



DCU BULLETIN
Division of Credit Unions
Washington State Department of Financial Institutions
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Initiatives and Exam Focus for 2023

This Bulletin includes several initiatives that we are working on in 2023 and what our examination focus will be during exams in 2023.

Initiatives

1. **Hybrid Examinations** – Since DCU resumed onsite examination work in April of 2022, we have made improvements to how we conduct our examinations. Using examination feedback from credit unions via our post exam survey, we have modified our protocol regarding how we gather data, assign onsite DCU staff, and the use of Microsoft TEAMS for meetings.

The Division will continue to conduct hybrid examinations in 2023 featuring an onsite and offsite presence. 2022 Examination feedback from credit unions indicate that they found our examination work to be less disruptive to credit union operations with fewer examiners onsite. The Division will also continue to solicit feedback on our hybrid examination model in 2023.

2. **Hiring and retaining qualified staff**

The Division has filled all but two of the open positions that were vacated during the hot job market in 2022. The new examiners will receive a combination of formal training via the National Credit Union Administration, and on-the-job training including working on examinations at credit unions.

The Division's training program will continue to focus on training examiners to understand how credit unions manage risk on their balance sheet and how strategic decisions are made at a minimum. Training will also include on-the-job training from our management and examination team on how to best provide value to credit unions during examinations.

3. **Expanded Reviews and Focus on Information Security & Technology (IS&T) reviews during Safety and Soundness examinations** – In 2022 we added a second IS&T examiner to increase the effectiveness of our IS&T exams. In 2023 we will continue to train regular safety and soundness examiners to assist in conducting IS&T exams as needed. Having two specialty IS&T examiners and

some assistance from safety and soundness examiners will allow us to spend additional time doing deeper dives into IS programs.

2023 Exam Focus

Liquidity Risk

The Federal Reserve raised interest rates several times in 2022, which is good news for credit unions that have the liquidity to buy new higher rate investments and to make loans at higher rates. The new higher interest rate environment has also created higher interest rate risk for those credit unions with loans and investments with longer duration to maturity. In some cases, credit unions are keeping low rate investments in their portfolios rather than taking a penalty for early withdrawal. Liquidity risk rises when the credit unions use excess liquidity to invest in new, higher yielding investments.

The Division monitors liquidity limits in two ways, during examination and during quarterly offsite caseload monitoring. In 2023, The Division examiners will assess credit union liquidity levels, policies, procedures, and liquidity monitoring practices. Additionally, examiners will review the Asset and Liability Committee (ALCO) and board minutes to assess how closely liquidity levels are monitored and what actions credit unions take when they approach their liquidity limits.

Credit Risk

Because credit unions worked closely with members to provide payment relief and options, this decreased the impacts of the COVID-19 pandemic on some borrowers. Government stimulus funds also offered aid to member business loan borrowers so overall delinquency and charge-offs remained at low pre-pandemic levels.

In 2023, examiners will continue to focus on credit risk management and portfolio credit quality. During examinations, examiners will review underwriting, monitoring, board reporting, and risk management of consumer and member business loan portfolios. Additionally, examiners will also review credit union loan modification policies and loans where modifications are granted to borrowers who ask for payment relief.

Examiners will also review concentration risks within credit union loan portfolios. Overreliance on a single loan product can pose significant risk to credit unions in certain economic situations.

Fraud Risk

The increased risk associated with inadequate internal controls will be an examination focus in 2023. Examiners will review and test internal controls related to cash and transactions and separation of duties. Many credit unions

adopted a work from home/offsite work environment pre and post pandemic, which could result in increased exposure to Transaction Risk.

The Division and examiners understand that not all credit unions have the staff to fully segregate operational duties. The examiners will review what mitigating factors and controls credit unions utilize to offset transaction risk.

Compliance with Current Expected Credit Losses (CECL):

CECL went into effect on January 1, 2023, and during examinations this year examiners will review credit union progress with complying with the rule as well as the adequacy of the Allowance for Loan Loss (ALLL). Examiners will review policies, procedures, and the accounting treatment for the ALLL.

Credit unions have been modeling the CECL methodology over the past two years as the final rule was delayed and examiners have reviewed the material during Safety and Soundness examinations in 2022.

Information Security & Technology (IS&T)

The financial services sector continues to experience heightened cyber threats and it is essential credit unions protect their information systems and member data. Examiners expect the board of directors and senior management to not only implement an adequate IS&T program, but to continuously adjust the program based on the credit union's current and evolving risks.

Additionally, examiners expect credit unions to remediate any outstanding IS&T related concerns identified through regulatory examinations and third-party audits. Senior management should keep the Board of Directors informed of these and any self-identified weaknesses and remediation actions.

Third-Party Service Providers

IS&T examiners will evaluate credit unions' third-party service providers risk management framework and oversight activities. Examiners expect credit unions to have an effective risk management program to identify, measure, monitor, and control risks associated with third-party relationships. A credit union's use of third parties does not diminish the responsibility of the Board of Directors and senior management to ensure oversight of vendor management is performed in a safe and sound manner and in compliance with applicable laws.

Consumer Compliance

The Division will conduct compliance reviews during regular safety and soundness examinations as well as during a limited number of concurrent, standalone compliance exams.

Safety and soundness exams will focus regular compliance on areas such as : overall effectiveness of a credit union's compliance program, Bank Secrecy Act/Anti-Money Laundering, TILA-RESPA integrated disclosure requirements, Regulation E, and Regulation Z.

A limited number of concurrent, separate compliance examinations will be scheduled at credit unions with total assets over \$500 million. Compliance exams will focus on: compliance management systems, fair lending, Regulation E, unfair practices under the Consumer Financial Protection Act (auto loan servicing, repossessions, GAP refunds, and freezing deposit accounts), and other consumer compliance areas as needed.

Conclusion

The Division is committed to working with our state chartered credit unions in 2023. We respect the challenges that our credit unions have worked through since the pandemic and look forward to a successful 2023 regulating and partnering with our credit unions to assist them in the vital role they play in providing financial services to the residents of Washington State.

If you have any questions, please contact Myriam Powers, Chief of Safety and Soundness Examinations, at myriam.powers@dfi.wa.gov, or Mark Vasquez, Chief of Specialty Exams (IS&T and compliance exams), at mark.vasquez@dfi.wa.gov.