

NATIONAL CREDIT UNION ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL

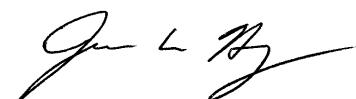
MATERIAL LOSS REVIEW  
OF  
VENSURE FEDERAL CREDIT UNION

Report #OIG-12-05  
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## **Acronyms and Abbreviations**

ACH	Automated Clearing House
Board	Board of Directors
C&D	Cease & Desist
Call Report	NCUA 5300 Call Report
Crowe	Crowe Horwath LLP
DOJ	Department of Justice
DOR	Document of Resolution
EIC	Examiner in Charge
FCU	Federal Credit Union
FICU	Federally Insured Credit Union
FOM	Field of Membership
FPR	Financial Performance Reports
GAFCU	Grand Adirondack Federal Credit Union
Guide	NCUA Examiner's Guide
LUA	Letter of Understanding and Agreement
MLR	Material Loss Review
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
NIFA	National Investors Financial Education Association
OGC	Office of General Counsel
OIG	Office of Inspector General
PWL	Preliminary Warning Letter
RFE	Risk-Focused Examination
ROAA	Return on Average Assets
SE	Supervisory Examiner
Trinity	Trinity Global Commerce Corp.
UIGEA	Unlawful Internet Gambling Enforcement Act
Vensure	Vensure Federal Credit Union

## Executive Summary

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) contracted with Crowe Horwath LLP (Crowe) to conduct a Material Loss Review (MLR) of Vensure Federal Credit Union (Vensure), a federally insured credit union (FICU). We reviewed Vensure to: (1) determine the cause(s) of the Credit Union's failure and the resulting estimated \$39 thousand loss to the National Credit Union Share Insurance Fund (NCUSIF); (2) assess NCUA's supervision of the Credit Union; and (3) make appropriate recommendations to prevent future losses. To achieve these objectives, we analyzed NCUA examination and supervision reports and related correspondence; interviewed NCUA management and staff from Regions I and V; reviewed NCUA guidance, including regional policies and procedures, NCUA 5300 Call Reports (Call Report), and NCUA Financial Performance Reports (FPR).<sup>1</sup>

Although the anticipated loss to the NCUSIF for Vensure does not meet the statutory loss threshold to require a MLR,<sup>2</sup> the NCUA OIG has identified the circumstances surrounding the conservatorship of Vensure to be unusual in nature and therefore determined a MLR be performed.

We determined NCUA placed Vensure Federal Credit Union into conservatorship for the following reasons:

- U.S. Attorney Action

On April 15, 2011, the Department of Justice (DOJ) unsealed an indictment against three leading on-line poker companies, which included Pokerstars, and Full Tilt Poker. Also at this time, the DOJ seized all funds of one of Vensure's members - Trinity Global Commerce Corp. (Trinity), a processor of on-line gambling transactions for these two companies. Trinity was Vensure's largest single depositor at the time and because Vensure derived nearly all of its income from transaction fees generated for processing Trinity's internet gambling transactions,<sup>3</sup> Vensure did not have adequate capital on hand after the DOJ seized Trinity's assets to absorb its Automated Clearing House (ACH) returns.

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<sup>1</sup> See Objectives, Scope, and Methodology section of this report for additional details.

<sup>2</sup> The FCU Act, 12 U.S.C. § 1790d, §216(j) requires that the OIG conduct a review when the NCUSIF has incurred a material loss with respect to a credit union. A material loss is defined as (1) exceeding the sum of \$25 million and (2) an amount equal to 10 percent of the total assets of the credit union at the time at which the Board initiated assistance or was appointed liquidating agent.

<sup>3</sup> Internet gambling transactions were determined to be a violation of the Unlawful Internet Gambling Enforcement Act (UIGEA). UIGEA was published in November 2008 and the compliance requirements for credit unions became effective June 1, 2010. NCUA issued Regulatory Alert 10-RA-08 to all federally insured credit unions to provide an overview of UIGEA and the joint rule, a summary of the obligations of participants, and examination procedures. The UIGEA AIRES questionnaire was provided to examiners on August 27, 2010 with the requirement that examiners begin reviewing for compliance with UIGEA in all federal credit union examinations with accounts subject to UIGEA after December 31, 2010.

- Inadequate Management and Board of Directors (Board) Oversight

Vensure's management and Board exposed the credit union to excessive amounts of financial risk due to its affiliation with high risk members and a high risk business model. Specifically, Vensure's management and Board failed to manage the credit union's risk related to its ACH payment processing activity for a member that processed payments for internet gambling websites.

- Business Model

Vensure's management and Board did not operate the credit union in a manner consistent with typical natural person credit unions. Although Vensure's Board indicated within its October 2009 business plan that the credit union's intent was to make loans and serve its members, it had minimal loans in 2009 and no loans during 2010 and 2011. In addition, member shares were significantly concentrated in accounts controlled by the Board as well as Trinity. As previously noted, Vensure derived a majority of its revenue from ACH payment processing fees associated with processing internet gambling payments for this member. When DOJ's actions essentially eliminated Vensure's ACH payment processing revenue stream, Vensure had insignificant traditional sources of earnings to provide for continued credit union operations.

### NCUA Supervision

NCUA's Region I supervised Vensure from formation through early 2010 when supervision changed from Region I to Region V as a result of Vensure's move from New York to Arizona. Through examinations and supervision contacts of Vensure, Region I had identified numerous operational and governance issues and had taken measures to have its management and Board correct them. However, NCUA Region I examiners did not readily identify the nature or scope of the majority of Vensure's Earnings component (i.e. fee income) during an examination or two supervisory contacts conducted in 2009, despite the credit union having significant and steady increases in non-interest income throughout the year.

Although a Region I targeted exam in the 4<sup>th</sup> quarter of 2009 focused on a review of the controls over ACH and wire transactions, the review did not identify the underlying source of the funds or nature of the activity that was creating the large amount of fee income for such a small credit union. Three DOS reviews conducted during May, June and October 2009 commented on the increasing level of fee income and need to follow up in depth regarding the ACH transaction activity and Wire transfer controls. A review of 2009 Call Report data and financial performance ratios provided examiners with indicators that Vensure was experiencing significant and rapid increases in fee income where traditional sources of fee income did not exist. We believe these increases and the recommendations by the DOS reviews

should have prompted a more detailed exploration by examiners into the volume and nature of the activities that were creating the increased fee income.

We believe had examiners looked behind the numbers into the source of the significant fee income activity, the credit union's involvement in processing illegal internet gambling proceeds may have been uncovered sooner, possibly before examiners released the credit union from an unpublished Letter of Understanding and Agreement (LUA).<sup>4</sup> In addition, we believe Vensure's management and Board did not appear forthright to examiners by disclosing their ties to processing internet gambling payments on behalf of Trinity. Ultimately, examiners did not identify Vensure's role in processing internet gambling payments until a March 31, 2010 limited examination (Effective Date) performed by Region V, which also included the use of a specialist in ACH payments.

We are making four observations and two recommendations as a result of our review of the conservatorship of Vensure. Although the lessons learned appear to be common sense in nature, we believe examiners need to be reminded of these important lessons as evidenced by the results of this MLR. These include examiners performing adequate due diligence when working with a new management team and Board; being aware when a credit union changes its business model and all the necessary inquiries brought about by such a change; looking behind the numbers for answers to explain why significant changes or questionable items occur, and finally, seeking assistance from Supervisory Examiners or other experts when confronted with issues in areas outside the examiner's comfort zone.

Based on the above, we recommended NCUA management remind examiners to fully evaluate questionable items in financial data consistent with a reasonable risk assessment and evaluation of the level of risk exposure, and to seek assistance from Supervisory Examiners or other specialists when significant risk issues are identified. We also recommended NCUA management develop additional off-site monitoring triggers for Call Reports and other financial performance reports.

As the OIG identifies major causes, trends, and common characteristics of credit union failures in its Material Loss Reviews, including recommendations, we will communicate those to NCUA management for its consideration. As resources allow, the OIG may also conduct more in-depth reviews of specific aspects of the NCUA's supervision program, and make recommendations, as warranted.

We appreciate the effort, assistance and cooperation NCUA management and staff provided to us during the review.

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<sup>4</sup> In March 2009, examiners issued a LUA to Vensure's management and Board based on concerns with operational and governance deficiencies within the credit union.

## Introduction and Background

The National Credit Union Administration (NCUA) Office of the Inspector General (OIG) contracted with Crowe Horwath, LLP (Crowe) to conduct a Material Loss Review (MLR) of Vensure Federal Credit Union (Vensure) as required by Section 216 of the Federal Credit Union Act (FCU Act), 12 U. S. C. 1790d(j).

### History of Vensure Federal Credit Union

NCUA chartered the credit union in 1955 as Grand Adirondack Federal Credit Union (GAFCU) to serve members of Grand Adirondack Lodge #426 of the Knights of Pythias, in New York, New York. In early 2008, GAFCU applied for a field of membership (FOM) expansion to include the members of the National Investors Financial Education Association (NIFEA) living or working in New York City, then a group of 68. In addition, GAFCU's board began to transition from the original Directors affiliated with the Knights of Pythias, to new Directors that were seeking to change the credit union's FOM. At this time, the credit union had approximately \$31,000 in assets (as of December 31, 2007), 26 members, one office, and no website.

On April 23, 2008, NCUA approved the FOM expansion and amended the credit union's charter to include members of the Manhattan Chapter of the NIFEA, located in New York, New York in accordance with its bylaws in effect March 31, 2008. Because NCUA's Chartering and Field of Membership policy permits the addition of non-natural person members, and Region I found no indication of potential abuse, GAFCU's amended FOM was not restricted to natural person members.

Prior to the addition of the Manhattan Chapter of the NIFEA, Vensure was a very small credit union, offering only basic loan and share products. Examiners had described it as "self-liquidating" due to an aging membership that saw its assets declining steadily from approximately \$74 thousand to \$31 thousand between December 1999 and December 2007 as well as shares falling from approximately \$61 thousand to just over \$19 thousand during the same period. In addition, the credit union had not granted one loan since 2001 and had not reported any loans on its books since 2002. Its CAMEL Composite rating had fluctuated between a 2 and 3 since 1998 due to repetitive strategic and transaction risk issues.

In early 2009, the credit union relocated to Gilbert, Arizona. At the time, the credit union's management and Board indicated the reason for the relocation was to serve a new FOM, one related to Vensure Employer Services. However, management never made a formal request to the NCUA for a change in the FOM prior to the move. Also, in connection with the move and in consideration of its intended new FOM, the Board (without prior approval from NCUA) changed the credit union's name to Vensure Federal Credit Union. NCUA later formally approved the name change and the expanded FOM on March 1, 2010. During this transition, the books and records resided with the Treasurer, who lived in Florida for a period of time.

From 2009 until the NCUA placed the credit union in conservatorship, Vensure's increase in assets and fee income was substantially related to the activity from a small number of members, with the most significant level of fee income being derived from processing ACH transactions related to on-line gambling activities for one member.

On April 15, 2011, NCUA placed Vensure into conservatorship. The NCUA estimates the loss to the NCUSIF at \$39,043; however, the final loss could be higher once the NCUA learns whether the DOJ will later seek to recover Vensure's earnings related to processing illegal internet gambling ACH transactions on behalf of Trinity.

### NCUA Examination Process

The NCUA uses a total analysis process that includes collecting, reviewing, and interpreting data; reaching conclusions; making recommendations; and developing action plans. The objectives of the total analysis process include evaluating CAMEL components and reviewing qualitative and quantitative measures. The NCUA uses a CAMEL Rating System to provide an accurate and consistent assessment of a credit union's financial condition and operations. The CAMEL rating includes consideration of key ratios, supporting ratios, and trends. Generally, the examiner uses the key ratios to evaluate and appraise the credit union's overall financial condition. During an examination, examiners assign a CAMEL rating, which completes the examination process.

Examiner judgment affects the overall analytical process. An examiner's review of data includes structural analysis<sup>5</sup>, trend analysis<sup>6</sup>, reasonableness analysis<sup>7</sup>, variable data analysis<sup>8</sup>, and qualitative data analysis.<sup>9</sup> Numerous ratios measuring a variety of credit union functions provide the basis for analysis. Examiners must understand these ratios both individually and as a group because some individual ratios may not provide an accurate picture without a review of the related trends. Financial indicators such as adverse trends, unusual growth patterns, or concentration activities can serve as triggers of changing risk and possible causes for future problems. The NCUA also instructs examiners to look behind the numbers to determine the significance of the supporting ratios and trends. Furthermore, the NCUA requires examiners to determine whether material negative trends exist; ascertain the action needed to reverse unfavorable trends; and

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<sup>5</sup> Structural analysis includes the review of the component parts of a financial statement in relation to the complete financial statement.

<sup>6</sup> Trend analysis involves comparing the component parts of a structural ratio to itself over several periods.

<sup>7</sup> As needed, the examiner performs reasonableness tests to ensure the accuracy of financial performance ratios.

<sup>8</sup> Examiners can often analyze an examination area in many different ways. NCUA's total analysis process enables examiners to look beyond the "static" balance sheet figures to assess the financial condition, quality of service, and risk potential.

<sup>9</sup> Qualitative data includes information and conditions that are not measurable in dollars and cents.

formulate, with credit union management, recommendations, and plans to ensure implementation of these actions.

### Risk-Focused Examination Program

In 2002, the NCUA adopted a Risk-Focused Examination (RFE) Program. Risk-focused supervision procedures often include both off-site and on-site work that includes reviewing off-site monitoring tools and risk evaluation reports. The RFE process includes reviewing seven categories of risk: *Credit, Interest Rate, Liquidity, Transaction, Compliance, Strategic, and Reputation*. Examination planning tasks may include: (a) reviewing the prior examination report to identify the credit union's highest risk areas and areas that require examiner follow-up, and (b) analyzing Call Reports and direction of the risks detected in the credit union's operation and on management's demonstrated ability to manage those risks. A credit union's risk profile may change between examinations. Therefore, the supervision process encourages the examiner to identify those changes in profile through:

- Review of Call Reports;
- Communication with credit union staff; and
- Knowledge of current events affecting the credit union.

### **Objectives, Scope and Methodology**

We performed this material loss review to satisfy the requirements of Section 216(j) of the FCU Act, 12 U.S.C. §1790d(j), which requires the OIG to conduct a material loss review when the NCUSIF has incurred a material loss.<sup>10</sup> Moreover, the 2010 amendments to the FCU Act, embodied in the “Dodd-Frank Wall Street Reform and Consumer Protection Act,”<sup>11</sup> further require the OIG to conduct an in-depth review of any loss to the NCUSIF where unusual circumstances exist that might warrant an in-depth review of the loss. In the case of Vensure, the OIG determined the circumstances surrounding the loss to the NCUSIF were unusual enough to warrant a review, even though the loss did not exceed the \$25 million threshold. Specifically, the OIG determined the indictment brought by the DOJ for illegal internet gambling and its connection traced to Vensure through ACH processing, warranted the OIG performing a full-scope MLR.

Our audit objectives were to: (1) determine the cause(s) related to the conservatorship of Vensure and the resulting loss to the National Credit Union Share Insurance Fund (NCUSIF); (2) assess NCUA’s supervision of the credit union, and (3) make appropriate observations/recommendations to prevent future losses.

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<sup>10</sup> The FCU Act deems a loss “material” if the loss exceeds the sum of \$25 million or an amount equal to 10 percent of the total assets of the credit union at the time in which the NCUA Board initiated assistance under Section 208 or was appointed liquidating agent.

<sup>11</sup> Public Law 111-203—July 21, 2010, 124 Stat.1939.

We conducted this review from September 2011 to January 2012 in accordance with generally accepted government auditing standards. 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 as described in the Scope and Methodology section, provides a reasonable basis for our findings and conclusions based on our audit objectives.

The scope of this audit included an analysis of Vensure from 2008 to April 15, 2011, the date the NCUA placed the credit union in conservatorship. Our review also included an assessment of NCUA regulatory supervision of the institution during the same period.

To achieve the objectives, we performed the following procedures and utilized the following techniques:

- We analyzed NCUA examination and supervision contact reports and related correspondence and workpapers contained within the AIRES<sup>12</sup> system.
- We interviewed management and/or staff from NCUA Regions I and V and reviewed NCUA guides, policies and procedures, as well as NCUA Call Reports, and NCUA Financial Performance Reports (FPR).
- We reviewed Vensure data and correspondence maintained at the NCUA in Tempe, Arizona as provided to Crowe by NCUA.

Crowe relied primarily upon the materials provided by the NCUA OIG and NCUA Region I and V officials, including information and other data collected during interviews. We relied on our analysis of information from management reports, correspondence files, and interviews to corroborate data obtained to support our audit conclusions. We conducted interviews to gain a better understanding of decisions made regarding the activities of credit union management and the NCUA's supervisory approach, and to clarify information and conclusions contained in reports of examination and other relevant supervisory correspondence between the NCUA and Vensure. Crowe relied on the information provided in the interviews without conducting additional specific audit procedures to test such information.

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<sup>12</sup> AIRES is NCUA's Automated Integrated Regulatory Examination System.

## Results in Detail

We determined that Vensure's management and Board contributed to the conservatorship and liquidation as well as the resulting loss to the NCUSIF. In addition, we determined Region I examiners could have prevented or mitigated the loss to the NCUSIF had they adequately identified and more aggressively pursued Vensure's primary source of income.

### A. Why NCUA Conserved Vensure Federal Credit Union

Department of Justice Actions and Inadequate Management Oversight Contributed to Vensure's Conservatorship

We determined NCUA conserved Vensure primarily due to the actions taken by the DOJ, which unsealed an indictment against several leading on-line poker companies<sup>13</sup> that were in violation of the UIGEA. Specifically, the DOJ's actions included the seizure of approximately \$3 billion of assets related to these poker companies, which included the seizure of all

property and funds held on account with Vensure that were traceable to one of its members, Trinity, a processor of internet gambling transactions for on-line poker companies. In addition to Vensure, the DOJ indictment identified more than 20 other financial institutions that also processed internet gambling transactions.

We determined inadequate management and Board oversight also contributed to the conservatorship of Vensure, which exposed the credit union to excessive amounts of financial risk due to its affiliation with a high risk member and a high risk business model. Management allowed Trinity to become Vensure's single largest depositor. At the time the DOJ seized all of Trinity's funds on account with Vensure, the credit union did not have sufficient capital to absorb any ACH returns. The DOJ's actions eliminated Vensure's ability to generate fee income from processing internet gambling payments. Vensure management's overreliance on fee income derived from processing internet gambling transactions and lack of traditional sources of income caused the credit union to become insolvent once they could no longer process these transactions.

In regards to Trinity's ACH payment processing activities:

- Vensure's management and Board were not forthcoming to examiners regarding its ACH FedWire transactions being for internet gambling activities. In an October 2009 strategic plan approved by the Board, the plan made no mention that the credit union's ACH FedWire activities were related to internet gambling processing; despite the fact management had already entered contracts related to this activity from which it derived a significant portion of its revenue.

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<sup>13</sup> The DOJ indictment included two internet gambling companies with ties to Vensure, Pokerstars and Full Tilt.

- Vensure's management and Board did not disclose the ACH payment processing to examiners until early in 2010 when Region V examiners began questioning Trinity's ACH transactions and discovered the transactions were tied to internet gambling activities executed by Pokerstars. However, we believe Vensure management's actions clearly show they were aware that Trinity was processing gambling transactions due to the fact that they (management) had obtained legal opinions in March and August 2009 to support the legality of processing these transactions. Management's actions clearly show they were aware that the ACH activities had an unusual degree of risk.
- During May 2010, Region V officials expressed concerns and issued warnings to the credit union concerning the processing of payments for Pokerstars; however, Vensure subsequently added processing of payments for another online poker company, Full Tilt.
- During 2010, Region V examiners estimated that Vensure derived 90 percent of its revenue from fees for processing internet gambling transactions.
- On April 15, 2011, the DOJ unsealed an indictment against the three leading on-line gambling companies, including Pokerstars and Full Tilt, which had funds traceable to Vensure, through Trinity. Also at this time, the DOJ seized all of Trinity's funds on account with Vensure, which ultimately led to the NCUA placing Vensure into conservatorship.
- Region V examiners determined Vensure did not have a sustainable source of revenue to support its operations after the DOJ's actions eliminated their primary source of income.
- After the DOJ seized Trinity's funds, Vensure had an ACH receivable of approximately \$877,000 as a result of subsequent return items. Vensure sent a demand letter to Trinity on June 22, 2011 requesting the receivable to be paid within seven days, which Trinity failed to do. When Vensure recognized the loss from the uncollectible ACH receivable, the credit union became insolvent.

Vensure management did not conduct operations in the manner of a typical natural person credit union. Although Vensure's Board indicated its intent to operate the credit union to serve the employees of Vensure Employment Services (its FOM) and to offer traditional deposit and loan services to its members, it had minimal loans in 2009 and no loans during 2010 and 2011. In addition, member shares were concentrated in accounts controlled by members of the Board and Trinity. Following are other indicators that the Board did not operate Vensure as a typical natural person credit union:

- Vensure derived 90 percent of its revenue in 2010 and 2011 from one member, Trinity, from fee activity associated with processing ACH payments.
- Regulatory findings in 2009 through 2011 identified numerous issues with inadequate policies, procedures, and systems to operate the credit union.
- Regulatory findings beginning in 2010 identified numerous conflicts of interest including Board members obtaining various sources of income from Vensure.
- The Board failed to implement an effective governance structure including the lack of sufficient independent supervisory committee members and failed to obtain external and other required audits on a timely basis, including a Bank Secrecy Act audit.
- The Board moved the physical location of the credit union from New York to Arizona during 2009 and failed to inform the NCUA of the change in locations. The move coincided with a period of time when the credit union's books and records were believed to be located in Florida.
- The Board changed the credit union's FOM two times after 2008.

Based on the above actions of the Board and management, we believe the Board clearly did not adhere to its stated intention to serve the needs of employees of Vensure Employment Services.

## B. NCUA Supervision of Vensure Federal Credit Union

Region I Examiners Did Not Readily Identify or Adequately Pursue the Source of Vensure's Fee Activity

We determined Region I examiners failed to readily identify or adequately pursue the nature of Vensure's primary source of income, ACH related fee activity, which was later determined to be tied to a criminal violation of the UIGEA. This occurred despite Region I examiners conducting an on-site risk-focused supervisory contact specifically focused on Vensure's FedWire controls and ACH activities and procedures.

Examiners explained they did not identify the nature and scope of Vensure's fee activity because their primary focus was getting the credit union "back on track" through the identification of issues such as appropriate record keeping, written policies, a business plan, and appropriate operating procedures. As a result, we believe Region I examiners not only missed uncovering what turned out to be an elaborate money laundering scheme tied to illegal internet gambling involving several Vensure members, but also could have prevented or mitigated the current and potential loss to the NCUSIF.

NCUA's Region I supervised Vensure from 1955 through 2009 when supervision responsibility transferred to Region V in 2010 due to the credit union's relocation to Arizona. During 2009, Region I identified significant operational and governance deficiencies with Vensure and had taken measures to have management and the Board correct them, including the issuance of an LUA. Region I considered other options to the LUA, including issuing a Cease and Desist, Conservatorship, Liquidation, or Merger but determined the LUA was most appropriate based on the credit union officials' cooperation and response to the numerous governance issues identified as well as the ability to restrict membership growth and operations under the LUA.

NCUA Region I examiners identified the increase in non-interest income but did not identify the nature of the specific activity that made up the majority of Vensure's Earnings component (i.e. fee income) during 2009, despite performing one regular risk focused examination (Effective March 31, 2009) and two risk-focused on-site supervision contacts<sup>14</sup>, one of which was related specifically to Vensure's ACH and FedWire transfers.

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<sup>14</sup> The risk-focused on-site supervision contacts had Effective Dates of June 30, 2009 and September 30, 2009.

Table 1 (below) provides detailed examination results from 2008 through 2010.

**Table 1: Examination Results**

Examination Effective Dates	Exam Type <sup>15</sup>	CAMEL NCUA Composite	Capital / Net Worth	Asset Quality	Management	Earnings	Liquidity
March 2008	10	3	1	2	3	3	2
June 2008	22	2	1	2	2	2	2
March 2009	10	4	3	2	4	3	3
June 2009	22	3	2	2	3	3	2
September 2009	22	3	2	2	3	3	2
March 2010	22	3	2	2	3	3	2
June 2010	10	4	1	1	3	1	1
December 2010	10	4	4	4	3	4	4

### Region I Supervision

From 1999 through 2007, Vensure's assets dropped steadily from \$74 thousand to \$31 thousand, and its CAMEL Composite rating fluctuated between 2 and 3 due to repetitive strategic and transaction risk issues. In 2008, the credit union's FOM and Board changed.

The June 30, 2008 examination (Effective Date) showed that shares, assets, and loans had begun to increase. By year-end 2008, assets, shares, and loans had increased to approximately \$349,000, \$324,000, and \$12,000, respectively. However, during the first quarter of 2009, the growth rates significantly increased with assets expanding to approximately \$2.1 million (a 510 percent increase), shares to approximately \$2 million (a 512 percent increase), and loans to approximately \$639,000 (a 5,371 percent increase). The credit union subsequently sold its loans to a Board member due to various regulatory violations.

The credit union's profitability also increased over this period with the return on average assets (ROAA) climbing from negative 2.61 percent in 2007 to 7.84 percent in 2008 and 40.38 percent (annualized) in March 2009. Most of this increase came from fees and "other operating income" and not from loan or investment income. Although the credit union's profitability had increased and it remained well capitalized, its net worth ratio declined sharply from 37.69 percent in December 2007 to 7.32 percent in December 2008, eventually lowering to 7.06 percent in March 2009 as a result of the asset growth.

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<sup>15</sup> Work Classification Code (Examination Type) 10 is a regular risk focused examination of a federally chartered credit union, whereas an Examination Type 22 is an on-site risk-focused supervision contact.

Table 2 (below) demonstrates selected financial indicators and the growth experienced by Vensure from 2007 through 2010.

**Table 2: Selected Financial Data**

(in thousands)

	12/31/2007	12/31/2008	12/31/2009	12/31/2010
<b>Total Assets</b>	\$ 31	\$ 349	\$ 2,273	\$ 2,706
<b>Net Worth</b>	\$ 12	\$ 26	\$ 315	\$ 907
<b>Net Worth Ratio</b>	37.69%	7.32%	13.86%	33.52%
<b>Net Interest Income</b>	\$ 1	\$ 1	\$ 4	\$ 8
<b>Non-Interest Income</b>	-	\$ 14	\$ 436	\$ 1,812
<b>Net Income (Loss)</b>	\$ (1)	\$ 15	\$ 290	\$ 592

Source: NCUA Form 5300.

On April 22, 2009, the president of the Arizona Credit Union League<sup>16</sup> contacted the NCUA Supervisory Examiner (SE) of Region V to ask for information on GAFCU. The league president told the SE that someone from GAFCU had contacted the Arizona League about wanting to join due to its recent move to Gilbert, Arizona. The Region V SE was unaware of GAFCU's Arizona move and contacted Region I.

As a result of the unannounced move and other changes enacted by management and the Board, Region I initiated a risk focused on-site examination in May 2009 (Effective March 31, 2009). At the conclusion of the examination, Region I examiners assigned GAFCU a CAMEL Composite rating of 4 and issued an unpublished LUA to management and the Board to address the following significant operational deficiencies:

- Operating without familiarity with the Federal Credit Union Act, Bylaws, and Rules and Regulations;
- Operating without appropriate systems of recordkeeping;
- Overdue audit with the last audit having been completed as of December 31, 2007;
- Operating without a formal strategic plan without adequate policies and procedures;
- Operating with a broader FOM than originally intended by NCUA's approval of request to add membership of the NIFEA; and

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<sup>16</sup> The Arizona Credit Union League is a trade organization which represents member credit unions located in Arizona. League services include advocacy, education, and providing members with access to league partnerships. In 2011, the Arizona Credit Union League was part of a three way merger to form the Mountain West Credit Union League that represents member credit unions in Arizona, Colorado and Wyoming.

- Impermissible loans issued.

In addition, the LUA also required GAFCU management and Board to:

- Obtain appropriate training;
- Select a data processing vendor and implement recordkeeping and internal controls;
- Obtain an audit of the financial statements;
- Develop a business plan, budget, and written policies;
- Cease accepting new members;
- Cease granting new loans; and
- Request approval for changes in the Board and executive officers.

In August 2009, Region I examiners conducted an on-site risk-focused supervisory contact (Effective June 30, 2009) related to the issues raised in the LUA. The results revealed that management and the Board were in substantial compliance with the LUA and thus examiners upgraded the credit union from a CAMEL Composite rating of 4 to a rating of 3. However, the LUA remained in place pending management's submission and Region I's review of GAFCU's business plan.

Region I's last supervisory contact prior to supervision responsibility changing to Region V took place in December 2009 (Effective September 30, 2009). The primary focus of this supervisory contact was a high level review of FedWire controls and ACH activities and procedures. As previously mentioned, Region I examiners did not identify the nature and scope of the credit union's large amount of fee activity, but did approve the credit union's business plan and lifted the LUA on February 19, 2010.

We believe through cycle to cycle Call Report and data analysis, Region I examiners should have identified earlier in 2009 the significant and steady increases in non-interest income derived from ACH activity concentrated in one member. We also believe examiners should have considered these red flags when planning and executing their risk-focused examination activities, especially in the area of ACH/FedWire activities since the Call Report data clearly showed the credit union generated its primary source of income from fee activity.

Vensure's 5300 Call Reports indicate that during 2009, Vensure clearly acted as a third-party ACH/FedWire processor, which inherently involves a higher level of risk.

Some of the red flags identified related to Vensure's ACH and FedWire activity included:

- Significant and rapid increases in non-interest income during 2009, especially considering the small size, limited membership, and asset composition of the credit union;
- The supervision log listed numerous wires which were very large considering the size of the credit union.

Despite these red flags, Region I examiners failed to readily identify and adequately pursue Vensure's primary source of income, their ACH related fee activity, which was later determined by the DOJ to be tied to a criminal violation of the UIGEA.

In 2008, NCUA issued Supervisory Letter 08-01 Evaluating Current Risks to Credit Unions to bring to examiners' attention emerging risks in the credit union industry. Although Supervisory Letter 08-01 focused on issues related to the economic climate at that time, it also alerted examiners to be aware of areas such as credit unions changing business models and balance sheet composition, and the Risk Focused Examination supervision program (with an emphasis on district management and off-site monitoring).

During our interviews with Region I supervisory personnel, they indicated that the focus of the examinations during 2009 were primarily directed at getting the credit union back on track with appropriate record keeping, written policies, a business plan, and appropriate operating procedures in line with the focus of the LUA. Although Region I increased the level of supervisory contacts, the primary focus remained on the items identified within the LUA. In addition, late in 2009, the credit union's increased fee income did cause Region I to direct a field examiner to review ACH and FedWire controls, however the examiner's review did not focus on the nature of the activity creating the increased level of fees. In addition, Region I never considered using an ACH specialist to review the activity, which might have also identified the nature and scope of the rapidly increasing fee activity.

#### Region V Supervision

In February 2010, NCUA Region I lifted the LUA and transferred supervision of Vensure to Region V. During Region V's first supervisory contact (Effective March 31, 2010), examiners identified the source of Vensure's fee activity was from processing internet gambling payments that flowed through the credit union from ACH transactions tied to one of its members, Trinity.

When Region V examiners further explored the nature and scope of the fee activity, they determined Vensure had been processing electronic funds for its non-natural

person members<sup>17</sup> as far back as the third quarter of 2008, with electronic funds transfer activity picking up significantly during 2009. Region V examiners also learned that Vensure had entered into an ACH agreement with Trinity in early 2010, which essentially committed Vensure to processing ACH transactions (i.e. internet gambling payments) on behalf of Trinity. As previously discussed, Vensure derived 90 percent of its operating income from processing internet gambling payments.

Upon the identification of Vensure's internet gambling related ACH transactions, Region V examiners also sought legal advice from NCUA's Office of General Counsel (OGC). Region V examiners continued to communicate with the OGC as various legal issues surrounding the processing of internet gambling payments were vetted and during the time that a federal investigation into the online poker companies was ongoing. Also at this time, examiners issued a Document of Resolution (DOR) to Vensure's management and Board requiring them to obtain legal opinions from each state from which internet gambling activity had originated or Vensure had executed an ACH payment transaction. Examiners wanted Vensure management to provide this information to support the legality of their ACH FedWire processing transactions. In addition, the DOR also required Vensure management to increase its reserves related to ACH payment activity and cease processing all of Trinity's transactions until such time that OGC could review the requested legal opinions.

In November 2010, Region V examiners had begun a regular risk focused examination (Effective June 30, 2010) and OGC had completed its review and concluded that the opinions Vensure management had obtained failed to address the legality of internet gambling. Examiners, however, delayed the examination's completion pending a decision on how best to address Vensure's ACH processing of internet gambling transactions.

Initially, Region V officials considered issuing a Cease & Desist Order (C&D) that would instruct Vensure management to cease all ACH processing related to internet gambling transactions until such time they could secure documentation attesting to its legality. After consulting with OGC, Region V officials determined a C&D was not the most appropriate course of action, and instead issued a Preliminary Warning Letter (PWL). On January 18, 2011, Region V issued a PWL to Vensure management requiring them to stop ACH/FedWire processing for their member until they obtained the proper legal opinions under UIGEA.<sup>18</sup> We determined in subsequent examinations that not only had Vensure management failed to stop processing payments for Trinity stemming from the aforementioned DOR, but they had entered into an agreement on December 1, 2010 to process payments for two additional on-line gambling companies.

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<sup>17</sup> Prior to this contract, Trinity had processed its ACH transactions through M2 Global, another Vensure member.

<sup>18</sup> According to a Memorandum from the NCUA's Associate General Counsel, on-line gambling transactions are not permissible according to the UIGEA.

Region V examiners then learned through Vensure's CEO that the credit union continued to process ACH FedWire transactions related to internet gambling payment activity. Region V examiners scheduled an on-site supervision contact for January 27, 2011 to ascertain the status of Vensure management's compliance with the PWL. The credit union's CEO and Treasurer indicated that the Board met and decided to fully comply with the PWL going forward and that all processing of ACH transactions related to processing internet gambling payments would cease immediately. The next day, Vensure management submitted a letter confirming that they would cease the activity.

Subsequent to the letter Vensure management submitted indicating they would cease all ACH processing activity, Vensure management sent a second letter to the Region V Regional Director indicating that because they were required to meet their fiduciary responsibility toward its member, Trinity, Vensure had terminated the contract within the 180-day notice requirement, but would not cease processing ACH transactions related to internet gambling payments until a determination by a competent legal authority had occurred through the NCUA in either an administrative hearing or a court of law.

Region V examiners confirmed that by the week of March 31, 2011 Vensure management was still processing ACH transactions related to on-line gambling payments. On April 15, 2011, the DOJ unsealed an indictment against the three leading on-line poker companies, including Pokerstars and Full Tilt. Also at this time, the DOJ seized all of Trinity's funds on account with Vensure, which ultimately led to the NCUA placing Vensure into conservatorship on the same date.

Region V officials worked closely with NCUA OGC to determine the appropriate regulatory action related to the internet gambling payment activity Vensure processed for its members. This close interaction allowed Region V officials to coordinate the conservatorship of Vensure to coincide on the same date as when the U.S. Attorney initiated a forfeiture action against Trinity and seized its funds on deposit at Vensure.

### **Observations and Lessons Learned**

We believe the significant and rapid increase in Vensure's fee related income, as well as the size of the individual and cumulative ACH wire transactions given the small size of the credit union, the significant change in the make-up of its management and Board, and its few traditional sources of income, should have triggered Region I examiners to expand the scope of their on-site examinations and supervision contacts to thoroughly evaluate the credit union's income to determine the nature of its source and why it increased so rapidly. In addition, we also believe Region I examiners' off-site monitoring of Call Reports and other financial performance data should have also identified this same questionable income activity and triggered examiners to look into the matter further.

Also, despite Region I having an examiner review the controls over Vensure's ACH and FedWire activities during 2009, there was no detailed review by examiners regarding the nature and scope of the business fee income during this same time period. We also found no evidence that Region I examiners extensively questioned Vensure's management and Board about its new business model, which may have also uncovered the nature and scope of the credit union's fee activity.

We believe the credit union's Call Reports and other financial performance ratios also provided clear indicators that the credit union was experiencing significant and rapid increases in fee income, where traditional sources of fee income did not exist. This too should have prompted examiners to perform further analysis on the source of the activity that was generating the significant fee income.

Important lessons learned from our review of this conservatorship include:

- Examiners must perform adequate due diligence when working with a new management team and Board. Inquiring with management regarding business plans and operations to gain an understanding as well as assessing management's ability to competently carry out those plans is crucial. In addition, examiners must consider operational results in its understanding and assessment of managements' plans.
- Examiners must be aware when a credit union changes its business model and perform all necessary inquiries.
- When examiners identify significant changes or questionable transactions in the balance sheet, Call Reports, and other financial performance data, they must look behind the numbers for answers to explain why such changes are occurring.
- Examiners must seek assistance from Supervisory Examiners or other experts in an area, such as ACH/FedWire transactions, if an explanation for why numbers are rapidly increasing or decreasing cannot be found.

## **Recommendations**

Based on the findings in this report, we are making the following two recommendations to NCUA management:

1. Remind examiners to fully evaluate questionable items in financial data consistent with a reasonable risk assessment and evaluation of the level of risk exposure, and to seek assistance from Supervisory Examiners or other specialists when significant risk issues are identified.

## **Management Response**

Management agreed with the recommendation and will take action to implement plans to address the issue through the soon to be released National Supervision Policy Manual. The Manual will emphasize the importance of evaluating financial trends and instruct examiners to recommend specialized resources in consultation with their supervisor when warranted based on the size, complexity, or potential risk to the National Credit Union Share Insurance Fund.

## **OIG Response**

We concur with management's planned actions.

## **Recommendation**

2. Develop additional off-site monitoring triggers for Call and other financial performance reports, including specific procedures to require supervising examiners to review and sign off on those items raised as "red flag" issues to ensure such items are fully investigated by examiners.

## **Management Response**

Management agreed with the recommendation and will continue to explore whether they need to develop additional risk triggers when performing reviews of risk and FPR triggering reports.

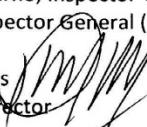
## **OIG Response**

We concur with management's planned actions to continually review and evaluate the battery of risk reports to determine whether additional risk triggers are needed. The OIG will also ensure during follow-up on this recommendation that the newly developed 5300/FPR Trending System includes specific procedures that require supervising examiners to review and sign off on those items raised by examiners as "red flag" issues.

## Appendix A - Management Response

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### SENT VIA E-MAIL

TO: William DeSarno, Inspector General  
Office of Inspector General (OIG)  
  
FROM: Dave Marquis  
Executive Director  
SUBJ: Comments on Material Loss Review of Vensure FCU #10293  
DATE: February 22, 2012

This memorandum responds to your request for official comments on the OIG draft report titled *Material Loss Review (MLR) of Vensure Federal Credit Union*. Vensure Federal Credit Union (Vensure) failed as a result of seizure of funds from Vensure's largest depositor due to:

1. The member's involvement in processing of on-line gambling transactions;
2. Exposure to excessive financial risk by Vensure's management and Board due to its affiliation with on-line gambling business settlement activity and;
3. An overall weak business model.

### **MLR Report Recommendations**

The MLR includes two recommendations. We agree with the recommendations and have taken appropriate action or will take action as outlined below:

1. ***Remind examiners to fully evaluate questionable items in financial data consistent with a reasonable risk assessment and evaluation of the level of risk exposure, and to seek assistance from Supervisory Examiners or other specialists when significant risk issues are identified.***

**Response:** We agree examiners should fully evaluate significant and rapid fluctuations in financial data and seek assistance from Supervisory Examiners or other specialists when significant risk exposure is identified. SME examiners and specialists are routinely used during the examination process to gain a deeper understanding of issues and concerns when risk exposure levels warrant. Examiners are challenged to make risk based decisions on a routine basis based on the materiality of risk exposure to the insurance fund.

We have already taken action to implement this recommendation. The soon to be released National Supervision Policy Manual (NSPM) emphasizes the importance of evaluating financial trends by requiring quarterly written 5300 Call Report Risk Reviews based upon national risk reports. The NSPM also outlines the use of specialized expertise by instructing examiners to recommend specialized resources in consultation with their supervisor when the size, complexity, or potential risk to the NCUSIF warrants it. We will train staff on the NSPM during the National Conferences in April 2012, to communicate these responsibilities.

In addition, our recent change to minimum scoping requires examiners to address risk flags and unusual or troubling trends identified by quarterly surveillance, and document conclusions as part of the examination scope. We provided training to staff in the second quarter of 2010 on proper scoping which included ensuring quarterly surveillance risk triggers are formally addressed in the examination scope.

2. *Develop additional off-site monitoring triggers for Call and other financial performance reports, including specific procedures to require supervising examiners to review and sign off on those items raised as "red flag" issues to ensure such items are fully investigated by field examiners.*

**Response:** We continually review and reevaluate our battery of risk triggers to ensure they evolve with the changing risk profile of the industry. We believe the current battery of risk reports provides examiners with adequate data to identify and evaluate significant and rapid fluctuations in financial data. We will explore whether additional triggers need to be included to highlight potential material exposures as part of our 2012 review of risk report and FPR triggering reports.

As part of the development of the NSPM, NCUA formalizes the risk trending and surveillance review process. The NSPM, as noted above, emphasizes the use of risk reports to identify emerging issues and includes the requirement for quarterly written 5300 Call Report Risk Reviews. The "5300 Call Report and Financial Performance Report Trending" portion of the NSPM establishes responsibilities of the field staff and supervisory examiners. E&I and OCIO are developing a 5300/FPR Trending System, which will provide information related to the FPR, Risk Reports and 5300 Call Report data. Supervisory examiners have responsibility for reviewing the risk reports, evaluating examiner risk conclusions and adjusting resources consistent with the level of risk exposure.

NCUA is committed to ensuring our policies, procedures and systems appropriately identify emerging risk. Thank you for the opportunity to comment.

cc: Executive Director Dave Marquis  
Deputy Executive Director John Kutchey  
E&I Director Larry Fazio  
Acting Deputy E&I Director Mark Vaughn  
Director E&I Risk Management Tim Segerson  
Director E&I Supervision Matt Biliouris  
Regional Director Elizabeth Whitehead  
ARDO Cherrie Freed  
Regional Director Mark Treichel  
ARDO Michael Wheeler  
General Counsel Mike McKenna  
AMAC President Mike Barton  
Deputy Inspector General James Hagen

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