

Concentration Risk Management: A Modern Framework for Credit Unions

Concentration risk appears to be an increasing regulatory priority for the NCUA. The number of questions from our clients in this area continues to trend higher—particularly over the second half of 2025. It does not come as a huge surprise given the agencies’ 2025 priorities, where they noted accelerating risk in credit cards, used auto loans, and junior-lien 1-4 family real estate. These carry higher loss volatility, weaker collateral protection, and greater sensitivity to economic and household-financial stress.

Regulators have long emphasized that concentrations pose heightened safety-and-soundness risks, not because of average performance but because of their tail-loss potential. The FFIEC’s Interagency Guidance on Concentrations in Commercial Real Estate (2006) stresses the need for robust identification, measurement, monitoring, and control systems. The NCUA—through 12 CFR 741, supervisory letters, and annual priorities—expects federally insured credit unions to maintain written, board-approved concentration limits that are measurable, defensible, and aligned with the credit union’s capital strength and risk appetite. Given the current macro environment, the NCUA is placing greater scrutiny on whether credit unions understand how adverse credit conditions could affect portfolios that are growing faster than historical norms.

Developing a Sound Approach to Concentration Limit Setting

A strong concentration-risk framework incorporates both quantitative analysis and peer-informed calibration, ensuring that policy limits are not arbitrary but grounded in demonstrated capacity to absorb losses. While approaches vary by credit union, regulators expect sound methodologies to include the following elements:

1. Identify a severe but plausible credit-loss scenario

A fundamental step is to establish a stress-case net charge-off rate for each major concentration. Credit unions often use:

- Their own historical worst-year charge-off rates
- Peer-group percentile losses
- Scenario-based adjustments informed by macroeconomic outlook

This aligns with the FFIEC’s expectation of using stress scenarios that reflect adverse economic outcomes and portfolio-specific vulnerabilities.

2. Apply the stress-loss rate assuming the concentration reaches its policy limit

Regulators consistently remind institutions that concentration limits should reflect potential exposure, not just current balances. The NCUA emphasizes evaluating exposure at limit, meaning the stress loss should be modeled as if the portfolio grows to the maximum amount permitted by policy.

This provides a forward-looking measure of whether the credit union could withstand losses if the concentration expands to the boundary approved by the board.

3. Assess capital impact and compare to risk-tolerance thresholds

The stress losses are then applied against current capital to calculate metrics such as:

- Capital at Risk (bps impact)
- Stressed Capital Ratio
- Post-stress Net Worth or Leverage Ratio

These metrics help boards determine whether current (or proposed) limits are supportable given the credit union’s capital strength, earnings capacity, and broader risk profile.

4. Compare policy limits against peer percentiles to avoid outlier status

A well-designed framework also benchmarks the credit union’s limits against peer concentrations for each portfolio type. This comparison provides two important benefits:

- Regulatory defense: The NCUA frequently flag credit unions whose limits far exceed peer norms, especially when not accompanied by enhanced monitoring or underwriting practices.

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- Strategic calibration: Ensures the limit reflects competitive posture, portfolio objectives, and the credit union’s balance-sheet diversification strategy.

Peer alignment is explicitly supported in FFIEC guidance, which states that limits should be commensurate with the institution’s capital, management expertise, and market environment.

Governance, Monitoring, and Ongoing Review

Regardless of the quantitative approach used, regulators expect strong governance practices, including:

- Clear board-approved limits tied to risk appetite
- Quarterly reporting of concentration levels, growth trends, and stress-based capital impacts
- Annual review and recalibration of limits based on updated losses, peer data, and capital position
- Documentation demonstrating board understanding and approval of the methodology

NCUA guidance emphasizes that concentration-risk management must be integrated with capital planning, CECL, ALM, liquidity planning, and strategic planning. It should not be treated as a stand-alone compliance exercise.

Loan Participations as a Tool to Manage Risk

More and more financial institutions are using loan participations as a primary tool for managing concentration risk. Participations enable institutions to sell portions of higher-growth segments that are approaching policy limits, while also purchasing exposure to asset classes that improve diversification. When aligned with the concentration-limit framework described above, participations serve as a flexible balance-sheet adjustment mechanism—allowing institutions to rebalance risk and support prudent growth without relying solely on organic runoff or tightened underwriting.

Conclusion

We expect concentration risk management to remain a key theme going into 2026 and beyond. To navigate this environment effectively, credit unions should adopt a stress-based, peer-informed, capital-aligned framework for setting and managing concentration limits.

By identifying severe but plausible loss rates, evaluating exposures at the policy limit, measuring capital impact, and ensuring alignment with peer norms, boards and executives can confidently demonstrate that their concentration limits reflect both regulatory expectations and prudent risk appetite. This approach enhances safety and soundness, strengthens capital planning, and positions credit unions for more constructive and credible examinations.

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