

UNITED STATES OF AMERICA
BEFORE THE NATIONAL CREDIT UNION ADMINISTRATION

In the Matter of

XXXX

Docket No. 04 – 16

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 Regulations¹ 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 actual balance at liquidation in a share draft account maintained by XXXX at Lynrocten.

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 perpetrated by its manager, Sue Newcomb, and its teller, Teresa Humphries, who embezzled a substantial sum of money over several years. Both women are presently incarcerated. There was no conservatorship in this case; instead, Lynrocten was placed immediately into liquidation.

The fraud that occurred at Lynrocten resulted in the compromise of the accounts of several members, including XXXX, who had both a regular share account and a share draft account. According to Lynrocten’s records, the balance in XXXX’s regular share account at liquidation was \$5.00, for which she has been paid. As of the liquidation date, following the payment of several items that were in process, the share draft account balance was negative \$196.38. Lynrocten’s records also showed XXXX to be the obligor on a loan, with a balance as of the liquidation date of \$6,950.66. The ALA sent a generic member letter to XXXX on May 7, 2013, advising that a statement of account would be sent under separate cover showing balances as of the liquidation date. The letter directed XXXX to confirm the actual balances using a “Members Confirmation and Affidavit Form,” a copy of which was also enclosed with the letter. The letter advised XXXX that

¹ 12 C.F.R. §745.202

she should use the form of affidavit to contest the amounts shown on the statement of account and to claim any balance alleged to be owed to her.²

XXXX completed the affidavit and returned it to the ALA, indicating that she disputed both the share draft account balance and her obligation on the loan. This affidavit, dated May 17, 2013, was accompanied by a letter from XXXX in which she specifically denied any obligation on the loan and challenged the finding on her share draft account balance, which she asserted should have been \$400.

The ALA responded to XXXX by letter dated September 27, 2013. This letter provided XXXX with copies of account statements for 2013 and 2012 (erroneously referred to in the letter as “2013 and 2013”) and requested that she review them and identify any specific transaction that she disputed. The letter went on to invite XXXX to provide copies of any documentation that might support her view concerning her share draft account’s liquidation balance. Examples of the type of documentation that would be useful were identified, including canceled checks, receipts, bank statements, and share certificates. The letter advised XXXX to disregard any loan information in the materials, noting that research concerning the loan account would be completed at a later date.

XXXX completed a second affidavit on October 15, 2013, using a form supplied with the ALA’s September 27th letter, by which she again challenged the share draft account balance calculation. She noted that she had not received any statements from Lynrocten since the death of her father in January 2010. However, she stated that she had called the credit union on April 1, 2013, to inquire as to her account balance and was told that her balance at that time was approximately \$25. She noted that she survived entirely on a Social Security disability payment of \$972 per month, which was deposited directly into her share draft account. After the deposit of that payment for April, she wrote five checks, all of which were returned for insufficient funds. Accordingly, XXXX asserted that her account balance should be \$997, based on the oral representation of the balance given to her by Lynrocten personnel, together with her Social Security deposit for that month.

In response, the ALA undertook a comprehensive review and reconstruction of the entire relationship between XXXX and Lynrocten. By January 2014, the ALA made the determination to write off the loan account, based on research showing that it had been created and charged to XXXX fraudulently. In addition, withdrawals that had been made from the account to service the loan were reversed. However, the ALA’s research did not reveal any other fraudulent withdrawal activity with respect to the share draft account. The ALA did uncover fraudulent deposit activity in the account, in the form of fictitious deposits that were made to cover checks and other withdrawals by XXXX from the account. The analysis also included an assessment of the relationship between XXXX’s account and an account maintained by her mother, to whom XXXX had referred as having been affected by the fraud at Lynrocten. The investigation revealed a series of fraudulent transfers from the account of the mother into XXXX’s account, beginning in June 2012 and continuing through the date of liquidation. All of these transactions were reversed except one transfer of \$500, which the mother acknowledged to be legitimate.

² NCUA has changed the form and content of the initial communication with members following the appointment of a liquidating agent since the date of Lynrocten’s liquidation. Under the present approach, in cases in which there is doubt about the accuracy of the credit union’s account records, the letter will include a disclaimer with the account summary notifying the member that the information is subject to change based on investigation and that the summary should not be considered an accurate or legally binding statement of account.

By letter of October 19, 2015, the ALA conveyed the conclusion that XXXX had, in fact, significantly overdrawn the account by \$25,461.38 as of the date of liquidation. The ALA provided XXXX with a statement showing the reconstruction of the account, including transactions affecting the account since January 1, 2010. Despite the overdrawn status of the account, the ALA offered to pay XXXX \$100 as full settlement of the account.

XXXX responded to this overture by letter of November 2, 2015, stating that she believed the account reconstruction provided by the ALA was based on fraudulent, and therefore unreliable, records maintained by Lynrocten. Noting that its two principal employees had both been convicted of theft and fraud, XXXX expressed incredulity that the ALA would give any credence whatsoever to the records of Lynrocten. She characterized the purportedly overdrawn balance identified by the ALA as “completely ridiculous,” and she indicated her belief that Lynrocten would have never allowed such an overdrawn condition to persist. She denied having made multiple credit card payments during a given month, as reflected in the reconstruction. Again noting that she survived on a fixed income, she requested that NCUA simply reimburse her last Social Security payment of \$972.

In response, the ALA undertook another full scale account review and reconciliation. By letter of August 8, 2016, NCUA’s Asset Management and Assistance Center (“AMAC”) conveyed to XXXX the results of its final, comprehensive account reconstruction. In this letter, AMAC again recited its view that the account balance at liquidation was negative \$25,461.38. However, the letter also stated that AMAC was prepared to revise its conclusion by providing credit for certain deposits to the account that initially appeared dubious or questionable. The result of this allowance was that the account was still negative, albeit in the smaller amount of \$7,256.72. Support for this calculation was enclosed with the letter. XXXX was invited to either seek reconsideration or appeal the determination to the Board.

By letter dated August 16, 2016, XXXX requested reconsideration. She characterized the reconstruction as having been based on records that were “completely false,” and she again questioned why Lynrocten would have allowed her to remain in an overdrawn position for so long. She acknowledged that she did not have statements that could verify or support her position relative to the balance in the account. In response, AMAC assigned a different analyst to reconsider the issues. By letter dated September 21, 2016, AMAC advised XXXX that, because she had not provided any new information with her request for reconsideration, the original account determination of negative \$7,256.72 was reaffirmed. The letter invited XXXX to appeal this determination to the NCUA Board, which XXXX did by letter of November 14, 2016 (received on November 22nd).

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.³ Ordinarily, the ALA 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,

³ 12 C.F.R. §745.200(a).

where it is known that fraud and embezzlement occurred, and also that some 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, ACH and EFT records, and teller transaction details. The ALA created a database with this information that was used to populate a spread sheet, and all transactions having any impact on XXXX's account since January 1, 2010 were evaluated and analyzed. The ALA determined that the following account adjustments to the liquidation balance were warranted:

- Withdrawals from the account totaling \$3,059.66 that were traced to fraudulent loan repayments were reversed and credited to the account.
- Fraudulent transfers in to the account in the amount of \$5,610 that were traced as coming from the account of XXXX, XXXX's mother, were reversed. One deposit, in the amount of \$500, was acknowledged by the mother as legitimate and was allowed to stand.
- Deposits in the amount of \$3,200 in the form of kited checks drawn on an unrelated member's account were reversed as fraudulent.
- Deposits in the amount of \$1,310 that were traced as fraudulent withdrawals from the accounts of other members were reversed.

Initially, the ALA reversed all deposits in cash to the account, since XXXX had said she did not generally conduct her credit union business in cash. The net result, if all cash deposits were reversed, would be an account balance at liquidation of negative \$25,461.38. As discussed above, in an effort to provide the benefit of any doubt to XXXX's favor, the ALA provided credit for the cash deposits to the account, despite some doubt as to their legitimacy. Even with that favorable adjustment, however, the account balance at liquidation was still negative (i.e., \$7,256.72).

The ALA was able to confirm that the direct deposits of Social Security funds were received each month by the credit union and that full credit for these deposits was provided. The ALA was also able to trace each withdrawal from the account that appeared to be legitimate, based on copies of paid drafts and ACH reports. The ACH reports confirmed that credit to an account in XXXX or her mother's name had been provided. This basic research showed that XXXX was significantly overdrawn as of the date of liquidation.

XXXX does not specifically refute that these apparently legitimate transactions in her account occurred. She does not, for example, dispute a particular payment to a particular creditor, or allege that she did not sign a given check as drawer. Instead, she provides a general disclaimer, alleging, for example, that she did not ever make multiple payments on her credit card account during any given month. Her position is founded on two related principles: first, that Ms. Humphries and Ms. Newcomb had so significantly manipulated the records with their criminal behavior as to render any determination regarding her account inherently suspect and unreliable, and second that the account reconciliation must be inaccurate because no financial institution would ever be foolish enough to allow such egregious overdrafting for such a lengthy period of time. Each of these arguments is discussed below.

Records in disarray. It is true that the account records at Lynrocten were compromised and unreliable on their face. However, the ALA was able to successfully go behind the superficial records and unravel the efforts utilized by Ms. Newcomb and Ms. Humphries to disguise their criminal behavior. Using forensic accounting principles and referring to outside records such as statements obtained from Lynrocten's correspondent institutions, wire and ACH records, and the review of paid drafts, the ALA was able to create a reasonably reliable reconstruction of the account. More importantly, perhaps, is the fact that XXXX did not offer any specific evidence to support her general denials, nor did she dispute any specific transactions noted on the ALA's spread sheet, even though she could have obtained and provided charge account statements, for example, showing transactions that were inconsistent with those reflected on the spread sheet.

The ALA has handled several account reconstructions involving other Lynrocten members, and that experience has led to familiarity with the methods used by the criminals to hide their tracks. With time and effort, the ALA has been able to arrive at a reasonably accurate account balance, despite the superficial disarray in the records. Furthermore, even though there were some unusual circumstances revealed in the account reconstruction,⁴ third party payments such as the type that ultimately led to the overdrawn condition in XXXX's account were not the arena in which the fraud committed by the insiders at Lynrocten occurred. Accordingly, the Board discounts this argument.

No legitimate institution would allow this. The Board views this as more like a rhetorical device than an actual argument. The Board acknowledges the unusual nature of the circumstances at Lynrocten, including specifically the degree of the fraud and its duration. Unfortunately, there is no doubt but that it did occur, and the Board is persuaded, based on the research conducted by the ALA, that the share draft account of XXXX was compromised. Over the course of several years, XXXX's share draft account was allowed to become significantly overdrawn. Accordingly, the Board discounts this argument as well.

Order

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

The appeal by XXXX, challenging the ALA's determination concerning the ending balance in her share draft account 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 20th day of April, 2017, by the National Credit Union Administration Board.

⁴ For example, the reconstruction shows several payments in small amounts to the same creditor on the same day or within a few days.

Gerard Poliquin
Secretary of the Board