**Section 190.70 Loan Loss Accounting Procedures**

a) For the purpose of absorbing and reporting loan losses, all credit unions must establish, at a minimum, the following accounts in the general ledger:

1) Allowance for Loan Losses (ALL) – A portion of the statutory Regular Reserve segregated and reported as a direct reduction of loans. The ALL shall fairly present the value of loans and probable losses for all categories of loans. Adjustments to the ALL shall be made prior to the distribution or posting of any dividend to the accounts of members.

2) Provision for Loan Losses (PLL) – An expense account, immediately preceding dividend expense, used to reflect the cost of losses on loans. Replenishment of the allowance for loan losses must be expensed using the PLL account.

b) The ALL shall be established and maintained subject to the following requirements:

1) The ALL shall be established based upon separate loss calculations reflecting loans secured by real estate and loans not secured by real estate. A credit union may further segment its loan portfolio, to recognize loss contingencies, by identifying risk characteristics that are common to groups of loans. Portfolio segmentation and impairment measurement may be based upon many factors, including without limitation major loan types and product line segments with differing risk characteristics.

2) The ALL shall be maintained at a level equivalent to an amount computed using an historical loan loss experience ratio and an individual classification of probable losses for all consumer and real estate loans. *In determining the appropriate balance in the* ALL, *a credit union may determine its historical loss rate using a defined period of time of less than 5 years, provided that:*

A) The credit union employs a certified public accountant to perform its annual external independent audit;

B) *The methodology* developed by the credit union *to determine the defined period of time is formally documented in the credit union's policies and procedures* or management memoranda, *and is appropriate to the credit union's size, business strategy and loan portfolio characteristics, and the economic environment of the areas and employers served by the credit union;*

C) *Supporting documentation is maintained* by the credit union for a period of no less than three audit cycles *for the technique used to develop the credit union loss rates, including the period of time used to accumulate historical loss data and the factors considered in establishing the time frames; and*

D) *The external auditor conducting the credit union's financial statement audit has analyzed the methodology employed by the credit union and concludes that the financial statements, including the allowance for loan losses, are fairly stated in all material respects in accordance with U.S. Generally Accepted Accounting Principles, as promulgated by the Financial Accounting Standards Board.* [205 ILCS 305/34(4)]

3) To the extent consistent with GAAP, the design and implementation of ALL methodologies and supporting documentation practices shall be in accordance with the National Credit Union Administration's Interpretive Ruling and Policy Statement (IRPS) 02-3 (NCUA, 1775 Duke Street, Alexandria VA 22314-3428, Allowance for Loan and Lease Losses Methodologies and Documentation for Federally-Insured Credit Unions, 67 Fed. Reg. 37445).

4) A credit union that does not employ a certified public accountant to perform an annual external independent audit shall utilize the five-year period preceding the subject fiscal period to compute its historical loan loss experience ratio. A credit union not employing a certified public accountant to perform its annual external independent audit may adjust the five-year historical time period to more accurately reflect its loan loss experience, upon application to and receipt of written approval from the Secretary.

5) Historical Loss Experience Ratio

A) The historical loss experience ratio is computed by dividing the total net loan losses for the appropriate period of time determined by the credit union under subsection (b)(2) or (b)(4), as applicable, by an amount representing the average loan balances for the defined period. The resulting ratio is multiplied by the total loans outstanding, less:

i) loans that have been classified individually; and

ii) pools of homogenous loans for which an estimated loss percentage has been utilized.

B) A new credit union will determine its historical loss experience ratio using available data. As used in this subsection (b)(5), "net loan losses" means loan chargeoffs, less loan recoveries, for the defined period of time.

6) If a pool consists of a large group of homogeneous loans, a credit union may utilize an estimated loss percentage on the pool to be determined by collectively evaluating the pool of loans for impairment in accordance with GAAP. The portion of the ALL attributable to the pool of loans may be determined by applying the estimated loss percentage to the total outstanding balance of the loans comprising the pool instead of individually classifying delinquent loans in the pool.

7) Notwithstanding anything to the contrary in this subsection (b), a credit union that employs a certified public accountant to perform its annual external independent audit must formally document its methodology to support:

A) Its utilization of any defined period of time in determining its historical loss rate; and

B) Its decision to change its defined period of time in determining its historical loss rate.

c) Delinquency is defined as the failure to make a required payment on or before the contractual due date. Loans delinquent more than 60 days, bankruptcy and loans that exhibit deficiencies that impair their full collectability shall be classified as either substandard, doubtful or loss.

1) Substandard Loans – A substandard loan is one that is inadequately protected by the current sound worth and paying capacity of the obligee or of the collateral pledged. Loans classified as substandard have a well defined weakness or weaknesses that jeopardized the liquidation of the debt. They are characterized by the distinct possibility that the credit union will sustain some loss if the deficiencies are not corrected. Loans in this category shall generally be listed in a range from zero to under 50 percent potential loss.

2) Doubtful Loans – A loan classified doubtful has all the weaknesses inherent in a loan classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonable specific pending factors that may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until a more exact status may be determined. Loans in this category shall be listed at a minimum 50 percent potential loss.

3) Loss Loans – Loans classified as loss loans are considered uncollectible and shall be listed at 100 percent potential loss. Loans considered loss loans include, but are not limited to:

A) Any loan 180 days or more delinquent without a payment of at least 75% of the contractual payment within the last 90 days. Involuntary transfers from shares and proceeds from the sale of collateral and insurance settlement shall not be considered as payments.

B) Any loan that is 180 days or more delinquent and referred to an attorney or a collection agency.

C) Any loan that was previously 180 days or more delinquent, has been refinanced or extended and has subsequently become 90 days or more delinquent. In instances in which a delinquent loan is refinanced or extended and does not fully and fairly disclose the delinquency as determined in a statutory examination of the credit union, the loan shall be immediately classified as a loss loan.

D) Any loan with respect to which the borrower has filed a Chapter 7 bankruptcy petition and has been granted a discharge by the court.

E) Any loan with respect to which the borrower has filed a Chapter 13 bankruptcy and the credit union has not received a payment within 180 days or more after the confirmation of the plan, unless the plan stipulates repayment of the loan in full and the credit union has determined from the Trustee that plan payments are being made on a timely basis to the Trustee but have not yet been disbursed to the credit union.

F) Any loan with respect to which the borrower's whereabouts is unknown (a "skip"), unless there is a comaker whose whereabouts is known and the loan is less than 180 days delinquent.

G) Any loan where a "deficiency balance" has resulted from the sale of collateral or an insurance settlement unless there is documented evidence of periodic payments on a consistent basis in an amount sufficient to retire the deficiency balance in a reasonable time.

4) When there is evidence of collectability of loans meeting the loss loans criteria of subsection (c)(3), the credit union's records shall list the loans and classify them as substandard or doubtful and detail the evidence of collectability used to exclude each loan from the loss loan category. Evidence of collectability shall be the following collection activities and remedies:

A) Execution and filing of an enforceable reaffirmation agreement on the loan in a Chapter 7 bankruptcy proceeding prior to completion of the Division's loan analysis in any statutory examination of the credit union.

B) Voluntary repayment of the loan pursuant to section 524(f) of the federal Bankruptcy Code (11 USC 524(f)).

C) Collection of the loan pursuant to repossession of collateral without judicial process, or by replevin, detinue, forcible entry and detainer or mortgage foreclosure proceedings.

D) Collection of the loan pursuant to post-judgment enforcement remedies including wage deduction, garnishment and turnover orders entered in citation to discover assets supplementary proceedings.

E) The entry of a judgment pay plan order providing for repayment of the loan in a judicial proceeding.

F) Documented evidence of repayment of that portion of the loan covered by collateral protection or other insurance policies.

G) Documented evidence of periodic payments on a consistent basis in an amount sufficient to retire the loan balance in a reasonable time.

5) Before every dividend declaration or every closing date, all delinquent and bankrupt loans shall be individually classified as either substandard, doubtful or loss. All loans classified as losses must be charged off to the ALL.

d) Nothing in this Section shall be applicable to the establishment of an Allowance for Loan Losses account for business loans. Business loans shall be classified pursuant to Section 190.165.

(Source: Amended at 37 Ill. Reg. 12450, effective July 16, 2013)