Frequently Asked Questions about NCUA’s Exam Flexibility Initiative
October 2016

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General Questions

Why is NCUA issuing this report?
Members of NCUA’s Exam Flexibility Initiative working group, established by Chairman Metsger in May 2016, have been working with credit union system stakeholders on a comprehensive review of the agency’s examination and supervision program. The report summarizes the results of the review, commenter feedback, and a high-level overview of the recommendations made by the working group.

How did you pick the credit unions you consulted with?
NCUA asked national credit union trade groups to nominate credit unions of various asset classes for inclusion on the stakeholder conference calls. Based on these recommendations, we formed groups of 8-10 credit unions by asset pairing and charter type. By doing so, we achieved good representation from various states, regions, and peer asset groups.

Will NCUA lose staff as a result of the new examination cycle?
We estimate NCUA will lose 47 staff over a two-year period. This will occur naturally, through attrition, as the agency fully implements the new, extended examination cycle. If the proposed recommendations are approved as part of the 2017-2018 budget, the agency’s authorized staffing levels will decline by 25 in 2017, and by an additional 22 in 2018.

What is NCUA’s annual attrition rate for examiners?
Our average attrition rate has been approximately 8 percent since 2010, which more than offsets the projected decline in staff over the next two years. NCUA will not lay off any staff. Examiners leave for a number of reasons, including promotion, to accept a new job, to improve their family-life balance, reduce travel, and the relocation of a family member. Turnover is highest among those who have less than five years of NCUA service.

What human capital needs are projected for field staff in 2017?
We do not project any changes to field staffing other than the examiner reduction described above. Changes in the credit union industry (such as the increasing complexity of credit union operations through new products and services, use of third-party vendors, and reduced regulation over the past few years) require NCUA to evaluate resources on an ongoing basis to ensure proper staffing and to retain our effectiveness as an insurer and regulator.

In recent years, NCUA has reprogrammed 44 examiner positions to regional specialists, particularly in the areas of information systems, capital markets, and lending.
Do you anticipate any human capital changes over the next three years?
NCUA will have a continuously increasing need to gain more expertise in enhanced data quantification techniques and case management. As exam team members become more specialized, examiners will also need improved team management skills.

How will NCUA use the hours saved by extending the exam cycle?
The working group has recommended that some resource hours be reprogrammed to exam planning, staff training and development, and the examination of a sample of small credit unions lacking desired internal controls.

When will NCUA implement major recommendations made by the working group?
The proposed recommendations are pending approval by the NCUA Board as part of the 2017-2018 budget. We have proposed the project plan below for planning purposes.

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<th>Action</th>
<th>Implementation date/range</th>
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<td>Jan. 1, 2017 (begin transition)</td>
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Extended Examination Eligibility Criteria (Federal Credit Unions)

What actions is NCUA taking now to plan for the transition?
The Office of Examination and Insurance and NCUA’s five regional offices are studying staffing and resource needs that must be addressed if the NCUA Board approves the extended examination cycle proposal. Each regional office will report progress on its transition planning to the Board and the Executive Director on a quarterly basis.

When will the extended cycle become effective?
We have proposed making the examination cycle changes effective January 1, 2017. Approval is dependent on NCUA Board action, which will take place as part of consideration of the 2017-2018 budget.
What percentage of credit unions are eligible for an extended cycle?

We anticipate about 62 percent of all federal credit unions will qualify for an extended cycle. Broken out by asset range:

- 64 percent of federal credit unions with assets of less than $1 billion
- 82 percent of federal credit unions with assets between $100 million and $1 billion
- 59 percent of federal credit unions with assets of less than $100 million

Why will credit unions with assets greater than $1 billion remain on an annual exam cycle?

The relative risk to the Share Insurance Fund is too great to extend the examination cycle for these large credit unions. Our approach is the same for all federally insured credit unions, regardless of charter. This threshold is also consistent with those set by the FDIC, OCC, and the Fed.

When will eligible credit unions begin the longer, extended cycle?

While some credit unions will begin the new cycle on January 1, it could take up two years to be fully phased-in. NCUA’s regional management team is working on a plan to ensure consistent application across the country. While some exams may need to be performed on an annual basis, others will start to move to a longer cycle in line with the lower range for eligible credit unions. This is similar to what we planned for and experienced when the agency adopted risk-based scheduling in 2001, and an annual examination in 2009.

What are the primary factors for determining eligibility for the extended cycle?

The primary variable in determining eligibility for an extended cycle will be the CAMEL Management component rating. Sixty-eight percent of all federal credit unions have a CAMEL rating of 1 or 2 in Management.

The CAMEL composite rating will be the second largest variable. Seventy-five percent of all federal credit unions have a composite CAMEL 1 or 2 rating in this area. A credit union must have both a composite rating of 1 or 2, and a 1 or 2 in management in order to be eligible for an extended exam cycle.

Other criteria will have a small effect on eligibility but are still important. Breaching any one criteria will disqualify a credit union from consideration for an extended cycle.

How will NCUA communicate the proposed changes to agency policy and let credit unions know about the extended exam cycle?

NCUA will issue a Letter to Credit Unions before Jan. 1, 2017. The letter will officially communicate the NCUA Board’s position with respect to an extended exam cycle and how the transition to an extended cycle will effect scheduled credit union examinations in 2017.
How will NCUA exercise the enhanced flexibility created by an extended cycle?
The new policy, if approved, will give NCUA the flexibility to reallocate resources from credit unions with a lower risk profile to those with a higher risk profile. We will also be able to reallocate some of the resources saved from transitioning to an extended exam cycle into improved exam planning, select examinations of credit unions lacking adequate internal controls, and into training.

Why are we using a range of 14–20 months to schedule examinations?
One of the primary purposes of the initiative was to promote flexibility in scheduling and performing onsite exams. The 14-20-month band provides examiners flexibility in determining when the examination can and should be completed. While risk is certainly a consideration, examiners also need flexibility to account for operational issues they would encounter with scheduling, coordinating team members, and arranging for specialists for the examination.

Is there a correlation between the amount of time between exams and credit union failures, losses, or loss amounts?
A longer cycle increases the probability of increased risk. To illustrate, 37 percent of all credit unions that have failed since 2001 had a CAMEL 1 or 2 composite rating 24 months before they failed. Intuitively, as the length of time between exams increases, there is a greater likelihood that a CAMEL rating will not accurately reflect potential changes in a credit union’s financial performance.

How will NCUA mitigate the risk of an extended cycle?
Effective offsite examination procedures are our primary mitigation tools. NCUA examiners review quarterly call reports, financial performance reports, and risk reports, and they provide comments on the trends for each assigned credit union quarterly. These reports are reviewed by the supervisory examiner and regional Division of Supervision. Each region and the Office of Examination and Insurance will use analytics to identify credit unions with emerging risk characteristics, flagging those for onsite follow-up supervision contacts.

If a credit union is eligible for an extended cycle, will NCUA perform a supervision contact between examinations?
Yes, if a supervision contact is determined to be needed. NCUA retains the authority to perform any supervision necessary to effectively manage and mitigate risk to the Share Insurance Fund.

Coordination of Federally Insured, State-Chartered Credit Union Examinations

Does NCUA intend to spend less time in state-chartered credit unions in 2017?
We anticipate time spent in state-chartered credit unions will decline proportionately with the declines planned for the federal program. In addition, a percentage of resource hours will be reallocated from credit unions with assets greater than $250 million and less than $1 billion to
performing an onsite contact at each federally insured, state-chartered credit union that has not been examined in the last five years.

**Does NCUA intend to coordinate onsite exams with the state supervisor primarily responsible for supervision?**

NCUA regional management meet with state supervisory authorities, at least, annually, to discuss various issues, including scheduling of examinations. To the maximum extent possible, we strive to align our schedules up with our state counterparts. While this practice will continue, our goal is to further improve coordination and increase flexibility. The 14-20 month range will give NCUA greater flexibility to perform joint exams consistent with state law and practice, which varies greatly from state to state.

**Why does NCUA examine federally insured, state-chartered credit unions?**

**Can’t we just rely on the state supervisors’ examination?**

NCUA relies on work completed by state supervisory authorities as much as possible; we review about one third of insured credit unions in given year. Federally insured, state-chartered credit unions are examined by their primary regulator (an independent state supervisor) according to their state laws, policies, and practices. Examination cycles of the 45 state supervisors generally range from 12 to 18 months, with some extending as long as 36 months.

The role and obligations of an insurer are different from the role of a supervisor, and NCUA has a fiduciary responsibility to the Share Insurance Fund and all the credit unions and credit union members who depend on it, to protect the Fund.

**What does NCUA consider in determining if we need to supervise a state-chartered credit union?**

The primary consideration is risk to the Share Insurance Fund. NCUA considers a credit union’s CAMEL rating, asset size, elapsed time between examinations, financial trends, complexity of operations, and the state’s ability to supervise the credit union.

**What else is changing about the state program?**

Most notably, the majority of federally insured, state-chartered credit unions with assets between $250 million and $1 billion will not receive an insurance review or joint exam every year with NCUA.

**Why are federal insured, state-chartered credit unions with $1 billion or more in assets subject to an examination every 8 to 12 months?**

The working group determined the relative risk to the Share Insurance Fund is too great to extend the examination cycle for these credit unions. Our approach is the same for all federally insured credit unions, regardless of charter. This threshold is also consistent with those set by the FDIC, OCC, and the Fed.
Why doesn’t NCUA allow states to determine the appropriate examination cycle for all federally insured, state-chartered credit unions?

As the insurer, NCUA has determined that an insured credit union with $1 billion or more in assets represents a higher level risk to the Share Insurance Fund and should be examined on an 8 to 12-month basis as measured from prior exam completion date to the start date of the subsequent examination. Most state supervisors also prioritize the examination of these credit unions on a shorter exam cycle due to the higher perceived risk.

Are there any federally insured, state-chartered credit unions where NCUA has not performed an examination or insurance reviews in more than five years?

Yes. There are more than 400 federally insured, state-chartered credit unions where NCUA has not examined the credit union within the past five years. Many of these are small credit unions. Some of the examiners hours which become available as a result of moving to a more flexible exam cycle, will be used to examine or review federally insured, state-chartered credit unions that have not had an exam in more than five years.

Does NCUA have any plans to address the number of examiners assigned to each examination, particularly for state-chartered credit unions?

State-chartered credit unions raised this issue on conference calls with the working group, often when recommending better coordination between NCUA and state supervisors. We followed up this issue with a discussion with state supervisors. Due to the different approach used by the 45 state supervisors, the issue is best addressed at the individual state level, with the state supervisory authority working in concert with regional NCUA staff and management.

Joint NCUA-State Supervisor Working Group

What state regulators will participate on the new working group?

NCUA will take the lead and will identify states interested in participating on the working group. While we will make the final determination regarding membership, we will work to get a cross-section of programs represented from across the country, including commissioners with banking and credit union supervision responsibility as well as those that solely supervise credit unions.

What issues will the group work on?

While the goals, objectives and vision will be left up to the new working group, we anticipate members will determine:

- Whether a national document of cooperation is needed;
- Changes needed to further improve coordination;
- Whether NCUA should pursue an alternating examination cycle for federally insured, state-chartered credit unions; and
- Other changes that can be made to lessen the impact on state-chartered credit unions while ensuring risk to the share insurance fund is managed effectively.
Reduced Onsite Presence

**Does NCUA envision a time when all examination work is completed offsite?**
No. While offsite processes are often effective risk mitigation strategies, there is no substitute for certain exam procedures being completed on-site on a prescribed frequency. At a minimum, NCUA needs to periodically validate the information received from credit unions, test data integrity, and evaluate board governance. While NCUA envisions that more work will be done offsite, some work will always be done on-site.

**What are the goals of the offsite examination pilot program taking place in Region IV?**
Region IV is currently piloting a program to determine if NCUA can maintain an effective examination while reducing the on-site presence and the associated burden credit unions experience as a result of onsite examination work. Offsite examination procedures benefit the agency by allowing us to reduce travel costs and improve productivity. Employees benefit by spending less time in travel status.

**How did NCUA roll out the pilot offsite exam program?**
The region socialized the concept with examiners, developed an instruction for the pilot, provided training to a segment of the region’s examination workforce, partnered with state regulators, and selected credit unions of varying asset sizes to participate in the program. The pilot started on July 1, 2016 and was originally scheduled to run through September 30, 2016. The pilot program has since been extended through the end of 2016 and, when appropriate, we plan to expand the pilot to all regions.

**How is the effectiveness of the pilot offsite exam program being evaluated?**
All participants, examiners, and supervisors involved in the program are completing surveys following each exam. The surveys are tabulated and summary information is shared with senior NCUA leadership. In addition, supervisory examiners meet with credit union management and state supervisors to get their perspective on the effectiveness of the program and recommendations for further enhancement.

**What has NCUA Region IV staff’s experience been with respect to the offsite examination procedures discussed in the report?**
While early results are encouraging, the program’s effectiveness primarily depends on the development of a fully functioning secure file transfer portal and resolution of wireless communication connectivity and speed issues. NCUA’s Region IV office will continue to pilot the procedures, and, when appropriate, will recommend the program be deployed to more agency staff. A carefully and deliberately managed process will ensure a more effective program in the long run.
Exam Planning and Notice

How will NCUA improve exam planning?
We are providing examiners more time to effectively plan an exam; and, will place a greater emphasis on this aspect of the exam during training and regional staff meetings. Our goal is for examiners to better prepared and informed of a credit union’s operation prior to the first day onsite, leading to a more efficient and effective exam.

What other changes are planned?
We recommend the National Supervision Policy Manual be modified to provide credit unions four to six-weeks’ notice, when practical, for credit unions with assets greater than $50 million. Small credit unions will receive at least two-weeks’ notice. In addition, we are reiterating the importance of using the template document request list, or something similar, when requesting documents for an examination. We are working to improve coordination of document requests with state supervisors and specialists.

Do any of the recommendations require technological changes?
Yes. The working group recommends NCUA develop a pre-examination planning tab in the Automated Integrated Regulatory Examination System (AIRES). The tab should include fields for examiners to capture the date they notified a credit union of an exam, to save a copy of their request list, and save notes of their discussion of their exam planning efforts.

The specifics for this module will be developed in coordination with the AIRES development team. As this change will require reprogramming an agency legacy IT system and will require staff training, we don’t anticipate it will be available until the third quarter of 2017 at the earliest.

Secure File Transfer Portal

What is the status of NCUA’s secure file transfer portal?
NCUA began piloting a secure portal with NCUA staff early in 2016 and expanded the pilot with a select number of credit unions in September of 2016.

When will NCUA roll out the portal to all credit unions and staff?
This is to be determined. NCUA staff are currently testing the functionality of the portal with credit unions. The Office of Examination and Insurance and the Office of Chief Information Officer will assess the feedback and make any changes to the business rules and product. The timing of the full implementation will depend on the extent of the changes, if any.

Examiner Training Consistency

What actions has NCUA taken to address examination consistency?
NCUA has taken many steps in recent years to improve consistency, including the release of the National Supervision Policy Manual, and. revisions to the examination report, training, credit
union surveys conducted by national trade groups and state leagues suggest NCUA is doing a better job over the past two or three years. Participants on conference calls and during CEO roundtables confirmed improvement over the past two or three years.

**Are any new actions planned?**
We have identified several areas in which additional training might minimize the number of complaints. Most notably, credit unions complain when examiners cite opinions or best practices as examiner findings. We propose that guidance be developed and communicated through NCUA’s training process and compliance be evaluated through NCUA’s existing quality control processes.

**Optional Credit Union Survey**

**Why are we reintroducing the optional credit union survey?**
The optional feedback form will give credit unions an opportunity to share their assessment of an examination directly with NCUA, providing clear and direct feedback. Completed surveys will help us understand issues that may arise, and determine if actions NCUA has taken to address a credit union’s concerns are effective. In addition, we anticipate survey information will better assist the agency in determining where additional training is needed.

**When will the new post-exam credit union survey be available?**
We do not anticipate the survey being available before mid-year 2017, at the earliest. While designing the survey is relatively easy, it will need to be vetted through the employee union, evaluated for Paperwork Reduction Act requirements, studied for cost of implementation, and incorporated into the agency budget. This will need to be considered during the mid-year 2017 budget review, unless the survey cost is determined to be immaterial.

**Will the survey be anonymous?**
While we intend the survey to be anonymous, a credit union can include its name. NCUA welcomes feedback any time, and credit unions are encouraged to communicate regularly and directly with their examiners or supervisory examiners.