

Examination Flexibility Initiative Comment Summary

NCUA Board

NCUA Board Chairman Rick Metsger established the [Examination Flexibility Initiative](#) on May 19, 2016 to evaluate relevant aspects of the supervision process. The initiative collected comments from external stakeholders on ways to improve NCUA's examination and supervision program.

The Exam Flexibility Initiative posed five questions to stakeholders to seek input on ways to improve the examination process.

1. As a regulator, how can we conduct future credit union examinations in ways that minimize disruptive operational impacts during your credit union examination?
2. What concerns do you have with respect to the agency's current examination and supervision program?
3. What actions should the NCUA consider to improve the efficiency of its examination program, while ensuring it remains effective?
4. How can we better use technology to do our jobs?
5. What metrics should the agency consider in determining a credit union's eligibility for a longer examination cycle?

The first three questions were posed to stakeholders to understand the current concerns with the examination process, activities most disruptive to credit union operations, and ways to improve the examination process. Question four was posed to understand how NCUA can better use technology to execute the examination program. And, question five was posed to obtain input on the metrics the agency should use to qualify credit unions for an extended examination cycle, if the agency were to move to an extended cycle.

NCUA received comments from 79 credit union system stakeholders by the August 1 deadline. Sixty-three credit unions, eight credit union leagues, three trade groups, and five other interested parties—including third-party vendors, and credit union and industry staff—provided thoughtful comments on a variety of issues.

This document summarizes the comments into three broad categories: the examination and supervision program, technology, and extended cycle qualification metrics.

Examination and Supervision Program

Disruptions, Current Concerns, Improvements

The majority of comments related to the examination and supervision program. The two most common comments were: reduce onsite presence and improve exam preplanning. These and other comments are discussed below.

Reduce Onsite Presence

NCUA received 29 comments explicitly stating the agency should focus on performing more offsite work, reducing the number of days examiners are onsite, reducing the number of examiners on the team, or some combination of these three options.

Fifteen commenters suggested **extending the examination cycle** or lengthening the time between examinations, with a reduced onsite presence being one of the main benefits.

Commenters indicated that much of the **examination work could be done offsite**, with time onsite spent:

- Communicating with credit union management
- Reviewing aspects of the credit union that must be reviewed onsite
- Obtaining clarification on any items noted during the offsite review

Additionally, some commenters suggested **improving offsite supervision** as part of an extended cycle program. Commenters also suggested examiners conduct offsite supervision and come onsite only if sufficient clarification cannot be obtained through an offsite review and communication with the credit union.

Improve Examination Pre-planning

NCUA received 35 comments suggesting the agency spend more time preparing for examinations.

Many comments in this area centered on the **items requested list**. Commenters suggested examiners spend more time preparing a request list that is streamlined and relevant to reduce disruptions to credit union operations. Credit union commenters indicated they receive duplicate requests, items not relevant to their credit union, requests for items already provided, multiple lists from multiple examiners or specialists or both regulators, or requests for items never reviewed. Some commenters suggested

giving credit unions more advance notice of the items requested list, and others stated that if the request list was received sooner, the credit union could provide some items in advance to assist with additional pre-planning or the actual start of the examination.

Other comments related to improving pre-planning suggested examiners **spend more time preparing for the examination** itself. Specifically, commenters suggested examiners take more **time to understand the credit union's** products, services and operations, have more **communication** with credit union management on exam priorities, areas of focus, and exam logistics, and organize the team to minimize duplication of effort.

The agency received 22 recommendations suggesting the **scope** of examinations could be improved.

Specifically, commenters described experiencing examinations not tailored to the credit union's risk profile or focused too much on immaterial areas of the credit union's operations. Commenters suggested examinations focus on the areas of highest risk. Some commenters expressed the need for better communication about the scope prior to the start of the examination.

Twenty-two commenters submitted remarks related to **scheduling**.

Many of these commenters requested more advance notice for the exam start date and flexibility when scheduling the examination. Additional comments suggested examiners ensure they can perform the examination at the designated time and within the time allotted. Some commenters expressed concern with exams being conducted too soon after completion of the prior exam. Commenters suggested examiners work with credit unions to make the timing of the exam effective and efficient for everyone.

Consistency

NCUA received 33 comments encouraging the agency to improve the consistency of the examination experience from exam to exam and examiner to examiner.

Comments in this area centered on what commenters described as the inefficiency of the examination program when different examiners have differing opinions on approach and risk. Commenters expressed concern with the range of subjectivity encountered during the examination process. Many commenters suggested additional consistency **training** for examiners to address this concern.

Twenty-one commenters expressed concern with examiners citing **best practices** to support examination findings.

Commenters suggested the citation of best practices has become too frequent and sometimes appears to be based on examiner opinion or preference rather than actual industry best practice. A few commenters suggested citing a best practice should only be allowable if the best practice is well documented in guidance or other well-known publications. Other commenters suggested regulation should be the only basis for recommendations. To remedy the existing concerns, commenters encouraged NCUA to provide additional training to examiners on how and when to cite best practices to effect change.

Communication

Twenty-two stakeholders expressed communication between the examiner and the credit union needs improvement.

Many suggested the examiner meet with credit union management on a regular basis. Some recommended setting aside intentional meeting time each day of the exam to discuss the credit union's products, services and strategies; communicating examination priorities to management; and meeting with either management or the appropriate credit union personnel to discuss any concerns before concluding the review. Commenters also invited more communication with their examiners, understanding that both credit unions and examiners can obtain valuable insight and feedback during open conversations.

Seven commenters also said there is a need for more consistency between verbal communications and written reports.

Commenters invited candid discussion around findings and recommendations at the exit meeting to reduce potential conflict upon receipt of the written report. Related comments expressed concern with the **contents of the examination report**. Some commenters described receiving reports where the report content was not previously discussed with the credit union. Others indicated receiving reports containing too much examiner opinion (See the Consistency section above) A few felt the same point or concern was repeated too often throughout the various report documents.

A few commenters suggested examiners hold periodic calls with credit union management throughout the year, perhaps coinciding with the quarterly Call Report review, if the agency moves to an extended cycle.

Improve Coordination with State Regulators

NCUA received 13 comments encouraging the agency to improve coordination of examinations with our state counterparts.

Commenters suggested the agency rely more on the state regulators' work, coordinate examination timing, request lists, and assigned areas of review to reduce duplication of efforts.

Additional Comments

A small number of commenters offered the following suggestions on other areas of the examination and supervision program and NCUA's operations as described below:

- Ten commenters suggested NCUA improve and update guidance, such as the Examiner's Guide, exam checklists, and examination priorities, for examiners and credit unions.
- Nine commenters suggested NCUA improve the appeals process or otherwise provide a mechanism for credit unions to offer feedback about the examination process.
- Seven commenters suggested improvements to NCUA's operations, including an expectation of a reduction in the agency's resource needs once NCUA fully implements its modernization and flexibility initiatives.
- Seven commenters suggested focusing on hiring specialists. Commenters acknowledged a specialist's expertise is beneficial as credit unions become more complex.
- Seven commenters suggested NCUA change the examination process to put more reliance on existing credit union activities, such as the CPA Audit; internal audit function, and/or implement self-exams for low risk credit unions.
- Six commenters mentioned the ongoing concern of regulatory burden and cautioned NCUA to include small credit unions in an extended exam cycle to address some of the existing burden.

Technology

NCUA requested stakeholder input on how we can better use technology to do our jobs. The agency received comments describing various technologies that would improve the agency's examination and supervision program. In almost all instances, the technological improvements support a reduced onsite presence at credit unions.

Secure Portal

Thirty-eight stakeholders suggested the use of a **secure portal** to share information between the credit union and NCUA.

Some commenters provided specific security requirements for the secure portal. Others described their expectation that NCUA disclose the security safeguards of the secure portal. Similarly, a few commenters suggested NCUA maintain responsibility for safekeeping information shared through the secure portal.

AIRES and Call Report Modernizations

The Examination Flexibility Initiative received some comments about **modernizing NCUA's Automated Integrated Regulatory Examination System** and the **Call Report**. Nine commenters indicated AIRES improvements would improve the efficiency and effectiveness of examinations.

Seven commenters suggested improvements to the Call Report would improve pre-planning, scoping, and offsite supervision, including the identification of red flags. Specific comments for improving AIRES and the Call Report will be shared with the Examination System Modernization team and the Call Report Modernization initiative, respectively.

Eight commenters suggested development of an **offsite monitoring tool** and four commenters encouraged the agency to develop **improved analytics** to support offsite supervision throughout the year and augment onsite examinations.

Extended Cycle Qualification Metrics

NCUA asked commenters to propose eligibility metrics for an extended examination cycle if the agency determines an extended cycle is appropriate. Fifty-nine commenters submitted metrics for consideration, covering a wide array of quantitative and qualitative criteria. Thirty-five of the eligibility metric comments included the **composite CAMEL** rating as one of the criteria.

Red flags, balance sheet composition, or a combination of the two were included in 40 of the commenters' lists of criteria. Commenters included examples for consideration such as the addition of new products and services, large growth in a particular asset category, trends in earnings, net worth, delinquency, and complexity of the balance sheet.

Two commenters suggested NCUA adopt criteria similar to the **FDIC eligibility requirements**.¹ Two others suggested NCUA use the criteria from the agency's risk-based scheduling policy **implemented in 2001**.²

Other considerations submitted included:

- Prior examination results,
- Recordkeeping and internal controls, such as audit results and quality of the verification of accounts,
- Credit union management, and
- Examiner input.

¹ The FDIC uses the following criteria to extend the examination cycle to 18 months: (1) The institution has total assets of less than \$1 billion; (2) The institution is well-capitalized as defined in regulation; (3) At the most recent examination the institution (a) was assigned a CAMEL 1 or 2 in Management (b) was assigned a composite CAMEL 1 or 2; (4) The institution is not under an enforcement proceeding by OCC, FDIC, OTS, or the Federal Reserve System; and, (5) No person acquired control of the institution during the preceding 12-month period in which a full scope, onsite examination would have been required but for this section.

² NCUA implemented a risk-based scheduling policy in 2001. Letter to Credit Unions 01-FCU-05 outlines the criteria: <https://www.ncua.gov/Resources/Documents/LFCU2001-05.pdf>

Outreach Strategy

NCUA adopted a multi-pronged outreach strategy for this initiative. In addition to the 79 comments received through examflexibility@ncua.gov, NCUA held 41 stakeholder conference calls, discussed the initiative during credit union and league roundtables, and surveyed state regulators. The issues raised and recommendations provided through these efforts were very similar in nature to the written comments received from stakeholders.

Stakeholder Conference Calls

Separate calls were held with federal credit unions with assets of less than \$100 million, credit unions with assets between \$100 million to \$1 billion, and credit unions with assets greater than \$1 billion. Separate calls were also held with federally insured, state-chartered credit unions using the same peer groups. Stakeholder participants were recommended by the Credit Union National Organization and the National Association of Federal Credit Unions and included credit union executives, directors and staff. The initial call with each group represented a brainstorming session, where participants communicated issues they would like to address in more detail. Subsequent calls focused on exam system modernization, call report modernization, and the secure file transfer portal; examination cycle metrics; pre-planning; opinion or sound business practice versus regulation, and consistency; and use of specialists and subject matter examiners.

Credit Union Roundtables

NCUA requested input on the agency's Examination Flexibility Initiative during seven meetings with credit unions and leagues held in Alabama, California, Florida, Indiana, Montana, New Mexico, and Texas. Feedback received during these meetings was consistent with written comments.

State Regulators

NCUA requested feedback and comments from all state authorities about their states' examination cycles. All 45 states with state-chartered credit unions responded to this request. NCUA requested each state regulator provide information about its examination cycle as required by state law or state policy and how frequently it examines its credit unions in practice. State regulators also provided comments about whether the extension of NCUA's exam cycle would have an impact on their respective programs.

NCUA worked with the National Association of State Credit Union Supervisors to choose a representative group of five state regulators to participate in a series of conference calls. Similar to credit union stakeholder calls, the initial meeting established topics for all subsequent calls. These calls focused on coordination between NCUA and state regulators, opportunities for a reduced onsite presence, examination cycle metrics, use of technology, and use of specialists.

Conclusion

NCUA appreciates the level of participation during the comment period. The comments received were thoughtful, candid, and constructive. Commenters took this opportunity to voice concerns and importantly, offer solutions. The Examination Flexibility Initiative now is carefully evaluating all comments as it moves forward with preparing formal recommendations to the NCUA Board. These recommendations will be submitted to the Board in early October.