

NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION 1775 Duke Street, Alexandria, VA 22314

DATE: August 2018 **LETTER NO:** 18-CU-01

TO: Federally Insured Credit Unions

SUBJ: Examination Modernization Initiatives

Dear Board of Directors and Chief Executive Officer:

The NCUA has several initiatives in process to improve and modernize how the agency conducts examinations and supervision.¹ The goals of these initiatives are to replace outdated, end-of-life examination systems, streamline processes, adopt enhanced examination techniques, and leverage new technology and data to maintain high quality supervision of insured credit unions with less onsite presence. The purpose of this letter is to provide more information on these ongoing initiatives.

Background

The NCUA Board approved five initiatives to modernize the agency's exam processes - the Flexible Examination Pilot Program (FLEX), Office of National Examinations and Supervision (ONES) Data Driven Supervision, the Shared NCUA-State Regulator Federally Insured, State-Chartered Credit Union (FISCU) Program, the Enterprise Solution Modernization Program (ESM), and the Virtual Examination Program. Some of the intended benefits of these initiatives are:

- More efficient examinations and supervision
- Reduced burden on credit unions
- More consistent and accurate supervisory determinations
- Greater ability to adapt to changes in the marketplace and credit union business models
- Enhanced coordination with State Supervisory Authorities
- Reduced travel costs
- Improved quality of life for examiners
- More secure, reliable, and flexible technology foundation able to support future expansion capabilities

¹ The NCUA is also participating with the other agencies on the Federal Financial Institutions Examination Council (FFIEC) on an interagency Examination Modernization project. The objective of the project is to identify and assess ways to improve the effectiveness, efficiency, and quality of safety and soundness examination procedures for financial institutions, particularly through increased leveraging of technology.

These five initiatives are interrelated and complement each other. As these initiatives support and build upon each other, they will ultimately result in a fully modernized examination and supervision program with various incremental improvements occurring along the way. Below is a more in-depth discussion of each of the initiatives:

Flexible Examination Program (FLEX)

The FLEX is a pilot program in Region IV. FLEX is evaluating conducting offsite certain existing exam procedures. The pilot was developed to assess examiners working remotely on elements of examinations of well-run credit unions that have the technology and platforms to securely provide electronic data. This program reflects the NCUA's most immediate solution to the agency's efforts to reduce, but not eliminate, onsite presence during exams.

In 2017, the NCUA tested the pilot with five examiner groups in 28 credit unions located in a variety of geographical locations.² The pilot was tested on credit unions as small as \$4 million in assets to those as large as \$9.4 billion in assets.

Preliminary results from the pilot show costs savings to the NCUA, realized in part by reducing travel time and costs for examiners. In designated FLEX reviews, over 35 percent of the total exam hours were performed offsite. Credit union feedback has also been positive, with the majority of credit unions reporting positive experiences with the modified exam approach.

However, the pilot identified the need for the NCUA to have a secure file transfer portal to support much of this work being done offsite efficiently. The secure file transfer portal was fully deployed in July, 2018. The agency is currently testing the portal and can soon move towards developing plans to increase agency use of offsite procedures

ONES Data- Driven Supervision

This initiative began in 2018 as an effort to move to a continuous supervision model for the large natural person credit unions supervised by the Office of National Examinations and Supervision. The continuous supervision model will use data-driven analytics to monitor and identify credit union risk and support the transition to credit union-driven stress testing. This work may lead to analytical advancements that can be adapted for use in the supervision of some or all other insured credit unions.

Shared NCUA-State Regulator FISCU Program

In 2017, the NCUA created the Joint NCUA-State Supervisor Working Group (working group). This working group is tasked with collaborating to improve coordination and scheduling of joint exams, provide scheduling flexibility, and reduce redundancy where possible. The group's goal is to minimize the burden on FISCUs resulting from having a separate financial regulator and insurer. In addition, the group is tasked with evaluating the efficacy, appropriateness, and feasibility of adopting an alternating examination approach for FISCUs.

² All pilot locations were located in Region IV.

The working group is developing a pilot program to explore and evaluate the effectiveness of the alternating examination concept. A pilot will allow the NCUA, state regulators, and stakeholders to evaluate benefits and challenges prior to finalizing a decision on an alternating exam program. Such a pilot will need to run about three years in order to evaluate one full alternating exam cycle.

For joint examinations of FISCUs, the working group is exploring ways to minimize duplication and overlap through process improvements and greater use of technology. The working group is also evaluating other areas, such as loan participations, CUSO and third party vendor reviews, and other supervisory matters, where the work of each party can be better leveraged in examining and supervising FISCUs.

Enterprise Solution Modernization (ESM)

In November 2015, the NCUA Board authorized the ESM program. This effort will replace legacy applications such as the examination system (AIRES) and the Call Report data collection tool (CU Online). ESM will also introduce emerging and secure technology that supports the NCUA's examination, data collection, and reporting efforts. The result will be a flexible technology architecture that integrates modernized systems and tools across the agency. The new systems will streamline processes and procedures helping create a more effective, less burdensome process.

ESM is providing the essential upgrades to the NCUA's technology foundation to support the FLEX and Virtual Exam programs with:

- More efficient ways to securely communicate with credit unions.
- Updated tools such as workflow management, data integration, document management, and customer relationship management capabilities.
- A flexible framework that will allow for integration of new solutions so the NCUA's supervisory systems can evolve with changes to regulations, data and analytical needs, and activities credit unions engage in.

The first of a series of technology upgrades from ESM are scheduled to begin in 2019. Throughout the multi-year implementation phase of this initiative, the NCUA will continue to provide updates and engage stakeholders. More information about this initiative, including the history of the program, can be found on NCUA's website at www.NCUA.gov.

Virtual Examination Program

In 2017, the NCUA Board approved the project and associated resources to research methods to conduct offsite as many aspects of the examination and supervision processes as possible. The virtual exam project team is researching ways to harness new and emerging data, advancements in analytical techniques, innovative technology, and improvements in supervisory approaches.

By identifying and adopting alternative methods to remotely analyze much of the financial and operational condition of a credit union, with equivalent or improved effectiveness relative to current examinations, it may be possible to significantly reduce the frequency and scope of onsite examinations. Onsite examination activities could potentially be limited to periodic data quality and governance reviews, interventions for material problems, and meetings or other examination activities that need to be handled in person.

The virtual exam should lead to greater use of standardized interaction protocols, advanced analytical capabilities, and subject matter experts. This should result in more consistent and accurate supervisory determinations, provide greater clarity and consistency with respect to how the agency conducts supervisory oversight, and reduce coordination challenges between agency and institution staff.

To be successful, it is likely examination staff will need to analyze more information about the credit union and communicate more frequently with management. However, it is not the agency's intent to intervene in credit unions' day-to-day operations or strategic planning.

The virtual examination team will deliver to the NCUA board by the end of 2020 a report discussing alternative methods identified to remotely analyze aspects of the financial and operational condition of a credit union. The agency's goal is to transform within the next five to ten years the examination and supervision program into a predominately virtual one for credit unions that are compatible with this approach. The transformation is expected to occur through incremental adoption of the corresponding new techniques and approaches.

Summary

Modernizing agency systems and processes will reduce burden on the credit union community and increase the effectiveness of the NCUA. Agency staff will continue to seek credit union input on ways to reduce the burden of the supervisory process without sacrificing the mission of the agency. Ongoing communication and transparency are key in the success of these endeavors. Please consult the NCUA website for additional information and ongoing project status updates.

I hope this letter clarifies these strategic examination program initiatives. If you have questions, comments, or suggestions on these initiatives, please contact the NCUA at exammodernization@ncua.gov.

Sincerely,

/s/

J. Mark McWatters
Chairman