

Examiner's Guide

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Chapter 24

SHARED BRANCH

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Chapter 24

SHARED BRANCH

Examination Objectives

- Determine whether the shared branch functions as a separate entity
- Assess whether the design of the shared branch agreement provides stability and limits the risk to the participating credit unions
- Determine whether the services offered by the shared branch operation comply with *NCUA Rules and Regulations*
- Determine whether the shared branch operation poses significant risk to the participating credit union's financial condition

Associated Risks

- Strategic risk – Includes the risk that a poorly managed CUSO will adversely affect the credit union's strategic goals and plans.
- Transaction risk – Includes the risk that member transactions will not be posted properly or promptly.
- Compliance risk – Includes the risk that CUSO personnel will not comply with applicable laws and regulations.
- Reputation risk – Includes the risk that the quality of service received at the CUSO will affect the credit union's reputation.

Overview

A shared branch operation, also known as a shared service center, can be structured as a corporation, limited liability company, or limited partnership, or it can result from an agreement with a third-party vendor that provides branch office services to more than one credit union. Many shared branch operations exist as Credit Union Service Organizations (CUSOs). Others may function as correspondent credit union activities or service contract activities.

Shared branch arrangements can provide added benefits to credit union members. For example, additional branch locations and services, and expanded office hours increase convenience to the membership. Additional services may include traveler's checks and money orders, utility bill payments, notary services, etc. The credit union may potentially reduce transaction costs because of economies of scale.

Thus, participating credit unions can offer these benefits without acquiring additional fixed assets or adding staff.

A shared branch operation is chartered under state law, and is not directly regulated by NCUA. However, since shared branch networks primarily perform member transactions, and the majority of the network's assets consist of credit union funds, NCUA has the responsibility to limit the exposure to the National Credit Union Share Insurance Fund (NCUSIF).

Officials of Participating Credit Unions

The board of directors of participating credit unions must perform due diligence regarding the shared branch operation. This includes reviewing the shared branch management and financial reports (such as board minutes, financial statements, budgets, audit reports, etc.) and periodically performing a cost/benefit analysis of the shared branch operation.

The participating credit unions must closely monitor the activities of the shared branch operation to mitigate the risks, both to the shared branch operation and to the participating credit unions as a result of the shared branch operation.

Examination Procedures

The examiner should determine if the credit union participates in a shared branch arrangement. If the shared branch is a CUSO, the examiner should determine whether the operation complies with Part 712 of the *NCUA Rules and Regulations*. (See Appendix 24A for further discussion of CUSO shared branches, Appendix 24B for shared branch CUSO review procedures, and the Credit Union Service Organizations (CUSO) chapter of the Guide for information on CUSO reviews.)

The examiner should ensure the credit union has a signed agreement with the shared branch provider. Examiners should document the review of the shared branch in the Scope Workbook. The examiner may include in the examination report, or possibly in the Supplementary Facts section, a discussion of the shared branch network.

Examiners should inform their supervisory examiners when they learn about newly formed or previously undetected shared branch networks.

References

- References
 - *NCUA Rules and Regulations*
Part 712, Credit
Union Service Organizations (CUSOs)

SHARED BRANCH CUSO - APPENDIX 24A

Review Objectives

- Determine whether the degree of risk the CUSO poses to affiliated credit unions and the NCUSIF is acceptable
- Review the financial stability and soundness of operations
- Determine the experience level, capabilities, and effectiveness of management directing the shared branch CUSO
- Determine the adequacy of policies, procedures, and controls safeguarding the assets of the participating credit unions and the individual credit union's membership
- Determine whether the CUSO maintains accurate and current records
- Determine the adequacy of surety bond coverage
- Ascertain whether contracts are legal and binding and do not require conditions or costs which adversely affect the financial condition or operations of the participating credit union
- Determine whether the shared branch CUSO operates in compliance with applicable laws and Part 712 of *NCUA Rules and Regulations*
- Determine the stability of the shared branch CUSO's participants

Associated Risks

- Strategic risk – Includes the risk that a poorly managed shared branch CUSO will adversely affect the credit union's strategic goals and plans.
- Transaction risk – Includes the risk that member transactions will not be posted accurately or promptly.
- Compliance risk – Includes the risk that shared branch CUSO personnel and management will not comply with applicable laws and regulations.
- Reputation risk – Includes the risk that the quality of service received at the shared branch CUSO will harm the credit union's reputation.

The participating credit unions must ensure they closely monitor the activities of the shared branch CUSO operation to mitigate these risks.

Overview

NCUA and the respective states periodically review shared branch CUSO operations. When only federally chartered credit unions participate in the CUSO, NCUA will perform the review. If federally insured state-chartered credit unions constitute the participating credit unions, the state assumes primary responsibility for the review, but NCUA may participate as the insurer. If all of the credit unions are privately insured, NCUA does not participate in the review. However, if a combination of federally insured and privately insured credit unions exists, NCUA requires access to the shared branch facility and all necessary records. §712.3(d)(3) of *NCUA Rules and Regulations* stipulates the CUSO will provide NCUA complete access to any books and records of the CUSO and the ability to review CUSO internal controls. Examiners should keep in mind NCUA does not regulate CUSOs, only the credit union's investment in or loan to the CUSO.

(Examiners should review both the Credit Union Service Organizations (CUSO) and the Shared Branch chapter for additional information.)

Review of a Shared Branch CUSO

Since shared branch CUSOs potentially involve a large number of credit unions, the regional director and the state supervisory authority should coordinate and give approval before the examiner schedules the review. Examiners should review regional guidance to determine the correct procedures for requesting a CUSO review.

Shared-Branch Review Procedures

Review procedures may vary depending on the size and structure of the shared branch arrangement. Examiners should consider reviewing the following areas:

- Structure of organization. To understand and evaluate the shared branch operation, the examiner should:
 - Identify the size, structure, and services during initial meetings with the CUSO's management;
 - Obtain and review a list of all participating credit unions, and the corresponding contracts and arrangements;
 - Obtain an organizational chart of the CUSO; and

- Determine the legal aspects of the CUSO by reviewing the Articles of Incorporation, Bylaws, contracts, and any legal opinions.
- Capital structure and financial condition. Several methods exist for funding a shared branch CUSO by the participating credit unions. The examiner should determine the following during the review of the shared branch operation's capital structure and financial condition:
 - The sufficiency of the CUSO's funding. Weak or inadequate funding arrangements may require additional, unanticipated costs to the participating credit unions;
 - The reasonableness of projected operating and capital costs under a variety of future operating and economic environments;
 - The future plans of management for the shared-branch CUSO. By reviewing management's budgetary process, business plan, and projected cash flows, examiners can estimate the effect such plans will have on the cost to participating credit unions;
 - The stability of the CUSO's financial condition. By analyzing ratios and financial trends in comparison to current industry standards, the examiner can evaluate the organization's financial performance. Examiners may need to review several years of ratios and financial trends, if available. Ideally, participating credit unions should track their own per-transaction costs and compare those costs to the monthly fees of the shared-branch CUSO arrangement; and
 - The changes in costs incurred by and transaction fees charged to the member credit unions over time. These include reviewing and analyzing income and expense, transaction costs, and monthly fees charged to the participating credit unions for appropriateness and proper controls. In most cases, economies of scale should reduce transaction costs in a growing shared branch CUSO.

- **Management.** The examiner may determine the quality and capabilities of management. The review of shared branch CUSO management is similar to the review of management performed during a regular credit union examination. The examiner should review:
 - Minutes of board and appropriate committee meetings;
 - The CUSO's mission statement and business plan;
 - Policies and procedures;
 - Personnel hiring practices including qualifications, training programs, and evaluation procedures;
 - Management contracts;
 - The planning and budgetary process; and
 - Methods by which participating credit unions have input in the operation (i.e., users' meetings.)

- **Recordkeeping.** The examiner should determine the records accurately reflect the financial condition of the shared branch CUSO, management accurately evaluates the costs of each separate shared branch, and the shared branch operation has reasonable and accurate records for allocating the costs and fees to the participating credit unions. The examiner should consider reviewing and testing the following items to determine the accuracy of the records:
 - Material general ledger and sub ledger accounts;
 - A sample of bank statements and reconcilements;
 - Major income and expense accounts;
 - Internal audit practices, procedures, and workpapers; and
 - Branch accounting procedures for allocating operating costs and assessing monthly fees and charges to the participating credit unions.

- **Annual audit.** The examiner should determine that the shared branch CUSO obtains annual audits. Examiners may review the most recent audit report and workpapers, including the confirmations of the member credit unions' investments, deposits, and additional paid-in-capital.

- Lending practices. The examiner should determine the type and extent of lending practices at the shared branch CUSO. Lending practices vary from one branch to another. Some shared branches only receive and forward applications to the participating credit unions for approval. Others receive loan applications, forward them to the participating credit union, and disburse the loan funds. In federal credit unions, an automated loan system, programmed to implement loan policies can approve loan applications. The automated loan system cannot deny applications; they can only refer the applications to a loan officer for lending decisions that the system's preset lending criteria would deny.

The depth of review depends on the extent of the lending practices. When the shared branch receives applications and disburses loan proceeds, but the participating credit union approves the loan, the examiner can limit the review to the controls for membership determination, document verifications, and disbursement procedures. In a shared branch CUSO for federal credit unions, shared branch staff cannot approve applications unless a loan officer is onsite. The examiner should determine that the practices and procedures used by the shared branch comply with the member credit union's individual loan policies.

- Internal controls. The examiner should review and evaluate all operating policies and procedures and determine that the shared branch has implemented complete and adequate internal controls throughout the shared branch CUSO operation. Examiners should make sufficient onsite contacts to shared branch offices to verify the standardization and consistency of the practices. When performing onsite contacts at the branches, examiners should consider reviewing the following:
 - Control of cash, money orders, traveler's checks;
 - ATM and night depository procedures and controls;
 - Access and control of passwords, keys, etc.;
 - Controls for preventing staff from performing fraudulent transactions on their own or family members' accounts at the participating credit unions;
 - Procedures for verifying membership and for becoming a member at the shared branch office;

- Procedures for safeguarding information about the member, and;
 - Contingency plans including backup systems, procedures, and authorization for member transactions when the computer is off line.
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- Insurance and surety bond coverage. The examiner should determine that the shared branch CUSO has sufficient insurance and surety bond coverage to protect the assets of the operation and limit potential loss to the participating credit unions. Examiners should review the adequacy of the bond coverage, whether on a standard bond form as seen at many credit unions or on other forms. (No regulatory requirement for minimum bond coverage currently exists for a shared branch CUSO.)

 - Information processing. Complex information processing procedures may exist at a shared branch CUSO. Processing transactions at various credit unions from one teller station requires that the shared branch employ a system commonly known as a “switch” which selects and accesses the appropriate credit union. To safeguard members' assets, the policies, procedures, and internal controls must control and limit access to authorized transactions.

If possible, the shared branch review team should include knowledgeable and qualified individuals to review the IS (i.e., an IS&T SME or IS auditor). A specialized IS review, which includes review of the system's controls and procedures, requires the examiner-in-charge to plan for and coordinate qualified team members well in advance of the review date.

Shared branch CUSO management should obtain independent, periodic, IS processing audits. The examiner should obtain a copy of the audit report and determine if management is correcting exceptions, deficiencies, and weaknesses noted in the auditor's reports, management letters or other correspondence.

- Regulatory compliance. The examiner should determine that the shared branch CUSO complies with all necessary federal and state laws and regulations.

- Review report. At the conclusion of the shared branch CUSO review, the examiner should prepare a review report. The report may take the form of a letter to the shared branch CUSO management, signed by the regional director and state supervisory authority (if applicable). The examiner maintains a field file containing the letter to the officials, all pertinent workpapers, and the confidential section. AIRES workpapers designed for credit union examinations will often not adapt to shared-branch CUSO reviews. Examiners may choose to design their own workpapers for these types of reviews.

As with any credit union examination, examiners should discuss findings with management as they discover questions or problems. Examiners should further discuss any resulting recommendations with management before issuing the final report to the officials. In the case of CUSOs involving FISCUs, examiners should follow regional policy for communicating issues to CUSO management.

References

- *NCUA Rules and Regulations*
Part 712, Credit Union Service Organizations (CUSOs)

SHARED BRANCH CUSO REVIEW PROCEDURES - APPENDIX 24B

Strategic Risk

- Review cost trends (e.g., per transaction)
- Review operational costs per transaction (e.g., increasing or decreasing)
- If costs are increasing, inquire as to whether management has alternative programs planned (e.g., emphasis on ATMs to limit labor costs)
- Review the extent of the CUSO's lending services
- Review a sample of contracts with various credit unions involved in the lending program

Transaction Risk

- Perform general ledger review
- Review accuracy of material adjusting journal entries
- Review appropriateness of the branch accounting procedures
- Inquire about contingency plans including backup systems, procedures, and authorization for member transactions when the Information System is off line
- Review Information System contracts, controls, and adequacy of output information
- Review internal controls for completeness, adequacy, and consistency throughout the shared branch network
- In the absence of an internal control function, review compensating controls (particularly in the cash area)
- If on-site contacts are performed at CUSO branches:
 - Review control of cash, money orders, travelers checks, and other negotiable instruments
 - Review ATM and night depository procedures and controls
 - Spot check teller cash reconcilements
 - Inquire about tellers' use of bait money, responsibility for this area, and frequency of bait money review
 - Review access and controls of passwords, keys, etc.
 - Inquire about controls to prevent staff from performing transactions on their own accounts and accounts of family members

- Review CUSO's loan application approval process for compliance with individual credit union's lending policies
- Review membership controls, verifications, and disbursement procedures
- Review consumer regulation compliance procedures
- Review compliance with terms and conditions of the contract

**Compliance
Risk**

- Review procedures to verify credit union membership
- Review procedures to safeguard release of information about credit union members
- Review compliance with:
 - Currency and foreign transactions
 - Posting of NCUA and/or other applicable insurance
 - Member confidentiality
 - The participating credit unions must ensure they closely monitor the activities of the shared branch CUSO operation to mitigate these risks