

Regulatory Compliance Priorities for 2020

Where to Focus and Common Pitfalls

Agenda

- Dedicated Compliance Exams
- Bank Secrecy Act
- Consumer Compliance
- Other Supervisory Priorities
- Statutory and Regulatory Updates

Dedicated Compliance Exams

- October 30, 2019 Press Release
 - NCUA Board Member Todd Harper requested public comment on proposal to create a dedicated consumer compliance exam proposal for large, complex credit unions
 - Likely impacts credit unions greater than \$1 billion in total assets
 - Separate consumer compliance rating, outside of CAMEL rating

Bank Secrecy Act

- Consumer Due Diligence
- Beneficial Ownership
- Currency Transaction Reports
- Suspicious Activity Reports
- Automated Surveillance Monitoring Systems

Bank Secrecy Act

- Consumer Due Diligence (CDD)
 - Requires the following:
 - Risk-based procedures to obtain and analyze sufficient member information to understand the purpose of member relationships for the purpose of developing a member risk profile
 - Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update member information
 - At a minimum must establish procedures that:
 - Enable the credit union to understand the nature and purpose of the member relationship in order to develop a member risk profile
 - Enable the credit union to conduct ongoing monitoring for:
 - Identification of suspicious transactions
 - On a risk basis, to maintain and update member information

Bank Secrecy Act

- Consumer Due Diligence– Common Issues
 - Requirements for when to complete a CDD risk assessment
 - Procedures for changing member risk ratings
 - Inconsistencies related to automated risk rating models
 - Failure to run automated risk rating models according to policy
 - Procedures and documentation of enhanced due diligence for high risk members

Bank Secrecy Act

- Beneficial Ownership
 - Control Prong
 - Single individual with significant responsibility to control, manage, or direct
 - One individual must be identified for each entity
 - Ownership Prong
 - Each individual, if any, that owns 25 percent or more of equity interests of the entity
- Must obtain the following for each beneficial owner or a legal entity:
 - Name
 - Date of Birth
 - Address
 - Identification Number

Beneficial Ownership

Bank Secrecy Act

- Beneficial Ownership – Common Issues
 - Failure to complete beneficial ownership identification for a legal entity
 - Lack of procedures regarding what triggers update of beneficial ownership information

Bank Secrecy Act

- Currency Transaction Reports (CTRs)
 - Must electronically file a CTR for each transaction in currency of more than \$10,000, by, through, or to the credit union
 - Multiple currency transactions totaling more than \$10,000 during any one business day are treated as a single transaction if the credit union has knowledge that they are by or on behalf of the same person
 - Electronic CTR filing includes certain fields which are marked as “critical” and must be completed or marked “unknown”
 - Must provide most complete filing information available, regardless of whether or not the individual fields are deemed “critical”
 - CTR must be filed electronically with FinCEN within 15 days after the date of the transaction

Bank Secrecy Act

- Currency Transaction Reports– Common Issues
 - Failure to timely file within 15 days of the transactions
 - Failure to aggregate multiple transactions within a single business day
 - Issues related to shared branching responsibility to file
 - Failure to complete all known fields on the CTR
 - Incorrect fields on the CTR

Bank Secrecy Act

- Suspicious Activity Reports (SARs)

- Required to file a SAR for the following:

- Criminal violations involving insider abuse in any amount
 - Criminal violations aggregating \$5,000 or more when a suspect can be identified
 - Criminal violations aggregating \$25,000 or more regardless of a potential suspect

- Required to file a SAR for the following, *continued*:

- Transactions aggregating \$5,000 or more, if the credit union knows, suspects, or has reason to suspect that the transaction:
 - May involve potential money laundering or other illegal activity
 - Is designed to evade the BSA or its implementing regulations
 - Has no business or lawful purpose and the credit union knows of no reasonable explanation

Bank Secrecy Act

- Suspicious Activity Reports (SARs)
 - Five key components to an effective monitoring and reporting system:
 - Identification or alert of unusual activity
 - Managing alerts
 - SAR decision making
 - SAR completion and filing
 - Monitoring and SAR filing on continuing activity
 - Electronic filing required no later than 30 calendar days from the date of the initial detection of facts that may constitute a basis for filing a SAR
 - Should report continuing suspicious activity by filing a SAR every 90 days
 - SAR narrative is deemed “critical”
 - Required reporting to appropriate board committee

Bank Secrecy Act

- Suspicious Activity Reports – Common Issues
 - Failure to timely file within 30 days of determination
 - Failure to file on continuing activity
 - Failure to have a quality SAR narrative (who, what, when, where, why, how)
 - Failure to report to board committee
 - Documentation of monitoring activities
 - Failure to identify potentially suspicious activity

Bank Secrecy Act

- Responsible implementation of automated surveillance monitoring systems
 - Parameters and filters should be reasonable and tailored to the activity the credit union is trying to identify or control
 - Parameters and filters should be reviewed prior to implementation to identify any gaps
 - Review and test system capabilities on a periodic basis
- Common Issues
 - Lack of model validation

Consumer Compliance

- Regulation E – Electronic Fund Transfers
- Fair Credit Reporting Act
- Gramm -Leach -Bliley Act
- Small Dollar Lending
- Regulation Z
- Military Lending Act and Servicemembers Civil Relief Act

Consumer Compliance

- Regulation E– Electronic Fund Transfers – Initial Disclosures
 - Required to be provided at the time a consumer contracts for an electronic fund transfer (EFT) service or before the first EFT
 - Content must include the following:
 - Liability of consumer
 - Telephone number and address at credit union
 - Business days definition
 - Types of transfers that can be made and limitations
 - Fees imposed on EFTs
 - Content, continued:
 - Summary of consumer’s rights to receipts and periodic statements
 - Summary of consumer’s right to stop payment of an EFT
 - Liability of credit union
 - Confidentiality
 - Error resolution procedures
 - ATM fees

Consumer Compliance

- Regulation E– Electronic Fund Transfers – Error Resolution Procedures
 - Required to determine whether an error occurred within 10 business days
 - Required to report results to consumer within three business days after investigation completion
 - 10 business day notice may be extended to 45 days if provisional credit is granted
 - 45 days may be extended to 90 days if EFT was not initiated within a state, was a point-of-sale debit card transaction, or occurred within 30 days after initial deposit to the account
- If no error determined or different error occurred, then a written explanation is required
 - When provisional credit is debited, required to honor checks, or similar instruments payable, without any overdraft fees, for 5 business days after notification

Consumer Compliance

- Regulation E– Electronic Fund Transfers – Common Issues
 - Failure to provide initial disclosure at account opening
 - Failure to timely investigate errors
 - Failure to timely provide provisional credit
 - Improper charging of overdraft fees
 - Over reliance on third parties (if utilized)

Consumer Compliance

- Fair Credit Reporting Act
 - Furnishers of information may not report inaccurate information that they know or have reasonable cause to believe is inaccurate
 - If an information provider determines that it has made an inaccurate report, it must promptly correct and update the information
 - Must prevent re-aging, or inaccurately changing the date of first delinquency on a consumer's account to a late date
- The date of delinquency is the month and year of the first thirty day late payment in a series. For instance:
 - An account becomes delinquent in March 2019, and the creditor places the account for collection in September 2019. March 2019 would be the date of first delinquency.
- Date of delinquency is utilized to determine how long the delinquency is reported on a consumer's credit report (typically seven years)

Consumer Compliance

- Fair Credit Reporting Act– Common Issues
 - Inaccurately reporting more recent dates of first delinquencies
 - Inaccurate reporting of past due balances
 - Reporting closed accounts and paid in full accounts for greater than three months
 - Accounts with joint contractual liability only reporting one individual
 - Inaccurate reporting of bankruptcies
 - Inaccurate reporting of repossessions

Consumer Compliance

- Gramm-Leach-Bliley Act (GLBA)– Nonpublic Personal Information
 - Nonpublic personal information generally is any information that is not publically available and that:
 - A consumer provides to a financial institution to obtain a financial product or service from the institution;
 - Results from a transaction between the consumer and institution involving a financial product or service; or
 - A financial institution otherwise obtains about a consumer in connection with providing a financial product or service
 - Consumers must be given a reasonable opportunity and reasonable means to opt out of a financial institution disclosing nonpublic personal information about them to a nonaffiliated third party
 - Required to design and implement a Member Information Security Program

Consumer Compliance

- Gramm-Leach-Bliley Act – Common Issues
 - Failure to have Member Information Security Program approved by the board of directors
 - Failure to report to the board of directors, or appropriate committee, annually regarding overall status of the Member Information Security Program

Consumer Compliance

- Small Dollar Lending (including Payday Alternative Lending)
 - Payday Alternative Loan (PAL) II– Final Rule
 - No minimum amount, \$2,000 maximum
 - 1 month minimum term, 12 month maximum term
 - No membership time requirement
 - Maximum interest rate of 28%
 - CFPB Payday, Vehicle Title, and High-Cost Installment Lending Rule: Small Entity Compliance Guide
 - Covers:
 - Short-term loans that require repayment within 45 days of consummation or an advance
 - Longer-term loans with certain types of balloon payments
 - Longer-term loans with greater than a 36% APR, and lender right to initiate transfers
 - Effective in 2020?

Small Dollar Lending

Consumer Compliance

- Small Dollar Lending (including Payday Alternative Lending) – Common Issues
 - Inaccurate advertisements
 - Failure to obtain proper written authorization for preauthorized electronic fund transfers

Consumer Compliance

- Regulation Z – Truth in Lending
 - APR is generally accurate if within $1/8^{\text{th}}$ of 1 percent
 - APR calculation guidance for closed-end loans contained within Appendix J of Regulation Z
 - Payments should be credited on the day of receipt
 - Loan promissory note will guide application of payments (and partial payments) to principal, interest, fees and other charges
 - Unless application of payment would result in pyramiding of late fees
 - Finance charge includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. Does not include any charge of a type payable in a comparable cash transaction
 - Pyramiding of late fees is imposing a late fee when a consumer sends a timely payment in an amount sufficient to cover the regularly scheduled payment but insufficient to cover a prior unpaid late or delinquency fee. If the creditor allocates payments first to late fees, the consumer's payment only partially covers the currently scheduled payment, resulting in a new late fee.

Regulation Z

Consumer Compliance

- Regulation Z – Common Issues
 - Stating an inaccurate APR
 - Failure to accurately disclose the finance charge
 - Inappropriate inclusion/exclusion of charges in calculation of the finance charge
 - Failure to timely credit periodic payments
 - Inappropriate application of payments

Consumer Compliance

- Military Lending Act (MLA) and Servicemembers Civil Relief Act
 - Military Lending Act does not cover credit that is secured by the property being purchased
 - Covered borrower is a consumer who at the time of obligation is an active duty member of the armed services, or his or her spouse or dependents
 - Covered transactions are capped at 36% APR
 - Safe Harbor for verification of covered borrowers
 - Defense Manpower Data Center Website
 - National Credit Reporting Agencies
 - SCRA allows Servicemembers to reduce interest rate of any pre-service loans to a maximum of 6%
 - SCRA provides protections against default judgements, foreclosure, and repossession of property

Consumer Compliance

- Military Lending Act (MLA) and Servicemembers Civil Relief Act – Common Issues
 - Failure to maintain documentation of safe harbor
 - Failure to send SCRA default notice within 45 days of a missed payment for mortgage loans
 - Failure to review covered borrower status prior to repossessions or drilling safe deposit boxes

Other Supervisory Priorities

- Credit Risk
- Current Expected Credit Losses (CECL)
- Information Systems and Assurance (Cybersecurity)
- LIBOR Cessation Planning
- Liquidity Risk

Other Supervisory Priorities

- Credit Risk
 - Examiners to focus review on a credit union's loan underwriting standards and procedures
 - Ability of borrower to meet debt service requirements without undue reliance on collateral value
 - Proposed interagency guidance addressing management of credit risk, ongoing credit review and appropriate communication to management and the board of directors
 - Examiner procedure to be enhanced, including supervisor concurrence and additional quality controls
 - Credit unions with high loan concentrations will be subject to the enhanced scrutiny
 - Specifically identified loan types include: participation loans, commercial loans, indirect loans, and residential real estate loans
 - Reiterates letter to federally insured credit unions dated March 2010 (10-CU-03)



Other Supervisory Priorities

- Concentration Risk Exposure – Current Trends
 - Credit union portfolios continue to see growth primarily in secured real estate lending (adjustable and fixed rate) and unsecured personal loans
 - Growth in the above loan segments attributed to decreases in the federal funds rate throughout 2019
 - New vehicle loan balances have decreased due to a significant decline in vehicle sales during 2019
 - Growth in other consumer and installment categories remained flat over the year

Other Supervisory Priorities

- Concentration Risk Exposure
 - Performing risk assessments
 - More significant concentrations should be met with a relatively more robust analysis
 - Ongoing reviews
 - Properly maintaining data
 - Loan types, interest rates, etc.
 - Assignment of risk ratings
 - Required to be validated by an independent review function
 - Timely reporting
 - Report against parameters approved by the board of directors
 - Credit score migration
 - Analyze potential impact of concentrations on net worth, individually and in the aggregate

Other Supervisory Priorities

- Concentration Risk Exposure
 - Why is proper management of concentration risk important?
 - Maintain earnings
 - Reduce losses
 - Capital protection
 - Prevent possible credit union failure
- Other reminders
 - Concentrations can exist in a credit union's operations outside of lending
 - Across different types of assets
 - Liabilities and funding sources
 - Third party providers

Other Supervisory Priorities

- Credit Risk – Common Issues
 - Inadequate or loosely followed underwriting standards
 - Mismatch between loan structure and source of repayment
 - Accuracy of repayment analyses
 - Changes in concentration levels not adequately considered when assessing qualitative factors as part of the allowance for loan loss model

Current Expected Credit Losses (CECL)

Other Supervisory Priorities

- Current Expected Credit Losses (CECL)
 - Delayed until January 2023
 - Examiners will continue to inquire regarding progress toward implementation
- How to continue preparing?
 - Continue researching requirements of the standard and stay up to date on industry news
 - Taking inventory of needed data and validating data inputs
 - Finalize model outsourcing, if applicable
 - Run parallel models



Interagency CECL
FAQ

Other Supervisory Priorities

- Information Systems and Assurance (Cybersecurity)
 - Implementation of cybersecurity assessment for lower asset size credit unions
 - New asset size schedule goes into effect beginning in 2022
 - All credit unions with greater than \$100 million in asset size will be subject to NCUA cybersecurity maturity assessments
 - Credit unions will be able to complete self-assessments using the new ACET tool provided by the NCUA
 - NCUA will implement new examiner procedures beginning in 2020 covering critical security controls
 - NCUA plans additional outreach to assist credit unions with current cybersecurity issues and recommendations to address concerns

Other Supervisory Priorities

- LIBOR Cessation Planning
 - LIBOR will likely no longer be supported by the end of 2021
 - UK regulatory agencies to phase out LIBOR due to market manipulations by major banks
 - There is strong support to use the Secured Overnight Financing Rate (SOFR) as the replacement benchmark
- How does LIBOR cessation affect credit unions?
 - Likely little impact to credit unions in terms of lending or derivative exposures
 - Examiners will review how the credit union has identified LIBOR-related transactions and progress planning, budgeting, accounting for, and addressing the transition

Other Supervisory Priorities

- LIBOR Cessation Planning
 - How to stay current on LIBOR cessation?
 - Follow industry updates, e.g. subscribing to newsletters published by the Alternative Reference Rates Committee (ARRC)
 - Resources include timely updates, fall back language newly entered into transactions and various other guides
 - <https://www.newyorkfed.org/arrc>
 - Other Updates
 - Major players are already using SOFR as a benchmark for certain financial products
 - The New York Federal Reserve has been publishing SOFR prices since April 2018

Other Supervisory Priorities

- Liquidity Risk
 - Examiner focus will be on sound liquidity risk management and planning
 - Specifically mentioned areas include:
 - Interest rate risk
 - Scenario analysis, such as member share migrations and cash flow projections
 - Contingency funding plans
 - Required for all credit unions with an asset size over \$50 million
- Common Issues
 - Lack of independent review of the liquidity risk management program
 - Inappropriate time horizons
 - Over reliance on non-core funding sources



Statutory and Regulatory Updates

- Commercial Real Estate Appraisal Rule
- Private Flood Insurance Rule
- Public Unit and Nonmember Shares
- Serving Hemp Businesses
- Supervisory Committee Audits Rule

Statutory and Regulatory Updates

- Commercial Real Estate Appraisal Rule
 - Final rule amending Part 722 became effective October 22, 2019
 - Increased appraisal threshold from \$250,000 to \$1,000,000 for commercial real estate transactions
 - Changed the exemption for federally related real estate transactions from \$250,000 to \$400,000
 - Strengthens independence requirements if a written evaluation is performed in lieu of an appraisal
 - No longer required to perform an appraisal for government-backed loans; however, government programs most likely still require an appraisal

Statutory and Regulatory Updates

- General Appraisal Requirements

- An appraisal is required for residential real estate transactions with values greater than \$400,000
- Transaction values less than \$250,000, but greater than \$26,700, do not require an appraisal unless the transaction is considered complex or meets the definition of a “higher-priced mortgage loan” under Regulation Z (§ 12 CFR 1026.35)
- Transaction values less than \$26,700 do not require an appraisal, but do still require a written evaluation
- Strengthens independence requirements for when a written evaluation is performed in lieu of an appraisal
 - Individual performing the evaluation must be independent of the production and collection processes
 - If not independent, the credit union must demonstrate the collateral valuation was properly isolated from the production and collection functions

Statutory and Regulatory Updates

- General Appraisal Requirements
 - State-certified versus State-licensed
 - State-certified appraisers must satisfy requirements of the state, whose criteria meet minimum requirements issued by the Appraiser Qualification Board of the Appraisal Foundation and earn a passing grade on a state examination
 - State-licensed appraisers are not required to take a state examinations and have various restrictions on which transactions they may perform an appraisal
 - State-licensed appraisers may perform appraisals on non-complex residential real estate transactions less than \$1,000,000 and up to \$250,000 if considered complex

Statutory and Regulatory Updates

- Private Flood Insurance Rule
 - Amends Part 760, effective July 1, 2019
 - Mandates acceptance of certain flood insurance policies from private providers
 - Allows credit unions to rely on written assurances from insurers stating the required criteria are met
 - Allows acceptance of flood insurance policies provided by mutual aid societies if certain criteria are met
- Policies are required to be accepted if they meet the definition of private flood insurance prescribed in the Biggert-Waters Flood Insurance Reform Act of 2012
 - Insurance company must be licensed by a state regulatory in which the subject property is located
 - Coverage must be at least as broad as coverage provided under a Standard Flood Insurance Policy (SFIP)

Statutory and Regulatory Updates

- Private Flood Insurance Rule– Flood Insurance Policy Requirements
 - The policy defines the term “flood” as would be defined in an SFIP
 - Contains coverage over building property, personal property and other covered property as under an SFIP
 - Deductibles are no higher than the maximum and contain similar non-applicability provisions as under an SFIP
 - May only exclude other causes of loss as excluded by an SFIP
 - Cannot contain provisions that narrow coverage provided by an SFIP
 - Must include a requirement for the insurer to give written notice 45 days prior to cancellation or non-renewal to the insured and credit union
 - Information regarding the availability of flood insurance coverage under the NFIP
 - A mortgage interest clause similar to the clause contained in an SFIP
 - A provision requiring an insured to file suit not later than one year after the date of a written denial of part or all of a claim

Statutory and Regulatory Updates

- Private Flood Insurance Rule
 - Compliance aid
 - “This policy meets the definition of private flood insurance contained in 42 U.S.C 4012a(b)(7) and the corresponding regulation .
 - If the above statement is made, no further review by the credit union is required
 - Private flood insurance policies can accepted on a discretionary basis if certain criteria are met under § 760.2
 - Amount of insurance is at least equal to the lesser of the outstanding principal balance or maximum coverage available
 - Issued by a licensed insurer
 - Covers the mortgagor and mortgagee as loss payees (excluding condominium complexes)
 - Provides sufficient coverage under safety and soundness principles



Statutory and Regulatory Updates

- Public Unit and Nonmember Shares
 - Amends Part §701.32 effective January 29, 2020
 - Allows greater flexibility to credit unions in choosing funding sources from external sources
 - Changes the limit to 50% of paid-in and unimpaired capital and surplus, less public unit or nonmember shares, or \$3,000,000, whichever is greater
- Requires a specific written plan by the board of directors concerning the use of such funds if public unit and/or nonmember shares exceed 70% of paid-in and unimpaired capital and surplus

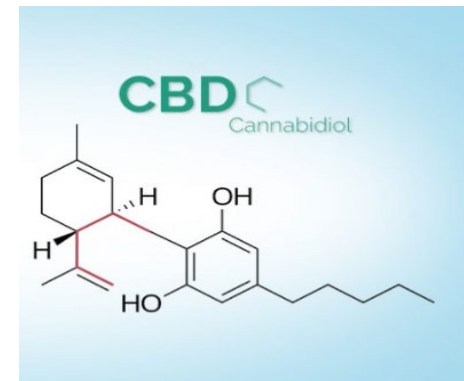
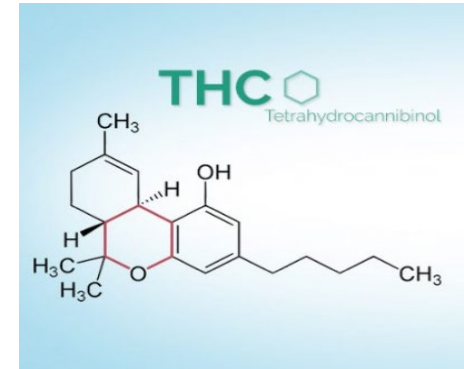
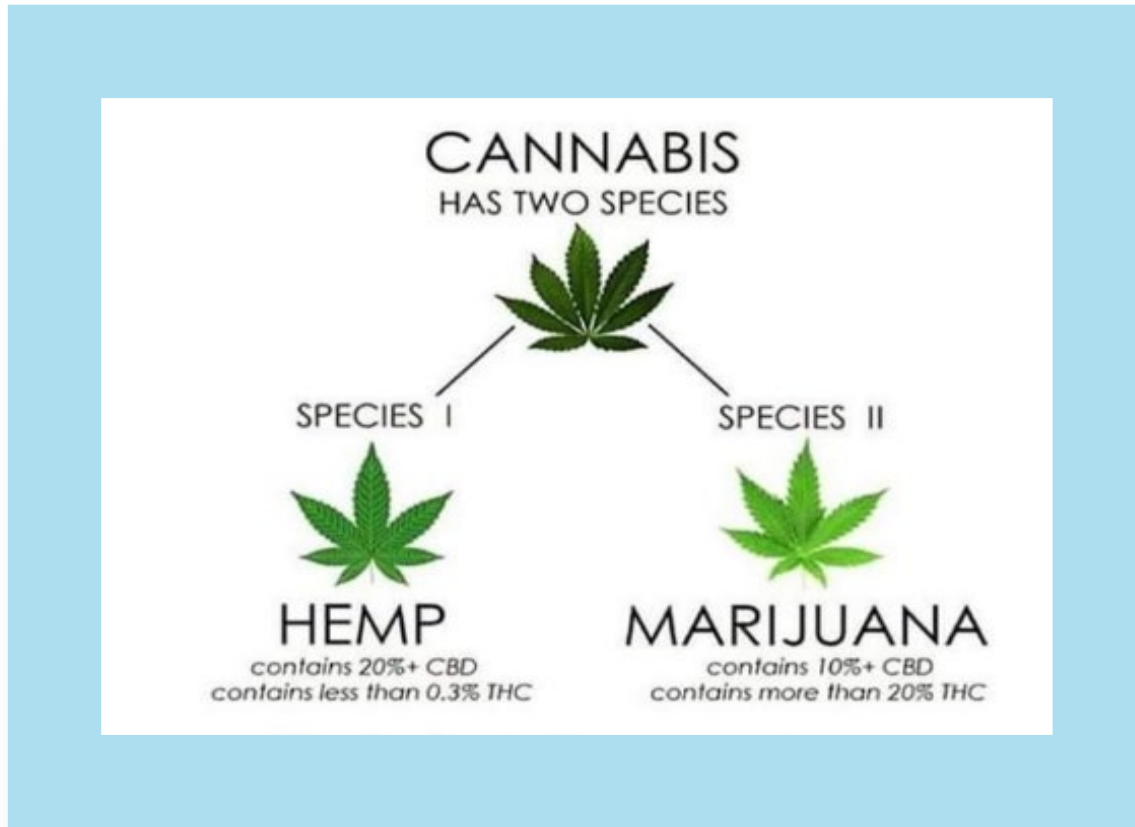
Statutory and Regulatory Updates

- Serving Hemp Businesses
 - Agriculture Improvement Act of 2018 removes hemp as a controlled substance at the federal level
 - US Department of Agriculture's interim ruling allows hemp to be lawfully produced, effective October 31, 2019
 - Credit unions may provide any traditional financial service for a business account to lawfully operating hemp-related businesses within their fields of membership
 - The NCUA will provide additional guidance throughout 2020
 - Refer to 19-RA-02, *Serving Hemp Businesses*



Statutory and Regulatory Updates

- Serving Hemp Businesses



Statutory and Regulatory Updates

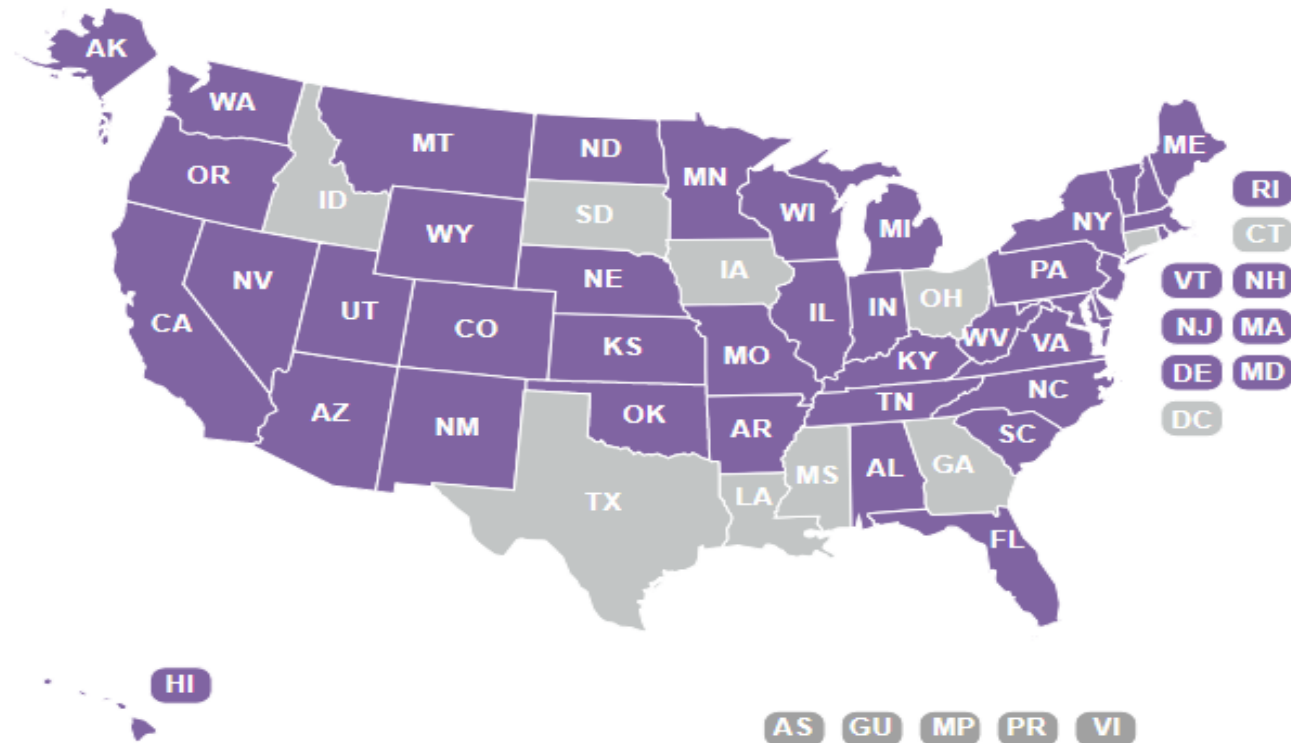
- Serving Hemp Businesses
 - Credit unions are required to perform appropriate due diligence procedures over hemp-related businesses
 - For example, credit unions must verify hemp-related businesses are part of a state's pilot program
 - BSA/AML program requirements do not change regardless of whether the credit union banks any cannabis-related business
 - Not required to file SARs for activity of lawfully operating hemp-related businesses
 - SARs are required if any indication of illicit activity is occurring

Statutory and Regulatory Updates

- Serving Hemp Businesses

Allows cultivation of hemp for commercial, research or pilot programs

Does not allow cultivation of hemp.



Statutory and Regulatory Updates

- Supervisory Committee Audits Rule

- Amends Part 715, effective January 6, 2020
- Engagement letters signed prior to the effective date are subject to the old Supervisory Committee Guide
- Simplifies the Supervisory Committee Audit Guide
 - Addition of Appendix A
 - Removes two rarely used audit types: Report on Examination of Internal Controls over Call Reporting option and the Balance Sheet Audit
 - Removes the 120 day filing deadline when using a compensated third party to deliver an audit report

- Supervisory Committee Audit Alternative

- Credit unions can choose between obtaining a financial statement audit (conducted under GAAP) or a Supervisory Committee Audit
- Must be performed by the Supervisory Committee, internal auditor, certified public accountant or league auditor
- Procedures and other requirements contained within Appendix A

Statutory and Regulatory Updates

- Supervisory Committee Audits Rule

Type of Charter	Asset Size	Minimum audit required to fulfill supervisory committee audit responsibility ¹
Federal Charter	\$500 Million or more	Financial statement audit per GAAS by independent, State-licensed person
	Less than \$500 Million but greater than \$10 Million	Either financial statement audit or other supervisory committee audit
	\$10 Million or less	Supervisory committee audit
State Charter	\$500 Million or more	Financial statement audit per GAAS by independent State-licensed person
	Less than \$500 Million	Supervisory committee audit unless audit prescribed by State law is more stringent

¹The Supervisory Committee audit responsibility under this part can always be fulfilled by obtaining a financial statement audit.

Questions?

STAY IN TOUCH

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Thank You!