



DCU BULLETIN
Division of Credit Unions
Washington State Department of Financial Institutions
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Initiatives and Exam Focus for 2022

This Bulletin includes several initiatives that we are working on in 2022 and what we will focus on during exams in 2022.

Initiatives:

- 1. Returning to On-Site Exam Work** – We currently plan to return to onsite exam work in April. Unlike exams pre-pandemic, we plan to use a hybrid approach, which will include some examiners working fully remotely and some working onsite at the credit union. DFI and NCUA will work closely to coordinate.

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

- 2. Using the New NCUA MERIT Exam Software Program for All Exams** – The MERIT (Modern Examination and Risk Identification Tool) replaced AIRES (Automated Integrated Regulatory Exam System) in September 2021 and we are now conducting all exams in MERIT. Examiners from Washington were among examiners from only two states who tested MERIT as it was being developed and conducted the first exams using MERIT. With MERIT, the credit union uploads the loans/shares to the NCUA's Data Exchange Application (DEXA), in addition to uploading them to DFI. This will be a bigger change for some credit unions, than others. Examiners are continuing to learn MERIT and all the new tools at their disposal.

Benefits: Creates an environment for examiners to share information more easily, and improved analytics.

- 3. Reconfiguring How IT Security Exams are Performed** – In 2020, we restructured the division and created four teams, three devoted to performing safety and soundness exams and one devoted to specialty exams. One of the goals of the restructure was to add a second IT examiner and to increase the effectiveness of our IT security exams. In March, we will at last have two examiners dedicated to IT security exams. This will include IT examiners spending additional time doing a deeper dive into the credit union's IT security program.

Benefits: Increased expertise for IT exams; Ability to timely share important security information with credit unions.

2022 Exam Focus:

1. Net Worth Ratio Pressure:

Examiners will have a continued focus on the declining net worth ratios. Decreased consumer spending coupled with the low interest rate environment, and low loan demand environment, has caused continued asset growth to outpace net worth growth, putting pressure on the net worth ratio. The examiners' focus will be tailored to reviewing the credit union's planned response to the pandemic-related influx of deposits. Examiners will consider the following areas:

- **Strategic Planning:** During safety and soundness examinations, examiners will review the strategic plan, business plan, and budget to evaluate the adequacy of a credit union's objectives and goals in relationship to the credit union's financial performance. Examiners will look for a well-structured process that is appropriate for the size, complexity, and financial and operational needs of the credit union. Strategic planning, business planning, and budgeting are important factors in the "Management" CAMELS component rating.

Strategic planning should focus on the long-term deployment of resources used by the credit union to achieve its objectives and goals. An effective strategic plan encompasses all areas of the credit union's operations. As part of the strategic planning process, the board of directors and management should consider services to members, competitive factors, location, economic factors, membership demographics, and the credit union's risk tolerances.

During the review, examiners will consider what the credit union is currently doing and what actions and processes the credit union plans to implement to strengthen its operations and financial position in the future. A sound strategic plan should have the following elements:

- Financial goals;
 - Operational goals;
 - Projected growth of assets, deposits, and loans;
 - Acquisition, implementation, and use of technology;
 - Timeframes for achieving the stated goals and objectives; and
 - An assessment of the credit union's current competitive and operational environment and an evaluation of its external and internal factors, such as regulatory issues, competition and talent retention.
- **Business Planning:** Business planning should focus on shorter-term actions designed to implement the strategic plan. A sound business plan flows logically from and should be consistent with the strategic plan. The business plan should have the following elements:

- Specific objectives;
 - Actions/steps to take to accomplish the priority issues and to achieve objectives;
 - Time frames in which to complete the actions and achieve the business plan goals; and
 - Action plans that stipulate the individual(s) or committee(s) responsible for accomplishing each objective.
- **Budget:** The budget should be based on the financial and operational goals established in the business plan. The budget should be realistic, and project cash flows occurring during the year. In addition, the budget should be supported by documented assumptions that correlate with the business plan. The management and board of directors should review and discuss a monthly or quarterly budget variance analysis and if necessary, determine actions to bring material variances back into alignment with the budget projections.

When developing the strategic plan, business plan, and budget, the credit union should utilize asset/liability management modeling to project potential effects on its balance sheet and risk profile. The board of directors and management should ensure that goals and growth assumptions within the plans and budget will result in satisfactory financial results. Once the plans have been developed and approved, the plans should be communicated throughout all levels of the credit union in order to create a strong commitment by staff, management and officials to implement actions to achieve the goals. As needed, adjustments should be made to the plans throughout the year to ensure the plans remain useful and relevant tools. Budgets should only be changed if very significant changes occur, which would greatly alter the effectiveness or reasonableness.

2. Credit Risk:

Examiners will consider trends in credit unions' loan portfolios. Credit unions have begun to offer new loan products and services in recent years. While these areas can offer opportunities to serve members, expand loan portfolios, and increase earnings, credit unions should be sure to perform adequate due diligence and to properly manage risk. Examiners will consider the following areas:

- **Underwriting:** Examiners will place an emphasis on the review of credit unions' loan underwriting standards and credit risk-management procedures. Examiners will also focus on reviewing policies that address the use of loan workout strategies, risk-management practices, and new strategies implemented as a result of the pandemic. There will be a continued focus on any adjustments credit unions made to lending programs to address borrowers facing financial hardship because of the COVID-19 pandemic. Credit unions should ensure risk monitoring practices are commensurate with complexity of the lending activities. In particular, examiners will evaluate credit unions' lending program, including controls, reporting, and tracking of these programs.
- **Loan Concentration:** Examiners will have a continued focus on large concentrations of loan products and concentrations of specific risk

characteristics. Each product or service carries some risk of financial exposure or loss for the credit union. Management needs to perform a risk assessment, which demonstrates their understanding of the risk of the product or service, quantifies the potential loss exposure, and documents a rational business decision on the acceptable concentration level based on the analysis. If excessive levels of credit concentration risk are identified, examiners will work with credit union management to identify strategies to mitigate the risk.

- **Commercial Lending:** Credit unions should follow [WAC 208-460-040](#) as a guide to implement their member business loan program. To properly manage the risk associated with commercial lending, a credit union should have staff with expertise and more specialized risk management experience. A credit union offering commercial loans should maintain prudent risk management practices and sufficient capital that is commensurate with the risks associated with its commercial lending activities at all times. The primary focus of a commercial lending examination is on the effectiveness of a credit union's risk management process and the aggregate risk profile of a credit union's loan portfolio. Examiners will assess whether a credit union's:
 - Board of directors understands the risks and provides sufficient oversight;
 - Management and staff have appropriate experience, expertise, and resources;
 - Commercial loan policy is adequate and complies with regulations;
 - Credit risk ratings are consistent and reliable; and
 - Commercial loan risk management is comprehensive and ongoing.

- **New Products:** Credit unions have begun to offer new loan products and services in recent years. Credit unions should be sure to perform adequate due diligence and to properly manage risk of any new products they choose to implement. Supply and demand issues caused by the pandemic have impacted automobile values. Examiners will apply additional scrutiny to credit unions with material exposure to higher risk forms of auto lending. Specifically, examiners will focus on portfolios with the following concentrations:
 - Extended loan maturities;
 - High loan-to-value;
 - Near-prime or subprime; and
 - Indirect lending programs.

3. 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 may be 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/Office of Foreign Assets Control including customer due diligence processes;
- Third party relationships;
- Flood Disaster Protection Act and private flood insurance regulations <https://www.ncua.gov/files/publications/regulations/loans-special-flood-hazards-feb-2019.pdf>;
- Mortgage loan loss mitigation and foreclosure procedures. CARES Act created a huge buildup of loans in forbearance. Although many are exiting forbearance, a fair percentage do not have a permanent loan modification arrangement, meaning there is a backlog of debts that need to be liquidated through foreclosure;
- Fair Credit Reporting Act; and
- Regulation E: overdraft procedures and NSF fees.

The Stand-alone consumer compliance exams will focus on:

- Compliance management system, including third party due diligence;
- Mortgage servicing and error resolution;
- Loss mitigation policies– loan forbearance, modifications, foreclosures;
- Fair Lending;
- Regulation E: overdraft procedures;
- NSF fees;
- Unfair, Deceptive or Abusive Acts or Practices; and
- Other consumer compliance areas as determined in risk-based exam scoping.

4. Information Security and Technology:

Information Security risks and increased cybersecurity threats continue to be a concern for all financial institutions. During 2022, IS&T examiners will:

- Continue to encourage credit unions to complete the FFIEC Cybersecurity self-assessment tool, the NCUA Automated Cybersecurity Assessment Tool (ACET), or use a similar type of tool to help the credit union assess its cybersecurity preparedness.
- Review third party risk management, especially for third parties with access to non-public member information. NCUA issued a Letter to Credit Unions [21-CU-16](#) that offers guidance to credit unions on how to establish a strong due diligence processes, policies and procedures, and supervisory considerations of these relationships.

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