

July 22, 2004
Alternatives Federal Credit Union

Allowance for Loan Loss Policy

The Alternatives' Board of Directors is responsible to ensure that management develops an Allowance for Loan Loss (ALL) policy that is in accordance with Generally Accepted Accounting Principles (GAAP). To make sure the methodology remains appropriate, the Board of Directors will have the methodology periodically validated and, if appropriate, revised.

The Chief Financial Officer and the **Risk Manager** are responsible to develop and implement the ALL policy. The ALL policy will conform to **FASB Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (FAS 5), and FASB Statement of Financial Accounting Standards NO. 114, Accounting by Creditor for impairment of a Loan (FAS 114)**, when applicable.

For financial reporting purposes, including regulatory reporting, the provision for loan losses calculations will be determined in accordance with GAAP. The **Risk Manager** will calculate the ALL evaluation monthly, appropriate adjustments will be based on the computed dollar amount, and information will be presented to the Budget Committee monthly.

The supervisory committee is responsible to review and ensure management's methodology and documentation in calculating the required ALL balance, and verify that it is in accordance with GAAP.

It is management's intention to utilize a methodology that is thorough, disciplined, and represents a consistently applied process that incorporates management's current judgments about the credit quality of the loan portfolio.

Alternatives' loan portfolio is composed of homogeneous pools of consumer loans, mortgages, and member business loans. Management will review all loans for relevant internal and external factors, loss history, collateral valued, guarantees, and methods to ensure they are applied consistently when estimating probable existing losses. Loss estimates will be modified for new factors affecting the loan portfolio. In calculating the ALL, management will utilize a **5-year** rolling average of net charge-offs that will be applied to the outstanding loan balanced in each loan category to determine the ALL requirement.

Loan categories are:

- Total Mortgage Loans
- Business Loans (**excluding business LOC**)
- Revolving VISA/LOC
- New Cars
- Used Cars
- Unsecured consumer loans
- Miscellaneous consumer loans
- **Excluded: Student Loans, Share Secured Loans, and Community Partnership Loans**

At times, adjustments of the loss measurement may become necessary. Management will consider the impact of the current environment factors and document which factors were used in the analysis and how these factors affect the loss measurement. Factors include, but are not limited to:

- Levels of and trends in delinquencies and impaired loans.
- Levels of and trends in charge-offs and recoveries.
- Trends in volume, mix, and terms of loans.
- Effects of any changes in risk selection and underwriting standards and other changes in lending policies, procedures, or practices.
- National and local economic trends and conditions.
- Experience, ability and depth of lending management and other relevant staff.
- Industry conditions.
- Effects of changes in credit concentrations.
- Real Estate collateral values.
- Losses that can be reasonably estimated.

