STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association

CREDIT UNION Directors NEWSLETTER

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NCUA Establishes 2019 Supervisory Priorities

BSA compliance, concentration of credit, and consumer compliance top the list.

NCUA's supervisory priorities for 2019 will come as no surprise to credit union board members: Bank Secrecy Act (BSA) compliance, concentration of credit, and consumer compliance top the list. Following is a closer look at those and other key examination emphases, which NCUA cites in its annual notification to credit unions to kick off the year: Letter to Credit Unions No. 19-CU-01.

Agency examiners will use the streamlined small credit union exam program procedures for most credit unions with assets of less than $50 million, while examiners will conduct risk-focused exams that concentrate on the areas of highest risk, new products and services, and compliance with federal regulations for all other credit unions.

Also, examiners will have increased flexibility to conduct suitable examination work offsite, which NCUA expects will reduce the time impact on credit unions, save on travel costs, and increase staff productivity.

NCUA WILL INQUIRE ABOUT CREDIT UNIONS' EFFORTS TO PREPARE FOR CECL.

BSA compliance

Examiners will perform in-depth reviews of BSA and anti-money laundering policies, procedures, and processes to assess compliance with regulatory requirements for customer due diligence, and to identify and verify beneficial owners of legal entity members. The new customer due diligence regulations went into effect May 11, 2018.

Concentration of credit

Examiners will focus on large concentrations of loan products and concentrations of specific risk characteristics.

NCUA defines concentration risk as any single exposure or group of correlated exposures that have the potential to produce losses large enough to threaten a credit union's health or ability to maintain its core operations.

Excessive credit concentrations are a common cause of financial losses. If examiners identify excessive levels of credit concentration risk, they will work with credit union management to identify strategies to mitigate the risk.

For more information, see NCUA's Letter to Credit Unions No. 10-CU-03.

Consumer compliance

Agency examiners will perform limited reviews of Home Mortgage Disclosure Act (HMDA) quarterly loan/application registers or full-year loan/application registers. The reviews will evaluate credit unions' efforts to comply with 2018 HMDA data collection and reporting requirements.

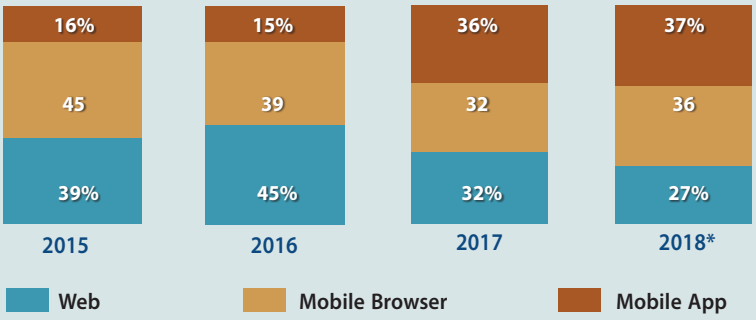
"While the Consumer Financial Protection Bureau has been relatively quiet on the rulemaking front under Mick Mulvaney's leadership, HMDA and Regulation C compliance remain a significant pain point for credit unions," says Jared Ihrig, CUNA's chief compliance officer. "We'll see what, if any, changes are in store under the agency's new director, Kathy Kraninger.

"Nevertheless," he continues, "credit unions need to

QUICK TAKE FOR YOUR NEXT BOARD MEETING

Fraud and Mobile Channels

Mobile applications and mobile browser transactions make up nearly three-quarters of fraud transactions, according to the RSA Quarterly Fraud Report. There is a growing preference among fraudsters to initiate unauthorized transactions through mobile applications.



*Through the third quarter
Source: *RSA Quarterly Fraud Report Q3 2018*

■ CUNA's Compliance Community: *compliancecommunity.cuna.org*

ensure they are up to speed on all 2018 HMDA changes in advance of the March 1, 2019, HMDA reporting date."

NCUA will also focus on Military Lending Act (MLA) compliance. Examiners will evaluate credit unions' effort to comply with MLA.

Plus, examiners will review compliance with Regulation B's notification requirements following adverse action taken on consumer credit applications. They'll also review overdraft policies and procedures for compliance with Regulation E.

Current Expected Credit Losses (CECL)

CECL may continue to evolve in 2019, but examiners will inquire about efforts credit unions have taken to prepare for the new accounting standard and whether they performed analyses to determine how CECL would alter funding needs for allowance for loan and lease losses.

Information systems and assurance

Examiners will use the Automated Cybersecurity Examination Toolbox (ACET) to conduct information security maturity assessments. Examiners will use ACET to assess credit unions with more than $250 million in assets that have not previously received an assessment.

Examiners will assess credit unions' information technology risk management efforts to ensure they effectively identify, remediate, and control inherent risks to appropriate residual levels. They'll also review service provider arrangements to make sure credit unions implement effective risk-based supply chain management.

Liquidity and interest-rate risk

NCUA will assess:

- **The potential** effects of rising interest rates on the market value of assets that affect changes to net worth and borrowing capacity.
- **Members'** shifting preference to shares with more market sensitivity.
- **Management's** ability to meet liquidity needs given the increased pressures that affect share balances.

Set Your Sights on Strategy, Technology

Pay attention to the retail experience and shifts in members' preferences.

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Board directors in the future will need to set their sights on strategy, technology, and—most importantly—the member.

"Look to your CEO for their vision of the credit union's future," says Jeff Rendel, president of Rising Above Enterprises. "What's required? What's missing? What must change?

"Focus on industry changes and shifts in consumer preferences," he adds. "Watch developments in retail as leading indicators of the member experience."

Rendel says the acronym "PFI," or primary financial institution, may change to mean "present financial institution."

Navigating this new terrain will require directors to understand the changes in financial services and retail businesses, Rendel says, and accept that member service is "shifting toward technology over face-to-face."

Current directors believe they'll be asked to take on additional responsibilities and become more knowledgeable in different areas, including technology and strategy.

Boards' duties "will be vastly different, while at the same time they will remain the same in many ways," says Eric Day, director at $1.4 billion asset Credit Union of Southern California in Anaheim. "We'll continue to make member-owners the main focus and ensure the credit union philosophy of people helping people continues.

"Regulators' expectations for us will continue to increase," he adds. "We'll need to be more knowledgeable in the ever-increasing complexities of running the credit union."

This includes technology and strategic thinking. "A phrase I recently heard is, 'the race toward technology is a race to indifferentiation,'" says Paul Sippl, board member at $1.6 billion asset Fox Communities Credit Union in Appleton, Wis. "If we want to remain relevant with all the disruptors entering our space, we need to find the niche that keeps our organization unique."

> **'REGULATORS' EXPECTATIONS FOR US WILL CONTINUE TO INCREASE.'**
>
> ERIC DAY

"Be aware of the strategic options available to the organization, and be quick to adapt or respond to change from disruptions caused by technologies, new types of competitors, increased demand for transparency, and economic conditions," says Nhu Yeargin, director at $2.6 billion asset Langley Federal Credit Union in Newport News, Va. "Sharpen your technological expertise on topics such as blockchain, cybersecurity, and opportunities for process improvements through analytics and artificial intelligence."

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Three Myths About Artificial Intelligence

Challenge misconceptions to see the technology's potential.

Credit unions face several new market realities: Consumers want faster service with greater personalization, technology is lowering barriers to entry for competitors, and legacy companies are planting the seeds of digital transformation and raising the bar for meeting consumer expectations.

While artificial intelligence (AI) addresses some of these market realities, the application of the technology in the financial service space is still in its infancy.

Three common AI misconceptions persist:

1 **BELIEF:** AI will overpower humans.
TRUTH: AI will empower humans.

When new technology takes over certain jobs, new jobs emerge. It happened during the Industrial Revolution and again in the 1980s.

Most AI-based solutions still require humans to reach their potential. As the early outcomes of those solutions indicate, great things happen when humans and machines work together.

We see this with AI integration in member support centers. Platforms based on natural language processing and interactive voice response data analytics tools are creating new opportunities for solving members' problems quickly. Each of these works to empower, not replace, member support staff.

2 **BELIEF:** AI is years down the road.
TRUTH: AI is already here.

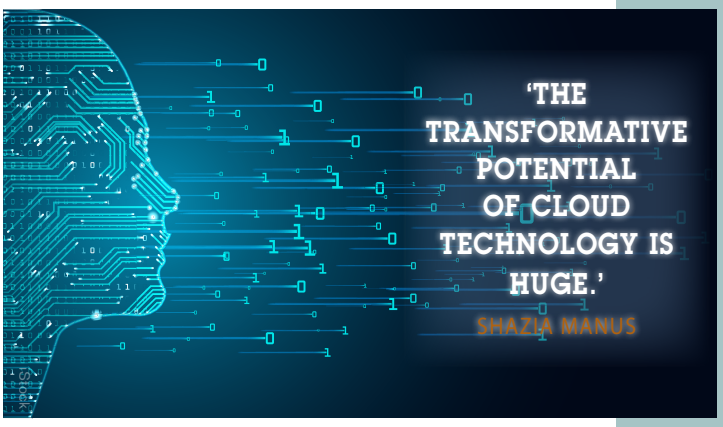
Few people expected autonomous vehicles would be possible by 2014, yet that was when Google revealed its self-driving car prototype. From quantum computers to robotics, dozens of other technologies have leapfrogged past expert predictions.

Technologies like AI won't be "new" for much longer, and the time to integrate is now. Almost 57% of credit union executives say they don't believe AI is too futuristic for their organization, according to a 2018 CUNA Mutual Group/AdvantEdge Analytics survey. And nearly 65% agree AI aligns with their organization's growth goals.

3 **BELIEF:** AI requires the cloud, and that's too risky.
TRUTH: Cloud and on-premises information technology (IT) both present risks.

AI requires real-time big data to thrive, and that calls for a migration to cloud-based technology. Although cloud computing continues to become more prevalent throughout the financial services ecosystem, security fears have remained.

However, researchers often conclude public clouds are more secure than traditional IT systems.



In fact, 64% of enterprises now consider cloud infrastructure a more secure alternative to legacy systems, according to a Clutch survey.

Beyond security, the transformative potential of cloud technology is huge. It's how many fintechs are so successful at rapidly rolling out new financial products and services. Cloud technology offers flexibility, scale, and security.

We have an innate desire to serve our members exceptionally well, even when doing so isn't easy. Credit union executives and their teams are eager to experiment and hungry to learn. That passion for knowledge will ultimately compel credit unions to work together to integrate new technologies, AI and beyond.

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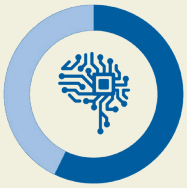

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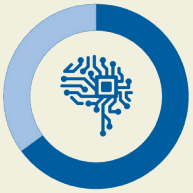


Nearly **65%** agree AI aligns with their growth goals.

Source: *2018 CUNA Mutual Group/AdvantEdge Analytics survey*

CUNA CEO Council:
cunacouncils.org

Align Your Mission and Goals

Alignment can lead to a harmonious board/CEO relationship.

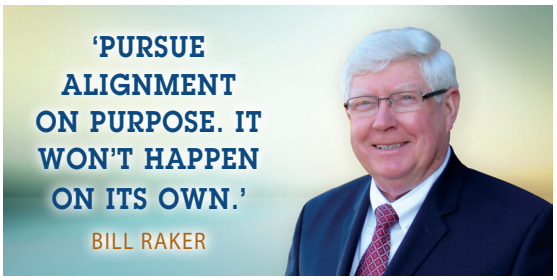
Aligning your credit union's mission, priorities, goals, strategies, and plans not only ensures everyone in the organization works toward the same end result, it also leads to a "harmonious CEO and board relationship," Bill Raker, former CEO of Firefly Credit Union in Minneapolis, says during "Board Relations: 3 CEOs—3 Perspectives," a virtual roundtable from the CUNA CEO Council.

"Alignment requires focus and discipline. It's not natural, and not something that's there automatically or develops without effort or initiative," says Raker, who served 10 years as a board member before he began his 21-year tenure as CEO at the credit union. "Pursue alignment on purpose. It won't happen on its own."

The board chair is responsible for keeping the board aligned and focused on the mission, priorities, strategy, and plan, while the CEO keeps staff on the right path.

Alignment starts with collaboration between the board chair and the CEO, Raker says. This involves working together on the board agenda and deciding how to address non-agenda issues that arise during board meetings. It also includes determining roles, the agenda, and processes during strategic planning sessions.

Three steps directors can take to ensure they align the credit union's mission and goals:



1. Avoid "shiny objects" or distractions. Attend conferences and other networking events to learn what other credit unions are doing and about new advancements in the industry. But don't look to implement those ideas at your credit union just because they're being done elsewhere. Instead, look at these ideas through the lens of your credit union's mission, vision, priorities, goals, and strategy to see if they fit.

2. Have a shared vision. Everyone at the credit union—board members, management, and staff—must understand where the credit union currently is and where it wants to be. This requires reinforcing what is being done, why it's being done, and how that transformation will happen.

3. Highlight the need for alignment. Alignment will require focus, effort, and attention to make sure everyone at the credit union works toward the same goals. Signs of misalignment at your credit union include factions on the board, employee disengagement, unclear or changing priorities and goals, and a vague or complex vision and mission.

If misalignment occurs, Raker says there are several tools that can be used to get the credit union back on track, including:

- **Assessments.** These include director self-assessments or peer assessments. Assessments can either affirm alignment among board members or identify the need for corrective actions, Raker says.
- **Team-building exercises.** Include directors and the CEO in an activity facilitated by an outside party to get the groups back together and operating with the same mindset.
- **Seminars or workshops.** Send the board chair to an event that focuses on leadership or governance. This can help board chairs develop their leadership style and characteristics while defining their role in directing the board's activities, Raker says.
- **Orchestrated board turnover.** There are times when boards need to remove toxic directors. "It takes courage and initiative for the board to do this," Raker says. "But it may be necessary."

Maintaining alignment of your credit union's mission, priorities, goals, strategy, plans, and recognition programs is a simple but powerful concept, Raker says.

"Having the same vision and goals reduces silos and the friction that can exist between people," Raker says. "Organizational alignment is key for us to do the best we can."

Send us your comments:
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