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**National Association of Federally-Insured Credit Unions**

August 28, 2020

Heather Phelps  
Program Analysis Officer for Virtual Examination Studies  
National Credit Union Administration  
1775 Duke Street,  
Alexandria, Virginia 22314

**RE: Strategies for Future Examination and Supervision Utilizing Digital Technology**

Dear Ms. Phelps:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to you regarding the National Credit Union Administration's (NCUA) Request for Information (RFI) on the future of examinations and supervision leveraging technology. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 121 million consumers with personal and small business financial service products. NAFCU appreciates the agency's progress to date with certain examination reform initiatives and recognizes that the unique circumstances posed by the COVID-19 pandemic forced the NCUA to quickly adopt a virtual examination posture. The NCUA's long term exam modernization plans, which seek to leverage new technology, analytics, and other capabilities to transition to a primarily virtual setting, should prioritize reducing examination burden, valuing credit union autonomy, and providing credit unions with an opportunity to have in-person interactions with their examiners.

The NCUA should fervently continue to pursue its exam modernization efforts in a transparent fashion that allows credit unions to consistently provide feedback. Transparency is essential in the examination process as well as during the NCUA's information-gathering process on how to structure its future approach to supervision and examinations. NAFCU urges the agency to continue to seek feedback from the credit union industry through RFIs such as this and provide credit unions with clear guidance as to what they should expect from their examiners.

**General Comments**

As the NCUA moves toward deploying more virtual examinations in the next five to ten years, the agency should ensure that this shift resolves persistent issues and concerns with the examination process. NAFCU members continue to share concerns about exam consistency, even during this year's virtual exams, making this an issue which should be the central focus of the NCUA's efforts to transition to virtual exams.

The NCUA has repeatedly acknowledged that improving examination consistency is one of its primary goals. For example, in an August 2018 Letter to Credit Unions, the agency explained that

the use of virtual exams “should result in more consistent and accurate supervisory determinations, provide greater clarity and consistency.” Although more consistent and accurate supervisory determinations is just one intended goal of the agency’s virtual examination initiative, it is arguably the most important.

NAFCU surveys its members regularly on their experiences with the examination process and through these surveys has noticed several trends among member respondents. In its most recent survey,<sup>1</sup> over half of member respondents said that they were at least somewhat concerned with exam consistency and 43 percent indicated that their highest priority for exam reform was more consistent examiner interpretation and application of rules and guidance. Credit unions also reported that accessing exam-related guidance is challenging, which likely contributes to examiners’ misunderstanding and divergent application of the agency’s rules and guidance.

The NCUA has issued a significant number of Letters to Credit Unions, Supervisory Letters, and other alerts this year due to the COVID-19 pandemic and NAFCU greatly appreciates the agency’s leadership during this difficult time. However, prior to the pandemic, 77 percent of credit union respondents indicated that the NCUA should produce more exam-related guidance to enhance transparency and better inform credit union management about the agency’s approach to supervision and examinations. NAFCU requests the NCUA continue this recent trend of providing more guidance on a go-forward basis once the nation has emerged from the COVID-19 pandemic, and beyond.

Inconsistent examinations may lead to some credit unions being dissatisfied with their examination results. Those credit unions may then seek to appeal their examination results and should be able to do so without fear of retribution. Unfortunately, the NCUA has yet to provide credit unions with a streamlined, independent appeals process for supervisory determinations. NAFCU’s credit union members have often indicated that they are not made aware of their appeal rights during their exam and that potential examiner retaliation is a barrier to pursuing an appeal. This demonstrates the urgent need for the NCUA to restore credit union confidence in what should be an entirely impartial examination process. NAFCU greatly appreciates the agency’s actions in recent years to expand the number of supervisory determinations appealable to the Supervisory Review Committee and the director of the Office of Examination and Insurance, but requests the NCUA adopt an independent process that provides credit unions with enhanced due process regarding agency decisions.

Regarding the exam modernization process generally, NAFCU asks that the NCUA proactively share assessments of its exam modernization efforts to promote open and frank discussion of ways to improve legacy examination processes and better transition to virtual exams. As the NCUA identifies alternative methods to remotely analyze aspects of the financial and operational condition of a credit union, it should publish the results of its studies in reports that are shared with the credit union industry. NAFCU encourages the NCUA to make its assessments of virtual exam reforms as public as its budget process given the scope and significance of this modernization initiative.

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<sup>1</sup> NAFCU’s Economic & CU Monitor (Nov. 2019).

## **Virtual Exams Should Prioritize Reducing Exam Burden and Duration**

Although NAFCU is encouraged by the positive developments documented in this RFI, outreach to our membership suggests that many credit unions are still not seeing a meaningful reduction in exam duration. In NAFCU's most recent survey, credit union respondents representing institutions under \$100 million reported that the time allotted to exams has "increased significantly."<sup>2</sup> Likewise, 61 percent of credit union respondents with assets above \$1 billion reported that the time allotted to exams had increased.<sup>3</sup> From 2018 to 2019, both the average number of onsite examiners (6.5 to 6.8 examiners) and the average length of exams (12.9 to 13.1 days) increased slightly across credit union respondents.<sup>4</sup> The average staff resource time also increased in recent years, averaging 15.4 days.<sup>5</sup> Duration of an exam has a direct correlation to the time and resources credit union staff can devote to serving members. Shorter, more efficient exams would allow credit unions to better serve their members, particularly during an unanticipated disruption, like the COVID-19 pandemic.

### *The Need for Virtual Examination Procedures*

During this year's virtual exams, credit unions generally reported positive feedback but did indicate that examiners asked for documents and information over the course of several weeks. Understandably, the first attempt at completely virtual examinations will not result in perfect execution, but as the NCUA contemplates primarily virtual exams in the future, it should work on shortening exam duration as well as adopting software to streamline document sharing, and concentrating examiner requests within a specified window and scope. More specifically, some of NAFCU's members have said that during their virtual exam, they were unable to share documents while on a call with their examiners. The NCUA should adopt software that permits credit unions to share documents in real time, while on a call with examiners, to facilitate easier and more efficient transmission of documentation in response to examiner requests. This could reduce the time spent providing additional documentation after conversations with examiners.

Relatedly, NAFCU's member credit unions report having continued or supplemental requests for documents that do not relate to the examiners' initial requests. Examiners should not be expanding the scope of their documentation requests beyond those initial requests as this creates additional burden for the credit union and could prolong the duration of the exam. Accordingly, during virtual exams, the NCUA should establish a cut-off date for document requests, beyond which examiners shall not request additional documentation beyond the scope of the initial requests, absent certain exigent circumstances. Examiners should be permitted to request additional documentation beyond the cut-off date only if: (1) there is a preliminary finding or question that surfaces during the exam that may require further documentation to clarify, answer or cure the issue; (2) the documents that were initially submitted were not the documents requested by examiners and the correct documentation is still required; or (3) a question arises during the exam pertaining to the safety and soundness of the credit union. This general time limit, absent extraordinary

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<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

circumstances, would help to ensure that credit unions are able to better direct their focus on the examination process, creating a win-win scenario which benefits not only the credit union and its members, but also examiners and the agency.

In recent months, credit unions noted that the volume of information requests they received during this year's virtual exams were very high, especially within the first four or five days of the exam. Credit unions also reported having to provide the same information to multiple examiners and have seen the same information requests across various sections of their request lists. This begs the question: How is the NCUA coordinating communication and collaboration among examiners during virtual exams? These types of burdensome and duplicative information requests came at a time when credit unions were already strapped for resources and struggling to figure out the best means of establishing business as usual among staff who were all now working remotely due to the COVID-19 pandemic. Robust internal processes for examiners must be established to avoid waste of credit union staff time and resources.

One method of improving examiner coordination may be to schedule more regular meetings between examiners and credit union management, whether in person or virtual. Such meetings are key to ensuring that examiners have a clear understanding of the credit union's processes as examiners conduct their virtual exams, particularly on instances where exceptions may have been identified. Although email is an effective method of communication, it is not a substitute for live conversations with management. It is important that examiners put in the time necessary to develop a good working relationship with credit unions to understand their unique needs and circumstances as well as keep management informed throughout the examination.

#### *Flexibility on Record Digitization*

Not all credit unions have adopted a completely electronic recordkeeping system, particularly smaller credit unions. This means that many of those institutions were under pressure to quickly scan in their documents to transmit that information to examiners during their virtual exam. This process is labor-intensive and takes a significant amount of time and resources. The unprecedented circumstances of the COVID-19 pandemic necessitated the electronic transmission of all documents, whereas previously credit unions could have shared that physical documentation with examiners onsite.

NAFCU asks that the NCUA provide credit unions with reasonable flexibility in digitizing their records and even permitting a hybrid approach for those credit unions that may not be able to afford to completely digitize their documentation. Credit unions should be permitted to decide with their examiner how much time should be spent onsite to gather necessary information from the credit union if they are unable to upload all of their records to an electronic format before the NCUA begins virtual exams in the future. For now, as the pandemic continues, the NCUA should encourage examiners to provide credit unions with as much time as necessary to scan all required documents for their virtual exams.

## **Virtual Exams Should Incorporate Strong Data Protections Requirements**

Most consumer protection laws and regulations on the topic of privacy provide exceptions for sharing information as required by law or in the context of an examination. However, credit unions can only do so if they are also providing sufficient protections regarding the confidentiality and security of that member information. Therefore, the NCUA should not require credit unions to share information in violation of their legal and regulatory obligations under the *Gramm-Leach-Bliley Act's* Safeguards Rule. Further, NCUA examinations should not expose credit unions to compliance or litigation risk in connection with state laws such as the *California Consumer Privacy Act*.

### *Protection of the Integrity and Confidentiality of Data*

In order to achieve these goals, the NCUA must establish sufficient security protocols of its own to protect the integrity and confidentiality of credit union information in the transfer, storage and use of confidential information in the context of an exam. Given the breadth of personal information the NCUA regularly transmits and retains, it should move toward the development of mature cybersecurity controls akin to those required by the Federal Financial Institutions Examination Council (FFIEC). The exact nature and structure of those controls would depend on the NCUA's internal structures, use of vendors, and other factors, as it does with credit unions. Sufficient controls must include robust patch-management programs, rigorous access controls, and appropriate firewall and anti-malware tools that are both functional and permit examiners to effectively do their job.

The NCUA should take all steps necessary to guarantee that data transmitted through its Secure File Transfer portal will be encrypted in transit and in storage on agency servers. Further, the NCUA should conduct virtual exams using end-to-end encryption wherever possible. NAFCU also recommends that the NCUA consider taking steps toward data segmentation to prevent the comingling of credit unions' data to reduce the risk of industry data being compromised in the event of a large-scale security breach. NAFCU requests the NCUA provide assurances that the agency's measures include data isolation along with unique and discrete encryption keys. The encryption keys used by the NCUA should be unique to each credit union's data and distinct from any encryption key used by a credit union whose data is collected or stored by the NCUA.

The NCUA should also implement tools to prevent unauthorized access to or exfiltration of confidential data, unpatched examiner or third-party devices, or unauthorized removable media. One such tool should be the incorporation of multi-factor authentication (MFA) for the Secure File Transfer portal. MFA is a key security practice that would ensure the documents and data that credit unions upload onto the portal is protected from unauthorized users and bad actors seeking to breach the system.

NAFCU recommends that the NCUA provide MFA for credit unions to significantly reduce the risk that confidential data is compromised. Some of NAFCU's member credit unions reported that during this year's virtual exam, they had to notify NCUA examiners each time they uploaded documentation to the portal so that the examiners could immediately pull the documents from the

portal into their network, thereby minimizing the length of time those documents remained in the portal and the associated risk. This mitigation procedure is neither efficient for the NCUA nor the credit unions it is examining. An effective MFA would remove the need for this procedure and better protect the integrity and confidentiality of data as it is uploaded, stored, and removed from the Secure File Transfer portal.

The NCUA must also establish and enforce significant physical controls for its examiners, particularly as examinations may be conducted from alternative locations including their permanent or temporary dwellings. The NCUA should also address data security standards in the use of vendors or third- and fourth-party providers. As the NCUA moves forward with virtual exams, NAFCU requests the agency provide specific details regarding the standards to which these parties are to be held, including whether these third-parties meet the same levels of protection expected of the NCUA, background checks, and other controls.

### *Risk Assessment and Mitigation*

Although the NCUA may seek to assess risk levels with the goal of reducing security costs, this practice may result in a misalignment of controls or failure to adopt appropriate information security standards. NAFCU requests transparency in the agency's rating of the information and information systems it is currently using and plans to use in the collection of the data under its virtual examinations to protect the safety and soundness of the credit union system.

The NCUA should minimize the confidential data it collects to eliminate risks associated with collecting, storing, and using that confidential data wherever possible. Credit unions have often expressed concerns that NCUA examiners collect more data and records than is necessary. The collection of excess data not only burdens credit unions' staff and resources, but it also unnecessarily exposes the data to security risk. Declining to collect unnecessary data eliminates this security risk entirely. The NCUA should conduct a careful and exhaustive cost-benefit analysis of all potential data fields to be collected that accounts for the security risks associated with each piece of data.

### **Ongoing Data Collection Must Respect Credit Union Autonomy**

NAFCU objects to data collection throughout the year as it would lead to an influx of communications and requests that would pose more burdens to credit unions than it would provide efficiencies. As the NCUA considers transforming the examination and supervision program into a predominately virtual program, NAFCU would like to emphasize the need to balance enhanced monitoring techniques with respect for credit union autonomy and decision-making processes. Leveraging technology to provide increased communication between examiners and credit union management to support virtual supervision should not interfere with day-to-day operations. Constant requests from examiners throughout the year would impede day-to-day operations and be more burdensome than the current examination process.

Credit unions prefer to have examiners onsite or offsite conducting an exam for only a limited period of time instead of providing documents and data to the NCUA on a flow basis throughout

the year. The NCUA should recognize the importance of preserving credit union autonomy as the cornerstone of the development of its virtual examination model. Collection of data through virtual exams should achieve more than just a reduction in examiner presence at an institution; rather, the goal should be to improve communication through a collaborative dialogue that does not second-guess decisions made by credit union management.

### **Virtual Exams Should Adopt Extended Exam Cycles for All Low-Risk, Well-Run Credit Unions**

Currently, the NCUA's extended examination cycle applies only to credit unions that meet certain eligibility criteria, including assets less than \$1 billion. The extended examination cycle became effective for credit unions on January 1, 2017. According to NAFCU survey responses in 2019, when compared to results in 2018, credit union respondents indicated that the median length between exams has remained largely unchanged at twelve months.<sup>6</sup> Slightly less than half of credit union respondents under \$1 billion in assets had an examination cycle of 18 months or greater.<sup>7</sup> As the NCUA contemplates a transition to virtual exams, NAFCU asks the NCUA to provide credit unions with an update on its progress in implementing an extended examination cycle for certain credit unions under \$1 billion in assets.

Further, in a December 2016 Letter to Credit Unions, the NCUA explained its extended exam cycle policy will permit the agency to "be more responsive to the needs of individual credit unions, manage resources more efficiently, and reduce the examination burden on credit unions."<sup>8</sup> The NCUA has previously justified maintaining the annual exam cycle for credit unions greater than \$1 billion in assets on the basis that such a policy would be consistent with thresholds set by the Federal Deposit Insurance Fund (FDIC), Office of the Comptroller of the Currency (OCC), and the Federal Reserve Board (collectively, "other banking agencies").

On August 23, 2018, the other banking agencies issued a final rule implementing Section 210 of the *Economic Growth, Regulatory Relief, and Consumer Protection Act*, which makes qualifying banks with up to \$3 billion in assets eligible for an 18-month onsite exam cycle. As a consequence, banks now have greater exam flexibility despite credit unions generally having less complex balance sheets. As the NCUA considers a shift to virtual examinations, it should reconsider its own exam cycle eligibility policy to align with the changes adopted by the other banking agencies. To better achieve its goal of reducing burdens on credit unions during the exam process, future virtual exams should be deployed on an 18-month or longer extended cycle for all low-risk, well-run credit unions.

In determining eligibility for an extended exam cycle, the NCUA should also take into account the individual risk of a credit union. As NAFCU has consistently maintained, the size of a credit union alone does not determine its risk or need for regulatory relief. Rather, relief would be better hinged

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<sup>6</sup> NAFCU's Economic & CU Monitor (Nov. 2019).

<sup>7</sup> *Id.*

<sup>8</sup> NCUA Letter to Credit Unions, 16-CU-12, *Risk-Based Examination Scheduling Policy* (Dec. 2016), available at <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/risk-based-examination-scheduling-policy>.

on multi-factor tests instead of arbitrary asset thresholds. That is why NAFCU supports extended exams for all low-risk, well-run credit unions. However, at a minimum, the agency should seek to maintain parity with the extended examination threshold used by the other banking agencies.

### **Conclusion**

NAFCU remains supportive of the NCUA's ongoing efforts to transition to a primarily virtual exam posture. The NCUA should ensure that its priorities are to reduce credit union examination burdens, achieve greater exam consistency, provide autonomy for credit union leaders, and adopt modern, more efficient process to provide further relief. The NCUA should act upon its commitment to transparency and share more information about the progress of its exam reform efforts in the form of public reports. In addition, the agency should issue more exam-related guidance, so credit unions are able to set their expectations for the process going forward. NAFCU urges the NCUA to continue to make strides toward achieving uniformity in the exam process and consider enhanced due process options for credit unions to challenge supervisory determinations. If you have any questions or concerns, please do not hesitate to contact me at [akossachev@nafcu.org](mailto:akossachev@nafcu.org) or (703) 842-2212.

Sincerely,

A handwritten signature in black ink, appearing to read "Ann C. Kossachev". The signature is fluid and cursive, with the first name "Ann" and last name "Kossachev" clearly legible.

Ann C. Kossachev  
Director of Regulatory Affairs