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LEGAL UPDATES AND NEWS

NCUA Outlines 2025 Supervisory Priorities

On January 7, 2025, the National Credit Union Administration (the "NCUA" or the "Agency") issued to all federally-insured credit unions Letter 25-CU-01 entitled "NCUA's 2025 Supervisory Priorities" (the "Letter"). The NCUA notes that its supervisory priorities focus on the areas posing the highest risk to credit union members, the credit union industry, and the National Credit Union Share Insurance Fund. In addition to noting the areas of supervisory focus in the coming year, the Letter collects prior guidance issued by the Agency, which every credit union should review and be familiar with before any upcoming examination.

2025 Supervisory Priorities

(1) *Credit Risk*

To assess credit risk, the NCUA will continue to review lending and related risk-management practices, including, but not limited to, the sufficiency of loan underwriting standards, collection programs, allowance for credit losses reserves, charge-off practices, management and board reporting, and management of any concentrations. Given the deteriorating performance of credit union loan portfolios cited in the Letter, the NCUA asserts that it is important for a credit union to work with borrowers facing financial difficulties, consistent with its statutory mission. In particular, NCUA examiners will assess modification and workout strategies, and will scrutinize whether the efforts in this area were reasonable and conducted with proper controls and management oversight.

Implicitly acknowledging the Agency's limitations regarding its authority to supervise third-party vendors, the Letter notes that "to the extent possible," examiners will review third-party risk management practices when lending, servicing, or collection functions are outsourced.

(2) *Balance Sheet Management and Risk to Earnings and Net Worth*

The Letter highlights the NCUA's focus on interest rate risk management due to the correlation of interest rate changes to the income generated from lending, and the downstream impacts on net worth and earnings. The Letter reveals lingering concerns regarding deteriorating net interest margins from the past few years' rise in interest rates, noting the potential negative financial consequences from further increases in operating expenses or declines in loan performance.

As part of its review of interest rate risk management programs, examiners will weigh an institution's current and prospective sources of earnings and the composition of net worth relative to its approved plans and thresholds. Examiners will be focused on trends in earnings with an eye toward concentration risks for both earnings and net worth. Agency examiners will also continue to consider the current and prospective sources of liquidity compared to funding needs to determine the adequacy of an institution's liquidity risk-management framework. Policies, procedures, and risk limits will all be under the microscope as the NCUA evaluates the adequacy of an institution's risk management frameworks relative to its size, complexity, and risk profile.

(3) *Cybersecurity*

The Letter confirms that cybersecurity remains a top supervisory priority for the NCUA, as the Agency has continued to observe cyberattacks against credit unions and their vendors that have increased in frequency and sophistication. The Letter directs boards of directors to prioritize cybersecurity as a "top oversight and governance responsibility."

To address the risks from a cybersecurity incident, the NCUA notes it is "crucial" for institutions to manage their information security programs and operations continuity plans proactively, and to conduct ongoing due diligence of critical service providers. Examiners will use the information security examination procedures cited in the Letter to assess whether the security program implemented by each credit union can safeguard its members and the entity. The Letter includes a reminder to continue to report cyber incidents to the Agency, including if a third-party provider experiences a cyber incident affecting the credit union, suggesting that the NCUA will continue to examine compliance with these regulatory deadlines.

(4) *Consumer Financial Protection*

In addition to reviewing any unique areas identified during a credit union's risk-focused examination scoping, Agency examiners in 2025 will assess an institution's compliance with the following consumer financial protection areas:

- <u>Overdraft programs</u>, including policies, procedures, disclosures, fees, account statements, member complaints, internal reviews, and websites;

- <u>Fair lending</u>, including policies and practices for identifying and mitigating potential discrimination in residential real estate valuation practices;

- <u>Home Mortgage Disclosure Act ("HMDA") and Regulation C</u>, including data collection and reporting policies and practices and transaction testing, for those credit unions above the reporting threshold;

- <u>Military Lending Act</u>, including policies and procedures, compliance management systems, and checking and monitoring for military status; and

- <u>Electronic Fund Transfer Act ("EFTA") and Regulation E</u>, including policies and procedures related to payments and error resolution.

(5) *Traditional Areas of Supervision*

The Letter includes a reminder that while "evolving risks" related to third parties, technology, and cybersecurity may receive additional attention, credit unions are encouraged to review and maintain "fundamental" controls over lending, recordkeeping, and internal controls. The Letter also encourages credit unions to "remain aware" of evolving BSA/AML requirements as the agencies continue to implement the Anti-Money Laundering Act of 2020.

Other Updates to Examination Procedures

In 2025, the Agency will update its exam flexibility initiative to extend the examination cycle for credit unions over $1 billion in assets where the NCUA rated the credit union a CAMELS composite 1 or 2 and where there was no change in CEO since the last examination. These institutions will now be eligible for a 12- to 16-month exam cycle. The extended examination cycle for eligible federal credit unions will be shortened from 14 to 20 months to 14 to 18 months.

Takeaways

- The cited stress on credit union balance sheets will likely prompt close scrutiny by the NCUA of credit risk, liquidity risk, and interest rate risk in the coming year, consistent with other federal financial regulators. In light of renewed regulatory focus on these areas after the failure of Silicon Valley Bank, industry financial performance in 2024, and the failure of a number smaller credit unions during the year, expect the NCUA to tighten its supervision of an institution's financial condition, especially in these areas.

- The NCUA's encouragement of CFPB enforcement actions at the end of 2024, for alleged unfair practices related to overdraft fees and the roll-out of digital banking systems, suggests the Agency is willing to step up its own enforcement activity. This may be due in part to an industry perception that its supervision is less stringent in these areas as compared to the federal banking regulators.

- Because it carries less political sensitivity, cybersecurity will remain at the top of the NCUA's priority list, even with the changeover in the Administration. Credit unions should review and incorporate existing Agency guidance on cybersecurity and prioritize enhancements to their information security programs before their next examination.

- In light of the overall banking landscape and the pace of new innovation in the industry, the prioritization of BSA/AML compliance and focus on electronic payments under the EFTA should also survive the change in Administration.

- The release of the Letter confirms the NCUA's recently-issued guidance establishing that overdraft protection programs will be a central focus of upcoming examinations. For more on the NCUA's focus on fee practices, see our prior Client Alert here.

- Inclusion of fair lending as an identified area of consumer compliance focus affirms that the NCUA is ramping up its efforts in this area, long considered to be under-scrutinized. Elevating HMDA compliance into its list of supervisory priorities reinforces the Agency's determination to reinvigorate its examination of credit union compliance with fair lending laws.

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Luse Gorman routinely advises credit unions on compliance issues, regulatory questions, and enforcement actions, 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 Brendan Clegg at (202) 274-2034 or by email at bclegg@luselaw.com, Jeffrey Cardone at (202) 274-2033 or by email at jcardone@luselaw.com, or Michael Brown at (202) 274-2003 or by email at mbrown@luselaw.com. To learn more about our firm and services, please visit our website.