



NCUA
National Credit Union Administration

**OFFICE OF INSPECTOR
GENERAL**

**AUDIT OF
THE NCUA'S EXAMINATION AND OVERSIGHT AUTHORITY OVER
CREDIT UNION SERVICE ORGANIZATIONS AND VENDORS**

**Report #OIG-20-07
September 1, 2020**



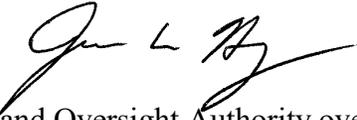


National Credit Union Administration

Office of Inspector General

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FROM: Inspector General James W. Hagen 

SUBJ: Audit of the NCUA's Examination and Oversight Authority over Credit Union Service Organizations and Vendors

DATE: September 1, 2020

The National Credit Union Administration (NCUA) Office of Inspector General conducted this self-initiated audit to assess the NCUA's examination and oversight authority of credit union service organizations (CUSOs) and third party vendors. The objectives of our audit were to determine whether: 1) the NCUA complied with applicable laws, regulations, policies, and procedures for CUSO and other (non-CUSO) third-party vendor reviews; and 2) the NCUA's vendor review process effectively helps to assess the adequacy of credit union management's due diligence reviews, and identify and reduce the risks vendor relationships pose to credit unions.

Results of our audit determined the NCUA complied with applicable laws, regulations, policies, and procedures for CUSO reviews. However, we determined that the NCUA needs authority over CUSOs and vendors to effectively identify and reduce the risks vendor relationships pose to credit unions in order to protect the National Credit Union Share Insurance Fund (Share Insurance Fund). Our audit also determined that since 2004, the last four NCUA Board Chairmen have led an effort through Congressional committee testimony to amend the Federal Credit Union Act to provide the NCUA with the authority over CUSOs to hold them accountable for unsafe and unsound practices. We are making one recommendation in our report related to amending the Federal Credit Union Act.

We appreciate the cooperation and courtesies NCUA management and staff provided to us during the audit. If you have any questions on the report and its recommendation, please contact me at 703-518-6350.

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TABLE OF CONTENTS

<u>Section</u>	<u>Page</u>
EXECUTIVE SUMMARY	1
BACKGROUND	2
RESULTS IN DETAIL.....	13
NCUA Needs Statutory Authority over CUSOs and Vendors.....	13
Examiners Substantially Complied with CUSO Policies and Procedures.....	21
APPENDICES:	
A. Objective, Scope, and Methodology.....	24
B. NCUA Management Response	26
C. Acronyms and Abbreviations.....	27



EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted this self-initiated audit to assess the NCUA's examination and oversight authority of credit union service organizations (CUSOs) and third party vendors. The objectives of our audit were to determine whether: 1) the NCUA complied with applicable laws, regulations, policies, and procedures for CUSO and other (non-CUSO) third-party vendor reviews; and 2) the NCUA's vendor review process effectively helps to assess the adequacy of credit union management's due diligence reviews, and identify and reduce the risks vendor relationships pose to credit unions. The scope of our audit covered the period of January 1, 2013, through December 31, 2019.

Our audit determined the NCUA complied with applicable laws, regulations, policies, and procedures for CUSO reviews. However, we determined that the NCUA needs authority over CUSOs and vendors to effectively identify and reduce the risks vendor relationships pose to credit unions in order to protect the National Credit Union Share Insurance Fund (Share Insurance Fund). Although the NCUA conducts CUSO reviews, there is currently nothing in the Federal Credit Union Act that provides the NCUA with the authority to supervise CUSOs and vendors to hold them accountable for unsafe and unsound practices that have direct and lasting impact on the credit unions they serve. In addition, 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 CUSOs and vendors that can cause significant financial hardship, or even failure to the credit unions that use them. We are making one recommendation in our report related to a statutory change to the Federal Credit Union Act.

We appreciate the cooperation and courtesies NCUA management and staff provided to us during this audit.



BACKGROUND

The NCUA is the independent federal agency created by the U.S. Congress to regulate, charter, and supervise federally insured credit unions. The NCUA's mission is to provide, through regulation and supervision, a safe and sound credit union system, which promotes confidence in the national system of cooperative credit. The NCUA's organizational structure consists of the Central Office, the Asset Management and Assistance Center, and three regional offices—Eastern, Southern, and Western.

The NCUA's Office of Examination and Insurance (E&I) is responsible for providing leadership and collaborating with other agency offices and regions on the establishment of sound policy, direction, and quality control over the examination, surveillance, and problem resolution programs. E&I's responsibility extends to approximately 5,200 federally insured credit unions with more than 120 million members and more than \$1.57 trillion in assets across all states and U.S. territories to ensure effective management of risk to the Share Insurance Fund and a safe and sound federally insured credit union system.

The NCUA's *National Supervision Policy Manual* (NSPM) establishes policies, procedures, and guidelines intended to provide effective district management,¹ supervision of credit unions, and quality assurance. In addition, the *NCUA Examiner's Guide* contains a framework intended for more consistent application of examiner judgment with respect to conclusions about a credit union's financial and operational condition and related CAMEL² and risk ratings. The *Examiner's Guide* also is intended to provide a consistent approach for evaluating the adequacy of a credit union's relevant risk-management processes, such as those related to credit union relationships with CUSOs and vendors.

A CUSO is an organization in which a federally insured credit union has an ownership interest or to which a credit union has extended a loan, which is engaged primarily in providing products or services to credit unions or credit union members, or, in the case of checking and currency services, to persons eligible for membership in a credit union having a loan, investment, or contract. A CUSO also includes any organization in which the CUSO has an ownership interest if that organization is engaged primarily in providing products or services to credit unions or credit union members. A vendor is an outside service provider with which a credit union or a CUSO contracts, but does not have an ownership interest.

Recognizing that thousands of banks, savings associations, and credit unions relied heavily on outside service providers and anticipating significant computer-related problems in the year

¹ District management encompasses the objective of managing and maintaining continuous and detailed knowledge of an assigned district of credit unions. This includes ongoing financial analysis, knowledge of local economic condition, knowledge of current events affecting assigned credit unions, identification of emerging risks, and the routine reporting to management on these issues. District management also includes scheduling, prioritizing, and the administrative tasks associated with the examiner position.

² The CAMEL rating system is based upon an evaluation of five elements of a credit union's operations: Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity/Asset-Liability Management.



2000, in March 1998, Congress enacted the *Examination Parity and Year 2000 Readiness for Financial Institutions Act* (Examination Parity Act). The Examination Parity Act gave the NCUA Board temporary examination and regulatory authority over CUSOs and service vendors. However, this authority expired on December 31, 2001.³ The NCUA has not had direct statutory authority over CUSOs or vendors since then. In contrast, federal banking agencies⁴ have direct statutory authority over bank service providers and bank vendors. NCUA Chairman Rodney Hood and three Board Chairs before him have testified before Congress about the need for NCUA authority over CUSOs and vendors because credit unions' reliance on CUSOs and vendors increased systemic risks⁵ across the financial services landscape.

Vendors

Credit unions use many of the same vendors. For example, approximately 5 core processor vendors serve multiple credit unions and control approximately 85 percent of credit union data. In addition, 5 technology service provider vendors serve over 52 percent of all credit unions that hold 75 percent of total credit union assets. Many vendors subcontract with others to provide services such as security services (including physical, data, network, and privacy security services) and application code development (including outsourcing to companies outside of the United States), and often these vendor relationships are unknown to the vendor's client credit unions.

From a credit union examination standpoint, in October 2007, the NCUA issued a Supervisory Letter (Letter), *Evaluating Third Party Relationships*, to examiners providing guidance on evaluating credit unions' relationships with vendors.⁶ The Letter noted that credit unions had increasingly contracted with vendors to meet strategic objectives and enhance member services, but that credit unions outsourcing functions without exercising an appropriate level of due diligence⁷ and oversight could take on undue risk.

The Letter stated that outsourcing complete control over one or more business functions to a vendor amplified the risks inherent in those functions, including credit, interest rate, liquidity, transaction, compliance, strategic, and reputation risks. Accordingly, the Letter stated that examiners should ensure credit unions addressed the following concepts in a manner commensurate with their size, complexity, and risk profile: risk assessment and planning; due diligence; and risk measurement, monitoring, and control.

³ Pub. L. No. 105-164 (March 20, 1998).

⁴ The federal banking agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency.

⁵ Systemic risk is the threat that a disruption at a firm, in a market, or from another source, will cause difficulties at other firms, in other markets, or in the financial system as a whole.

⁶ Supervisory Letter No. 07-01.

⁷ Due diligence is the systematic, on-going process of analyzing and evaluating new strategies, programs, products, or operations to prepare for and mitigate unnecessary risks.



The NCUA conducted direct reviews of vendors on a voluntary basis after its statutory authority expired in 2001, and continued to conduct them through 2008, when the review program stalled for a number of reasons:

- Federal banking regulators' reluctance to include the NCUA in their reviews of bank vendors, even though those vendors also served credit unions, because of the NCUA's lack of statutory examination and regulatory authority;
- Leadership and direction of the vendor program was split between E&I and the Office of National Examinations and Supervision, with neither directorate pursuing reviews; and
- Most vendors declined reviews.

We determined that the NCUA conducted its last vendor review in 2013 and does not have a formal vendor review program in place or any policies, procedures, or instructions for performing such reviews. However, we learned that the NCUA plans to ask the top 20 credit union vendors to participate on a voluntary basis in the agency's review process. In the meantime, the NCUA continues to evaluate credit unions' use of vendors as part of its examination program.

CUSOs

In recent years, an increasing number of credit unions have shifted many of their services to CUSOs to leverage economies of scale and to benefit from CUSOs' specialized expertise. For example, CUSOs often provide lending services and loan underwriting, including mortgage loans, student loans, and commercial loans. CUSOs manage the loans but the loans are owned by credit unions.

A CUSO is legally separate from a credit union and its incentives may not always align with the credit unions it serves. CUSOs are not directly subject to NCUA regulation or examination and are not chartered or insured by the NCUA. Nevertheless, the NCUA has an interest in credit unions' relationships with CUSOs because if not properly managed, they can pose risks to an individual credit union's financial or operational condition and potential systemic risks to the credit union industry.



A credit union's relationship with a CUSO can take the form of one or more of the following:

Investor or owner	A credit union may own all or a portion of the CUSO, constituting an equity relationship. The credit union may be a shareholder (corporation), member (limited liability corporation), or partner (limited partnership) in the CUSO.
Lender	A credit union may loan funds to the CUSO, constituting a debt relationship.
Client	A credit union may be a user of a CUSO's services or a purchaser of products offered by a CUSO, constituting a vendor-client relationship.

Federal law and regulations limit the amount a federal credit union may invest in or loan to a CUSO and allow federal credit unions to establish relationships only with CUSOs that offer pre-approved services. Restrictions for federally insured state credit unions (FISCU) are similar but may vary according to state laws and regulations.

Investment and Loan Limits

The Federal Credit Union Act permits a federal credit union, with approval of the NCUA Board, to invest in CUSOs. Those investments must not exceed, in the aggregate, 1 percent of the total paid-in and unimpaired capital and surplus of the credit union as of its last calendar year-end financial report.⁸ In addition, the Federal Credit Union Act permits a federal credit union, with approval of the credit union's board of directors, to lend up to 1 percent of the paid-in and unimpaired capital and surplus of the credit union to CUSOs.⁹ The NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit any CUSO activities or services or refuse to permit any CUSO activities or services.¹⁰

Maintaining Legal Separation

A CUSO has its own board of directors and management that operate separately from the credit union's board and management. However, members of the credit union board and management team may also serve on the board of directors of a CUSO or in a dual employee capacity; this is particularly true for CUSOs that are wholly owned by a credit union. However, CUSOs must be structured and operate in a way that demonstrates that the CUSO and its owner credit union(s) are separate and distinct businesses.¹¹ Failure to achieve this separation exposes a credit union to a legal risk referred to as "piercing the corporate veil," in which the credit union would be held liable for the CUSO's actions or debts beyond the credit union's investment or loan.

⁸ 12 U.S.C. § 1757(7)(I); see also 12 C.F.R. § 712.2(a).

⁹ 12 U.S.C. § 1757(5)(D).

¹⁰ 12 C.F.R. § 712.5; see also 12 C.F.R. § 702.202(4)(b)(2) (as part of prompt corrective action for undercapitalized credit unions, the NCUA may restrict an undercapitalized credit union's transactions with a CUSO or require the undercapitalized credit union to reduce or divest its ownership interest in a CUSO).

¹¹ 12 C.F.R. § 712.4.



CUSO Services

Federal credit unions may invest in or provide loans to CUSOs that offer any of the following pre-approved categories of activities:¹²

Basic Activities and Services	Complex/High-Risk Activities and Services*
<ul style="list-style-type: none"> • Checking and currency services • Clerical, professional, and management services • CUSO investments in non-CUSO providers • Financial counseling services • Fixed asset services • Insurance brokerage or agency • Leasing • Real estate brokerage services • Securities brokerage services • Travel agency services 	<ul style="list-style-type: none"> • Business loan origination • Consumer mortgage loan origination • Loan support services • Student loan origination • Credit card origination • Electronic transaction services • Record retention, security, and disaster recovery services • Payroll processing services • Custody, safekeeping, and investment management services for credit unions (including trust and trust related services) • Shared credit union branch operations
<p>* CUSOs that provide complex or high-risk services (as defined by regulation) must report additional information through the CUSO Registry.</p>	

Federal credit unions may invest in CUSOs that engage in activities and services within these pre-approved categories. However, CUSOs may offer additional services with the permission of the NCUA Board. A CUSO that intends to offer a service that is not pre-approved must first seek an advisory opinion from the NCUA’s Office of General Counsel.

CUSO Registry

Annually, the NCUA requires credit unions with CUSOs to have written agreements with the CUSOs requiring them to provide the NCUA operational and financial information.¹³ The NCUA collects this information through a CUSO Registry.¹⁴ As of December 31, 2018, there were 953 registered CUSOs, including 38 CUSOs serving corporate credit unions.

¹² 12 C.F.R. § 712.5.

¹³ 12 C.F.R. § 712.3(d)(4).

¹⁴ CUSOs report year-end information to the registry during the annual registration period (February 1 through March 31). The registry provides the NCUA with accurate information about CUSOs to evaluate their potential financial and operational risks to credit unions. This information also helps the NCUA identify inter-relationships between credit unions and CUSOs to help determine which CUSOs to focus on and to identify any systemic risks.



The table below outlines the information CUSOs are required to report based on the services they provide. CUSOs offering complex or high-risk activities must report additional information to the NCUA through the registry.¹⁵

Required Information	Who is Required to Report?
Basic registration information including: <ul style="list-style-type: none"> • Tax Identification/Employer Identification Number • Legal name including trade or Doing Business As names • Address • Telephone number • Website • Contact person • Chief Executive Officer name and contact information • Date of last financial audit 	All CUSOs
Services offered by the CUSO	
Federally insured credit unions that invest in, lend to, or receive services from the CUSO (the credit union "customer" information)	
Ownership information	
Services provided to each federally insured credit union customer	CUSOs that offer one or more high-risk services
Investment, loan, or level of activity of each federally insured credit union	
Audited financial statements	
Total dollar amount of loans facilitated*	CUSOs that offer credit or lending services
Total number of loans facilitated*	
Total dollar amount of loans granted year-to-date*	
Total number of loans granted year-to-date	
* As applicable for the types of services that are offered	

¹⁵ 12 C.F.R. § 712.5.



CUSO Reviews

The NCUA requires any federally insured credit union with an investment in or a loan to a CUSO to enter into a written agreement with the CUSO that it will provide the NCUA with complete access to its books and records and the ability to review the CUSO's internal controls.¹⁶ The NCUA considers several factors, including the CUSO's geographic range of operations and types of services offered, when deciding which CUSOs will receive an onsite review. A CUSO review may be part of a credit union examination using the CUSO review questionnaire found in the NCUA's Automated, Integrated, Regulatory Examination System (AIRES).¹⁷ A CUSO review can also be stand-alone review, conducted in response to recommendations from NCUA or State Supervisory Authority (SSA)¹⁸ staff. A follow-up review may be performed at the direction of a supervisory examiner, Division of Special Actions Director, or other senior NCUA official to determine whether a CUSO has properly acted upon previously recommended corrective actions from the stand-alone review.

As with its other risk-focused examinations, the NCUA expects examiners to tailor examination procedures according to the size, complexity, and business of the CUSO being reviewed. The NCUA may perform CUSO reviews in conjunction with the SSA in the case of FISCUs. In most cases, the agency that initiates the review will be in charge of the review. Some SSAs have been granted examination and enforcement authority over CUSOs under state law. In that case, an SSA may conduct the CUSO review independently and provide a copy of the resulting report to the relevant NCUA regional office.

Regional Office Roles and Responsibilities

Yearly, regions are required to solicit CUSO recommendations from NCUA staff and each SSA in the region. During NCUA's annual resource budgeting process, the Associate Regional Director for Programming is required to determine which CUSOs will receive on-site CUSO reviews based on SSA and field staff recommendations, a CUSO's overall risk profile (identified through CUSO Registry information), and the availability of staff resources.

Associate Regional Directors for Programming then determine which CUSOs require cross-regional coordination and staffing, including identifying the region that will be primarily responsible for scheduling and staffing the review as well as any necessary specialized resources. Associate Regional Directors of Programs also determine which CUSOs will receive reviews

¹⁶ 12 C.F.R. § 712.3(d)(3).

¹⁷ AIRES is the NCUA's credit union examination tool. The NCUA plans to replace AIRES with the Modern Examination and Risk Identification Tool (MERIT) in 2020. The NCUA is piloting MERIT as of the date of this report.

¹⁸ Each state that has a FISCU has its own SSA, which is responsible for completing examinations of FISCUs. Five states and the District of Columbia, Guam, Puerto Rico, and the Virgin Islands do not have FISCUs.



staffed and coordinated within the region, including identifying the supervisor (supervisory examiner or Division of Special Actions) responsible for scheduling and staffing the review.

Division of Supervision

Division of Supervision staff are responsible for:

- Coordinating report actions with the examiner-in-charge, supervisor, SSAs, and CUSO officials;
- Coordinating report responses with the CUSO, SSAs, and the examiner-in-charge; and
- Finalizing and distributing draft and final reports to internal and external recipients.¹⁹

Supervisory Examiners and Division of Special Actions

Supervisory examiners and Division of Special Actions staff coordinate with examiners, specialists, and problem case officers to identify CUSOs whose operations may pose potential risk, and when identified, will recommend an independent CUSO review to regional management. Supervisory examiners and Division of Special Actions staff are responsible for reviewing the yearly CUSO review recommendations provided by staff. If an examiner alerts them to an issue with a CUSO that warrants more immediate attention, they are required to immediately notify the regional Division of Supervision Director, Associate Regional Director, and Associate Regional Director for Operations.

Field Staff

Field examiners, specialists, and problem case officers are responsible for identifying potential risks associated with CUSOs based on information gathered during on-site contacts, examinations, and insurance reviews. If an examiner, specialist, or problem case officer believes that a CUSO poses significant risk to a credit union because it is not financially stable or because of issues with the CUSO's products or services, they must recommend it for an independent review.

Selecting, Scheduling, and Resourcing CUSO Reviews

The final selection of CUSOs for review is based on emerging risks and the potential for systemic risk if the CUSO serves multiple credit unions. On a quarterly basis, regions are required to provide in their quarterly workload memo to E&I any additions or deletions to the list

¹⁹ Internal recipients include regional management, central offices, and E&I, and external recipients include CUSOs, SSA (when applicable), and the affiliated credit union.



of CUSOs scheduled for a review and the anticipated dates for completion of CUSO reviews for the quarter.

CUSO Report Process

The examiner-in-charge has flexibility in developing the overall content of the CUSO report but generally may not include information that is considered to be a CUSO's trade secret or proprietary information, or that could expose a CUSO to additional risk, such as information related to security controls. If it is important nonetheless for this information to be included in a report, the examiner-in-charge includes it in a "Closed Section" appendix, which is provided to the CUSO but not the associated credit union.

Distributing the Draft CUSO Report

The examiner-in-charge forwards the draft CUSO report to his or her supervisor for review, and upon review and approval, the supervisor forwards the report to the Division of Supervision, which assigns an analyst to review the report within 14 days. Coordinating with the supervisor and the examiner-in-charge, the analyst edits and clarifies the report as necessary. Once the analyst makes any necessary changes, they send the report to any SSA that participated in the on-site review and ask for a response within 15 days. Working with the examiner-in-charge, the analyst may revise the report based on the SSA response. The analyst then sends the report to CUSO management to respond to the findings and recommended corrective actions within 15 days of receipt of the report.

Management Response and Report Distribution

Once the analyst receives the response from CUSO management, the analyst forwards it to the examiner-in-charge to address the response within 10 days of receipt. The examiner-in-charge, the analyst, and SSA staff (if applicable) coordinate with CUSO management regarding the response if necessary. If no agreement can be reached regarding the report or response, in consultation with NCUA regional management, the report is finalized and issued to CUSO officials, credit union officials,²⁰ and the SSA (if applicable) on a case-by-case basis. If a CUSO does not respond, the NCUA will indicate that in the report and issue the report.

CUSO Review Report Maintenance

Instead of using AIRES, E&I maintains all CUSO reports and associated documents in a SharePoint²¹ site that serves as the central repository for all agency CUSO reviews. Division of Supervision staff upload the report file to the SharePoint site and send an email to the E&I mailbox and all other regional Division of Supervision mailboxes to alert them of the upload.

²⁰ Credit union officials are owners of the CUSO (investors).

²¹ SharePoint is a web-based collaborative platform, which is primarily a document management and storage system.



CUSO Follow-Up Reviews

At management's direction, examiners-in-charge may conduct CUSO follow-up reviews. The examiner-in-charge may use discretion in developing both the content and the format of the follow-up review report, but at a minimum, they must address any action taken by CUSO officials on the recommended corrective actions outlined in the original report. The NCUA follows the same review and distribution process for follow-up reports as for original reports.

State Supervisory Authorities & CUSO Reviews

As previously stated, CUSO reviews may be performed jointly with an SSA or independently by an SSA. If conducted independently by an SSA, a Division of Supervision analyst must prepare a summary of the SSA's report that highlights the SSA's areas of concern and conclusions identified in the report. The analyst routes this summary and a copy of the SSA's report to the Director of the Division of Supervision, Regional Director, Associate Regional Director for Operations, and the Associate Regional Director for Programming for their comments. Within 30 days of receiving comments from management, the analyst posts the SSA's report and the associated comments to the CUSO SharePoint site and provides the report and summary to regional supervisory examiners and the Division of Special Actions' staff.

Banking Agencies' Authorities

The Bank Service Company Act provides federal banking agencies statutory authority to examine and regulate bank service companies (service companies) to the same extent as if such services were being performed by the depository institution itself.²² A bank service company is defined as any corporation authorized to perform services for the depository institution; and all of the corporation's capital stock is owned by 1 or more insured depository institutions;²³ and any limited liability company, which is organized to provide services to a depository institution; and all of the members are 1 or more insured depository institutions.²⁴ Thus, bank service companies differ from CUSOs because CUSOs can be either wholly or partially owned by credit unions and there is no requirement that all of the members of a CUSO be one or more insured credit unions. In fact, although they may share board members and employees, a CUSO must be legally separate from a credit union.

The Bank Service Company Act also provides federal banking agencies statutory authority to examine and regulate service companies used by depository institutions. In contrast, as previously stated, although the NCUA had statutory authority over CUSOs and vendors from

²² 12 U.S.C. § 1867(a).

²³ Insured depository institutions are subject to examination where the accounts or deposits are insured or guaranteed under state law and are eligible to be insured by the NCUA.

²⁴ 12 U.S.C. § 1861(b)(2).



March 1998 through December 2001 under the Examination Parity Act, it has not had statutory examination or regulatory authority since then.

Although the NCUA did not have statutory authority after 2001, the NCUA participated in the Federal Financial Institutions Examination Council interagency supervisory program for technology service providers from the early 2000s until approximately 2009. The program, called the Multi-Regional Data Processing Servicer (MDPS) program, considers reviewing a technology service provider when it provides mission-critical applications for a large number of financial institutions that are regulated by more than one agency, or processes information from data centers located in different geographic regions.

Many of the technology service providers that serve banks also serve credit unions. The MDPS is intended to reduce supervisory duplication, which promotes effective use of agency resources and reduces the burden on technology service providers by producing a single report of examination for the technology service provider and its associated financial institution. The MDPS also enables the federal financial agencies to share their knowledge of technology service providers' operations with each other and to develop a joint supervisory strategy. However, since 2013–2014, the federal banking agencies have not allowed the NCUA to participate in any MDPS program examinations because of a banking agency legal opinion that the NCUA was not statutorily authorized and could only participate in the MDPS program with written permission from the third party service provider under examination.



RESULTS IN DETAIL

The objectives of our audit were to determine whether: 1) the NCUA complied with applicable laws, regulations, policies, and procedures for CUSO and other (non-CUSO) third-party vendor reviews; and 2) the NCUA's vendor review process effectively helps to assess the adequacy of credit union management's due diligence reviews, and identify and reduce the risks vendor relationships pose to credit unions.

Our audit determined that the NCUA complied with applicable laws, regulations, policies, and procedures for CUSO reviews. We did not assess the NCUA's vendor reviews because none occurred during our audit scope period. We also determined that the NCUA's authority regarding CUSOs and vendors is limited, and that statutory authority over CUSOs and vendors could enable the agency to more effectively identify and reduce the risks that CUSOs and vendors pose to credit unions, particularly in light of credit unions' increased reliance on CUSOs and vendors to perform mission-critical functions, including technology services, which impact over 120 million credit union members.

The need for statutory authority may be even more important for the NCUA because CUSOs may be owned by non-credit unions and are required to be separate and distinct, which could result in less oversight by credit unions themselves. In addition, non-CUSO third-party vendors are always separate and distinct from credit unions, which results in even less oversight by credit unions. The Financial Stability Oversight Council (FSOC), of which the NCUA and the federal banking agencies are members, supports providing the NCUA with statutory examination and enforcement authority, as does the Government Accountability Office (GAO) when it made a recommendation consistent with the FSOC's position in a July 2015 report on cybersecurity.²⁵ The detailed results of our audit follow.

**NCUA Needs
Statutory Authority
over CUSOs
and Vendors**

Our audit determined that NCUA's CUSO review program and its planned vendor review program could be improved if the NCUA were to obtain examination and enforcement authority over CUSOs and vendors similar to its current authority over credit unions. As previously noted, NCUA regulations require any federally insured credit union with an investment in (or a loan to) a CUSO to enter into a written agreement with the CUSO that it will provide the NCUA with complete access to its books and records and the ability to review the CUSO's internal controls.²⁶ However, because the NCUA lacks authority to enforce corrective actions to mitigate significant problems it identifies during CUSO reviews,²⁷ problems that occurred between 2008 and 2015 could be

²⁵ *Cybersecurity: Bank and Other Depository Regulators Need Better Data Analytics and Depository Institutions Want More Usable Threat Information*, GAO-15-509, July 2015.

²⁶ 12 C.F.R. § 712.3(d)(3).

²⁷ As stated in footnote 10 of this report, as part of prompt corrective action, the NCUA can restrict undercapitalized credit unions' use of CUSOs.



repeated.²⁸ During that period, nine CUSOs caused more than \$300 million in direct losses to the Share Insurance Fund and led to the failures of credit unions with more than \$2 billion in aggregate assets. One of the CUSOs caused losses in 24 credit unions, some of which failed.

Details

During our audit, we learned that between 2011 and 2012, federal banking agencies tried to stop the NCUA's participation in vendor reviews due to the NCUA lacking vendor authority. The other federal banking agencies were concerned that NCUA's participation without statutory authority could result in vendors not allowing the federal banking agencies to conduct reviews. This led the other federal banking agencies to draft and eventually adopt a "guiding principles document" for vendor reviews, which essentially stopped the NCUA from participating in examinations of technology service providers with the other federal banking agencies. Because the NCUA could not meet the requirements in the guiding principles document, the NCUA's vendor review program stalled.

Specifics of the guiding principles included in part:

- Non-federal banking agencies with a supervisory interest may participate in interagency supervisory activities regarding technology service providers *with documentation of appropriate legal authorities* [emphasis added].
- In instances where an agency does not have clear legal authority to participate in the examination, but does have a supervisory interest in the technology service provider that cannot be addressed by another agency with shared supervisory responsibility for the client institutions, the federal banking agencies may allow for participation in the examination of the technology service provider by the non-federal banking agency *if the technology service provider is notified of, and agrees in writing to, the non-federal banking agency's participation in the examination* [emphasis added].
- Where services are reviewed as part of an examination that are exclusive to financial institutions outside of the supervisory authority of the federal banking agencies, such as federal credit unions, information specific to that service can only be requested and used as part of the technology service provider examination activity *with the technology service provider's written consent* [emphasis added]. This is necessary as the federal banking agencies have no legal authority to require the information be provided.

Given these restrictions, the NCUA was unable to participate in joint examinations of technology service providers that served credit unions, nor could the NCUA receive copies of

²⁸ The NCUA uses a document of resolution to outline high priority problem(s) and concern(s) from an examination or supervision contact and uses corrective action plan(s) that represent agreements reached with credit union officials to correct these problems. The NCUA can escalate its enforcement actions from a document of resolution to a Regional Director Letter or to a Letter of Understanding and Agreement for failure to correct problems.



completed review reports because banks and the federal banking agencies did not share their reports with the NCUA.

The NCUA has addressed its lack of vendor authority through testimony before the U.S. Senate Banking Committee beginning in 2004. Since that time, four NCUA Chairmen have testified five times before Congress regarding the need for authority over CUSOs and (non-CUSO) third-party vendors. In June 2004, Chairman JoAnn Johnson testified, and in 2010 and 2011, Chairman Debbie Matz testified. Following are excerpts from the two most recent testimonies given by Chairmen Rodney E. Hood and J. Mark McWatters in May 2019 and October 2018, respectively.

- May 15, 2019—Testimony of NCUA Chairman Rodney E. Hood before the Senate Committee on Banking, Housing, and Urban Affairs, “Oversight of Financial Regulators.” Chairman Hood stated the following related to NCUA’s need for vendor authority:

Consumer demand for more modern services and realities about economies of scale have forced many credit unions, particularly smaller ones, to either merge or rely heavily on third-party vendors to enable them to provide those services....Fintech and credit union reliance on third-party vendors increases systemic cybersecurity risks across the financial services landscape. The credit union system is particularly at risk because the NCUA does not have sufficient legal authority to directly identify and address systemic cybersecurity risk and the potential contagion risk that key fintech service providers can pose.

Currently, the NCUA may only examine CUSOs and third-party vendors with their permission. We cannot enforce any necessary corrective actions or share the results of a voluntary review with customer credit unions of the third-party vendor. In recent years, nearly all of the core technology service providers that exclusively serve credit unions declined a voluntary review by the NCUA. Even though CUSOs are required to give the NCUA access to their books and records, without the NCUA’s enforcement authority, the CUSOs are free to reject the NCUA’s recommendations to implement the appropriate corrective actions that would mitigate identified risks. This lack of vendor authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators, a situation identified as a concern by both the GAO and the Financial Stability Oversight Council.

Following Chariman Hood’s testimony, he responded to questions for the record from Senator Catherine Cortez Masto that related to vendor authority:

Question: In your witness testimony, you highlighted the need for the NCUA to have the legal authority to correct systemic cybersecurity risks presented by



vendors. Please elaborate on what the risks presented by third-party vendors and credit union service organizations (CUSOs) are.

Response: The financial sector, including banks and credit unions, increasingly rely on third-party service providers (vendors) to provide and or support technology-related functions. These functions span a wide range of activities, including internet banking, transaction processing, and funds transfers. There are a number of risks that may arise from a credit union's use of third parties.

Some of the risks are associated with the underlying activity itself, similar to the risks faced by an institution directly conducting the activity. Other potential risks arise from, or are heightened by, the involvement of a third party. Failure to manage these risks can expose an institution to regulatory action, financial loss, litigation, reputation damage, and may even impair the institution's ability to establish new or service existing customer relationships.

Question: In your witness testimony, you state that NCUA can examine CUSOs and third-party vendors with their permission and that CUSOs are required to provide access to their books and records. What information would expanded examination authority provide that you do not have now?

Response: While the NCUA has access to CUSO books and records through a regulation imposed on the investing credit unions, this does not provide access to examine all of the CUSO's operations. For example, reviewing books and records alone may not provide sufficient information to determine if deficiencies exist in internal controls or overall governance. Additionally, this requirement only applies to CUSOs and does not provide the NCUA with the ability to review the books and records of other third-party vendors that credit unions may be doing business with.

Question: Which of NCUA's recommendations have the CUSOs rejected?

Response: Due to the lack of supervisory authority over third-party vendors, we do not have recent examples of recommendations that have been rejected.

- October 2, 2018—Testimony of then NCUA Chairman J. Mark McWatters before the Senate Committee on Banking, Housing, and Urban Affairs, "Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act." Chairman McWatters stated in part the following regarding NCUA's need for vendor authority:

The NCUA requests that the Committee consider legislation to provide the agency with examination and enforcement authority over certain third-party vendors—including CUSOs. As fintech options increase both in importance



and use in credit unions, this request becomes even more crucial to the NCUA's defense against cybersecurity risks in the credit union system.

The rapid movement toward digital financial transactions and services benefits smaller financial institutions like credit unions by improving service to consumers and small businesses and reducing costs. However, fintech also increases potential systemic cybersecurity risks across the financial services landscape. The credit union system is particularly at risk because the NCUA does not have sufficient legal authority to directly identify and address systemic cybersecurity risk and the potential contagion risk that key fintech service providers can pose. Specifically, in order to manage the systemic risk that fintech poses to the credit union system appropriately, the NCUA needs vendor authority comparable to the authority provided to our Federal Financial Institutions Examination Council counterparts.

Currently, the NCUA may only examine CUSOs and third-party vendors with their permission and cannot enforce any necessary corrective actions or share the results of a voluntary review with customer credit unions of the third-party vendor. To underscore the seriousness of this situation, nearly all of the core technology service providers that serve credit unions exclusively declined a voluntary review by the NCUA in recent years. Even though CUSOs are required to give the NCUA access to their books and records, without enforcement authority, they are free to reject the NCUA's recommendations to implement the appropriate corrective actions that would mitigate identified risks. This lack of vendor authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators, a situation noted as a concern by both the General Accountability Office and the Financial Stability Oversight Council.

We asked NCUA officials about vendors declining voluntary reviews as noted in both testimonies above and learned of instances that capture the lengths some vendors have gone to not be subject to a CUSO review, including the following two examples.

- A technology provider, a former CUSO, purchased back all of its stock in order to change its designation from a CUSO back to a privately owned vendor in order to prevent the NCUA from conducting a CUSO review. Following the stock transfer, the NCUA still requested to review the vendor, but received a rejection. Because of its lack of authority, the NCUA could take no further action.
- A technology vendor had six small credit union clients with assets valued at approximately \$5 to \$10 million each, one of which was a state-chartered credit union located in Texas. The vendor's website listed its business location as Sugarland,



Texas.²⁹ Working with the state of Texas, the NCUA planned to participate in a joint review. However, examiners discovered the vendor's address was actually that of a United Parcel Service store. When examiners tried to initiate the review, the vendor updated its business address to a location in Florida. Examiners surmised that the vendor's owner previously lived in Texas, moved to Florida, and used a Post Office Box at the United Parcel Service store in Texas for mail and business address purposes.

Texas examiners took the lead on this review because they had authority, and notified the vendor that they would begin a review. However, the vendor did not reply to the request. Examiners followed up and received a reply letter from the owner of the company stating that he had terminated the contract with the Texas state-chartered credit union. The letter specified that since the vendor no longer serviced a state regulated credit union, the need for a vendor review no longer existed. Therefore, the vendor declined to participate.

In addition to NCUA Board Chairmen informing the Congress of the agency's need to have vendor authority, the GAO has also reported that the NCUA has a limited ability to assess and mitigate the risks vendors, including CUSOs, pose to credit unions and ultimately the Share Insurance Fund. In its 2015 report on cybersecurity threats to banks (GAO-15-509), the GAO stated the following:

We have long supported granting NCUA such authority. In a July 1999 report, we found that joint regulatory examinations of third-party service providers might increase the economy and efficiency of federal oversight of Internet banking activities. At the time, NCUA's temporary authority to examine third-party providers was set to expire in December 2001. We suggested that Congress consider extending NCUA's temporary examination authority beyond 2001. The authority was not extended. In an October 2003 report, we found that NCUA had adopted a risk focused examination program but faced challenges in implementing it, partly because NCUA lacked authority to examine third-party service providers, on which credit unions increasingly relied to provide services. We asked that Congress consider granting NCUA legislative authority to examine third-party service providers that provide services to credit unions and are not examined through the other federal banking agencies. This matter was never implemented. We maintain that NCUA would benefit from this authority. The services of the third-party providers are integral to the operations of many credit unions, and deficiencies in providers' operations quickly could become deficiencies that produce financial and other harm at credit unions. In its response to our 2003 report, NCUA also stated that because many third-party service providers service numerous credit unions, a failure of a provider posed systemic risk issues.

²⁹ The state of Texas has both vendor authority and vendor oversight.



In its 2015 annual report, FSOC stated the following:

The Council notes that approaches and authorities to supervise third-party service providers vary across financial regulators. The Council supports efforts to synchronize these authorities, including by passing new legislation that helps to enhance the security of third-party service providers and the critical services they provide. The Council supports the granting of examination and enforcement powers to NCUA and FHFA [Federal Housing Finance Agency] to oversee third-party service providers engaged respectively with credit unions and the GSEs [Government Sponsored Enterprise such as Fannie Mae and Freddie Mac].

The GAO agreed with FSOC's assessment, noting in its 2015 cybersecurity report that without the authority to examine third-party service providers, the NCUA risks not being able to effectively monitor the safety and soundness of regulated credit unions.

Although not having vendor authority, the NCUA has tried to address vendor-related issues through its examinations of credit unions. As previously noted, in October 2007, the NCUA issued a Letter to examiners providing them guidance on evaluating credit union relationships with vendors, stating that examiners should ensure credit unions engage in risk assessment and planning, due diligence, and risk measurement, monitoring, and control regarding their vendors – to a level commensurate with the credit union's size, complexity, and risk profile.

However, we found that this credit union-focused approach is not adequate. If an examination determines that a credit union is not properly addressing risks associated with their vendor(s), the NCUA is unable to conduct an independent review of the vendor(s) to determine whether the credit union is at risk. Regarding CUSOs, although the NCUA reviews them as required by credit union agreements with CUSOs, the agency has no authority to enforce corrective measures if it identifies problems during CUSO reviews.

Testing the Effectiveness of the CUSO Review Program

To determine whether the NCUA's CUSO review process effectively assessed credit union due diligence reviews to identify and reduce the risks that CUSOs may pose to credit unions, we selected and tested a judgmental sample of CUSO reviews the NCUA conducted from January 2013 through December 2018. We determined that the NCUA conducted 101 CUSO reviews during this period for 73 CUSOs. In addition, we determined that the NCUA had conducted 2 or more reviews for 18 of the 73 CUSOs.

Our universe for sampling came from the reviews conducted for these 18 CUSOs and from this universe, we identified 7 CUSOs that had undergone 3 or more reviews. Of these, 5 CUSOs were reviewed 3 times, 1 CUSO was reviewed 4 times, and 1 CUSO was reviewed 5 times, for a total of 24 CUSO reviews in our sample. Our audit considered whether these CUSOs were the subject of multiple reviews because of repeat issues that were not adequately resolved by CUSO management, thus causing the NCUA to have to re-examine them.



Results of our testing concluded that in 5 out of 24 (21 percent) CUSO reviews, examiners identified either repeat issues or that CUSO management did not take sufficient action to address recommendations from a prior CUSO report. In one sampled report dated July 31, 2017, we found examiners had identified 13 reportable findings having 13 associated recommendations in the following areas:

- Policy Considerations
- Risk Rating System and Methodology
- Loan Monitoring Procedures
- Underwriting
- Commercial Lending Servicing - Periodic Reviews
- Guarantor and Global Cash Flow Analysis
- Loan-to-Value Computation
- Commercial Lending Quality Control
- Reporting
- Capitalization and Earnings
- Vendor Due Diligence
- Expertise and Experience Requirements
- Line of Credit

In addition, our test determined that 8 of the finding areas listed above were repeat issues from the previous report examiners issued to this CUSO in May 2016.

Our sample did not include vendor reviews. As previously discussed, we learned during our audit that the NCUA's vendor review program ended around 2013–2014 due to a federal banking agency legal opinion regarding the NCUA not having statutory vendor authority. Therefore, we had no (non CUSO) third-party vendor reviews to select for testing. However, based on the results of our CUSO testing, we believe it is important that the NCUA have statutory examination and enforcement authority over CUSOs and third-party vendors to properly identify and mitigate risks posed by them. Statutory authority would allow NCUA to monitor the risks within each CUSO and vendor, evaluate their risk mitigation strategies, determine the systemic risk to the credit union industry, assist NCUA in mitigating the risk, and help credit unions better understand any risks their vendors may pose to their operations.

We believe the NCUA should have statutory examination and enforcement authority over CUSOs and vendors performing services for credit unions. This authority should be consistent with that exercised by other federal banking agencies. CUSOs and third-party vendors have become integral to the operations of many credit unions, and deficiencies in their operations could cause significant widespread financial disruption and other harm if statutory examination and enforcement authority is not provided to the NCUA. Therefore, we are making the following recommendation.



Recommendation

1. We recommend NCUA management continue its efforts to work with appropriate Congressional committees regarding amending the Federal Credit Union Act to grant the NCUA the authority to subject credit union service organizations and credit union vendors to examination and enforcement authority to the same extent as if they were an insured credit union.

Management Response

Management agreed with the recommendation. Management indicated that post recovery [from COVID-19 pandemic] they plan to work with Congress on providing the NCUA vendor authority to allow the agency to better supervise for third-party cybersecurity risks. We have attached management's entire response in Appendix B.

OIG Response

We concur with management's planned actions.

Examiners Substantially Complied with CUSO Policies and Procedures

Our audit determined that NCUA staff substantially complied with applicable policies and procedures for workpaper and reporting requirements for CUSO reviews. Specifically, results of our testing effort determined that NCUA staff conducting CUSO reviews completed a significant portion (89 percent) of the NSPM's required elements when documenting and reporting on CUSO reviews. The NSPM's CUSO review section establishes policy that NCUA staff must follow when conducting CUSO reviews. This includes mandatory use of the CUSO review scope workbook and adhering to the required CUSO review report format. Because we determined that NCUA staff conducting CUSO reviews substantially complied with all applicable policies and procedures for workpaper and CUSO review reporting, staff were able to determine whether the CUSOs in our testing effort engaged in permissible activities or services, the degree of risk the CUSO posed to the affiliated credit union, and the ongoing feasibility of the CUSO.³⁰

Details

NCUA staff conducting stand-alone CUSO reviews must use the CUSO review scope workbook. The CUSO review scope workbook is not required for follow-up CUSO reviews or reviews of

³⁰ The NSPM indicates that not all scope steps outlined in the workbook are required and that each scope should be commensurate with the size and complexity of the CUSO being reviewed. Because the NSPM provides examiners-in-charge with the flexibility to customize the scope of a CUSO review as needed, we tested only mandatory sections of the CUSO review process to ensure consistency across all CUSO reviews selected in our sample.



CUSOs conducted as part of the normal examination process. The CUSO review scope workbook includes CUSO review steps common to all CUSOs regardless of service type.³¹

The CUSO review scope workbook also provides specific review scope steps based on the products or services provided by the CUSO. The NCUA uses the scope workbook to provide more consistency during CUSO reviews, but examiners-in-charge have the flexibility to customize the scope as needed. Not all scope steps outlined in the workbook are required, but NCUA expects examiners-in-charge to scope each CUSO review appropriately based on the size and complexity of the CUSO being reviewed.

In addition to using the CUSO review scope workbook, the NSPM requires every CUSO report to include the following six specific sections (if applicable to the CUSO):

- Cover page
- Review summary
- Review findings and recommended corrective actions (when applicable)
- Loan exceptions (if applicable)
- Management response
- Confidential Section (not included in draft or final report provided to CUSO officials)

The NSPM also requires examiners-in-charge to format the required sections using the CUSO review report template. CUSO review reports must include the following information, which the examiner-in-charge can provide in any of the six required report sections:

- CUSO's background information
- List of CUSO officials/senior management (including individual backgrounds)
- CUSO's organizational chart
- List of credit unions that invest in, loan to, or are affected by the CUSO, and the level of involvement for each credit union listed
- Scope of review
- List of services offered by the CUSO
- CUSO's financial data and trends

In addition, regional supervisors responsible for a CUSO review may request expertise outside of their group and bring in subject matter experts or other specialized resources available in the region such as regional lending specialists, regional information systems officers, or others.

Testing Compliance with Policies and Procedures

To determine whether the NCUA complied with applicable policies and procedures for CUSO reviews, we used our same judgmental sample of 24 CUSO reviews from our previous

³¹ CUSO review steps are, in large part, based on requirements outlined in 12 C.F.R. Part 712.



effectiveness testing effort to conduct a test of compliance with policies and procedures. As previously discussed, the NSPM requires certain mandatory sections be present in all CUSO reviews. Because there are six sections that must be included in every CUSO report and seven specific areas that must be addressed within those sections (as applicable), we were able to test whether examiners-in-charge completed 360 different required items from the 24 CUSO review reports we selected for our judgmental sample.

Of the 360 different items, we determined that for 267 items (74 percent), examiners-in-charge included these items in the report and therefore we marked them as “Yes,” a positive assessment. For 60 items (17 percent), we determined that examiners-in-charge had scoped down the CUSO review and therefore did not address these items in the CUSO report because they were not applicable. For these, we marked them as “N/A,” a neutral assessment. For the remaining 33 items (9 percent), we found that examiners-in-charge did not address these items in the CUSO report, but should have because they did not scope down these issue areas during the CUSO review. For these, we marked them as “No,” a negative assessment.

To determine NCUA staff compliance, we first removed all of the items that we determined to be “N/A” (a neutral assessment) because examiners-in-charge had determined them not applicable due to scope considerations during the CUSO review. By removing these 60 neutral items, 300 required items remained. Based on this, we determined an 89 percent positive assessment, which enabled us to conclude that NCUA examination staff substantially complied with scope workbook policies and procedures when conducting and reporting on the results of CUSO reviews. Therefore, we are not making any recommendations at this time.



OBJECTIVES, SCOPE, AND METHODOLOGY

We developed our objectives for this engagement from the OIG's 2019 Annual Performance Plan. Specifically, our objectives were to determine whether: 1) the NCUA complies with applicable policies, procedures, laws, and regulations for CUSO and other (non-CUSO) third-party vendor reviews; and 2) the NCUA's vendor review process effectively helps to assess the adequacy of credit union management's due diligence reviews to identify and reduce the risks vendor relationships pose to credit unions. To accomplish our objectives, we conducted fieldwork at the NCUA's Central Office in Alexandria, Virginia. The scope of our audit covered all NCUA examination program policies, practices, and procedures related to the review and oversight of CUSOs and vendors for the period from January 1, 2013, to January 31, 2019.

To achieve our objectives we:

- Interviewed NCUA management and staff to obtain an understanding of the CUSO review process and the non-CUSO vendor review process.
- Judgmentally selected a sample of 24 CUSO review reports to determine whether the CUSO review process effectively helped to assess the adequacy of credit union management's due diligence reviews to identify and reduce the risks vendor relationships pose to credit unions.
- Used a sample of 24 CUSO review reports to determine whether the NCUA complied with applicable policies and procedures when conducting CUSO reviews.
- Reviewed Congressional testimonies of NCUA's Chairmen and management on the agency's lack of authority over CUSOs and vendors, which also included reviewing follow-up questions for the record raised by Senate committee members, as well as the Board Chairman's responses to those follow-up questions.
- Reviewed the NCUA's E&I White Paper, dated April 2013, titled *Third-Party Vendor Authority*, which addressed concerns surrounding the lack of vendor examination authority and enforcement powers of the NCUA and the negative impact the lack of authority can have on the nation's credit union industry and the Share Insurance Fund.
- Obtained and reviewed all applicable policies and procedures related to CUSO reviews.

We used computer-processed data from NCUA's system. We did not test controls over this system but we relied on our analysis of information from management reports, correspondence files, and interviews with management to corroborate data obtained from this system to support our audit conclusions.

We conducted this audit from February 2019 through September 2020 in accordance with generally accepted government auditing standards (Yellow Book) and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that



the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



NCUA MANAGEMENT RESPONSE



National Credit Union Administration
Office of the Executive Director

SENT BY EMAIL

TO: Inspector General Jim Hagen

FROM: Executive Director Larry Fazio **LARRY FAZIO** Digitally signed by LARRY FAZIO
Date: 2020.08.28 09:22:11 -0400

SUBJ: Management Response Audit of the NCUA's Examination and Oversight
Authority Over Credit Union Service Organizations and Vendors

DATE: August 31, 2020

We have reviewed the Office of Inspector General's draft audit report titled *Audit of the NCUA's Examination and Oversight Authority Over Credit Union Service Organizations and Vendors*. We agree with the recommendation.

OIG Report Recommendation: NCUA management continue its efforts to work with appropriate Congressional committees regarding amending the Federal Credit Union Act to grant the NCUA the authority to subject credit union service organizations and credit union vendors to examination and enforcement authority to the same extent as if they were an insured credit union.

Management Response: For the past two decades, NCUA requested Congress reinstate the vendor authority similar to the other federal banking regulators. The agency originally received temporary vendor authority through the Examination Parity and Year 2000 Readiness for Financial Institutions Act (Examination Parity Act). This temporary vendor authority was discontinued in December 2001 when the Act sunsetted.

Since that time, multiple NCUA leaders have signalled support for reinstatement of vendor authority in Congressional testimonies and letters. In addition, both the GAO and FSOC have publically supported NCUA's need for vendor authority in reports to Congress.

Post recovery, NCUA will work with Congress on providing the NCUA vendor authority to allow the agency to better supervise for third-party cybersecurity risks. Credit unions may expand third party services and credit union service organizations' cooperative arrangements to embrace new technology and remain competitive with increasing market innovations. The NCUA will monitor the situation on the ground during the pandemic to ensure protection of our nation's system of cooperative credit.

Thank you for the opportunity to review and comment.

1775 Duke Street – Alexandria, VA 22314-3428



ACRONYMS AND ABBREVIATIONS

Acronym	Term
AIRES	Automated, Integrated, Regulatory Examination System
CUSO	Credit Union Service Organization
E&I	Office of Examination and Insurance
Examination Parity Act	Examination Parity Year 2000 Readiness for Financial Institutions Act
FISCU	federally insured state credit union
FSOC	Financial Stability Oversight Council
GAO	Government Accountability Office
Letter	Supervisory Letter
NCUA	National Credit Union Administration
NSPM	National Supervision Policy Manual
MDPS	Multi-Regional Data Processing Servicer
MERIT	Modern Examination and Risk Identification Tool
OIG	Office of Inspector General
Share Insurance Fund	National Credit Union Share Insurance Fund
SSA	State Supervisory Authority
vendor	Service provider