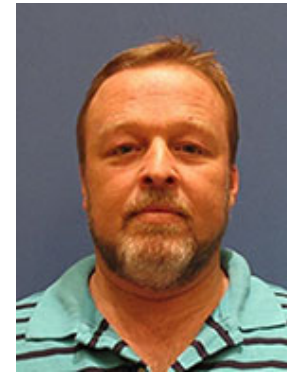




# **Welcome to NCUA Supervisory & Examination Priorities for 2017**



**Jared Ihrig**  
**Chief Compliance Officer**  
**Credit Union National**  
**Association**



**Tim Segerson**  
**Deputy E&I Director**  
**National Credit Union**  
**Administration**

# Agenda

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- **Look at the Numbers**
- **Process**
  - Mechanics of the Priorities Letter
  - Exam Process Improvements
- **Issues**
  - Cybersecurity Assessment
  - Bank Secrecy Act Compliance
  - Internal Controls and Fraud Prevention
  - Interest Rate and Liquidity Risk
  - Commercial Lending
  - Consumer Compliance
- **Q&A**

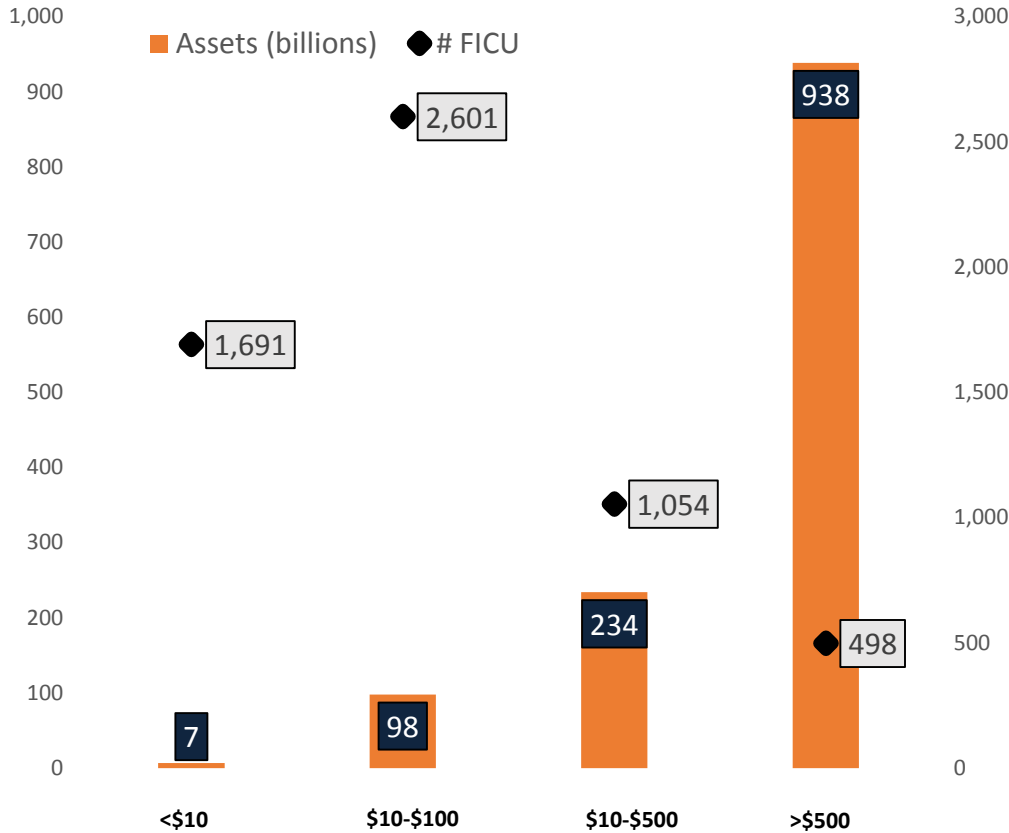
# Industry is doing well, but...

	Asset Group Under \$10 million	Asset Group \$10 million to \$100 million	Asset Group \$100 million to \$500 million	Asset Group \$500 million and Greater
# of Credit Unions	1,691	2,601	1,054	498
Total Assets	\$6.97 billion	\$97.87 billion	\$234.02 billion	\$938.43 billion
Average Assets/CU	\$4.12 million	\$37.63 million	\$222.03 million	\$1,884.40 million
Net Worth / Total Assets	15.05%	11.84%	10.91%	10.70%
Average Net Worth (non-dollar weighted)	16.26%	12.28%	10.95%	10.86%
Net Worth Growth*	0.70%	3.39%	5.88%	8.69%
Return on Average Assets (ROA)*	<b>0.12%</b>	<b>0.36%</b>	<b>0.55%</b>	<b>0.89%</b>
Net Interest Margin/Average Assets	3.34%	3.04%	3.06%	2.82%
Fee & Other Income/Average Assets	0.66%	1.13%	1.44%	1.34%
Operating Expense/Average Assets	3.67%	3.59%	3.65%	2.91%
Members / Full-Time Employees	410.12	393.99	346.93	399.11
Provision for Loan Loss/Average Assets	0.28%	0.25%	0.33%	0.41%
Loans / Shares	57.27%	60.45%	72.95%	82.20%
Delinquent Loans / Total Loans	1.85%	1.09%	0.85%	0.72%
% of Real Estate Loans Delinquent > 59 Days	1.61%	1.07%	0.78%	0.57%
% of Member Business Loans Delinquent > 59 Days	1.12%	0.60%	1.21%	1.63%
Net Charge-Offs/Average Loans	0.63%	0.48%	0.47%	0.55%
Share Growth*	2.05%	4.54%	6.53%	9.72%
Loan Growth*	1.75%	5.18%	8.51%	11.57%
Asset Growth*	1.86%	4.50%	6.61%	9.58%
Membership Growth*	-1.24%	0.49%	2.79%	6.90%
Net Long-Term Assets / Total Assets	9.94%	22.92%	31.03%	33.36%
Cash + Short-Term Investments / Assets	30.23%	21.88%	15.41%	13.30%
Borrowings / Shares & Net Worth	0.12%	0.31%	1.37%	4.98%

\*Note: These items are based on the same federally insured credit unions reporting at 12/31/2015 and 09/30/2016, based on 09/30/2016 assets.

# Concentration Continues

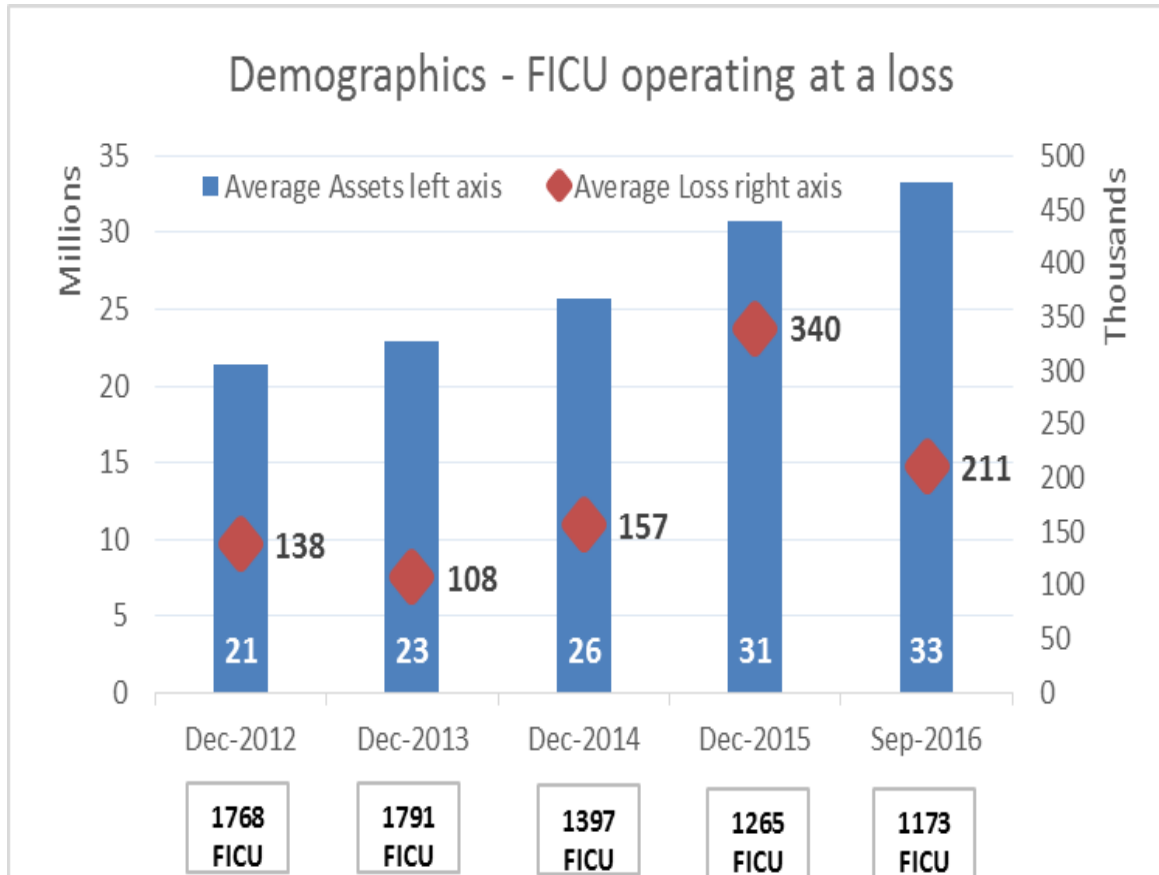
Asset Distribution by Asset Range (09/30/2016)



- **73% FICU = 8% system assets**
- **27% FICU = 92% system assets**
- **FICU > \$500mm = 74% assets**

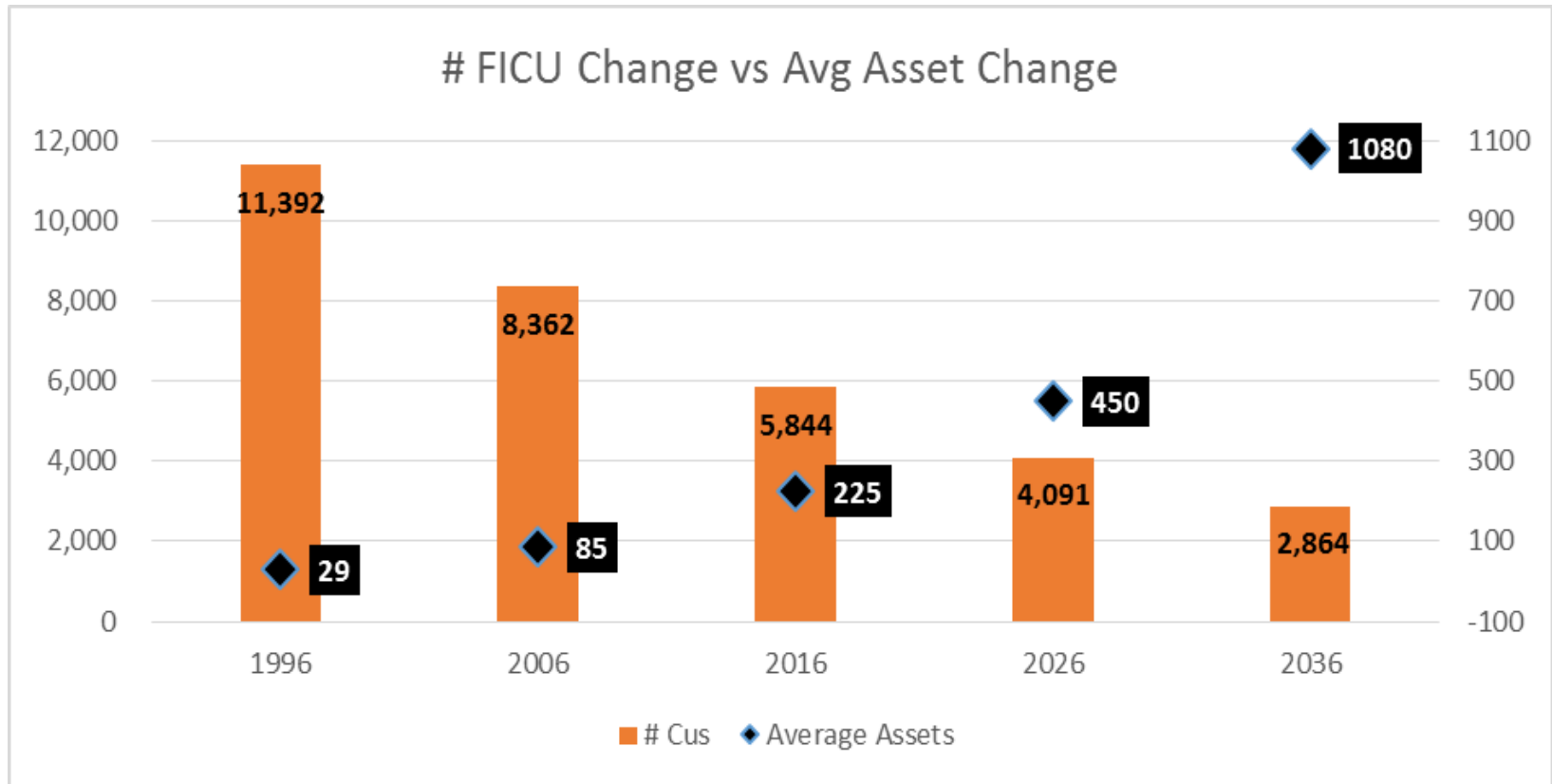
Avg. Assets	<\$10	\$10-\$100	\$10-\$500	>\$500
	\$4.1 million	\$37.6 million	\$222 million	\$1.9 billion

# Operating at a Loss



- **20% FICU**
- **\$30 billion Total Assets**
- **\$1.3 billion losses over 5 Years**
- **Asset Growth <1%**
- **Member Growth 1%**
- **Delinquency 3.5%**
- **Loan Loss 2%**
- **Margin=Operating Exp. (4.1 vs. 3.9)**
- **Cash = 19% Assets**

# Looking out 10-20 years



# A word about examinations

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- **Communication is key**

- 98% of CUs well run, interested in doing the right thing for the organization and members.
- For the 98% providing insight and context to examiners can make a big difference – smooth the road, shorten the exam, and improve the experience.
- Examiners are expected to be open and collaborative wherever possible.

- **Set Expectations up Front**

- Work out exam administration details ahead of time.
- Work space, conducting meetings and interviews, touch points on issues and concerns.
- Questions/call examiner in advance to get answers.
- Expect logical and professional rationale and justification.
- Offer solutions – no one has all the answers or the best ideas.



# Exam Priorities Development

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## Forward Assessment

- Robust Internal Discussion
- Monitoring Industry and Economic Trends
- Identifying Risk, Risk Trends and Risk Drivers
- Identifying New Requirements

## Exam Scope Design

- Review exam scope procedures
- Identify needed changes
- Issue staff directives and train where needed.

## Industry Focus Letter

- Identifies area of emphasis – upcoming exam cycle
- Resource commitment
- Ideal transparency

# Process Improvement – Exam Flexibility

## FCU Extended Exam Cycle – must meet all of the following:

- Assets less than \$1 billion;
- CAMEL code 1 or 2, in both the composite rating and the management component rating;
- “Well capitalized” under prompt corrective action regulations;
- No outstanding documents of resolution items related to significant recordkeeping deficiencies; and
- Not operating under a formal or informal enforcement or administrative order

## FISCU Exam – selective based on risk and trends unless a FISCU meets any of the following:

- Assets > \$1 Billion
- NCUA CAMEL Composite 4 or 5 with assets > \$50 million
- NCUA CAMEL Composite 3 with assets > \$250 million

## Examination Procedure Improvement:

- Four weeks notice
- Improved alignment of information/document requests
- Formalize/separate pre-exam planning

# A Few Notes

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## Caveats

- Presence of risk either financial or operational can trigger accelerated contact.
- Growing emphasis and importance of ongoing offsite monitoring.
- There are no absolutes – specific issues, trends or combination of trends and issues may drive alternate supervision plan.

## Offsite Supervision – evolving and will grow in importance

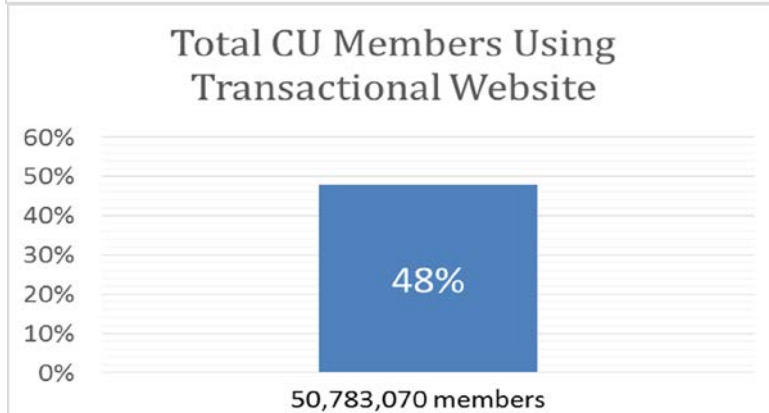
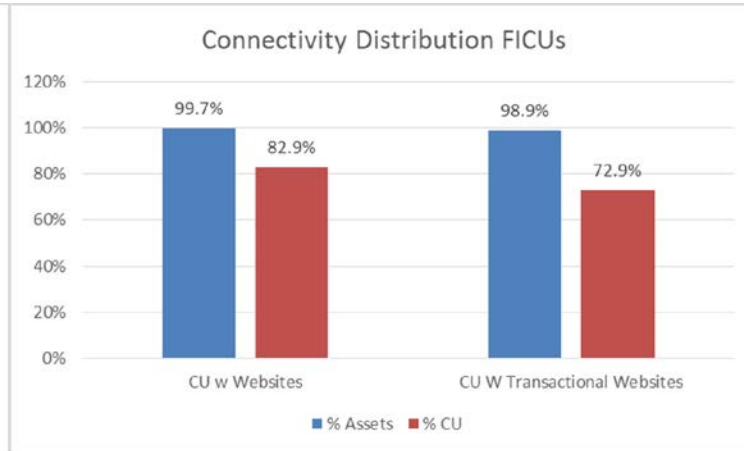
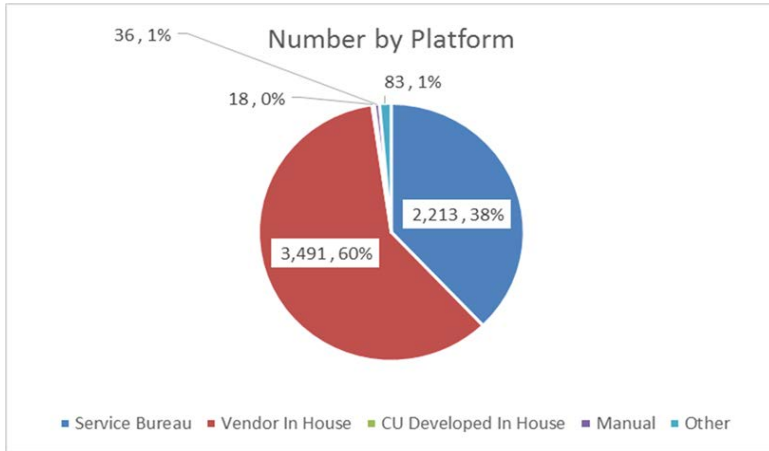
- **Recent Change – Obtain audit report during cyclical risk reviews – when audit is completed.**
  - Preferred direct receipt
  - Via Supervisory Committee when necessary
  - Must be independent of management
  - This is not an indictment of management

**Ongoing work - leveraging technology, coordinating with SSAs and improving coordination with SSAs.**

**Will there be an increased focus on the effectiveness of a credit union's compliance management program? The effective date of the Consumer Compliance Rating System (FFIEC) is at the end of March, can you provide detail on how credit unions will be evaluated for compliance with consumer protection statutes and regulations?**

**We've heard that firms conducting financial audits for credit unions have been asked to submit the audit reports directly to NCUA. We understand that credit unions are obligated to share this information with the agency, but audit firms are not. Can you provide more information on this?**

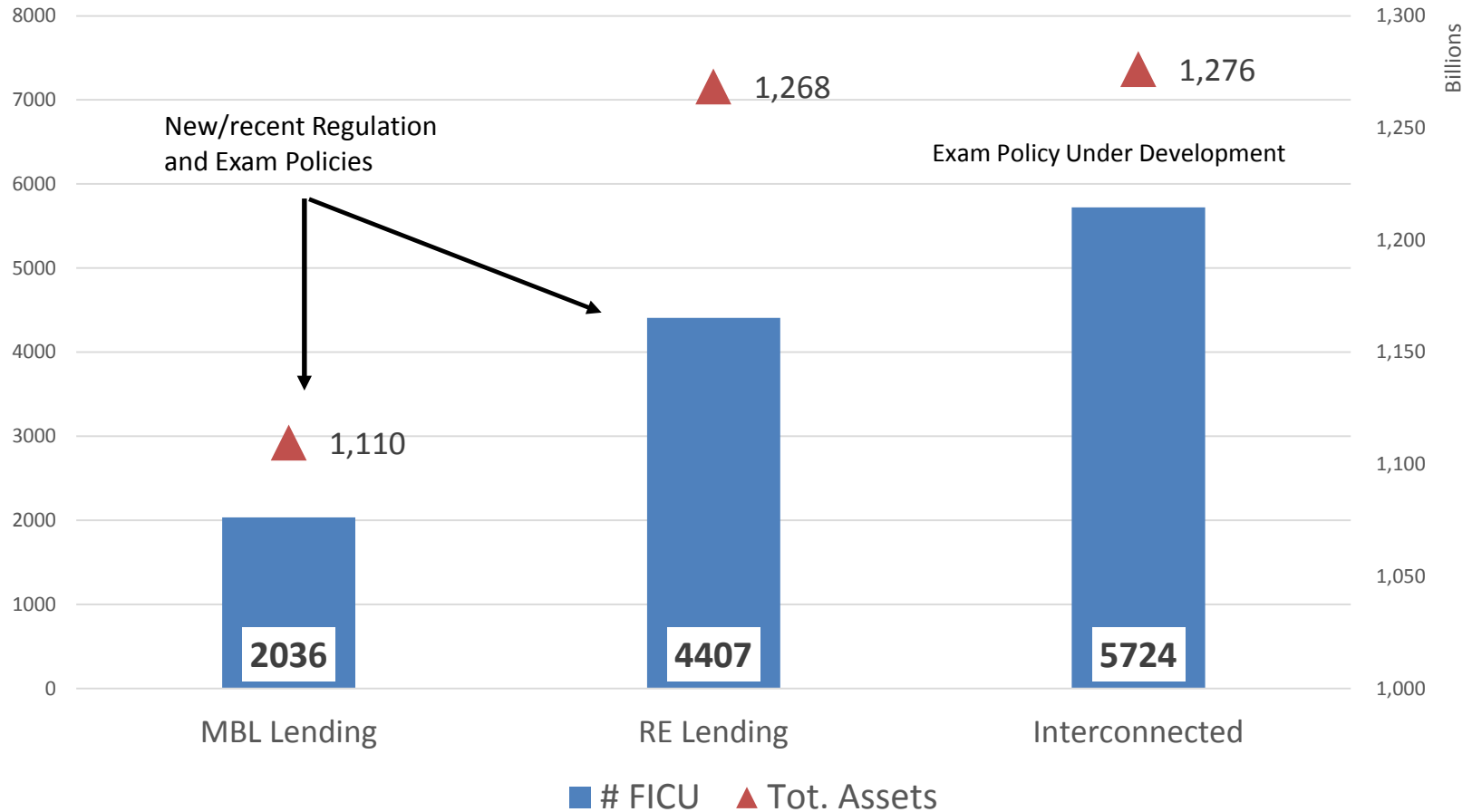
# Cybersecurity



As threat landscape changes potential exposure in the system is among the largest.

# Comparative Risk Drivers

## Risk by #Units & Assets Exposed



# NCUA Goals

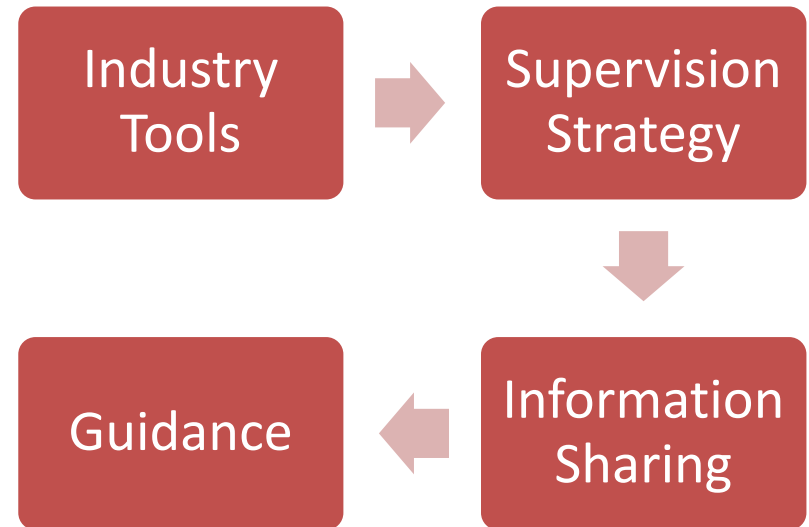
Transparent, collaborative and entrepreneurial strategy toward Cyber.

Facilitate growth and strengthening

Weaving cyber into day to day business in industry and as a regulator

Evolutionary process adapt to changing environment ..... Continuous progress

Baseline and beyond





# Cybersecurity Considerations

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- **Have a strategy that is consistent with your risk.**
- **Design or embrace a structured approach (like the CAT) to evaluate strengths, weaknesses.**
- **Identify priorities.**
- **Make a plan for improvement.**
- **Periodically revisit the plan, and assessment.**
- **Examiners will be testing a new CAT based exam approach in late 2017.**

**Navigating the cyber assessment tool is cumbersome, are there any plans to address this?**

**Do you anticipate a review of IT staff credentials, certifications, and training during the exam process?**

**Will there be an increased focus on a credit union's oversight of third-party technology vendors?**

# Bank Secrecy Act

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- **Changing Risk Dynamics:**
  - Growing number of business accounts.
  - Increasing interconnectivity and electronic services.
  - Sophistication of criminal enterprises growing.
- **Technology changes insulates, streamlines and eliminates once relied upon safeguards.**
- **CUs and the US financial market place is more “global” than ever.**
  - It is important to know drug trafficking and high risk areas.
  - It is important to know global affairs more than ever.

# The Good News

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- Enforcements are Relatively Few in Credit Unions.
- Scrutiny is increasing.
- Pace of major violations is accelerating.

## FinCEN Enforcement Actions

### 1999 - 2017

Casinos	12
Depository Institution	35
Money Service Business	30
MSB Depository Inst.	1
Precious Metal	1
Securities Dealers	4
	83

### 2008 - 2017

Casinos	9
Depository Institution	18
Money Service Business	22
Precious Metal	1
Securities Dealers	2
	52

### Credit Unions

1999-2017	3
2008-2017	2

<https://www.fincen.gov/news-room/enforcement-actions>

# The Bad News

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- **FICU especially small may be targeted for manipulation or takeover:**
  - High fee revenue is tempting
  - Less expertise and separation of duties (oversight)
  - Flow of funds may not be readily noticeable to volunteers
- **Increasing findings of institutions not prepared to manage the risk.**
  - Staff qualifications
  - Insufficient analytics
  - Insufficient SAR detail when reporting

**Remember – BSA is primarily a reporting requirement.**

# Bank Secrecy

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- **NCUA Letter to CU 14-CU-10 sheds light on sound practices**
- **Important to treat businesses with greater care**
- **Important to treat higher risk businesses like non bank financial companies with a greater level of care.**
  - Initial due diligence and risk assessment
  - Level setting (what is the norm)
  - Monitoring and analyzing
  - Investigating changes and periodic re-assessing
- **School yourself if you are into or thinking of getting into providing account services to businesses.**



**What will an examiner look for during a credit union's BSA exam that does business with an MSB(s)? Are there any other types of business that NCUA considers high-risk?**

**Will there be an increased focus on a credit union's incident response program as it relates to unauthorized use/access of member information?**

# Military Loan Act

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- **Compliance Review for MLA is a baseline review in 2017**
- **Some considerations**
  - Covered persons service persons and dependents
  - Covered transactions may include other types of consumer loans
  - Prohibitions on certain actions and fees
- **Understand safe harbor protections**
  - It is on the FICU to identify covered persons
  - See Letter to Credit Union 16-CU-07 for complete information



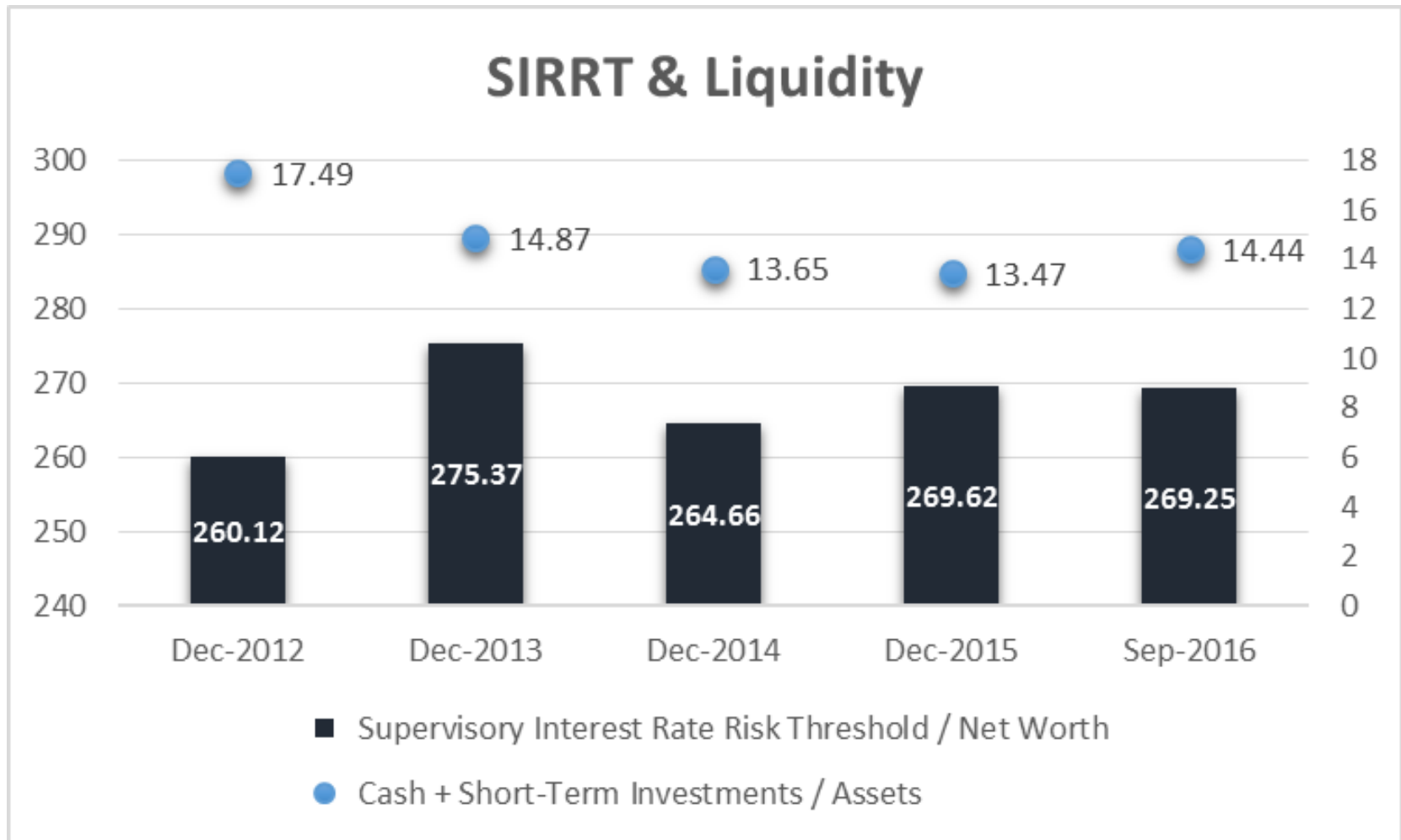
# Fraud Identification and Detection

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- **NCUA is not a Fraud Auditor**
  - Exam scope is much broader
  - Focus on consumer protection and safety and soundness
- **Tailored exam procedures contain fraud detection techniques**
  - SCUEP Exam Procedures
  - Ongoing supervision processes changes
  - Identifying IC weaknesses and offsetting mitigation strategies
- **See Inspector General Reports for Issues and NCUA Improvements.**



# IRR Indicators



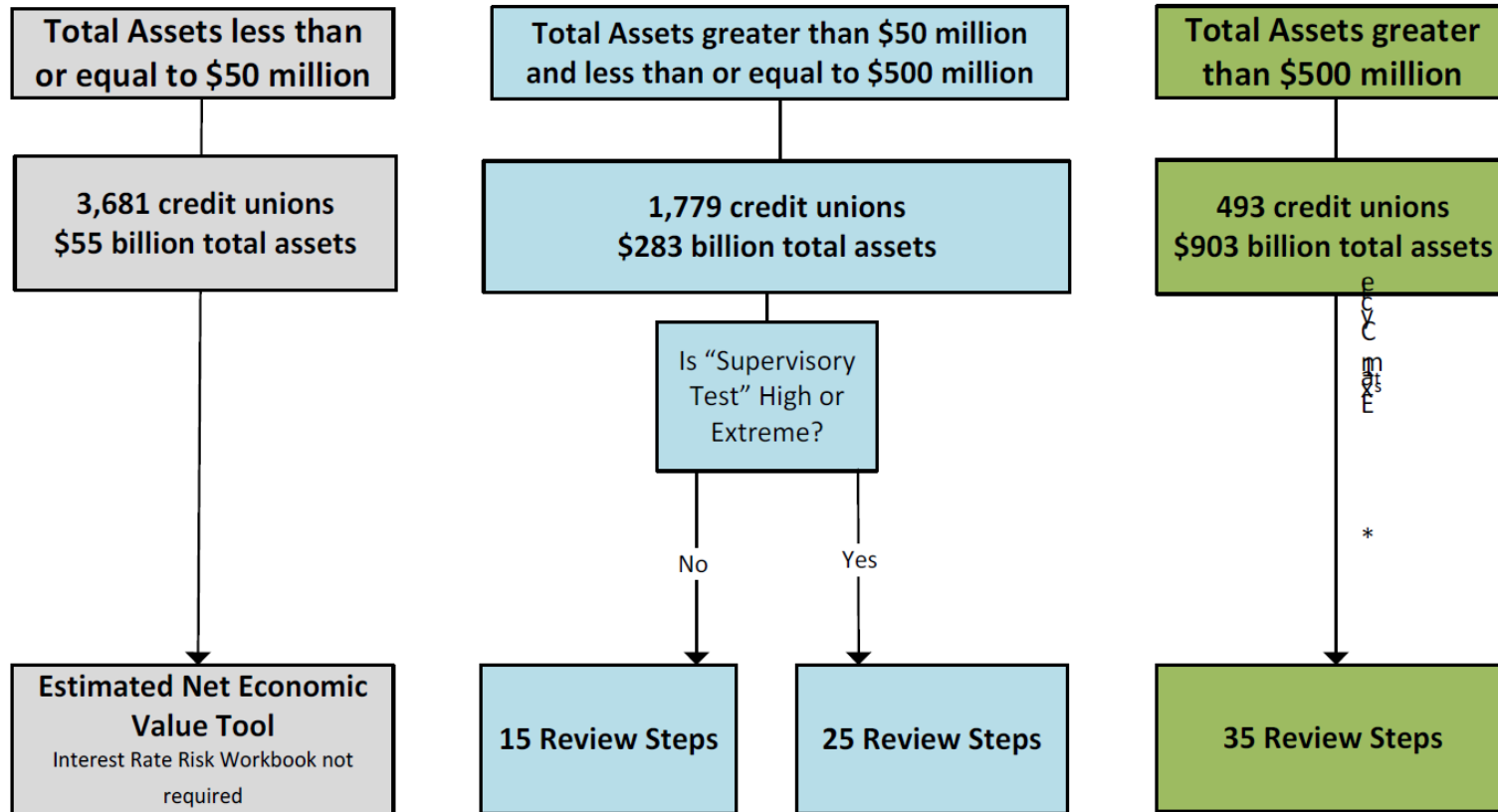
# IRR Structured Exam Process

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- **IRR Review Restructure**
  - More precision and consistency in risk assessment.
  - More precision in resource deployment.
  - Minimizes burden on lowest risks.
  - Baseline review on moderate risk.
  - Expanded review on highest risk.
- **Liquidity can be the event trigger in unsettled markets.**
  - Poor liquidity management can spell disaster.
  - Good liquidity management provides time and options
- **16-CU-08 guides examiners on process**



# Interest Rate Risk Supervisory Structure

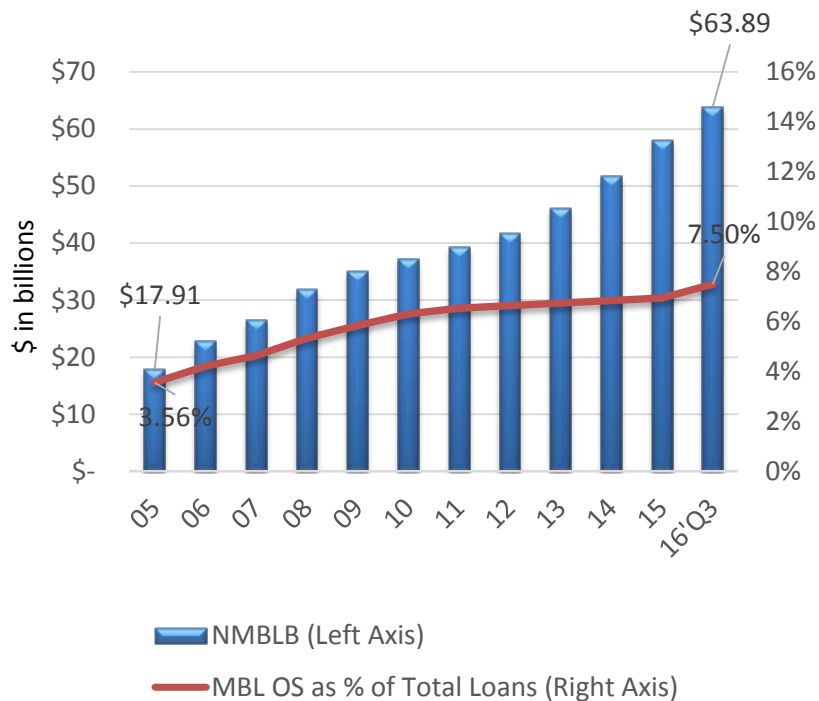


\* Examination Scope to be reassessed after one full exam cycle

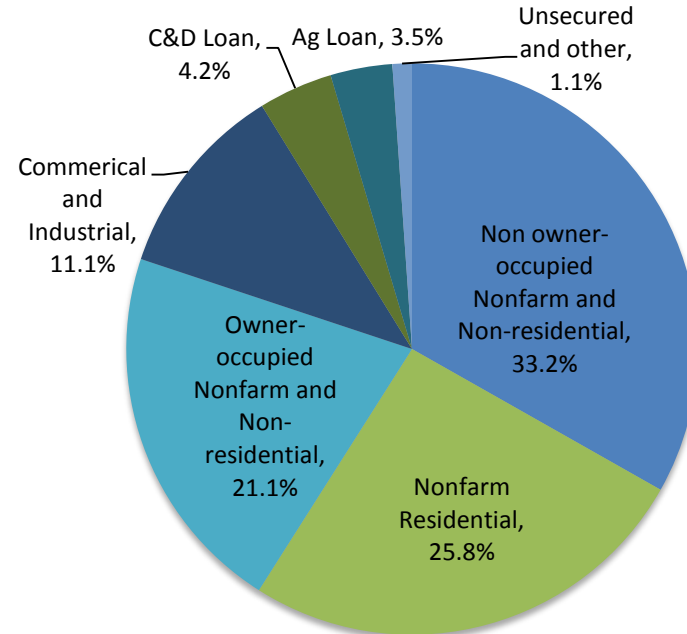
Data from March 2016

# MBL a Major CU Product Line

Net MBL Balance (NMBLB) and  
MBL as % of Total Loans



Distribution of Commercial Loans





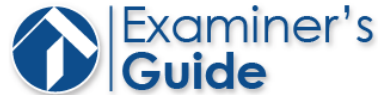
# Commercial Lending

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- **New Regulations – New Approach**
  - Automatic safeguards are removed
  - Management must thoughtfully develop the program
  - Sound principles are emphasized and expected
- **Exam Strategy**
  - Evaluating robustness of risk management process and program
  - Significant and ongoing training for examiners
  - New Examination Guidance – Letter to CU 16-CU-11 will guide examiner reviews.

# New Examiner Procedures and Guidance

Interest Rate Risk and Commercial Lending are Published New Review Areas in 2017



A screenshot of the Examiner's Guide website. On the left is a navigation menu with a "Contents" tab and a "Glossary" tab. The "Contents" menu lists various topics such as "Commercial and MBLs", "Business Entity Types", "Board and Mgmt Responsibilities", "Commercial Loan Policy", "Credit Risk Rating Systems", "Loan Administration", "Collateral", "Personal Guarantees", "C&amp;D Loans", "Prohibited Activities", "Aggregate MBL Limit", "State Rules", "Exam Procedures", "Fidelity Bond Coverage", "Interest Rate Risk", "Risk-Focused Examination", and "Total Analysis Process". The main content area shows the "Examiner's Guide Home" page. It includes a heading "Examiner's Guide" and a paragraph stating that NCUA provides the guide as a resource for staff. A grey box contains an update notice: "NCUA is updating sections of the Examiner's Guide on an ongoing basis. As of November 25, 2016, Rate Risk, Risk-Focused Examination Program, Total Analysis Process, and Commercial and Member Services are being updated. Until content for other review areas is finalized, existing supervisory guidance (available on NCUA's website) will be informed." Below this, a heading reads "To help examiners navigate the content of the guide, it has been organized into three primary areas". A table with two columns, "Examination Process" and "Review Area", is partially visible at the bottom of the screenshot.

<https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/Home.htm%3FTocPath%3D1>

# **What are the roles of the Board and Senior Management as it relates to a credit union's commercial lending program?**

## Questions?



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