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January 31, 2024

LEGAL UPDATES AND NEWS

NCUA Announces 2024 Supervisory Priorities and Issues Advisory on Liquidity Risk Management

On January 22, 2024 the National Credit Union Administration (the "NCUA" or the "Agency") issued a letter ("Letter") to credit union boards of directors and CEOs outlining its annual supervisory priorities and highlighting the areas it views as posing the highest risk to the credit union industry this year. The Letter noted that during 2023, the Agency had observed "growing signs of financial strain" on credit union balance sheets, and highlighted that interest rate and liquidity risks in particular resulted in an increase in the number of composite 3, 4, and 5-rated credit unions. The NCUA continues to highlight the interrelated risks posed by liquidity risk and interest rate risk on other CAMELS components and its observation that worsening composite ratings demonstrates the weight accorded to these specific risk components.

The table below lists the NCUA's 2024 Supervisory Priorities, and how they compare to its 2023 Supervisory Priorities.

2024	2023
Credit Risk	Interest Rate Risk
Liquidity Risk	Liquidity Risk
Consumer Financial Protection	Credit Risk
Information Security (Cybersecurity)	Fraud Prevention and Detection
Interest Rate Risk	Information Security (Cybersecurity)
	Consumer Financial Protection

2024 Supervisory Priorities

Credit Risk	Inflation, high interest rates and borrowing costs, declining savings, and the end of pandemic-era stimulus programs are identified as having negative impacts on members' ability to repay debts. Aggregate loan performance was observed as showing signs of deterioration in 2023. Supervisory focus will be on underwriting and portfolio monitoring, loan modification and borrower relief programs, collections, allowance for credit loss methodology, and overall risk management.
Liquidity Risk	Increased uncertainty as to interest rate levels and economic conditions are cited as posing liquidity risk management challenges. Deposit pricing pressure, reliance on wholesale funding, and slowing loan sale markets are noted as relevant risk factors.

	Supervisory focus will be on preparation of contingency funding plans (taking into account 2023 Agency guidance), identification of prospective sources of liquidity, risk limits, risk modeling (and accounting for deposit migration), stress testing, and overall risk management framework.
Consumer Financial Protection	Supervisory focus will be on overdraft programs (advertising, settlement, fees), fair lending (marketing, pricing discrimination), auto lending including indirect auto loans (disclosures, TILA, GAP insurance policies), and flood insurance.
Information Security (Cybersecurity)	Cybersecurity threats, especially new and evolving threats, are cited as a "key" examination focus, and credit unions are encouraged to stay abreast of the latest developments. Supervisory focus will be on information security programs (including coverage of members' information), the new Cyber Incident Notification Reporting Rule, and cyber incident response.
Interest Rate Risk	Higher interest rates and the effect on asset and liability repricing mismatches are cited as a relevant concern, with interest rate risk management becoming of increasing importance at credit unions in the past two years. Supervisory focus will be on documentation of assumptions, back testing, exposure measurement, communications with management and the board, and compliance with policy limits.

The Letter also states that Bank Secrecy Act compliance continues to be a "supervisory area of interest," and notes that the Agency will update its supervisory expectations and examination procedures as rulemakings implementing the Anti-Money Laundering Act of 2020 are issued during 2024.

The NCUA concluded the Letter by describing its commitment to adopting innovations and implementing efficient practices in its examination program, pledging to continue to evolve and improve its supervision process.

Credit unions supervised by the NCUA should ensure they carefully consider the NCUA's Supervisory Priorities and especially the supervisory areas of focus within those Priorities identified above. Prior to their next upcoming examination, credit unions should ensure that they have policies and procedures in place that specifically account for the effects of the current economic climate and the downstream impacts the environment may have on the entire institution. Engagement by senior management and boards of directors is critical, and the NCUA will expect credit union leadership to be proactively addressing the potential impacts from these risks and actively monitoring those impacts as the year progresses.

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Separately, the NCUA also issued an Advisory on Liquidity Risk Management on January 17, 2024 (the "Advisory"). The Advisory dug deeper into the specific liquidity-related challenges credit unions faced in 2023, and emphasized the importance of board and management engagement and leadership's continuous monitoring of all aspects of the institution's liquidity position. The Advisory also made clear that the NCUA will be focused on liquidity and asset-liability management planning in its 2024 examinations. The Advisory highlighted the following "key areas of focus" for managing liquidity:

- Managing and forecasting cash flows under normal operating and stressed conditions;
- Conducting sensitivity analyses of cash flows and deposit assumptions;
- Maintaining a viable contingency funding plan that is reevaluated and updated in periods of uncertainty;
- Hiring staff with relevant experience and training in managing liquidity under various market conditions;
- Controlling asset composition such as lending quality and volume, including pricing, limits for lending personnel and loan types, and originating loans eligible for future sale;
- Structuring liabilities to be congruent with asset growth;
- Controlling and monitoring more "volatile" funding sources, such as brokered deposits and uninsured shares;
- Developing governance and monitoring structures that clearly identify roles and responsibilities, accountability, and segregation of duties;
- Developing monitoring systems to identify and quantify liquidity risk exposure;
- Implementing reporting processes to communicate accurate, timely and relevant risk identification;
- Maintaining diverse liquidity sources that can be accessed in various situations, including access to at least one contingent federal liquidity source during times of economic distress; and
- Considering access to the Central Liquidity Facility or the Federal Reserve's Discount Window under all scenarios, not just in times of economic crisis.

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Luse Gorman routinely advises credit unions on compliance issues and regulatory questions, and counsels those institutions on the impacts of new developments at the federal and state level. If you have any questions related to this Client Alert, please reach out to Jeffrey Cardone at (202) 274-2033 or by email at jcardone@luselaw.com, Michael Brown at (202) 274-2003 or by email at mbrown@luselaw.com, or Brendan Clegg at (202) 274-2034 or by email at bclegg@luselaw.com. To learn more about our firm and services, please visit our website.