



DCU BULLETIN

Division of Credit Unions

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Examination Focus for 2018

This Bulletin establishes the Division of Credit Unions' (Division's) examination focus areas for 2018 and will help credit unions better prepare for their 2018 examinations.

1. Cybersecurity

Cybersecurity risks represent a significant area of concern to all financial institutions. Because of these risks, the Division will continue to allocate additional resources to our information technology (IT) security exams. Onsite IT security exams will be performed during most safety and soundness examinations. IT examiners will continue to stress the importance of each credit union completing the FFIEC cybersecurity self-assessment tool¹ or a similar assessment tool.

Cybersecurity attacks against credit unions remain persistent, sophisticated, and expensive to remedy. The FFIEC cybersecurity assessment tool or an appropriate substitute will help the credit union assess its cybersecurity preparedness. The Division will review the cybersecurity self-assessment work that was completed by each credit union and will provide guidance to help address potential cybersecurity vulnerability gaps. It is important that the credit union management, including the board of directors, continue to carefully evaluate all cybersecurity risk management practices.

2. Member Business Loans (MBL)

As of June 30, 2017, Member Business Loans (MBLs) represented approximately 8.7% of total assets² for all Washington state chartered credit unions. Because of an increase in the growth of MBL lending, and due to proposed changes to WAC 208-460, management must be able to provide documentation to support its ability to effectively monitor and manage its commercial loan portfolio. This includes having qualified staff, processes, and policies to ensure the safety and soundness of its MBL program. Additionally, the board of directors must adopt specific MBL loan policies and review them at least annually.

¹ For a copy of the FFIEC Cybersecurity Assessment Tool, see <https://www.ffiec.gov/cyberassessmenttool.htm>.

² Based on 5300s and data as of June 30, 2017.

Examiners with specialized commercial lending expertise will closely review a credit union's MBL lending program to assess whether risks are being properly managed and controlled. Any Washington state chartered credit union with a significant amount of MBLs is expected to have a safe and sound MBL program comparable to a bank of similar size and complexity.

3. Consumer Protection Law Compliance

Consumer protection law compliance is complex due to a number of federal rules³. Our examination objectives are to ensure compliance with the consumer protection laws, and to assist credit unions in identifying compliance problem areas and corrective actions. We continue to use the Division's Consumer Compliance Exam Manual⁴ during our compliance exams.

The Division continues to schedule separate compliance examinations at credit unions with total assets over \$500 million. For credit unions with total assets less than \$500 million, compliance examination work is performed during regularly scheduled safety and soundness examinations.

In addition to the above, examiners will focus on compliance with Financial Crimes Enforcement Network (FinCEN) requirements for the following areas during these exams: Bank Secrecy Act (BSA) and FinCEN guidance on banking licensed marijuana businesses (as applicable). Examiners will also review procedures and processes relating to the Beneficial Owner Rule, 31 CFR 1010.230.

4. Interest Rate Risk (IRR)

Interest Rate Risk (IRR) continues to be a significant regulatory focus. 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). NCUA has provided IRR resources for credit unions⁵ and guidance for examiners⁶.

Credit unions that have high long-term asset concentrations that are funded primarily by short-term deposits will be exposed to low margins and decreased profitability as interest rates rise.

³ We estimate that the Consumer Financial Protection Bureau finalized approximately 70 rules applicable to credit unions from 2013 through 2016.

⁴ A copy of the Compliance Manual is available at <http://www.dfi.wa.gov/credit-unions/for-credit-unions/consumer-compliance-exam-manual>.

⁵ See NCUA's IRR resource center; a copy is available at <https://www.ncua.gov/regulation-supervision/Pages/policy-compliance/resource-centers/interest-rate-risk.aspx> and NCUA Letter to CUs 16-CU-08 titled "Revised IRR Supervision" at <https://www.ncua.gov/regulation-supervision/Pages/policy-compliance/communications/letters-to-credit-unions/2016/08.aspx>.

⁶ The Examiner's Guide contains a Chapter on IRR, a copy is available at https://publishedguides.ncua.gov/examiner/Pages/default.htm#ExaminersGuide/IRR/IRR_Overview.htm%3FTocPath%3DInterest%2520Rate%2520Risk%7C_____0.

The examiners' scope of review on 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 an extensive IRR management program.

5. The Importance of Strong Management to Credit Union Success

The single most important 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 prudently manage risks, while keeping the credit union productive, profitable, and competitive.

6. Effective Due Diligence and Program Management Over Indirect Lending Programs

In accordance with DCU Bulletin B-16-18, titled Indirect Lending and Credit Tier Exceptions, and NCUA Letter to Credit Unions 10-CU-15, titled Indirect Lending and Appropriate Due Diligence, examiners will closely review a credit union's policies, procedures and practices over its indirect lending programs to determine whether risks are being properly managed and controlled. Additionally, examiners will closely evaluate whether satisfactory due diligence (both new and ongoing relationship) is performed on the indirect lending dealerships (usually an auto dealership).

Credit unions engaged in indirect lending must have clear underwriting practices that take into account objective factors such as a borrower's creditworthiness, the age and value of the collateral, and the terms of the transaction, and must be able to demonstrate effective monitoring and control over the indirect lending program and its dealerships. Credit unions must be proactive, rather than being reactive, should problems occur.

Conclusion

The Division is committed to using its examiner resources in an effective manner, and ensuring a financially healthy and competitive state chartered credit union system in Washington State.

Examiners continue to risk focus each individual examination to effectively and efficiently use our limited exam resources. This helps the Division of Credit Unions (Division) better address the safety and soundness and regulatory concerns of the 54 state chartered credit unions under its regulatory purview. As such, the actual examination focus for an individual credit union may vary from the Division's 2018 exam focus in this Bulletin, depending on the credit union's financial condition, its risk profile, and its organizational/management structure.

If you have any questions about this Bulletin, please contact Keith Schuster at Keith.Schuster@dfi.wa.gov or (360) 902-8717.