



DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

Phone: (360) 902-8701

FAX: (360) 704-6901

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Strategic Initiatives and Exam Focus for 2021

This Bulletin includes an update on the Division's 2020 strategic initiatives and provides an overview of the examination focus and continued initiatives for 2021.

Strategic Initiatives:

When we issued the Division of Credit Union's (Division) strategic initiatives and exam focus bulletin in 2020, we certainly had no idea what was ahead. Like credit unions, the Division has had to modify operations and develop new strategies to continue to have an effective examination program. Washington State Chartered Credit Unions have been instrumental in providing input and feedback through this unprecedented time. We thank you for that.

The Division's four main strategic initiatives and objectives for 2020 were:

- 1. Successfully Implement the Restructure of the Division** – This initiative was successfully implemented in 2020. Our examiners are structured into four teams, three devoted to performing safety and soundness exams and one for specialty exams.

Benefits: Increased expertise on each team, increased teamwork and increased support and mentoring from team supervisor.

- 2. Perform More Offsite Exam Work** – This initiative was implemented beyond the original scope due to the COVID-19 pandemic. This initiative will continue through 2021. Once it is safe to return to an onsite presence, we anticipate a hybrid approach which will include some examiners working fully remotely and some working onsite at the credit union.

Benefits: Less disruptive to the credit union, decreased travel for examiners, increased work/life balance and hopefully increased retention of qualified examiners.

- 3. Implement Using the New NCUA MERIT Exam Software Program** – The MERIT (Modern Examination and Risk Identification Tool) was slated to replace the existing examination software, AIRE (Automated Integrated Regulatory Exam System), in September 2020. NCUA has paused the implementation to 2021 due to the COVID-19 pandemic. Examiners from Washington were among examiners from only two states who tested and piloted MERIT. Because

of this, division examiners continue to test and pilot the MERIT platform with some credit unions. Once NCUA resumes implementation, credit unions will receive training from NCUA on the new platform.

Benefits: More user friendly platform, improved analytics.

4. Reconfigure How IT Security Exams are Performed – The Division successfully converted to the InTREx (Information Technology Risk Examination) program in 2020.

Benefits:

- Allows DFI to use an enhanced, risk-based approach to conduct IT exams. NCUA will adopt InTREx for conducting IT exams starting full-scale in 2021.
- Provides a Uniform Rating System for Information Technology (URSIT) system for component and composite ratings.
- Allows examiners to assess a CUs cybersecurity preparedness by reviewing four different sections: 1. Audit; 2. Development & Acquisition; 3. Management; and 4. Support & Delivery.
- Provides an IT profile questionnaire, which gives examiners a more focused insight on a CUs IT environment.
- Implemented quarterly contacts with credit union IT staff after they review the IT profile questionnaire.

Exam Focus for 2021

1. Allowance for Loan and Lease Losses (ALLL):

Credit unions should be proactive in evaluating and considering adjustments to their ALLL funding methodology in anticipation of a possible economic downturn. DCU examiners will discuss with management whether the credit union has adjusted its ALLL account funding analysis due to expected losses because of the COVID-19 pandemic. If so, examiners will want to know what factors were involved in the decision to increase the ALLL account balance. ALLL account funding should take into consideration qualitative and environmental factors, such as economic, political, geographical and industrial factors. Examiners will consider the credit union's size, its lending program complexity, and the inherent risks in its loan portfolio when evaluating the credit union's ALLL funding analysis.

2. Changes in Asset Quality:

The economic impacts from the pandemic have been substantial. As credit unions have worked with their members, many have implemented options such as forbearance, skip a pay, and modification agreements. Examiners will review underwriting at loan origination and the how pandemic related programs were implemented, what monitoring is in place and what the credit union is anticipating for future payments. Lack of effective monitoring and collections plans in relation to programs could impact the credit union's asset quality and management ratings.

3. Potential Interest Rate Risk (IRR) Changes:

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 and analyze compliance with [12 C.F.R. 741.3\(b\)\(5\)](#). Given the recent economic impacts, some credit unions have been exposed to low margins and decreased profitability as interest rates decrease. Examiners will consider the overall strategic and business plans the credit union is planning to deploy during the pandemic.

Examiners will review the following main factors when evaluating a credit union's overall IRR level and its IRR management program:

- The current and projected levels of net income and net worth;
- The ability of management, including the board of directors, to manage and control IRR;
- The ability of staff and management to accurately measure and assess IRR exposure;
- The credit union's current IRR trend; and
- 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.

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.

4. Liquidity:

Credit unions have recently experienced an unprecedented increase in deposits coupled with decreased loan demand leading to increased cash and short-term investments. Examiners will review the credit union's liquidity policy, procedures and practices for compliance with the liquidity and funding plan requirements listed in [12 CFR 741.12](#). Additionally, examiners will review plans and projections for the credit union's liquidity position in the event there is another stimulus package approved and in the event there is not a stimulus package approved. These plans and projections should include credit union specific data regarding loans in forbearance or skip status, member unemployment and the current deposit balances.

5. Network Security:

Telework and remote access can pose greater exposure to the credit union's network, systems and data. DCU recommends that credit unions review their network protections and determine if enhancements are needed to align with this new telework environment. Some specific review areas of network protections will include at least the following:

- Policies and procedures for remote access, including how to process a remote access request and remote access termination.
- Review of network authentication, password limitations, and privacy law safeguards.
- Review and updating monitoring systems.
- Review and updating incident response plans.
- Limiting a user's access rights to what is necessary for them to do their work.

6. Performing Comprehensive Review of New Program Offerings and Vendors:

With the recent changes to consumer spending, some credit unions are looking at new products and services to replace income. Examiners will evaluate whether credit unions have strong procedural guidance and programs in place to ensure that satisfactory due diligence is performed on new program offerings and over its vendor management. It is important that credit unions develop and implement new programs which minimize operational and financial risks while keeping the credit union profitable.

Examiners will closely review new program offerings, especially new lending programs, to assess whether risks are properly managed and controlled. Examiners will also evaluate whether satisfactory due diligence is performed on new vendors and whether effective vendor oversight is performed on an ongoing basis.

Credit unions must be proactive in performing due diligence over new programs and vendors, rather than being reactive in nature when problems occur. Examiners will factor the credit union's ability to do this into their CAMELS ratings.

7. Consumer Compliance:

The Division conducts compliance reviews in two different ways: either as part of the safety and soundness exam or as a stand-alone compliance exam. Stand-alone consumer compliance exams for credit unions with \$500 million or over in assets are scheduled on a periodic basis. These exams are usually concurrent with the safety and soundness exams.

The compliance reviews conducted as part of the safety and soundness review will focus on:

- Bank Secrecy Act
- Loss mitigation policies and procedures – loan forbearance, modifications and skip a pay
- Updated [CFPB rules](#) for Qualified Mortgages (QM) and Ability to Repay (ATR)
- Regulation E and overdraft procedures

The stand-alone consumer compliance exams will focus on:

- Compliance management system
- Third party due diligence
- Truth in Lending / Real Estate Settlements Procedures Act
- Fair Credit Reporting Act

If you have any questions, please contact Tammie Nuber, Program Manager for Safety and Soundness at Tammie.Nuber@dfi.wa.gov.