Sample Federal Credit Union
Member Business Lending
Risk Appetite Statement

The Board of Directors and management Sample Federal Credit Union recognize the opportunities and potential earnings enhancement benefits of member business lending. Risks associated with these loans are also recognized. In order to improve earnings related to these loans, the Credit Union will continue the growth of this segment of the loan portfolio in 2001 and will retain a greater share of originated loans. To compete effectively in the local market for these loans, limits of loans to any one borrower and lending limits of relationship managers will be increased.

While this represents an increase in risk, management and the Board of Directors believe that this additional, incremental increase in risk is effectively mitigated by changes in member business lending practice, procedures, controls and organization. Risk mitigation controls will be further strengthened through the deployment of enhanced credit risk management processes and systems in 2011.

The following sections outline the goals for future member business lending; the potential risks associated with such lending and risk management and mitigation practices.

Member Business Lending

The Credit Union has participated in member business lending for the past few years, first through the acquisition of participations and more recently through the internal origination of commercial and commercial real estate loans in the Credit Union's local markets. With regard to future member business lending, the focus of Sample is on originating loans: 1) within the credit union's defined local market, 2) in the general range of $6 to $8 million per loan and 2) secured primarily by commercial real estate with appropriate LTV.

New member business loans in 2011 are projected to be $180 million. It is anticipated that the majority of these loans will be internally generated by the credit union's Commercial Relationship Managers. Internally generated loan production will be augmented by selective purchases of loan participations from other credit unions and CUSOs that have a demonstrated record of quality credit underwriting. All loan participations will be underwritten by the Credit Union in accordance with its guidelines.

The regulatory limit for aggregate loans to one borrower is 15% of the credit union's net worth. This is approximately $40 million. Initially, Sample established the loans to one borrower limit at $6 million. Based on a number of factors, including: 1) the knowledge of commercial lending gained over the last three years, 2) the employment of experienced commercial lenders, 3) the shift to internally generated commercial loans versus purchases of participations and 4) the enhancement of lending policies, procedures and systems, this limit will be increased to $12 million. This remains substantially below the allowable limits.

The target member business loan portfolio balance for 2011 is $400 million. This represents approximately 11% of projected total assets at December 31, 2011 and is well within the NCUA regulatory guideline of 12.25% of assets. The projected portfolio would be comprised approximately 85% of loans secured by commercial real estate, with the remaining 15% secured by commercial and industrial (e.g., taxi medallion, operating lines, etc.).

Risk Impact

Analysis of member business lending losses (i.e., charge-offs) of a peer group of 26 credit unions over the last 2 ½ years versus Sample's performance reflects the following:

	Jun-10	Dec-09	Dec-08
Credit Union Peer Group Average*	1.000%	0.519%	0.726%
State Credit Unions Average	0.242%	0.287%	0.140%
Sample FCU	0.814%	0.177%	0.398%

***Credit Union Peer Group Average – 26 credit unions across the US or similar size and business characteristics to Sample**

Sample's loss experience compares favorably with the credit union peer group. It compares somewhat unfavorably with State Credit Union group as a whole. This is due primarily to losses

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on participations. Many State CUs that have member business lending programs have not purchased participations. Losses in the range of Sample are significantly less than those on similar commercial lending programs of commercial banks nationally and locally. Losses in the ranges incurred by Sample and peer groups would not have significant impact on future earnings, net worth or capital adequacy requirements.

Each of the loan categories noted in the prior section (i.e., commercial real estate, commercial) is includable 100% in risk-weighted assets for capital adequacy calculations. This would require a minimum net worth allocation of 7% or $25 million.

Management is aware that certain credit unions in the peer group experienced significantly higher loss rates in the 2008-2010 period than the peer group average. For example, Fairwinds CU (Orlando, FL) experienced the following loss percentages in that time period, 2010 - .97%, 2009- 13.54% and 2008 – 4.91%. Additionally, it is likely that other loans in the portfolio at this credit union required substantial reserves against potential losses and that further impaired earnings.

The Board of Directors and management, however, believe that the scope of the proposed member business lending program for Sample, and the potential losses on that portfolio would be more in line with: 1) the State Credit Union averages as a Best Case scenario, 2) 75% of current loss percentages as an expected case scenario, due to substantial suspension of participation purchases and a shift to internally generated, local market loans. A worst case scenario would be a range from 5%, the annual average loss percentage of the five worst peer group performers to 8% the annual average loss percentage of worst of the peer performers. This range of worst case loss percentages represents losses of $20-$32 million on a portfolio of $400 million.

Credit Risk Management and Mitigation

Risk characteristics of these loans will be conservative, with LTV's 70% and below. This limit is below the allowable limit under NCUA guidelines of 80% LTV. In accordance with the credit union's credit risk rating guidelines, a debt service coverage ratio of 1.30 is the target for loans

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with acceptable risk. In instances where other factors, including demonstrated repayment record of the borrower, strength of collateral, and others, loans may be originated with debt service coverage ratio up to 1.40%. Loans in excess of $12 million will be participated out without recourse. Sample will retain servicing and the deposit relationship. Construction loans will be entertained on a select conservative basis.

In addition, the credit union's credit administration practices have been enhanced and will include:

- Employment of a Credit Administration Officer, independent of the loan origination process
- Functional segregation of responsibilities between loan origination/approval and loan funding and administration
- Annual Reviews of each credit relationship, with updated financial statements and analyses; and validation of risk rating
- Monitoring of portfolio delinquency, stress testing results, risk rating migration, and concentrations by industry, collateral, location and other factors
- Independent 3rd party reviews of the quality of the member business lending portfolio and compliance regulatory and credit union guidelines and policies

Summary

The Board of Directors and management's opinion is that the Credit Union has sufficient net worth and earnings capacity to support the increase in the member business loan portfolio to $400 million, created in accordance with prudent, conservative, but competitive underwriting guidelines in place at Sample, with credit risk effectively managed as outlined in this statement.

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