

UNITED STATES OF AMERICA
BEFORE THE NATIONAL CREDIT UNION ADMINISTRATION

In the Matter of

XXXX

Docket No. 08 –14

Share Insurance Appeal
Lynrocten Federal Credit Union

Decision and Order on Appeal

Decision

This matter comes before the National Credit Union Administration Board (Board) pursuant to §745.202 of NCUA Regulations (12 C.F.R. §745.202), as an appeal of the determination made by the Agent for the Liquidating Agent (ALA) for Lynrocten Federal Credit Union (Lynrocten). The determination involves the account balance for purposes of calculating the amount of share insurance available to the share account maintained under member account number XXXX at Lynrocten by Mr. XXXX.

Background and Initial Determination

The Board ordered Lynrocten closed due to its insolvency on May 3, 2013, and appointed itself Liquidating Agent. Located in Lynchburg, Virginia, with assets of approximately \$13.8 million, Lynrocten had been victimized by fraud allegedly perpetrated by its manager and its head teller.¹ There was no conservatorship in this case; instead, Lynrocten was placed immediately into liquidation.

Before the liquidation occurred, but after the examiners began to suspect that fraud had occurred, the examiners conducted an on-site visitation, during which members were contacted and invited to provide a statement indicating their estimation of the actual balance in their accounts. According to Lynrocten's records, the balance in Mr. XXXX's account immediately prior to liquidation was \$19.63. With the assistance of his wife, Mr. XXXX completed an affidavit, dated May 1, 2013, in which he disputed the share account balance as reflected in the records and stated, instead, that he thought the balance should be "about \$10,000." Mrs. XXXX also signed the affidavit.

¹ The head teller has pled guilty to embezzlement and is cooperating with authorities. The manager has been indicted and is scheduled to stand trial in December. There is no indication that Lynrocten's other two employees, a part-time teller and a bookkeeper, were involved with the fraud.

Upon the appointment of the Liquidating Agent, the ALA sent a letter to all members, including Mr. XXXX, explaining the closure of Lynrocten and advising that a statement showing share account balances as reflected on the records would be sent separately. This letter also advised Mr. XXXX that he should either challenge or confirm the identified balance using a “Members Confirmation and Affidavit Form,” a copy of which was enclosed with the letter. The letter advised Mr. XXXX that he must use the form of affidavit to contest the amount shown on the statement and to claim any additional funds alleged to be owed to him on the share account.

Mr. XXXX contested the identified balance in an affidavit signed by him on June 4, 2013. In the affidavit, he asserted that two checks he had previously deposited with Lynrocten had not been credited to his account. He enclosed photocopies of the two checks, in the amounts of \$55,251.38 and \$4,367, respectively, and asserted that his correct liquidation account balance should be the sum of these two checks (*i.e.*, \$59,618.38) together with interest, in an amount he did not specify. Mr. XXXX made no reference to the affidavit he had submitted approximately one month earlier in which he stated that his correct balance was approximately \$10,000.

The ALA sent another letter to all members, including Mr. XXXX, who had indicated a dispute with respect to their balance. The letter, which enclosed copies of quarterly member statements between 2001 and 2011, directed Mr. XXXX to review the statements and to specifically identify which transactions he was disputing. Mr. XXXX submitted a third affidavit, signed by him on October 28, 2013, in which he disputed virtually all of the transactions that had been listed on the statements provided to him by the ALA. He specifically noted his dispute over a check withdrawal in the amount of \$25,200 that the credit union’s records show him as receiving in April 2004. He noted that he did not receive any statements for 2008 or for 2009, and that he therefore disputed all of the transactions listed for that time frame. He denied having made any new car purchase during 2004 or 2005, and he provided copies of his car insurance coverage declarations for those years as support for this assertion.² In his affidavit, Mr. XXXX also characterized his account as one that he intended primarily for retirement savings, with the implication being that it was an inactive, non-transactional account from which he made very few withdrawals.

In response, the ALA conducted a comprehensive review and reconstruction of the account. By letter of May 15, 2014, the ALA advised Mr. XXXX of the outcome of the comprehensive review and provided a spreadsheet showing the adjustments to the account that had been made. The ALA enclosed a check in the amount of \$10,860.21 with this letter, representing the amount by which the reconstructed balance exceeded the originally identified liquidation balance of \$19.63, which the ALA had previously paid to him. By letter of June 12, 2014, counsel for Mr. XXXX wrote to the ALA requesting reconsideration of this determination. Attached to this letter was another affidavit from Mr. XXXX, reiterating his dispute as to the account balance and stating again that he used the account mainly for retirement savings. Mr. XXXX stated specifically in this affidavit that he had made only “around \$3,000” in withdrawals from the account since its inception, and he explained that his previous affidavit [*i.e.*, the one indicating the balance should be around \$10,000] was incorrect because he had not seen the account statements at that time and had not perceived “that the balance should be much more.” By letter of July 11, 2014, the ALA rejected the reconsideration

² It appears that he provided the insurance information in response to a suggestion made by the ALA in a telephone conversation with Mr. XXXX’s wife in which the ALA suggested that Mr. XXXX might have used this significant withdrawal for some large purchase, such as an automobile.

request and reaffirmed the initial determination, noting that no new factual information or evidence in support of the request had been submitted. By letter of August 29, 2014, counsel for Mr. XXXX filed an appeal with the Board.

Discussion and Analysis.

In accordance with applicable NCUA regulations, the Board is charged with determining “the amount of the insured account or accounts of each . . . accountholder” at an insured credit union in liquidation. 12 C.F.R. §745.200(a). Ordinarily, the Liquidating Agent can reasonably rely on the records of the institution in determining the amount the members have in their share accounts. In cases like this one, however, where it is clear that fraud and embezzlement occurred, and it is also clear that the account records were manipulated to disguise that illicit activity, reliance on the nominal account records would be misplaced. Instead, the ALA conducted an exhaustive reconstruction of the account, using as reference points Lynrocten’s bank statements, copies of checks, deposit activity, and teller transaction details. This data was used to populate a spread sheet, and all transactions having any impact on Mr. XXXX’s account were evaluated and analyzed.

To disguise their fraud, the insiders would advise members that there were no statements being generated. In fact, statements were generated but not sent to members. If a member came into the lobby to transact business, the head teller would either provide a handwritten receipt or generate a fraudulent receipt by first generating a fictitious deposit, then processing the legitimate transaction and providing the member with a receipt that showed a resulting balance that was reasonably close to what the member would have expected. Typically, the resulting balance would have been a little higher than actual, so as to minimize suspicion by the member. After the transaction, a fictitious withdrawal would be posted.

Thus, the usual scheme was that legitimate member transactions were sandwiched between a fictitious deposit and a fictitious withdrawal, which typically were booked on the same day. These transactions were initially reflected in the credit union account records. Starting in August 2007, however, the insiders would simply delete the record of the fraudulent deposit transaction from the credit union account records, but preserve a record of it in a data report referred to as “teller corrections.” Since the deposit transaction was deleted, the insiders no longer had to do an offsetting, fraudulent withdrawal. In either case, there was a paper trail by which the ALA was able to discern the legitimate transactions undertaken by members whose accounts had been compromised. The insiders did not generate the fictitious deposit and withdrawal records when they were simply stealing money. Instead, this method was only employed when the member whose account had been compromised came in to the lobby to transact business, in order to generate a receipt that would not raise suspicion.

The ALA reconstructed Mr. XXXX’s share account and determined the actual balance in the account at liquidation. The methodology followed by the ALA was documented in the spread sheet sent to Mr. XXXX as an attachment to the ALA’s May 15, 2014, letter. Specifically, starting with the record balance as of March 31, 2001, the earliest date for which adequate records exist, the ALA traced the deposit and withdrawal activity of the account up through the date of liquidation. Broadly speaking, the methodology followed by the ALA was as follows:

- All deleted transactions were first restored to the account record.

- Fictitious deposits appearing to have been made in cash were reversed. These totaled \$367,120.00.
- Disputed withdrawals or transfers from the account by cash that could not be traced as having benefitted Mr. XXXX were reversed and credited back to the account. These totaled \$233,010.21.
- Withdrawals by cash that appeared to be legitimate, including those which had been deleted from the credit union's records, were applied as debits to the account. These resulted in an aggregate reduction in the account of \$24,673.57.
- Deposits by check were credited to the account in the amount of \$60,310.95.
- Withdrawals by check were debited to the account in the amount of \$27,200.
- Dividends that were posted to the account were left intact, at \$279.96; however, the ALA did not recalculate dividends based on the reconstructed account balance.

The net effect of these adjustments relative to the account balance of \$19.63 as shown on Lynrocten's records as of the date of liquidation was that the liquidation balance was understated in the amount of \$10,860.21. As noted above, a check in this amount has been sent to Mr. XXXX.

In essence, Mr. XXXX disputes whether the withdrawals the ALA determined as legitimate debits to his account actually did occur. In particular, he denies the legitimacy of a check withdrawal apparently made by him in the amount of \$25,200 in April 2004. He also disputes the legitimacy of all but \$7,991 in other withdrawals charged against his account based on the ALA's analysis and reconstruction.³ In addition, he also asserts that credit was never given to him for two checks he deposited into the account in 2004 and early 2005. Each of these elements is discussed below.

2004 check withdrawal. Lynrocten maintained its primary checking account with Beacon Credit Union (Beacon), from which it made loan disbursements and other substantial withdrawals. Beacon did not provide copies of canceled checks to Lynrocten. Furthermore, as of the liquidation date, Beacon had already destroyed copies of checks written in 2004, so they were not available for inspection. However, in Lynrocten's counter receipt records for its checking account, there is a carbon copy of a \$25,200 check, payable to Mr. XXXX, along with a separate signature block for signature by the payee to acknowledge receipt of the check. Mr. XXXX's signature appears in the signature block. Upon visual inspection, it is reasonably clear that the signature on the receipt conforms to his signature on the affidavits he submitted. The check, which was issued on a Tuesday, cleared the Beacon account that Friday.

The ALA characterized the check as a legitimate withdrawal from Mr. XXXX's account, largely because the transaction did not exhibit any of the characteristics that were common to the fraudulent behavior. When a fraudulent withdrawal from a member account occurred, invariably it was done by a cash transaction, not by check. Where a loan disbursement check was used for fraud, it was always re-deposited the same day. In this case, none of the deposits made around the time this check was issued were in amounts sufficient to have included it, and the deposit activity for the day

³ Mr. XXXX is not consistent in his identification of the amount of withdrawal activity he accepts. The \$7,991 figure derives from notes he made on copies of the statements the ALA provided to him; however, in the affidavit submitted with his appeal to the Board he says that legitimate withdrawals from the account were only "around \$3,000." Complicating matters further, in the letter from Mr. XXXX's counsel to the Board presenting the appeal, he uses the figure of "approximately \$5,000" as the maximum for legitimate withdrawals.

in which this particular check would have cleared did not include any of the typical fraud-type check deposits such as loan payments or insider deposits.

More significant, perhaps, is the observation that Mr. XXXX made no objection concerning this allegedly fraudulent withdrawal until after the criminal activity involving Lynrocten became public knowledge. For example, Mr. XXXX had received a receipt following a transaction he made in 2009 showing a balance of \$12,113.86, i.e., reflecting the 2004 withdrawal, but Mr. XXXX made no objection at that time. Furthermore, in his initial affidavit, made days before the liquidation and to which he attached the 2009 receipt, he makes no mention of the account allegedly being \$25,200 short.⁴ Instead, he noted that the account balance should have been “about \$10,000,” which figure would have been consistent with the substantial withdrawal having previously occurred.

Mr. XXXX does not offer any specific explanation in support of his position. He simply included a reference to the check in a general listing of transactions he disputes, under a heading that notes that he disputes “all of the withdrawals” listed. His wife accused the ALA of inserting Mr. XXXX’s signature onto the counter receipt copy of the check improperly, using Photoshop. From this it may be inferred, assuming no improper behavior by the ALA, that the XXXXs acknowledge that the signature is that of Mr. XXXX. Mr. XXXX’s intention of including paperwork concerning his auto insurance coverages for 2004 and 2005 with his third affidavit is to refute any possible inference that the purpose of this \$25,200 check was to purchase an automobile. This does not, obviously, rule out any number of other possible uses for this withdrawal.

The Board concludes that the available evidence supports the ALA’s conclusion that this withdrawal by check in 2004 was legitimate.

Other withdrawals. As described more fully in the discussion above concerning the methodology followed by the insiders, when members came in to the lobby to conduct business in person, the insiders would disguise their fraud by handling the legitimate transaction in between a fictitious deposit and a subsequent fictitious withdrawal. This was done in order to generate a receipt, to be given to the member reflecting an approximation of the actual, correct balance, so that suspicion would be avoided. Beginning in 2007, the insiders would delete the entire series of transactions from the underlying record, including the legitimate withdrawal. However, the insiders kept a separate accounting of these transactions in their daily “teller corrections” report. The ALA was able to reconstruct the deleted transactions through reference to this report. In all, the ALA was able to identify \$24,673.57 in apparently legitimate lobby transactions conducted by Mr. XXXX. The ALA’s judgment as to the number and amount of these withdrawal transactions that were legitimate is reasonable and supportable.

Mr. XXXX offers no evidence in support of his assertion that he made relatively few withdrawals from this account. Instead, his position seems to be that the absence of evidence of these withdrawals in the teller detail and the member account statements means that they must not have

⁴ According to the NCUA examiner who witnessed the affidavits obtained at Lynrocten on May 1, 2013, any materials supplied by the member were attached to their affidavits. The only document that would have been produced by the credit union and attached to an affidavit was a share account summary obtained off the system and any handwritten notes pertaining to that member. The examiner did not recall any discussions with Mr. or Mrs. XXXX disputing that the balance should have been higher than what was indicated on the affidavit. Had there been such a dispute at that time, the examiner indicated that he would have directed the member to write that down.

occurred. As the research conducted by the ALA demonstrates, however, the absence of these transactions from the credit union's account records does not mean they did not occur.

In essence, Mr. XXXX argues that NCUA is bound by what the account records show or, more accurately here, do not show, in terms of legitimate withdrawal activity. Although there is some authority for the proposition that account records of an insured credit union are "conclusive," 12 C.F.R. §745.2(c), that principle applies only in the limited context of determining whether a relationship exists among account owners (*e.g.*, trustee or custodian) that would form the basis for additional insurance coverage. *See, e.g., Waukesha State Bank v. NCUA Board*, 968 F.2d 71 (D.C. Cir. 1992) (account records are controlling despite evidence of contrary subjective intent of the depositor); *Nimon v. Resolution Trust Corp.*, 975 F.2d 240, 245-46 (5th Cir. 1992) (Court refused to look beyond the account records, despite the depositors' claim that the bank had configured their accounts without proper authorization, noting that "when the account records are clear and unambiguous, their statement of the capacity in which funds are owned is conclusive."). The issue of account ownership is not present in this case, as this account was maintained as a single ownership account of Mr. XXXX, as to which there is no uncertainty or debate. By its terms, the regulation does not speak to the issue of whether the records are presumptively conclusive as to the balance in the account. There is no doubt in this case that the balance in the account, under any realistic scenario, is well within the insurance limits. This tends to undermine any reliance on §745.2(c).

Furthermore, there is a recognized exception to the general rule pertaining to the conclusiveness of account records, which is in the event of fraud. *See, e.g., McCloud v. FDIC*, 853 F.Supp 556, 559-60 (D. Mass. 1994) (noting the "well-established principle that records that would otherwise be conclusive may be attacked as fraudulent") (internal citations omitted). Where, as here, virtually all of the records in the institution are unreliable, and the ALA has determined that some apparent transactions appearing in the records did not occur, while others not recorded did occur, the decision to reconstruct the account balance by reference to external documentation is supportable.

2004 and 2005 check deposits. In his second affidavit, Mr. XXXX asserts that two checks he deposited with the credit union into his account were never properly credited. The checks were in the amounts of \$55,251.38 and \$4,367, respectively. From the submitted materials, it is unclear whether Mr. XXXX continues to advance this position, or whether he simply relies on the view that his liquidation balance should reflect the sum of these two checks (*i.e.*, \$59,618.38) minus the approximately \$3,000 to \$5,000 in withdrawals that he acknowledges. This is just as well, since it is abundantly clear from the materials that full credit for both checks was indeed provided by Lynrocten and carried forward through the reconstruction by the ALA. In other words, the reconstruction of the account and the conclusion concerning the correct liquidation balance takes fully into account the receipt and crediting to Mr. XXXX of both of these checks. Accordingly, to the extent this aspect of the appeal is being asserted, it lacks merit and is rejected.

The Board finds the appeal as advanced by counsel for Mr. XXXX lacking in several respects. For example, counsel states that funds in the account were stolen by those running Lynrocten and that this, and not legitimate withdrawal activity, accounts for the purportedly low balance in the account at liquidation. In effect, counsel asserts that the fact of the fraudulent insider activity, *per se*, is the only explanation necessary and constitutes a full validation of Mr. XXXX's assertions. Counsel makes no attempt to explain the inconsistent affidavits submitted by Mr. XXXX or to explain why

Mr. XXXX apparently did not object to the stated balance on the transaction receipt he obtained in 2009, which balance obviously reflected substantial withdrawal activity following the check deposits made in 2004 and 2005. Counsel makes no reference to the reconstruction spread sheet or the May 15, 2014, correspondence from the ALA that describes those adjustments. Instead, counsel simply states that Mr. XXXX's position, that is that virtually all of the account was stolen, is "well evidenced via their [i.e., Mr. and Mrs. XXXX] financial conduct." By this he apparently means their statement to the effect that they had an account at another financial institution for most if not all of their transactions, save only a relative few withdrawals for vacation and Christmas expenses. He states that his clients would be "incapable" of manufacturing a scheme to wait until the theft was discovered and then falsely claim that their account balance was looted by the insiders running Lynrocten rather than reduced by their own withdrawal activity. He concludes by saying that all of the indications here are that the balance in this account was reduced by theft by employees of Lynrocten, not by legitimate withdrawals, and that Mr. XXXX and his wife would both submit to a polygraph test as further proof of their bona fides.

Counsel has not offered anything substantive in support of his argument, which is based on speculation and mere allegation. By contrast, the ALA has conducted a thorough reconstruction and reconciliation of the account.

The account records at Lynrocten were deliberately and deceitfully manipulated by insiders who either admitted to or have been charged with criminal behavior. Through diligent review of those records, tracing of funds, and verification through reconciliation of Lynrocten's bank account records, the ALA was able to obtain a good understanding of the actual balance in Mr. XXXX's account. Aside from inconsistent affidavits, car insurance declarations, and an explanation that most of his financial activity was handled through an account at a different institution, Mr. XXXX has not provided documentation or other materials that support his view of the correct balance in his account at liquidation.

Order

For the reasons set forth above, it is ORDERED as follows:

The appeal by Mr. XXXX, challenging the ALA's determination concerning the insured balance in account number XXXX at Lynrocten Federal Credit Union, is denied.

The Board's decision constitutes a final agency determination. Pursuant to 12 C.F.R. §745.203(c), this final determination is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States District Court for the Federal judicial district where Lynrocten's principal place of business was located. Such action must be filed within 60 days of the date of this final determination.

So **Ordered** this 21st day of November, 2014, by the National Credit Union Administration Board.

Gerard Poliquin
Secretary of the Board