



## **Managing Examinations in Challenging Times**

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*This document is designed to highlight how credit unions may challenge actions or findings made by NCUA examination staff. In addition, it will discuss issues that credit unions may wish to consider when “managing” the supervision and examination process. It is important to remember that each credit union’s situation is unique. The decision regarding how to respond to an NCUA examination is, of course, the responsibility of each individual credit union and very much depends on the particular circumstances. For that reason, this document does not give legal advice. Rather, it highlights existing processes, guidance documents and ideas shared with us by both NCUA officials and NAFCU member credit unions. In providing this document, NAFCU does not necessarily infer inappropriate behavior on the part of NCUA examiners or inadequate internal controls on the part of credit union boards and management. Rather, NAFCU is highlighting resources and ideas that can lead to examinations that accurately rate the operation of a credit union against existing NCUA requirements. Finally, this document is intended to be preventive – to assist credit unions in avoiding a serious dispute when less confrontational means of resolution are available.*

The current economic downturn has placed a great deal of stress upon the financial services industry, including NCUA and the credit union industry. In response to the pressures of increased NCUSIF assessments, increased delinquencies, foreclosures, charged off accounts and member unemployment, federal regulators have taken a more aggressive stance concerning enforcement and administrative actions. Agency officials have indicated that NCUA will take administrative actions more quickly than before in order to protect our insurance fund.

Our industry may take some solace in the fact that we are not alone. A recent article in the *American Banker* by David D. Gibbons, former Deputy Comptroller of the Currency for Special Supervision discussed supervisory actions. Gibbons, in “Responding to Regulatory Actions: 5 Steps to Get it Right,” wrote that, “the surge in supervisory enforcement actions is a painful reality for bankers today ... (that) CEOs and board of directors cannot afford ... (to) ignore .... (as) enforcement actions ... are growing steadily....” Gibbons went on to state that examiner “tolerance for further risk is low, and their expectations for corrective action are high,” and he listed “five essential” steps:

- Taking it seriously and mobilizing one's team – not denying the problems, ignoring their severity or “fighting city hall”;
- Planning for contingencies and communications;
- Not waiting for the enforcement action to be executed to establish appropriate board and management governance and oversight.
- Getting a plan in place to comply with the action and its provisions.
- Ensuring balance sheet risks are measured and reported accurately and in a timely fashion with accurate credit risk ratings and loan accounting.

From the credit union perspective, NCUA's new stance has created more disagreements between credit unions and examiners. NCUA acknowledges that their examiners are not infallible, and in spite of examiner training, disagreements and inconsistencies may occur in any given examination report. NCUA has a process in place for accommodating these situations. How to navigate this process, and even whether to challenge examiner findings, are things that credit unions should consider as an ongoing concern.

First, keep in mind that NCUA has a broad range of administrative tools at its disposal. Two good sources of information about these administrative powers are Chapters [20](#) and [30](#) of the NCUA Examiner's Guide. The following briefly describes some of the powers NCUA has at its disposal.

- **Document of Resolution.** Examiners use this administrative power, commonly referred to by its acronym of DOR, to formally document plans and agreements reached with credit union staff and officials to reduce areas of unacceptable risk. NCUA has indicated that this tool should not be used for minor issues.
- **Letter of Understanding and Agreement.** A Letter of Understanding and Agreement, commonly referred to by its acronym of LUA, is essentially a contract between NCUA and a credit union. In an LUA, the credit union agrees to take, or not take, actions outlined in the document. NCUA has indicated that it issues LUAs when credit unions have not adequately responded to less severe measures such as DORs.
- **Cease and Desist Order.** Akin to an injunction, the Federal Credit Union Act generally empowers NCUA to issue cease and desist orders when a credit union is or has engaged in an unsafe or unsound practice, or when the credit union has or is about to violate a law, regulation or a condition imposed in writing by NCUA's board. Credit unions that receive a cease and desist order have a right to a formal hearing before an administrative law judge. Once effective, violating the terms of a cease and desist order can trigger additional administrative actions, including civil money penalties.
- **Other Powers.** NCUA has numerous other administrative powers, including the following:
  - Issuing civil money penalties.
  - Removing credit union officials.
  - Issuing prohibition orders, which prohibit an individual from being involved in the affairs of any insured credit union.
  - Conservatorship.

NCUA's more aggressive stance very likely has led to inconsistent examinations. NCUA, like any organization, acts through its employees and agents. No matter how much training is received, employees will react differently to the same situation. Some employees are more seasoned and will be better prepared than others. Mistakes will be made by examiners and credit unions; neither is immune from this phenomenon. It is no surprise that there are increasing occasions when a credit union and the NCUA examiner do not see eye-to-eye on a given issue.

What is a credit union to do when it disagrees with an examination finding? It is an easy question to ask, but a very difficult one to answer. NAFCU members have indicated that it is best to consider this issue in a step-by-step process that must be undertaken in a very careful, considered and deliberate manner.

**Do nothing.** If the issue is minor, a credit union may wish to concede. Challenging an examination takes time, effort and occasionally a good deal of money. Many credit union executives have indicated to NAFCU that they "pick their battles" carefully, avoiding a costly confrontation except in the most extreme and unusual circumstances. If a finding is minor and can be corrected quickly, many credit unions will make the suggested change even though they may disagree with the examiner's logic.

**Discuss the issue.** If the credit union disagrees and wishes the examiner to reconsider his or her position, the first step would be to discuss the disagreement informally with the examiner. NCUA officials have indicated to NAFCU that when they investigate credit union-examiner disagreements, a breakdown in communications is usually the cause. To maximize their chances of success at this level, NAFCU members have indicated to us that a credit union should communicate the rationale for its position clearly and without emotion. In addition, should attempts to resolve the matter with the examiner be to no avail, NAFCU-member credit unions have indicated that, depending on the weight of the matter, it can be advantageous to bring supervisory examiners into the conversation before resorting to a formal dispute.

**Formal appeals.** Should informal conversations fail to resolve a disagreement between a credit union and an examiner, credit unions have rights through which they can formally appeal exam findings. NCUA discussed these rights in the [March 2010 issue](#) of the NCUA report. Keep in mind that a credit union's board must authorize an appeal before it is filed. In short, the steps are as follows:

1. Request a review from the appropriate regional director in writing within 30 days of receiving a final report from an examiner. The regional director is to respond within 60 days.
2. Should a credit union not agree with the regional director's response or if the regional director does not respond within 60 days of receiving the request for appeal, a credit union may submit an appeal to NCUA's Supervisory Review Committee. The Committee's structure and operation are outlined in

[Interpretive Ruling and Policy Statement \(IRPS\) 95-1](#), as amended by [IRPS 02-1](#). Credit unions should review the IRPS closely, as the Supervisory Review Committee only handles a limited number of “material issues.” In addition, the following text from IRPS 95-1 is worth noting:

*The material supervisory determination remains in effect pending appeal. The appeal does not prevent the NCUA from taking any action, either formal or informal, that it deems appropriate during the pendency of the appeal.*

The Committee’s decision is appealable to the NCUA Board within 30 days of receipt.

3. There are other procedures in place for credit unions to use when contesting examiner findings. These can be found in the following Parts of NCUA’s rules and regulations:
  - [Part 709](#) (creditor claim appeals)
  - [Part 745](#) (share insurance appeals)
  - [Part 792](#) (Freedom of Information Act appeals)
  - [Part 747](#) (appeals of various administrative and enforcement actions)
  - In addition, the NCUA Board serves as the final administrative decision maker for major disputes that are not otherwise covered by IRPS 95-1 (amended by IRPS 02-1) or the regulations noted above. These issues include disputes over chartering, insurance applications, field of membership expansion, merger, certain corporate credit union matters, charter changes and letters of understanding and agreement. NCUA has indicated that these issues should first be pursued through the appropriate Regional Office. After that, appeals concerning these matters should be addressed to the NCUA Board, but submitted through the appropriate Regional Office.

Given the various avenues that credit unions can pursue, it is important to know which avenue is the proper one given the nature of the credit union’s appeal.

In addition, there may be some other issues to keep in mind as you work through the exam process.

1. **Respect NCUA’s position.** No matter how junior the examiner, he or she represents an independent agency of the United States government. That agency has a wide array of administrative powers at its disposal. Keep in mind that an examination report, e-mail, or letter comes from NCUA, not the examiner. The examiner is an agent of the agency. For that reason, NAFCU members have indicated to NAFCU that they treat official communications that they receive from NCUA with gravitas. The same would go for communications they send to NCUA or other regulators.
2. **Due diligence.** Do not sign anything on behalf of your credit union unless you understand the nature of the document. NCUA officials have indicated that credit

unions who sign a Document of Resolution or Letter of Understanding and Agreement will be held to the agreement. Be prepared to discuss the terms of these agreements with the examiner. Even issues such as timing are open to debate.

3. **Develop in-house capabilities.** In order to confidently appeal an examiner's finding, a credit union must understand NCUA's official position on a given issue. Credit unions should consider the development of staff with strong skills and expertise in the areas of accounting, finance, legal, loan underwriting, compliance, and statistics. Developing expertise in these areas will not only help you during a dispute, but having skilled staff will help you run your credit union in compliance with the laws, regulations and regulatory guidance documents that govern it. While the development of such skills may use considerable salary and training dollars, that development may pay off later in dealing with a dispute or preventing one from happening.
4. **Develop outside relationships.** Credit unions may wish to develop relationships with outside auditors and attorneys. Along those lines, many NAFCU members advise us that it is their routine practice to have legal counsel present when the agency requests to meet with the credit union's CEO and board. In addition, credit unions should consider consulting with these outside experts on a regular basis, rather than waiting for a formal dispute or other "emergency" to develop. Bringing an outside auditor or attorney up to speed on an issue is much easier to do when he or she is already knowledgeable about your credit union's operations. In addition, consulting with outside experts can also help you avoid problems, thereby minimizing the chance that a need for a formal appeal would be necessary. Such experts often can perform audits to identify problem areas before an examiner can locate them. Much like developing in-house capabilities, developing outside relationships will take up credit union resources.
5. **Be proactive.** Many credit unions have indicated to NAFCU that it pays to be proactive during an exam process. Examiners visit many credit unions, but no one examiner is an expert on *your* credit union. Credit unions that actively teach examiners about their skilled staff, dedicated board, credit union operations and the rationale behind practices, policies, and procedures may benefit.
6. **Document policies, procedures and training.** Board training, practices and the reasons why things are done must be translated into records, procedures and other documents that an examiner can review. In addition, research, statistics, and information as to why a credit union created a certain practice or procedure may be helpful.
7. **Be readily acquainted with NCUA's examiner manual.** NCUA has an [Examiners Guide](#). Thirty-two chapters in length, the Examiners Guide is the reference guide for credit union examiners. Chapters cover issues such as lending, asset liability management, exam report writing, and administrative actions. The guide is a good way to understand NCUA expectations on a given issue. If the examiner is not following the guide's recommendations, it would be reasonable to ask why.
8. **Stay professional.** Creating an honest and cordial relationship with an examiner can go a long way. Many NAFCU CEOs have repeated a common theme – make

- the examiner's job as easy as possible. If items have been requested ahead of the exam, gather them and have them ready when the examiner arrives. If the examiner asks for a document or policy, promptly provide it. Treating an examiner with respect and giving the examiner a comfortable and productive work environment can only help your case.
9. **Be specific.** When an examiner (or outside auditor) indicates that you must not do A or B, or that you must do C or D, ask them what law, regulation or guidance document is the basis for the recommendation. Many credit unions ask for the specific legal or regulatory citation.
  10. **Stay connected.** While each credit union is unique, many of the situations we face have been seen by others. NAFCU-member credit unions have indicated to us that the more a credit union taps into networking, trade associations, training, and conferences, the better prepared they are to deal with the uncertainties involved with NCUA supervision and examinations.

Given the unique nature of each credit union's operations, NAFCU understands that it is nearly impossible to generalize how a credit union should respond to NCUA. Each situation will be unique, and the credit union must make a business decision on how to choose to respond, or not to respond, to an examination finding. In the current environment, NAFCU wants credit unions to be able to access all the tools available to get the examinations that they feel are accurate and support the condition of their credit union.