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January 17, 2017

SENT BY E-MAIL

RE: FOIA 17-FOI-00015

This acknowledges receipt of your Freedom of Information Act (FOIA) request to the National Credit Union Administration (NCUA) on January 3, 2017. You requested a digital/electronic copy of the following: 1) Enforcement Manual (NCUA Instruction 4820); 2) Administrative Remedies (Supervisory Letter 10-04); 3) Special Assistance Manual (NCUA Instruction 4810); and 4) NCUA Personnel Manual (table of contents only).

Your request necessitates additional time to consult among multiple NCUA components with substantial subject matter interest. 12 C.F.R. § 792.16(a)(3). Consequently, we are extending our anticipated response time to February 16, 2017. 12 C.F.R. § 792.15. You may telephone FOIA staff at 703-518-6540 or e-mail [FOIA@ncua.gov](mailto:FOIA@ncua.gov) with questions, to limit your request scope, or to discuss an alternative processing time frame. 12 C.F.R. § 792.16(c).

Sincerely,

A handwritten signature in black ink that reads "Regina Metz".

Regina M. Metz  
Senior Attorney Advisor

GC/RM:CS  
17-FOI-00015

# SUPERVISORY LETTER

NATIONAL CREDIT UNION ADMINISTRATION  
OFFICE OF EXAMINATION AND INSURANCE  
1775 DUKE STREET, ALEXANDRIA, VA 22314

**DATE:** June 2010 **Supervisory Letter No.:** 10-04  
**TO:** All Field Staff  
**SUBJECT:** Administrative Remedies

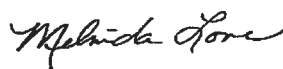
The number of problem credit unions continues to grow and the rapid rate of financial deterioration in recent cases requires NCUA to promptly and vigorously utilize all available administrative remedies and enforcement tools to ensure compliance with laws and regulations and the safety and soundness of federally insured credit unions. The failure to take decisive action to resolve problem credit unions can result in tremendous losses to the National Credit Union Share Insurance Fund (NCUSIF). We do not have the luxury of time to prolong addressing unsafe and unsound conditions.

The attached Supervisory Letter provides current guidance, a summary of our administrative remedies, and the framework for maintaining an administrative record. NCUA examiners should continue to utilize available discretionary authority to ensure credit unions follow safety and soundness principles. This will prompt credit unions to take the necessary corrective actions to decrease the risk of financial deterioration; thereby, minimizing potential risk to the membership and the NCUSIF.

NCUA's goal is not to intimidate, but to be a partner with credit unions to achieve safe and sound operations. We want to detect and resolve problems before they become insurmountable. This may include addressing safety and soundness problems that are determined through qualitative analysis versus relying on quantitative factors. To encourage corrective actions and help ensure credit union service is available to as many consumers as possible, we will increase the intensity of our administrative actions.

This letter is for "internal use only" and should not be given to credit union management. If you have any questions on this issue, please direct them to your immediate supervisor or regional management.

Sincerely,



Melinda Love  
Director, Office of Examination and Insurance



# Supervisory Letter



## Administrative Remedies and/or Enforcement Actions

Risk in the credit union industry continues to evolve and requires NCUA's ongoing evaluation of our risk monitoring and supervision procedures. NCUA's goal is not to intimidate, but to be credit unions' partner in safety and soundness. We want to detect and resolve problems before they become insurmountable. To encourage corrective actions and help ensure credit unions provide continued service to consumers, we will increase the intensity of our administrative actions.

This Supervisory Letter (Letter) emphasizes our formal and informal administrative remedies and/or enforcement actions and provides guidance for addressing risks, particularly in the current economic climate. The specific topics covered in this Letter include:

- Current principles for administrative remedies;
- Formal and informal actions available to NCUA examiners;
- Examples of situations when an action may be appropriate; and
- Guidance for building a sound administrative record.

This letter reiterates previous guidance, instructions and training to examiners regarding the administrative remedies. It also stresses the importance of communication with credit union officials and management regarding the correction of deficiencies. Credit union officials and management should have a clear understanding of the problems and focus on the material issues before they become fatal. Detailed guidance on administrative remedies and enforcement actions is contained in NCUA Instruction No. 4820, Enforcement Manual, dated September 16, 2004 and Chapter 30 of the Examiner's Guide, Administrative Actions. The appendix to this letter contains a chart to help you decide on a possible appropriate remedy.

To assure greater uniformity of action and direct supervisory efforts to credit unions most in need of them (b)(7)(E),(b)(8)

(b)(7)(E),(b)(8)

(b)(7)(E),(b)(8)

Examiners should document in the examination report confidential section and/or contact memos the:

1. Evaluation of administrative remedies;
2. Options considered for prompt resolution of the credit union's problems;
3. Pre-planned path for administrative remedies; and
4. Reason for not using an available remedy.

The documentation will become part of the administrative record and alleviate disruptions in future supervision and planned corrective actions should examiner responsibilities change. The administrative record<sup>1</sup> will provide continuity for any examiner to focus efforts on correcting deficiencies before they materially affect the credit union's financial condition.

## **Principles for Administrative Remedies**

To appropriately address a credit union's problems before they become fatal, NCUA staff should adhere to the following principles for administrative remedies.

- Maintain open communications. This includes dialogue between NCUA and credit union management and officials, and among regional staff, the Office of General Counsel and the Office of Examination and Insurance. Regions should contact the appropriate offices to discuss the facts, recommended actions, and alternatives for the case, well before a formal request for concurrence.
- Maintain open communications with the state regulator for any state-chartered credit union. The type of administrative remedy may vary depending upon the state's enforcement powers.
- Minimize the period between informal and formal actions. The lack of timely effective action by credit union officials and management must be met with quick response and elevation of the action used.

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<sup>1</sup> The administrative record is the total collection of information NCUA needs for decision-making purposes and must include sufficient documentation should administrative or legal actions become necessary.

- Determine the type of formal enforcement action based on the nature and scope of the problems, the urgency of the situation and the ability and willingness of credit union management and officials to implement appropriate corrective action. It is not necessary to wait until net worth drops to a critical level before taking administrative action. Unsafe and unsound programs can quickly deteriorate net worth levels.
- "Begin with the End in Mind."<sup>2</sup> The action must be appropriate for the desired outcome. Resolution plans should not focus on merger or liquidation, but rather a coordinated effort to rehabilitate the credit union. To ensure we implement timely actions in the event of a credit union's non-compliance, staff should develop a preplanned administrative path and maintain open communications with applicable parties.
- Verify management substantially corrects problems identified during prior examinations and contacts. A more urgent tone and/or issuing an administrative remedy may be necessary if the severity of the situation warrants.
- Prioritize problems because credit union management may be overwhelmed with the issues and not focus on the most serious problems and risks to the credit union.
- Focus on the major issues and do not allow less important concerns to detract from the priorities. It is easy to become distracted by numerous problems, failure to get necessary information and other secondary issues.
- Provide factual and accurate information. Credit union management rightfully expects correct facts. Administrative actions may be viewed as adversarial so NCUA may lose credibility when facts are inaccurate.
- Verify all documented actions are Specific, Measurable, Achievable, Results-oriented, and Timely.
- Determine and intensify supervision on increased risk ratings of moderate or high, significant variances between NCUA and SSA risk ratings, and use all data available to detect emerging risks.
- Advocate the use of formal actions (Published LUA, Cease and Desist Orders, Conservatorship) in the following situations:
  - Existence of material unsafe or unsound practices in conducting the business of the credit union;
  - The credit union poses an abnormal risk to the NCUSIF;
  - Credit union management refuses to sign a Letter of Understanding and Agreement or will not comply with a Preliminary Warning Letter;
  - Serious insider abuse involving members of senior management or the officials, whether or not it harms the credit union immediately;
  - Serious regulatory compliance problems or substantial violations of law;
  - The credit union has disregarded, refused, or been unable to appropriately respond to prior supervisory efforts to correct previously identified serious problems or weaknesses. The timeline does not have to include multiple contacts; or

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<sup>2</sup> One of the habits described in "The 7 Habits of Highly Effective People" by Stephen R. Covey.

- You cannot determine the credit union's true condition because it has refused to or cannot satisfactorily maintain its books and records, it has attempted to place unreasonable limitations on how, when, or where the examination is conducted, or it has imposed limits or restrictions on examiner access to personnel, books, and records.

## Administrative Remedies or Enforcement Actions

The administrative remedies are divided between informal and formal actions.<sup>3</sup> The list is not a step 1, 2, 3 process for resolving safety and soundness concerns. At any point, for any CAMEL rating, the following actions may be used and will depend upon the circumstances at each credit union.

Informal actions include:<sup>4</sup>

- Examination report with board resolution (Document of Resolution(DOR)),
- Regional Director Support Letter,
- Letter of Understanding and Agreement (non-published),
- Preliminary Warning Letter, and
- Regulator leverage.

Formal actions include:<sup>5</sup>

- Published Letter of Understanding and Agreement,
- Immediate and/or Permanent Cease and Desist Order,
- Civil Money Penalties,
- Involuntary Liquidation,
- Conservatorship,
- Removal and/or Prohibition,
- Termination of Insurance and/or Revocation of Charter, and
- Prompt Corrective Action related actions.

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<sup>3</sup> For additional information, examiners should refer to Regional Guides, Chapter 30 of the Examiner's Guide – Administrative Actions, and NCUA Instructions 4810 - Special Assistance Manual, and 4820 – Enforcement Manual.

<sup>4</sup> All informal actions (excluding a DOR) must be approved by the Regional Director.

<sup>5</sup> The Office of General Counsel (OGC) must be consulted on all formal actions and they must be approved as outlined in the Delegations of Authority. When considering a formal administrative action OGC should be consulted as early in the process as possible. (b)(7)(E);(b)(8)

(b)(7)(E);(b)(8)



## ***The Following Provides a Summary of the Informal Actions<sup>6</sup>***

### **Examination Report with Board Resolution (Document of Resolution)**

The report to officials must clearly prioritize conclusions and problems and address root causes of problems so that no ambiguity exists about responsibility for problems and required corrective action. The report must highlight any repeat deficiencies and non-compliance with prior commitments. Examiners must provide an accurate assessment and description of the credit union's conditions and commitments for corrective action.

### **Regional Director Support Letter (RD Letter)**

The RD Letter conveys information to the directors so they completely understand the problems, their relative severity, and the effect on the credit union if left uncorrected. The RD Letter should remain focused on the core safety and soundness issues and provide the essential foundation for any potential enforcement action. RD Letters address serious and/or persistent problems not being resolved through normal supervision.

RD Letters are appropriate when:

- Officials have failed to take agreed-upon corrective action;
- Appropriate level of NCUA supervision has been completed yet problems are not resolved;
- Officials are not meeting the terms of the Document of Resolution or Letter of Understanding and Agreement; or
- A letter will reinforce the sense of urgency on the major issues.

### **Letter of Understanding and Agreement (Non-Published)**

This bilateral document with the credit union officials itemizes agreed upon actions. The LUA will comprehensively address the areas of concern.

The agreement should:

- Detail the major areas of concern;
- Include action-oriented steps for resolution; and
- Establish reasonable benchmarks and timeframes for correction.

Any violation may serve as a basis for establishing grounds for other administrative action if the underlying safety and soundness concerns persist. Should the credit union fail to comply with the terms of the LUA and this failure constitutes a material safety and soundness violation or violation of a law or regulation, NCUA may take an enforcement action even if the LUA is not published.

### **Preliminary Warning Letter (PWL)**

This is a one-way communication from the Regional Director to the officials notifying them of specific affirmative actions they must take and/or activities they must refrain from. The letter may be used in lieu of an LUA if time is of the essence, if officials are uncooperative, or if they will not agree to sign the LUA. This letter will formally notify the officials of the intent to initiate administrative remedies. Since non-compliance with the

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<sup>6</sup> The lists and possible reasons for actions are *not* all inclusive. Examiners should consult their supervisors, regional office, or the Office of General Counsel for further information.



PWL will lead to other administrative remedies, the corrective actions outlined in the PWL should focus on correcting those problems that present risk to the NCUSIF.

### **Regulator Leverage**

This is an action to withhold or allow conditional approval as part of the approval process because of a regulatory compliance or safety and soundness issue. This tool is available when the credit union is seeking fixed asset waivers, member business loan waivers, field of membership expansions, etc. Rescinding previously approved waivers due to safety and soundness issues is considered regulator leverage.

## ***The Following Provides a Summary of the Formal Actions<sup>7</sup>***

### **Published Letter of Understanding and Agreement [Section 206(s) of the FCUA, (12 U.S.C. § 1786(s)(1)(A))<sup>8</sup>]**

The same guidelines are in place as with the non-published LUA. A published LUA is always acceptable in any factual situation where an unpublished LUA is under consideration in order to correct problems. The question of whether to utilize a published or unpublished LUA depends upon the credit union's history of cooperation with NCUA's supervision and whether the needed corrections are likely to occur if the LUA is not published. NCUA may enforce non-compliance with a published LUA by pursuing an enforcement action, such as a cease and desist order or civil money penalty, and proving noncompliance with the published letter. Note that these agreements can be drafted two ways. The first approach includes language acknowledging that the LUA will be published immediately. The second approach includes language acknowledging that the agreement will be published at the discretion of the Regional Director upon a failure by the credit union to correct specific identified problems within specified timeframes.<sup>9</sup>

### **Examples of when a Published LUA may be used**

- *The board has two factions – one supports the manager and one does not. The manager is approving loans for ineligible members because they are friends. A non-published LUA is issued and signed. The language in the non-published LUA states the Regional Director has the discretion to publish the LUA at a later date if the credit union fails to correct the required items. Despite the examiners frequent on site contacts and phone calls to individual directors, the manager continues to violate the non-published LUA. The Region publishes the LUA, which forces the board to take corrective action.*
- *The credit union has not charged off loans to members affected by a sponsor layoff two years prior to the examination. Current loan underwriting is poor with many loans approved to members with adverse credit. Recordkeeping is weak with many out of balance or delinquent general ledger reconciliations and the annual audit is late. The board is not conducting monthly meetings and the*

<sup>7</sup> The lists provided and possible reasons listed are *not* all inclusive. Examiners should consult their supervisors, regional office, or the Office of General Counsel for further information. Chapter 30 of the Examiner's Guide and NCUA Instruction No. 4820 provide detailed guidance in this area.

<sup>8</sup> These agreements are published on the NCUA website.

<sup>9</sup> See Chapter 2 of NCUA Instruction No. 4820.

*supervisory committee is not fulfilling its duties. A non-published LUA is issued and signed. The language in the non-published LUA states the Regional Director has the discretion to publish the LUA at a later date if the credit union fails to correct the required items. The board and manager are very slow to correct the items shown in the LUA. The Region publishes the LUA to prompt the board to fulfill its fiduciary responsibilities.*

- *The exam for year 2 shows the credit union did not comply with prior DOR items. A Regional Director Letter is issued within 1 month of the exam to reinforce the board of directors needs to take action. A follow up contact within 3 months shows no improvement, so an LUA is issued and published.*
- *The exam determines that the federal credit union has failed to have a supervisory committee audit that meets the requirements of Section 715 of NCUA's Rules and Regulations. The DOR requires corrective action within 45 days but an examiner contact two months after the exam indicates that the federal credit union has not taken any steps to correct the deficiency. An LUA is issued and published.*
- *XYZ FCU enters into building contracts to develop a new branch office that also includes plans for space that will not be utilized to transact credit union business. The preliminary indications are that the investment in the project may cause the federal credit union to violate the fixed asset provisions of Section 701.36 of NCUA's Rules and Regulations and create a safety and soundness problem. The federal credit union has not provided information regarding compliance with the fixed asset limitations and does not appear to have Board resolutions in place outlining definitive plans for full occupation within one year of the project's completion. An LUA is issued and published assuring compliance with the fixed asset limitation and committing the credit union's board to pass appropriate resolutions regarding occupancy of the premises upon completion.*

**Cease and Desist (C&D) [Section 206(e) of the FCUA, (12 U.S.C. § 1786(e)&(f))]**

There are two types of C&D orders, an immediate/temporary C&D and a permanent C&D. Both may be issued against any insured credit union or institution affiliated party (IAP).<sup>10</sup> Both require that an IAP or a credit union engage in (or be about to engage in) an unsafe or unsound practice or a violation of relevant law or regulation. These actions can be:

- affirmative – requiring the credit union to take certain actions, or
- prohibitive – requiring the credit union to cease certain actions or practices.

In cases involving a state-chartered credit union, either the state may issue a C&D or NCUA must provide the regulator with notice of our proposed action and a specific time for them to accomplish satisfactory corrective action. If the regulator does not complete the corrective action in the specified timeframe, NCUA may proceed with its own action.

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<sup>10</sup> An IAP can be any member, director, officer, or employee of, or agent for, an insured credit union. An IAP can be any consultant, joint venture partner, and any other person as determined by the NCUA Board who participates in the conduct of the affairs of an insured credit union. An IAP can also be any independent contractor who participates in the conduct of affairs of an insured credit union and knowingly or recklessly participates in any violation of any law or regulation, any breach of fiduciary duty, or any unsafe and unsound practice.

### **Immediate/Temporary C&D**

These are effective immediately and are issued prior to an administrative hearing when the unsafe or unsound practice, regulatory or legal violation or the continuation thereof is likely to:

1. Cause insolvency or significant dissipation of assets or earnings of the credit union; or
2. Weaken the condition of the credit union or otherwise prejudice the interests of its insured members prior to the completion of the administrative hearing and process.

They are most effective when it is necessary to prevent the continuation of any bad acts, to limit harm, or to force corrective action while the administrative process goes forward. An administrative hearing follows before the temporary C&D becomes permanent.

The document setting forth the immediate C&D will also contain a "Notice of Charges and Hearing" outlining the alleged unsafe or unsound practice or regulatory or legal violation. The document is effective immediately upon service but the statute allows for immediate challenge of the C&D Order in U.S. District Court.

### **Permanent C&D**

A permanent C&D may be issued upon consent of the credit union or IAP or after the completion of the administrative hearing and any judicial review.

### **Possible Reasons for Cease and Desist orders**

A C&D may be used to address violation of law, regulation, or a published LUA as well as to correct unsafe and unsound business practices. Generally, this administrative action is most effective in addressing specific acts or omissions rather than systemic problems in an institution. For example, a C&D may be appropriate if a credit union or IAP is:

1. Engaging in or has engaged in, or the examiner has reasonable cause to believe that the credit union or the persons involved are about to engage in, an unsafe or an unsound practice in conducting the business of the credit union.
2. Violating or has violated, or the examiner has reasonable cause to believe that the credit union or persons involved are about to violate a law, a rule, a regulation, any condition imposed in writing by the NCUA Board, or any written agreement entered into with the NCUA Board, as long as the agreement has been published in accordance with Section 206(s) of the FCU Act (12 U.S.C. § 1786(s)).

### **Example of when a C&D may be used**

- *ABC Federal Credit Union converts to a new data processing system without understanding the general ledger account mapping in the new system. ABC proceeds to incorrectly post daily work to the wrong general ledger accounts. Six months later, ABC has an out of balance condition in its corporate bank account totaling 50 percent of total assets. During the 6 months, the CFO has been unable to produce financial statements for the board and the most recent corporate reconciliation is 40 pages long and 4 months old. Two thirds of the*

*general ledger accounts are not reconciled. When the board asks for progress updates, the CEO repeatedly states, "we are working on it." There is no discussion about hiring a third-party to assist in correcting the out of balance condition and the CEO has no sense of urgency to correct the problem. ABC cannot accurately determine its financial condition or net worth ratio. NCUA issues an Immediate Cease and Desist order to compel the board to take immediate action to correct the out of balance condition and determine ABC's true financial position.*

**Civil Money Penalties [Section 206(k)(2) of the FCUA, (12 U.S.C. § 1786(k)(2))]**

The Federal Credit Union Act specifies three tiers of civil money penalties. The NCUA Board may assess civil money penalties against either a credit union or an institution-affiliated party. Any penalties are paid to the U.S. Treasury. Determination of an appropriate amount for a civil money penalty may only be made after consideration of the mitigating factors set forth in Section 206(k)(2)(G) of the FCUA, 12 U.S.C. § 1786(k)(2)(G).

1. First tier. Any credit union or institution-affiliated party that violates a law or regulation, a final order of the NCUA Board, a published agreement with the Board (such as a published LUA), or a condition imposed in a published writing by the Board in connection with the granting of any application (such as the Insurance Agreement), may receive a penalty of not more than \$5,000 for each day of the violation. First tier penalties may apply to credit unions that, even after warnings, repeatedly submit late or substantially inaccurate call reports.
2. Second tier. If the credit union or institution-affiliated party commits a first tier violation, and exhibits reckless conduct or a breach of fiduciary duty, and the violation, practice or breach is part of a pattern of misconduct, or causes more than a minimal loss to the credit union, or results in a monetary gain or other benefit to the institution-affiliated party, then the NCUA Board may assess a civil money penalty of not more than \$25,000 per day for each day of the violation.
3. Third tier. Any credit union or institution-affiliated party that knowingly commits a first tier violation, knowingly engages in unsafe or unsound practices, knowingly breaches any fiduciary duty, or knowingly or recklessly causes a substantial loss to the credit union or a substantial monetary gain or other benefit to a party because of the violation, breach, or practice, may be assessed a civil money penalty of not more than \$1,000,000 per day for each day of the violation, or in the case of a credit union, 1 percent of assets, whichever is less.

**Examples of when a civil money penalty may be used**

- *ABC Federal Credit Union failed to file its annual Home Mortgage Disclosure Act reports in the required timeframes. The NCUA Board determines grounds exist to assess civil money penalties. To avoid the time and expense of administrative litigation, ABC consents to an "Order of Assessment of Civil Money Penalty."*

- *ABC Federal Credit Union has repeatedly filed its quarterly 5300 reports after the filing deadlines. The NCUA Board determines grounds exist to assess civil money penalties.*

**Conservatorship [Section 206(h) of the FCUA, (12 U.S.C. § 1786(h)(1))]**

The NCUA Board may impose a conservatorship on any insured credit union. In the case of a state-chartered institution, the state regulator must be notified and given 30 days to provide a written approval of the proposed action. If the state regulator disagrees, the NCUA Board may proceed after the 30-day period only by unanimous vote. Some state regulators may place state chartered credit unions into conservatorship pursuant to state law.

Generally, this authority is most effective where problems are systemic, we have lost confidence in the board and management or when a quick action is required. A Conservatorship Order is effective immediately upon service. It provides immediate possession and control of all books and records as well as the operation of the institution. A Conservatorship Order may be challenged in U.S. District Court within 10 days of issuance.

**Possible Reasons for a Conservatorship**

- To conserve the credit union's assets;
- To protect the NCUSIF;
- To protect the interest of the insured members;
- By resolution of the credit union board of directors;
- Willful violation of a Final Cease and Desist Order;
- Concealment of or refusal to make available the books and records for inspection by an examiner or lawful agent of the NCUA Board;
- Notification by the Attorney General that the credit union has been found guilty of certain criminal provisions;
- Classification of the credit union as *significantly undercapitalized* with no reasonable prospect of becoming *adequately capitalized* (PCA Conservatorship); or
- Classification of the credit union as *critically undercapitalized* (PCA Conservatorship).

**Example of when a conservatorship may be used**

- *Poor underwriting, lack of monitoring, lack of appropriate due diligence, unsafe risk mitigation controls and stress in the local real estate market cause delinquency in ABC Federal Credit Union's construction and development loan (CDL) portfolio to increase by 200 percent in 18 months. Management does not have sufficient access to third party permanent financing for the CDL loans. Foreclosures are rapidly increasing. ABC initiates a poorly conceived workout program leading to higher delinquency and losses. The primary source of funds for the CDLs is either in high cost, large deposits (uninsured shares) or borrowings. The provider of the borrowings closes the line of credit as ABC's financial situation deteriorates. ABC management terminates the excess share insurance coverage further exacerbating liquidity concerns as the large balance*

*depositors begin withdrawing funds. NCUA guarantees a line of credit so ABC may continue to operate. Management does not comply with an LUA or PWL and cannot demonstrate an ability to operate the credit union safely and soundly. NCUA places ABC into conservatorship.*

**Removal and Prohibition of an Official** [Section 206(g) of the FCUA, (12 U.S.C. § 1786(g))<sup>11</sup>]

It may become necessary to initiate a formal removal action when a breach of fiduciary duty occurs on the part of a director, officer, or committee member and when the credit union's board will not or cannot discharge the responsible person and when that person does not voluntarily resign. A removal or prohibition of an individual may be issued based upon conviction of certain offenses, upon consent, or after the completion of the administrative hearing and any judicial review.

**Possible Reasons for Removal and Prohibition**

Removal or prohibition of an official requires that person to directly or indirectly violate, engage in, or commit one of the following:

- Statute or regulation;
- Provision of a Final C&D Order;
- Any published written agreement between the NCUA Board and the credit union;
- Any condition imposed in writing by the NCUA Board related to granting any application or request by the credit union (e.g. application for insurance or 208 Assistance);
- Any unsafe or unsound practice related to the credit union; or
- Any act, omission, or practice constituting a breach of fiduciary duty.

And their violations or actions either:

1. Involved personal dishonesty; or
2. Demonstrated their unfitness to participate in the credit union's affairs.

And their actions resulted in at least one of the following:

1. The credit union has or will suffer financial loss or other damage;
2. The interests of the members have or could be prejudiced; or
3. The party receives financial gain or others benefit because of the violation, practice, or breach.

**Examples of when a removal or prohibition may be used**

- *A former credit union manager is convicted of fraud in connection with his employment at the credit union. (18 U.S.C. § 1006) The former manager is sentenced to prison, followed by supervised probation and is ordered to pay restitution. Because there is a conviction related to a criminal offense involving dishonesty or a breach of trust, the prohibition is established by the Federal Credit Union Act.<sup>12</sup>*
- *A credit union manager provides loans to himself and family members that are outside of established lending policies and without notification to the credit union's Board of Directors. The loans are also at favorable rates and*

<sup>11</sup> These actions are posted on the NCUA website.

<sup>12</sup> It is not a requirement there is a criminal conviction prior to proceeding with a prohibition.

*subsequently a number of them become delinquent and the credit union suffers losses. The manager refuses to resign and the Board refuses to terminate the individual. For a variety of reasons, including limited resources, there is no criminal prosecution.*

**Involuntary Liquidation** [Section 120(b)(1) and Section 207(a) of the FCUA, (12 U.S.C. §§ 1766(b)(1) and 1787(a))] Section 120(b)(1) should be used only in cases involving federal credit unions that are not insolvent. Liquidation of a solvent federal credit union under this section requires completion of an administrative hearing and possible judicial review. Section 207(a) is available in cases involving insolvent federal credit unions. An order placing an insolvent federal credit union into involuntary liquidation pursuant to this section is effective immediately upon service but may be challenged in federal district court with 10 days.

**1. Involuntary Liquidation of an Insolvent Federal Credit Union**

A credit union will be determined insolvent<sup>13</sup> when the total amount of its shares exceeds the present cash value of its assets after providing for liabilities unless:

- a) The NCUA Board determines the facts causing the deficient share-asset ratio no longer exist; and
- b) The likelihood of further depreciation of the share-asset ratio is not probable; and
- c) The return of the share-asset ratio to its normal limits within a reasonable time for the credit union concerned is probable; and
- d) The probability of a further potential loss to the insurance fund is negligible.

**2. Involuntary Liquidation of a Solvent Federal Credit Union**

Possible reasons include:

- a) Abandonment of the credit union's operations and affairs by the officials.
- b) Plant closure and officials' refusal to vote to present the question of liquidation to the members. Such plant closure may force insolvency under the concept of a going concern or may cause a dissipation of the assets and expose the creditors and the NCUSIF to a greater than normal risk.
- c) Other specific serious violations of its charter, its bylaws, the FCU Act, or regulations that cannot be reversed and may cause insolvency.
- d) Serious operational deficiencies the officials have not acted to correct and which, if allowed to continue, may cause insolvency.

**Example of when an involuntary liquidation may be used**

- *Following a tip from external sources, the NCUA initiates a surprise contact at ABC Federal Credit Union. There is strong evidence the manager is maintaining two sets of books, since non-member deposits are not reported on the quarterly 5300s. ABC's board suspends the manager and cooperates fully with NCUA by initiating a fraud audit and account verification. The audit determines that the manager has embezzled significant amounts of cash over a period of years and that the due dates on numerous loans have been advanced hiding a significant*

<sup>13</sup> NCUA Rules and Regulations § 700.2(e)



*amount of delinquency which requires significant charge-offs. Together these activities render the credit union insolvent with no hope of restoring solvency in the future. NCUA issues an Order of Involuntary Liquidation and quickly facilitates a Purchase & Assumption transferring shares and member accounts to another credit union.*

**Termination of Insurance and Revocation of a Charter [Section 206(b)(1) of the FCUA, (12 U.S.C. § 1786(b)(1))]**

**Possible Reasons for Termination of Insurance**

1. Unsafe or unsound practices or conditions; or
2. Violation of a law, rule, regulation, any condition imposed in writing by the NCUA Board, or any written agreement entered into with the NCUA Board.

**Example of when a termination of insurance and revocation of a charter may be used**

- *ABC Federal Credit Union has been convicted of money laundering (18 USC § 1956) and all the officials and manager knew of the money laundering scheme. One of the directors was the mastermind of the scheme and convinced the others they would never be caught. The US Attorney General notifies the NCUA Board of the conviction. The NCUA Board follows required notification and judicial review procedures for revoking ABC's charter. The NCUA Board also determines there are several area credit unions with overlapping fields of membership. Due to the conviction and the involvement of all the management officials, the NCUA Board terminates insurance coverage and revokes ABC's charter.*

**Prompt Corrective Action Related Actions [Section 216 of the FCUA, (12 U.S.C. § 1790d)]**

Depending on the credit union's Prompt Corrective Action (PCA) classification, certain restrictions and actions are automatically imposed by operation of law. Congress mandated that NCUA follow the strict statutory timeframes of PCA to help reduce the risk of loss to the NCUSIF.<sup>14</sup> The specific details surrounding the procedures that are applicable in situations requiring prompt corrective action are set forth in Part 702 of NCUA's Rules and Regulations. PCA includes two types of supervisory actions: mandatory supervisory actions and discretionary supervisory action. Staff should be familiar with all agency issued PCA related guidance.<sup>15</sup>

**Examples of when a prompt correction action may be used**

- *ABC Federal Credit Union is critically undercapitalized (Net Worth less than 2 percent) and \$50 million in assets. ABC prepares a Net Worth Restoration Plan (NWRP) which shows net worth will rise above 2 percent within 90 days and continue to increase over the next three years. Rather than place the credit*

<sup>14</sup> Refer to the Delegations of Authority for approval and concurrence requirements.

<sup>15</sup> Part 702 of the Rules and Regulations, NCUA Instruction No. 3501.01, Discretionary Supervisory Actions (DSAs) under Prompt Corrective Action (PCA) dated April 15, 2003, Examiners Guide Chapter 17, etc.

*union into conservatorship or liquidate within 90 days, the NCUA Board approves Other Corrective Action to allow ABC to operate under the NWRP.*

- *ABC Federal Credit Union has 4.5 percent net worth (Undercapitalized). ABC has submitted two Net Worth Restoration Plans for approval, but NCUA has rejected both plans. ABC is the sole owner of a mortgage origination CUSO which has lost money since ABC purchased it seven years ago. The CUSO's most recent net loss dropped ABC's net worth from 6.0 percent to 5.0 percent. Since the proposed NWRP does not indicate ABC intends to make any changes to the CUSO's operations, NCUA requires ABC to divest the CUSO.*
- *ABC Federal Credit Union has 3.0 percent net worth (Significantly Undercapitalized). The ABC board recently terminated the long time CEO for lack of prudent decisions to restore net worth. Rather than searching for a qualified CEO, the ABC board promotes the Chief Operating Officer to the CEO position. The COO has never managed a credit union or other financial institution and was just recently promoted to the COO position from the VP Branches position. NCUA determines the COO is not qualified to manage a troubled financial institution and requires the ABC Board to employ a qualified CEO.*

## **Establishing the Administrative Record**

Developing the administrative record for an enforcement action is an essential part of the NCUA's supervision process. In many cases, the documentation starts before you know the enforcement action will be necessary. Several examiners, subject matter examiners, analysts, specialists, and problem case officers may be involved in building the administrative record.

Staff may develop the administrative record over several periods or even years of supervision or in a relatively short period. It is important to document material information to support enforcement action, if necessary. Information that is not documented is much harder to include in the administrative record. The time necessary to maintain a good administrative record may appear to conflict with the risk focused examination process; however, the responsibility for a good administrative record falls primarily on the field examiner. The examiner must use considerable judgment to determine the documentation necessary to support possible future action.

The administrative record is the total compilation of information NCUA needs for decision-making purposes. Therefore, the record should present a complete, factual, and documented history of the credit union's problems and the attempts by NCUA and the credit union to resolve them.<sup>16</sup>

The examiner, the supervisory examiner, and the Division of Supervision are all involved with the development of the administrative record.<sup>17</sup> The record should indicate the attempts to correct problems without adequate corrective actions. The

<sup>16</sup> Examiner's Guide, Administrative Record, page 1-27 and Administrative Actions page 30-3

<sup>17</sup> Examiner's Guide, Examination Evaluation and Review Policy, pages 22-2 and 22-3

unresolved problems should be documented in each contact report. In some cases, there may only be one documented contact if the issue is material enough to threaten the credit union's viability.

Each exam or supervision contact must document any agreements reached with management and any lack of progress on previous agreements with management. The reports should contain a clear concise description of the problem from its inception or identification.

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## **Conclusion**

This Supervisory Letter stresses the importance and proper utilization of the available administrative remedies and provides suggested guidelines for assembling the administrative record. It is not intended as a template for supervising a credit union. The administrative remedy and the content of the record vary greatly and are dependent on the credit union's activities. Each problem case has unique attributes. The type of action and documentation requirements necessitates examiner judgment and open communication with all involved parties.

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Withheld pursuant to exemption

(b)(7)(E):(b)(8)

of the Freedom of Information and Privacy Act