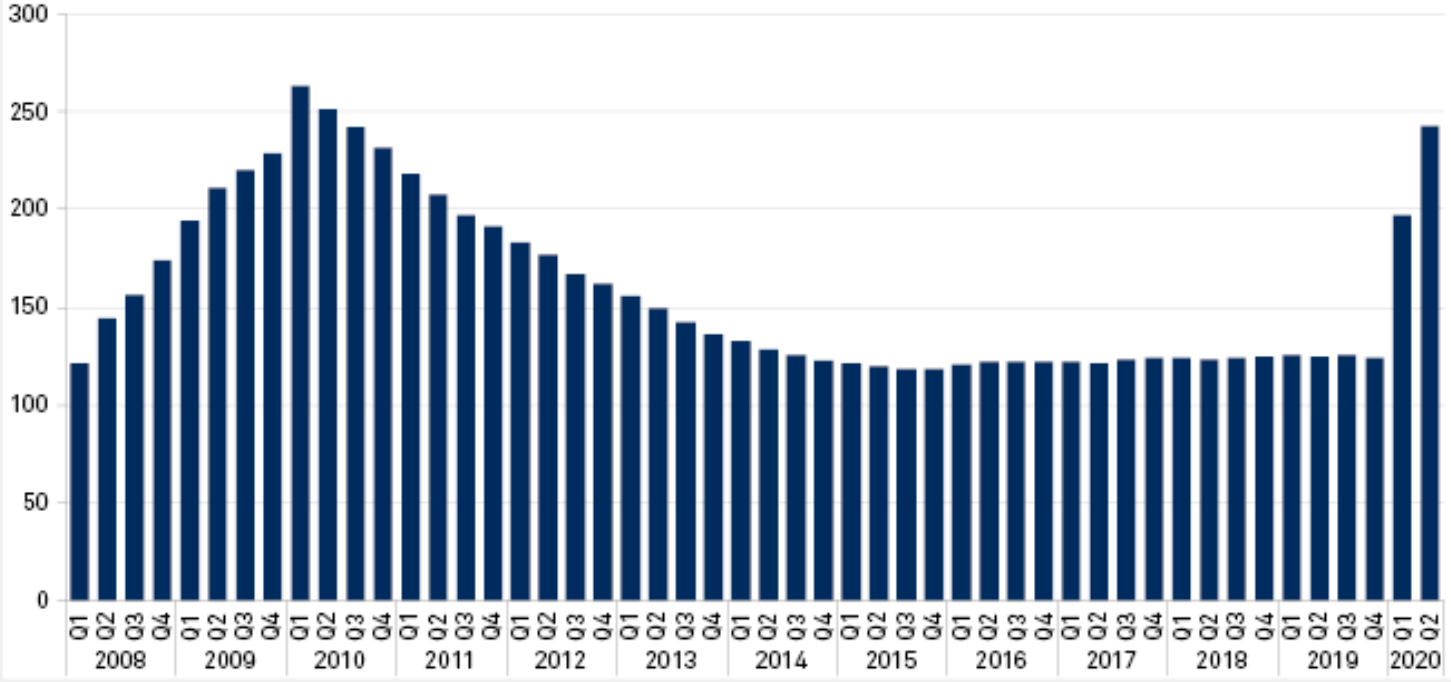
Company	Total loans and leases ($B)	NPLs/ loans (%)	NPLs/ loans vs. Q2'19^	Reserves/ NPAs (%)	Reserves/ NPAs vs. Q2'19^	NCOs/ average loans (%)	NCOs/ average loans vs. Q2'19^
Navy FCU	83.73	0.71	▼	345.63	▲	1.75	NC
State Employees' CU	24.56	1.48	▼	91.27	▲	0.29	▼
Pentagon FCU	20.51	0.93	▲	100.58	▲	0.87	▲
Boeing Employees CU	14.05	0.23	▼	487.89	▲	0.32	▼
SchoolsFirst FCU	11.66	0.35	▼	212.87	▲	0.41	▼
America First FCU	9.81	0.95	▼	169.75	▲	0.80	▲
First Technology FCU	9.08	0.24	▼	259.18	▲	0.58	▼
Suncoast CU	8.87	0.36	▼	336.88	▲	0.51	▲
Mountain America FCU	8.83	0.59	▼	141.59	▲	0.52	▼
Golden 1 CU	8.83	0.37	NC	266.48	▲	0.46	▲
Security Service FCU	8.82	0.39	▼	268.75	▲	0.65	▼
Alliant CU	8.64	0.62	▲	194.42	▲	0.72	▲
Randolph-Brooks FCU	7.96	0.33	▼	203.70	▲	0.56	▲
VyStar CU	7.15	0.36	▲	186.19	▲	0.28	▼
Digital FCU	7.08	1.06	▲	196.01	▲	0.63	▼
Bethpage FCU	6.67	2.11	▲	59.29	▼	0.15	▼
Alaska USA FCU	6.59	1.12	▲	64.96	▼	0.34	▼
San Diego County CU	6.20	0.16	▼	329.93	▲	0.10	▼
Lake Michigan CU	5.83	0.11	NC	112.58	▲	0.03	▼
GreenState CU	5.78	0.55	▼	120.45	▲	0.35	▼
Industry aggregate		**0.58**	▼	**159.00**	▲	**0.49**	▼

Data compiled Aug. 28, 2020.
NPLs = nonperforming loans; NPAs = nonperforming assets; NCOs = net charge-offs; NC = no change
Analysis includes operating U.S. credit unions that filed call reports for the quarter ended June 30, 2020. Excludes corporate credit unions.
^ The year-over-year comparison represents the change in values rounded to two decimal places.
Source: S&P Global Market Intelligence

Loan loss reserves are increasing at banks

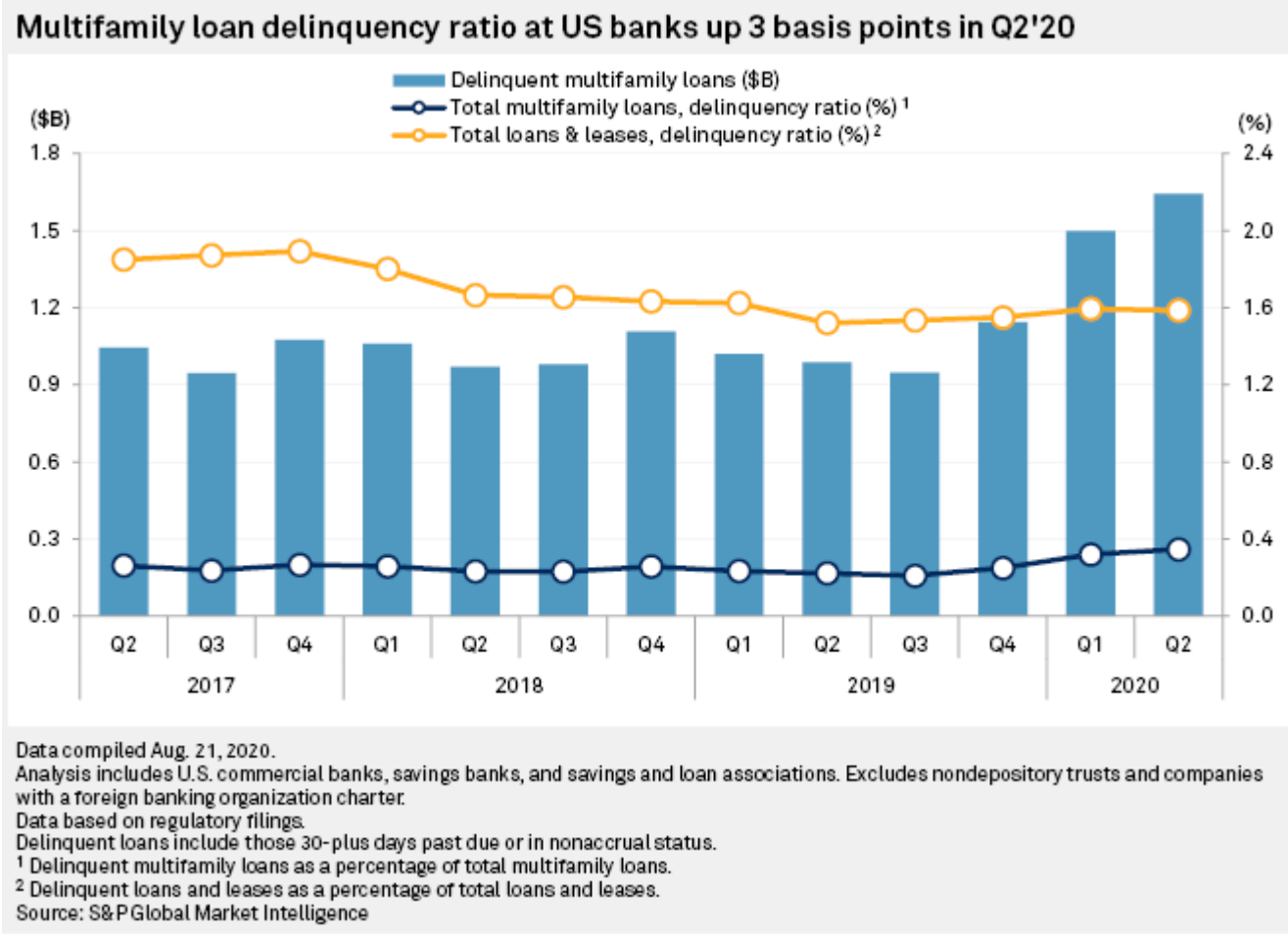
- ✓ As of 6/30/20, industry wide reserves totaled $243 billion, only slightly behind the peak during the Great Recession of $263 billion during Q1 2010
- ✓ Q2 2020 provision was $62 billion compared to a peak of $72 billion in Q4 2008.
- ✓ Large banks continue to report uncertainty in the direction for Q3 2020 provisions

2020 reserves approach post-2008 crisis levels ($B)



Data compiled Sept. 2, 2020.
Data based on regulatory filings as of June 30, 2020.
Analysis includes U.S. commercial banks, savings banks, and savings and loan associations. Nondepository trusts and companies with a foreign banking organization charter are excluded.
Source: S&P Global Market Intelligence

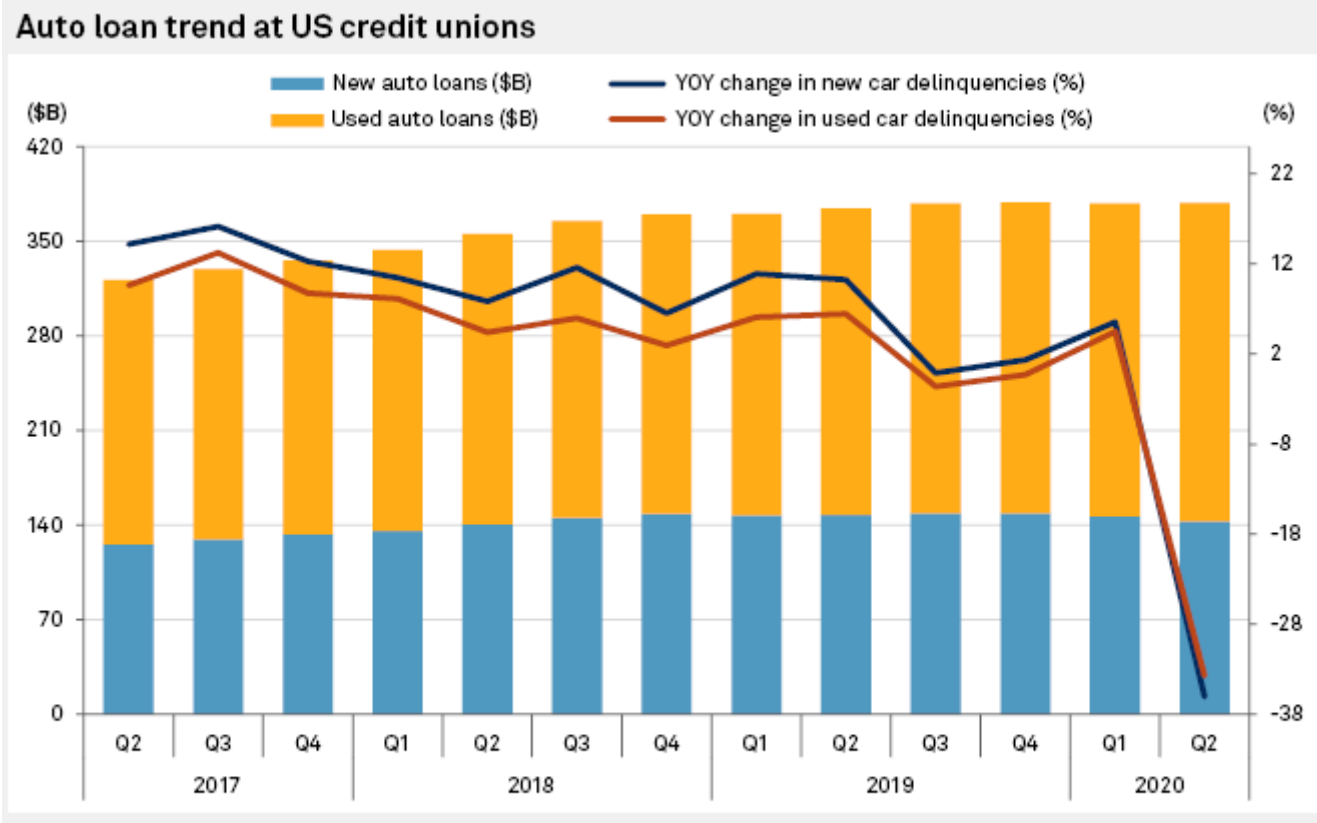
Multifamily loan delinquencies are on the rise



- ✓ Moratoriums on evictions issued by the CDC and some states may stress cash flows in the future
- ✓ New York based multifamily lenders are reporting that landlords are collecting 80 – 85% of rent
- ✓ Overall, lenders report portfolio performance has been better than expected

Auto loans increase slightly and delinquencies plunge

- ✓ Auto loans grew to less than 1% to $378 billion
- ✓ Delinquencies have dropped approximately 34% year over year
- ✓ The drop is generally attributable to work out programs



Data compiled Sept. 1, 2020.
Analysis based on regulatory filings by U.S. credit unions.
Delinquencies include auto loans 30 days or more past due.
Source: S&P Global Market Intelligence

Credit unions lent $8.34 billion under the PPP program

- ✓ $525 billion in total was disbursed through August 8, 2020
- ✓ Has contributed to growth in business loans at credit unions of over 16% year over year
- ✓ JP Morgan was the biggest lender with $29.35 billion disbursed

Top PPP lenders among credit unions

Financial data for the quarter ended June 30, 2020

Company	City, state	Total assets ($B)	ROAA (%)	PPP loans outstanding (#)	PPP loans outstanding ($M)	PPP loans outstanding Percent of total loans (%)
Mountain America FCU	Sandy, UT	10.99	1.56	6,989	346.8	3.93
Greater Nevada CU	Carson City, NV	1.26	2.73	794	182.5	21.20
Notre Dame FCU	Notre Dame, IN	0.84	0.65	1,056	178.6	24.44
Self-Help FCU	Modesto, CA	1.45	0.20	1,463	174.1	14.70
Idaho Central CU	Chubbuck, ID	6.04	1.77	3,835	163.0	3.41
Vibrant CU	Moline, IL	0.91	1.83	745	152.0	20.00
Navy FCU	Vienna, VA	128.53	0.21	5,157	143.4	0.17
ESL FCU	Rochester, NY	7.37	2.09	1,235	131.3	4.26
VyStar CU	Jacksonville, FL	9.52	0.66	4,358	130.2	1.82
America First FCU	Riverdale, UT	13.40	0.65	2,667	119.8	1.22
Redwood CU	Santa Rosa, CA	5.69	1.27	1,756	116.3	2.70
Lake Michigan CU	Byron Center, MI	8.43	2.04	1,285	115.8	1.99
Members 1st FCU	Mechanicsburg, PA	5.32	1.17	1,594	107.7	2.93
Northwest FCU	Herndon, VA	4.01	0.85	1,267	99.2	3.17
Technology CU	San Jose, CA	3.39	0.90	436	99.1	4.00
Goldenwest FCU	Ogden, UT	2.02	1.13	1,080	96.4	6.66
Boeing Employees CU	Tukwila, WA	24.75	1.46	2,354	91.4	0.65
Alaska USA FCU	Anchorage, AK	9.54	0.13	1,604	87.4	1.33
Numerica CU	Spokane, WA	2.84	1.26	998	82.3	3.72
Navigant CU	Smithfield, RI	2.67	0.13	1,165	80.7	3.81

Data compiled Aug. 17, 2020.
PPP = Paycheck Protection Program
Analysis includes the top 20 U.S. credit unions by outstanding non-commercial PPP loans, according to quarterly call reports as of June 30, 2020.
Source: S&P Global Market Intelligence

Allowance and Financial Reporting Considerations

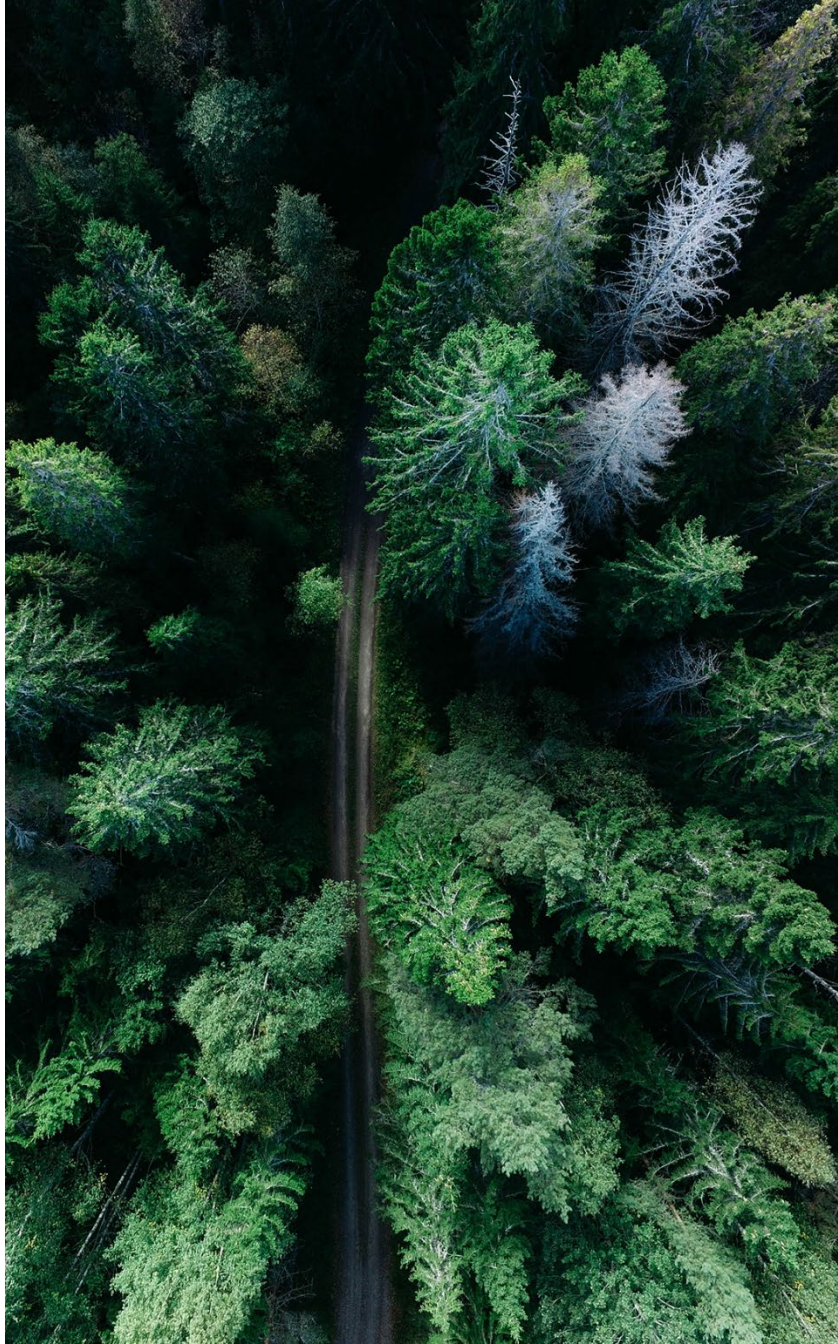
Polling Question 3

Has your audit plan or risk assessment been updated due to the Pandemic?

A) Yes

B) No, but on the agenda

C) No and no plans to update



Allowance and Financial Reporting Considerations

- How are we comprehensively analyzing members with multiple loans?
  - Grading considerations in general and by industry (higher risk industries)
  - What about members that are attached to these businesses?
  - Did they receive PPP loans?

- How are we analyzing unfunded commitments and potential increased utilization by product?

- Are we monitoring credit reports, and are we just focused on FICO? Or, are we paying attention to other trends identified?

- How are we building upon qualitative factors within the allowance estimate within each major segment, breaking down by concentrations of employment? Industry?

- How can delinquency masking occur, how can we monitor this?

Allowance and Financial Reporting Considerations

- Financial reporting risk – Liquidity is high, margins are thin, fee income is low, there could be pressure for manipulation in general. Increased risk attention.

- Financial reporting risk – knowing re-defaults will occur, have we ensured modification protocols and reporting stay intact?

- Call reporting – How is management ensuring accurate preparation of the 5300 Call Report?
  - Modified loans
  - Delinquencies
  - Changes on the horizon

Additional Audit Considerations

Additional Audit Considerations

- Has the Supervisory/Audit Committee discussed the control environment related to pandemic modifications?

- Audit programs should be updated based on assessed level of risk. For instance:
  - Increase focus on file maintenance controls
  - Targeted testing of modifications
  - Testing accuracy of reports
  - Use of non-lending employees to process loans
  - Post-boarding quality control reviews

- What other areas of the Credit Union may be suffering due to increased focus on collections?

- Balance sheet – have assumptions been updated within financial modeling?

- How rigorously will IT controls be tested?
  - Have IT controls related to system updates been implemented?
  - Have user access controls been monitored?
  - Any compromises to IT systems?

Polling Question 4

Do You Expect to Complete Your Audit Plan During 2020?

A) Yes

B) Yes, but we are outsourcing more audits

C) No, we will reduce audits completed

Navigating Through Challenging Times

We are in unprecedented times which will change daily, and financial institutions need to keep up to speed on various accounting, tax, regulatory and economic changes.

We maintain an active COVID-19 dedicated website:

https://www.mossadams.com/covid-19-implications

We also encourage you to sign up to receive our insights and alerts:

https://mossadams.com/insights

THANK YOU