Dear XXXX:

On February 12, 2019, you filed a request for review by the Director of the Office of Examination and Insurance (“E&I”) of your credit union’s XXXX, examination report. E&I received your request on February 19, 2019.

The written material supervisory determination you are requesting a review of was made on January 17, 2019 by Regional Director XXXX. You filed this request pursuant to 12 C.F.R. § 746.106, which allows a credit union to seek my review of a written material supervisory determination by a program office. Specifically, you are seeking my review of the Document of Resolution (DOR) items issued during your XXXX examination, your CAMEL composite rating, and Capital Adequacy, Management, and Earnings CAMEL component ratings.

As discussed below more fully below, I approve your request to remove the Bank Secrecy Act (BSA) and Monthly Reporting DORs. However, I deny your request to change the CAMEL composite and component ratings.

Background

At the conclusion of your examination (effective date XXXX), you requested the Region reconsider a number of items resulting from the examination. Your request for changes included the following items.

- Upgrading the CAMEL component ratings for Capital Adequacy, Management, and Earnings from a “3” to a “2,” as well as the overall CAMEL composite rating;
- Removing the DOR for aggregate cash transaction monitoring;
- Removing the DOR for the monthly reporting; and
- Removing the Examiner’s Finding for quarterly cash counts.

The Region denied your request on January 17, 2019, for the following reasons.

- “The composite CAMEL 3 rating is consistent with the credit union being less capable of withstanding business fluctuations and being more vulnerable to outside
The examiner based your CAMEL ratings on concerns in the following areas: increasing delinquency, rapid growth and concentration in indirect loans, profitability analysis on the indirect program, weak earnings, declining net worth, BSA violation, and the number of other examiner findings. The findings reflect the need for ongoing risk management and internal control improvement in the compliance, strategic, credit, and liquidity risk areas. The examiner appropriately used the guidance in NCUA Letter to Credit Unions 07-CU-12 in assigning your CAMEL ratings. Examiner XXXX will return to your credit union during the week of XXXX to perform a BSA follow up contact, and schedule a follow up review to assess your progress with resolving the concerns noted in the XXXX exam report and re-evaluate your CAMEL ratings.

The results of the exam support the need for monthly monitoring. As part of NCUA's offsite supervision efforts, it is common for an examiner to request a credit union's monthly board package. This allows the examiner to monitor financial trends remotely and reduces the need for onsite contacts. In particular, we continue to have a need for monitoring your loan programs, delinquency, and earnings. Requesting financial information from a credit union is consistent with provisions in Section 106 of the FCU Act, 12 U.S.C. 1756.

The results of the exam support the BSA violation and DOR corrective action. NCUA Rules and Regulations Part 748.2cl requires a credit union's BSA compliance program provide for an adequate system of internal controls to assure ongoing compliance, including systems to detect suspicious activity. Page 64 of the Bank Secrecy Act/Anti Money Laundering Examination Manual states the type and frequency of reviews and resulting reports used should be commensurate with the credit union's BSA/AML risk profile and appropriately cover its higher-risk products, services, customers, entities, and geographic locations. The manual references filtering reports for currency transactions involving multiple lower dollar transactions (e.g., $3,000) over a period of time (e.g., 15 days) aggregate to a substantial sum of money (e.g., $30,000). The BSA chapter of the NCUA National Supervision Policy Manual (NSPM) states significant BSA violations require a Document of Resolution and a compliance risk rating of high. CEO XXXX stated the credit union has since implemented the DOR corrective action. The examiner will return to the credit union during the week of XXXX to verify the corrective action taken. Your letter states the examiner did not indicate at the XXXX exit meeting the BSA violation would be included in a DOR. The findings presented at the exit meeting were a draft. The final examination report included the BSA violation in the DOR consistent with NCUA guidance.
• “I understand after the XXXX conversation with XXXX, CEO XXXX agreed to strengthen internal controls for cash by providing the supervisory committee with the results of the cash counts performed by the management and compliance teams. The CEO also indicated the credit union is looking to have a third party complete the cash counts on a quarterly basis for the supervisory committee. The examiner will verify the corrective action taken at the next follow up exam starting on XXXX.”

Discussion

Pursuant to the NCUA’s regulations, 12 C.F.R. § 746.106, the Director of E&I has jurisdiction to review a program office’s material supervisory determination, if the request for review was preceded by a request for reconsideration with the program office, and filed within 30 days of a response from the program office. The NCUA’s regulations define a “material supervisory determination” as a written decision by a program office that may significantly affect the capital, earnings, operating flexibility, or that may otherwise affect the nature or level of supervisory oversight, of an insured credit union. 12 C.F.R. § 746.103(a). Your request for review was timely and met the definition of a material supervisory determination.

Following the receipt of your request, my staff and I reviewed the information provided, as well as additional information requested from the Region and the credit union. My staff and I also discussed relevant law and agency guidelines with the NCUA’s Office of General Counsel and a BSA Officer.

The determination listed below is the result of the review of documentation and communications with the parties involved (credit union, Region, etc.). All information is as of the XXXX, examination report.

Document of Resolution (DOR)

Aggregate Cash Transaction Monitoring DOR

There is no BSA requirement to aggregate cash transactions over a two to four week period. While this is a prudent practice, a credit union’s cash transaction monitoring should be commensurate with its BSA and Anti-Money Laundering (AML) risk profile. In my review of information provided by the credit union, I have determined the credit union was looking at cash transactions on a daily basis and aggregating totals on a quarterly basis, which is not a BSA violation. Based on the results of the NCUA’s XXXX BSA follow-up, our records indicate this DOR item is no longer outstanding and the compliance risk rating was changed from high to moderate. I appreciate your work to enhance aggregate cash transaction monitoring at XXXX.
Monthly Reporting DOR

It is a customary practice for an examiner to request monthly monitoring reports from a credit union when there is a supervisory concern. For your credit union’s situation, this is not a requirement outlined in NCUA’s National Supervision Policy Manual. Therefore, I am nullifying this DOR. However, I would note the NCUA has the authority to request and review such information as needed and at any time as part of an onsite or offsite examination or supervision contact. Thus, I suggest you coordinate with your examiner to determine a mutually acceptable way to share information needed to supervise your credit union.

CAMEL Ratings

You requested changes to the composite CAMEL rating, as well as your Capital Adequacy, Management, and Earnings CAMEL component ratings. The CAMEL composite rating of “3” and the Management component rating of “3” are material supervisory determinations as they affect the nature and level of supervisory oversight of an insured credit union. While the other CAMEL component ratings in themselves are not material supervisory determinations, my staff and I evaluated them relative to your request for review of the CAMEL composite rating.

Capital Adequacy

Your Net Worth ratio declined significantly from XXXX percent as of XXXX, to XXXX percent as of XXXX. The decline is primarily due to low earnings, which could not keep pace with asset growth during this period.

The credit union’s ability to maintain or improve its net worth ratio is uncertain. Specifically, the credit union continues to experience weak earnings. The credit union is going to continue to experience pressure on its net income due to your investment in fixed assets and the potential for increased loan losses as a result of the significant increase in delinquency.1 In addition, management plans to continue to pursue strong share and asset growth through 2022 based on the XXXX provided.

Therefore, I conclude the credit union’s capital is less than satisfactory given its current and prospective risk profile. This meets the definition of a “3” rating for Capital Adequacy as outlined in the NCUA’s Letter to Credit Unions 07-CU-12.

Management

The credit union’s net worth ratio has declined significantly over the last several years. Management concurrently significantly increased the credit risk profile of the credit union. Indirect loans grew over XXXX percent from XXXX to XXXX. This led to high overall loan growth of about XXXX percent during this period. Even with the high loan growth, the delinquency ratio has more than XXXX during this period and is elevated. As a result, the credit

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1 While I recognize XXXX experienced, “…a fraudulent credit card charge off that impacted our Allowance for Loan Loss by $XXXX and multiple large real estate loans that hit at the same time,” the credit union’s delinquency aging trends indicate it is at risk of increased levels of loan losses.
union has experienced an increase in loan losses. Further, the credit union’s ability to withstand the increased risk and maintain sound capital levels is limited given the weaknesses in the credit union’s earnings.

Management insufficiently planned for this increase in risk exposure coupled with the decline in capital to absorb the risk. Management also did not initially put in place adequate means to measure, monitor, and control this additional risk. While management has been responsive to recommendations from examiners in this area, this is not an acceptable substitute for management having established sound plans and controls as part of the decision to increase the credit union’s risk profile.

Therefore, I conclude the credit union’s risk management practices are less than satisfactory given the nature of the credit union’s activities. Problems and significant risks may not be adequately identified, measured, monitored, and controlled. This meets the definition of a “3” rating for Management as outlined in the NCUA’s Letter to Credit Unions 07-CU-12.

Earnings
Your credit union has weak or negative earnings for each of the last three years. Earnings remained weak through XXXX. The credit union is likely to continue to have earnings challenges because of its significant investment in fixed assets and potential for an increase in loan losses. The extent to which earnings will be sufficient to maintain or improve capital levels remains in question.

While I recognize you have taken steps to reduce expenses in some areas, overall operating expenses remain high and net income remains low. Therefore, I conclude the credit union’s earnings may not support current and future capital and allowance funding commensurate with the credit union’s overall condition, growth, and risk factors. This meets the definition of a “3” rating for Earnings as outlined in the NCUA’s Letter to Credit Unions 07-CU-12.

Other CAMEL Components
While you did not specifically request a review of the Asset Quality and Liquidity component ratings, I noted that your letter states, “Our liquidity has dramatically improved and is being currently monitored with monthly ALCO meetings. XXXX believes that this area should be upgraded from its current rating.” Your letter also states, “XXXX has worked diligently to implement NCUA recommendations from previous examinations in regards to improving credit and believe that our current low rating is not justified in this examination.”

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2 Land and building plus other fixed assets nearly XXXX from $XXXX million in XXXX to $XXXX million in XXXX. Your strategic plan shows you have additional investment in fixed assets planned through 2022.

3 Over the next four years (XXXX thru XXXX), your XXXX show a XXXX percent growth in net income; XXXX percent growth in assets; a XXXX percent growth in loans; and a XXXX percent increase in total shares resulting in a net worth of XXXX percent by XXXX.
As noted above, these component ratings are not reviewable under the rule as material supervisory determinations. However, my staff and I did note that during the XXXX, examination, your Liquidity Risk rating was lowered from high to moderate and the component rating for Asset Liability Management improved from a “3” to a “2.” This reflects an improvement and sound condition for this area, and is not a key reason for the credit union’s CAMEL composite rating of “3.” With respect to Asset Quality, the credit union’s level and management of credit risk is consistent with a component rating of “3” and the moderate Credit Risk rating.

**Composite CAMEL Rating**

As described in LCU 07-CU-12, the following characteristics apply with respect to a composite “3” credit union.

“Credit unions in this group exhibit some degree of supervisory concern in one or more of the component areas. These credit unions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than ‘4’. Management may lack the ability or willingness to effectively address weaknesses within appropriate timeframes. Credit unions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those rated a composite ‘1’ or ‘2’. Additionally, these credit unions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the credit union’s size, complexity, and risk profile. These credit unions require more than normal supervision, which may include enforcement actions. Failure appears unlikely, however, given overall strength and financial capacity of these credit unions.”

While I acknowledge your credit union made progress since the XXXX, examination, for the reasons discussed above your credit union continues to exhibit financial and operational weaknesses that are consistent with a CAMEL composite “3” rating.4

**Other Matters**

Your letter mentioned four Examiner’s Findings you believe were incorrectly marked as repeat findings. Examiner’s Findings are not material supervisory determinations under the rule and therefore not appealable. I encourage you to maintain a dialogue with your examiner on this matter.

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4 My review focused solely on the accuracy of the current examination’s CAMEL ratings. CAMEL ratings assigned for prior examinations are not a factor in the assignment of the XXXX, examination CAMEL ratings.
Final Determination
Based on the information outlined above, I will instruct the Region to remove the Monthly Reporting DOR in our administrative record. The BSA DOR has already been marked as resolved and the Compliance Risk rating changed from high to moderate. However, I deny your request to change the CAMEL composite and component ratings.

Pursuant to the NCUA’s regulations, 12 C.F.R. § 746.107, you may appeal this decision to the Supervisory Review Committee within 30 calendar days of receipt of this letter. Such an appeal must follow the requirements of the regulation, and must be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428. Please refer to § 746.107 of the NCUA’s regulations for additional information regarding the required contents of an appeal to the Supervisory Review Committee.

Sincerely,

Larry Fazio, Director
Office of Examination and Insurance

cc: Board Chairperson XXXX
    Regional Director XXXX
    Board Secretary Poliquin