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National Credit Union Administration
Exam Flexibility Initiative Report



NCUA is the independent federal agency created by the U.S. Congress to regulate, charter, and supervise federal credit unions. With the backing of the full faith and credit of the United States, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of nearly 105 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

At [MyCreditUnion.gov](https://www.mycreditunion.gov) and [Pocket Cents](#), NCUA also educates the public on consumer protection and financial literacy issues.



NCUA's Exam Flexibility Initiative

Creation and Objectives

The National Credit Union Administration's regulation and supervision of credit unions is designed to protect the safety and soundness of credit unions and to enforce the applicable laws and regulations that protect members. NCUA is the regulator for federally chartered credit unions and the predominant insurer for most of the U.S. credit union system. As the financial services industry and credit union risk landscape evolve, NCUA must smartly adapt by continuously improving our current processes to operate even more efficiently, while maintaining a robust supervision program.

As part of his continual quality improvement initiative, NCUA Board Chairman Rick Metsger established an [Exam Flexibility Initiative](#) internal working group on May 19, 2016. Chairman Metsger invited NCUA Region IV Regional Director C. Keith Morton to lead the agency's efforts to modernize by evaluating the agency's largest function—our examination and supervision program. The working group included representatives from each [NCUA region](#), as well as representatives from the [Office of Examination and Insurance](#), [Office of the Chief Economist](#), and the [Office of the Chief Financial Officer](#).

NCUA's goal is to improve our ability to adapt to economic changes and emerging issues while ensuring staff have the resources they need to appropriately examine and supervise credit unions. The working group's objectives included:

- Determining the future examination cycle for federally insured credit unions;
- Improving coordination with state supervisors in the examination of federally insured, state-chartered credit unions;
- Seeking information from stakeholders, summarizing their input and discussion, and considering their views;
- Taking advantage of new technology to make exams more efficient and to reduce onsite presence; and
- Identifying program areas where the added flexibility and hours from an extended examination cycle should be repurposed to mitigate risk from an extended cycle and ensure the agency's supervision program remains effective.

Stakeholder Input

As a first step in the *Exam Flexibility Initiative*, NCUA sought input from credit unions and others to obtain opinions and advice regarding our existing examination and

supervision program. Seven in-person meetings and 35 conference calls were held to generate input, concerns, and recommendations from CAMEL 1 and CAMEL 2-rated credit unions with assets ranging from approximately \$10 million to \$10 billion, including federal and state charters.

Credit unions specifically requested that NCUA consider:

- Extending the examination cycle for low-risk credit unions;
- Reducing its onsite presence by improving the use of analytics;
- Improving exam planning, including advance notice, document requests, scheduling, and scoping;
- Improving coordination with state regulators;
- Improving technology, including developing a secure portal to improve information sharing, modernizing the Automated Integrated Regulatory Examination System (commonly known as AIREs), adding improved offsite monitoring tools, and modernizing NCUA's Call Report system;
- Improving consistency between examiners; and
- Improving communication.

In addition to seeking input from credit unions, the working group held calls with five state regulators. NCUA also received [79 letters](#) from credit unions, state leagues, and three national trade groups, each of whom provided recommendations. A summary of those comments is available [here](#).

NCUA staff and management were encouraged to provide feedback and propose solutions via conference calls, in-person meetings, and written recommendations. To determine which recommendations were actionable, acceptable, and appropriate, these recommendations were reviewed and applied against the following principles to determine if they would:

- Protect the National Credit Union Share Insurance Fund;
- Improve examination quality;
- Promote increased flexibility; or
- Manage agency resources in a more efficient and effective manner.

Recommendations

After careful and deliberate analysis, the *Exam Flexibility Initiative* working group developed ten recommendations for the NCUA Board's consideration. The following recommendations complement one another, can be implemented in a safe and sound manner, and are fundamental to the agency's vision of a future-state examination program.

1. **Establish Federal Credit Union Eligibility Criteria for Extended Examination Cycle**

Effective January 1, 2017, NCUA will transition well-managed, low-risk federal credit unions that meet all of the following criteria to an extended examination cycle:

- CAMEL code 1 or 2, both in composite and management rating components;
- Less than \$1 billion in assets;
- Well capitalized per prompt corrective action regulations;
- No documents of resolution related to significant recordkeeping deficiencies; and
- No formal or informal enforcement or administrative order, such as a cease and desist order, letter of understanding and agreement, or preliminary warning letter.

For qualifying credit unions, examinations will generally begin between 14 and 20 months from the prior examination completion date.

2. **Adjust Examination Cycle for All Other Federal Credit Unions**

Effective January 1, 2017, examinations at federal credit unions that do not meet the criteria above will generally begin between 8 and 12 months from the prior examination completion date.

3. **Continue Enhanced Examinations at Small Federal Credit Unions**

NCUA will continue to conduct targeted, defined scope exams using the Small Credit Union Examination Program for financially and operationally sound federal credit unions with less than \$30 million in assets. NCUA field staff will continue to have the discretion to perform these procedures for a credit union with \$30 million to \$50 million in total assets that received a composite CAMEL code 1, 2, or 3 at its last examination. NCUA will continue to perform risk-focused exams for more complex credit unions with assets in excess of \$50 million.

4. Enhance Coordination of Federally Insured, State-Chartered Credit Union Examinations

To the extent possible, NCUA will coordinate completion of federally insured, state-chartered credit union examinations with state supervisors in accordance with state scheduling practices, most of which currently range from 12 to 18 months. Examinations will occur not less frequently than once every five years, except for credit unions that meet any one of the following criteria:

- Greater than \$1 billion in assets;
- Composite CAMEL code 4 or 5 with assets greater than \$50 million; or
- Composite CAMEL code 3 with assets greater than \$250 million.

Examinations of these three categories of federally insured, state-chartered credit unions will generally begin between 8 and 12 months from the prior completion date, consistent with the treatment of federal credit unions ineligible for an extended cycle. Also, this ensures parallel treatment of credit unions greater than \$1 billion, regardless of charter type;

5. Establish a Joint NCUA-State Supervisor Working Group

In 2017, NCUA will create an agency-led working group that includes a representative group of state supervisors to evaluate and recommend further changes to our examination program for federally insured, state-chartered credit unions.

The working group will collaborate to improve coordination and scheduling of joint exams, provide scheduling flexibility, and reduce redundancy where possible. The group's goal will be to minimize the burden on state-chartered credit unions that results from having a separate prudential financial regulator and insurer. The working group will also evaluate the efficacy, appropriateness, and feasibility of adopting an alternating examination approach for the supervision of federally insured, state-chartered credit unions.

6. Establish Applicable Provisions for All Federally Insured Credit Unions

Random Sampling Examinations. NCUA will perform annual examinations of a select group of small credit unions that lack either desired segregation of duties or essential internal controls to mitigate risk to federally insured credit unions and the Share Insurance Fund. These examinations will be completed using the Small Credit Union Examination Program.

Measurement of the Examination Cycle. NCUA will change how we measure duration for an examination cycle. Instead of being measured from the completion of one examination to the completion of the next exam, it will now be measured from the completion of one examination to the start of the next exam. (Start date is

defined as the first date onsite.) This subtle change provides greater clarity for credit unions who really want to know when the next examination is starting, and it improves examination scheduling efficiency.

Authority to Conduct More Frequent Examinations. The changes to NCUA’s examination cycle do not limit NCUA’s authority to examine any federally insured credit union as frequently as the agency deems necessary. NCUA will consider financial trends, risk, and other facts or circumstances related to safety and soundness to determine if a more frequent examination is required.

7. Enhance Planning and Notice Procedures

Effective July 1, 2017, NCUA will make further positive enhancements to examination planning, including:

- Providing examiners’ specific time to plan and scope the examination, when practical;
- Providing credit union’s more advanced notice; and
- Improving coordination of document requests tailored to the credit union’s specific risk profile and product offerings.

8. Reinstitute Optional Credit Union Survey

Effective July 1, 2017, NCUA will reinstitute an optional survey for credit unions to complete following examinations. This survey will provide credit unions an opportunity to provide feedback to NCUA, which we believe will assist the agency in evaluating the effectiveness of current examination policy, communication, and new training initiatives.

9. Reduce NCUA’s Onsite Presence

Ongoing initiative. This report does not recommend NCUA move away from a point-in-time examination, but recognizes and encourages the agency continue to evaluate alternatives to our current examination approach, which may include a continuous supervision model. The expanded use of off-site examination procedures could prove foundational to this model and potentially improve employee satisfaction and reduce turnover.

Our ability to implement effective off-site exam procedures, and a reduced onsite presence depends on several important factors, including:

- A reliable secure file transfer portal. NCUA staff recently completed an internal test of a utility that will enable secure communications. In the past few weeks, NCUA started testing this program with credit unions. We need time to test, evaluate the utility’s functionality, and make modifications

before this can be used on a system wide basis. As this program matures, NCUA's on-site presence during examinations is likely to be reduced.

- Robust communication capabilities. Field staff use a wireless hot-spot to connect to NCUA's virtual private network and the internet. Connection speeds vary significantly based on an examiner's locale and working conditions. With nearly two thirds of the agency workforce working remotely, these services are critical to the agency's success.
- Continued effective examiner communication with credit unions.

To achieve long-term success, improve efficiencies, and modernize offsite monitoring capabilities, NCUA must also:

- Successfully complete the current Call Report and Exam System Modernization Initiatives;
- Enhance data collection practices;
- Deploy critical business intelligence tools and new analytical capabilities; and
- Address future human capital business needs, including a greater expertise in enhanced data quantification techniques and case management.

10. Improve Consistency of Examiner Training

Ongoing initiative. NCUA's Talent Management Council will work to maintain effective training programs for all field staff. Training will continue to emphasize the importance of timely, ongoing, and open communication. It will also work with NCUA's senior leadership to evaluate actions the NCUA can take to further improve examination consistency from one examiner to the next. Further, NCUA will allocate hours and budgeted funds to ensure examiners and specialists receive expedited classroom and on-the-job training to accelerate their learning.

Together, the recommendations outlined in this report aim to lessen the examination burden on credit unions while ensuring proper regulatory safeguards remain in place to protect the credit union system, the deposits of credit union members, and the National Credit Union Share Insurance Fund.

The successful implementation of these recommendations requires NCUA to invest some of the resource hours saved from an extended exam cycle into improved exam planning, to examine a select group of small credit unions that do not have desired internal controls, and to deliver additional classroom and on-the-job training opportunities. We must also continue investing in new technology and explore

alternative approaches to examination as credit unions grow larger and more complex. The economic environment will not always support strong credit union performance.

Timeline

The NCUA Board is scheduled to vote on NCUA's 2017 - 2018 Operating Budget during the November Board meeting. We anticipate the NCUA Board will consider the recommendations made by the [Exam Flexibility Initiative](#) working group when they vote on the 2017 - 2018 Operating Budget. If approved, beginning January 1, 2017, NCUA will change our examination cycle policy in order to:

- Provide greater flexibility to both address emerging risk and be more responsive during economic downturns;
- Improve coordination with state supervisors to ensure it better aligns with respective state scheduling practices that largely vary between 12 and 18 months; and
- Increase efficiency through joint examinations, enhanced exam planning, and data sharing.

Again, pending NCUA Board action recommendations 1-6 will become effective January 1, 2017. On July 1, 2017, enhanced planning and notice procedures become effective (recommendation 7) and the optional credit union survey will be reinstated (recommendation 8). The remaining recommendations described in this report represent ongoing initiatives that do not have an established end date.