

NATIONAL CREDIT UNION ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL

**SEMIANNUAL REPORT  
TO  
THE CONGRESS**

**April 1, 2009 – September 30, 2009**



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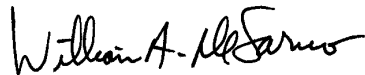
## **INSPECTOR GENERAL'S MESSAGE TO THE NCUA BOARD AND THE CONGRESS**

With the issuance of this semiannual report, for the period from April 1, 2009, through September 30, 2009, the National Credit Union Administration (NCUA) Office of Inspector General (OIG) is looking back at what has been its most challenging 6 months since the inception of this office at NCUA in 1989. As we reported in our previous semiannual report, the OIG's audit resources are overwhelmingly devoted to conducting Material Loss Reviews (MLRs). In addition, the unfolding events giving rise to NCUA's unprecedented actions to stabilize the corporate credit union system have required my office to carry out its oversight responsibilities in new and critical ways. Indeed, the recent demands on the credit union system and the financial services industry as a whole have required that every NCUA employee be fully engaged in protecting the safety and soundness of credit unions, protecting the insured deposits of credit union members, and maintaining stability and public confidence in the credit union system. The OIG remains committed to helping NCUA successfully achieve its longstanding mission of facilitating the availability of credit union services to all eligible consumers, especially those of modest means, through a regulatory environment that fosters a safe and sound credit union system.

As discussed in more detail in the body of this report, we focused the majority of the OIG's resources this reporting period on conducting MLRs. Under the Federal Credit Union Act (Act), the OIG is required to perform a MLR when the National Credit Union Share Insurance Fund (NCUSIF) incurs a material loss with respect to an insured credit union. The Act currently defines a material loss as (1) exceeding the sum of \$10 million and (2) an amount equal to 10 percent of the credit union's total assets at the time at which the NCUA Board initiated assistance or was appointed liquidating agent. Our reviews determine the cause of the loss to the NCUSIF and assess the agency's supervision of the credit union. We issued the results of one MLR during the reporting period and had 3 others ongoing at the end of the reporting period. Based on the cumulative results of the reviews, we are formulating initial summary observations on the causes, trends, and characteristics of these material losses. We intend to

analyze certain of those issues in more detail and make recommendations, as indicated, in the upcoming months.

Another major endeavor of my office over the past reporting period has been to continue to foster strong working relationships with agency management, members of Congress, and all of our colleagues in the Inspector General community. At a time when our contact with all of these parties has greatly increased in frequency due to the rapidly changing economic environment, I am pleased with our efforts to keep all of them fully apprised of the important work we do. I especially express my gratitude to the OIG staff who, during the reporting period, consistently displayed their superior work ethic to successfully conduct the demanding work of this office.

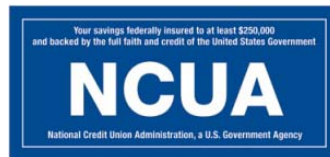


William A. DeSarno  
Inspector General

## THE NCUA MISSION

NCUA's charge is to foster the safety and soundness of federally insured credit unions and to better enable the credit union community to extend the availability of financial services for provident and productive purposes to all who seek such service, while recognizing and encouraging credit unions' historical emphasis on extension of financial services to those of modest means.

The NCUA's mission is accomplished by managing the NCUSIF in an efficient and prudent manner through an effective supervision program and a regulatory environment that encourages innovation, flexibility and continued focus on attracting new members and improving financial service to existing members.



## THE OFFICE OF INSPECTOR GENERAL MISSION

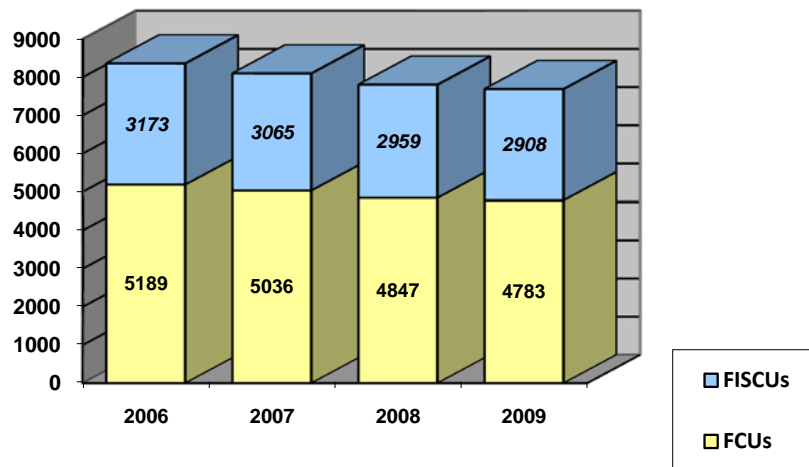
The OIG promotes the economy, efficiency, and effectiveness of NCUA programs and operations, and detects and deters fraud, waste, and abuse, thereby supporting the NCUA's mission of monitoring and promoting safe and sound federally insured credit unions.

We accomplish our mission by conducting independent audits, investigations, and other activities, and by keeping the NCUA Board and the Congress fully and currently informed of our work.

## INTRODUCTION

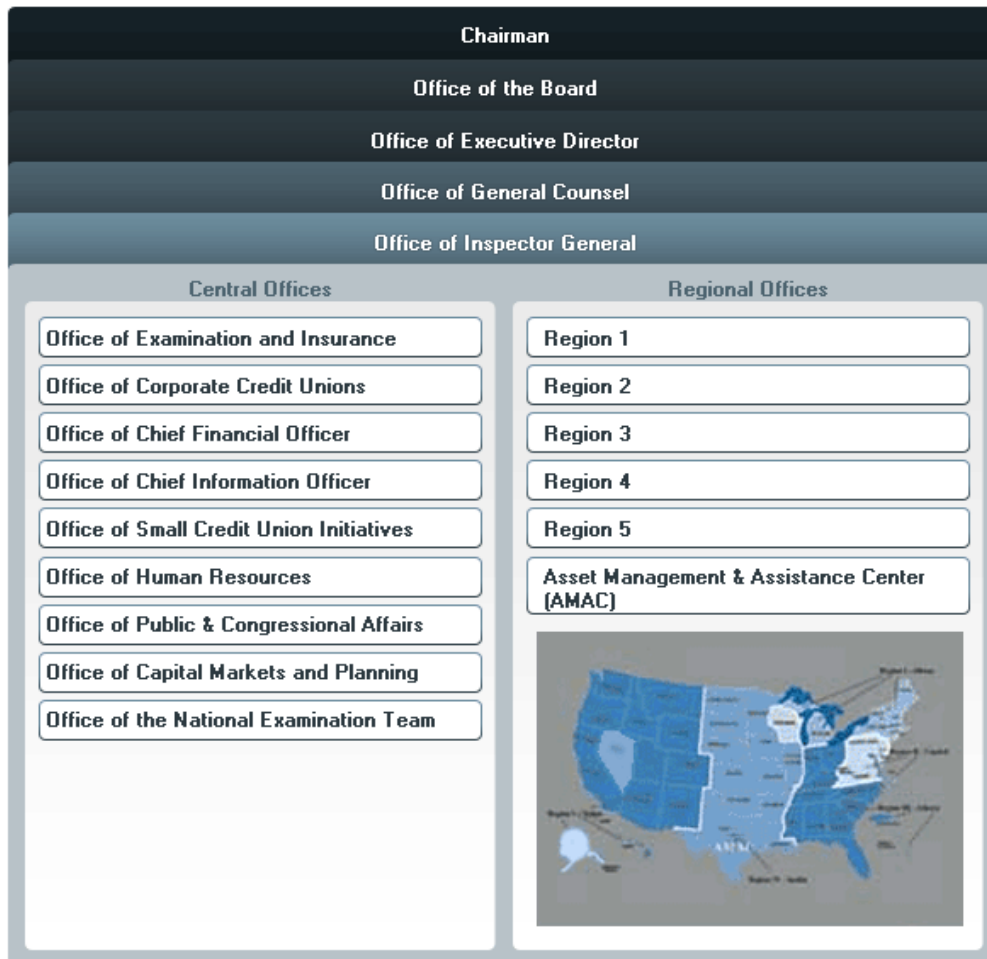
The NCUA was established as an independent, federal regulatory agency on March 10, 1970. The agency is responsible for chartering, examining, supervising, and insuring federal credit unions. It also insures state-chartered credit unions that have applied for insurance and have met National Credit Union Share Insurance requirements. The NCUA is funded by the credit unions it supervises and insures. As of June 30, 2009, the NCUA was supervising and insuring 4,783 federal credit unions and insuring 2,908 state-chartered credit unions, a total of 7,691 institutions. This represents a decline of 64 federal and 51 state-chartered institutions since December 31, 2008, for a total decline of 115 credit unions nationwide, primarily as a result of mergers.

**Federally Insured Credit Unions**

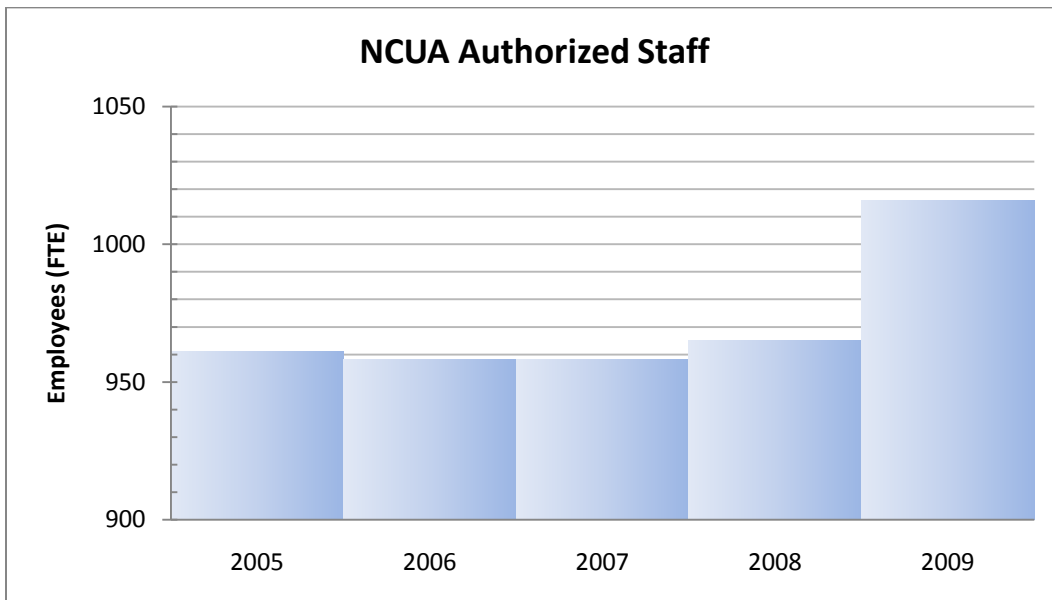
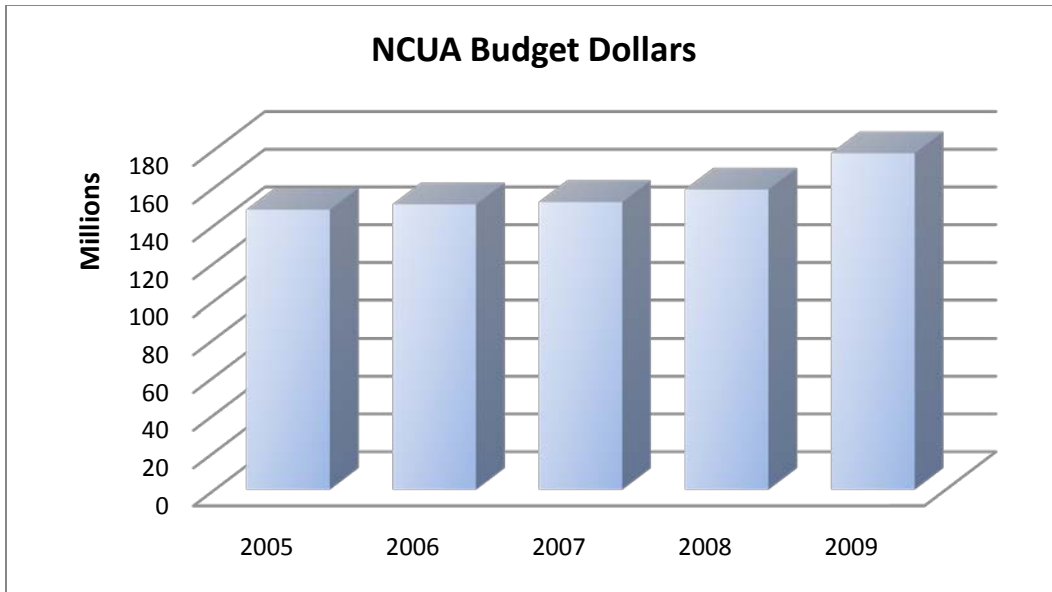


The NCUA operates under the direction of a Board composed of three members. Board members are appointed by the President and confirmed by the Senate. They serve six-year terms. Terms are staggered, so that one term expires every two years. The Board is responsible for the management of the NCUA, including the NCUA Operating Fund, the Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund.

The NCUA executes its program through its central office in Alexandria, Virginia and regional offices in Albany, New York; Alexandria, Virginia; Atlanta, Georgia; Austin, Texas; and Tempe, Arizona. The NCUA also operates the Asset Management and Assistance Center (AMAC) in Austin, Texas. Please refer to the NCUA organizational chart below.



The NCUA Board adopted its 2009 budget of \$177,863,682 on November 20, 2008. The Full-Time Equivalent (FTE) staffing authorization for 2009 is 1,016, representing an increase of 51 FTEs from 2008.





## NCUA HIGHLIGHTS

### NCUA Deborah Matz Assumes NCUA Chairmanship

Deborah Matz took the oath of office and became the eighth chairman of the NCUA on August 24, 2009. Nominated May 21, 2009, and designated by President Barack Obama to become Chairman upon assumption of office, Chairman Matz was confirmed by the U.S. Senate on August 7, 2009. Chairman Matz replaced Michael E. Fryzel as Chairman. Mr. Fryzel, whose NCUA board term expires on August 2, 2013, will continue to serve as an NCUA Board member. As one member of NCUA's three-person Board, Chairman Matz replaced former Vice Chairman Rodney Hood, whose term on the NCUA Board expired on April 10, 2009.

Chairman Matz's experience spans many years in the public and private sector. After concluding a three-year stint on the NCUA Board in October 2005, she was executive vice president and CEO of a Maryland credit union. Her 26-year government career includes 10 years on Capitol Hill as an economist with the Joint Economic Committee and 8 years as a senior executive at the Department of Agriculture, including 3 years as Deputy Assistant Secretary.

Chairman Matz's NCUA Board term will expire on April 10, 2015.

### NCUA Names Hunt Corporate Director

On September 24, 2009, the NCUA Board named Scott Hunt Director of the Office of Corporate Credit Unions (OCCU). Hunt had been Acting Special Assistant to the Acting Director of the OCCU since February 2009, and prior to that was Acting Director of the same office.

Since joining the agency in 1989, Hunt has served in a variety of capacities, including as a credit union examiner, Associate Regional Director, and Senior Investment Officer in the Office of Capital Markets and Planning. Hunt earned an undergraduate degree from Penn State University and his MBA at the George Mason University in Virginia. He is a CPA and CFA charter holder.

### NCUA Approves 0.15% Premium to Replenish NCUSIF

The NCUA Board voted unanimously at its September 24, 2009, Board meeting to assess federally insured credit unions a 0.15% premium to replenish the NCUSIF and assist the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund), established under section 217 of the "Helping Families

Save Their Homes Act of 2009,” in repaying the loan from the U.S. Treasury Department. The Board announced that the premium will be billed in mid-November and due in mid-December. The premium will ensure that the NCUSIF’s equity ratio is 1.3% and enable the Stabilization Fund to repay \$310 million of the funds it borrowed from Treasury. Credit unions with assets of less than \$50 million will have their premiums for the NCUSIF portion based on the number of insured shares as of December 31, 2008, while those with more than \$50 million in assets will have it based on the number of insured shares as of June 30, 2009.

The Stabilization Fund, which Congress authorized in May 2009, following NCUA’s conservatorships of U.S. Central Federal Credit Union (U.S. Central) and Western Corporate Federal Credit Union (WesCorp), allows for the incremental payment of the liability incurred from the corporate stabilization actions.

#### [NCUA Chairman Matz Advises Credit Unions on Mortgage Modifications, Financial Trends](#)

In Letter to Credit Unions 09-CU-19, NCUA Chairman Matz advised credit unions on how best to handle the “unprecedented levels” of mortgage defaults that credit unions are seeing. Chairman Matz encouraged credit unions that originate real estate loans to work with their borrowers to modify their loans, if needed. Potential loan modifications suggested by the NCUA supervisory letter include reducing interest rates, extending the maturity date of the loan, and/or offering principal forbearance or forgiveness. The agency also recommended that credit unions consider waiving late fees or reducing or capitalizing past due amounts, taxes, accrued interest, insurance, or fees.

In a separate Letter to Credit Unions 09-CU-18, NCUA noted that the real estate market continues to affect the credit quality of loans. However, the letter included a report on credit union trends that found the majority of loan growth over the first six months of this year came from the real estate sector. The report also found that while the credit union industry “remains sound,” the impact of the financial crisis “continues to have a negative impact on credit union trends.” In the letter, Chairman Matz emphasized the crucial role of proper risk and asset-liability management for credit unions given the difficulties of the current environment, and advised credit unions that originate real estate loans to “remain vigilant and enforce sound underwriting practices.”

## Board Member Gigi Hyland Addresses Proposed Changes to NCUA Corporate Rule and Audit of U.S. Central Financials

Addressing the National Association of Federal Credit Union (NAFCU) Congressional Caucus on September 22, 2009, and First Carolina Corporate Credit Union's Financial Conference on September 10, 2009, Board Member Gigi Hyland indicated that proposed revisions to NCUA's corporate regulation, Part 704, would be issued by year-end. Board Member Hyland stated that many of the issues the proposed corporate rule will address were previewed in the agency's testimony before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit in May 2009. The proposed rule includes changes to capital requirements, asset liability management, investments, and corporate governance. Board Member Hyland stated her belief that corporates are integral to the credit union system and indicated that "it behooves the industry and the agency to carefully consider changes that will ensure corporates' long-term viability."

At the NAFCU Caucus, Hyland also discussed the implications of the recently issued audit of U.S. Central's financials, her initiative to provide a set of recommendations to the NCUA Board on the possible use of supplemental capital for credit unions, her views regarding proposed legislation on increasing the cap for Member Business Loans, the ongoing legislative deliberations over regulatory restructuring, and the possibility that Congress might create a new Consumer Financial Protection Agency.

## U.S. Central's 2008 Audited Financial Statements Released

The NCUA welcomed the September 11, 2009, release of U.S. Central's 2008 audited financial statements as an important step forward that provides essential information about the corporate's condition and its ongoing conservatorship by NCUA. The Deloitte & Touche audit report asserted that U.S. Central, with NCUA's assistance, is a viable institution and has ongoing capability to provide products and services used by many in the credit union system. U.S. Central's 2008 annual report, issued in conjunction with its audited financial statements, also outlined the steps the institution has taken to stabilize its balance sheet, improve operating efficiency, and reduce costs. Among others, those measures include a 25 percent reduction in 2009 expenses.

## NCUA Makes PIMCO Report Available Online

On June 4, 2009, NCUA posted online a redacted version of a report prepared by the Pacific Investment Management Company, LLC (PIMCO) on behalf of the NCUA. In January 2009, as part of its ongoing corporate stabilization efforts, the NCUA Board engaged PIMCO to conduct a comprehensive analysis of expected credit losses for select securities held by corporate credit unions.

In engaging PIMCO, the NCUA Board sought an independent analysis of corporate credit union residential mortgage backed securities (RMBS) to: (1) obtain an objective and independent third party's views of potential credit losses, market values, and risks; and (2) obtain an additional tool to better assess the reliability of information developed and reported by the corporate credit unions.

The market turmoil and observance of wide ranging valuations of RMBS securities caused NCUA to seek this form of additional due diligence to augment the agency's analysis of the potential losses stemming from the corporate credit union portfolios and confirm the agency's risk management concerns.

Redacted versions of the report are available on the NCUA website at the following location: [http://www.ncua.gov/GenInfo/FOIA/FOIA\\_Request.aspx](http://www.ncua.gov/GenInfo/FOIA/FOIA_Request.aspx)

## Former NCUA Chairman Fryzel Testifies on Corporate Stabilization Efforts, Legislation

In his capacity as then-NCUA Board Chairman, Board Member Michael Fryzel testified, on May 20, 2009, before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit, concerning credit union stabilization. Minutes after Board Member Fryzel told the House Subcommittee that he supported H.R. 2351, the "Credit Union Share Insurance Stabilization Act," President Obama signed S. 896 and NCUA's Corporate Stabilization Plan became law, "providing a responsible, pragmatic mechanism for credit unions to maintain a strong federal insurance fund in a financially manageable manner," according to Mr. Fryzel.

The House and Senate bills contained nearly identical NCUA provisions, demonstrating the level of Congressional commitment to address credit union issues. Detailing contributing events, Board Member Fryzel told the House Subcommittee that during the summer of 2008, unrealized losses from investments in mortgage-backed securities placed significant pressure on corporate credit union liquidity. To stabilize the system, Mr. Fryzel testified,

Congress granted NCUA's request to secure the full \$41.5 billion CLF borrowing authority. Since September 2008, the CLF received requests for almost \$2 billion dollars, and as of the date of his testimony, NCUA had stabilized a tenuous situation by infusing almost \$21 billion into the corporate credit union system.

To stabilize the corporate system and ensure uninterrupted member service, in January 2009 the NCUA Board infused \$1 billion into U.S. Central, the wholesale corporate that provides services to other corporates, and NCUA guaranteed deposits in all corporates through at least September 2011. In March 2009, NCUA placed U.S. Central and WesCorp into conservatorship to preserve retail credit union deposits, enable NCUA to gain more information about their portfolios, and enable NCUA to take steps to mitigate future losses.

In his testimony, then-Chairman Fryzel also outlined a broad set of corporate reforms initiated by NCUA to address investment authority, risk concentration, corporate governance, and other aspects of the corporate credit union operations.

#### [NCUA Modifies Terms of Temporary Corporate Credit Union Share Guaranty Program](#)

On April 21, 2009, NCUA modified the terms of the Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP) to extend the program to accommodate a 2-year rolling expiration date and provide the option of quarterly extensions through December 2012. If the credit union fully uses the option, the final guarantee would expire on December 31, 2014.

The NCUA Board's action also included a revision to TCCUSGP agreements with corporate credit unions to eliminate ambiguities, provide greater flexibility, and improve operations. According to the Board, its intent was to "[s]end a clear signal to natural person credit unions that their investments in the corporate credit unions are not only safe, but also meet sound asset liability management principles by providing for orderly laddering of these investments." The NCUA Board also emphasized the importance of maintaining the liquidity necessary to maintain corporate stability.

The NCUA Board created TCCUSGP on January 28, 2009, as part of its effort to stabilize the corporate credit union system. TCCUSGP included an immediate, temporary guarantee of all shares (excluding paid-in-capital, membership capital accounts, and other NCUA liquidity programs) until February 28, 2009. The guarantee extends through December 31, 2010, for all corporate credit unions electing to participate in the voluntary share guarantee program.

To stabilize cash flows and allow for an orderly laddering of investments, the Board approved a recommended rolling 2-year term for the guarantee program that operates as follows:

- Maximum 2-year maturity for new share deposits is covered under the guarantee. Existing deposits maturing before the expiration date are covered by the guarantee, regardless of the original term.
- Initial extension of the December 31, 2010, expiration date to September 30, 2011.
- At least 30 days prior to the end of each calendar quarter, starting September 2009, the OCCU will evaluate the need to extend the expiration date; and, with concurrence of the Director of Examination and Insurance, request that the NCUA Executive Director approve and announce extension of the guarantee to two years beyond the end of the following quarter.

## FEDERALLY INSURED CREDIT UNION HIGHLIGHTS

Credit unions submit quarterly call reports (financial and operational data) to the NCUA. An NCUA staff assessment of the June 30, 2009, quarterly call reports submitted by all federally insured credit unions found that key financial indicators show concern.

### Key Financial Indicators Showing Concern

Looking at the June 30, 2009 quarterly statistics for major balance sheet items and key ratios shows the following for the nation's 7,691 federally insured credit unions: assets grew 7.26 percent; net worth to assets ratio decreased from 10.62 to 10.03 percent; the loan to share ratio decreased from 83.10 percent to 77.50 percent; the delinquency ratio increased from 1.37 to 1.58 percent; and credit union return on average assets decreased from .31 percent to .28 percent.

### Savings Shifting to Money Market Accounts

Total share accounts increased 7.99 percent. Money market shares increased 13.72%. Regular shares comprise 26.92 percent of total share accounts; share certificates comprise 31.50 percent; money market shares comprise 19.87 percent; and share draft accounts comprise 10.67 percent; and all other share accounts comprise 11.04 percent.

### Loans Increased Slightly

Loan growth of .71 percent resulted in an increase in total loans by \$4.04 billion. Total net loans of \$570 billion comprise 65 percent of credit union assets. First mortgage real estate loans increased 3.23 percent. First mortgage real estate loans are the largest single asset category with \$214.70 billion accounting for 37.66 percent of all loans. Other real estate loans of \$93.46 billion account for 16.40% of all loans. Used car loans of \$96.70 billion were 17.00% of all loans, while new car loans amounted to \$79.22 billion or 13.90% of total loans. Credit card loans totaled \$32.47 billion or 5.70% of total loans and other loans totaled \$53.29 billion for 9.34% of total loans.

## LEGISLATIVE HIGHLIGHTS

### House Poised to Move Forward on Regulatory Restructuring Legislation

The House, the Senate, and the Obama administration are currently discussing reforms of the federal financial regulatory structure, as well as the creation of a single federal agency, the Consumer Financial Protection Agency (CFPA). President Obama, in the Financial Regulatory Reform proposal issued in June 2009, called for the creation of the CFPA to protect consumers and investors from financial abuses. The proposed CFPA would have broad jurisdiction regarding credit, savings and payment products.

In response, NCUA proposed the creation of an NCUA Consumer Protection Office in its 2010 Agency budget. The new office would create a liaison relationship between NCUA and relevant parties, such as the CFPA, if that proposed entity becomes a reality. NCUA believes the new Office would underscore the priority of its existing role as sole examiner and enforcer of consumer protection laws for credit unions.

### House Appropriation Subcommittee Retains Maximum CLF Borrowing Authority

On June 25, 2009, a U.S. House of Representatives Appropriation Subcommittee voted to not place a cap and to maintain the CLF maximum, approximately \$40 billion, borrowing authority through fiscal year 2010 to ensure NCUA has a source of funding available to meet liquidity needs. The Subcommittee also approved \$1 million in technical assistance for the Community Development Revolving Loan Fund. The measures await consideration by the full Committee.

### Federal Agencies Propose Rule to Implement S.A.F.E. Act Mortgage Loan Originator Registration Requirements

NCUA joined the other Federal financial institution regulatory agencies (the Agencies) on June 1, 2009, in issuing for public comment proposed rules for public comment requiring mortgage loan originators who are employees of Agency-regulated institutions to meet the registration requirements of the S.A.F.E. Mortgage Licensing Act of 2009 (S.A.F.E. Act). The S.A.F.E. Act is Title 5 of the "Housing and Economic Recovery Act" which President Bush signed into law on July 30, 2008. The S.A.F.E. Act requires the Agencies to jointly develop and maintain a system for registering residential mortgage loan originators who are employees of national and State banks, savings associations, credit unions, and Farm Credit system institutions, and certain of their subsidiaries. The Act



will require licensing or registration for mortgage loan originators and will require registration for credit union employees who are loan originators.

The law is part of a state and national effort to fight and prevent mortgage fraud as well as promote accountability in the mortgage market. Registration will require information about an employee, including their fingerprints, to conduct state and national background checks. Additionally, the law requires an information collection about an employee's personal history, including authorization for the System to obtain any administrative, civil, or criminal findings by any governmental jurisdiction. The System is to be implemented one year after enactment of the Title.

#### [The "Credit Card Accountability, Responsibility, and Disclosure Act of 2009" \(Credit CARD Act\) Becomes Law](#)

Congress passed the "Credit Card Accountability, Responsibility, and Disclosure Act of 2009," (Credit CARD Act,) on May 22, 2009, as an amendment to Regulation Z, the "Truth in Lending Act," for which the Federal Reserve Board has rulemaking authority. The Credit CARD Act becomes effective February 22, 2010, but provisions regarding advance notice of rate increases and timing of payments became effective August 20, 2009. In late September 2009, the FRB proposed rules amending its Regulation Z to implement the provisions of the Credit CARD Act that went into effect in August.

The changes to Regulation Z apply to credit unions, and NCUA has enforcement authority for federal credit unions, while the Federal Trade Commission will continue to have enforcement authority for state-chartered credit unions for Regulation Z purposes.

With some differences, the Credit CARD Act puts requirements and limits on the same credit card practices that the NCUA, the Federal Reserve Board, and the Office of Thrift Supervision focused on in the Unfair or Deceptive Acts or Practices (UDAP) rule (NCUA Rules and Regulations, Part 706) issued in late 2008, including limiting the ability of credit card issuers to raise interest rates, limiting fees on subprime credit cards, and providing for fair allocation of payments and computation of timeliness of payments.

#### [Stabilization Legislation is Enacted](#)

On May 20, 2009, Senate bill S. 896, "The Helping Families Save Their Homes Act of 2009," was signed into law by President Obama, thus making NCUA's Corporate Stabilization Plan law. The legislation includes the following credit union provisions:

- Extend \$250,000 deposit insurance protection to 2013;
- Enable credit unions to spread the cost of corporate stabilization over 7 years;
- Extend replenishing the NCUSIF through premiums to 8 years;
- Increase NCUA borrowing authority to \$6 billion; and
- Establish \$30 billion NCUA emergency borrowing authority

Speaking in support of the legislation, NCUA Board Member Fryzel noted that the law:

- “Preserves the strong, well-capitalized Insurance Fund that Congress, NCUA and the public demand;
- Enables credit unions to bear the costs in a more manageable way; and
- Complies with GAAP accounting, which is mandated by the Federal Credit Union Act and which must be adhered to if we are to maintain public confidence in the industry.”

#### [House Passes H.R. 3330, the “Improved Oversight by Financial Inspectors General Act”](#)

On July 29, 2009, the House of Representatives passed, without amendment and by voice vote, H.R. 3330, the “Improved Oversight by Financial Inspectors General Act.” H.R. 3330 addresses issues raised in a Subcommittee on Oversight and Investigations hearing held on May 5, 2009, with Inspectors General of several banking agencies. The legislation would amend section 38(k) of the Federal Deposit Insurance Act and the Federal Credit Union Act (Act) to raise the threshold of loss required to trigger a Material Loss Review (MLR). For federally insured credit union losses, the proposed amendment to the Act would raise the MLR threshold to \$25 million (from \$10 million) and 10% of a credit union’s total assets at the time the NCUA stepped in to provide assistance. The legislation also requires the NCUA Inspector General (IG) to report semiannually to the NCUA Board and Congress regarding (1) losses estimated to be incurred by the NCUSIF with respect to insured credit unions; (2) each loss that is not a material loss, the grounds for appointing the NCUA as liquidating agent for any federal or state credit union, and whether any unusual circumstances exist that might warrant an in-depth review of the loss; and (3) the results of the IG’s determinations. The proposed bill also instructs the Comptroller General to (1) review reports regarding material losses to the NCUSIF; and (2) make recommendation for improvements in the supervision of insured credit unions.

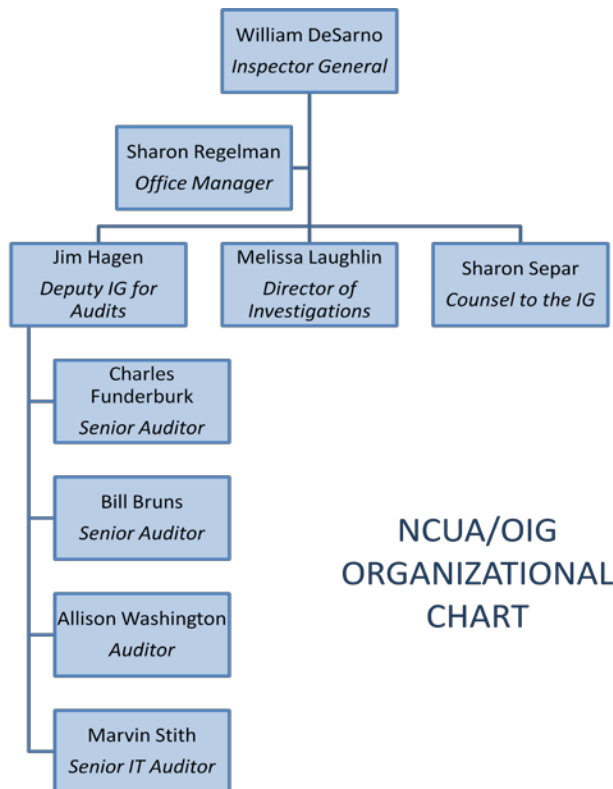
The bill awaits action in the Senate.

### OFFICE OF THE INSPECTOR GENERAL

The Office of the Inspector General was established at the NCUA in 1989 under the authority of the Inspector General Act of 1978, as amended. The staff consists of the Inspector General, Counsel to the Inspector General, Deputy Inspector General for Audits, Director of Investigations, Auditor, two Senior Auditors, Senior Information Technology Auditor, and Office Manager.

The Inspector General reports to, and is under the general supervision of, the NCUA Board. The Inspector General is responsible for:

1. Conducting, supervising, and coordinating audits and investigations of all NCUA programs and operations;
2. Reviewing policies and procedures to ensure efficient and economic operations as well as preventing and detecting fraud, waste, and abuse;
3. Reviewing existing and proposed legislation and regulations to evaluate their impact on the economic and efficient administration of agency programs; and
4. Keeping the NCUA Board and the Congress apprised of significant findings and recommendations.



## AUDIT ACTIVITY

### Audit Reports Issued

*OIG-09-01 – May 11, 2009*

#### Material Loss Review of Norlarco Credit Union

The NCUA OIG conducted a Material Loss Review of Norlarco Credit Union (Norlarco). We reviewed Norlarco to: (1) determine the cause(s) of Norlarco's failure and the resulting loss to the NCUSIF; and (2) assess NCUA's supervision of the credit union.

We determined that Norlarco management's actions created credit, liquidity, compliance, and strategic risks which directly contributed to the credit union's failure. Specifically, the Board of Directors (Board) and management ignored sound risk management principles by committing a significant portion of the credit union's assets to a risky Residential Construction Lending (RCL) program without adequate controls in place to oversee the program's daily operations.

Significant factors in Norlarco's failure were management's inability to adequately identify, manage, and mitigate the risks within its RCL program. Specifically, management's poor strategic decisions over its lending practices, as well as the inability to find adequate funding sources to meet commitments, created risks that Norlarco management did not, or could not, effectively manage. In addition, the risks and issues plaguing Norlarco were interrelated and inseparable. Eventually, management's inability to effectively manage the risks its own actions had created, led to Norlarco's failure.

Colorado SSA and NCUA examiners determined, and the OIG agrees, that Norlarco management failed to perform due diligence and establish appropriate controls over the RCL program. Specifically, Norlarco management:

- Failed to conduct a due diligence review of its relationship with its third-party vendor;
- Failed to adequately oversee the RCL program;
- Created a concentration risk by committing to fund \$30 million per month in construction loans;
- Failed to develop an adequate Asset-Liability Management (ALM) policy; and

- Failed to develop adequate policies and a strategic plan to guide the credit union and the RCL program.

In addition, we determined Norlarco management took undue advantage of its field of membership to grow the RCL program.

We also determined Colorado SSA and NCUA examiners did not adequately evaluate the safety and soundness of Norlarco's loan participation program. As a result, we believe SSA and NCUA examiners missed an opportunity to slow the RCL program's growth, which might have mitigated the loss to the NCUSIF.

Auditor Observations made as a result of our review of Norlarco's failure included:

- Examiners did not view the participation program and the participation agreements as safety and soundness concerns fraught with risk.
- Examiners did not associate the rapid rise of loans sold through participations as a potential safety and soundness concern to Norlarco, or to the NCUSIF, but rather examiners merely viewed participations as a means to manage Norlarco's balance sheet risk.

## AUDITS IN PROGRESS

### NCUA Financial Statements 2008

Our contracting audit firm, Deloitte & Touche LLP, is working to issue its opinion on the 2008 financial statements of the NCUA Operating Fund, National Credit Union Share Insurance Fund, the Central Liquidity Facility, and the Community Development Revolving Loan Fund. We expect to issue our report in November 2009.

### NCUA Financial Statements 2009

Our contracting audit firm, KPMG, is working on the 2009 financial statements of the NCUA Operating Fund, National Credit Union Share Insurance Fund, the Central Liquidity Facility, the Community Development Revolving Loan Fund and the Temporary Corporate Credit Union Stabilization Fund.

The NCUA Operating Fund was established as a revolving fund managed by the NCUA Board for the purpose of providing administration and service to the federal credit union system. The National Credit Union Share Insurance Fund was established as a revolving fund managed by the NCUA Board to insure member share deposits in all Federal credit unions and qualifying state credit unions. The CLF was established as a mixed ownership government corporation managed by the NCUA Board to improve general financial stability by meeting the liquidity needs of credit unions. And the Community Development Revolving Loan purpose is to stimulate economic activities in the communities served by low-income credit unions. This in turn will result in increased income, ownership and employment opportunities for low-wealth residents and other economic growth. We expect to issue our report February 15, 2010.

### Material Loss Reviews of Cal State 9, New London and Center Valley

The FCU Act provides that a review is required when the NCUSIF incurs a material loss. For purposes of determining whether the NCUSIF has incurred a material loss with respect to an insured credit union such that the OIG must make a report, a loss is material if it exceeds the sum of \$10,000,000, and an amount equal to 10 percent of the total assets of the credit union at the time at which the NCUA Board initiated assistance under section 208, or was appointed liquidating agent. In addition, the OIG may perform a material loss review on selected cases that caused a loss of less than \$10,000,000 at the discretion of the Inspector General.

The OIG was notified by NCUA that the losses incurred by Cal State 9 and Center Valley credit unions had exceeded the statutory requirements, triggering a material loss review by the OIG. New London was selected for a material loss review at the discretion of the Inspector General due to the fraud allegations involved in this case. The scope of these audits will include an analysis of the credit union's transactions and activities to determine the causes of failure and a review of the supervision of the credit union. The review will be performed in accordance with Government Auditing Standards for performance audits. Our objectives are to determine (1) the causes of the credit union's failure and resulting material loss to the share insurance fund; and (2) assess the NCUA's supervision of the institution, including implementation of the Prompt Corrective Action requirements of the FCU Act. We expect to issue our report on Cal State 9 and New London in the fall of 2009, and Center Valley in the beginning of 2010.

#### **Independent Evaluation of the NCUA's Compliance With the Federal Information Security Management Act 2009**

The OIG engaged Carson & Associates Inc. to independently evaluate its information systems and security program and controls for compliance with the Federal Information Security Management Act (FISMA), Title III of the E-Government Act of 2002.

Carson & Associates Inc. is evaluating NCUA's security program through interviews, documentation reviews, technical configuration reviews, social engineering testing, and sample testing. NCUA is being evaluated against standards and requirements for federal government agencies such as those provided through FISMA, National Institute of Standards and Technology (NIST) Special Publications (SPs), and OMB memoranda. We anticipate issuing the final report in October 2009.

#### **Significant Audit Recommendations on which Corrective Action Has Not Been Completed**

As of September 30, 2009, there were no significant audit recommendations on reports issued over six months ago that have not been either fully implemented or are in the process of implementation.

## INVESTIGATIVE ACTIVITY

In accordance with professional standards and guidelines established by the Department of Justice, the OIG conducts investigations of criminal, civil, and administrative wrongdoing involving agency programs, operations and personnel. Our investigative program focuses on activities designed to promote accountability, effectiveness, and efficiency, as well as fighting fraud, waste, and abuse in agency programs and operations. In addition to our efforts to deter misconduct and promote integrity awareness among agency employees, we investigate referrals and direct reports of employee misconduct. Investigations may involve possible violations of regulations regarding employee responsibilities and conduct, Federal criminal law, and other statutes and regulations pertaining to the activities of NCUA employees.

Moreover, we receive complaints from credit union members and officials that involve NCUA employee program responsibilities. We examine these complaints to determine whether there is any indication of NCUA employee wrongdoing or misconduct. If not, we refer the complaint to the appropriate regional office for response, or close the matter if contact with the regional office indicates that the complaint has already been appropriately handled.

### OIG HOTLINE CONTACTS

The OIG maintains a toll free hotline to enable employees and citizens to call with information about suspected waste, fraud, abuse or mismanagement involving agency programs or operations. We also receive complaints through an off-site post office box, from electronic mail, and facsimile messages. All information received from any of these sources is referred to as a *hotline contact*. The OIG hotline program is handled by our Office Manager, under the direction of our Director of Investigations. The majority of hotline contacts are from consumers seeking help with a problem with a credit union. These contacts are referred to the appropriate NCUA regional offices for assistance. During this reporting period, we referred 70 consumer complaints to regional offices. We referred 6 allegations of potential fraud at credit unions to the NCUA Office of General Counsel.



## INVESTIGATIONS

### False Statements / Breach of Telecommuting Agreement / Violation of Agency Instructions / Violations of Ethics Standards / Violation of Computer Security Rules of Behavior

During this reporting period, the OIG reported on and closed its investigation into allegations it received in the last reporting period that an NCUA employee fabricated official agency documents related to her employment within the agency.

The OIG's investigation into the initial allegations concluded that the employee fabricated documents using her agency-issued government computer during work hours in violation of the *Standards of Ethical Conduct for Employees of the Executive Branch* (Ethics Standards) as well as the agency's *Computer Security Rules of Behavior* (CSROB).

The investigation of the initial allegations gave rise to questions about false statements the employee may have made to her supervisor regarding leave requests and a telecommuting arrangement, which began in July 2008 and ended in January 2009. Consequently, the OIG expanded its investigation in this reporting period to encompass the false statements as well as the ethics and agency policy violations. The investigation concluded that the employee had violated Ethics rules, the agency's CSROB, made statements that amounted to a violation of 18 U.S.C. 1001—False Statements, breached the terms of the Telecommuting Agreement with the agency, and violated the agency's Instruction on Telecommuting.

The OIG issued a final report of investigation to agency management concerning its investigation of the initial and subsequent allegations. The employee resigned prior to the agency issuing its final disciplinary action decision.

### Non-Compliance with Paperwork Reduction Act

In the previous reporting period, the OIG received two referrals from the United States Government Accountability Office (GAO). The referrals were based on information submitted anonymously to GAO's *FraudNet* Operations Hotline. Both complaints alleged that the agency engaged in violations of the *Office of Management and Budget (OMB) Paperwork Reduction Act* (PRA). Investigations were conducted into both matters. In this reporting period, the OIG closed both matters.

In the first instance, the investigation revealed that the agency's information request for specific data from the corporate credit unions were part of the

examination process and, therefore, were considered supervisory contacts. Therefore, we determined the activities to be appropriately within the scope of the NCUA's existing (active) OMB information collection approval.

In the second case, we found that the agency requested corporate credit union payment system activity information that went beyond the scope of its current OMB information collection approval. NCUA management explained that its need for this information was critical in light of the current financial crisis confronting corporate credit unions. Specifically, the agency stated that it needed to collect the information to, in turn, respond to information requests from the Federal Reserve Board on payment system operations in corporate credit unions.

### Sexual Harassment

The OIG investigated, reported on, and closed a case involving allegations the OIG received that two NCUA Examiners, respectively, sexually harassed two credit union employees, respectively. In one instance, the OIG determined that the allegation was a misunderstanding between the credit union employee and credit union management. The named complainant explained that at no time did she view the Examiner's conduct as harassing or inappropriate. The facts the OIG developed confirmed the lack of a viable complaint.

In the second case, the OIG determined (1) that language used by the Examiner did not rise to the level of sexual harassment and (2) the charge that the Examiner inappropriately touched the employee's elbow could neither be substantiated nor conclusively disproved. With regard to the first charge, the OIG reported that the Examiner's language, while it did not constitute sexual harassment, could be viewed as inappropriate. The OIG issued a report of investigation and forwarded it to agency management.

### Office of Worker's Compensation Fraud

The OIG received an allegation that an employee was abusing the Office of Worker's Compensation Program (OWCP). The employee retired before the investigation was completed. The OIG closed the case.

### Unprofessional Behavior

The OIG received a complaint that two Examiners exhibited unprofessional behavior during an examination on credit union premises. In addition, the complaint alleged a conflict of interest on the part of one of the Examiners.

In the case of the first Examiner, the investigation concluded that he likely made some or all of the comments alleged. The use of this language during an examination could be viewed as unprofessional and inappropriate conduct for an NCUA examiner. A report of investigation was issued and referred to management for appropriate action.

The information developed in the second case did not support the allegation of conflict of interest nor did it substantiate the allegation of unprofessional comments. A report of investigation was referred to management.

### Misuse of Government Email

The OIG received a complaint forwarded from the GAO *FraudNet* that an employee was using his NCUA email improperly on a website for his personal business. We found that the website in question did contain several links to his NCUA email account. The employee was counseled on the relevant NCUA Instruction regarding Use of Government Property and promptly removed all references to his NCUA email address from the website.

### Improper Promotion

The OIG received an allegation that an employee had been promoted outside the merit system promotion process. The investigation concluded that the allegation was without merit. The OIG intends to issue its report of investigation at the beginning of the next reporting period.

### Time and Attendance Fraud

During this reporting period the OIG received an allegation of potential time and attendance as well as travel voucher fraud. This investigation is ongoing.

### Misconduct/Unethical Behavior

During this reporting period the OIG received a complaint alleging misconduct and unethical behavior on the part of an NCUA employee and the NCUA Board of Directors. The OIG reviewed the matter and found the allegations to be without merit.

## LEGISLATIVE AND REGULATORY REVIEWS

Section 4(a) of the Inspector General Act requires the Inspector General to review existing and proposed legislation and regulations relating to the programs and operations of the NCUA and to make recommendations concerning their impact. Moreover, we routinely review proposed agency instructions and other policy guidance, in order to make recommendations concerning economy and efficiency in the administration of NCUA programs and operations and the prevention and detection of fraud, waste and abuse.

During the reporting period, the OIG reviewed 26 items, including proposed and final legislation and regulations, Letters to Credit Unions, and agency Interpretive Rulings and Policy Statements (IRPS). We issued formal comments on two legislative items, H.R. 3330, the "Improved Oversight by Financial Inspectors General Act of 2009" and S. 1354, the "Improved Financial and Commodity Markets Oversight and Accountability Act."

SUMMARY OF STATUTES AND REGULATIONS REVIEWED	
Legislation	Title
P.L. 111-22	"Helping Families Save Their Homes Act of 2009"
P.L. 111-24	"Credit Card Act of 2009"
H.R. 3126	"Consumer Financial Protection Agency Act of 2009"
S. 1508/H.R. 3393	"Improper Payments Elimination and Recovery Act of 2009"
H.R. 1479	"Community Reinvestment Act (CRA)"
H.R. 3380	"Promoting Lending to America's Small Business Act of 2009"
	Financial Regulatory Restructuring
S. 976	Paperwork Reduction Act Amendments
H.R. 3330	"Improved Oversight by Financial Inspectors General Act of 2009"
S. 1354/H.R. 885	"Improved Financial and Commodity Markets Oversight and Accountability Act"

Regulations/Rulings	Title
12 CFR Parts 741, 748 & 749	Credit Union Reporting
12 CFR 701	Proposed rule: Operating Fees
12 CFR Part 701	Interim final rule with request for comments: Exception to the Maturity Limit on Second Mortgages
12 CFR Part 717	Procedures to Enhance the Accuracy and Integrity of Information Furnished to Consumer Reporting Agencies under Section 312 of the Fair and Accurate Credit Transactions Act
	Interagency Questions and Answers Regarding Flood Insurance with Proposed Additions
12 CFR Part 761	Interagency Proposed Rule to Implement S.A.F.E. Act Mortgage Loan Originator Registration Requirements
12 CFR Part 717	Guidelines for Furnishers of Information to Consumer Reporting Agencies
12 CFR Part 706	Interagency Proposed Rule – Unfair or Deceptive Acts or Practices Clarifications

Regulations/Rulings	Title
Letter to Federal Credit Unions 09-CU-09	2009 Community Development Revolving Loan Fund Grant Initiatives
Letter to Federal Credit Unions 09-CU-10	Matters Related to “Paid-in-Capital” and “Membership Capital” of Corporate Credit Unions
Letter to Federal Credit Unions 09-CU-11	Extended Time Frame for Temporary Increase To Standard Maximum Share Insurance Amount
Letter to Federal Credit Unions 09-CU-12	Interagency Examination Procedures on Credit Credit Extended to Military and Their Dependents
Letter to Federal Credit Unions 09-CU-13	Hurricane Preparedness and Pandemic Planning
Letter to Federal Credit Unions 09-CU-14	Corporate Stabilization Fund Implementation
Letter to Federal Credit Unions 09-CU-16	Guidance on Acceptance of California Warrants
Letter to Federal Credit Unions 09-CU-19	Evaluating Residential Real Estate Mortgage Loan Modification Programs

TABLE I INSPECTOR GENERAL ISSUED REPORTS WITH QUESTIONED COSTS				
		Number of Reports	Questioned Costs	Unsupported Costs
A.	For which no management decision had been made by the start of the reporting period.	0	\$0	\$0
B.	Which were issued during the reporting period.	0	0	0
	Subtotals (A + B)	0	0	
C.	For which management decision was made during the reporting period.	0	0	0
	(i) Dollar value of disallowed costs	0	0	0
	(ii) Dollar value of costs not allowed	0	0	0
D.	For which no management decision has been made by the end of the reporting period.	0	0	0
E.	Reports for which no management decision was made within six months of issuance.	0	0	0

Questioned costs are those costs the OIG has questioned because of alleged violations of laws, regulations, contracts, or other agreements; findings which at the time of the audit are not supported by adequate documentation; or the expenditure for the intended purpose is unnecessary or unreasonable.

Unsupported costs (included in "Questioned Costs") are those costs the OIG has questioned because of the lack of adequate documentation at the time of the audit.

TABLE II INSPECTOR GENERAL ISSUED REPORTS WITH RECOMMENDATIONS THAT FUNDS BE PUT TO BETTER USE			
		Number of Reports	Dollar Value
A.	For which no management decision had been made by the start of the reporting period.	0	\$0
B.	Which were issued during the reporting period.	0	0
Subtotals (A + B)		0	0
C.	For which management decision was made during the reporting period.	0	0
	(i) Dollar value of recommendations agreed to by management.	N/A	N/A
	(ii) Dollar value of recommendations not agreed to by management.	N/A	N/A
D.	For which no management decision was made by the end of the reporting period.	0	0
E.	For which no management decision was made within six months of issuance.	0	0

Recommendations that "Funds to be Put to Better Use" are those OIG recommendations that funds could be used more efficiently if management took actions to reduce outlays, de-obligate funds from programs/operations, avoid unnecessary expenditures noted in pre-award reviews of contracts, or any other specifically identified savings.

<p style="text-align: center;">TABLE III SUMMARY OF OIG ACTIVITY APRIL 1, 2009 THROUGH SEPTEMBER 30, 2009</p>		
<p style="text-align: center;"><b>PART I – AUDIT REPORTS ISSUED</b></p>		
Report Number	Title	Date Issued
OIG-09-01	Material Loss Review of Norlarco Credit Union	5/11/2009
<p style="text-align: center;"><b>PART II – AUDITS IN PROGRESS</b> <i>(as of September 30, 2009)</i></p>		
	NCUA Financial Statement Audit 2008	
	NCUA Financial Statement Audit 2009	
	Material Loss Review of New London	
	Material Loss Review of Cal State 9 FCU	
	Material Loss Review of Center Valley	
	Independent Evaluation of The National Credit Union Administration’s Compliance With The Federal Information Security Management Act (FISMA) 2009	



INDEX OF REPORTING REQUIREMENTS		
Section	Data Required	Page Ref
4(a)(2)	Review of Legislation and Regulations	24
5(a)(1)	Significant Problems, Abuses, or Deficiencies Relating to the Administration of Programs and Operations Disclosed During the Reporting Period.	16
5(a)(3)	Recommendations with Respect to Significant Problems, Abuses or Deficiencies.	16
5(a)(3)	Significant Recommendations Described in Previous Semiannual Reports on Which Corrective Action Has Not Been Completed.	19
5(a)(4)	Summary of Matters Referred to Prosecution Authorities and Prosecutions Which Have Resulted.	None
5(a)(5)	Summary of Each Report to the Board Detailing Cases Where Access to All Records Was Not Provided or where Information Was Refused.	None
5(a)(6)	List of Audit Reports Issued During the Reporting Period.	28
5(a)(7)	Summary of Particularly Significant Reports.	19
5(a)(8)	Statistical Tables on Audit Reports With Questioned Costs.	26
5(a)(9)	Statistical Tables on Audit Reports With Recommendations That Funds Be Put To Better Use.	27
5(a)(10)	Summary of Each Audit Report Issued Before the Start of the Reporting Period for Which No Management Decision Has Been Made by the End of the Reporting Period.	None
5(a)(11)	Description and Explanation of Reasons for Any Significant Revised Management Decision Made During the Reporting Period.	None
5(a)(12)	Information Concerning Significant Management Decisions With Which the Inspector General is in Disagreement.	None