



Office of Inspector General

OIG/JH

SENT BY EMAIL

**TO:** The Honorable Todd M. Harper, Chairman  
The Honorable Kyle S. Hauptman, Vice Chairman  
The Honorable Tanya F. Otsuka, Board Member

**FROM:** Inspector General James W. Hagen

A handwritten signature in black ink, appearing to read "James W. Hagen".

**SUBJ:** Top Management and Performance Challenges Facing the  
National Credit Union Administration for 2024

**DATE:** February 15, 2024

The Inspector General is required by the Reports Consolidation Act of 2000, 31 U.S.C. § 3516, to provide an annual statement on the top management and performance challenges facing the agency and to briefly assess the agency's progress to address them. We identified the top challenges facing the National Credit Union (NCUA) for 2024 based on our past and ongoing work, our knowledge of the NCUA's programs and operations, information from the U.S. Government Accountability Office, and NCUA management and staff. In determining whether to identify an issue as a challenge, we consider its significance in relation to the NCUA's mission, its susceptibility to fraud, waste, or abuse, and the NCUA's progress in addressing the challenge.

We identified five Top Challenges facing the NCUA as follows:

1. Managing Interest Rate Risk
2. Managing Credit and Liquidity Risks
3. Cybersecurity – Protecting Systems and Data
4. Risks Posed by Third-Party Service Providers
5. Industry Consolidation and Challenges Facing Small Credit Unions

We believe our identification of Top Challenges will be beneficial and constructive for policy makers, including the NCUA and Congressional oversight bodies. We further hope that it is informative for the credit union industry regarding the programs and operations at the NCUA and the challenges it faces.

Information on the challenge areas and related Office of Inspector General work products are found in the attachment. If you have any questions, please contact me or Bill Bruns, Deputy Inspector General.

Attachment

Top Management and Performance Challenges Facing  
the National Credit Union Administration for 2024

Page 2

cc: Executive Director Larry D. Fazio  
Deputy Executive Director Rendell L. Jones  
General Counsel Frank S. Kressman  
Director, Office of External Affairs and Communications Elizabeth A. Eurgubian

## INTRODUCTION

Below is a brief overview of the NCUA's organizational structure, its mission, and vision, as well as details on each of the top management challenges my office identified for 2024.

### **Organizational Structure**

The NCUA is an independent federal agency that insures deposits at all federal and most state-chartered credit unions and regulates federally chartered credit unions. A Presidentially appointed three-member Board oversees the NCUA's operations by setting policy, approving budgets, and adopting rules.

### **Agency Mission and Vision**

In its Strategic Plan 2022-2026, the NCUA states it works to achieve the statutory mission of the credit union system of meeting the credit and savings needs of members, especially those of modest means, and can achieve that objective by advancing economic equity and justice within communities of color, rural places, and underserved areas. NCUA states it must also foster greater diversity, equity, and inclusion within the NCUA, the credit union system, and the broader financial services sector.

## AGENCY CHALLENGES

### ***Managing Interest Rate Risk***

The economic environment is a key determinant of credit union performance. The Federal Reserve adjusts the federal funds rate based on economic indicators, with the goal of achieving its dual mandate of keeping prices stable and maximizing employment. The tightening in U.S. monetary policy over the past 2 years has increased the importance of interest rate risk management at credit unions as higher interest rates continue to expand market risk. Job and wage growth and low unemployment supported consumer spending throughout the year, with spending growth strengthening in the second half of 2023 as inflation moved lower. Even so, performance in key sectors for credit unions was mixed. New car sales strengthened considerably in 2023, whereas elevated mortgage rates and home prices weighed heavily on housing activity, causing home sales to fall to a 12-year low.

High levels of interest rate risk can increase a credit union's liquidity risks, contribute to asset quality deterioration and capital erosion, and put pressure on earnings. Credit unions must be prudent and proactive in managing interest rate risk and the related risks to capital, asset quality, earnings, and liquidity. This is particularly the case for those credit unions whose assets are concentrated in fixed-rate long term mortgages that were originated when interest rates were at record lows.

My office issued audit report #OIG-15-11 that recommended NCUA management develop an "S" component (Sensitivity to Market Risk) to better capture a credit union's sensitivity to

market risk and to improve interest rate risk clarity and transparency. Since April 2022, the NCUA has been using the revised CAMELS Rating System that includes the S rating, which has helped the agency keep a sharp focus on these risks to ensure they remain within safe and sound policy limits. For 2024, the NCUA must continue to analyze the S component to determine whether credit unions are proactively managing their interest rate risk and the related risks to capital, asset quality, earnings, and liquidity to ensure their overall level of interest exposure is properly measured and controlled.

Despite the rapid tightening in credit conditions, the credit union system turned in a solid performance in 2023. However, the ability to manage economic risks will remain a crucial determinant of credit union performance. Credit unions' ability to manage and mitigate interest rate risk and the NCUA's continued focus to ensure it is monitored and measured will continue to be extremely important in 2024.

### ***Managing Credit Risk and Liquidity Risk***

The general outlook for the economy in 2024 is favorable. However, slowing growth and moderately higher unemployment could cause challenges for credit unions, such as reduced loan demand and higher credit risk. The changing interest rate environment will also affect credit union performance. In 2023, rising short-term interest rates put pressure on credit unions to raise deposit rates to avoid deposit attrition. The expected decline in short-term interest rates in 2024 should relieve pressure on credit union funding costs and liquidity. However, many experts believe longer-term rates are expected to fall, which could also put downward pressure on credit union loan rates.

I am pleased agency regulations contain scaled credit union contingency funding plan expectations, based on a credit union's assets. In July 2023, the NCUA issued Letter to Credit Unions 23-CU-06, *Importance of Contingency Funding Plans*, and added an addendum to the 2010 *Interagency Policy Statement on Funding and Liquidity Risk Management*, both of which will help reinforce the need for credit unions to adjust to changing market conditions. It is imperative the NCUA examines institutions under this framework in 2024. Also, audit report #OIG-15-11 recommended that the NCUA modify the "L" (Liquidity) in the CAMELS rating system to not only evaluate credit unions' policies, procedures, and risk limits, but also credit unions' current and prospective sources of liquidity, the adequacy of its liquidity risk management framework relative to its size, complexity, and risk profile compared to funding needs. NCUA management agreed with the OIG's recommendation and redefined the "L" component in April 2022.

### ***Cybersecurity and IT Governance – Protecting Systems and Data***

Cybersecurity risks continue to remain a significant, persistent, and ever-changing threat to the financial sector. Credit unions' growing reliance on increasingly complex technology-related operating environments exposes the credit union system to escalating cyberattacks. Cyberattacks can affect the safety and soundness of institutions and lead to their failure, thus causing losses to the NCUA's Share Insurance Fund. The prevalence of malware, ransomware, distributed denial

of service attacks, and other forms of cyberattacks are causing challenges at credit unions of all sizes, which will require credit unions to continually evolve and adapt to counter these threats effectively. These trends are likely to continue, and even accelerate, in the years ahead.

For 2024, the NCUA must continue to prioritize this area as a key examination focus and continue to assess whether credit unions have implemented robust information security programs to safeguard both members and the credit unions themselves. The NCUA must remain focused on advancing consistency, transparency, and accountability within its information technology and cybersecurity examination program. To help the agency provide credit unions the capability to conduct a maturity assessment aligned with the Federal Financial Institutions Examination Council Cybersecurity Assessment Tool, the NCUA must continue to use the Automated Cybersecurity Evaluation Tool (ACET) application, which allows institutions, regardless of size, to maintain a high level of vigilance and ability to respond to evolving cybersecurity threats by measuring their cybersecurity preparedness and identifying opportunities for improvement. I am pleased the NCUA encourages credit unions to access the NCUA's Cybersecurity Resources webpage for cybersecurity information and resources. These resources provide valuable insights and guidance to help credit unions strengthen their cybersecurity stance and stay abreast of the latest developments.

Given the growing frequency and severity of cyber incidents within the financial services industry, NCUA has emphasized the importance in receiving timely notice of cyber incidents that disrupt a credit union's operations, lead to unauthorized access to sensitive data, or disrupt members' access to accounts or services. As a result, effective September 2023, the NCUA implemented a new Cyber Incident Notification Reporting Rule mandating federally insured credit unions swiftly—within 72 hours—notify the NCUA after the credit union reasonably believes that a reportable cyber incident has occurred. This rule also recommends credit unions notify the NCUA if a third-party provider experiences a cyber incident affecting the credit union. In the OIG's 2024 Annual Work Plan, my office has two audits planned to address cybersecurity-related issues. One will assess whether the new reporting rule is working as intended and the other will review the agency's efforts to share threat information.

To ensure the NCUA remains vigilant in protecting its systems and data, in 2023, my office contracted with CliftonLarsonAllen, LLP (CLA) to assess how well the agency is preventing and detecting cyber threats. In May 2023, we issued audit report #OIG-23-05, which reviewed the NCUA's network, including its firewalls, to determine the strength of its defense strategy to protect the agency's network. The audit reviewed the agency's software that collects, aggregates, categorizes, and analyzes log data and incidents and events generated throughout the organization's technology infrastructure, as well as the security-related incidents and events reports that could signal potential security issues based on failed logins and malware and other possible malicious activities. CLA determined that although NCUA management needed to strengthen some internal controls, overall, the agency had adequately designed and implemented its firewall and security information and event management security technologies to prevent and detect cybersecurity threats.

In addition, pursuant to the Federal Information Modernization Act of 2014 (FISMA), P.L. 113-283, we contract with CLA to annually evaluate the NCUA's implementation of FISMA information security requirements and the effectiveness of the agency's information security program on a maturity model scale. On September 14, 2023, we issued CLA's FISMA report titled, *National Credit Union Administration Federal Information Security Modernization Act of 2014 Audit—Fiscal Year 2023*, #OIG-23-08. CLA determined the NCUA implemented an effective information security program by achieving an overall Level 4 - Managed and Measurable maturity level, complied with FISMA, and substantially complied with agency information security and privacy policies and procedures. As stated in its 2022-2026 Strategic Plan, NCUA management recognizes that cybersecurity threats and other technology-related issues continue to concern the agency as increasingly sophisticated cyberattacks pose a significant threat to credit unions, financial regulators, and the broader financial services sector.

### ***Risk Posed by Third-Party Vendors and Credit Union Service Organizations***

Even with implementation of the Cyber Incident Notification Reporting Rule, the credit union system remains vulnerable because the NCUA lacks vendor oversight authority. Without this authority, the NCUA cannot accurately assess the actual risk present in the credit union system or determine if the risk-mitigation strategies of credit union service organizations and third-party vendors, which provide much of the industry's information technology infrastructure, are adequate and can effectively protect the system from potential attacks. This regulatory blind spot leaves thousands of credit unions, millions of credit union members, and billions of dollars in assets potentially exposed to unnecessary risks. To address this, the NCUA continues to request authority comparable to its counterparts on the Federal Financial Institutions Examination Council (FFIEC) to examine credit union service organizations and third-party vendors.

Although Congress provided the NCUA vendor oversight authority in 1998 in response to concerns about the Y2K changeover, that authority expired in 2002. Since then, the OIG, the Financial Stability Oversight Council, and the Government Accountability Office have each recommended that this authority be restored.

Currently, the NCUA may only examine credit union service organizations and third-party vendors with their permission, and vendors, at times, decline these requests. Further, vendors can reject the NCUA's recommendations to implement appropriate corrective actions to mitigate identified risks. This lack of authority stands in stark contrast to the authority of NCUA's counterparts on the FFIEC.

Activities that are fundamental to the credit union mission, such as loan origination, lending services, Bank Secrecy Act/anti-money laundering compliance, and financial management, are being outsourced to entities that are outside of the NCUA's regulatory oversight. In addition, credit unions are increasingly using third-party vendors to provide technological services, including information security and mobile and online banking. Member data is stored on vendors' servers.

As I have stated in previous Top Management Challenges statements, in 2020, my office issued audit report #OIG-20-07 on NCUA's lack of vendor authority. In that audit, we determined the NCUA needs authority over CUSOs and vendors to effectively identify and reduce the risks vendor relationships pose to credit unions to protect the Share Insurance Fund. The audit concluded that despite the NCUA's ability to conduct limited credit union service organization reviews, there is currently nothing in the Federal Credit Union Act that provides the NCUA with the authority to supervise credit union service organizations to hold them accountable for unsafe and unsound practices that have direct and lasting impact on the credit unions they serve. In addition, the audit determined the lack of statutory vendor oversight and regulatory enforcement authority hinders the NCUA's ability to conduct effective reviews of vendors. As a result, the NCUA's Share Insurance Fund is exposed to risk from credit union service organizations and vendors that can cause significant financial hardship, or even failure to the credit unions that use them.

While there are many advantages to using service providers, the concentration of credit union services within credit union service organizations and third-party vendors presents safety and soundness and compliance risk for the credit union industry. In his November 2023 testimony before the U.S. House of Representatives Committee on Financial Services, NCUA Board Chairman Harper urged in his written testimony that Congress should amend the Federal Credit Union Act because the risks resulting from the NCUA's lack of authority are real, expanding, and potentially dangerous for the nation's financial infrastructure.

The continued transfer of operations to credit union service organizations and vendors lessens the ability of NCUA to accurately assess all the risks present in the credit union system and determine if current risk mitigation strategies are adequate. Audit report #OIG-20-07 confirmed that the NCUA needs comparable authority as its FFIEC counterparts to ensure a safe and sound credit union system.

### ***Industry Consolidation and Challenges Facing Small Credit Unions***

Small credit unions face challenges to their long-term viability for a variety of reasons, including lower returns on assets, declining membership, high loan delinquencies, increasing non-interest expenses, and a lack of succession planning for credit union boards and key personnel. If current consolidation trends persist, there will be fewer credit unions in operation and those that remain will be considerably larger and more complex.

To ensure the NCUA continues to help the credit union system grow, my office is currently conducting an audit reviewing the NCUA's chartering activities. The objectives of the engagement will determine whether: 1) the NCUA's efforts to streamline its chartering process have made it more efficient and effective for potential organizers interested in applying for a new federal credit union charter; and 2) the NCUA has adequately communicated its revised chartering process to potential organizers interested in applying for a charter and operating a federally insured credit union.

In the third quarter of 2023, there were 710 federally insured credit unions with assets of at least \$500 million, 30 percent more than five years earlier. These 710 credit unions represented only 15 percent of all federally insured credit unions but accounted for 82 percent of credit union members and 83 percent of system-wide assets. In comparison, the remaining 3,935 credit unions accounted for only 18 percent of credit union members and 17 percent of the system's total assets.

Large credit unions tend to offer more complex products, services, and investments. Increasingly complex institutions will pose management challenges for the institutions themselves, as well as the NCUA, because consolidation means the risks posed by individual institutions will become more significant to the Share Insurance Fund.

Additionally, all credit unions need to consider whether their product mix is consistent with their members' needs and demographic profile. For example, credit unions may need to explore how to meet the needs of an aging population, a growing Hispanic population, or an increasing consumer population that prefers using digital services. The NCUA must continue to promote financial inclusion to better serve a changing population and economy. For 2024, the NCUA should continue to develop initiatives to create opportunities to promote financial education and financial inclusion and foster an environment where those with low-to-moderate incomes, people with disabilities, and the otherwise underserved have access to affordable financial services.