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NATIONAL CONSUMER
COOPERATIVE BANK

Oversight Adequate But
Federal Loan Repayment
Needs Monitoring





United States
General Accounting Office
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General Government Division

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The Honorable Alfonse M. D'Amato
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

The Honorable Marge Roukema
Chairwoman, Subcommittee on Financial
Institutions and Consumer Credit
Committee on Banking and Financial Services
House of Representatives

The past chairmen of your committee and subcommittee asked us to determine if the National Consumer Cooperative Bank's (NCB)¹ safety and soundness is effectively monitored by the present oversight arrangement. Congress created NCB in 1978 to provide financial and technical assistance to cooperatives to increase their contribution to the nation's economy. The Farm Credit Administration (FCA) examines this approximately \$536 million asset institution; however, Congress did not assign regulatory or enforcement powers over NCB to FCA or any federal financial regulator. The U.S. Department of the Treasury holds approximately \$183 million in NCB debt that NCB must repay no later than October 31, 2020.

This report addresses the adequacy of federal oversight for monitoring NCB's safety and soundness and NCB's obligation to repay the Treasury debt. We are making recommendations to Congress to ensure better monitoring of the government's financial interest.

Results in Brief

Although NCB was chartered by Congress, it is a private, cooperatively owned financial institution with limited ties to the government. Despite its name, NCB is not a true bank because it does not accept insured deposits. While NCB is examined by FCA, an independent federal agency that is overseen by Congress, its primary discipline comes from private sector lenders, from whom NCB borrows most of its funds. The government does not guarantee any obligations incurred by NCB. In addition, it appears that NCB's creditors do not believe that the government would intervene if NCB became financially stressed. In the absence of insured deposits or an explicit or implicit federal guarantee, we do not see any need for additional regulatory oversight because NCB's safety and soundness appear

¹In November 1984, the National Consumer Cooperative Bank adopted "National Cooperative Bank" as a trade name, although its formal name has never been changed.

to be effectively monitored by the existing combination of federal examination and market discipline.

While NCB is a private institution, as defined above, it does have a direct financial link to the government—the part of its debt held by Treasury. Should NCB fail, the government’s direct exposure to loss as of December 31, 1993, was about \$183 million in NCB’s debt held by Treasury and any interest owed on that debt. NCB is required to pay interest semiannually. The law requires NCB to maintain a schedule to ensure repayment of the principal amount of the debt no later than October 31, 2020. NCB adopted a plan in February 1993 to accumulate a portion of the funds needed to repay the debt. During the course of our review, NCB adopted a plan to prepare for retiring the total principal amount no later than October 31, 2020.

Treasury is not required by law to approve or monitor NCB’s repayment plan. However, we believe it would be appropriate for the law to be amended to require that Treasury approve NCB’s repayment plan and, through FCA, monitor NCB’s performance against the plan. In our opinion, Treasury’s involvement would help ensure that NCB maintains the repayment schedule, thus meeting the requirements of its debtor relationship with Treasury and better protecting the taxpayers’ interest.

Background

NCB’s mission is to support eligible cooperatives with credit and technical assistance and encourage broad-based ownership, control, and participation in NCB. In general, cooperatives eligible for NCB loans and services are organizations operating on a cooperative, not-for-profit basis to produce or furnish goods, services, or facilities primarily for the benefit of their member-stockholders who are the ultimate consumers.²

Under the 1978 National Consumer Cooperative Bank Act, NCB was established as a mixed-ownership government corporation and “instrumentality of the United States.” NCB received initial federal funding through Treasury purchases of shares of its class A stock. In 1981, Congress converted NCB from an instrumentality of the United States to a federally chartered, private financial institution that is owned and

²The National Consumer Cooperative Bank Act sets out additional criteria. For example, an eligible cooperative must make membership available on a voluntary basis without discrimination. It must restrict voting control to members on a one-person, one-vote basis. The act excludes certain cooperatives, such as credit unions (although certain credit unions may receive technical assistance), mutual savings banks, and mutual savings and loan institutions. Except under certain circumstances, the act also excludes cooperatives eligible for credit from the Farm Credit System banks for cooperatives, the Rural Electrification Administration, the Rural Telephone Bank, and others.

controlled by its cooperative stockholders. The 1981 amendments to the act provided that all Treasury-held stock be exchanged for NCB class A notes. The act prohibited Treasury from purchasing any class A stock issued by NCB after the exchange occurred on December 31, 1981. Treasury now holds approximately \$183 million in class A notes, which must be repaid no later than October 31, 2020.

In addition to these public funds, NCB raises funds from private lenders; its major creditors are banks and insurance companies. NCB uses these funds and funds from other liabilities, combined with members' equity (retained earnings and members' stock), to make loans and provide services to eligible cooperatives. The act requires all borrowers to own not less than 1 percent of the face amount of their loans in class B stock when the loan is made. It has been NCB's practice to guarantee that it will redeem the borrowers' stock at par value when the loan is repaid. It is through this required stock purchase that borrowers become member-stockholders in NCB.³ NCB's total common stock and retained earnings comprised its core capital of 20 percent as of December 31, 1993.

The business activities of NCB have diversified since its creation. Initially, NCB served cooperatives in retail food, sporting goods and other industries, and housing cooperatives. Today, NCB serves community health centers, health maintenance organizations, and employee stock ownership plans as well as worker-owned cooperatives in manufacturing, retail, and service industries. In addition, NCB serves retailer-owned wholesale food and hardware cooperatives. NCB's transactions range from making a simple loan to a quilting cooperative in rural Alabama to securitizing assets⁴ to improve liquidity for cooperatives.

NCB is governed by a 15-member board of directors. Twelve members are elected by the stockholders, who are borrowers or organizations controlled by eligible borrowers. Three members are appointed by the president of the United States, with the advice and consent of the U.S. Senate. Of these three members, the act requires that small business proprietors, eligible low-income borrowers, and the federal government be

³A similar practice in the Farm Credit System led Congress, in 1987, to provide statutory protection for such stock to existing stockholders and to expressly require that borrower stock issued in the future be at risk. There is currently very little remaining protected stock in the Farm Credit System. We recently issued two reports on the System and its regulator. See *Farm Credit System: Farm Credit Administration Effectively Addresses Identified Problems* (GAO/GGD-94-14, Jan. 7, 1994) and *Farm Credit System: Repayment of Federal Assistance and Competitive Position* (GAO/GGD-94-39, Mar. 10, 1994).

⁴Securitizing assets is the process of bundling similar types of loans and creating a security, which is sold in the securities markets.

represented. The government position on the Board has been vacant since 1990.

The act, as amended in 1981, provides for the creation of a nonprofit affiliate of NCB that does not have capital stock. This affiliate, the NCB Development Corporation, specializes in lending to low-income and newly established cooperatives and also provides loans and technical support to established cooperative enterprises. The Development Corporation's assets are not included on NCB's consolidated financial statements. As of December 31, 1993, the Development Corporation's fund balance was over \$56 million, which was derived from about \$25 million in government appropriations, \$13 million from NCB, and about \$18 million in retained earnings. Its nine-member board includes six NCB directors who elect three outside directors.

Since 1984, NCB has acquired a federally insured savings bank and created six subsidiaries to help serve its customers. The NCB Savings Bank (NCBSB) had approximately \$76 million in assets at December 31, 1993. NCBSB is examined and regulated by the Office of Thrift Supervision (OTS). Deposits of up to \$100,000 at the savings bank, like those of other thrift institutions, are insured by the Savings Association Insurance Fund (SAIF), which is backed by the full faith and credit of the U.S. government. If NCBSB were to fail, SAIF would be responsible for repaying insured depositors.

The subsidiaries perform services for cooperatives, such as investment management. See appendix I for a list of NCB subsidiaries and affiliates. As shown in table 1, the consolidated assets of NCB, its subsidiaries, and NCBSB totaled approximately \$536 million at December 31, 1993.

Table 1: Selected Financial Data for NCB, Its Subsidiaries, and NCBSB, as of December 31, 1993

Category	Amount
Assets	
Cash and cash equivalents	\$31,300,314
Investment securities	
Available-for-sale	26,406,171
Held-to-maturity	3,380,698
Loans and lease financing	417,438,593
Loans held for sale	40,274,829
Less: allowance for loan and other assets	(12,309,359)
Excess servicing fees receivable and other assets	29,275,730
Total assets	\$535,766,976
Liabilities and Members' Equity	
Short-term borrowings	\$31,541,577
Long-term debt	130,354,889
Other borrowings	2,040,406
Patronage dividends payable in cash	3,147,860
Other liabilities	75,653,929
Subordinated class A notes	182,989,162
Total liabilities	\$425,727,823
Members' Equity	
Common stock	\$80,245,148
Retained earnings	
Allocated	12,844,968
Unallocated	16,949,037
Total members' equity (core members' equity)	\$110,039,153
Total liabilities and members' equity	\$535,766,976

Source: NCB consolidated financial statement, 1993 annual report.

NCB acquired NCBSB to help fulfill its mission of providing credit to cooperatives. According to NCB's application, its primary reasons for acquiring NCBSB were to have an institution that could solicit nontransactional deposits from its cooperative members,⁵ originate loans to cooperative borrowers, and buy portions of NCB loans using the

⁵Nontransactional deposits involve limited banking activity, such as certificates of deposit, for a fixed number of days or years. Such deposits are in contrast to a checking account where deposits and withdrawals are made often.

NCB-attracted deposits as the funding source. The act authorizes NCB to accept certificates of deposit and pay interest on them; but NCB officials said that they could not attract large deposits (e.g., in amounts of \$10,000 or more) without federal insurance.

In the past, we provided two legal opinions on NCB matters at the request of Congress. In a 1982 legal opinion, we determined that NCB's conflict of interest policy met the statutory requirements and that a specific cooperative was an eligible NCB customer.⁶ In 1986, we opined that NCB was authorized to form subsidiaries and invest in affiliates.⁷ We also issued a report⁸ on NCB soon after it was converted to a federally chartered, private financial institution owned by its cooperative stockholders.

Objectives, Scope, and Methodology

The primary objective of our review was to determine if the financial safety and soundness of NCB is effectively monitored by the present oversight arrangement. In addition, we wanted to determine the extent of any potential losses to the government if NCB were to fail. Our work focused on NCB, including its relationship with NCBSB.

In the course of our work, we analyzed the National Consumer Cooperative Bank Act to determine NCB's mission and operational requirements and requirements related to its Treasury debt. We analyzed the statutory provisions applicable to safety and soundness. We reviewed FCA's examination reports and related documents on NCB for 1990 through 1994 to determine the key safety and soundness and other issues FCA assessed. We also analyzed the deficiencies or problems examiners identified. We reviewed FCA, NCB, and other organizations' relevant documents to determine NCB's responses to FCA's findings.

We compared the scope and results of FCA's examinations with issues that we have found, in previous work, to be important to the safety and soundness of financial institutions. In making this comparison, we looked for any constraints FCA examiners might have had in identifying or addressing NCB problems. We also asked FCA examination officials about their experiences and opinions regarding any such constraints.

⁶Letter of the Comptroller General, GAO, to the Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, December 16, 1982, (B-200951).

⁷Letter of the Comptroller General, GAO, to the Chairman, Committee on Banking, Finance and Urban Affairs, House of Representatives, October 10, 1986, (B-219801).

⁸See The National Consumer Cooperative Bank: An Institution In Transition (GAO/RCED-84-75, Dec. 15, 1983).

We reviewed OTS examination reports and other documents on NCBSB, and we also reviewed OTS reports for 1990 through 1994 on NCB as the savings bank's holding company. We focused on any transactions between NCBSB and NCB, documented and analyzed any safety and soundness deficiencies examiners identified, and traced both institutions' responses and OTS' and FCA's follow-up.

To form our opinion on the adequacy of the government's monitoring of NCB's safety and soundness, we compared the results of our analyses to the safety and soundness provisions of the act, FCA's own standards, and the characteristics of lax financial institution oversight that we had identified in previous work. We modified these criteria to reflect the fact that FCA does not have regulatory or enforcement authority over NCB. We considered whether FCA called for NCB to address examiner-identified deficiencies or problems documented in each examination report and whether FCA followed up until these issues were corrected. We met with NCB, FCA, OTS, and Treasury officials to discuss our work and solicit their opinions about the adequacy of federal oversight of NCB.

To assess the discipline imposed by the private sector lenders, we analyzed opinions of NCB's creditworthiness issued by credit rating firms and the performance requirements imposed by NCB's major private creditors. We compared our findings to the performance requirements of selected federal regulators of financial institutions.

To identify the extent of the government's exposure to financial loss, we reviewed the Treasury-NCB financing agreement, notes, and applicable law. We compared NCB's credit ratings and the characteristics of its financial relationship to the government with those of other business entities with government ties.

We did our work between December 1993 and September 1994 at the NCB headquarters in Washington, D.C., and at the FCA headquarters in McLean, VA. Our work was done in accordance with generally accepted government auditing standards.

We obtained written comments on a draft of this report from NCB, FCA, and Treasury. We incorporated these comments in the text where appropriate and summarized them on pages 24 and 25 of this report. In addition, the full text of each entity's comments and our responses are provided in appendixes II through IV.

NCB Has Few Ties to the Government

One important reason that the government regulates financial institutions is to help stabilize the nation's financial system. A second and related reason is to protect depositors whose accounts it insures and to protect the government deposit insurance funds from large losses. Neither of these reasons apply to NCB because it is a comparatively small institution that does not have insured deposits.⁹

The government also regulates certain financial institutions, e.g., certain government-sponsored enterprises (GSE), when the market perceives that the government stands behind their obligations. These GSEs expose the government to the potential for large losses.¹⁰ Because GSEs have congressional charters and strong financial ties to the government, investors perceive that GSE debt has an implicit government guarantee. Although NCB is a federally chartered, private institution that is cooperatively owned by its stockholders, it has much weaker financial links to the government. It appears NCB's creditors do not believe that the government will intervene if the bank becomes financially stressed. Thus, because NCB is a small institution that does not accept insured deposits, and the government's potential loss due to NCB's outstanding debt to the Treasury is limited to \$183 million, the reasons why the government regulates financial institutions do not apply to NCB.

Congress chartered NCB to help fulfill the financial and technical assistance needs of a special segment of the economy—cooperatives. Congress found a lack of access to adequate credit and a lack of technical assistance hampered consumers' and other self-help cooperatives' formation and growth. The reasons Congress established NCB are similar to its reasons for establishing GSEs. Congress chartered GSEs to help fulfill the credit needs of certain sectors of the economy, and their charters limit each GSE's activities. For example, the Farm Credit System exists to facilitate the flow of funds to the agricultural sector. Similarly, NCB is limited to providing credit to cooperatives.

⁹NCBSB has deposits that are insured by SAIF. However, NCBSB is regulated by OTS, which has comprehensive regulatory and enforcement powers.

¹⁰The largest GSEs and the estimated assets they control in fiscal year 1995 are: the Federal National Mortgage Association, \$863 billion; the Federal Home Loan Mortgage Corporation, \$617 billion; the Federal Home Loan Bank System, \$172 billion; the Farm Credit System, \$60 billion; and the Student Loan Marketing Association, \$49 billion. NCB is not identified by the Office of Management and Budget or by us as a GSE. See *Budget Issues: Profiles of Government-Sponsored Enterprises* (GAO/AFMD-91-17, Feb. 1991). In addition, the Congressional Budget Office has cited NCB as an example of Congress' subsidizing an entity's activities without giving it federal grants or the legal characteristics of a GSE that would imply a federal guarantee of its debt securities. See *An Analysis of the Report of the Commission to Promote Investment in America's Infrastructure*, CBO, February 1994.

Other than its charter, NCB's link to the government is financial. Congress provided funds to establish NCB, and it continues to support NCB by allowing Treasury to hold its debt until 2020. When Congress privatized NCB in 1981, it required that all outstanding Treasury stock in NCB be converted to subordinated debt.¹¹ The act prohibited Treasury from buying any NCB stock in the future. Further, as we discuss later, Congress required repayment of the debt by October 31, 2020. At the same time, the government declared that it does not guarantee obligations incurred by NCB.

Government-Held Debt Enhances NCB's Credit but Government Exposure to Loss Is Limited

NCB's Treasury debt has a favorable interest rate for NCB and, because it is subordinated debt, it enhances NCB's creditworthiness to private lenders. However, the actual amount at risk and, therefore, the potential loss to the government is limited to principal and accrued interest. Thus, the government's potential loss, as of December 31, 1993, would have been limited to about \$183 million in principal and any interest due. In contrast, most GSEs have access to federal funding at Treasury's discretion, should it ever be needed. Treasury's funding authority varies for each GSE, but totals billions of dollars. For example, Treasury is authorized to purchase up to \$2.25 billion of the Federal National Mortgage Association's obligations.

Until October 1, 1990, NCB paid interest rates on its Treasury debt that were below the interest rates paid on Treasury debt of comparable maturities. The act, as amended in 1981, limited the interest NCB paid on the debt to 25 percent of NCB's gross revenues less necessary operating expenses, including a provision for possible losses. The effective rates of interest for 1988, 1989, and 1990 were 2, 2, and 3.5 percent, respectively. According to FCA, the subsidy due to the below market rates (assuming a market rate of 8 percent) amounted to approximately \$11 million in 1989 alone. We believe this comparison underestimates the actual subsidy because NCB would not have been able to borrow long-term funds at Treasury rates.¹²

¹¹The debt is represented by notes that are subordinated to any secured or unsecured notes and bonds issued by NCB, but the notes have first preference over all classes of NCB stock.

¹²It was not within the scope of our work to explore the accounting treatment of this subsidy by NCB and Treasury.

A 1989 amendment to the act provided for a change in the interest rates on the notes.¹³ After October 1, 1990, the interest paid was to be pegged to outstanding Treasury debt of comparable maturities. This action raised the 1991, 1992, and 1993 effective interest rates to 7.1, 6, and 5.4 percent, respectively. The future rates for four series of notes were to be set, according to their respective maturities, to equal market rates for Treasury obligations having the same maturities.¹⁴ At December 31, 1993, those rates ranged from 2.98 percent to 8.82 percent. These rates were better than NCB could have obtained in the private market so it still benefited from the Treasury funds, although the subsidy had been reduced since 1990.

In addition to the favorable interest rate on this debt, NCB's creditworthiness is enhanced by the nature of this subordinated debt. Subordinated debt gives private creditors some assurance that, should the institution fail, funds owed to them will be repaid before those of subordinated debt holders. Thus, subordinated debt acts like equity from a superior creditor's perspective. The value of this debt to other creditors is illustrated by the fact that agreements with these creditors generally prohibit NCB from prepaying the debt. This limitation preserves private creditors' place "in line" should the bank be liquidated. One NCB official explained that the prepayment prohibition was demanded by their lenders. He said lenders did not want to extend credit without the additional security provided by the prepayment prohibition.

Without Guarantee, Market Provides Funds Under Strict Covenants

In previous work on GSES,¹⁵ we noted that their close ties to the government, and especially the markets' perception of an implicit government guarantee of their debt, encouraged GSE risk-taking and exposed the government to possible losses. GSE debt totals hundreds of billions of dollars and their operations are important to certain sectors,

¹³The amendment also provided that NCB may, with Treasury's approval and consistent with the other provisions of the act, issue replacement notes. The full amount of the class A notes can still remain outstanding until 2020. However, the final due date was advanced from December 31, 2020, to October 31, 2020.

¹⁴Per NCB's agreement with Treasury, the total principal of the debt comprises four series of notes whose interest rates are tied to the 91-day, 3-year, 5-year, and 10-year Treasury rates. As each note comes due, NCB has the right to borrow again from Treasury, the maturing amount under the same terms. NCB has stated it intends to avail itself of this right. For example, the 3-year Treasury note for approximately \$37 million, with an interest rate of 4.24 percent, matures on October 1, 1996. At that time, NCB can borrow the principal amount again and Treasury is to issue a new 3-year note at the prevailing rate of interest. Interest on all notes is payable semiannually.

¹⁵See Government-Sponsored Enterprises: The Government's Exposure to Risks (GAO/GGD-90-97, Aug. 15, 1990) and Government-Sponsored Enterprises: A Framework for Limiting the Government's Exposure to Risks (GAO/GGD-91-90, May 22, 1991).

such as housing and agriculture. Because of their size, their public policy purposes, and the probability that the federal government would assist a financially troubled enterprise, we recommended that the government supervise GSES' risk-taking activities. However, NCB is a comparatively small institution, and the cooperative community is not entirely dependent on NCB for financing. Most importantly, it appears creditors do not believe that the government would assist NCB if it were financially stressed. The creditors impose discipline on NCB as a requirement of extending credit, and NCB appears to be responsive to this market discipline.

The 1981 amendments state that debt issued by NCB is not guaranteed by the government. In remarks concerning this amendment, one Member of Congress said in regard to NCB debt that

“ . . . the bank's obligations should be viewed in the market as are other issues of private corporations. The U.S. Government is not to be responsible in any way for these obligations. There is not even to be a moral obligation of the United States behind these obligations.”

Credit-rating firms accept the government's declaration that it is not liable for NCB debt. The three credit-rating firms that have given NCB's short-term senior debt an investment-grade rating assumed that the government would not protect NCB's creditors if the bank failed. For example, Moody's Investors Service reported in October 1993 that “NCB retains loose ties with the U.S. Government, but it is unlikely that the Government would provide support to the bank in a stress situation.”

NCB borrows funds from private lenders on the strength of its own credit and is subject to the discipline imposed by the market through covenants in agreements with its creditors. NCB's creditors impose restrictions that are typical of those in private market financial transactions. For example, NCB's major creditors require that NCB

- maintain proper books and records that are available for creditors' inspection;
- not transact business with affiliates except on an arms-length basis;
- remain primarily in its present line of business and not change its operations significantly; and
- meet specific minimum standards for net worth, earnings, liquidity, and debt ratio.

Breaching any of these requirements would result in default and, according to NCB, probable liquidation of the institution. NCB's creditors also require periodic reports to enable them to monitor NCB's performance. These include quarterly financial reports, reports of an annual independent audit, detailed calculations showing compliance with various financial requirements, reports on the loan portfolio, and reports on loan losses and loan loss reserves.

These creditor requirements show that NCB is subject to significant market discipline similar to the discipline imposed by government regulators on banks and GSEs.¹⁶ In the case of capital standards, NCB actually meets a higher standard. For example, the regulatory standards for bank core and total risk-based capital are 4 percent and 8 percent of assets, respectively. NCB believes that it needs to hold much higher amounts of capital to obtain funding in the private markets. As of December 31, 1993, NCB held 20-percent core and 26-percent risk-based capital.

NCB's Plan to Repay Treasury Is Not Subject to Government Approval

The act contains two provisions relating to the repayment of NCB's Treasury debt. One section provides for repayment of the debt on the basis of any annual sale of class B stock. However, the act does not specify that NCB must sell class B stock. The other section requires that NCB maintain a schedule to ensure repayment of the debt by October 31, 2020.¹⁷ This provision does not require that Treasury monitor the repayment plan. FCA encouraged NCB to adopt a long-term repayment plan. NCB adopted a partial schedule or plan in February 1993 and a new plan in November 1994.

Mechanism to Paydown Debt Effectively Eliminated

Section 104(c) of the act, added in the 1981 amendments, states that beginning October 1, 1990, NCB shall use the proceeds from the sale of certain stock to borrowers (class B stock) to redeem an equal amount of the Treasury-held notes (class A notes). NCB applied such proceeds for

¹⁶FCA imposes some similar requirements on the Farm Credit System, as does the Office of Federal Housing Enterprise Oversight on the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, and the Federal Housing Finance Board on the Federal Home Loan Banks. The failure of the regulated entities to meet regulatory requirements would not necessarily result in liquidation.

¹⁷In addition, section 211(c)(1) of the act provides that before NCB makes contributions to the nonprofit NCB Development Corporation it "shall set aside amounts sufficient to satisfy its obligations to the Secretary of the Treasury for payments of principal and interest on Class A notes and other debt." As we noted previously in this report, NCB has paid all interest when due. NCB also has made payments on the notes required due to the sale of class B stock, as we discuss in this section.

fiscal years 1991 and 1992 (approximately \$1.4 million and \$.3 million, respectively). However, in March 1992, NCB changed its policy on borrower stock to effectively eliminate this mechanism for paydown of the debt.

In March 1992, NCB announced it would no longer sell class B stock to borrowers, but would facilitate the sale of stock among the borrowers themselves. Borrowers are required to hold at least 1 percent of the amount of their NCB loans in class B stock.¹⁸ However, the act does not specify that NCB must sell class B stock. Thus, although the act requires NCB to use the proceeds from the sale of class B stock to redeem the Treasury-held notes, under its current policy, there will no longer be stock sales that generate such proceeds. If the policy should change so that NCB would again make payments on the principal of the debt, Treasury would once again receive such payments.

In addition, before the March 1992 policy change, NCB guaranteed that it would redeem outstanding class B stock at par when a borrower repaid its loan. Under the new policy, NCB will honor outstanding commitments but will not redeem this stock in the future. NCB officials stated that the Board changed the policy to enhance NCB's financial base. Over the long term, NCB officials believed that with this enhancement they would have a larger financial cushion (capital plus subordinated debt) than if NCB repaid part of the Treasury-held notes with proceeds from the sale of class B stock and obligated itself to redeem that class B stock in the future. In short, NCB believes it is not prudent to repay the Treasury debt sooner than the ultimate due date of October 31, 2020.

NCB Recently Adopted a New Plan for Repaying the Debt

Another section of the act (section 116(a)(3)(C)), also added in the 1981 amendments, states that "after December 31, 1990, the Bank shall maintain a repayment schedule for class A notes which will assure full repayment of all class A notes not later than December 31, 2020."¹⁹

¹⁸There is an adequate amount of outstanding class B stock to allow potential borrowers to obtain the required 1 percent and to allow growth in NCB lending because there is class B stock in excess of 1 percent of NCB's total loan portfolio. As of December 31, 1993, outstanding class B stock totaled \$59.7 million. NCB's loan portfolio totaled \$457.7 million; borrowers needed to hold a total of only \$4.577 million in class B stock (1 percent of \$457.7 million). Thus, some \$55 million is available for sale to borrowers. NCB customers have excess class B stock because NCB previously paid a portion of its patronage dividends in class B stock. Between 1984 and 1990, NCB paid 20 percent of its patronage dividends in cash and 80 percent (up to 10 percent of the customers' loan amounts) in class B stock. The balance was paid in class C stock.

¹⁹In a 1989 amendment to the act, the final redemption date for all class A notes was changed to October 31, 2020. (See P.L. 101-206, Sec. 2, 103 Stat. 1831 (1989)).

NCB adopted a plan in February 1993 to accumulate a portion of the funds needed to repay the debt. Because this plan provided for accumulating a portion of the funds ultimately needed, rather than the total amount, we refer to it as a “partial plan.” The partial plan established a sinking fund and provided for NCB to pay \$1 million to the fund annually for 15 years. The fund, plus its accrued income, was to be used with other funds to retire the Treasury debt when due. The partial plan did not address how the balance of the funds would be obtained.

The NCB Board also directed management to develop a new plan for the retirement of the total amount of the debt. In November 1994, the Board approved a new plan for the ultimate repayment of the total principal amount by October 31, 2020. NCB’s new plan provides for the creation of a class A Note Redemption Reserve Fund and the sale over the next 25 years of preferred stock or subordinated debt. NCB projects that the Reserve Fund will accumulate \$100 million by 2020 from NCB contributions and an assumed average yield of 6 percent. The NCB plan notes that given the subordinated status of the class A notes, the Reserve Fund will be subject to claims of senior creditors. The plan stipulates that NCB will obtain the remaining funds needed to retire the class A notes through the sale of preferred stock or subordinated debt. NCB adopted a strategy for issuing such stock or subordinated debt every 5 years beginning in 2000.

The subordinated debt is viewed as added equity by senior creditors and thus affords NCB creditors some protection should NCB become troubled. NCB’s new repayment plan maintains this protection by noting that the Reserve Fund will be subject to claims by senior creditors. Without the subordinated debt or an amount of equity that creditors believe to be adequate, the risks posed to creditors would be greater, and we believe creditors might demand that NCB meet even more stringent standards or pay higher interest rates.

We met with Treasury’s Director of the Office of Cash and Debt Management and other Treasury officials to get their views on NCB’s responsibilities regarding the \$183 million in subordinated debt. The officials reported that NCB has made all interest payments as required, and we verified this fact by reviewing Treasury’s records. In 1992 and 1993, NCB used the proceeds from the sale of class B stock in the preceding fiscal years (a total of about \$1.7 million) to redeem an equal amount of class A notes as the law requires. Treasury officials were unaware of the 1992 NCB policy change that will preclude similar redemptions in the future. The officials said that they saw nothing in the act that requires NCB to sell class

B stock and that, therefore, they concluded NCB's policy change is not inconsistent with the act.

The Treasury officials told us they fully expect NCB to repay all outstanding debt by October 31, 2020, and believe it is NCB's responsibility to have a plan to do so. They noted that the act says "the bank shall maintain a repayment schedule" to ensure full repayment of the notes and thus, they said, it is up to the bank to determine what that plan will be. Treasury officials were not aware of NCB's partial repayment plan and had not discussed with NCB any additional plans for repaying the debt. The Treasury officials told us that if NCB were unable to repay the full principal in 2020, as the law requires, NCB ultimately would have to answer to Congress. During the course of our review, Treasury officials contacted NCB officials who told them of the sinking fund plan. After NCB adopted its new repayment plan in November 1994, NCB officials told us they provided the plan to Treasury officials and discussed its implementation with them. As of December 1994, NCB was seeking its senior creditors' approval of the new plan.

The Treasury officials also told us they will continue to monitor receipt of NCB's payments of interest, monitor notes when due, and follow up as needed. Treasury is, therefore, monitoring the current interest payments on, and renewal of, NCB's class A notes. As with failure to repay principal, if NCB were not able to meet their obligations, Treasury officials believe, based on their past experience, that NCB ultimately would have to answer to Congress. In commenting on our draft report, Treasury officials noted that in instances when other borrowers did not make principal payments at maturity, "Treasury notified these entities of their failure to pay and required payment, including late fees." Further, the Treasury officials noted that they would consider whatever legal or other action they view as appropriate in the event of an NCB default.

In summary, the officials did not believe Treasury is obligated to ensure that NCB has and follows an acceptable plan to repay the debt. We agree that Treasury is not so obligated under present law. We believe, however, that prudent and responsible financial management on the part of the government would call for Treasury, as NCB's government creditor, to protect the public's investment in NCB by approving and monitoring NCB's plans to repay its debt. We believe this is more important now because NCB's policy change regarding selling class B stock means that one mechanism for debt repayment has been effectively eliminated.

We asked the Treasury officials if there were entities similar to NCB with outstanding debts to Treasury and what the repayment requirements were. The officials could not identify any similar entity with such debt. They did tell us about two semipublic entities for which Treasury held notes. However, in both cases a federal agency had cosigned the notes. It appears to us, therefore, that NCB and Treasury have a unique debtor-creditor relationship.

FCA Advised NCB to Adopt a New Plan for Repaying the Treasury Debt

FCA officials were aware of both NCB's policy change regarding class B stock and the creation of the sinking fund. They noted in the 1991 examination report, issued in 1992, that the new method of stock exchange among borrowers would allow NCB to preserve and strengthen its financial cushion. The officials told us they had not considered the effect of the policy change on the repayment of the Treasury debt, but on the immediate safety and soundness of NCB.

FCA did not directly address NCB's repayment of the Treasury debt in the 1990 or 1991 examination reports. Examination officials told us that in discussing NCB's long-range planning process with the Board, they noted the need for NCB to make plans regarding this debt. NCB included this objective in its 1993 revised strategic plan and established a sinking fund for repayment of the debt, which FCA acknowledged in its 1992 examination report issued in early 1993. FCA told us they again questioned NCB officials about the plans for debt repayment during their 1993 examination completed in May 1994. FCA notified NCB in the report of examination that it should adopt a long-term plan to repay the Treasury notes. NCB responded that it was considering such a plan and would provide FCA a copy when it was adopted by the NCB Board.

We asked FCA officials if they planned to approve or comment on NCB's proposed plan. The officials noted that FCA had no authority to approve or disapprove the plan. If NCB adopts such a plan, FCA officials said they would evaluate it during the next annual examination. We believe it would be useful to Congress for FCA to evaluate and report on NCB's repayment plans in the annual reports of examination. However, we do not believe it would be appropriate for FCA to be given authority to approve such a plan. Such authority could be interpreted as a regulatory function and lead to confusion about FCA's role as NCB's examiner. In addition, as FCA acknowledges, there may be a perceived conflict between FCA's examination function and its involvement in the design or approval of the debt repayment plan. We believe that responsibility for approving and

monitoring the implementation of any such plan should rest with Treasury, NCB's government creditor.

In a past study of government programs to assist troubled private firms and municipalities, we developed guidelines for structuring and administering such programs.²⁰ NCB is not a troubled institution, but like some of the entities aided by assistance programs, it received a loan from the government that must be repaid. Our guidelines proposed that Congress create some mechanism to administer and oversee assistance programs. A primary reason for oversight is to help ensure that the government funds are repaid. In our past study, we recommended that an administrator or board review, approve, and monitor the financial plans of the assisted entity and report to Congress.²¹ We see no reason why these guidelines, with regard to repayment of government funds, should not be applied to NCB. While NCB is not a troubled institution, it seems appropriate for the government to approve and monitor implementation of NCB's plan to repay this long-term debt.

We believe that it would be prudent for Congress to require Treasury to approve and monitor NCB's required plan for repaying its outstanding debt. Congress required similar oversight arrangements in extending loans or loan guarantees to the Consolidated Rail Corporation, the Chrysler Corporation, Lockheed Aircraft Corporation, New York City, and the Farm Credit System. We believe that the clear intent of the law is for NCB to have a plan that ensures full repayment. We also believe that such a plan, at a minimum, should specify how NCB would accumulate or obtain the total amount of the funds due to Treasury in 2020. The law requires that after December 31, 1990, NCB maintain "a repayment schedule" to ensure full repayment in 2020, but does not define this repayment schedule. In November 1994, NCB adopted a new plan. In commenting on our draft report, NCB officials said they were seeking the approval of their senior creditors to implement the plan.

These senior creditors' reviews raise the possibility of revisions to the new plan. We understand NCB's need for the subordinated Treasury debt to

²⁰See *Guidelines for Rescuing Large Failing Firms and Municipalities* (GAO/GGD-84-34, Mar. 29, 1984). We developed these guidelines from our own experiences and those of others involved in the government programs to assist the Consolidated Rail Corporation, Lockheed Aircraft Corporation, the Chrysler Corporation, and New York City.

²¹The mechanism Congress established in 1987 to oversee assistance to the Farm Credit System reflected our guidelines. The Farm Credit System Assistance Board approved plans of the assisted Farm Credit Banks, monitored them closely, and reported to Congress. (See GAO/GGD-94-39, Mar. 10, 1994).

borrow in the private markets, and we recognize that Congress intended to support NCB by allowing the Treasury debt to remain outstanding until 2020 (except for partial payments on the principal when class B stock is sold). Nevertheless, we believe it is appropriate for Congress to give Treasury a broader role in reviewing, approving, and monitoring NCB's plans to repay the debt. NCB took the initiative to submit its new repayment plan to Treasury. In addition, NCB officials said they had discussed with Treasury officials the possibility of entering into an agreement relating to the implementation of the plan if the plan is acceptable to Treasury.

To avoid duplication in reviewing NCB's financial records, we believe FCA could review NCB's performance against a Treasury-approved repayment plan during its annual examination process. FCA could report the results of this review in its examination reports and provide copies to Treasury.

The act already provides for the government to have a representative on the NCB board, and Congress could link the selection of the representative to the government's need to ensure the NCB debt is repaid. Of the 15-member NCB board, 3 members are to be appointed by the president with the advice and consent of the Senate. According to the act, one of these three members is to be "selected from among the officers of the agencies and departments of the United States. . . ." Congress could require that this representative be from Treasury.

FCA Examinations Focus on NCB Safety and Soundness

FCA examines NCB annually and addresses issues that are important to safety and soundness, such as capital adequacy, internal controls, and standards of conduct.²² The examiners evaluate NCB against requirements in the act and NCB policy and procedures. The act directs FCA to examine NCB and forward the reports to Congress. It does not specify the frequency, scope, or purpose of the examinations.

On the basis of our review of FCA's examinations of NCB, and other documents that reflect its monitoring of NCB operations, we believe FCA applies the same standards of quality to its examination of NCB that it applies to the Farm Credit System. In a recent study, we determined FCA was an effective regulator of the Farm Credit System.²³ FCA effectively

²²We identified capital, internal controls, external and internal audits, financial reporting, standards of conduct, and lending and investing practices as key safety and soundness issues in previous work. Deficiencies related to these issues have been associated with problem and failed financial institutions.

²³(See GAO/GGD-94-14, Jan. 7, 1994).

addressed the problems examiners identified at the System banks we studied. FCA customized its examinations and monitoring for each individual institution within a framework of minimum standards. FCA also ensured quality and reliability in examinations through supervisory review, quality standards, peer reviews, and other techniques.

FCA has conducted full examinations of NCB's capital, asset quality, asset and liability management, management, earnings, liquidity, and related internal controls since 1990. FCA assigns a CAMEL²⁴ rating to NCB to reflect its overall condition and the nature of oversight needed. FCA officials told us that their examinations before 1990 were more limited in scope because they focused on asset quality. However, the officials said FCA has always reviewed NCB's compliance with the act's borrower eligibility requirements.

We believe FCA examiners have the combination of experience and acquired expertise on NCB lending to make them appropriate examiners for NCB. FCA officials noted that NCB's lending to cooperatives is similar to lending activities of the Farm Credit System banks for cooperatives. Because FCA has retained a core group of examiners on the NCB examination team for some 12 years, the FCA officials believed they had developed the special expertise needed to examine a particularly unique portion of NCB's loan portfolio—its cooperative housing loans. In discussions with us, NCB officials agreed that FCA had developed appropriate expertise to examine the bank.

In addition to its annual, on-site examinations, FCA reviews OTS examinations of NCBSB and OTS' reports on NCB as the thrift's holding company. Since 1992, OTS and FCA have exchanged examination reports. In 1994, OTS participated in FCA's examination of NCB as part of its holding company review. The FCA officials told us that they are comfortable with the ongoing arrangement with OTS, and they believe it allows them to adequately monitor the relationship of NCB and NCBSB.

Since 1991, FCA has reviewed NCB's compliance with the statutory limit for housing-related loans and the standard for loans to low-income cooperatives, or those serving low-income persons. FCA broadened its examination scope in 1993 to review other statutory requirements related to NCB's mission, such as the eligibility of its board members.

²⁴CAMEL is a rating system that assesses capital adequacy, asset quality, management, earnings, and liquidity management. Regulators of all financial institutions assign CAMEL ratings on the basis of their examinations.

FCA Supports Regulation of NCB

On two occasions since 1991, the FCA Board recommended to congressional banking committee officials that FCA or some other regulator be given comprehensive regulatory authority over NCB. According to the Board, comprehensive authority would add the power to promulgate regulations and take enforcement action to FCA's authority to examine NCB. The current FCA Board members told us that comprehensive authority is needed to address any problems that might arise and, if FCA is to continue examining NCB, protect its credibility as a regulator.

FCA Board members and senior officials emphasized in March 1994 meetings with us, and previously to banking committee officials, that NCB is functioning satisfactorily. FCA has found that NCB is adequately capitalized, and NCB cooperates in addressing any FCA-identified weaknesses. Nevertheless, the FCA Board members and senior officials believed comprehensive regulation of NCB is warranted and will become more important if NCB grows and undertakes new activities. The FCA Board had no official position on which government agency should regulate NCB, but the Board maintained that FCA has the requisite experience.

FCA's NCB examination team leaders told us they generally were able to talk through issues with NCB officials and reach an acceptable settlement. We saw evidence of this in examination reports and correspondence between FCA and NCB. In the four examinations we reviewed (for calendar years 1990 through 1993), NCB sometimes made incremental changes over the 4-year period to address FCA's safety and soundness-related concerns.²⁵ Essentially, the FCA officials told us that they must rely on moral suasion to convince NCB to make a change because FCA has no regulatory or enforcement authority. FCA can only suggest that NCB address any deficiencies it believes exist; without regulatory and enforcement power, FCA cannot compel NCB to take any action or cease any activity.

As noted previously, FCA is required to forward examination reports to Congress; FCA submits the reports to the House and Senate banking committees. The reports we reviewed provided information that enabled us to compare NCB's current condition with the previous year and to evaluate NCB's responsiveness to FCA. The examination reports discussed NCB's current conditions relative to safety and soundness and mission-related requirements of the act. FCA described and evaluated actions taken by NCB to address weaknesses noted in past examinations. It noted additional weaknesses that needed to be addressed. Other useful

²⁵We did not provide specific examples to illustrate this point because the examinations are confidential documents and their contents cannot be publicly disclosed.

information was provided as well. For example, circumstances that mitigated or contributed to an identified risk were discussed. NCB management's responses to the examiners' findings were reported. At times, NCB management agreed during the course of an examination that changes in some policy or procedure were needed, and FCA reported their position. Appendixes to the reports provided financial data for the past 2 years, included comments on selected loans FCA reviewed, and provided other information.

Although it lacks enforcement authority, FCA has explicitly directed NCB to correct weaknesses and respond by a certain date. FCA's letters transmitting the reports to the NCB Board Chairman directed the board to address each concern or weakness identified in the examination report, and the letters also listed specific issues for the NCB Board to address in a written response to FCA. FCA asked for a written response within a specific time after the next NCB Board meeting.

In addition, FCA has communicated with the relevant congressional committees as needed. It appears to us that this direct line of communication strengthens FCA's role as NCB's examiner. On two occasions, as we noted previously, a congressional committee requested us to provide legal opinions on the issues that concerned FCA.

The examination reports are not publicly released. However, NCB issues publicly available annual reports, which include audited financial statements and quarterly reports as required by the securities laws.

The FCA Board cited two undesirable consequences of the agency's continuing as NCB's examiner without regulatory authority. The FCA officials said FCA could be criticized if NCB had serious problems that remained unresolved, even though FCA has no power to compel NCB to address problems. In addition, the officials said the Farm Credit System could be harmed if FCA's reputation as an effective regulator were questioned. Because the System raises debt in the capital markets, the FCA officials believed that any damage to FCA's reputation could translate into higher cost debt for the System and, ultimately, for farmers.

The first potential negative consequence—criticism of FCA—reflects FCA's concern about its reputation and the resultant standing in the regulatory community and with Congress. It is our opinion that FCA's limited responsibility regarding NCB is clear. Therefore, if NCB did not resolve problems that FCA identified, we think that NCB would be subject to

criticism, not FCA. The act requires FCA to examine NCB and report to Congress, and our review showed that FCA is providing Congress with detailed information on NCB's financial condition in its annual examination reports. It is clear to us that if NCB did not resolve problems identified by FCA, FCA can, as it has in the past, convey its concerns to Congress. Once informed, it becomes Congress' responsibility to act, as it has in the past.

We discussed the second potential consequence—higher debt costs for the Farm Credit System—with the head of the corporation that markets System debt. He said the possibility of any negative impact on the System from FCA's inability to require NCB to take any necessary actions would be remote because creditors would understand that NCB is not part of the System. We concur that it is unlikely that the cost of System debt would increase due to any unresolved problems at NCB because it is clear NCB is not part of the System. In commenting on our draft report, FCA officials said they had no substantive disagreement with this position.

Conclusions

The government's current arrangement for overseeing NCB's safety and soundness appears to be working satisfactorily. Given NCB's weak ties to the government, the markets' apparent perception that there is no implied government guarantee of NCB's debt, and the significant discipline imposed on NCB by its creditors, there does not appear to be any need for a different oversight arrangement.

However, there is a need for closer monitoring of NCB's plans to repay its debt to Treasury. NCB has a unique position as a federally chartered, private entity that is cooperatively owned by its stockholders with subordinated debt held by Treasury. The act makes NCB responsible for maintaining a schedule to ensure full repayment of the class A notes no later than October 31, 2020. During the course of our review, NCB adopted a new plan. However, no representative of the government is charged with approving the plan. In the past, Congress required government oversight when it provided loans or loan guarantees to several private firms. To safeguard the public funds loaned to NCB, we believe the government should ensure that NCB makes and follows a plan for repaying the full amount of its outstanding debt that is acceptable to Treasury. We believe a government-approved plan is especially important now that the statutory provision for repaying a portion of the debt each year has been effectively eliminated by NCB's policy change on the sale of class B stock.

Although FCA encouraged NCB to adopt a new plan for repaying its Treasury debt, it is not responsible for approving NCB's repayment plans. FCA's role is to review NCB's safety and soundness through annual examinations and report to Congress. To charge FCA with approving NCB's repayment plan could lead to confusion about FCA's limited role of examining and reporting. In addition, as FCA acknowledges, there could be a perceived conflict between FCA's examination function and its involvement in the design or approval of the debt repayment plan.

Treasury is NCB's creditor and has a responsibility, as a matter of good financial management, to ensure that debts owed to the government are repaid. As NCB's creditor, Treasury currently administers the loan and receives the interest payments. Therefore, it seems appropriate to us that Treasury should be responsible for approving and monitoring NCB's compliance with a plan for principal repayment. Once Treasury has approved NCB's plan, FCA should include in its annual examination a review of NCB's performance against the approved plan. Thus, Treasury could use FCA's work to monitor NCB's compliance with the plan.

The National Consumer Cooperative Bank Act does not, however, require Treasury to approve or monitor NCB's plan to repay the debt. The act does allow the president, with the advice and consent of the Senate, to appoint 3 members of NCB's 15-member Board. The government has not appointed a representative to the NCB Board for almost 4 years. Since Treasury holds NCB's debt on behalf of the government, one of the government's representatives could be from Treasury.

Recommendations to Congress

We recommend that Congress amend the National Consumer Cooperative Bank Act to require the Department of the Treasury to approve NCB's plan, including any future revisions, for repayment of the class A notes. Treasury should also, through FCA, monitor NCB's performance against the plan and require revisions as needed. The amendment should provide for FCA to evaluate and report NCB's compliance with the terms of NCB's approved repayment plan as part of FCA's annual examination process and provide Treasury, as well as Congress, with the reports of examination.

We also recommend that Congress require that the government's representative on the NCB Board be a representative of Treasury.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from NCB, FCA, and Treasury. The written comments of each entity and our responses appear in appendixes II through IV. NCB did not disagree with the substance of our recommendations. However, NCB prefers that the recommendations be accomplished without statutory amendments. NCB expressed a desire to avoid any matter, such as pending congressional action, that might pose concerns to the private capital markets regarding NCB's status. We continue to believe that the changes we recommended should be made through statutory amendments to better ensure their consistent implementation in future years despite changes in personnel and other intervening factors. For example, before the NCB debt is due in 2020, changes in the economy and NCB's performance could necessitate revisions to NCB's debt repayment plan. Treasury's duty to approve any revisions, and to require revisions if necessary, should be provided for in the law and not left to the judgment of future officials. NCB's status as a congressionally chartered financial institution with subordinated debt held by Treasury is well known to the private capital markets. Our recommendations to Congress do not propose any change in NCB's status. Thus, while we cannot predict the reaction of the capital markets, we see no reason for our recommendations to pose concerns to them.

FCA reaffirmed its opinion that regulatory and enforcement authority should be given to some federal financial institution regulator. However, FCA officials said they would offer no further objections to the current arrangement whereby they examine NCB and report to Congress, and they did not object to providing examination reports to Treasury, as we recommend. FCA agreed with our finding that Treasury is the appropriate entity to approve NCB's plan for repaying the Treasury debt. FCA agreed that evaluating and reporting on NCB's compliance with a Treasury-approved NCB repayment plan is an appropriate part of its examination function. FCA expressed concern about our description of this FCA role in some portions of our draft; we clarified the language where appropriate.

Treasury did not object to monitoring an NCB repayment plan, but noted that without specific legislation requiring NCB to meet the conditions of such a plan, it would have no authority to hold NCB to the plan's conditions. We recognize that Treasury would not have such authority and expanded our recommendation to say that it should be given authority to require revisions. Congress, unless it chose otherwise, would continue to retain the responsibility for taking any action warranted against NCB. This is the same arrangement Congress has relative to NCB's safety and soundness—FCA monitors NCB's performance and reports to Congress.

Also, Treasury did not object to our recommendation that Congress require the government's representative on the NCB Board to be from Treasury. However, Treasury noted this representation would not necessarily be an effective way to ensure NCB's repayment of the Treasury debt. We believe a Treasury representative could assist the Board in considering the effects of NCB policies and practices on its long-term financial health, including provisions for repaying the Treasury debt. A Treasury representative could provide valuable expertise in other areas as well. While many factors will affect NCB's ultimate ability to repay its debt, we continue to believe a Treasury representative on the Board could be effective in ensuring repayment of the debt.

Finally, although Treasury did not directly object to our recommendation that Congress require Treasury to approve NCB's repayment plan, the Department stated that such a requirement and having a Treasury official on NCB's Board could create a conflict of interest. In Treasury's opinion, such involvement could cloud its role as an "arms-length creditor." We note, however, that in the past, Treasury representatives have served on the boards of entities with outstanding Treasury loans or loan guarantees. For example, the Secretary of the Treasury served on the boards that oversaw federal programs to assist Lockheed and Chrysler. As we discuss in our report, it is appropriate for Congress to require oversight of outstanding government loans, and it is appropriate for Treasury, as NCB's creditor, to fulfill this role. Good financial management calls for such oversight. NCB's financial health and its ability to repay the debt owed Treasury are inextricably linked. Thus, we see no reason why Treasury's role as NCB's creditor would be compromised by having a Treasury representative on NCB's Board.

We are sending copies of this report to the Chairman of the NCB Board, the Secretary of the Treasury, and the Chairman of the FCA Board. We will also make copies available to other interested parties upon request.

Please contact me on (202) 512-8678 if you have any questions concerning this report. Major contributors to this report are listed in appendix V.

A handwritten signature in black ink that reads "James L. Bothwell". The signature is written in a cursive style with a large initial "J" and "B".

James L. Bothwell
Director, Financial Institutions
and Markets Issues

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Abbreviations

CAMEL	capital adequacy, asset quality, management, earnings, and liquidity management
FCA	Farm Credit Administration
GSE	government-sponsored enterprise
NCB	National Cooperative Bank
NCBSB	National Cooperative Bank Savings Bank
OTS	Office of Thrift Supervision
SAIF	Savings Association Insurance Fund

List of NCB Subsidiaries and Affiliates

NCB Mortgage Corporation, a majority-owned subsidiary, originates, sells, and services real estate and commercial loans.

NCB Financial Corporation is a wholly owned subsidiary established as the holding company of NCB Savings Bank.

NCB Business Credit Corporation, a wholly owned subsidiary, provides equipment lease financing and financial services.

Cooperative Funding Corporation, a wholly owned subsidiary of the NCB Business Credit Corporation, is a registered broker-dealer and provides corporate financial services.

NCB Investment Advisers, Inc., a wholly owned subsidiary of the NCB Business Credit Corporation, offers investment management services tailored to the needs of cooperatives.

NCB I, Inc., a wholly owned subsidiary of NCB, is a special purpose corporation that holds credit enhancement certificates related to the securitization and sale of cooperative real estate loans.

NCB Development Corporation, an NCB affiliate, is a nonprofit organization that provides loans and technical support to cooperatives.

NCB Savings Bank, located in Hillsboro, OH, is a federally chartered and insured savings bank.

Comments From the National Cooperative Bank

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



National Cooperative Bank

December 14, 1994

Mr. Thomas J. McCool
Associate Director, Financial Institution
and Market Issues
General Government Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

Thank you for providing the National Cooperative Bank the opportunity to comment on the draft GAO Report, NATIONAL CONSUMER COOPERATIVE BANK, Safety and Soundness Monitoring Adequate But Repayment Needs to be Monitored.

We are in complete agreement with the analysis in the draft Report and the conclusion to which that analysis led GAO -- that no change in the present oversight of the National Cooperative Bank ("NCB") is necessary in that "NCB's safety and soundness appear to be effectively monitored by the existing combination of federal examination and market discipline." In addition, we believe that any significant change in the attenuated relationship between NCB and the federal government could well be counterproductive. The private capital markets upon which NCB relies for funding have educated themselves over the last nine years as to NCB's present structure, operations and relationship to the government, and any significant change could well be unsettling.

With respect to the issue of NCB's repayment of its Class A Notes issued to the Treasury Department, we agree with the draft Report's analysis of the importance of the subordinated debt as a part of NCB's capitalization and the importance of NCB's having in place a comprehensive plan acceptable to Treasury for the ultimate repayment of the Class A Notes. NCB's Board of Directors in its November, 1994, meeting approved such a comprehensive plan, and NCB is now seeking approval of its senior creditors to the implementation of that plan. NCB also has submitted the plan to Treasury, and we have discussed with Treasury officials the entry by Treasury and NCB into an agreement relating to implementation of the plan if it is acceptable to Treasury.

1401 Eye Street, N.W., Suite 700
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(202) 336-7700
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See comment 1.

Appendix II
Comments From the National Cooperative
Bank

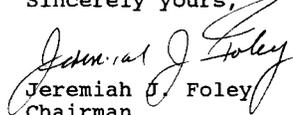
Mr. Thomas J. McCool
December 14, 1994
Page 2

See p. 23.

The only area of any concern raised for NCB by the draft Report is the procedural recommendation for Congressional amendments to the National Consumer Cooperative Bank Act to accomplish GAO's substantive recommendations that NCB's repayment plan be subject to Treasury approval and monitoring and that the government representative on the NCB Board be a Treasury employee. We have no disagreement with the substantive recommendations, but we would hope and expect that they could be accomplished without the necessity of statutory amendments. As noted above, we are presently working with Treasury on the first of the two recommendations. Our concern, as expressed above in another context, is simply an abundance of caution to avoid any matter, such as a pending bill in Congress, that might be of any conceivable concern to the private capital markets regarding NCB's status.

Thank you again for the opportunity to comment on the draft Report. Please do not hesitate to contact me or NCB's President, Charles Snyder, if you have any questions about our comments.

Sincerely yours,


Jeremiah J. Foley
Chairman
Board of Directors

cc: Mr. Charles E. Snyder

National Cooperative Bank

Appendix II
Comments From the National Cooperative
Bank

The following are GAO's comments on the National Cooperative Bank's (NCB) December 14, 1994, letter.

GAO Comments

1. We added information about NCB's newly adopted plan to repay the Treasury debt. See pages 2 and 12 through 14.

Comments From the Farm Credit Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

December 16, 1994



Mr. William J. Kruvant, Assistant Director
Financial Institutions and Market Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Kruvant:

Thank you for providing the Farm Credit Administration (FCA) with the opportunity to comment on the General Accounting Office's (GAO) draft report entitled National Consumer Cooperative Bank: Safety and Soundness Monitoring Adequate But Repayment Needs to be Monitored. The following comments highlight a significant issue to consider in your report. Enclosed are additional comments for your consideration.

The FCA continues to hold the opinion that regulatory and enforcement authority over the National Consumer Cooperative Bank (NCB) should be assigned to a Federal financial institution regulatory agency. The FCA's position is that examination responsibility without certain other authorities could subject the Agency to criticism for conditions it has no power to correct. However, we will offer no further objection to a continuation of the current oversight arrangement whereby the FCA conducts examinations of the NCB without regulatory and enforcement authority and submits such reports to Congress and the U.S. Department of Treasury (Treasury), as recommended in the GAO draft report.

The following statements from the GAO draft report are of concern to the FCA.

We believe it would be useful to Congress for FCA to evaluate and report on NCB's repayment plans in the annual reports of examination. However, we do not believe it would be appropriate for FCA to be given authority to approve or to judge NCB's compliance with such a plan. Such authority could be interpreted as a regulatory function and lead to confusion about FCA's role as NCB's examiner. Moreover, because the Treasury debt stabilizes and enhances NCB's financial condition, there may be a perceived conflict between FCA's monitoring of short-term safety and soundness and long-term debt repayment. We believe that responsibility for approving and monitoring the implementation of any such plan should rest with Treasury, NCB's creditor.

The FCA agrees that the appropriate entity to approve the NCB's plan for principal repayment is the Treasury in its role as creditor. We are concerned with the statement that it is not appropriate for the FCA to be given the authority to "judge compliance" with the terms of a

See comment 1.

**Appendix III
Comments From the Farm Credit
Administration**

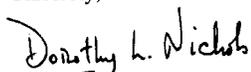
2

Treasury debt repayment plan to the extent the term “judge” is extended to encompass an evaluation of compliance. Evaluating compliance is a natural function of examination. For example, the FCA currently evaluates the NCB’s debt agreement compliance on debt held by a consortium of lenders as a routine part of its examinations.

We sense that the GAO’s concern is that involvement with the design or implementation functions of a Treasury repayment plan could conflict with the FCA’s responsibility for monitoring the NCB’s safety and soundness. The FCA agrees with this. What the FCA is suggesting is that it continue to execute the routine examination functions attributable to any debt. The FCA believes that such activity would not be confused as a regulatory function and does not conflict with the FCA’s responsibility for monitoring the NCB’s safety and soundness. Repayment of debt according to terms, as established by the creditor, is a proper safety and soundness concern.

Thank you again for the opportunity to comment on the draft report. If you would like to discuss these comments or desire more clarification, please contact Mark P. Connelly of my staff at (703) 883-4107.

Sincerely,



Dorothy L. Nichols
Chief Operating Officer

Enclosure

See comment 2.

The following are GAO's comments on the Farm Credit Administration's (FCA) December 16, 1994, letter.

GAO Comments

1. FCA's additional comments included suggestions to further clarify or expand on portions of the draft report. We modified the text as appropriate.
2. We modified the text to clarify our position, with which FCA agrees, that it is appropriate for FCA to evaluate NCB's compliance with a Treasury-approved plan for NCB's repayment of Treasury debt.

Comments From the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 23, 1994

Mr. Thomas J. McCool
Associate Director, Financial
Institutions and Market Issues
U.S. General Accounting Office
1730 Pennsylvania Avenue, Suite 9000
Washington, D.C. 20429

Dear Mr. McCool:

This is in response to a draft report issued by the General Accounting Office and submitted to Treasury on November 16, 1994. The report addresses the adequacy of federal oversight for monitoring the National Consumer Cooperative Bank's safety and soundness and its obligation to repay funds owed to the U.S. Department of the Treasury.

In the report a recommendation was made that Congress amend the National Consumer Cooperative Bank Act to require Treasury to approve NCB's plan for repayment of the class A notes and, through the Farm Credit Administration (FCA), monitor its performance against the plan.

See comment 1.

Treasury does not object to monitoring a repayment plan to ensure the pay down of the outstanding principal. NCB delivered such a plan to Treasury on December 2, 1994 which calls for the setting aside of funds to begin paying down the outstanding principal at a point in the future. However, without specific legislation requiring NCB to meet the conditions of such a repayment plan Treasury would have no authority to hold NCB to those conditions.

See comment 2.

Current legislation requires NCB to use funds obtained through the sale of class B stock to pay down the outstanding balance of class A notes held by Treasury. The legislation does not require NCB to sell class B stock. Therefore, the decision by NCB to discontinue the sale of such stock cannot be challenged by Treasury. The same could hold true with a class A note repayment plan if NCB decided to deviate from the plan sometime in the future.

See comment 3.

Treasury has loans outstanding with many entities which have legislative authority to borrow. Some loans are for short duration, others longer term. Treasury policy is to monitor each loan according to its terms and to ensure that principal and interest are paid when due. Treasury has applied this same policy to NCB.

Appendix IV
Comments From the Department of the
Treasury

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In a few instances there were borrowers who did not make their principal payment at maturity. In the interest of prudent and responsible financial management Treasury notified these entities of their failure to pay and required payment, including late fees. In some cases the Treasury was successful. In other cases borrowers sought relief from Congress of their outstanding indebtedness since Treasury has no authority to relieve a borrower from their obligation.

The GAO draft report implies that if NCB failed to pay the principal amount outstanding at maturity, Treasury would do nothing and leave it to Congress to resolve. The comment made that NCB would have to answer to Congress was a statement of what Treasury believes would, in fact, ultimately happen based on Treasury's experience. The comment was not intended to suggest that Treasury would itself take no action in the event of an NCB default. We would, as with other borrowers, consider whatever legal or other action we view as appropriate in the circumstances.

GAO's draft report also recommends that Congress require the government's representative on the NCB Board to be from Treasury. Although Treasury does not object to this recommendation, we do not believe that a position on the Board is necessarily an effective way to ensure the repayment of class A notes owed by NCB. Furthermore, it could create an inappropriate conflict of interest. Treasury's current relationship with NCB is that of arms-length creditor. A statutory responsibility to approve and monitor a repayment plan would place Treasury in a quasi-regulatory role for which we believe Treasury's independence should be maintained. To require Treasury to be a member of the board of directors would impose additional responsibilities with respect to NCB which could cloud Treasury's role and result in less effective oversight.

Sincerely,



Donald A. Chiodo, Director
Office of Cash & Debt Management
Office of Fiscal Assistant Secretary

See comment 4.

See p. 25.

The following are GAO's comments on the Treasury's December 23, 1994, letter.

GAO Comments

1. Our draft report noted our agreement with Treasury's position that under present law Treasury is not obligated to ensure NCB has and follows an acceptable repayment plan. (See p. 15.) We recognize that without explicit legislation, Treasury has no authority to hold NCB to the conditions of any plan. We added Treasury's reiteration of this point on page 24.
2. We did not suggest in our draft report that Treasury challenge NCB's current policy not to sell class B stock. Our draft noted Treasury's finding that the NCB policy is not inconsistent with the act, and we did not take issue with this position. (See pp. 14 and 15.) Treasury proposed that it likewise could not challenge NCB if it decided to deviate from its class A note repayment plan in the future. We do not disagree with Treasury, and we again note our recommendation that Congress give Treasury authority to approve and, through FCA, monitor a repayment plan.
3. Our draft report noted that Treasury was monitoring the interest payments and renewal of NCB's class A notes. (See p. 15.)
4. We clarified Treasury's position regarding its treatment of NCB, or other borrowers who might fail to pay principal owed when due, by adding the additional information provided. (See pp. 15 and 16.)

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