STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association
CUNA

CREDIT UNION
# Directors
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## Proactively Manage Interest Rate Risk

*Adopt safety and soundness practices to address NCUA's new review procedure.*

While NCUA constantly monitors all risk, in recent years it has made interest rate risk (IRR) a particular priority.

IRR reflects the concern that an investment's value will change due to a variance in the absolute level of interest rates. That change affects the value of bonds more than stocks, and depends on the investments' sensitivity to changes in the market. Credit unions can reduce overall risk by diversifying the duration of investments it holds at a given time.

While to some degree IRR is inherent in all credit unions, it's potentially a significant risk in certain organizations, due to mismatches of asset/liability maturity and the types of shares and deposits used to fund loans.

So, it's critical for the board to adopt safety and soundness practices to address NCUA's new IRR review procedure—to stay in compliance and protect your credit union.

During the past 10 years, many credit unions have grown significantly, in size and complexity. At the same time, risk management techniques have improved to support these organizations, and the same principles can protect smaller credit unions.

IRR can be prevalent in non-703 investments, which credit unions often use to fund Charitable Donation Accounts, benefits prefunding programs, and funding of 457(f) nonqualified deferred compensation plans. NCUA doesn't permit some of these investments outside of this context because of their higher risk profiles, despite their higher earnings potential.

**THE NEW NCUA REVIEW PROCEDURES INCLUDE A 'SHOCK TEST' REQUIREMENT FOR CUs.**

Effective Jan. 1, 2017, after years of analysis, NCUA implemented changes to its IRR review procedures. Key changes to IRR supervision include:

- **Developing** the Interest Rate Risk Review Procedures Workbook;
- **Updating** IRR tolerance thresholds in the Net Economic Value Supervisory Test;
- **Creating** an estimated net economic value tool (for credit unions with total assets of $50 million or less); and
- **Revising** the IRR chapter in the Examiner's Guide.

These changes aim to support the efficiency and effectiveness of NCUA examinations, and allow examiners to focus on higher-risk credit unions. The changes will address new rule requirements, enhance examiner guidance, reduce inconsistency, and identify outlier risk.

### Managing IRR

Credit unions can take actions to minimize risk, but first must understand the risks specific to their organization. As long as you can determine how your balance sheet will perform in a rising and/or declining interest rate environment, you should be able to plan ahead.

IRR depends on how and why rates rise, and whether that occurs consistently across investment vehicles. You'll need to determine how your credit union must match market rate increases to maintain deposits, and consider how quickly rates are changing.

New NCUA supervisory rules require examiners



**QUICK TAKE** FOR YOUR NEXT BOARD MEETING

### OFFER VALUE AND EASE OF USE

Four key findings in Accenture's North America Consumer Digital Banking Survey reveal that financial institutions (FIs) must provide value to customers while delivering an easy and seamless experience through physical and digital channels.

**VALUE MATTERS**

**45%**

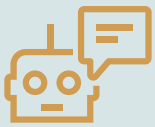
of consumers say they'd stay loyal if their FI offers discounts on key purchases.

**SWITCHING IS EASY**

**11%**

of consumers left their FI in the past year—and many are switching to virtual banks.

**ROBO-ADVICE IS WELCOME**



**46%**

of consumers are willing to bank using robo-advice in coming years.

**BRANCH IS ALIVE AND WELL**

**87%**

of consumers will use their branches in the future—and they want human interaction.

**Source:** *Accenture North America Consumer Digital Banking Survey*

- CUNA Mutual Group resources: *cunamutual.com/total-benefits-prefunding*
- CUNA Environmental Scan resources, including the 2017-2018 report, available in June: *cuna.org/escan*

to assess a credit union's risk inherent to interest rate changes by conducting a "shock test," which assesses the impact of a 300 basis point increase in interest rates. This shock test uses the credit union's Call Report data, ensuring accuracy and relevance.

The net result is a corresponding decrease in net worth and capital position, showing whether a rapid rise in interest rates could cause insolvency.

Knowing this, a credit union can identify the investments or loans that represent the greatest risk and plan accordingly. Generally, investments and loans that carry the longest durations and highest interest rates will represent the greatest risk to changes in interest rates.

By limiting the credit union's exposure to long-term investments and loans, and balancing the durations of all assets, you can more easily prepare for interest rate increases. Diversifying investments into different categories—particularly investments that aren't interest sensitive—also can help.

Last, the credit union can divest itself of investments and loans that might be more sensitive to interest rates.

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## Top NCUA Exam Priorities in 2017

CUNA Chief Compliance Officer Jared Ihrig writes in CUNA's 2017-2018 Environmental Scan Report that, in addition to interest rate and liquidity risk, NCUA examiners will focus on these priorities in 2017:

- **Cybersecurity assessment.** NCUA continues to "carefully evaluate" credit unions' cybersecurity risk management practices. The agency recommends credit unions use its Cybersecurity Assessment Tool, which NCUA integrated into its exam processes.
- **Bank Secrecy Act compliance**. NCUA will continue to focus on credit unions' relationships with money services businesses and other accounts that might pose a higher risk for money laundering.
- **Internal controls**. Credit unions should address weaknesses such as inadequate board policies, inactive supervisory committees, lack of mandatory vacation policy, failure to maintain adequate audit trails, and inaccurate or incomplete records.
- **Commercial lending**. NCUA's revised Part 723 went into effect Jan. 1, 2017. Credit unions should note key changes from the previous regulation. These include giving credit union loan officers the ability, under certain circumstances, to not require a personal guarantee.

- Comprehensive coverage of CUNA's Governmental Affairs Conference, including daily wrap-up videos: *news.cuna.org/gac*
- CUNA legislative and regulatory advocacy: *cuna.org/advocacy*

# Nussle: Commit to Year-Round Advocacy

### *'Highly credible' CU staff and directors have great impact, legislators say.*

CUNA and the leagues advocated successfully for a number of significant regulatory changes last year, such as changes to field-of-membership and member business lending rules.

But CUNA President/CEO Jim Nussle told CUNA Governmental Affairs Conference (GAC) attendees that credit union staff and directors have an even greater influence on lawmakers, because they speak directly for their member constituents. "It's up to you to be that 'advocacy army' and actually deliver on telling the credit union story," Nussle said. "I need you in this fight."


Jim Nussle

Rep. Walter Jones, R-N.C., who won re-election thanks to credit union support, also encouraged credit union leaders to get involved.

"The future of credit unions being able to serve as the 'people's bank,' so to speak, depends on your involvement today," Jones said. "Your membership is the people who live in the towns and cities and communities. Politically speaking, you've got the power."

Rep. Kurt Schrader, D-Ore., who was first elected in 2009, echoed that sentiment.

"To have an organization with such widespread support, with all the good work you do in the community, the way you lend in the community, particularly to small businesses and individuals, you're highly credible," said Schrader, who has introduced CUNA-backed small business lending legislation.

Advocacy work must continue year-round through league Hike the Hill trips, engagement in the CUNA Member Activation Program, and in-branch visits back home, Nussle said.

# Address Two Important Cybersecurity Questions

### *Upgrade—but don't overstate—the quality of your defenses.*

In recent years, governmental agencies and the legal system have demonstrated decreasing degrees of leniency toward organizations with cybersecurity shortcomings—whether in their actual defenses, or even misrepresentations of those defenses.

Some enforcement actions have included fines of $100,000 or more, and in many jurisdictions plaintiffs no longer need to demonstrate actual damages for the courts to consider their lawsuits.

Against that backdrop, Patrick Sickels of CU Answers says credit union boards must ask two crucial questions: "Do you have a problem with your cybersecurity defenses, or are you misrepresenting your cybersecurity practices to the public?" he says. "Either one of those can get you into some pretty significant hot water."

The regularity of major incidents in recent years has stripped some of the shock value from breaches, and has changed the way organizations view and structure their defenses.

"I think credit unions are very aware the cybersecurity wolf is at the door," says Sickels, who will speak about recent developments in cybersecurity litigation and enforcement at the NASCUS/CUNA Cybersecurity Symposium in June.

"If somebody is determined to get into your system, it's hard to stop them," he adds. "So people need to be in what I call the breach management business: This is likely to happen, so do you have a plan for it?"

The first step for directors seeking to craft an effective cybersecurity plan starts with taking an objective view, Sickels advises.

"Step away from the concept of fault," he says, "and decide how to approach this issue from the standpoint of reducing the chance a state or federal agency will investigate, of reducing the chance of lawsuits, because it doesn't look like we cared or had our eye on the ball when it came to cybersecurity."

For that reason, documentation and awareness of public perception are key, according to Sickels.

Include all discussions about cybersecurity strategies in your official board meeting minutes. This demonstrates to examiners that you adequately address the foundational elements of your program.

In terms of perception, review consumer-facing messaging to ensure your cybersecurity defenses align with the manner in which you present information to the public. For instance, institute regular reviews of your print and online notices to prevent access to materials that are outdated or overstate the capabilities of your defenses.

Sickels recommends you ask your attorneys to regularly review your cybersecurity posture to gauge whether a "reasonable person" would interpret your communication correctly.

More fundamentally, realize the paradigm shift that occurred in the "watershed" Target breach regarding consumers' attitude toward cybersecurity, Sickels says.

"For the most part, business returned to usual for Target," he says, which illustrates that "consumers have reached a point where, as long as the company that suffered the breach takes care of them, they'll be OK. The flip side is, if they don't feel they're being taken care of, they might look more aggressively toward legal remedies."

Credit unions with the most effective oversight structure incorporate cybersecurity into governance, Sickels says. Maintain open communication between credit union staff, management, and the board about security incidents, business resiliency, and disaster recovery planning.


At that point, directors enter a gray area where they must weigh the costs and benefits of cybersecurity defenses. The subjective concept of "reasonable defenses" can benefit credit unions in this instance.

"Sometimes, the right answer is to say, 'We accept the risk,'" Sickels says. "That's one of the nice things about the way a lot of the laws are written—they do give some protection. If you can say, 'For our size and scale, this is reasonable protection,' I think you've gone a long way."

Another effective strategy is collaborating with other industry leaders to develop best practices, which aids your ability to respond to cyberincidents. Also, standardization provides a more defensible approach for all credit unions.

"The more uniformity we get in the industry, it becomes more of a challenge for state and federal agencies to come in and say, 'You're clearly an outlier. You're not doing what you're supposed to be doing,'" Sickels says. "Plus, you also get a little bit of a legal defense. That creates a stronger argument than if you're going it alone, or if your technology is falling behind the times."

One last development Sickels indicates credit unions should monitor: New York recently implemented cybersecurity legislation establishing requirements for financial institutions that operate in the state, which might become a model for the rest of the country.

- NASCUS/CUNA Cybersecurity Symposium, June 5-6, San Diego: *nascus.org/Cyber17*
- CUNA compliance resources, including the Compliance Community and CompBlog: *cuna.org/compliance*

- Comprehensive coverage of CUNA's Governmental Affairs Conference, including daily wrap-up videos: *news.cuna.org/gac*
- CUNA's Campaign for Common-Sense Regulation: *cuna.org/commonsensereg*

Send us your comments: *directors@cuna.coop*

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# GAC Keynoters: Take Control of Your Message

## *Communicate the CU story to push for regulatory relief and attract members.*

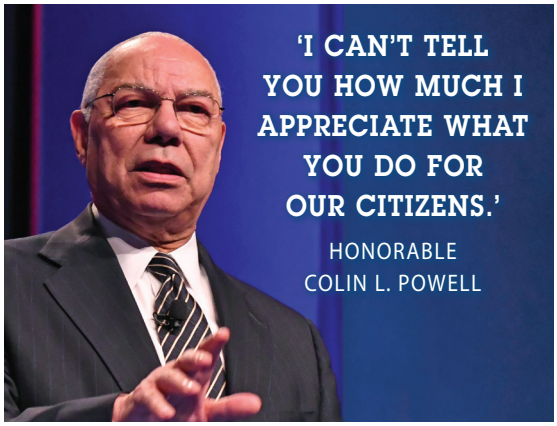
Having dealt with governmental bureaucracy throughout his career, the Honorable Colin L. Powell compliments CUNA, the state leagues, and credit unions for their pursuit of more sensible regulation.

"I think you are so wise to come to Congress and say, 'Don't do any more than is necessary,'" Powell said during a keynote address at the CUNA Governmental Affairs Conference (GAC) in Washington, D.C.

After sharing an anecdote about how as secretary of state he craftily circumvented a rule that tried to add layers of administration, Powell observed that more than ever, you have to "trim down and get smart."

Excessive regulations intended for Wall Street cost credit unions $7.2 billion every year—an average of $71 per credit union member, according to CUNA, which created the Campaign for Common-Sense Regulation to curtail that impact.

Regulatory burden subjects the 105 million credit union members to higher loan rates, fewer and less convenient services and products, less access to modernized technology, and longer wait times for mortgages.




During his speech, Powell—a retired four-star general, and the first African-American to serve on the Joint Chiefs of Staff—recounted his long association with credit unions, dating to his early days in the military.

"I decided to put money into a credit union and you even explained finances to me," he said. "You educate your members, and that is so important. I can't tell you how much I appreciate what you do for our citizens—solely to serve."

## Win with differentiation, relevance

Credit unions must prioritize brand building to extend their legacy and reach, FOCUS Brands President Kat Cole told GAC attendees.

"There are two truths and only two truths to brands


that win today: relevance and differentiation," Cole said. "Relevance means, does it matter to the customer you're trying to appeal to today? It's a very easy question. Talk to the next generation of potential credit union members and find out if you're relevant to them. Differentiation is what you're doing particularly special in some way relative to other financial services."

Credit unions can—and must—share the wonderful stories of their impact on the community, said Cole, a lifelong credit union member. She was raised along with two siblings by a single mother on a $10 per week food budget, and their credit union membership "in many ways saved us."

"To appeal to not only a future consumer, but a future employee, you have to be incredible at brand-building and storytelling," Cole said.

"There are so many stories inherent within the credit union community that aren't told, aren't positioned," she added, "and what that means is you miss out on opportunities to recruit the next generation of both members and talent."

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