

# NACUSAC Annual Conference and Expo

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## Understanding and Monitoring Examiner Findings and Directives

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# EXAMINER FINDINGS AND DIRECTIVES

## DISCUSSION AREAS

- The Examination Process (State, Federal, or Both)
- Examiner Expectations and Requests
- Current Regulatory Environment
- Types of Findings and Directives
  - Examination Overview
  - Examiner's Findings
  - Document of Resolution (DOR)
  - Letter of Understanding and Agreement (LUA)
- The Committee's Role in Current and Future Exams

# THE EXAMINATION PROCESS

## Examination vs. Audit

***Examinations*** (by your regulator)...focus on:

- Safety and soundness
- Overall controls
- Regulation compliance
- Record Keeping

***Audits*** (by your outside auditor)...focus on:

- Accuracy of accounting records
- Internal controls related to the accounting records

# THE EXAMINATION PROCESS

## The Examination

Who are the examiners?

- Federal Credit Unions...National Credit Union Administration (NCUA)
- State Credit Unions...State regulatory authority (varies by state)
  - ...sometimes "joint" exam (federal and state) based on credit union size and complexity
- Usually from credit union's region, but **sometimes specialists** from other regions added

# THE EXAMINATION PROCESS

## The Examination

When does the examination take place?

- Typically, examinations are annual
- Examinations could occur more or less frequently depending on the credit union's risk profile or other issues
- Seldom are examinations "surprise" visits
- Credit union can request an examination if issues arise

# THE EXAMINATION PROCESS

## The Examination

What tools or techniques will the examiners use?

In addition to traditional risk modeling, **new examination procedures** will have the examiners looking for:

- Investment knowledge and thorough stress testing regiments
- Concentration risk monitoring
- Appropriate handling of loan modifications and allowance levels
- Policy thoroughness for all operational areas

# EXAMINER EXPECTATIONS AND REQUESTS

## Examiner Expectations

- Examiners will send the credit union a preliminary notification titled: “**Information Needed for NCUA Examination**”
- The document will indicate the date of the exam, the number of examiners to expect, and the anticipated length of stay
- The document will list the various documents and reports that the examiners will need from the credit union upon their arrival

# EXAMINER EXPECTATIONS AND REQUESTS

## Examiner Requests (regarding Supervisory Committee)

- An appointment with the Committee Chair (or full Committee) during the exam
- Copies of the Committee minutes for the examination period
- Copies of the outside audit reports and audit engagement letters
- Location of outside audit work papers
- Copies of internal audit program, schedule, completed audits, and work papers

# CURRENT REGULATORY ENVIRONMENT

## Examiner Approach...what's on their mind

- Recent economic conditions have resulted in increased credit union mergers and failures...Politics...Congress...Oversight Boards
- Credit union fraud has increased significantly in the last few years
- When losses occur, everyone points fingers >>>
  - Where were the auditors?
  - **Where were the examiners**
  - Where was the Supervisory Committee

# TYPES OF FINDINGS AND DIRECTIVES

## “Examination Overview”

- Will be completed during each examination
- Will disclose the components of the **CAMEL** ratings
- If material risks exist, the overview should:
  - Relate the applicable risks to the **CAMEL** ratings
  - Clearly show the relationships between the Overview, Document of Resolution, Examiner’s Findings, and Loan Exceptions

# TYPES OF FINDINGS AND DIRECTIVES

**C** – Capital (also known as members' equity, net worth)

**A** – Asset quality (includes delinquencies, charge-offs)

**M** – Management (subjective rating)

**E** – Earnings (Net income or ROA)

**L** – Asset/Liability Management

- Used by regulators to rate credit unions on overall soundness
- Rating system is 1 to 5 with 1 being the most sound



# TYPES OF FINDINGS AND DIRECTIVES

## "Examiner's Findings"

- Document is used by the examiner to list significant:
  - Operating exceptions
  - Violations of law or regulation
  - Unsafe or unsound policies, practices, and procedures
- Will not include minor, infrequent infractions
- May or may not be included in Examination Report to Board

# TYPES OF FINDINGS AND DIRECTIVES

## "Examiner's Findings"

- Document should cite specific section of the *FCU Act, FCU Bylaws, NCUA Rules and Regulations*, or other authority
- Document should also list exceptions noted during previous examinations that **have not been corrected** (*and should be conspicuously notated*)

# TYPES OF FINDINGS AND DIRECTIVES

## “Document of Resolution (DOR)”

- Used by the examiners to outline plans and agreements reached with the officials to reduce areas of unacceptable risk
- The DOR will include the persons responsible and the timeframes for correction
- The examiners will strive to reach agreement with the officials on needed corrective action

# TYPES OF FINDINGS AND DIRECTIVES

## “Document of Resolution (DOR)”

- If the officials do not agree to the DOR, the examiner should work with them to develop alternative solutions or **give them time to develop acceptable plans of their own**
- If the officials do not agree to the DOR or offer acceptable alternate plans, then the examiner may recommend administrative action, depending on the severity of the identified risks

# TYPES OF FINDINGS AND DIRECTIVES

## “Letters of Understanding and Agreement (LUA)”

- A more formal supervisory tool (to be taken seriously)
- A **contract with the government**, signed by each Director and/or adopted by a majority vote of the Board
- Used for **serious violations** cited by the examiner or when a credit union has ignored or **failed to comply** with a DOR.
- Once an LUA is signed or adopted, if breached, can be enforced through severe administrative action

# TYPES OF FINDINGS AND DIRECTIVES

## “Letters of Understanding and Agreement (LUA)”

- Therefore, before signing or adopting a LUA:
  - Carefully review the LUA in its entirety
  - Request clarification from the examiner if needed
  - Seek the advice of legal counsel (even if you think it is clear)
  - Make sure terms are in the best interest of the credit union...and  
are achievable

# TYPES OF FINDINGS AND DIRECTIVES

## Tips for Handling DORs and LUAs

- Do not sign or agree to when presented
  - Should be considered a “draft” when presented
  - Should be reviewed and discussed first
  - The terms of DORs and LUAs can be negotiated
- Keep in mind that examiners are civil servants with limited expertise in running a business
- Never ignore a DOR or LUA

# TYPES OF FINDINGS AND DIRECTIVES

## Possible Administrative Actions

- Broken into “tiers” based on severity and persistence of violations
- Civil money penalties assessed based on tiers (see handout from NCUA Examiner’s Guide)
- Cease and Desist Letters
- Removal of officials

# THE COMMITTEE'S ROLE IN CURRENT AND FUTURE EXAMS

## Per Best Practices:

- Be aware of when the regulatory exam(s) will take place
- Be aware of any current or prior regulatory issues
- Be available to meet with the examiner during and after
- Be receptive to suggestions or concerns brought forward
- Ask questions and remain impartial

# THE COMMITTEE'S ROLE IN CURRENT AND FUTURE EXAMS

## Per NCUA Supervisory Committee Guide:

Ensure that management addresses each of the issues listed in all reports promptly. To do this, Committee should:

- Request a report from management that outlines actions taken
- Review management's response to ensure that corrective actions appear reasonable and adequate
- If corrective actions are inadequate, is alternate plan in place?
- If Committee review shows no progress, then bring concern to Board, and discuss with examiner or auditor if unresolved



# OPEN FORUM

Other Issues and Your Questions

# Speaker Information

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## **Excerpts from NCUA Examiners' Guide**

### **LETTERS OF UNDERSTANDING AND AGREEMENT EXAMINER'S GUIDE**

#### **Chapter 29 - Definitions**

Letters of Understanding and Agreement (LUAs) serve as supervisory tools. Regional offices sometimes use LUAs as informal administrative actions because other administrative actions often enforce violations of the terms of the LUAs.

An LUA is essentially a contract between NCUA and a credit union. The credit union agrees to take, or not take, certain specified actions. Regional directors issue LUAs when credit unions have not adequately responded to less severe measures, such as Documents of Resolution. NCUA also requires LUAs for newly chartered credit unions and to grant permanent special assistance.

Delegation of Authority SUP 16 authorizes regional directors to enter into LUAs with elected and appointed officials of FCUs and FISCUs. Regional directors discuss and negotiate publication of LUAs with the credit unions to prevent unfair surprises to credit unions and their officials. The regional directors will address the issue of publication in every LUA between NCUA and a federal credit union by including one of the following three provisions:

1. This LUA will not be published;
2. This LUA will be published; or
3. The regional director is reserving for a reasonable time the right to publish this LUA

Specific and clear language in the LUA enables all parties to understand the expectations. As appropriate, examiners or the regional office staff prepares the proposed LUAs and tailors them to each case.

(Note to Examiners): Refer to the Special Assistance Manual for additional LUA details, guidance on LUA language, and procedures for publication.

In credit unions with outstanding LUAs, the examiner must determine compliance with the LUA and document compliance within the examination report. The examiner or credit union should support recommended changes to the LUA by attaching appropriate supporting workpapers and documentation for the regional office. For credit unions with special assistance, the regional director must approve material modifications to LUAs that affect the workout period or amount of assistance. Depending on the amount and terms, the modification may require concurrence and approval of the NCUA Board or the Office of Examination and Insurance.

Once the credit union has corrected the problem areas addressed by the LUA, the regional director removes the LUA.

## Published LUA

The Federal Credit Union Act requires the NCUA Board to publish and make available to the public “any written agreement or other written statement for which a violation may be enforced by the Board unless the Board, in its discretion, determines that publication would be contrary to public interest.” The NCUA Board will publish an LUA if the Board can legally enforce the violations.

The NCUA Board may take administrative actions against credit unions or officials that fail to meet terms of published LUAs. Violations of the terms of a published LUA alone constitute grounds for administrative actions and, although not required, the LUA may include language to that effect. This provides evidence that the officials know, or should know, of the consequences of noncompliance.

## Non-Published LUA

NCUA may take an administrative action, even when it has not published the LUA if the credit union (1) fails to comply with the terms of the LUA, and (2) conducts itself in a way that constitutes a safety and soundness violation or violation of law or regulation.

## **Chapter 30 - Administrative Actions**

First tier. Any credit union or institution-affiliated party that violates a law or regulation, a final order of the NCUA Board, a published agreement with the Board (such as a Letter of Understanding and Agreement), or a condition imposed in a published writing by the Board in connection with the granting of any application (such as the Insurance Agreement), may receive a fine of not more than \$5,000 for each day of the violation. First tier penalties may apply to credit unions that, even after warnings, repeatedly submit late or substantially inaccurate call reports.

Second tier. If the credit union or institution-affiliated party commits a first tier violation, and exhibits reckless conduct or a breach of fiduciary duty, and the violation, practice or breach is part of a pattern of misconduct, or causes more than a minimal loss to the credit union, or results in a monetary gain or other benefit to the institution-affiliated party, then the NCUA Board may assess a civil money penalty of not more than \$25,000 per day for each day of the violation.

Third tier. Any credit union or institution-affiliated party that knowingly commits the first tier violations, knowingly engages in unsafe or unsound practices, knowingly breaches any fiduciary duty, or knowingly or recklessly causes a substantial loss to the credit union or a substantial monetary gain or other benefit to a party because of the violation, breach, or practice, may receive assessment of a civil money penalty of not more than \$1,000,000 per day for each day of the violation, or in the case of a credit union, 1 percent of assets, whichever is less.

The normal administrative procedure for a civil money penalty action is as follows:

The NCUA Board issues a Notice of Assessment, setting forth a statement of the law and facts on which it bases the assessment.

The assessed party has 90 days to make payment, but may request a hearing within 20 days. An administrative law judge will hold a formal hearing if requested.

After the administrative hearing, the administrative law judge submits a recommended decision to the NCUA Board.

The NCUA Board issues its final order.

An institution-affiliated party or credit union may appeal to the U.S. Court of Appeals within 20 days of receipt of the final order.

### Removal of Officials

12 U.S.C. §1786(g) contains NCUA's authority to issue a removal order; 12 C.F.R. 747, Subpart A contains the rules and regulations governing removal administrative hearings. The administrative action to remove directors, officers, or committee members as provided in §206(g) of the FCU Act is available as an initial course of action or as a continuation of a cease and desist order if the officials refuse to comply as directed. Whether this enforcement action is an initial course or a continuation of a cease and desist order, it is separate and has its own applicability to particular situations.

In some cases involving a breach of fiduciary duty on the part of the director, the officer, or the committee member, discharge of the responsible person is an internal matter performed by the board of directors. On occasion, the director, the officer, or the committee member will voluntarily resign. It may be necessary to initiate formal removal proceedings, however, when internal or voluntary solutions do not work.

Removal of a director, an officer, or a committee member is not anticipatory in nature as in the cease and desist action. Removal is appropriate only when an official committed an act that constitutes grounds for removal, i.e., it cannot be imposed for future or threatened conduct. Removal can follow only if NCUA has issued a Notice of Intent to Remove or a Notice of Suspension and Intent to Remove and after completion of the appropriate administrative proceedings as provided in the FCU Act and NCUA Rules and Regulations.

NCUA may remove a person who voluntarily withdraws or whose services the credit union terminated. A removal action may be brought any time up to six years after resignation, termination of employment, liquidation, or any other termination of a relationship with the credit union (see §206(k)(3), 12 U.S.C. 1786(k)(3)).

Any party who has been removed or suspended from office is also automatically removed, suspended, and prohibited from participating in the affairs of any federally insured financial institution without the express written consent of the appropriate regulatory authority.

### Grounds

NCUA can remove from office directors, officers, or committee members when they have:

Directly or indirectly violated:

A statute or regulation; or

A provision of a final cease and desist order (but not a provision of an immediate, temporary cease and desist order); or

Any condition imposed in writing by the NCUA Board regarding the granting of any application or other request by the credit union (e.g., an application for insurance or 208 Assistance); or

Any published, written agreement between the credit union and the NCUA Board; or

if they have Engaged or participated in any unsafe or unsound practice in connection with the credit union; or

Committed or engaged in any act, omission, or practice which constitutes a breach of fiduciary duty; and

Because of the violation, practice, or breach described above:

The credit union has or will suffer financial loss or other damage; or

The interests of the members have or could be prejudiced; or

The party receives financial gain or others benefit because of the violation, practice, or breach; and

Such violation, practice, or breach:

Involves personal dishonesty by the party; or

Demonstrates the party's unfitness to serve the credit union or to participate in its affairs.

An official's past or current violation of the Depository Institution Management Interlocks Act is an additional ground for removal.

Following are the administrative procedures for removal: The NCUA Board issues a Notice of Intent to Remove.

If the official or employee does not resign or consent, a hearing is held before an administrative law judge 30 to 60 days after service of the order.

The administrative law judge sends the recommended decision and the hearing record to the NCUA Board.

The NCUA Board issues a final order.

The respondent may appeal to U.S. Court of Appeals, but the final order remains in effect unless modified by the NCUA Board or the court.

#### Notice of Intent to Remove

The notice to remove an official from office contains a statement of facts constituting the grounds for removal and will establish a time and a place for holding a hearing before an administrative law judge, normally, between 30 days and 60 days serving the notice.

The rules and the procedures contained in Part 747, Subpart A of the NCUA Rules and Regulations apply to suspension and removal actions. The examiner should inform the official upon delivery of the notice that unless the official personally or an authorized representative appears at the hearing, the judge deems that the official has consented to the issuance of an Order of Removal. The party may also consent to the issuance of a removal order to save the time and expense of hiring counsel or appearing at the hearing. In this case, rather than holding an administrative hearing, the matter will go directly to the NCUA Board for issuance of a final order of removal.

#### Immediate Suspension of an Official

An immediate suspension is similar to a temporary cease and desist order. If necessary to protect the credit union or the interests of its members, NCUA can immediately suspend an official from all official duties pending completion of the administrative hearing. This would be appropriate, for example, when it appears that the individual, once served with a notice, likely will cause further loss to the credit union or destroy credit union records before completion of the hearing or the issuance of the NCUA Board's final Order of Removal. Like a temporary cease and desist order, an Immediate Suspension will usually be a part of or will be served simultaneously with the Notice of Intent to Remove, although it may be served any time after the notice. It, too, becomes effective immediately upon service and remains in effect until dismissed or until the NCUA Board issues a final order. The official may challenge it in court within 10 days of service, and the NCUA Board may enforce the order by suing in US. District Court or by assessing civil money penalties.

## Prohibitions

12 U.S.C. §1786(g) contains NCUA's authority to issue a prohibition order; 12 C.F.R. 747, Subpart A contains the rules and regulations governing prohibition hearings. A prohibition action is similar to, but broader in scope, than a removal proceeding. A removal action removes a person from a specified official position in a credit union, while a prohibition action stops any institution-affiliated party from participating in the affairs of a credit union. Because institution-affiliated parties are not always elected or appointed officials of an insured credit union, they may not always be removed as directors, officers, or committee members. Instead, NCUA must prohibit them from further participation in the affairs of an insured credit union.

The examiner prepares a recommendation for prohibition in the same manner as other administrative actions. The recommendation includes:

Recipient of the prohibition action, i.e., name of the person, business address, and position with the company, group or enterprise (including name of the proprietorship, partnership, or corporation) and the relationship with the credit union;

Sufficient evidence to establish the grounds necessary for a prohibition action; and

Specifics of the prohibition action, e.g., events causing the insured credit union's (or the other business enterprise's) realized or probable financial loss (or other damage) or events that allowed the institution-affiliated party to profit.

Prohibition of a person, like the removal of an official, is not anticipatory in nature as in a cease and desist action. Prohibition can follow only if NCUA issued a Notice of Intent to Prohibit and completed the appropriate administrative proceedings or the institution-affiliated party consented. NCUA may combine proceedings for removal and prohibition if appropriate. The procedures for a prohibition action are essentially the same as those for a removal action.