



National Credit Union Administration
Office of Examination and Insurance

November 21, 2019

SENT BY FEDERAL EXPRESS AND EMAIL

XXXX
President and Chief Executive Officer
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Dear XXXX:

This letter responds to your October 18, 2019, request for review by the Director of the Office of Examination and Insurance (“E&I”) of the denial for concurrence on your credit union’s \$XXXX million secondary capital request. The Regional Director for the XXXX Region (Region) denied concurrence with the state of XXXX (SSA) secondary capital approval on July 22, 2019, and denied concurrence on a subsequent request for reconsideration on September 18, 2019.

On October 23, 2019, you provided a certification from your board of directors authorizing the credit union’s request for E&I’s review. This request, pursuant to 12 C.F.R. §746.106, allows a credit union to seek my review of a written material supervisory determination by a program office. Specifically, you are seeking my concurrence for your \$XXXX million secondary capital request as outlined in your August 19, 2019, request for reconsideration.

As discussed more fully below, I am denying concurrence on your \$XXXX million secondary capital plan.

Background

On January 11, 2019, XXXX Credit Union (credit union) submitted a secondary capital plan to the SSA and the Region, requesting approval to accept \$XXXX million in secondary capital accounts. The Region denied the request on February 25, 2019, and affirmed that denial upon reconsideration on April 24, 2019. The credit union appealed the Region’s denial to the Supervisory Review Committee (SRC) on May 17, 2019. On June 4, 2019, the Region rescinded its prior denials after determining the matter required prior action by the SSA. On June 5, 2019, the SRC dismissed the credit union’s appeal for lack of jurisdiction. On July 1, 2019, the credit union appealed the SRC’s dismissal to the NCUA Board, and on July 18, 2019, the NCUA Board affirmed the SRC’s decision and dismissed the appeal without prejudice.¹ On July 26, 2019, the SSA approved the credit union’s secondary capital plan to accept accounts the amount

¹ A dismissal “without prejudice” allows a new suit to be brought on the same cause of action. *See Without Prejudice*, Black’s Law Dictionary (4th ed. rev. 1971).

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November 21, 2019

Page 2

of \$XXXX million; however, the Region denied concurrence with the SSA's approval of the credit union's \$XXXX secondary capital plan, based on the following three deficiencies:

- *“Lack of comprehensive analysis of the credit union’s ability to repay the secondary capital (Section 701.34(b)(91)(iii)).”*
- *“Lack of information on how the planned use of the secondary capital conforms to the credit union’s strategic plan, business plan, and budget (Section 701.34(b)(1)(v)).”*
- *“Lack of detailed pro-forma financial projections (Section 701.34(b)(1)(v)).”*

On August 19, 2019, the credit union submitted a request for reconsideration on the Region's concurrence denial, which the Region affirmed upon reconsideration, on September 18, 2019, based on the following deficiencies:

- *“The additional information you provided indicates you no longer plan to use Federal Home Loan Bank (FHLB) borrowings to highly leverage the balance sheet to purchase Collateralized Mortgage Obligations (CMOs). You made major changes in key components of the original secondary capital plan (Plan) submitted January 11, 2019. You lowered the requested amount of secondary capital from \$XXXX million to \$XXXX million dollars. Additionally, both the deployment of secondary capital funds and the use of leveraging are vastly different from the original Plan.*

You addressed some of my previous concerns in your reconsideration request; however, some of my initial concerns remain. In addition, I have new concerns with the three new options provided for reconsideration.

- *Lack of Detailed Pro-Forma Financial Projections (Section 701.34(b)(1)(v))*
- *Inadequate Liquidity Risk Assessment (Section 701.34(b)(1)(iii))*
- *Inadequate Support for Key Assumptions Used in the Plan (Section 701.34(b)(1)(v))*
- *Inadequate Interest Rate Risk Assessment (Section 701.34(b)(1)(iii))*
- *Inadequate Exit or Stop-Loss Strategy (Section 701.34(b)(1)(iii))*
- *Inadequate Support for Operating Expenses (Section 701.34 (b)(1)iv) and Section 701.34(b)(1)(v)).”*

Discussion

Pursuant to the NCUA's regulations, 12 C.F.R. § 746.106, the Director of E&I has jurisdiction to review a program office's material supervisory determination, if the request for review was preceded by a request for reconsideration with the program office, and filed within 30 days of a response from the program office. The NCUA's regulations define a "material supervisory determination" as a written decision by a program office that may significantly affect the capital, earnings, operating flexibility, or that may otherwise affect the nature or level of supervisory oversight, of an insured credit union, 12 C.F.R. § 746.103(a). Your request for review was timely and met the definition of a material supervisory determination because the Region's decision has a significant impact on the credit union's operating flexibility and capital.

Following the receipt of your request, my staff reviewed the information provided, as well as additional information requested from the Region and the SSA.

The Region expressed concern with the three separate pro-forma projections, one for each of the three separate options to deploy the secondary capital, included in your request for reconsideration. Your request for reconsideration failed to identify which plan the credit union anticipated deploying.

Your request for E&I Director review contained additional information, which helped address some of the deficiencies noted in the Region’s earlier secondary capital plan denial. However, you developed some of this information *after* the Region’s concurrence denials. Specifically, you indicate your plan is now to accept the secondary capital over a three-year period and lend it back to other credit unions. Both planned receipt of the funds and use of the funds changed materially between the request for reconsideration and the request for the E&I Director’s review. Further, review of the pro-forma projections contain material changes as summarized below.

Loan Growth	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
August 19, 2019 Reconsideration	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
October 17, 2019 E&I Review	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
Share Growth	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
August 19, 2019 Reconsideration	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
October 17, 2019 E&I Review	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX

As part of E&I’s review of your appeal, § 746.106 requires a credit union to submit to the Director of E&I, “Any evidence relied upon by the insured credit union that was not previously provided to the appropriate program office making the material supervisory determination.” However, the additional information you submitted, as noted above, did not exist or had not been determined at the time of the Region’s concurrence denials, so your credit union could not have relied upon it in concluding the Region erred in its determination.

Further, the Region did not have an opportunity to request or consider this evidence, since it did not exist at the time. Therefore, I am only considering the evidence provided to the Region and other documentation you provided, or that my office requested in considering this appeal, that existed at the time of the Region’s concurrence denials. If you want the agency to consider the information developed after the Region’s concurrence denials you must then reapply to the SSA for approval and to the Region for concurrence.

Additionally, I note your secondary capital plan continues to contain deficiencies. Your plan does not contain sufficient detail on the deployment of secondary capital and associated pro-forma projections and underlying assumptions. For example, your loan growth projections require further support. You project robust loan growth in the credit union’s credit card and commercial loan portfolios. Senior management at the credit union indicated, when speaking to

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November 21, 2019

Page 4

my staff, the credit union is utilizing the services of a credit union service organization (CUSO) to generate the commercial loan growth. However, the plan does not sufficiently support that the credit union has the expertise to manage this relationship and the risk associated with commercial lending. Also, your plan does not include sufficient information regarding how the credit union will safely achieve such extraordinary credit card loan growth given the competitiveness of this market.

Based on the information provided in your January 2019 secondary capital request, your request for reconsideration, and the information that would have been available to the Region that was included in your E&I review request, I cannot fully assess the safety and soundness of your plan.

Decision

For the reasons noted above, my decision is to affirm the Region's denial for concurrence on your \$XXXX million secondary capital request.

To the extent you intend to reapply, I recommend you address the deficiencies discussed above and submit a new secondary capital plan to the SSA and the Region. In addition, you should include in any revised secondary capital plan the additional information you provided in your request for E&I review addressing stress testing and stop-loss strategy. You should also ensure, in the event you choose to reapply, that your strategic initiatives, secondary capital plan and pro-forma projections are in alignment. I encourage you to engage in a dialogue with the SSA and the Region in developing any revised request.

Pursuant to NCUA's regulations, 12 C.F.R. §746.107, you may appeal this decision to the Supervisory Review Committee within 30 calendar days of receipt of this letter. Such an appeal must follow the requirements of the regulation, and must be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428. Please refer to Part 746 for additional information regarding the required contents of an appeal.

Sincerely,

Larry Fazio
Director
Office of Examination and Insurance

cc: Board Chairperson XXXX
Regional Director XXXX
Board Secretary Poliquin
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