DCU BULLETIN

Division of Credit Unions
Washington State Department of Financial Institutions
Phone: (360) 902-8701 ***FAX: (877) 330-6870***

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Examination Focus for 2014

This Bulletin is written to give the Division of Credit Unions' (DCU) examination focus for 2014. DCU has seven main areas of exam focus for 2014, which are discussed below.

The examination focus for your individual credit union may or may not correspond with DCU's seven main areas of exam focus for 2014. 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 62 state chartered credit unions under its regulatory purview.

The following are DCU's seven main areas of exam focus for 2014:

1. **Interest Rate Risk (IRR)** – Examiners will closely evaluate and review each credit union's overall IRR 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 high 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.

2. **Balance Sheet Management** – Examiners will evaluate whether the credit union has a well distributed balance sheet that generates sufficient net income to be long-term viable without creating excessive risks (credit, IRR and liquidity). Examiners will ask management about improving balance sheet management when revenues are not creating sufficient earnings (net

income), and when it appears that credit, interest rate or liquidity risks are excessive and not well managed or controlled.

3. **Operating Expense Control** – Examiners will meet with management, if operating expenses are too high for the credit union's ability to generate revenues and be profitable. Credit unions should continually seek to reduce operating expenses without negatively impacting their ability to generate sufficient revenue. One area that examiners have found lacking is branch profitability analysis. Branch profitability analysis is more and more important as competitive and efficiency stresses continue throughout the financial services industry.

4. **Consumer Protection Law Compliance –** Consumer compliance examinations will continue to be focus in 2014. DCU will schedule eight separate compliance examinations in 2014 at credit unions with total assets over $500 million. Examiners will evaluate a credit union as to the following: (1) The overall compliance management program; (2) Its 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 regulations. During regular safety and soundness examinations, examiners will focus on compliance with the new Consumer Finance Protection Bureau mortgage lending laws (effective in early 2014), and the overall effectiveness of a credit union's compliance program, given its asset size and product offerings.

5. **The Advancement and Use of New Financial Delivery Technologies and Safeguarding Member Confidential Information** – Because new financial product and delivery technologies will significantly change the financial services industry in the future, examiners will ask management about how it is implementing these new technologies in an effective and safe and sound manner, particularly as it pertains to the operational, compliance, and security risks of these new technologies.

   Examiners will check that credit unions are vigilant about protecting their information technology (IT) systems from attacks, and ensuring confidential member information is safeguarded. More specifically, examiners will ask management and staff on how they educate themselves on current and emerging cyber threats and deploy appropriate defenses to protect information systems and confidential information. Examiners will also ask how management ensures that member confidential information entrusted to vendors is properly protected.

6. **Credit Risk & Credit Risk Management** – Examiners will closely review specialized and new lending programs to evaluate whether credit risks are properly managed and controlled. Examiners will also continue to stress the importance of having strong credit risk management programs that effectively and pro-actively manage credit risk.

7. **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 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.

Any questions about this Bulletin should be directed to Doug Lacy-Roberts at Doug.Lacy-Roberts@dfi.wa.gov or (360) 902-8753.