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General Government Division



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April 8, 1997

The Honorable Spencer Bachus
Chairman, Subcommittee on General Oversight and
Investigations
Committee on Banking and Financial Services
House of Representatives

The Honorable Bill McCollum
House of Representatives

Subject: Allegations of Improper Management Practices at NCUA

This letter responds to your June 12, 1996, letter regarding the National Credit Union Administration (NCUA). You were concerned about certain allegations made by former Board Member Robert H. Swan about management practices at NCUA. These allegations were made in his May 1, 1996, statement before your committee about 3 weeks after his involuntary termination. Mr. Swan's term as board member expired in August 1995, and he continued to serve as a holdover board member for approximately 8 months before his termination by the President.

Under the Federal Credit Union Act of 1934, as amended (hereafter referred to as the act), NCUA, an independent agency, is the federal regulator of all federally chartered, as well as federally insured state-chartered, credit unions.¹ NCUA is governed by a three-person board consisting of a chairman, vice chairman, and a board member. These persons are appointed by the President and confirmed by the Senate to serve 6-year terms on a staggered basis. On December 31, 1995, about 11,700 credit unions, having total assets of over \$300 billion, were under NCUA jurisdiction.

The current NCUA Chairman, Norman D'Amours, was appointed to his position in November 1993. According to Mr. Swan, an adversarial relationship between Mr. D'Amours and himself developed in 1994 and continued until he was terminated in April 1996. Mr. Swan sued the President in connection with his

¹The Federal Credit Union Act is codified at 12 U.S.C. 1751, et seq.

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removal from office. On November 22, 1996, the U. S. Court of Appeals for the District of Columbia Circuit affirmed a summary judgment in favor of the President.

In addition, according to Vice Chairman Shirlee Bowné, an adversarial relationship between Mr. D'Amours and herself developed in 1995. Mr. Swan and Ms. Bowné were not only dissatisfied with Board operations but were dissatisfied with certain actions of some key NCUA staff members, most notably, NCUA's Executive Director, Karl Hoyle. Mr. Hoyle, who was hired by Mr. D'Amours, oversees most of the daily operations of the agency and also serves as Mr. D'Amours' executive assistant.

Disagreements between the Chairman and other Board members were evident not only in minutes of meetings of the NCUA Board but also in other internal and external communications. The failure of Capital Corporate Federal Credit Union (Cap Corp) raised especially strong disagreements between the Chairman and the other Board members. (Enc. I briefly describes Cap Corp's activities and capitalization prior to failure.) In addition, the Chairman has confirmed that difficulties have existed between himself and the industry's two largest trade associations (who work on behalf of credit unions) but not, in his opinion, with credit unions on the whole.

Our objective was to test the validity of Mr. Swan's allegations about activities and procedures at NCUA and to address the related concerns you raised. Your concerns are described in detail in enclosure II. To facilitate our work, we divided the allegations made by Mr. Swan into three groups: (1) the internal operations of the NCUA Board and the role of the chairman; (2) the role of NCUA staff in establishing official NCUA policy; and (3) the legality and propriety of NCUA actions in sponsoring and promoting a 1996 conference, "Serving the Underserved." We believe these three groups include the substance of your concerns and Mr. Swan's allegations.

The first group of allegations made by Mr. Swan suggests that the Chairman and/or the Executive Director violated the act or another law by unilaterally performing certain actions that the law requires to be taken by the Board as a whole. Specifically, we considered the following allegations: (1) the Chairman improperly excluded Board members from participating in Board affairs by controlling or restricting information flow, (2) the Chairman improperly manipulated the Board's meeting agendas, (3) the Chairman unilaterally adopted NCUA policies or regulations, and (4) the Chairman ordered staff to conduct surveillance of Board members.

The second group includes the allegation that NCUA staff exceeded their authority by establishing or attempting to establish official policy, a function reserved to the Board. Finally, the third group of allegations relates to events surrounding a conference sponsored by NCUA for member credit unions on "Serving the Underserved." Mr. Swan told your committee that "credit unions have been asked by examiners at the

time of examination and on other occasions to make contributions . . ." to support the conference. Moreover, he suggested that NCUA had violated the Federal Advisory Committee Act (FACA).

Much of the information we gathered during our review was in the form of interviews with the affected parties. Board Member Yolanda Wheat was not interviewed by us because she joined the Board subsequent to Mr. Swan's departure. We obtained relevant documentation where available, such as internal memorandums and file notes, Board minutes, minutes of Regional Directors' meetings, and relevant reports of the Inspector General. In many cases, however, sufficient documentation that might either support or refute Mr. Swan's allegations was not available so we had to rely on the sometimes conflicting oral accounts we were given by participants, each of which reflected that participant's perception of events. We could not always make a determination regarding each allegation presented. In such cases, we presented whatever evidence was available. (See enc. III for a more complete description of the scope and methodology of our work.)

Former Board Member Swan and the current Chairman and other NCUA Board members were asked to comment on this letter. Their comments and our evaluation are discussed on p. 10 of this letter.

RESULTS IN BRIEF

First, we did not find any evidence that the Chairman of the NCUA Board acted illegally in his conduct of Board operations as alleged by Mr. Swan. However, because of the apparent distrust and animosity that existed among Board members and in some cases extended to certain senior staff, the influence and effectiveness of the other Board members were almost certainly diminished.

Second, for the most part, actions taken by NCUA staff that we were able to document appear to have been primarily the implementation of policies determined by the Board, although certain actions arguably could be characterized as the making of new policy. Policymaking and policy implementation form a continuum, and legitimate disagreements can occur about the boundary between them. Members of the Board, in carrying out their oversight responsibilities, should have the right and opportunity to discuss and determine whether any particular action by staff may have crossed that boundary. Largely because of poor communication between the Chairman and the Board members, together with the Chairman's control of the agenda, it appears that the Board, as a whole, did not always have that opportunity.

Third, while the NCUA has the legal right to sponsor, plan, and promote educational conferences for credit unions, such as the 1996 conference, the NCUA failed to

provide timely direction to regional managers and examiners about their proper role in such an undertaking. Because of this failure, some examiners contacted credit unions to solicit financial support for the conference. Although these actions appear not to have been illegal, we believe they were inappropriate and that such conduct could jeopardize the professional relationship that should exist between a financial institution and its examiner.

INTERNAL OPERATIONS OF THE NCUA BOARD AND THE ROLE OF THE CHAIRMAN

Under the act, the Board's powers and responsibilities include comprehensive regulation and supervision of federal and federally insured credit unions, management of the NCUA, and the adoption of rules for the transaction of the Board's business.² The act does not define the term "management." However, the act sets aside some managerial functions as specific to the chairman. It specifies that the chairman shall be the spokesperson for the Board, shall represent the Board and the NCUA in its official relations with other branches of the government, and shall determine each Board member's area of responsibility. Moreover, the act provides that the chairman shall direct the implementation of the adopted policies and regulations of the Board. Thus, the chairman's legally recognized role could be described as a dominant one.

During Mr. D'Amours' administration, he has looked to Executive Director Hoyle for management of the agency on a day-to-day basis. Thus, Mr. Hoyle has played a key role in implementing policy and other matters on behalf of the Chairman. Although some of the actions taken by Mr. D'Amours and Mr. Hoyle may raise concerns from a management perspective, our review has not established that the Chairman or Executive Director acted unlawfully.

Were Other Board Members Excluded Improperly From Participating in Board Affairs by Restrictions Placed on the Flow of Documents and Information From Staff and Others to the Board Members?

Mr. Swan stated to your committee that there were instances in which senior management instructed staff not to communicate with Board members despite specific requests for information. Vice Chairman Bowné, Mr. Swan, and both of their executive assistants stated that the flow of information to their offices from NCUA staff had been curtailed. For their part, Chairman D'Amours and Executive Director

²The provisions pertaining to the general management of the NCUA and the Board are contained in section 102 of the act as amended, 12 U.S.C. 1752a. NCUA's rules of procedure are set forth in 12 C.F.R. part 791.

Hoyle deny that this happened except in the case of Cap Corp. It is their contention that senior management has consistently responded to every request from all Board members and that staff were free to contact them.

One example of allegedly impeded information flow to Mr. Swan and Ms. Bowné that was of strong concern to them involved the resolution of the Cap Corp failure. Later in the year, after the establishment of the conservatorship in January 1995, Mr. Hoyle instructed NCUA staff to clear through his office all internal communications regarding Cap Corp, including communications to the Board. Mr. Hoyle confirmed that Mr. Swan and Ms. Bowné were not advised of this instruction, but learned of it only when Mr. Swan's executive assistant requested certain information from NCUA's Office of General Counsel. Mr. Hoyle told us that information about Cap Corp had been improperly divulged outside the agency, and he wanted to ensure better internal control over information thereafter.

The controls placed on information flow to Board members with regard to Cap Corp do not appear to have violated the act. Although the Executive Director imposed access controls on information relating to Cap Corp, we found no evidence that these controls resulted in the withholding of information from a Board member that might have limited his or her authority to exercise regulatory or management responsibilities. Whether this could have happened is a matter of speculation. Mr. Swan told us he had not requested any additional Cap Corp information from Mr. Hoyle after he established the controls. Ms. Bowné could not say what documents, if any, were withheld, but her concern was that information or documents could be withheld from a Board member.

Other alleged instances of interference with Board members' communication were more difficult to document. It is possible that informal communications from NCUA staff to both Ms. Bowné and Mr. Swan diminished during Mr. D'Amours' chairmanship. We believe that it is reasonable to assume that the staff might react this way if they perceived increasingly strained relationships at the Board level. Because most senior staff were directly supervised by the Executive Director, who in turn reported to the Chairman, it could be possible that staff communications with Ms. Bowné and Mr. Swan were inhibited without any explicit instructions having been given. Ms. Bowné and Mr. Swan told us that during the tenure of former NCUA Chairman Roger Jepsen, there was a more collegial atmosphere at NCUA. They said informal contacts between Board and staff at that time were frequent and cordial and were often initiated by NCUA staff. They said this was not the case during Mr. D'Amours' chairmanship. (See enc. IV for a more complete description of the alleged restrictions and relevant evidence.)

Was the Board Agenda Being Improperly Manipulated by the Chairman?

Mr. Swan said he attempted in early 1996 to include on the Board's agenda a discussion of procedures used to set the agendas for Board meetings. NCUA regulations specified that the chairman had authority to set the final agenda for Board meetings. However, Mr. Swan believed that this authority was being abused because certain issues that he and Ms. Bowné had wished to discuss at Board meetings were not included in the agenda. Ms. Bowné told us she agreed that this had been a problem for her as well.

The issues that Mr. Swan and Ms. Bowné had wanted the Board to discuss involved certain actions taken by NCUA staff. Mr. Swan and Ms. Bowné were not in agreement with these actions and wanted the Board to review them. Examples included an executive performance appraisal, a new procedure for reviewing proposed credit union mergers, and a credit union examination that resulted in a disputed rating of a credit union. Mr. D'Amours and Mr. Hoyle stated that staff were taking the actions under general authority that the Board had previously delegated to them. The Board members were frustrated by their inability to bring these issues to a vote by the Board because they said that the Chairman would not place the issues on the agenda. In an opinion dated February 16, 1996, the NCUA General Counsel found that Board member requests for agenda items should be honored but that the chairman could control the timing of placing items on the agenda.

A partial solution to this problem was adopted by the Board at its October 16, 1996, meeting. The agenda rule was changed so that the chairman or any two board members, acting together, could require that items be placed on the Board agenda within 60 days of the submitted request. Ms. Bowné proposed an alternative rule that would entitle a single Board member to submit an agenda item for consideration at a regular Board meeting. In addition, her proposed rule would have required that a special Board meeting requested by any member be held no later than 10 days from the date of the request. However, Ms. Bowné told us that her proposal was never brought to a discussion or vote of the Board.

Were NCUA Staff Ordered to Conduct Surveillance of Board Members?

Former Board Member Swan stated to your committee that NCUA staff were instructed to conduct surveillance of Board members and report back to Mr. Hoyle. Chairman D'Amours and Executive Director Hoyle acknowledged one such activity in which NCUA Regional Directors were requested to report the content of Mr. Swan's public speeches. We found no evidence to support two other allegations of surveillance made by Mr. Swan. (See enc. V.)

On March 17, 1995, Mr. Swan addressed the annual meeting of the Virginia Credit Union League, a trade organization representing credit unions in Virginia. In its subsequent newsletter to members, the League reported several criticisms of NCUA made by Mr. Swan. For example, Mr. Swan was reported to have referred to NCUA's resolution of Cap Corp as an "assassination" rather than a liquidation. Mr. Swan confirmed to us that he had used that term. This was and continues to be a sensitive issue because the resolution of Cap Corp caused some of its member credit unions to experience losses. According to Mr. D'Amours, Mr. Swan's characterization of NCUA's actions was of concern to Mr. D'Amours partly because of the possibility that these credit unions might sue NCUA to recover their losses.³

Mr. D'Amours said that because of his concern about Mr. Swan's speech, he gave instructions that Mr. Swan's future speeches be monitored and their contents reported to the Office of the Chairman. The reporting mechanism that resulted from the monitoring activities was not systematic, and we were unable to determine how long it was in effect or how many of Mr. Swan's speeches were monitored. However, Mr. D'Amours said that Mr. Swan subsequently apologized to the Board for the Virginia League speech and that the monitoring arrangement was then discontinued.

Ms. Bowné said she assumes that some surveillance of her has been done. While she has no specific knowledge of such activities, she said that she does believe, based on comments that were made to her by the Chairman, that some form of reporting had taken place.

Did the Chairman Unilaterally Adopt Policies Against the Wishes and Without the Consent of Other Board Members?

The chairman is statutorily responsible for directing the implementation of policies that are adopted by the Board. Because policies are often expressed in general terms, their implementation can result in a variety of outcomes. Such policies are generally left to the staff to implement, and if the implementation is questioned, the Board should then resolve the issue. However, the line between policymaking and policy implementation can be hard to draw.

We could find no stated policy that the Chairman had unilaterally adopted. However, there have been cases where two Board members disagreed with actions taken by NCUA staff, believing the actions were not consistent with policy as they saw it.

³On November 22, 1996, 96 of the credit unions did file suit, and this is now pending.

ROLE OF NCUA STAFF IN ESTABLISHING NCUA POLICY

Did NCUA Staff Establish or Attempt to Establish Official NCUA Policy Without the Knowledge or Consent of the NCUA Board?

Mr. Swan cited cases to us in which he believed that NCUA staff had engaged in policymaking activities. In some instances, Vice Chairman Bowné agreed with Mr. Swan. For example, they both alleged that in 1995 Executive Director Hoyle had, in opposition to their views, changed NCUA's policy on approving or disapproving proposed mergers of credit unions. Section 205 (c) of the Federal Credit Union Act provides that the NCUA Board use six criteria for reviewing merger proposals. An excerpt from the act listing the six criteria is shown in enclosure VI. The authority to decide on these mergers using the six criteria has been delegated by the Board to the regional directors. On April 18, 1995, Mr. Hoyle sent a memorandum to the regional directors requiring them to forward certain merger proposals to him for review prior to approval. Although the criteria set forth in Mr. Hoyle's memorandum could be construed as merely amplifying the existing criteria, the memorandum was sent despite Mr. Hoyle's knowledge that Ms. Bowné and Mr. Swan disagreed with the concept it described. (For more details on this and other alleged staff policymaking activities, see enc. VII.)

The making and the implementation of policy are overlapping parts of a continuous process. NCUA's formal policies are set forth in its regulations as established by the Board. These regulations are frequently expressed in general terms. The implementation of regulations requires the chairman and staff to make general and specific judgments that should reflect established policy. It is reasonable to expect that good faith disagreements might arise from time to time about whether a particular decision or action by the staff represented merely the implementation of an existing policy or the establishment of a new one. In this case, disagreements did occur, and they were not always amicably resolved. Even when a majority of the Board disagreed with policy implementation, informal or formal means of timely addressing the problem were not clearly available to them. Poor communication between the Chairman and the other Board members, and the Chairman's control of the Board agenda contributed to the problem.

THE LEGALITY AND PROPRIETY OF NCUA ACTIONS IN SPONSORING AND PROMOTING A CONFERENCE ON "SERVING THE UNDERSERVED"

In June 1995, NCUA began planning an educational conference for credit unions. Two primary goals of the conference were for credit unions of all sizes to learn how to better serve their current members and to find new ways to expand their membership to include groups of people who do not have access to credit unions. The conference

was held in Chicago in August 1996. Mr. Swan made two allegations about the conference: that NCUA examiners illegally solicited contributions in support of the conference and that NCUA violated FACA in establishing an advisory committee to plan it.

Did NCUA Examiners Illegally Request Credit Unions to Make Contributions to Projects Initiated by the NCUA?

In his statement before your subcommittee, Mr. Swan alleged that examiners had, at the time of examinations, requested credit unions to donate funds in support of the conference. Both Mr. Swan and Ms. Bowné told us that certain credit unions had complained to them in confidence about such solicitations and there were press reports of this activity from unnamed sources.

We found that regional managers were told to encourage participation by credit unions in their regions. In this regard, we identified evidence of a few cases where examiners asked credit unions to support the conference by providing funds that would be allocated to assist other, financially weaker, credit unions to participate in the conference. These cases occurred in NCUA's Region VI. (See enc. XI for more details.) In no case that we found, however, did any examiner personally accept money from a credit union or direct a contribution of funds to or for a specific credit union. Although solicitations of support that have been identified do not appear to constitute an illegal act, we believe they were inappropriate and could jeopardize the professional relationship that should exist between a financial institution and its examiner.

The NCUA embodies a dual role in its relationships with credit unions and the credit union industry. It is an educator and a supporter of the industry, but it is also a regulator, supervisor, and examiner of individual credit unions. Confusing or mixing these two functions could impair the NCUA's ability to function as an effective regulator. Because of this risk, we question whether it was the best practice for NCUA to have taken the initial lead in planning and sponsoring a conference such as this. Having decided to do so, NCUA did not, at the very beginning, issue instructions to regional managers prohibiting any examiner solicitations for contributions. Instead, regional managers were told to encourage credit union participation in the conference and to report on the expected participation by credit unions in their regions, including credit unions that needed financial assistance to attend and credit unions that would provide such financial assistance. In some cases, contributions were then solicited by examiners. The lack of clear instructions at the outset put some regional management and staff in a position that could have raised questions about a possible compromise of the regulatory process.

Did the NCUA Violate FACA by Establishing an Advisory Committee?

Based on our review of the information NCUA provided in connection with the planning of the "Serving the Underserved" conference, it appears that the agency did not violate FACA, 5 U.S.C. App. §§ 1-15. The statute applies to committees that offer policy advice.⁴ A committee that is "primarily operational, rather than advisory," is not covered by FACA.⁵ We agree with NCUA that the group that planned the conference was primarily operational and, therefore, not subject to FACA.

AGENCY COMMENTS AND OUR EVALUATION

Chairman D'Amours, Vice Chairman Bowné, and Mr. Swan each provided comments on a draft of this letter. Enclosure XII includes Chairman D'Amours' letter. Vice Chairman Bowné's letter and our response appear in enclosure XIII.

Although Chairman D'Amours agreed with our basic conclusion that staff did not act illegally, he suggested that the Board members needed to take more responsibility for acquiring information from staff, and he offered his own views about the reason for a breakdown in the collegiality of the Board. He also agreed that NCUA should have provided more detailed and timely written instructions to regional staff concerning NCUA's proper role in supporting the conference. In this respect, Chairman D'Amours stated that NCUA would provide such instructions should it sponsor or promote similar conferences in the future. We have addressed technical points raised by Chairman D'Amours in the letter and enclosures, where appropriate.

Vice Chairman Bowné did not agree with all aspects of our findings and conclusions and raised concerns about certain statements in the letter. She reiterated her view that a communication problem had developed in NCUA and that controls, which restricted the flow of information to Board members, inhibited their ability to perform their duties. Also, she felt that we had not correctly characterized her efforts to change the Board's rules to reduce Chairman D'Amours' control of the Board agenda. We have made changes to address her concerns, where appropriate.

⁴Judicial Watch, Inc. v. Clinton, 76 F.3d 1232, 1233 (D.C. Cir. 1996); Sofamor Danek Group, Inc. v. Gaus, 61 F.3d 929 (D.C. Cir. 1995).

⁵See H.R. Rep. No. 92-1017, 92d Cong., 2d Sess. 4 (1972) (quoted in Sofamor Danek Group, 61 F.3d at 934 n. 28). See also S. Rep. No. 1098, 92d Cong., 2d Sess. 8 (1972); 41 C.F.R. § 101-6.1004(g); (GSA regulation exempting from "advisory committee" definition any committee established "to perform primarily operational as opposed to advisory functions").

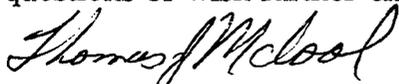
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In general, Mr. Swan did not agree with the conclusions drawn from our review. However, he presented no new information that would cause us to change our conclusions. Mr. Swan also raised some issues concerning the way in which our review was conducted. We have responded to these issues in a separate correspondence.

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We are sending copies of this letter to the Chairman and Board members of NCUA, and former Board Member Robert Swan. In addition, copies will be sent to the Ranking Minority Member of the Subcommittee on General Oversight and Investigations. Copies will be available to others upon request.

The major contributors to this letter are listed in enclosure XIV. If you have any questions or wish further clarification, please call me on (202) 512-8678.



Thomas J. McCool
Associate Director, Financial Institutions
and Markets Issues

Enclosures - 14

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ABBREVIATIONS

CAMEL	capital, assets, management, earnings, and liquidity
Cap Corp	Capital Corporate Federal Credit Union
FACA	Federal Advisory Committee Act
IRPS	Interpretive Ruling and Policy Statement
NCUA	National Credit Union Administration
OCDCU	Office of Community Development Credit Unions

FAILURE OF CAP CORP

On January 31, 1995, a majority of the NCUA Board, Mr. Swan dissenting, voted to place Cap Corp into conservatorship. The Board appointed the Director of the Office of Corporate Credit Unions as conservator. Cap Corp was a corporate credit union, whose only members were other credit unions. It was one of the 45 corporate credit unions nationwide at the time. These institutions serve credit unions in several ways—as providers of short-term liquidity, as check processors, and as investors of varying proportions of the unloaned deposits of the credit unions. Cap Corp had a special class of members' investment accounts that were exposed to loss. These accounts were uninsured and were also subordinated to other member accounts. The eventual failure of Cap Corp resulted in losses to those special member accounts.

QUESTIONS THE HOUSE BANKING SUBCOMMITTEE ASKED GAO TO INVESTIGATE

At a hearing on May 1, 1996, Mr. Robert Swan, former Board member of the National Credit Union Administration (NCUA), made certain allegations to the Subcommittee on General Oversight and Investigations, House Banking Committee concerning management practices at NCUA. Based on Mr. Swan's testimony, Subcommittee Chairman Spencer Bachus and Representative Bill McCollum raised questions of concern, as set forth below, and asked us to conduct an investigation.

Flow of Information and Efforts to Control the NCUA Board

1. Is the NCUA Board being dominated improperly by its Chairman?
2. Are other Board members being excluded improperly from participating in Board affairs by restrictions placed on the flow of documents and information from staff and others to the Board members?
3. Is the Board agenda being improperly manipulated by the Chairman?
4. Has the Chairman unilaterally adopted policies against the wishes and without the consent of other Board members?
5. Has the NCUA violated the law in its operation of the Board of Directors?

Surveillance of Board Members

6. Have NCUA staff been ordered to conduct surveillance of Board members?
7. Has this or any other staff action undermined the authority of Board members?

Establishment of NCUA Policy

8. Have NCUA staff established or attempted to establish official NCUA policy without the knowledge or consent of the NCUA Board?
9. Have the positions of Board members been misrepresented to outside parties?

10. What role have the Offices of the Executive Director, General Counsel, and the Director of Corporate Credit Unions played in any misrepresentations?

Solicitation of Contributions

11. Have NCUA examiners, at the time of examination, illegally requested credit unions to make contributions to projects initiated by the NCUA?
12. Has the NCUA violated the Federal Advisory Committee Act by establishing an Advisory Committee?

SCOPE AND METHODOLOGY

The questions raised in your request letter are based upon the opinions and perceptions of Mr. Swan as stated in his allegations before your Subcommittee's hearing. Documentary evidence was not always available, which means that in some cases we had to rely on the oral recollections of Board members and various NCUA officials, that did not always coincide.

Several of Mr. Swan's statements indicated that Ms. Bowné had also been adversely affected by certain management practices. For that reason, we tried to ascertain Ms. Bowné's views as well. Our effort to document and/or test the validity of Mr. Swan's and Ms. Bowné's assertions of misconduct on the part of Chairman D'Amours and other NCUA staff included an examination of any counter allegations or explanations of the issues raised that were obtained through interviews, records of internal NCUA communications, and published reports. In view of the legal and ethical issues raised, our investigative work included the cooperative efforts of our Offices of General Counsel and Special Investigations.

In the course of our review, we obtained relevant documentation where available, such as internal memorandums and file notes, Board minutes, minutes of regional directors' meetings, and relevant reports of the Inspector General. In many cases, documentation was not available, and we had to rely on oral accounts we were given by participants. In addition, to better understand NCUA's policies and management practices we reviewed the Federal Credit Union Act (the act) and applicable NCUA regulations.

We interviewed at length each Board member and his or her executive assistant. We also interviewed other NCUA staff, including certain members of the Offices of Executive Director, General Counsel, Inspector General, Community Development Credit Unions (OCDCU), and Corporate Credit Unions. There were allegations that examiners had solicited credit union contributions in support of an NCUA-sponsored 1996 summer conference, "Serving the Underserved." To learn more about conference plans and examiner activities, in addition to OCDCU staff, we interviewed NCUA's six regional directors. In NCUA's far west Region VI, where the complaints were concentrated, we conducted on-site and/or telephone interviews with the Regional Director, Associate Director for Programs, and three examiners including one supervisory examiner. We also interviewed senior managers of the four credit unions that reportedly had been solicited in California, Hawaii, and Oregon. While there were credit unions other than those in Region VI that had allegedly been solicited, we did not learn their identities.

ENCLOSURE III

ENCLOSURE III

We also interviewed officials of the industry's two largest trade associations, the private contractor who was retained to organize the NCUA conference, and the National Association of State Credit Union Supervisors.

We worked primarily at NCUA's Central Office in Alexandria, VA, from June through November 1996. Our work was done in accordance with generally accepted government auditing standards.

ALLEGED RESTRICTIONS PLACED ON THE FLOW OF
DOCUMENTS AND INFORMATION TO BOARD MEMBERS

Mr. Swan stated to your subcommittee that there were instances in which senior management instructed staff not to communicate with Board members despite specific requests for information. Vice Chairman Bowné and the executive assistants of both Mr. Swan and Ms. Bowné all stated that the flow of information to their offices from NCUA staff had been curtailed. Chairman D'Amours and Executive Director Hoyle both deny that this happened. It is their contention that senior management had consistently responded to each Board member's requests and that staff were free to contact them.

Ms. Bowné cited two instances where she believed that she was denied information. First, in 1995, NCUA was considering three candidates for the presidency of a credit union. NCUA management selected one of them and recommended him to the NCUA Board for approval. Ms. Bowné reported that she requested information regarding the other two candidates, but she said that her request was denied. The Director, Office of Corporate Credit Unions, was processing this selection. He told us he could not recall having received Ms. Bowné's request. Second, Ms. Bowné said she was unable to obtain detailed information regarding the actions of the NCUA management team that was involved in the conservatorship of Cap Corp. She said that she requested the minutes of the team's meetings and was incorrectly told that no minutes existed. Thereafter, as a result of a Freedom of Information Act lawsuit filed by the Pentagon Federal Credit Union, Ms. Bowné learned that minutes did exist. Ms. Bowné was unable to recall whom she had asked about the minutes, and we did not identify which staff member may have been involved.

There was another case of allegedly impeded information flow to Mr. Swan and Ms. Bowné that was of strong concern to them both. This also involved the resolution of Cap Corp. Later in the year, after the establishment of the conservatorship in January 1995, Mr. Hoyle instructed NCUA staff to clear through his office all internal communications regarding Cap Corp, including communications to the Board. Mr. Hoyle confirmed that Mr. Swan and Ms. Bowné were not advised of this instruction, but learned of it only when Mr. Swan's executive assistant had requested certain information from the NCUA Office of General Counsel. Mr. Hoyle told us that information about Cap Corp had been improperly divulged outside the agency, and he wanted to ensure better internal control over information thereafter.

Mr. Hoyle told us that he had never withheld information requested by Ms. Bowné on Cap Corp or any other issue and stated that he had no statutory authority to do so. However, he said he had issued the instruction as a way to emphasize to all concerned the need for strict control of such confidential information.

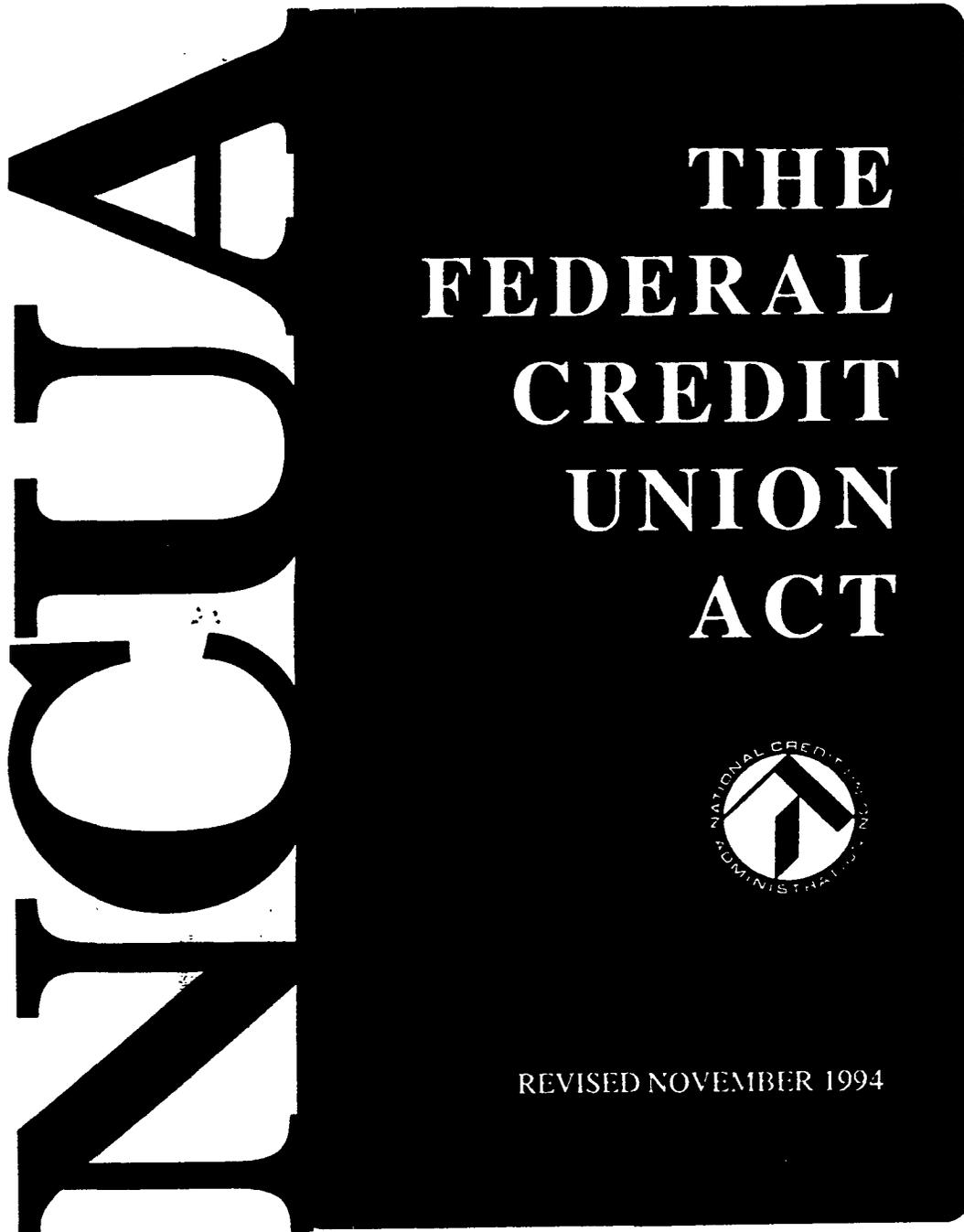
The Office of the Inspector General investigated the source of press leaks of sensitive information about four other corporate credit unions during the summer of 1995. In a report dated September 20, 1995, the Inspector General stated that the source of these leaks had not been determined. The report found that there was inadequate control over unauthorized access by NCUA staff to confidential data regarding corporate credit unions, which made it difficult to fix responsibility. The Inspector General was not asked to investigate the information leak regarding Cap Corp.

ALLEGED SURVEILLANCE OF BOARD MEMBERS

In addition to having his speeches monitored, Mr. Swan told us that the Office of the Chairman had monitored his travel vouchers. He said that while this procedure had not resulted in actual harm to himself, he believed it constituted personal harassment. Mr. Hoyle's former deputy acknowledged that she had made copies of the travel vouchers of both Mr. Swan and Ms. Bowné. She explained that this occurred in the early months of Mr. D'Amours' administration. She said it was simply a precaution that was taken in the early days and that it was discontinued when the extra copies were found to be unnecessary. She said that no use had ever been made of this material and that no harassment had been intended.

Mr. Swan reported that on one occasion his desk had been searched. He said that both official and personal papers had been disturbed, although nothing was apparently taken. He advised Mr. Hoyle of this and was told that no such search had been authorized. Mr. Swan said that he had no actual evidence of the search. The Inspector General was not asked to investigate this matter.

THE FEDERAL CREDIT UNION ACT (EXCERPTED)



mit a report to the Congress on compliance by insured credit unions with the requirements of the national flood insurance program.

(B) **Contents.**—The report shall include a description of the methods used to determine compliance, the number of insured credit unions examined during the reporting year, a listing and total number of insured credit unions found not to be in compliance, actions taken to correct incidents of noncompliance, and an analysis of compliance, including a discussion of any trends, patterns, and problems, and recommendations regarding reasonable actions to improve the efficiency of the examinations processes.

§ 1785

Requirements governing insured credit unions.—(a) Every insured credit union shall display at each place of business maintained by it a sign or signs indicating that its member accounts are insured by the Board and shall include in all of its advertisements a statement to the effect that its member accounts are insured by the Board. The Board may exempt from this requirement advertisements which do not relate to member accounts or advertisements in which it is impractical to include such a statement. The Board shall prescribe by regulation the forms of such signs, the manner of display, the substance of any such statement, and the manner of use.

(b)(1) Except with the prior written approval of the Board, no insured credit union shall—

(A) merge or consolidate with any noninsured credit union or institution;

(B) assume liability to pay any member accounts in, or similar liabilities of, any noninsured credit union or institution;

(C) transfer assets to any noninsured credit union or institution in consideration of the assumption of liabilities for any portion of the member accounts in such insured credit union; or

(D) convert into a noninsured credit union or institution.

(2) Except with the prior written approval of the Board, no insured credit union shall merge or consolidate with any other insured credit union or, either directly or indirectly, acquire the assets of, or assume liability to pay any member accounts in, any other insured credit union.

(c) In granting or withholding approval or consent under subsection (b) of this section, the Board shall consider—

(1) the history, financial condition, and management policies of the credit union;

(2) the adequacy of the credit union's reserves;

(3) the economic advisability of the transaction;

(4) the general character and fitness of the credit union's management;

(5) the convenience and needs of the members to be served by the credit union; and

(6) whether the credit union is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

(d) **Prohibition.**—

(1) **In General.**—Except with the prior written consent of the Board—

(A) any person who has been convicted of any criminal offense involving dishonesty or a breach of trust or has agreed to enter into a pre-trial diversion or similar program in connection with a prosecution for such offense, may not—

(i) become, or continue as, an institution-affiliated party with respect to any insured credit union; or

(ii) otherwise participate, directly or indirectly, in the conduct of the affairs of any insured credit union; and

(B) any insured credit union may not permit any person referred to in subparagraph (A) to engage in any conduct or continue any relationship prohibited under such subparagraph.

(2) **Minimum 10-year prohibition period for certain offenses.**—

(A) **In general.**—If the offense referred to in paragraph (1)(A) in connection with any person referred to in such paragraph is—

(i) an offense under—

(I) section 215, 656, 657, 1005, 1006, 1007, 1008, 1014, 1032, 1344, 1517, 1956, or 1957 of title 18, United States Codes; or

(II) section 1341 or 1343 of such title which affects any financial institution (as defined in section 20 of such title); or

ALLEGED ESTABLISHMENT OF OFFICIAL NCUA
POLICY BY NCUA STAFF

Mr. Swan was especially critical of the actions taken by NCUA staff during the period when Cap Corp was under conservatorship and, ultimately, liquidation. Minutes of the January 31, 1995, Board meeting show that Vice Chairman Bowné voted in favor of the conservatorship. Nevertheless, she was not entirely comfortable with all aspects of how it was handled. The minutes of that meeting indicated that Mr. Swan voted against the action in part because he wanted to give the Cap Corp board and its credit union members additional time to complete a rescue plan that would be financed by the members. NCUA staff explained that there were practical difficulties posed by such a delay, together with some doubt that a rescue plan could have been completed at all. This was because a 60-day moratorium on member withdrawals, imposed by the Cap Corp board, was to end on February 6, 1995, and detailed operational arrangements would have to be completed by that time to implement the conservatorship and meet what were expected to be very large member withdrawals on that date. NCUA staff were critical of the Cap Corp board for allegedly inadequate contingency planning during the 60-day moratorium. In addition, NCUA staff said that Cap Corp had borrowed in excess of its regulatory limit, and Cap Corp was directed not to borrow any more. NCUA staff said the possibility of a full-scale run on Cap Corp deposits could not be dismissed.

Ms. Bowné told us that she did not expect the sale of nearly all of Cap Corp's investments during the first month of the conservatorship. She was not provided timely information about the conservatorship once it had been established by the NCUA Board.¹ For example, she said that she did not know that a (conservatorship) board had been formed at the staff level. The NCUA's Board minutes did not reflect a detailed discussion of the conservator's plan to substantially liquidate Cap Corp's investment portfolio. However, such a plan might reasonably have been anticipated since other options to rescue Cap Corp, considered by NCUA staff and the Board during the 60-day moratorium, had not been accepted or supported by the Board at that time. In the absence of such an arrangement, NCUA, as conservator, continued to be responsible for managing Cap Corp's portfolio. As stated in its February 1995 testimony, GAO believed that the portfolio

¹On November 22, 1996, 96 credit union members of Cap Corp filed suit against the NCUA Board regarding its handling of the Cap Corp failure. Each of these credit unions held a class of Cap Corp instruments known as preferred capital shares; these shares were not federally insured and the shareholders experienced losses as a result of the failure. Because this matter is being litigated, we shall not comment on it in detail. However, as stated in our February 28, 1995, testimony (GAO/T-GGD-95-107), we believed that Cap Corp's portfolio, which was concentrated in collateralized mortgage obligations, was excessively risky and was thus inappropriate for Cap Corp to hold.

appeared subject to an unacceptably high level of interest rate risk. Under that condition, it might be expected that a substantial liquidation of investments could be necessary to reduce the exposure to additional losses.

Liquidation of the portfolio is not equivalent to outright liquidation of the institution, in which its affairs are wound up and its charter surrendered. However, as the portfolio is liquidated, the adverse impact on the institution's earnings may cause it to become nonviable. For example, an institution's holdings of high-yield securities are sold because they are judged to be too risky, and if the proceeds of this sale are reinvested in low-yielding, low-risk securities, the institution may not be able to retain deposits or outside credit. On April 12, 1995, the NCUA Board authorized the liquidation of Cap Corp. It also permitted another corporate credit union to purchase most of Cap Corp's assets and assume liability for Cap Corp's members' accounts. This permitted the members to continue receiving services. Only after that transaction was Cap Corp financially liquidated.

Another instance in which Mr. Swan alleged NCUA staff had established policy was in regard to credit union mergers. NCUA's regional directors are authorized to approve or disapprove proposed mergers of credit unions in their respective regions. On April 18, 1995, Executive Director Hoyle sent a memorandum regarding merger proposals to the regional directors. The purpose of the memorandum was to permit NCUA's Central Office to review a merger proposal before it was approved in cases where the merger would, in the regional director's view, have certain anticompetitive effects. The review process and participants were not described. The memorandum stated five criteria for evaluating such a merger application. See enclosure VIII.

In December 1994, NCUA staff had drafted for presentation to the Board an Interpretive Ruling and Policy Statement (IRPS) on this subject. The criteria set forth on pp. 8-14 of the IRPS, as shown in enclosure IX, were similar to those in Mr. Hoyle's memorandum. Had the Board approved the IRPS as drafted, it would have been issued for public comment and could have become an NCUA regulation. However, the IRPS was not introduced to the Board. Mr. Hoyle said it had been withdrawn because it was informally opposed in advance by both Mr. Swan and Ms. Bowné. Their position was that the statutory criteria for NCUA approval of a proposed credit union merger were already sufficient and the additional criteria were either unnecessary or inappropriate. Therefore, Mr. Hoyle's memorandum appears to have been issued, although it was already understood that a majority of the Board could be expected to disagree with its contents.

Mr. Hoyle said that Mr. D'Amours had approved the memorandum but that the other Board members had neither been consulted nor advised of it at the time the memorandum was sent to the regional directors. Mr. Hoyle's memorandum continued to be in effect despite the opposition of Ms. Bowné. In November 1996, Ms. Bowné told us

that she continued to oppose the criteria because she believed that they go beyond the traditional standards of credit union safety and soundness and member benefits.

Ms. Bowné said that this was clearly a policy issue that the Board should debate and decide, not the executive director. Mr. Hoyle asserted that the use of his criteria did not constitute new policy, and thus did not require Board approval. We believe it could be argued that Mr. Hoyle's criteria were simply refinements of the criteria in the act. This is an example of the difficulty of separating policymaking from policy implementation. However, Mr. Hoyle acknowledged to us that he might have found a better way to deal with the merger issue.

Under the circumstances, Mr. Hoyle's action could be viewed as a step by the Chairman toward circumventing the Board members' opposition and adopting new criteria. On the other hand, the memorandum on its face simply directed regional directors to provide to the executive director additional information about their recommendations to approve merger applications under specific circumstances. The issuance of the memorandum itself does not appear to have been inconsistent with the provision of the act authorizing the chairman "to direct the implementation of the adopted policies and regulations of the Board."² As of September 1996, according to Mr. Hoyle, no proposed mergers had been forwarded to him for review under the requirements of his memorandum. Subsequently, Ms. Bowné advised us that she believed regional staff had sent merger applications to Mr. Hoyle for his review prior to approval. We did not attempt to verify this.

Another example of alleged policymaking by NCUA staff was a Letter to Credit Unions (Letter No. 169) dated April 1995 that Mr. Hoyle signed for the Board. The text of this letter, which appears in enclosure X, briefly described a procedure by which credit unions should attempt to evaluate the risk profile that exists in their assets and liabilities. Quantitative limits of risk-taking acceptable to NCUA were set forth in the letter. The limits were described as guidelines to both credit unions and NCUA examiners.

It is important to understand the problem that the letter was addressing. In the first half of 1994, many credit unions had experienced declines in the market value of their investments because of an unexpected rise in market interest rates. It was clear at the

²Section 102 of the act, 12 U.S.C. § 1752a(e), provides as follows:

The Chairman shall be the spokesman for the Board and shall represent the Board and the (NCUA) in its official relations with other branches of the Government. The Chairman shall determine each Board member's area of responsibility and shall review such assignments biennially. It shall be the Chairman's responsibility to direct the implementation of the adopted policies and regulations of the Board.

time to NCUA management that NCUA examinations had not been adequate to identify the degree of risks that credit unions were undertaking. The failure of Cap Corp emphasized the need for better risk management and better NCUA supervision.

Mr. Swan objected to this letter on the grounds that it did not reflect the views of the Board and that it was a premature attempt to set stricter controls over credit unions before proposed but controversial changes in official NCUA regulations had been adopted by the Board. However, Ms. Bowné told us that the text of this Letter To Credit Unions had been reviewed in advance by her office and that it was acceptable to her. Thus, while Mr. Swan may have disapproved of Letter No. 169, a majority of the Board approved its message. Even if the letter had established "new policy," it would not have been a unilateral act by the Chairman. However, Ms. Bowné said she still questions the appropriateness of the Executive Director, rather than the Chairman, having signed this letter.

In another example of alleged policymaking by staff, Mr. Swan's office was concerned that the Office of Corporate Credit Unions was using an unfair procedure for assigning a composite CAMEL rating for corporate credit unions. The composite CAMEL rating is related to the examiner's numerical rating of five components—capital, assets, management, earnings, and liquidity—that measure the soundness of each credit union. This rating is regarded as a key indicator of the safety and soundness of all credit unions. Since at least 1989, the procedure for assigning composite CAMEL ratings for corporate credit unions provided that the composite rating should generally be equal to the lowest of the five CAMEL components. The examiner was given discretionary authority to improve the composite rating by one step. This contrasted with the procedure for assigning composite CAMEL ratings to natural person credit unions, where an arithmetic mean of the five components formed the basis of the composite rating.

Thus, the rating system for the corporates had the potential result of a lower composite rating than it would have received under the other procedure. In January 1995, the examiner's authority to improve the rating by one step was withdrawn, and any recommended improvement needed the approval of the Director, Office of Corporate Credit Unions.

In October 1995, Mr. Swan's executive assistant proposed to Ms. Bowné's executive assistant that the NCUA Board should require that composite corporate ratings be determined by a procedure similar to the one used for natural person credit unions.

Ms. Bowné told us she had taken exception to the CAMEL rating given to one corporate credit union. Although two Board members disagreed with the rating given to this institution, the rating was not changed. This was because of two official delegations of Board authority and a Board regulation that were in effect at the time. First, the Board

had delegated its authority to examine corporate credit unions to the Director, Office of Corporate Credit Unions. Second, the Board had delegated to the Chairman alone the authority to bar the exercise of any delegation. The Chairman had not interfered with the examiner's rating of the institution. In addition, under NCUA's Rules and Regulations, the Chairman was given authority to set the agenda for Board meetings, and the other Board members stated that this arrangement had caused a delay in addressing the problem.

The revised procedure for assigning composite CAMEL ratings for corporate credit unions may not fit a narrow definition of policymaking because the development and implementation of examination procedures for such credit unions had been specifically delegated by the Board to the Office of Corporate Credit Unions. Nevertheless, if a majority of the Board disagrees with policy implementation, informal and formal means of addressing the problem could have been used. The vice chairman and former Board member expressed frustration at their inability to discuss this issue at a Board meeting.

CENTRAL OFFICE REVIEW OF MERGER PROPOSALS
(MEMORANDUM FROM THE EXECUTIVE DIRECTOR)
(APRIL 18, 1995)



National Credit Union Administration

EI/BSG:bg
SSIC 6300

TO: All Regional Directors

FROM: Executive Director Karl T. Hoyle 

SUBJ: Central Office Review of Merger Proposals

DATE: April 18, 1995

This is to clarify the circumstances that will require you to submit merger proposals between healthy credit unions for Central Office review.

Merger proposals must clearly support any claims that the consolidation is "for the good of the members" or that member services will be improved. As always, when granting or withholding approval, conditions imposed by Section 205(c) of the Federal Credit Union Act must be addressed.

Mergers between healthy credit unions will be forwarded to the Executive Director for review only when you recommend approval and one or more of the following conditions exists:

- (1) The claim that the merger will benefit the member is not clearly and convincingly supported.
- (2) The merger appears to be of a predatory nature.
- (3) The merger is being consummated primarily for growth rather than service.
- (4) The competitive effect on other credit unions in the consolidated and proposed operational area could be perceived to be detrimental.
- (5) The motivation for the merger appears to be potential financial benefits for the directors and management officials.

Please call me if you have any questions.

cc: Office of General Counsel
E&I Director
E&I Director of Supervision

e:\bg\mergers.doc

PROPOSED INTERPRETIVE RULING AND POLICY STATEMENT: SUPPLEMENTAL
CRITERIA FOR VOLUNTARY MERGERS (IRPS 95-1)



National Credit Union Administration

19 DEC 1994

GC/JJE:bhs
SSIC 6300

TO: Distribution List
FROM: Deputy General Counsel James J. Engel
SUBJ: IRPS 95-1
DATE: December 16, 1994

A handwritten signature in black ink, appearing to be 'J. Engel', written over the 'FROM' line of the memo.

Attached is the latest draft of IRPS 95 -1, merger criteria. Major changes in the body of the document are in bold. Please provide your comments to Bob Fenner by January 15, 1995.

Distribution
Karl Hoyle
John Butler
Russ Clark
Allen Carver
Bob Loftus
Dave Marquis
Frank Thomas
Len Skiles
All Regional Directors

NATIONAL CREDIT UNION ADMINISTRATION

Friday 12/16/94

5:00 PM

12 CFR Part 708b

Interpretive Ruling and Policy Statement; Supplemental Criteria for Voluntary Mergers

AGENCY: National Credit Union Administration ("NCUA")

ACTION: Proposed Interpretive Ruling and Policy Statement 95-1 ("IRPS 95-1")

SUMMARY: The NCUA Board ("Board") proposes merger criteria to supplement the criteria found in the Federal Credit Union (FCU) Act and provide additional guidance to federally-insured credit unions on the evaluation process used by the agency to determine whether to approve a voluntary merger involving at least one federally-insured credit union. This proposal clarifies how NCUA interprets relevant sections of the FCU Act, NCUA's Regulations and NCUA's chartering policy regarding mergers.

DATE: Comments must be postmarked or received by NCUA [30 days after publication in the Federal Register].

ADDRESSES: Send comments to Becky Baker, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428, or via NCUA's electronic bulletin board to Becky Baker at 703 - 518 - 6480.

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FOR FURTHER INFORMATION CONTACT: Richard S. Schulman, Associate General Counsel, or Michael J. McKenna, Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518-6540.

SUPPLEMENTARY INFORMATION:

The Proposed IRPS

A. Background

Section 205(c) of the FCU Act sets forth six criteria that the Board shall consider in "granting or withholding approval or consent" of a merger. 12 U.S.C. §1785(c). The Act does not, however, limit the Board's review to these six statutory criteria as the sole and exclusive criteria for its consideration. For the reasons discussed below, the Board now believes additional guidance is needed and is proposing to delineate the criteria it will use to evaluate merger proposals and that credit unions must address when proposing a merger.

Although the Board has never formally adopted a "merger policy", in IRPS 94-1, NCUA's chartering and field of membership policy statement, 59 Fed. Reg. 29066, (June 3, 1994), the Board briefly addressed mergers in the context of field of membership. The Board stated that merging credit unions must meet the requirements under the field of membership rules. *Id.*, at 29078. As more fully discussed below, a merging credit union's field of membership must match the "operational area" of the continuing credit union.

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The process of how NCUA approves mergers was not in controversy until the proposed merger of three large west coast credit unions. The proposed merger has caused many in the credit union industry to consider the potential effects of such a merger and similar large mergers that may be likely to follow. The Board is not stating that it opposes merges of two or more large credit unions. The merits of any merger proposal must be weighed individually. NCUA intends, however, to carefully analyze motives that underlie a merger proposal. NCUA is not inclined to approve mergers in which growth is the primary consideration, but will look to assure that a merger application substantially meets the requirements as addressed in the various authorities discussed below and any resulting from this proposed IRPS.

The FCU Act provides six areas of consideration, set forth below, which the Board must address in a merger. With the exception of emergency mergers, full consideration must be given to the Act's six criteria, operational area requirements, and other criteria established in a final IRPS. This proposed IRPS sets out six new criteria to supplement the six criteria found in the FCU Act. These proposed criteria are addressed below under section D.

B. Authorities

1. FCU Act and the Rules and Regulations

The FCU Act specifically requires Board approval of mergers of all insured credit unions, both federal and state chartered. 12 U.S.C. §1785(b). To aid the Board in its supervisory authority over mergers, the FCU Act sets forth a list of subject areas that must be addressed. In approving or disapproving a merger under 12 U.S.C. §1785(c), the Board must, at a minimum, consider:

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- (1) the history, financial condition, and management policies of the credit union;
- (2) the adequacy of the credit union's reserves;
- (3) the economic advisability of the transaction;
- (4) the general character and fitness of the credit union's management;
- (5) the convenience and needs of the members to be served by the credit union; and
- (6) whether the credit union is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

In addition to the above, the Board requires that a merger pose no risk to the National Credit Union Share Insurance Fund ("NCUSIF"). 12 C.F.R. §708b.105(b). These are the same criteria the Board considers in approving insurance for state chartered credit unions. See, 12 U.S.C. §1781(c); reserves are covered in 12 U.S.C. §1781(b)(5) and (6). Merger procedures are set forth in Part 708. (The Board also has the authority to approve emergency mergers, 12 U.S.C. §1785(h). However, because such mergers are subject to their own statutory criteria and are exempt from other provisions of the FCU Act, they would not be covered under this proposed IRPS.)

2. IRPS 94-1 and the "Operational Area" Requirement

IRPS 94-1 was issued primarily as a guide on chartering credit unions and changes in fields of membership. Within the context of changes of fields of membership, however, it does address mergers. A merging credit union must meet operational area requirements if it does not share a common bond with the continuing credit union. The IRPS defines "operational area" as that area which "may reasonably be served by a

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credit union service facility and is accessible by the groups to be included in the field of membership . . . " 59 Fed. Reg. at 29078.

The greatest difficulty in applying "operational area" to a merger is found when a federally insured state chartered credit union (FISCU) proposes to merge into a federal credit union (FCU). Under such conditions, the merging credit union becomes an FCU and, "the field of membership rules applicable to a credit union converting to a federal charter apply." 59 Fed. Reg. at 29085. The problem in these mergers is often caused by the great differences between NCUA's field of membership requirements and those state credit union laws that either do not recognize or more liberally construe a credit union's operational area. In converting to an FCU, the FISCU may be required to change its field of membership. Consequently, the continuing credit union may not automatically gain all of the groups in the merging credit union's field of membership.

Field of membership requirements for a merger are met only if (the merging credit union's) groups could have been added to the continuing credit union without the benefit of the merger. This requires analyzing each individual group in the merging credit union's field of membership as if the continuing credit union was expanding its own field of membership to include those groups without a merger. In this latter situation, IRPS 94-1 states that:

As with new multiple occupational/associational federal credit unions, occupational and associational groups may be added to occupational/associational federal credit unions in two ways. If the group is part of an occupational or associational common bond which constitutes a majority of the federal credit union's field of membership, the group may be added regardless of location. These are commonly

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called "common bond additions." For any other occupational or associational common bond, the group must be within the credit union's operational area. These are commonly called "select employee additions." (Emphasis added)

59 Fed. Reg. at 29085. The proposed policy will require a credit union to make and report this analysis when seeking merger approval. In some cases, this will require amending the merging credit union's field of membership.

IRPS 94-1 also provides that when a state chartered credit union is merged into a federal charter, operational area requirements for each group to be added to the continuing credit union's field of membership may be waived, "on a proper showing that the [continuing] credit union will continue to be able to provide quality service to its current field of membership as a federal credit union. . . . Any subsequent field of membership amendments must comply with applicable amendment procedures." 59 Fed. Reg. at 29085. This provision does not revoke operational area requirements for a merger involving a state chartered credit union. It is discretionary on the part of NCUA; it only permits groups already receiving quality credit union services, located outside of what NCUA would have determined to be the credit union's operational area, to continue to have credit union service after the merger. In exercising its discretion, NCUA will also consider whether these groups have services available through other credit unions. Merger plans must demonstrate how operational area requirements for each select employee group have been met before NCUA can approve the merger. Any waivers of operational area for state chartered credit unions should be discussed fully with the regional office before the merger plan is submitted for approval.

C. How Current NCUA Policy Affects Mergers
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The Board believes that the criteria in the FCU Act and operational area requirement do not impose difficulties in most mergers. If, for example, two small federal credit unions operating in Alexandria, Virginia, desired to merge for valid reasons and serve members in the same operating area, there would be no operational area concerns and the merger would likely be approved. Even if operational area is an issue, the concept of a planned service facility will most likely alleviate any serious concerns. IRPS 94-1 states in pertinent part that:

a credit union may add groups within the operational area of one of its planned service facilities if:

- The planned facility begins operation shortly after the group is added; and
- The current field of membership constitutes a significant portion of the total field of membership to be served initially by the proposed facility. Although the addition of a new select group alone is not enough to justify a planned service facility, it is permissible to include new groups as partial justification for such a facility.

59 Fed. Reg. at 29085. In mergers, the continuing credit union may be able to use the service facilities (or branches) of the merging credit union as planned service facilities for the purpose of meeting the operational area requirements for field of membership expansions. In the above example, if the merging Alexandria credit union was serving a select employee group from a branch office in New York City, the planned service facility concept would allow that portion of the field of membership to be transferred

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intact to the continuing credit union, if the continuing credit union's current field of membership included individuals in the area of the branch who would constitute a "significant portion" of the members to be served by the continuing credit union through that branch.

The analysis applied in the majority of small credit union mergers becomes more difficult to apply in larger mergers, especially if the merging credit union serves numerous select employee groups over a wide geographic area. The Board recognizes that by adding new criteria it may increase the burden on merging credit unions, particularly when FISCUs with a diverse field of membership merge into an FCU. However, the Board believes this extra effort is essential if credit unions are to maintain their unique identity to their membership.

D. Proposed Merger Criteria

The Board proposes that in any merger, other than an emergency merger, involving a federally-insured credit union, the six issues discussed below as well as the six statutory criteria be addressed in any merger plan submitted to NCUA.

Proposed Criterion 1. The purpose of the merger.

Although the Board is proposing this as a specific criterion, it is an essential subject that credit union management should address whether or not the Board adopts a final IRPS. It is being included to require management to focus on current operations and services, expected goals, anticipated trends and its capability to provide quality service to an expanded field of membership. In

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effect, it provides a general overview and basis for responding to both the statutory criteria and those set forth below.

The Board is well aware that the decision to merge is a business decision for credit union management and it does not intend to substitute its business judgment for that of management. It does, however, intend to require credit unions to address the issue and evaluate it in terms of a merger being a sound business decision.

Proposed Criterion 2. The competitive effect on other credit unions, including small credit unions, in the merger partners' present and prospective operational areas.

The Act requires NCUA to consider the "economic advisability" of the merger, 12 U.S.C. §1785(c)(3), and NCUA Regulations require the Board to determine that the proposed merger does not present an undue risk to the NCUSIF, 12 C.F.R. §708b.105(b). The Board believes consideration of the "economic advisability" criteria extends beyond the direct economic effects on the merging institutions to the direct and indirect economic impact on smaller credit unions which may be affected by the merger. Smaller credit unions can easily have their fields of membership and their ability to continue operating affected by the merger of large credit unions. Such mergers could permit the new, larger continuing credit union to use its greater economic powers to solicit and take the smaller credit union's existing and potential membership. If the merger were not approved, one of the merger candidates alone would be less likely to dominate the smaller credit unions' operational area. It follows that mergers of large credit unions can create an inevitable trend towards the decline and merger of smaller credit unions. From a safety and soundness viewpoint for an individual credit union, diversification of a field of membership through a merger may be desirable

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and a prudent method for reducing risk. In rulemaking or in establishing a policy of general applicability, however, the Board must be concerned with safety and soundness in a broader context. The declining number of credit unions increases concentration of risk and can have adverse consequences for the credit union system.

IRPS 94-1 permits credit unions to more easily add small groups to their field of membership without NCUA approval. Concerns have been expressed that this policy alone has increased the ability of larger credit unions to undercut other credit unions' ability to offer services and attract members. The Board is concerned that a merger policy should not add to the difficulties that small credit unions already face in attracting new members and improving the level of services. The ultimate result of such a policy may lead to a decrease in productive small credit unions and an increase in mergers under duress. Recognizing that, as a general premise, competition within a given system can be healthy, the Board must also consider whether in a given situation, due to the unique nature of credit unions, it can be harmful. The Board, therefore, proposes to require that credit unions address the competitive effect of their proposed merger on other credit unions, particularly small credit unions, in their *present and prospective* operational areas.

Proposed Criterion 3. The extent to which merger partners serve their existing fields of membership.

The Board must consider the "history, financial condition, and management policies of the credit union" as well as "the convenience and needs of the members to be served by the credit union." 12 U.S.C. §§1785(c)(1) and (5). While increasing the number of persons eligible for credit union service is a laudable goal, NCUA is opposed to the

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addition of new groups under circumstances where they may not be adequately served. The Board is concerned that some mergers may result in a lack of quality credit union service to some groups in the continuing credit union's field of membership. The Board believes that the extent to which each credit union is serving its existing field of membership may indicate how well the continuing credit union may serve its new field of membership. If a credit union is not adequately serving its current field of membership and seeks to add new groups through a merger, the Board believes such action would call into question the credit union's management policies as well as the benefits the members would derive from the merger.

The Board proposes that credit unions address the extent to which they are currently serving their existing field of memberships. A credit union may choose to demonstrate this with service status reports. Such reports may show the number of primary potential members of each select group and the number of persons from each select group who have actually enrolled as credit union members. These reports should also show the aggregate share and loan activity by select group. If NCUA determines that a credit union is not adequately serving its current members, the merger may be disapproved until service levels show improvement.

It is important to note here that the Board recognizes that the percentage of a credit union's field of membership currently being served may not be indicative of adequate service. Therefore, as a general rule, the Board will not view percentage of penetration of field of membership as the sole factor in evaluating this criterion. Low penetration of current eligible membership alone will not automatically preclude a merger, but the Board will expect a credit union to explain the reasons for low penetration. Likewise, high penetration will not necessarily satisfy this criterion if the level of services appears inadequate. Here

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too the Board will expect explanations on such matters as lack of offered services or low utilization of offered services. The Board believes that requiring these types of issues to be addressed will aid credit union management in evaluating the soundness of the merger as a business decision.

Proposed Criterion 4. The effects of the proposed merger on the continued ability of credit unions to operate as a cooperative movement.

This proposed criterion is derived from 12 U.S.C. §§1781(c)(1)(E) and 1785(c)(6) and the Congressional purpose underlying the FCU Act: to established a system "to make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States." 12 U.S.C. §1751 (emphasis added). The Board is concerned that mergers consummated primarily for growth can adversely affect the ability of credit unions to operate as a cooperative movement.

The cooperative nature of credit unions applies to the individual credit union's ability to serve as a cooperative organization as well as the ability of the local and national credit union communities to meet that goal. It is, therefore, inconsistent with the spirit of the cooperative movement to sanction mergers which would result in the demise of smaller cooperatives on which the industry was founded. The Board is concerned that an accelerated decline in the number of small credit unions may result from the pressures of large "regional" credit unions formed through predatory field of membership expansion and ill conceived mergers. This proposed criterion requires the credit union parties to the merger and NCUA to reflect on whether they meet the definition of a cooperative association not only as individual credit unions, but as part of the credit union community as a whole. Evaluating competitive effect on other credit unions

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in response to criterion 2 should provide some assistance in addressing this criterion.

Proposed Criterion 5. The expected financial benefits to be derived by directors and management officials of the merger partners.

The Board must consider the general character of the credit union's management as well as the needs of the credit union's members. 12 U.S.C. §§1785(c)(4) and (5). Benefits such as larger retirement incomes or golden parachutes may be a major motivation for a proposed merger. NCUA does not believe that management involved in the merger process should be permitted to receive any special personal financial benefit from the transaction. Such benefits reflect poorly on the character of management and are not in the best interests of the members. Therefore, the Board proposes to require that credit unions proposing to merge address the anticipated financial benefits to be derived by the management officials of the merging credit unions.

Proposed Criterion 6. If the merger partners do not have the same common bond or are not located in the same operational area and the continuing credit union is a federal credit union, whether each group in the merging credit union's field of membership meets operational area requirements. If not, identify which groups, other than members of record, will be served by the continuing credit union.

Section 708b.101(c) of NCUA's Regulations requires compliance with the Board's chartering policies if the continuing credit union is an FCU. IRPS 94-1 requires the merging credit unions to comply with operational area requirements if the merging credit unions do not share the same common bond.

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Most mergers fall into one of two field of membership categories. First, there are mergers where the credit unions have the same common bond or are located in the same operational area. If the merging credit unions have the same common bond, they may merge without regard to the locations of their respective service facilities. If they are in the same operational area, they can merge as multiple group fields of membership.

The second category involves credit unions with widely spread dissimilar fields of membership (such as two credit unions serving multiple group fields of membership). They may only merge when they are located in the same operational area. In this case, the credit unions may merge only if at least one of the service facilities of the merging credit union is within the operational area of the continuing credit union. Groups served by a non-operational area facility may be merged, but only as members of record. New members may not be included unless a significant portion of the continuing credit union's existing members (or persons currently eligible to be members) could be served by that facility. As discussed above under "Authorities", the continuing credit union needs to analyze each *individual group* in the merging credit union's field of membership as if the continuing credit union was seeking a field of membership expansion from the NCUA.

E. Procedures

Currently, the Board has delegated merger approval authority to the six NCUA regions. The recent proposed merger of three large credit unions has convinced the Board that some mergers proposals need to be addressed first by the region with final action from the Board. In any merger proposal, the NCUA region would complete all required

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investigations, work with the credit unions to finalize a proposed field of membership, and ensure that all the criteria have been satisfactorily addressed. The Board proposes that the regions communicate all mergers exceeding \$100 million to the Board at least five days before approving the merger. A majority of the Board would be required to pull the merger proposal from the region for further discussion or request that it be placed on the Board's agenda.

F. Request for Comments

The Board requests comments from all interested parties on the content of the proposed IRPS, including whether it should only apply to credit union mergers above a specified asset amount (e.g., assets of the merging credit union or the resulting credit union).

In addition to the five proposed criteria, the Board seeks comments on when it, and not the region, should consider a merger proposal. For example, should the Board itself only consider mergers of certain asset size credit unions, or large mergers involving FISCUs and FCUs. Should the Board extend only limited delegated authority to the regions, and if so, how large a credit union merger should the region be able to approve? Should the Board review and approve mergers where the resulting credit union's assets exceed \$250 million, or where the resulting credit union exceeds \$100 million in assets? Other merger proposals could be considered by the Board on a case by case basis.

The Board also requests comment on whether merger proposals should be published in the Federal Register for written public comment. The Board is considering the value

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of holding public hearings in situations where a merger could affect other credit unions, and welcomes comments on that issue as well.

Regulatory Procedures

Regulatory Flexibility Act

The proposed IRPS is designed to clarify existing statutory authority and agency policy. As proposed the IRPS could have an effect on a substantial number of small credit unions. However, the analysis and burden imposed on these credit unions would not be significant. For the most part, competitive effect (criterion 1) and operational areas (criterion 5) would generally not be in issue.

Executive Order 12612

Executive Order 12612 requires NCUA to consider the effect of its actions on state interests. The proposed IRPS will apply to all federally insured credit unions. The proposed IRPS is not designed or intended to interfere with the state regulation of state chartered institutions nor does it impose federal field of membership requirements on state chartered credit unions. However, the Federal Credit Union Act requires the Board to consider the same general criteria when reviewing all mergers, whether involving only federal credit unions or only state chartered credit unions. The Board believes that, with the exception of field of membership requirements, a subject reserved for the appropriate chartering authority, supplemental criteria deemed necessary for proper evaluation of merger proposals must be applied on a uniform basis. Where required by state law, the approval of a merger involving a state chartered credit union by the

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appropriate state supervisory authority will still be required. See, 12 C.F.R. §§708.101(d) and 708.104(a)(6).

Paperwork Reduction Act

The proposed IRPS, if adopted, will impose additional paperwork requirements on a merging credit union. The paperwork requirements will be submitted to the Office of Management and Budget (OMB) for review under the Paperwork Reduction Act. Written comments on the paperwork requirements should be forwarded directly to the OMB Desk Officer indicated below at the following address: OMB Reports Management Branch, New Executive Office Building, Room 10202, Washington, D.C. 20530. Attn: Milo Sunderhauf. NCUA will publish a notice in the Federal Register once OMB action is taken on the submitted requirement.

By the National Credit Union Administration Board on January 27, 1995.

Becky Baker
Secretary of the Board

Accordingly, NCUA proposes IRPS 95-1 to read as follows:

Interpretive Ruling and Policy Statement 95-1 - Supplemental Criteria for Voluntary Mergers

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Part 708b.104(b) of NCUA's Regulations requires merging credit unions to submit a merger plan to NCUA. The merger plan must address the following subjects as well as the six criteria found at Section 205(c) of the Federal Credit Union Act:

- 1) **The purpose of the merger.**

- 2) **The competitive effect on other credit unions, including small credit unions, in the merging credit unions' present and prospective operational areas.**

- 3) **The extent to which the merger partners serve their existing fields of membership.**

- 4) **The effects of the proposed merger on the continued ability of credit unions to operate as a cooperative movement.**

- 5) **The expected financial benefits to be derived by directors and management officials of the merger partners.**

- 6) **If the merger partners do not have the same common bond or are not located in the same operational area and the continuing credit union is a federal credit union, whether each group in the merging credit union's field of membership meets operational area requirements. If not, identify which groups, other than members of record, will be served by the continuing credit union.**

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LETTER TO CREDIT UNIONS, LETTER NO. 169, APRIL 1995

<p style="text-align: center;">NATIONAL CREDIT UNION ADMINISTRATION NATIONAL CREDIT UNION SHARE INSURANCE FUND</p> <p>LETTER LETTER NO. 169</p> <p>TO CREDIT UNIONS DATE: April 1995</p>
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DEAR BOARD OF DIRECTORS:

In today's changing interest rate environment, credit union officials are faced with increasingly complex investment decisions and asset-liability management (ALM) planning. This letter is intended to clarify the National Credit Union Administration's (NCUA's) position on divestiture of Collateralized Mortgage Obligations (CMOs) and Real Estate Mortgage Investment Conduits (REMICs) that fail one or more parts of the high-risk securities test (HRST). The guidelines set forth in this letter may also assist in your analysis of future investment purchases and decisions.

The most significant investment fluctuations that credit unions have experienced involve CMOs and REMICs. We conducted a special review last fall of credit unions that reported large investments in CMOs and REMICs. We found that:

- 57 percent of these credit unions were holding at least one security that failed one or more parts of the HRST;
- 29 percent of these credit unions ran the HRST semiannually or less often (normally at the request of an examiner or auditor); and,
- 39 percent of the managers of these credit unions did not have an adequate understanding of the risks involved in these investments.

As a result of the findings of this review, I have placed a high priority on examining credit unions that hold high concentrations of investments that may pose a significant risk to safety and soundness. Our examiners will be working with the management of these credit unions to ensure that sound investment policies and adequate asset-liability management (ALM) planning are in place.

It is apparent that credit unions who hold CMOs and REMICs often do not have a clear understanding of the requirements for testing and periodic retesting. Furthermore, many credit unions fail to understand what NCUA expects them to do when the investments fail one or more parts of the high-risk securities test (HRST).

Part 703.5(g)(1) of the NCUA Rules and Regulations prohibits federal credit unions from purchasing fixed-rate CMOs or REMICs that fail any one of the three parts of the HRST, which are:

- *Average Life Test,*
- *Average Life Sensitivity Test, and*
- *Price Sensitivity Test.*

These tests must be applied not only at the time of purchase, but also periodically after purchase. If a security fails any one of the three parts of the HRST, divestiture may be required. These cases will be reviewed by our examiners on an individual basis.

In addition, Part 703.5(j) requires that the *Price Sensitivity Test* be applied to floating or adjustable rate CMOs or REMICs.

For Federally Insured State Credit Unions, CMOs/REMICs that fail one or more parts of the high-risk securities test (HRST) are non-conforming investments that require the establishment of a special reserve as required by Section 741.9(a)(3).

If your credit union finds that it is holding securities that fail one or more parts of the HRST, you should immediately dispose of them or, within five business days of discovery, develop and submit to NCUA a written action plan that at a minimum includes:

- an ALM modeling analysis that demonstrates the impact that both holding and selling the failed instruments will have on earnings, liquidity and capital;
- evidence of the credit union's ability to hold the failed instrument(s) and manage the risks under +/- 300 basis points interest rate shocks;
- an individual dollar loss figure for each failed security that will trigger their sale;
- a monthly log of market bids offered for the failed securities; and
- a monthly monitoring process to evaluate the stress test results for all CMOs and REMICs.

In failed CMO and REMIC cases, NCUA examiners will assess the credit union action plans. This assessment will consider the reasonableness of the plan the credit union's ability to manage the balance sheet risk. Specific factors examiners will focus on will be the ability of the credit union officials to :

- satisfactorily explain the securities characteristics and risks to the ex
- obtain and adequately evaluate the security's market pricing, cash test modeling;

- define, explain and document how the failed securities fit into the credit union's ALM strategy;
- analyze the impact that either holding or selling the failed securities will have on earnings, liquidity and capital in different interest rate scenarios; and
- demonstrate the likelihood that the failed securities may again pass the high risk security tests at a future date.

After a careful review of the above factors, the examiner and the credit union management should be able to agree on whether divestiture is appropriate and necessary. If the examiner does not feel that a suitable action plan has been developed, the credit union will be required to sell the failed CMOs or REMICs in accordance with a written directive which will be given to the credit union by NCUA.

NCUA will also propose revisions later this year to Part 703 of the NCUA Rules and Regulations (Investment and Deposit Activities) to update the regulation for the changing environment that exists today in complex investment areas. You will, as always, be given ample opportunity to comment on these proposed changes, and your comments will be carefully considered.

Credit unions need to carefully look at all investments, regardless of what they are or who offers them. We also believe that credit unions investing or depositing large amounts in any financial institution should obtain sufficient information about the operational and financial condition of these institutions in order to make informed investment decisions. This includes analyzing the safety of the institution standing behind the investment. Credit union investment policies should include the requirement and the criteria for an evaluation of the risk involved with every type of investment and deposit that the credit union makes.

NCUA examiners have been instructed to review each investment a credit union makes to determine its appropriateness in relation to the credit union's overall funds management goals.

For the National Credit Union Administration Board,



Karl Hoyle
Executive Director

FCU

EVENTS SURROUNDING THE ALLEGED EXAMINER
SOLICITATION OF SUPPORT FOR NCUA-SPONSORED CONFERENCE

Through two memorandums dated February 22 and April 30, 1996, Executive Director Hoyle requested and encouraged the regional offices and NCUA examiners to provide active support to the conference. We were told that other conference instructions of Mr. Hoyle's were communicated by voice mail, but we were unable to document them. Through interviews, the six regional directors or their designated associates described to us the support activities in their respective regions.

During telephone interviews with five of the six NCUA regions, we found that they engaged in similar types of activities but provided varying levels of support in promoting the conference. Managers from three regions said they promoted the conference during speeches (at industry meetings). Two of the three also said that they promoted the conference by contacting credit union leagues as well as state credit union supervisors. Two of three regions, which reported that they contacted small credit unions, said that they alerted them of the availability of scholarship funds.

Examiner involvement in conference activities was an area of concern to NCUA officials from the initial planning stages of the conference. Three of the regional managers indicated that they provided conference materials to their examiners for distribution (to credit unions) at the time of examination. However, these three regions reported that they gave specific instructions or emphasized to their examiners that they were not to solicit (credit unions) for financial donations. The two other regional managers indicated that they were not comfortable with examiner involvement. To insulate their examiners, they did much of the promotional activities themselves.

Region VI appears to have been the most active regarding the conference. For example, among the six regions, Region VI was the only one to specifically identify support of the conference in its 1996 annual goals and objectives. As directed by Region VI management in January/February 1996, the region's examiners were to (1) identify credit unions that might require financial or manpower assistance to attend the conference and (2) identify and seek support commitments (financial and/or manpower) from credit unions in the region with assets of \$100 million or more.

Also, Region VI was the only one in which complainant credit unions were identified to us by name. Four credit unions were so identified, along with three examiners, including one supervisory examiner said to have been involved in their solicitation. Some of the credit unions expressed discomfort and concern about NCUA examiner solicitation. Similarly, the examiners expressed discomfort at being put in this position.

NCUA management became concerned about press reports of inappropriate examiner solicitations being made. Responding to this concern and the request for guidance concerning examiner conference activities, on March 21, 1996, NCUA Ethics Officer, James Engel, drafted a memorandum to all examiners noting complaints about the promotional appeals and providing strict constraints on promotional activities of examiners. This memorandum was not accepted by Mr. Hoyle or issued to examiner staff. Subsequently, on April 30, 1996, with the ethics officer's approval, Mr. Hoyle issued a memorandum to all regional directors requesting continued distribution of conference materials and encouraging staff to promote credit union attendance. Regarding fundraising, the memorandum stated that "under no circumstances should contributions to the scholarship program be requested." Although Mr. Hoyle's instructions to the regions were less restrictive than Mr. Engel's draft examiner guidance proposal, the prohibition against soliciting donations was emphasized. Also, the memorandum instructed that matters concerning contributions or scholarships were to be referred to the National Association of Credit Union Chairmen.

According to the Region VI management, Mr. Hoyle's memorandum constituted the first written directions received for making the promotional contacts concerning the conference. However, the memorandum was written over a month after (1) the examiners had been told to cease their promotional contacts and (2) regional conference attendance/scholarship information had been reported to the NCUA Office of Community Development Credit Unions.

In an April 16, 1996, letter to the Hawaii Credit Union League, Chairman D'Amours indicated that NCUA had heard of some complaints about implied pressure by NCUA examiners, calling the charges inaccurate. According to Messrs. D'Amours, Hoyle, and Engel, they contacted some of the third parties who had forwarded complaints and asked for but were not given the names of the credit unions making the complaints. Mr. Swan, Ms. Bowné, and others stated that the sources who had confided in them did not wish to go public, fearing NCUA retaliation. Similarly, press reports indicating examiner solicitation for contributions in NCUA Region V did not result in identified complainant credit unions. Consequently, no further action was taken.

COMMENTS FROM NCUA BOARD CHAIRMAN

National Credit Union Administration

Office of the Chairman

February 28, 1997

Thomas J. McCool
 Associate Director, Financial Institutions
 and Market Issues
 United States General Accounting Office
 Washington, D.C. 20548

Dear Mr. McCool:

Thank you for the opportunity to comment on your report on allegations made by former National Credit Union Administration Board Member Robert H. Swan about management practices at the NCUA. I appreciate your staff's professionalism and the many months of hard work that have gone into this report. While I welcome your conclusion that neither individual NCUA Board members nor NCUA staff acted illegally while conducting agency business, I do not agree with every aspect of the report.

For example, I disagree with your suggestion that the events described in the report may have diminished the effectiveness of NCUA board members. It is important to stress the responsibility of each board member to fully participate in the affairs of the agency and to take an active role in requesting the information needed to properly discharge their responsibilities.

Parts of the report suggest an overall lack of collegiality¹ that might be construed as attributable to management practices of the Chairman and Executive Director. Without discounting any possibility, I believe that in the interest of balance, another possible impediment to collegiality should be noted. Upon joining NCUA as Chairman of the Board, I sought to effectuate a better separation between the Agency and industry trade groups. The NCUA Board under my Chairmanship began to address needed regulatory changes that many felt were long overdue in order to strengthen the safety and soundness of both corporate and natural person credit unions.

These regulatory changes were passed by a majority of the Board and occasioned a strongly vituperative reaction from some trade group and industry leaders. Mr. Swan consistently opposed regulatory changes intended to weaken trade group control of

¹ In fact, of the 350 Board votes taken during the time covered by the report, the vote was unanimous 93% of the time. Of those votes that were not unanimous, Mr. D'Amore was in the minority only once. In contrast, Mr. Swan was the minority 46% of the time.

Thomas J. McCool
February 28, 1997
Page 2

corporate credit unions², the conservatorship of Cap Corp and sale of its investments³, and proposed amendments to NCUA's corporate credit union regulation. Mr. Swan's speech to the Virginia Credit Union League, noted in the report, was only one symptom of the depth and pervasiveness of the invidious reaction to these reasonable Board initiatives.

In your report, you determined that NCUA staff did not make policy but simply implemented policies established by the NCUA Board. I agree there is a fine line between policymaking and policy implementation and will continue to strive to ensure that the line is not crossed. However, in one particular instance addressed on pages 2 and 3 of Enclosure VII and involving credit union mergers, actions by NCUA staff clearly did not circumvent Board policy, notwithstanding any contrary inference. While Board members did disagree on interpretation of merger criteria, action by NCUA staff did not change those criteria. The memorandum regarding central office review of merger proposals of healthy credit unions, which was reviewed for legal ramifications and approved by NCUA's General Counsel, did not involve establishing new criteria for approving mergers. Rather, it established standards by which the Chairman would exercise his properly delegated authority to determine whether certain mergers would be scheduled for consideration by the full NCUA Board. The NCUA General Counsel agreed with and gave express approval of the Chairman's and staff's actions with regard to the memorandum.

I agree with your finding that NCUA's sponsorship and promotion of a conference to serve the underserved was proper and legal. I also agree with your finding that NCUA should have provided more detailed and timely written instructions to regional staff concerning NCUA's proper role in supporting the conference. We appreciate and will follow this advice should we sponsor or promote similar conferences in the future. I remain personally unaware of any improper solicitations by staff concerning the underserved conference.

Enclosure II sets forth the questions the House Banking Subcommittee asked GAO to investigate. It is clear from a careful reading of your report that the answer to each question is "no" or a qualified "no", but to the casual reader, it might not be so apparent. I suggest that you set forth the answers to each question in the enclosure to provide greater clarity.

² The potential for harmful conflicts of interest arising from this control was noted in GAO's 1991 report Credit Unions - Reforms for Ensuring Future Soundness (pages 153, 154).

³ GAO has noted, at footnote 1 in enclosure VII to the draft report, that Capital Corporate's CMO investments were excessively risky and inappropriate for the institution to hold.

Thomas J. McCool
February 28, 1997
Page 3

One could quibble with some of the wording and opinions expressed in your report, but considering the important challenges facing credit unions, I believe it would not be in the best interests of NCUA or the credit union system to rehash discredited allegations.

As a final comment on the report, there are a limited number of instances of what are, in my view, factual errors or omissions. These points are addressed in an enclosure to this letter.

Again, notwithstanding these concerns about the report, I appreciate its professionalism and the opportunity to comment. I hope that Former Board Member Swan's allegations are finally put to rest, and that this report will enhance NCUA's effectiveness as a federal financial regulator.

Sincerely,



Norman E. D'Amours
Chairman, NCUA Board

Enclosure

COMMENTS FROM NCUA BOARD VICE CHAIRMAN

National Credit Union Administration

March 14, 1997

Office of the Vice Chairman

Mr. Thomas J. McCool
Associate Director, Financial Institutions
and Market Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

Thank you for your letter of February 13, 1997, and for sharing with me a draft of the GAO's response to Chairman Bachus. I appreciate the opportunity to comment on this draft and have chosen to do so in writing. I apologize for the delay in my response but a family illness required my attention. The following are my comments on sections in the order they appear in the draft.

Letter Page 6 - Regarding flow of information between NCUA staff and Board Members, the report states that the Chairman and Mr. Hoyle contend that senior staff responded to every request and were free to contact Board Members. As I explained during several interviews, from my perspective a communications problem did develop in this agency. Whereas there had been a free flow of information between senior staff and my office, it became necessary for my executive assistant and me to seek information from these same staff people. It is the responsibility of senior level employees to keep all Board Members fully informed on pertinent issues; at their level they understand pertinent issues and it is not a defense that the Board Member didn't make a request or "ask the right question." (The report acknowledges the changes in communication on Page 7.)

The report concludes that controls placed on the information flow to Board Members (with regard to Cap Corp) do not appear to have violated the Act. This Board manages the agency. Therefore, any controls that explicitly or implicitly restrict flow of information inhibit that Board Member's ability to perform the duties required by the Act.

Mr. Thomas J. McCool
 March 14, 1997
 Page 2

Further, while the Chairman clearly has additional duties, the Board Members share equal responsibility in setting policy and that responsibility is, without question, hampered when critical information is tampered with in any way.

See comment 1.

Further, the Act gives the Chairman, and certainly not a staff member, no authority over the actions of a Board Member. Mr. Hoyle's suspicion that information was improperly divulged was insufficient justification for improperly withholding information from the Board. If he had a concern, the proper course of action was to bring that concern to the full Board.

See comment 2.

All of this was discussed in some, if not all, of the interviews with that I felt some frustration from these interviews because it seemed that held some strong opinions of his own, about the staff role at NCUA. He appeared defensive for staff and argumentative on their behalf. Although he was not hostile or uncivil with these arguments, it seemed that he was opinionated and lacked the objectivity I would have thought appropriate for an investigator.

Letter Page 8 - Regarding the agenda rule. Apparently there was some misunderstanding regarding my concerns and the actions taken. My proposal would have allowed any one Board Member to submit an agenda item and have that item considered by the Board at a regular meeting. Furthermore, under current regulations, any Board Member can request a special meeting and the Chairman must call such a meeting. However, there is no time constraint on the Chairman and an issue could become moot before a special meeting takes place. My proposal also would have required a special meeting be held no later than ten days from the date of the request.

See comment 3.

The action taken on October 16, 1996, regarding the agenda was passed by a majority of the Board. I've no quarrel with that. However, I was disappointed in the staff work for this issue. I had requested the item by submitting a B-1 and had offered the proposal described above. The staff brought to the Board and recommended the proposal that passed. Staff did not include as an option at the board meeting my proposal. I expect staff to provide the full Board with any options a Board Member feels appropriate to be considered, on any issue.

Mr. Thomas J. McCool
 March 14, 1997
 Page 3

Enclosure IV Page 1- The letter states: "Ms. Bowné cited two instances where she believed that she was denied information." The first instance is described incorrectly. Actually, this information had to do with the need to place an item on the agenda.

A major corporate credit union had been without a permanent CEO for some time. Due to the CAMEL rating which resulted partially from the lack of a CEO, NCUA had to approve the selection.

Three names were submitted. I learned from the NCUA reading file that one name had been approved and no mention was made of the other two. The corporate's board went forward in their attempt to hire the person approved. I inquired from the Director of the Office of Corporate Credit Unions what problems he found with the other two and advised him that he was required to notify the corporate of those findings. I was told that no problems were found and that it was his intent to "later" o.k. them. I told him that the Board was justified in assuming the other two were not approved. The person approved declined the job. (This occurred in August of 1995.)

The corporate's board submitted another name, a former NCUA employee. The Director of the Office of Corporate Credit Unions prepared and signed a letter that in my view was inaccurate and irresponsible. I learned of this letter from a source outside NCUA and at this time cannot remember the source. However, once having learned of it I questioned both Mr. Carver (Director of OCCU) and Mr. Hoyle. I was told that the letter was not actually sent to the corporate. However, I do know that it received some circulation outside the agency.

I was concerned about this staff conduct, especially in view of the size and importance of the corporate. I asked the Chairman, based on these concerns, to bring the issue of a CEO for the corporate to the Board. He refused. His view was that he had total control over the agenda. General Counsel gave a verbal opinion that the Chairman had total control. He later gave a written opinion that differed, which I believe is in your files.

The issue of the corporate CEO then became moot, because the Director of OCCU apparently faxed a letter to the corporate approving one of the names from the previous list and the corporate in turn faxed a response withdrawing the name of the former NCUA employee.

Mr. Thomas J. McCool
 March 14, 1997
 Page 4

(All three letters: the two page letter on the former NCUA employee, the letter accepting a name from the previous list, the response letter withdrawing the name of the former NCUA employee were dated November 15, 1995.)

Even though I had expressed concern on the issue when I learned of the content of the denial letter for the former NCUA employee, the other letters and the information therein were not made available to me until I learned of the action and asked for the letters.

Again, this was all discussed previously with GAO.

See comment 5. Enclosure VII Page 1- The statement: "Vice Chairman Bowné also disagreed with certain aspects of the conservatorship, although she voted in favor of taking that step at the January 3, 1995, NCUA Board meeting." I don't know how the writer came to this conclusion. (Possibly this has been confused with my vote on the first corporate proposal.)

The statement: "She said she could not obtain information about the conservatorship once it had been established by the NCUA Board." I don't remember that statement. We did talk about the informality of information due to the staff's work load and long hours. Also, we discussed the fact that I did not know that a Board had been formed at staff level, or that minutes were being kept, etc.

See comment 6. The statement: "The Board minutes did not reflect a detailed discussion of the conservator's plan to substantially liquidate Cap Corp's investment portfolio. However, such a plan might reasonably have been anticipated in view of the fact that other options to rescue Cap Corp, considered by the NCUA staff and the Board during the 60-day moratorium, had not been accepted or supported by the Board at that time."

I strongly disagree with that assumption on the part of GAO staff.

Mr. Thomas J. McCool
 March 14, 1997
 Page 5

The following are part of the minutes of the January 31, 1995, Board Meeting.

“Chairman D’Amours clarified that the Agency has been working from the very beginning to avoid liquidation. Mr. Carver agreed. The Chairman inquired whether this had been clearly communicated to everyone; i.e., that liquidation still remains the last option. Mr. Carver responded affirmatively.”

ee comment 7. Statements repeatedly made by Chairman D’Amours, Karl Hoyle, and Allen Carver to the Bachus committee staff conflict with D’Amours statement at the January 31, 1995, NCUA Board Meeting.

I believe your staff had access to these minutes.

Enclosure VII Page 3 Regarding Mr. Hoyle’s memorandum on mergers, you state, “As of September 1996, according to Mr. Hoyle, no proposed mergers had been forwarded to him for review under the requirements of his memorandum.” As previously noted to your staff, we were told by regional staff that merger applications were sent to Mr. Hoyle.

In addition, I believe the mere existence of this memorandum affected the work of regional staff on mergers. Moreover, the memorandum was sent in the aftermath of the proposed Patelco-First Technology-Seattle Telco merger controversy.

ee comment 8. Enclosure VII Page 4 Regarding Letter 169, the report states that it was acceptable to me. However, as I previously advised your staff, the letter was very technical. I questioned E&I staff on whether this made any changes and whether it implemented any of the proposed changes to 703. I was assured the letter did not. When I began to receive comments from the industry and again questioned, I was again assured this was not the case.

Enclosure VII Page 4 Regarding the CAMEL rating for one corporate, the report mentions three delegations. I want to clarify two of them. The Board had delegated to the Chairman the authority to bar the exercise of any delegation generally, not only regarding examination of corporate credit unions. The Board had not delegated to the Chairman the authority to approve the final agenda for Board meetings. A previous Board had done this by regulation.

ENCLOSURE XIII

ENCLOSURE XIII

Mr. Thomas J. McCool
March 14, 1997
Page 6

Again, thank you for the opportunity to comment. If you have any questions,
please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Shirlee Bowné". The signature is written in black ink and is positioned above the printed name and title.

Shirlee Bowné
Vice Chairman

COMMENTS FROM NCUA BOARD VICE CHAIRMAN

The following comments represent our response to Vice Chairman Bowné's comments made on a draft of this letter on March 14, 1997.

GAO COMMENTS

1. Ms. Bowné expressed concern that restrictions on the flow of information to Board members, tampering with critical information, and withholding information from the members inhibited the Board's ability to execute its duties under the act. She did not specifically disagree with our conclusion that controls on the distribution of information did not violate the act. As discussed on page 5, we were unable to corroborate Ms. Bowné's allegations that she had been denied information and do not believe that the controls on information flow violated the act. We agree, however, that Board members should be entitled to all information relating to agency business.
2. Ms. Bowné raised an issue concerning the way in which our review was conducted. Our work was conducted in accordance with generally accepted government auditing standards. These standards include systematic supervisory review of work while it is underway and of the completed product. On that basis we have assured ourselves that our standards were appropriately met.
3. Ms. Bowné was disappointed that the NCUA staff had not offered to the Board her proposal regarding the submission of agenda items and the timing of a special meeting. She stated that the staff brought to the Board and recommended only the proposal that was passed. Ms. Bowné told us that the staff did not include her proposal as an option. We discuss the issue of the Chairman's control of the agenda on page 6. Also, we amplified our discussion of Ms. Bowné's proposed rule and the changed agenda rule.
4. Ms. Bowné commented that our first example of her being denied information (noted on p. 19, enc. IV) was described incorrectly and that this information had to do with the need to place an item on the agenda. In separate interviews on June 24 and November 5, 1996, Ms. Bowné cited this instance (the consideration of three candidates for the presidency of a credit union) in which she believed she had been denied information. While this example may also be a related agenda issue, we have characterized it as an information issue based on our discussions with her.

5. Ms. Bowné did not understand our original characterization that she disagreed with certain aspects of the conservatorship although she had voted for it. We changed our discussion to include the fact that the minutes of the January 31, 1995, Board meeting show that Vice Chairman Bowné voted in favor of the conservatorship. Nevertheless, she was not entirely comfortable with all aspects of how it was handled.
6. On page 24 of enclosure VII, we state that "The Board minutes did not reflect a detailed discussion of the conservator's plan to substantially liquidate Cap Corp's investment portfolio. We further state that "such a plan might reasonably have been anticipated in view of the fact that other options to rescue Cap Corp, considered by the NCUA staff and the Board during the 60-day moratorium, had not been accepted or supported by the Board at that time." Ms. Bowné strongly disagreed with our latter statement, and pointed out that the minutes of the January 31, 1995, Board meeting showed that "Chairman D'Amours clarified that the Agency has been working from the very beginning to avoid liquidation." We interpret statements made by Chairman D'Amours in the Board minutes quoted by Ms. Bowné as relating to the liquidation of Cap Corp itself and not the liquidation of Cap Corp's portfolio. Regardless of the ultimate form of resolution of Cap Corp itself, weaknesses in the investment portfolio required that it be substantially liquidated.
7. The Vice Chairman wrote that statements repeatedly made by Chairman D'Amours, Karl Hoyle, and Allen Carver to the Bachus committee staff, conflict with Mr. D'Amours statement at the January 31, 1995, NCUA Board meeting. We have no information about any statements made to the Bachus committee staff on this point.
8. Ms. Bowné makes reference to our statement on page 27, enclosure VII, that Letter No. 169 was acceptable to her. She does not dispute her original agreement with Letter 169. However, Ms. Bowné points out that she had a number of questions relative to the technical complexity of the issues raised.

MAJOR CONTRIBUTORS TO THIS LETTER

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