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STATEMENT OF
J. DEXTER PEACH, DIRECTOR
RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE OF THE
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ON

THE NATIONAL CONSUMER COOPERATIVE BANK

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to be here today to discuss our review of selected matters concerning the National Consumer Cooperative Bank.

The Bank, established by the National Consumer Cooperative Bank Act (12 U.S.C. 3001 et. seq.) in August 1978 to provide financial and technical assistance to consumer, housing, and producer cooperatives has had a turbulent history. Within a year from the date the Bank made its first loan and before its regional offices were fully operational, the Administration moved to abolish it. The Congress in amendments to the act dated August 13, 1981, chose to convert the Bank from a mixed ownership government corporation to a congressionally chartered financial institution and transferred control of the Bank from

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the Federal Government to the Bank's shareholders. In addition, the amendments converted class A stock held by the U.S. Treasury and the remainder of the Federal Government's capital commitment totaling $184 million into capital notes. Also the amendments did not provide for future Federal appropriations for the Bank's program administration.

Title II of the original act established a Self-Help Office to loan to less creditworthy cooperatives and administer developmental and outreach activities. The amendments, however, required the Bank's Board of Directors to establish a nonprofit corporation to perform these functions in the future. These changes coupled with controversial organizational changes in June 1981 and a large turnover of Bank employees through dismissals, resignations, and job abolishments have had a negative impact on the Bank. This is reflected in a low quality loan portfolio as reported by the Farm Credit Administration, negative publicity and charges of wrongdoing, low employee morale, and a disillusioned cooperative community.

At your request Mr. Chairman, we reviewed the Bank's operations from inception concentrating on Title II non-loan activities, regional operations, the 1982 process for electing nine board members, the contracting process, the organizational structure, communication methods, personnel matters, conflict-of-interest policies, and the legality of one loan. We reported separately on the legality of a $5.2 million loan to the Dunbar No. 1 Cooperative Housing Corporation and the adequacy of the Bank's conflict-of-interest policies by letter dated December 16, 1982.

We have now completed our field work on the remaining items and are in the process of preparing our draft report which we expect to furnish to the Bank for formal comment in the near future. At this time I will briefly summarize our preliminary findings and conclusions.

The Bank continues in a transitional phase. Under the 1981 amendments the Bank is setting up a non-profit corporation to administer assistance primarily to new, developing, and low-income cooperatives. Also, the Bank recently reorganized, unifying its lending process, closing three of its regional offices, and converting two others to branch offices. We believe that these actions should improve the delivery of financial assistance to cooperatives, increase administrative effectiveness, and reduce operating costs. However, reducing the number of regional offices and regional staff will limit the Bank's ability to develop cooperatives nationwide.

Statements made to us or in public by key Bank officials indicate that the number of creditworthy cooperatives available to do business with the Bank is limited. Although one of the Bank's objectives is to help develop financially sound cooperatives, it cannot now demonstrate that it will be capable of developing the number of cooperatives needed to make enough sound loans to allow the Bank to mature into a viable organization. Beginning in 1990, the Bank is required to pay the full interest cost on its $184 million Treasury notes unless the Secretary of the Treasury defers such payments. Also, between 1991 and 2020 it must repay that loan.

Title II activities have lost visibility

The original act established a Self-Help Office to loan to less creditworthy cooperatives and administer developmental and outreach activities. Until December 1982, the Bank maintained a separate Self-Help Office on paper, but that office was effectively eliminated in the June 1981 reorganization. Since that time the Bank has continued to decrease the emphasis given to the Title II non-loan activities,such as technical assistance to non-borrowers, outreach, and training.

Under the 1981 amendments, a separate non-profit corporation was incorporated in the District of Columbia on December 30, 1982 to administer the Title II programs. The new corporation may help restore visibility to cooperative developmental and outreach activities if it secures necessary funding. While the corporation may receive tax deductible contributions from several sources, such as foundations, churches, and pension funds, it will probably rely largely on a Bank subsidy. While the Bank has stated a willingness to support the corporation, the extent to which it will be able to do so will depend on its ability to mature into a viable organization.

Regional resources are limited

In relationship to the responsibilities assigned to regional offices and the territory to be covered by each, the Bank had limited professional staff in its regions and the situation has become more limited. The regional offices are responsible for primary contact with cooperatives, conducting business development activities, developing and analyzing loans, managing loans, and providing technical assistance. Before the April 1983 reorganization, the 8 regions had from 2 to 6 professional employees to cover from 3 1/2 to 12 States. For example, the Minneapolis Regional Office had 2 professionals to service 8 1/2 Midwestern States and the Atlanta office had 2 professionals to service 12 Southeastern States. The New York Regional Office, which had the 6 professionals, including a regional director, 2 loan officers, 2 loan development officers, and a credit analyst was responsible for servicing five States, Puerto Rico and the Virgin Islands.

The Bank's April 1983 reorganization, which abolished 3 of the 8 regional offices, converted 2 others to branch offices, and terminated 23 positions, will further limit the Bank's regional capabilities. The Bank made these changes to reduce operating costs during a time it faces the difficult tasks of developing creditworthy loans and providing technical assistance to, and addressing developmental needs of, cooperatives.

Contracting procedures not followed

During its first meeting in September 1979, the Bank's Board of Directors adopted an interim procurement policy to guide the Bank during its initial organizational efforts. While the policy was brief, it did base contract awards on competition, whenever practical. From inception the Bank has not fully complied with its contracting policies and procedures.

For example, the Bank awarded most of the contracts that we reviewed without competition and without any written justification for going sole-source. Also, we found that at times the Bank officials did not timely prepare required procurement requests and did not always comply with requirements for modifying and/or evaluating contracts.

The Bank has recently adopted a new procurement manual which, if followed, should correct many of the contracting deficiencies we identified.

Communication methods improved

We found that the Bank Board and management have taken or were in the process of taking, several actions to increase the flow of information to, and feedback from, member cooperatives in specific and the public in general. Communication methods now used by the Bank include public hearings, annual meetings, newsletters, and other special mailings.

Personnel policies applied consistently

A number of allegations have been made by former Bank employees that the Bank did not consistently apply personnel policies. We did not find any evidence of this for the policies we tested. We did find that the Bank changed certain policies one or more times and put other policies into practice before they were written and published. We believe that changing policies and applying policies before they were written contributed to how former employees perceived the way they were treated.

Questions concerning the election

In January 1982, the Bank's shareholders elected nine new Board members. The Board on May 26, 1982, reported to the Bank's shareholders that its review of the election process showed that the election was handled with integrity and completely in accordance with the election rules. However our review of the election process identified a number of concerns about the election. Examples of our concerns follow.

--The Bank established more stringent eligibility requirements for the purchase of voting stock after it announced the election. On the one hand, these requirements prevented many cooperatives which had applied to purchase stock from becoming shareholders in time to vote. On the other hand, these same requirements were not consistently applied to all 62 cooperatives that were issued stock after the establishment of these new eligibility requirements.

--The election rules state, "* * *In order to be counted* * * each vote by a stockholder must be cast on the official ballot form issued by the Bank, and must be certified by the corporate secretary or other official of the stockholder who is authorized to certify its corporate documents." The Board disqualified five ballots because "an officer of the cooperative other than the secretary signed" the certification. Our review of relevant documents and interviews with present and former Bank officials suggested several differing explanations why the Board rejected the ballots. Had these five ballots been qualified the election of one Director would have changed.

--Five election envelopes were opened before the official election date. There was no record of who opened the envelopes or the circumstances leading to the premature opening. A sealed envelope was a shareholder's only safeguard that its completed ballot was the one used in the tally. Once the seal was broken, a ballot could have been replaced undetected because the official ballot contained no identifying marks.

We also found that the Board's report to the shareholders contained inaccurate, incomplete, or misleading statements. For example:

--The report said that the CPA firm that assisted in vote count, certified the election results. An official of the CPA firm told us that the firm did not certify the election results because they did not control all aspects of the election.

--The report said that every effort was made to qualify eligible cooperatives. As I noted earlier, the Bank tightened its eligibility criteria after it announced the election and that action prevented a large number of applicants from becoming shareholders in time to vote.

--The report said that 62 of 66 cooperatives that submitted applications to purchase stock by the record date were able to vote. Our review of Bank records showed that about 175 cooperatives not 66 had applied for Bank stock. In other words, approximately 113 instead of 4, were not approved to vote in the election.

--The report said that no official envelope had been opened prematurely. As I mentioned previously five such envelopes had been opened before the official election date.

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In summary, we believe that the Bank is at a crossroads in its history. As we have pointed out, the Bank cannot now demonstrate that it will be capable of developing the size and quality portfolio needed to allow it to mature into a viable organization. However, this situation should be tempered by the fact that the Bank has only been operational for a little over 3 years and may not have had the time needed to demonstrate an ability to develop the cooperative community as envisioned by its enabling legislation. Also, the Bank has had to adjust to the loss of financial support from the Federal Government, and has had to contend with much turmoil resulting from changes made within its organization. In addition, the Bank is in the process of establishing the separate corporation provided for by the 1981 amendments to carry out Title II activities and only time will tell how effective this organization will be in carrying out its responsibilities and in obtaining the necessary funds to do so.

Mr. Chairman this concludes my statement. We will be pleased to respond to your questions.