NATIONAL CREDIT UNION ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

LESSONS LEARNED –
SUCCESSFUL OUTCOMES WITH CREDIT UNIONS
EXHIBITING SUPERVISORY CONCERNS

Report #OIG-14-07

April 3, 2014

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ACRONYMS AND ABBREVIATIONS

C&D	Cease and Desist Order
CAMEL	[C]apital Adequacy, [A]sset Quality, [M]anagement, [E]arnings, and [L]iquidity/Asset-Liability Management
CEO	Chief Executive Officer
DOR	Document of Resolution
DSA	Division of Special Actions
EIC	Examiner in Charge
HELOC	Home Equity Line of Credit
LUA	Letter of Understanding and Agreement
MBL	Member Business Loan
NCUA	National Credit Union Administration
OIG	Office of Inspector General
PWL	Preliminary Warning Letter
RDL	Regional Director Letter
SSA	State Supervisory Authority

EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted this self-initiated audit to help NCUA in the supervision of credit unions moving forward. The objective of this audit was to identify lessons learned from NCUA cases where specific corrective actions helped revitalize credit unions exhibiting supervisory concerns. To accomplish our objective, we interviewed NCUA regional management and staff. We also obtained and reviewed NCUA guidance, policies, procedures, and other available information addressing credit unions experiencing supervisory concerns. In addition, we judgmentally selected from each of NCUA's five regions two credit unions where corrective actions helped revive the credit unions.[1] Furthermore, we identified and discussed the supervisory concerns at the ten credit unions.

We determined examiners and regional staff used various informal and formal actions that were instrumental in helping credit union management to correct the various supervisory concerns. Specifically, with each of the credit unions, examiners increased their supervision with more frequent onsite visits and offsite monitoring such as follow-up telephone calls and financial report reviews; examiners issued Documents of Resolution (DORs) at each credit union in an effort to help correct the problems; and with credit unions where increased supervision and DORs did not suffice, regional staff issued Regional Director Letters, Letters of Understanding and Agreement, a Preliminary Warning Letter, and a Cease and Desist order.

In addition, we determined that NCUA regional management and staff worked closely with credit union management and staff to revive the credit unions. We also determined that with credit unions where management was initially resistant, examiners had to work diligently to convince management of the findings and guidance regarding emerging issues. Furthermore, we determined that regional staff used uncommon approaches with some of the credit unions to address supervisory concerns.

We believe the positive outcomes regions experienced with the credit unions were the result of examiners identifying the issues early and taking the necessary administrative actions. We also believe regional staff taking the time to build positive relationships and their diligent efforts to communicate with credit union management helped ensure management's cooperation and played a major role in overcoming the supervisory concerns. Accordingly, we are not making any formal recommendations at this time.

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

[1] We sampled 10 credit unions exhibiting supervisory concerns.

BACKGROUND

NCUA is an independent federal agency that regulates, charters, and supervises federal credit unions. NCUA has five regional offices and the Office of National Examinations and Supervision where field staff regularly examine federally insured credit unions to help ensure safe and sound operations. Accordingly, regional management and staff routinely make critical decisions on credit unions exhibiting supervisory concerns. These decisions result in intervening actions intended to revive or reduce losses at the credit unions.

For credit unions exhibiting supervisory concerns, NCUA has various methods to help resolve issues. One of the first actions examiners can take is to increase supervision and monitoring of credit unions through frequent onsite and offsite contacts. Also available to examiners are administrative remedies, which include informal and formal actions that focus special attention on the problems or weaknesses and requires corrective action by credit union officials and management. All informal actions, except for the Document of Resolution, require the Regional Director's approval. Formal actions are authorized or mandated by statute, are generally more severe, and may be disclosed to the public. In addition, the NCUA Office of General Counsel must be consulted on all formal actions, and the actions must be approved as outlined in the Delegations of Authority.

Informal Actions

<u>Document of Resolution (DOR)</u> – Outlines the problem(s) identified and corrective action plan(s) that represent agreements reached with credit union officials to correct problems of the highest priority and concern arising from the examination or supervision contact. The DOR identifies persons responsible and timeframes for corrective action(s).

<u>Regional Director Letter (RDL)</u> – Is a tool to use when a credit union has serious and/or persistent problem areas not being resolved through field supervision alone. Examiners will ensure they fully address the issues through the examination process first, but a letter from the Regional Director is an option to further emphasize the areas of concern.

<u>Non-Published Letter of Understanding and Agreement (LUA)</u> - Lists the credit union's specific material problems and the agreed upon corrective actions necessary to resolve the problems. Regional offices sometimes use non-published LUAs as informal administrative actions. The LUA demonstrates to the credit union officials that the problems are of a major concern to NCUA and formally requests that the officials agree to the listed actions in lieu of NCUA taking formal administrative action.

<u>Preliminary Warning Letter (PWL)</u> - Is a warning of potential formal administrative action if corrective action is not taken. The Regional Director issues a PWL when a credit union's problems are serious and/or persistent and a credit union's board is unwilling to sign an LUA.

Formal Actions

Published Letter of Understanding and Agreement – Is the same as a non-published LUA; however, a published LUA is a formal administrative action. (See Non-Published LUA description under Informal Actions)

Cease and Desist Order (C&D) - Normally requires the credit union to stop violating a relevant law or regulation or unsafe or unsound activities which caused or are likely to cause more than a minimal financial loss to, or have a significant adverse effect on the insured credit union.

Civil Money Penalties - May be assessed against either a credit union or an institution-affiliated party that violates a relevant law or regulation or any final or temporary order. Under certain circumstances, NCUA may also assess fines for violations of regulatory reporting requirements and breaches of fiduciary duty.

Removal – Allows the removal of credit union directors, officers, or committee members for an action or omission which constitutes a breach of fiduciary duty and involves personal dishonesty or demonstrates unfitness to serve when the credit union's board will not or cannot discharge the responsible person and that person does not voluntarily resign.

Prohibition - Stops any institution-affiliated party such as a former credit union official, from participating in the affairs of a federally-insured financial institution.

Conservatorship – Allows NCUA to take immediate possession and control of the credit union's business, assets and operations until the credit union is: (1) able to resume business on its own; (2) transferred to a state authority's possession and control in the case of a federally insured state-chartered credit union; (3) liquidated; (4) merged with another institution; or (5) declared insolvent.

CAMEL Rating System

Examiners use the CAMEL[2] Rating System to assign a CAMEL rating to the credit union at the conclusion of an examination. The CAMEL Rating System provides a consistent assessment of a credit union's financial condition and operations. The CAMEL rating includes consideration of key ratios, supporting ratios, and trends. CAMEL ratings range from a 1 (the highest rating) to a 5 (the lowest rating). Credit unions with a composite CAMEL code 3 rating exhibit some degree of supervisory concern in one or more of the component areas. CAMEL code 4 credit unions generally exhibit unsafe and unsound practices or conditions, and CAMEL code 5 credit unions exhibit extremely unsafe and unsound practices and conditions.

[2] The acronym CAMEL is derived from the following components: [C]apital Adequacy, [A]sset Quality, [M]anagement, [E]arnings, and [L]iquidity/Asset/Liability Management. The CAMEL ratings disclosed in this report refer to the overall composite CAMEL rating examiners assign a credit union and not the individual component ratings.

OBJECTIVE, SCOPE AND METHODOLOGY

To help NCUA in the supervision of credit unions moving forward, the objective of this audit was to identify lessons learned from NCUA cases where specific corrective actions helped revitalize credit unions exhibiting supervisory concerns. To accomplish our objective, we interviewed NCUA regional management and staff. We obtained and reviewed NCUA guidance, policies, procedures, and other available information addressing credit unions experiencing supervisory concerns. In addition, we reviewed ten credit unions[3] where corrective actions helped revive the credit unions.[4] Furthermore, we identified and documented the supervisory concerns at the ten credit unions. Appendix A contains our summary of the supervisory concerns at each credit union. Appendix B provides an overview of the status of each credit union.

We used computer-processed data from NCUA's Automated Integrated Regulatory Examination Software (AIRES). We did not test controls over this system. However, we relied on our analysis of information from management reports, correspondence files, and interviews to corroborate data obtained from these systems to support our audit conclusions.

We conducted this performance audit from June 2013 through April 2014 in accordance with generally accepted government auditing standards 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. Furthermore, we provided NCUA management officials a discussion draft of this report and included their comments where appropriate.

PRIOR AUDIT COVERAGE

NCUA OIG has not conducted any prior audits within the past five years related to this subject.

[3] We judgmentally selected two credit unions from each of the five regions.
[4] Revived credit unions were credit unions that examiners downgraded to a composite CAMEL 3, 4, or 5 due to supervisory concerns; however, subsequent intervening actions resulted in examiners upgrading these credit unions to a composite CAMEL 1 or 2.

RESULTS IN DETAIL

We determined that regional management and staff actions were instrumental in persuading credit union management to overcome supervisory concerns. We also determined that credit union management cooperation was essential in resolving many of the issues; however, in some instances examiners had to be persistent to convince credit union management that the problems existed. Finally, we determined that regional staff employed uncommon methods to successfully address some of the issues.

Examples of Lessons Learned

NCUA Staff and Credit Union Management Worked Together to Resolve Issues

NCUA regional management consistently stressed that constant communication and involvement by regional staff and the cooperation of credit union management were key to correcting the problems within the credit unions. Regional management also stated that they allowed field staff necessary time to work with credit union management, which facilitated resolving the issues. The following are cases where we determined NCUA management and staff and credit union management and staff worked together to revive the credit union or reduce losses to the share insurance fund:

<u>Credit Union 1</u>

Examiners identified multiple problems during the September 30, 2008 examination of this credit union. Specifically, examiners determined that the credit union experienced an increase in delinquencies and charge-offs primarily related to real estate loans; high credit risk; weak earnings; declining net worth; and expected continued loan losses. Accordingly, examiners downgraded the credit union’s composite CAMEL to 3. Examiners also increased onsite contacts, performed monthly financial reviews and issued multiple DOR items to help address the problems. In addition, regional management indicated that DOR progress was closely tracked by credit union management and NCUA field staff. Regional management attributed the successful resolution to examiners identifying the problems early on and obtaining the chief executive officer’s (CEO) buy-in that the problem resolution actions were necessary and realistic. Furthermore, credit union management was receptive to NCUA's guidance and recommendations and established attainable earnings goals. Ultimately, credit union management cooperation and field staff actions resulted in improved financial performance, subsequently resulting in examiners upgrading the credit union to a composite CAMEL 2 during the September 30, 2011 examination.

<u>Credit Union 2</u>

During the March 31, 2008 examination of this credit union, examiners determined that inefficient operations; inadequate loan policy and procedures; and weaknesses in loan underwriting led to high credit risk. Accordingly, examiners issued a DOR that targeted the issues and downgraded the credit union's composite CAMEL rating from 2 to 3 and the Earnings component to 5. Additionally, regional management transferred the credit union to its Division of Special Actions (DSA). DSA staff performed frequent onsite contacts and monthly offsite monitoring of board minutes and financial trends; provided weekly liquidity updates to the regional office; and reported the credit union's status on the region's monthly management report. However, a continued decline in the credit union's asset quality; ongoing planning, budgeting and member business loan (MBL) policy weaknesses; and regulatory violations resulted in the examiners further downgrading the credit union's composite CAMEL to 4 during the examination effective December 31, 2009. Consequently, regional staff continued the frequent onsite contacts and offsite monitoring as well as revising the DOR to include corrective actions for the additional issues uncovered during subsequent examinations.

Regional management indicated that in response to examiner concerns, the credit union board replaced the CEO and other top management positions. The new credit union management team helped identify and develop programs to offset loan losses such as closing branches and reducing staff. In addition, the management team and regional staff worked on strategic plans together and developed positive working relationships. For instance, credit union management brought regional staff in early on during the decision process, valued NCUA input and listened to regional staff. Both parties engaged in regular and constant communication, such as weekly updates during the first six months. Ultimately, the management team changed the culture of the credit union by emphasizing membership growth over asset growth, and as conditions improved, examiners upgraded the credit union's composite CAMEL rating to 3 during the September 30, 2010 examination and then to a CAMEL 2 during the March 31, 2013 examination.

<u>Credit Union 3</u>

During the March 31, 2008 examination of this credit union, examiners determined that management did not establish reasonable concentration limits for higher risk real estate loans and experienced rising Home Equity Line of Credit (HELOC) losses due to sub-prime loans. Examiners also determined that management actions resulted in an unsafe and unsound level of risk exposure given the credit union's net worth position and the operational environment. Accordingly, examiners downgraded the credit union's composite CAMEL rating from 1 to 4 and issued an LUA requiring that management establish loan concentration limits to help mitigate risks. In addition, examiners issued an RDL which emphasized the major areas of concern and urged credit union officials to take immediate and ongoing action to achieve the goals detailed in the examination report and LUA. Furthermore, examiners increased both their onsite and offsite monitoring of the credit union and issued DORs targeted toward the issues. As a result of examiners' findings, management became very co-operative and receptive to examiners' guidance and recommendations. While credit union management personnel did not change, management changed the way they operated the credit union. For instance, management became aggressive with loan collections and worked on reducing risk. Regional staff and credit union management's diligent efforts resulted in examiners assigning the credit union a composite

CAMEL 3 rating for the December 31, 2011 examination and a CAMEL 2 rating for the December 31, 2012 examination.

Credit Union 4

During the September 30, 2006 examination of this credit union, examiners initially noted liberal underwriting practices led to a large concentration of loans with increased credit risk and advised management to strengthen their underwriting policies and strategic plans. According to regional staff, credit union management had successfully dealt with the elevated levels of credit risk in the past, but the economic downturn in the local housing market combined with the onset of the national recession led to excessive loan defaults. Consequently, elevated loan delinquencies and losses resulted in examiners downgrading the credit union from a composite CAMEL 1 to a CAMEL 3 during the examination effective December 31, 2007, and subsequently to a CAMEL 4 during the June 30, 2008 examination. Additionally, as conditions worsened, regional management assigned the credit union to its DSA group. DSA staff provided additional onsite and offsite supervision, assisted with identifying the underlying problems, and helped convince credit union officials to implement the corrective actions.

Regional management indicated the key factors which helped the credit union recover included matching the right regional problem case officer with the credit union, in addition to pure hard work and commitment from the credit union board and management. For instance, the CEO hired a mid-level management team which included the former CEO who initially built up the credit union and an outside third party consultant to evaluate the credit union's loan portfolio. Credit union management also put an emphasis on loan collections. In addition to increased onsite and offsite contacts, examiners issued multiple DORs, a PWL and an LUA which focused on the issues. As conditions improved, examiners upgraded the credit union's composite CAMEL rating to a 3 for the examination effective December 31, 2011, to a CAMEL 2 during the September 30, 2012 examination, and finally back to a composite CAMEL 1 for the March 31, 2013 examination.

Credit Union 5

Examiners discovered problems existed with the MBL portfolio at this credit union and expressed concerns over high-risk business loans and an alarming level of loan delinquency in the portfolio. As a result, examiners downgraded the credit union's composite CAMEL 2 rating to a CAMEL 3 during the December 31, 2007 examination. In addition, examiners increased contacts and monitoring and issued multiple DORs and an RDL targeted toward the problems. Also, when several credit union employees stated that discretionary spending by management was too high, examiners investigated and determined that internal control weaknesses resulted in excessive spending. Consequently, the credit union board removed the CEO and quickly hired interim management. Regional management stated the credit union was transferred to its DSA during late 2009, and DSA worked closely with credit union management. For example, credit union management and NCUA staff jointly developed an expense reduction plan which included salary reductions, benefit reductions and employee reductions. In addition, the examination team took the time and energy to build a good working relationship and rapport with credit union management. Ultimately, the examiners upgraded the credit union to a composite CAMEL 2 during the September 30, 2010 examination.

Examiners Persistence Resulted in Positive Management Actions

We found instances where examiners had to work diligently to overcome initial management resistance and convince management of the findings and guidance regarding emerging issues. The following are cases where examiners worked successfully to convince management to address emerging issues:

Credit Union 6

During an annual examination of this credit union, a district examiner observed that the credit union's largest concentration of loans were to the CEO and the CEO's spouse. The CEO was well respected in the credit union community, on the board of the state credit union league and trusted by the credit union board. Consequently, when confronted with the examiner's concerns over personal loans the CEO obtained from the credit union, the credit union board was initially resistant. However, regional staff was persistent and convinced the board's treasurer that the loans were questionable and needed to be looked into further. Examiners eventually determined that the CEO had obtained the loans without the board's approval and embezzled money from a member's account to finance a personal investment. The CEO subsequently pled guilty to bank fraud and received jail time. Accordingly, NCUA issued a Prohibition Order against the former CEO. As a result of the regional staff's efforts, the board became more involved with the management of the credit union and improved the loan approval process.

Credit Union 7

A new examiner in charge (EIC) leading the March 31, 2011 examination of this credit union noticed some questionable lending trends. In an effort to get a more accurate picture of the credit union's condition, the EIC instructed the examiners to expand the examination procedures. Examiners subsequently determined that a high level of interest rate risk existed within the credit union's real estate loan investment portfolio and downgraded the credit union's composite CAMEL rating from a 2 to a CAMEL 3.

The CEO was not receptive to examiner concerns. According to regional management, field staff met with the CEO and other executives four or five times trying to convince them that the problems existed and needed immediate attention. Regional staff was finally able to persuade the chief financial officer that a high level of interest rate risk existed. In turn, the chief financial officer convinced the other executives that the credit union's interest rate risk was high. After acknowledging the problems, the credit union management team became very cooperative and supportive. Because the EIC was proactive, examiners identified the issues in a timely manner and took prompt supervisory and administrative actions, which included increased contacts and monitoring, DOR items, and an RDL highlighting the concerns. The efforts of regional staff and the cooperation of credit union management resulted in examiners upgrading the credit union's composite CAMEL to a 2 during the examination effective December 31, 2012.

Regional Staff Used Uncommon Approaches to Address Credit Union Issues

We found that although most of the actions taken with credit unions followed standard NCUA practices, there are some cases that illustrate uncommon approaches regional staff used to address credit union issues. Specifically:

Credit Union 8

According to regional management, this state-chartered credit union had numerous problems in all areas which stemmed from incompetent management. For instance, during the September 30, 2007 joint examination with the State Supervisory Authority (SSA), NCUA examiners determined that credit union management's questionable long-term investment strategy led to increased credit and interest rate risks. Examiners also determined that the credit union was experiencing high delinquencies and net charge offs and downgraded the credit union's composite CAMEL rating from a 2 to a CAMEL 3. During the December 31, 2008 joint examination, examiners identified multiple issues with the credit union, including a need for significant write-downs of the private label investment portfolio and corresponding loan losses funding which led to a decline in the credit union's net worth; safety and soundness issues involving the private label investment portfolio; unsafe and unsound practices in the MBL program; a lack of control over the indirect lending program; and internal audit program weaknesses. To address these concerns, the examiners further downgraded the credit union to a composite CAMEL 4 and issued multiple DOR action items that targeted the problems. More importantly, on May 1, 2009, NCUA and the SSA issued a joint C&D, which required credit union management to stop the numerous unsafe and unsound practices and to develop a management plan. Finally, on December 6, 2011, NCUA issued an LUA detailing specific corrective actions, in addition to examiners increasing their supervision of the credit union through frequent onsite and offsite contacts.

Regional management stated that the level of supervision provided by regional staff was not standard given the credit union's larger size and complexity. Normally, senior management of larger credit unions provides NCUA with a plan to address the issues. However, because many of the problems were the result of incompetent management, regional staff provided hands-on guidance. For example, the EIC met offsite with the credit union's board, associate board and audit committee members for approximately four hours to discuss the lending, investment and management issues. Moreover, the EIC continued to meet with the board members on a monthly basis to discuss the credit union's progress, and the supervisory examiner allowed the EIC the time needed to work with credit union management. This resulted in the examiner establishing trust with the credit union board. Over time, the board replaced most of the senior and executive staff and hired a consultant to assess staffing needs and the current management team. Improvements by credit union management resulted in examiners eventually upgrading the credit union's composite CAMEL rating to a 2 and recommending the termination of the LUA during the December 31, 2012 examination.

Credit Union 9

Examiners determined that significant systemic risk existed in this credit union's large portfolio of MBL participations and its consumer real estate loan portfolio. The examiners also determined that the MBLs were poorly documented and had significant monitoring weaknesses. Examiners further determined that product profitability analysis and collection monitoring were inadequate and downgraded the credit union's composite CAMEL rating from a 1 to a 4. In addition, regional staff issued a DOR and an LUA, which required credit union management to hire experienced and qualified member business lending personnel familiar with managing complex commercial portfolios. Regional staff also required credit union management to contract with a qualified external member business lending consulting group to assess and address the MBL portfolio management deficiencies. As conditions improved, examiners upgraded the credit union's composite CAMEL rating to a 3, then to a 2. According to regional management, requiring the use of external specialists through a DOR and an LUA was not a commonly used option before the financial crisis. However, regional management believes that the use of third party expertise should be required more often.

Credit Union 10

During the March 31, 2009 examination of this credit union, examiners noted concerns with the credit union's large concentrations of real estate loans and MBL weaknesses and downgraded the composite CAMEL rating from a 1 to a 3. More importantly, an initiative by the regional Division of Supervision to further review trends identified at various regional credit unions[5] prompted a special onsite contact to this credit union four months later. As a result, examiners determined that credit risk management was inadequate and further downgraded the credit union to a composite CAMEL 4. Because the initiative prompted a special onsite visit in advance of the next annual examination, examiners detected the credit risk issues earlier and were able to address them in a timely manner.

Over the course of several examinations, examiners also determined that credit union management did not adequately identify or assess the risks in their loan products and rapidly expanded both residential and commercial real estate loan portfolios in the years leading up to the recession. To help rectify the issues, examiners increased the supervision and monitoring of the credit union,[6] and issued DORs and an LUA. Consequently, over a four year period, conditions at the credit union steadily improved, resulting in examiners upgrading the credit

[5] The initiative applied specific criteria to generate a target sample of credit unions exhibiting high risk on their balance sheets and required examiners outside of the current supervisory examiner group to perform risk-focused reviews of these credit unions.
[6] Examiners increased supervision and monitoring through frequent onsite contacts and offsite monitoring such as weekly follow-up telephone calls.

union to a composite CAMEL 3 for the examination effective June 30, 2012, and then to a CAMEL 2 during the June 30, 2013 examination.

Summary of Lessons Learned from NCUA Regional Staff Actions

Using the lessons learned from these successful resolutions could help examiners and management in reducing future failures and losses to the National Credit Union Share Insurance Fund. The following summarize lessons learned from actions taken by regional staff to help revitalize credit unions exhibiting supervisory concerns:

- Regional staff initiated various informal and formal actions as needed to address the supervisory concerns. Specifically (see the summary in Table 1 below):
  - In every case, examiners increased their supervision of the credit unions with more frequent onsite visits and offsite monitoring such as follow-up telephone calls and financial report reviews.
  - Examiners issued DORs at all of the credit unions in an effort to help correct the problems.
  - In seven of the ten cases increased supervision and DORs did not suffice, necessitating more stringent actions by NCUA regional staff. Consequently, regional staff used additional tools available and issued RDLs at three credit unions, LUAs at five credit unions, a PWL at one credit union, and a C&D at the remaining credit union.

Table 1

Informal and Formal Actions Taken						
Credit Union	Increased Contacts & Monitoring	Document of Resolution	Regional Director Letter	Letter of Understanding & Agreement	Preliminary Warning Letter	Cease & Desist Order
1	X	X				
2	X	X				
3	X	X	X	X		
4	X	X		X	X	
5	X	X	X			
6	X	X				
7	X	X	X			
8	X	X		X		X
9	X	X		X		
10	X	X		X		
Totals	10	10	3	5	1	1

We believe that regional staff actions were instrumental in helping credit union management to overcome supervisory concerns. We also believe the positive outcomes the regions experienced with the credit unions were the result of examiners identifying the issues early and taking the necessary administrative actions. Finally, we believe regional staff taking the time to build positive relationships and the staff's diligent efforts to communicate with credit union management helped ensure management's cooperation and played a major role in overcoming the supervisory concerns. Accordingly, we are not making any formal recommendations at this time.

Appendix A: Summary of Supervisory Concerns

Examiners identified various supervisory concerns among the credit unions reviewed. Although some of these credit unions had multiple issues, examiners identified lending problems at all of the ten credit unions. Specifically, we determined that (see the summary in Table 2 below):

- Five of the credit unions had member business loan (MBL) issues. Some of the examiner MBL findings included significant systemic risk within a large portfolio of MBL participations;[7] MBL policy weaknesses; poorly documented MBLs; and unsafe and unsound MBL practices.

- Six of the credit unions had real estate loan problems such as rising home equity line of credit losses; increased real estate loan delinquencies and charge-offs; high credit risk due to inadequate loan policy and procedures; and inadequate real estate loan underwriting.

- Examiners determined that liberal underwriting practices at one of the credit unions led to a large concentration of high risk vehicle loans.

- Seven of the credit unions experienced significant net worth issues.

- The chief executive officer at one of the credit unions fraudulently obtained personal loans.

- One credit union had a long history of numerous problems in all areas of operations stemming from incompetent management.

[7] A participation loan is a loan where one or more eligible organizations participate pursuant to a written agreement with the originating lender. Eligible organizations include credit unions, credit union organizations, and financial organizations.

Table 2

Summary of Supervisory Concerns							
	Lending				Other		
Credit Union	Member Business Loans	Real Estate Loans	Personal Loans	Vehicle Loans	Net Worth	Fraud	Management
1		X			X		
2	X	X			X		
3		X					
4				X	X		
5	X				X		
6			X			X	
7		X			X		
8	X				X		X
9	X	X					
10	X	X			X		
Total	5	6	1	1	7	1	1

Appendix B: Overview of Credit Union Status

We found that the length of time to resolve the supervisory concerns and to improve or return the credit union to its pre-issue status ranged from one to six years, with most cases taking three or more years for resolution. Table 3 (below) provides an overview of the status of each credit union and the length of time it took to resolve the issues.

Table 3

Overview of Credit Union Status								
Credit Union	Federal (F) or State (S) Chartered	Composite CAMEL Prior to Issues	Assets	Exam/Date Issues Discovered	Lowest Composite CAMEL	Date Returned to Normal Supervision	Composite CAMEL October 2013	Time to Resolve Supervisory Concerns (in Years)
1	S	2	753M	9/30/2008	3	9/30/2011	1	3.0
2	F	2	2.2B	3/31/2008	4	3/31/2013	2	5.0
3	F	1	673M	3/31/2008	4	12/31/2012	2	4.8
4	F	1	1.6B	9/30/2006	4	9/30/2012	1	6.0
5	F	2	575M	12/31/2007	3	9/30/2010	2	2.8
6	F	2	37M	12/31/2010	3	12/31/2011	2	1.0
7	F	2	1.3B	3/31/2011	3	12/31/2012	2	1.8
8	S	2	542M	9/30/2007	4	12/31/2012	2	5.3
9	S	1	1.5B	3/31/2009	4	6/30/2013	2	4.3
10	F	1	512M	3/31/2009	4	6/30/2013	2	4.3

Appendix C: NCUA Management Response

National Credit Union Administration
Office of the Executive Director

E&I/JMK:jmk
SSIC 1920

SENT BY E-MAIL

TO: Inspector General James Hagen

FROM: Executive Director Mark Treichel Mark K

SUBJ: Response to Lessons Learned – Successful Outcomes Report

DATE: March 31, 2014

This memorandum responds to your request for a response on the Office of Inspector General's (OIG) draft report titled Lessons Learned – Successful Outcomes with Credit Unions Exhibiting Supervisory Concerns. While there are no formal recommendations, the report identifies common supervisory practices consistently observed in your review of successful outcomes:

- Early identification of problems;
- Appropriate Documents of Resolution (DOR) focused on the issues;
- Increased supervision both off-site and on-site;
- Effective communication and relationship building; and,
- Progressive enforcement when necessary.

We agree examiners are using the examination and supervision process to appropriately identify concerns and work cooperatively with credit union management. We reinforce these practices in our national policies through the National Supervision Policy Manual (NSPM), enhanced DOR policy and AIRES exam work papers, National Training Conferences, and through our core and continuing training for staff. We appreciate your recognition of this success and will continue to monitor our programs to leverage successful supervision practices.

Thank you for the opportunity to respond.

cc: DED Kutchey
DEI Fazio
DDEI Segerson
DRM Komyathy
DOS Neat
D-IG Stith
Regional Directors

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