UNITED STATES OF AMERICA
BEFORE THE NATIONAL CREDIT UNION ADMINISTRATION

In the Matter of

XXXX Docket BD-08-19

Appeal of Supervisory Review Committee Determination
To Affirm Regional Disapproval of Request to Accept
Secondary Capital

**Decision and Order on Appeal**

**Decision**

This matter comes before the National Credit Union Administration Board (Board) [1] as an administrative appeal under 12 C.F.R. Part 746, Subpart A. The appeal concerns the determination by the Supervisory Review Committee (SRC) to affirm the Regional Director for the XXXX Region's (Region) denial of an application to accept secondary capital by XXXX Federal Credit Union (Petitioner).

***Background.*** Petitioner, a low-income designated credit union (LICU), is appealing the SRC's decision to affirm the determination of the Region to deny Petitioner's application to accept secondary capital accounts in the amount of $XXXX. The Region initially denied Petitioner's secondary capital plan (SC Plan)[2] on December 20, 2018, and affirmed its denial upon reconsideration by letter of February 14, 2019. Petitioner appealed the Region's determination to the SRC, and requested an oral hearing on the matter. Petitioner also requested additional information from the primary examiner, among other things. Petitioner's request for additional information from the primary examiner was denied by letter from the SRC Panel Chairman on April 1, 2019, and an oral hearing before the SRC was held at the NCUA's headquarters on June 21, 2019. On July 22, 2019, the SRC issued a written decision, affirming the Region's denial of Petitioner's SC Plan. Petitioner is seeking administrative review of that determination by the Board. [3] In connection with its appeal, Petitioner requested approval to present its case orally before the Board. The Board denied that request[4] on September 9, 2019, by notation vote, but agreed to consider the merits of the appeal on the basis of the written record.

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[1] Chairman Hood and Board Member Harper considered this appeal. Board Member McWatters was recused from this matter.
[2] Petitioner hired XXXX (XXXX) to prepare its application and SC Plan. XXXX also assisted Petitioner in the preparation of its appeal.
[3] The appeal letter was received by the Board Secretary on August 21, 2019.
[4] Petitioner's request for oral hearing argued there was good cause for an oral presentation, and the appeal could not be presented adequately in writing, primarily because "the case presents 'significant issues of supervisory policy' that impacts all [LICUs]," and the issues in this case "involve the interpretation of NCUA Regulations that cannot be

***Secondary capital regulation.*** The central issue on appeal in this case involves questions of regulatory interpretation relative to the NCUA's secondary capital rule. Both Petitioner and the Region appear to agree that §701.34(b)(1) of the secondary capital rule establishes five criteria upon which a regional director will consider a federal credit union's application to accept secondary capital accounts. However, the parties disagree on the relative subjectivity allowed within the scope of that provision.

As discussed in the Board's recent decision in Docket BD-07-19 (BD-07-19),[5] a separate appeal involving a similar fact pattern and raising nearly identical substantive issues, it is clear and unambiguous that the secondary capital regulation sets forth the minimum content requirements for what a federal credit union must submit in a secondary capital plan that is forwarded to the NCUA for approval. The rule does not go further to impose a mandatory duty on the regional director to approve secondary capital plans that include the five minimum components in §701.34(b)(1).[6] Accordingly, the Board concluded in that case that the SRC was correct in affirming the Region's multiple safety and soundness concerns regarding the credit union's SC Plan were reasonable, well supported, and within the scope of the rule.

Similarly, here, there is ample support in the written record that Petitioner's SC Plan is not sound. The Region points to multiple, legitimate safety and soundness concerns regarding Petitioner's SC Plan. The SRC echoed and expanded on those concerns and concluded the denial of the SC Plan was appropriate.

***Regulatory standard of review.*** Petitioner argues the SRC erred in its decision to affirm the Region's denial because, under §746.104(a), it is obligated to give no deference to the legal or factual conclusions of the program office or subordinate reviewing authority. Petitioner contends the SRC failed to meet the rule's standard of review because the SRC reiterated several conclusions of the Region and thus, it argues, the SRC did not render an independent decision on whether the Region's decision was appropriate.

Section 746.104(a) of NCUA's regulations states, in pertinent part:

> Each reviewing authority shall make an independent decision regarding whether a material supervisory determination by the program office subject to appeal was appropriate. The reviewing authority shall give no deference to the legal or factual conclusions of the program office or a subordinate reviewing authority; *provided,*

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resolved through the reconsideration process or at the SRC level." However, a separate appeal, BD-07-19, involving similar facts and raising substantially identical issues relative to the interpretation of the secondary capital rule was already pending before the Board. In that case, the Board determined there was good cause for an oral presentation because the case involved questions of regulatory interpretation that presented issues of first impression for resolution through the Board appellate process. The oral hearing for BD-07-19 was held on September 24, 2019. To the extent that the Board was already scheduled to hear oral presentation on the same substantive issues in short order in another appeal, the Board determined an oral hearing was not warranted in this case.

[5] The Board's appeal decisions are available on the agency's website at https://www.ncua.gov/about-ncua/ncua-board/board-appeals. The NCUA posts Board appeal decisions dating back to 1994, with redactions made for personal privacy in accordance with exemption (b)(6) of the Freedom of Information Act (FOIA).

[6] The Board adopts the analysis in BD-07-19, by reference, in this decision.

> *however,* that the burden of showing an error in a material supervisory determination shall rest solely with the insured credit union.[7]

Section 746.104(a) does establish a *de novo* standard of review for each stage of the SRC appeals process. This means that each reviewing authority will make an independent decision regarding whether a material supervisory determination subject to appeal was appropriate, without giving deference to the conclusions of the program office. The objective of the *de novo* standard of review is to ensure that the appealed determination is correct and not merely reasonable.[8] Thus, if a reviewing authority determines the appealed determination is incorrect upon its respective independent review, then it will render a corrected determination.

The standard of review articulated in §746.104(a) is a relatively low standard of review such that the program office decision can be overturned or varied if the respective reviewing authority determines the subordinate authority's decision is incorrect.[9] But this standard of review does not preclude a higher reviewing authority from agreeing with the subordinate reviewing authority, or from reiterating its concerns, or from determining that its conclusions are reasonable. In other words, the regulatory standard of review does not require the reviewing authority to disregard or ignore the subordinate authorities' assessment, it simply provides that it will not be held to that determination and is free to make a different determination in its own judgment.

Here, the Board is required to give no deference to the Region's or the SRC's determination but it is not obligated to substitute its own judgment for that of those authorities delegated with the responsibility for making judgments and determinations like the one under appeal in this case. The standard of review in §746.104(a) *allows*[10] the Board to substitute its own judgment for that of the subordinate authority but does not *require* it.

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[7] 12 C.F.R. §746.104(a) (emphasis in original).

[8] While the Board is not a reviewing court, in general, a *de novo* review is "independent." *See Agyeman v. INS*, 296 F.3d 871, 876 (9th Cir. 2002). No deference is given to the lower court. *See Barrientos v. Wells Fargo Bank, N.A.*, 633 F.3d 1186, 1188 (9th Cir. 2011). *De novo* review means that the court will "view the case from the same position as the district court." *Hyatt v. Office of Mgmt. & Budget*, 908 F.3d 1165, 1170 (9th Cir. 2018) (citing *Nev. Land Action Ass'n v. U.S. Forest Serv.*, 8 F.3d 713, 716 (9th Cir.1993) (quoting *Marathon Oil Co. v. United States*, 807 F.2d 759, 765 (9th Cir.1986))).

[9] In contrast, generally speaking, a high standard of review means deference is accorded to the determination under appeal, such that it will not be disturbed merely because the reviewing authority might have come to a different determination. *See, e.g.*, *Krull v. SEC*, 248 F.3d 907, 914 (9th Cir. 2001) (noting deferential standard of review "constrains us, even if we might decide otherwise were it left to our independent judgment"). Under a high standard of review, the subordinate authority's decision will be overturned only if determined to have been made in obvious error.

[10] Generally, a court will not substitute its judgment for that of the agency in reviewing a final agency determination. *See, e.g., Kleppe v. Sierra Club*, 427 U.S. 309, 410, n. 21 (1976). A federal court is barred from substituting its judgment for that of an agency if the exercise of that judgment would require it to perform functions which are "essentially legislative or administrative." *Federal Radio Commission v. General Electric Co*., 281 U.S. 464, 469 (1930). Indeed, under Article III of the Constitution the courts cannot perform non-judicial functions. *See Keller v. Potomac Electric Power Co*., 261 U.S. 428 (1923). However, courts have determined that, as part of the decision making unit of the agency, a presiding officer in an administrative appeal, unlike a reviewing court, is free to substitute his judgment for that of the program office that made the determination subject to appeal, where the facts and circumstances warrant it. The principal limitation on his authority is the requirement that his

In fact, courts have determined that significant weight should be given to the recommendations of expert bank (or credit union) examiner. For example, in *Sunshine State Bank v. F.D.I.C.*, the court noted that predictive judgments made by examiners are the kind of agency function that are "primarily a question of probabilities, and thus peculiarly subject to the expert experience, discretion, and judgment of the [agency]."[11]

In considering this appeal *de novo*, the Board is at liberty, but not obligated, to substitute its judgment for that of the SRC or the Region. The Board is free to consider the judgment and recommendations of the agency's experts, and to agree with the determinations of the Region and the SRC, even if it is not bound to give deference to them.

In any regard, the Board finds Petitioner's argument on this point unpersuasive. Petitioner argues the SRC should have given no deference to the legal or factual conclusions of the Region, yet simultaneously asserts the SRC exceeded its regulatory authority in rendering a determination, "replete with its own opinions" [12] regarding the sufficiency of Petitioner's SC Plan. Petitioner contends the SRC erroneously "gives complete deference" to the conclusions of the Region, while also protesting that it "expands upon them."[13] In the Board's view, it is incongruous to assert the SRC must not give deference to the Region's determination, while also maintaining it erred in coming to an independent decision replete with its "own opinions" and which "expands" upon the Region's decision. To the contrary, the fact that the SRC's decision included its own expanded analysis and opinions bolsters, not undermines, the notion that the SRC properly conducted a *de novo* review of the appeal as required under §746.104(a).

Here, the Board takes the view that Petitioner's SC Plan reflects inadequate due diligence. The lack of detail and material omissions in Petitioner's pro forma financial statements do not allow the agency to properly evaluate the safety and soundness of the plan. Moreover, the SC Plan does not adequately correlate to Petitioner's forecasts and strategic plan. Notably, both the Region and the SRC have determined, and the Board agrees, that because there is a negative spread between the projected interest rate for the secondary capital loan (XXXX%) and the average rate of return for the assets in the safety net plan (XXXX%), this negative spread will become a stress on earnings and a duration mismatch between funding sources.

***Conclusion.*** As the Board determined in BD-07-19, before granting approval for a low-income designated federal credit union to accept secondary capital accounts, the FCU Act and applicable NCUA regulations mandate that the agency consider a credit union's secondary capital plan, including its underlying safety and soundness, which must meet minimum content requirements and be forwarded to the NCUA for approval per §701.34(b). The regulation is clear and unambiguous that the Region has no mandatory obligation to approve an uninsured secondary capital plan meeting the minimum content requirements in §701.34(b). In this case, the Region has multiple, legitimate safety and soundness concerns, well documented in the record, about

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decision be based solely on the facts appearing of record in the proceeding. *See In the Matter of: National Pollutant Discharge Elimination System Permit for Louisville Gas & Electric Company Trimble County Power Plant*, 1981 WL 37729, at *4 (1981).

[11] *Sunshine State Bank v. F.D.I.C.*, 783 F.2d 1580, 1582 (11th Cir.1986).

[12] Petitioner's Notice of Appeal, p. 30.

[13] *Id.*

Petitioner's SC Plan. Consistent with the standard in §746.104(a), the SRC conducted a *de novo* review of the administrative record and made an independent decision[14] that the Region's "safety and soundness concerns were correct,"[15] and its decision to deny the application was both "appropriate,"[16] and "consistent with the regulation."[17]

While giving no deference to the subordinate authorities' determinations, the Board is not obligated to substitute its own judgment for that of the subordinate authorities in order to come to an independent decision on this appeal. The Board is free to come to a different decision on the application, but it is likewise free to agree that the subordinate authorities' assessments and determinations regarding Petitioner's SC Plan are reasonable, appropriate and correct, and thus, to come to the same decision on appeal. Such is the case here.

Accordingly, upon a review of the entire written record in this case, the Board finds that the Region's denial of Petitioner's application for secondary capital, which was affirmed by the SRC, is reasonable and appropriate, and sees no error or sound legal basis on which to overturn it.

The Board emphasizes that this Decision and Order does not preclude Petitioner from submitting to the Region a new or subsequent application and SC Plan. As the SRC stated in its decision, and the Board reiterates here, should Petitioner choose to reapply for secondary capital, the agency encourages ongoing dialogue with the Region to address deficiencies discussed in previous denials.[18]

## Order

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

The Board upholds the decision by the Supervisory Review Committee and denies the appeal of XXXX Federal Credit Union.

The Board's decision constitutes a final agency determination and is subject to judicial review in accordance with Chapter 7 of Title 5 of the United States Code.

So **ORDERED** this 24th day of October, 2019, by the National Credit Union Administration Board.

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[14] The SRC's appeal decisions are available on the agency's website at https://www.ncua.gov/regulation-supervision/supervisory-review-committee/appeal-decisions. Published SRC appeal decisions, including intermediary decisions issued by the Director of the Office of Examination and Insurance, may be cited as precedent in appeals of material supervisory determinations. These decisions are published by subject matter, with redactions to protect confidential or exempt information.
[15] SRC-06-19, p. 9.
[16] *Id.* at 11.
[17] *Id.* at 9, 11.
[18] *See id.*, fn. 1.

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Gerard Poliquin
Secretary of the Board