Dear Board of Directors and Chief Executive Officer:

This letter outlines the NCUA’s primary areas of supervisory focus for 2019, and is intended to assist you in preparing for your next NCUA examination.

Regarding the examination cycle and procedures to be employed, the extended exam cycle introduced in 2017 will be fully implemented in 2019.\(^1\) Consistent with 2018, agency examiners will continue using the streamlined small credit union exam program procedures for most credit unions that have assets under $50 million. For all other credit unions, examiners will conduct risk-focused examinations, concentrating on the areas of highest risk, new products and services, and compliance with federal regulations.

In 2019, NCUA examiners will have increased flexibility to conduct suitable examination work offsite. In the agency’s Flexible Examination Program (FLEX) pilot, examiners were able to conduct as much as 35 percent of examination time offsite.\(^2\) The NCUA expects this increased flexibility will reduce the time impact on credit unions, save on travel costs and increase staff productivity.

**Supervisory Priorities for 2019**

The following are the NCUA’s primary areas of supervisory focus for 2019.

**Bank Secrecy Act Compliance**

Examiners will perform more in-depth reviews of credit unions’ Bank Secrecy Act and anti-money laundering policies, procedures, and processes to assess compliance with regulatory requirements for customer due diligence and for identifying and verifying beneficial owner(s) of legal entity members. New Customer Due Diligence regulations for Financial Institutions (31 CFR 1010.230) became effective May 11, 2018. Examiners began assessing credit unions’ efforts to comply with the new regulations during the second half of 2018.

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\(^1\) The extended examination cycle is described in more detail in NCUA Letter to Credit Unions, 16-CU-12, [Risk Based Examination Policy](https://www ncua gov).  
\(^2\) For more information on the FLEX Pilot Program, see NCUA Letter to Credit Unions 18-CU-01, [Examination Modernization Initiatives](https://www ncua gov).
Concentrations of Credit

Examiners will have a continued focus on large concentrations of loan products and concentrations of specific risk characteristics. Concentration risk is defined as any single exposure or group of highly correlated exposures that have the potential to produce losses large enough to threaten a credit union’s health or ability to maintain its core operations. Excessive credit concentrations are a common cause of financial losses. If excessive levels of credit concentration risk are identified, examiners will work with credit union management to identify strategies to mitigate the risk.

For more information, see the NCUA Letter to Credit Unions, 10-CU-03, Concentration Risk.

Consumer Compliance

As in 2018, examiners will continue to perform limited reviews of Home Mortgage Disclosure Act (HMDA) quarterly Loan/Application Registers, or full-year Loan/Application Registers when applicable. The reviews will evaluate federal credit unions’ good faith efforts to comply with 2018 HMDA data collection and reporting requirements. These reviews will account for the statutory partial exemptions that took effect on May 24, 2018. You can find information on the changes in the Consumer Financial Protection Update 18-01, Information about the Bureau of Consumer Financial Protection's 2018 HMDA Interpretive and Procedural Rule.

The NCUA will continue to focus on Military Lending Act (MLA) compliance, and examiners will evaluate credit unions’ efforts to comply with the MLA. For more information on this supervisory focus, see NCUA Regulatory Alerts 16-RA-04, Guidance on Regulatory Changes Affecting Military Lenders and 16-RA-06, Department of Defense’s Interpretive Guidance on Military Lending Act Limitations on Terms of Consumer Credit Extended to Service Members and Dependents.

Examiners will review credit unions’ compliance with Regulation B’s notification requirements following adverse action taken on consumer credit applications. They will also review overdraft policies and procedures for compliance with Regulation E. For additional consumer compliance tools and resources, visit the NCUA’s Consumer Compliance Regulatory Resources website.

Current Expected Credit Losses (CECL)

While the CECL requirements may continue to evolve in 2019, examiners will inquire about efforts a credit union has taken to prepare for the new accounting standard, and whether a credit union has performed analysis for how CECL would alter the Allowance for Loan and Lease Losses funding needs. In June 2016, the Financial Accounting Standards Board (FASB) issued the new accounting standard introducing the current expected credit losses methodology for
estimating allowances for credit losses, with an effective date of January 1, 2022 for most credit
unions.3

For more information about this topic, see NCUA Letter to Credit Unions 17-CU-05, Frequently
Asked Questions on the New Accounting Standard on Financial Instruments - Credit Losses and
NCUA Letter to Credit Unions 16-CU-13, Frequently Asked Questions on the New Accounting
Standard on Financial Instruments - Credit Losses.

Information Systems and Assurance

Examiners will continue conducting information security maturity assessments with the
Automated Cybersecurity Examination Toolbox (ACET). Examiners will use the ACET to
assess credit unions with over $250 million in assets that have not previously received an
assessment. The security, confidentiality, and integrity of credit union member information
remains a key supervisory priority for the NCUA.

Two additional areas of supervisory focus for 2019 are the assessment of credit union IT risk
management to ensure it effectively identifies, remediates, and controls inherent risks to
appropriate residual risk levels, and oversight of service provider arrangements to ensure credit
unions implement effective risk-based supply chain management. These areas of focus were
established as a result of historical examination analysis, emerging threat trends, and sample
results of ACET maturity assessments to date.

For more information, visit the NCUA’s Cybersecurity Resources website.

Liquidity and Interest Rate Risks

Examiner will assess liquidity and interest rate risk management, including the following:

- The potential effects of rising interest rates on the market value of assets that
  affect changes to net worth and borrowing capacity;

- Member preference shifts to shares with more market sensitivity; and

- Credit union management’s ability to meet liquidity needs given the increased
  competitive pressures that affect share balances.

An effective liquidity and interest rate risk management program is a key component of
a credit union’s safety and soundness. The projected economic fluctuations in 2019
make this an increased area of emphasis. When rates rise, it puts pressure on credit
unions to raise deposit rates in order to maintain deposit account volume. Also,
enhanced mobile and internet banking applications and non-bank financial technology
may result in greater challenges to retain low cost core deposits compared to prior
interest rate cycles.

3 Accounting Standards Update (ASU) No. 2016-13, Topic 326, Financial Instruments – Credit Losses
Resources and guidance on interest rate and liquidity risk can be found in the online version of the NCUA’s Examiner's Guide.

If you have any questions about the agency’s supervisory priorities or 2019 examination program, please contact your NCUA regional office.

Sincerely,

/s/
J. Mark McWatters
Chairman