DCU BULLETIN

Division of Credit Unions

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Examination Focus for 2015

The Division of Credit Unions' (DCU) six main areas of exam focus for 2015 are discussed below.

Many of the examination focus areas have changed from 2014 to 2015. Specifically, liquidity and cybersecurity are added to the 2015 list, while balance sheet management, operating expense control, and the advancement and use of new financial delivery technologies and the safeguarding of member confidential information were deleted from the list.

The examination focus for your individual credit union may or may not correspond with DCU's 2015 exam focus areas. Examiners will continue to risk focus each individual examination to effectively and efficiently use our limited exam resources. This helps DCU better address the safety and soundness and regulatory concerns of the 60 state chartered credit unions under its regulatory purview.

The following are DCU's six main areas of exam focus for 2015:

1. **<u>Liquidity Risk</u>** – On average, liquidity levels at credit unions decreased significantly in 2014 (from January 1, 2014 to September 30, 2014). Specifically, the cash plus short-term investments ratio declined significantly. DCU examiners are closely monitoring this trend and they will review whether overall liquidity management is sufficient and whether credit unions can meet its future cash flow needs under stressed scenarios. DCU examiners will continue to evaluate whether credit unions are adhering to the requirements of NCUA's liquidity rule 12 CFR 741.12, which became effective on March 31, 2014. The intent of this rule is to ensure credit unions conduct sound liquidity planning. Additionally, DCU may require credit unions to set higher liquidity ratio floor limits, if deemed appropriate for the credit union. Lastly, DCU will breakout the CAMEL component rating of "L" (currently used to examine several factors within asset liability management). This component rating will be separated into a component rating of "L" for liquidity and a separate component rate of "S" for sensitivity to market risk (interest rate risk). This change will be implemented in the spring of 2015.

2. **Interest Rate Risk (IRR)** – Examiners will closely evaluate and review each credit union's overall IRR management program and balance sheet composition to determine whether IRR levels are too high and to analyze compliance with 12 C.F.R. 741.3(b)(5). Examiners will consider the following main factors when evaluating a credit union's overall IRR level: (1) The current and projected levels of net income and net worth; (2) The ability of management, including the board of directors (board), to manage and control IRR; (3) The ability of staff and management to accurately measure and assess IRR exposure; (4) The credit union's current IRR trend; and (5) Whether the credit union's asset liability management (ALM) and IRR strategies and practices are consistent with anticipated market interest rate changes and board approved IRR tolerance limits.

   Examiners' focus on ALM and IRR will be more in depth for credit unions with higher levels of long-term fixed rate assets and higher levels of IRR. Credit unions with higher levels of IRR and balance sheet complexity should have more developed IRR policies, procedures, modeling systems, reporting, and control systems in place. Credit unions with limited IRR exposure will not be expected to have extensive IRR management programs.

3. **Cybersecurity** – Cyber-attacks against credit unions and other financial institutions are becoming more frequent and sophisticated. Credit union management must be proactive in protecting their credit unions from cyber-attacks and helping ensure member confidential data is sufficiently protected. Examiners will ask management and staff about how their credit unions deploy appropriate defenses to protect information systems and confidential information, including confidential information entrusted to vendors. Specifically, DCU examiners will focus their reviews on the following cybersecurity/information security program content:

   - Information security policies and procedures;
   - Cybersecurity/information security risk assessments;
   - Cybersecurity/information security control testing;
   - Information systems unusual activity monitoring;
   - Security awareness education and training;
   - Encryption of credit union information systems and sensitive member information;
   - Vendor oversight as it relates to keeping member information secure;
   - Incidence response program; and
   - Business operations recovery after a cybersecurity incidence.

   DCU understands that cybersecurity does not have a one size fits all solution and that the success of an information security program will be dependent upon its business model, size and complexity.

4. **Credit Risk Management Program**– Examiners will continue to stress the importance of having a strong credit risk management (CRM) program that effectively and proactively manages credit risk. Successful CRM programs help reduce loan losses, increase the effectiveness of loan pricing, proactively address potentially troubled borrowers, and increase lending volume by finding opportunities for the credit union to better serve its members. Strong CRM programs use credit score and collateral value migration analysis to proactively limit and reduce loan portfolio credit risk exposures and to seek out ways to better serve its membership's lending needs.

   Examiners will focus on evaluating whether the credit union's CRM program is appropriate for the size and complexity of its lending program and risk profile. They will review how well the CRM program is implemented and used in lending, collections and credit risk decision making processes, including the setting of appropriate loan concentration limits.

5. **Consumer Protection Law Compliance** – The focus of DCU's 2015 compliance examination program will continue to be similar to its focus in 2014, with the addition of the new TILA-RESPA integrated disclosure rule requirements that will be required as of August 1, 2015.

   DCU plans on scheduling six separate compliance examinations at credit unions with total assets over $500 million. Examiners will continue to evaluate the following: (1) The effectiveness of the overall compliance management program; (2) The program's ability to detect and self-correct compliance problems; and (3) The credit union's timeliness in implementing new regulatory compliance requirements. This is in addition to examiners reviewing a credit union's compliance with specific consumer compliance regulations.

   Except for the six credit unions with scheduled separate compliance exams, compliance work will be done during regular safety and soundness examinations. Examiners will focus on the overall effectiveness of a credit union's compliance program, given its asset size and product offering, the new TILA-RESPA integrated disclosure requirements, and the Ability-to-Repay and Qualified Mortgage Standards Rule that became effective in early 2014.

6. **The Importance of Having Strong Management Throughout the Credit Union** – The biggest determinant of a credit union's success is the quality of its management (including the board of directors and supervisory committee). Examiners will continue to evaluate whether a credit union has strong management to develop and implement programs and products that minimize risks while keeping the credit union productive and profitable.

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