Administrative Actions

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Administrative actions are those actions that the regulatory authority can take or enforce against a problematic credit union in order to reverse negative trends or operational results, remove officials, or take over management of a credit union. Generally these actions are time consuming and expensive. Examiners working with a problem credit union should try to resolve problems through off and on-site supervision. Often problems can be resolved and the necessary changes affected through a well-written Document of Resolution that is a part of every annual examination.

The Document of Resolution (DOR) is the key document for problem resolution within the examination report; it lays out the groundwork for corrective action. Examiners develop the DOR jointly with officials and management. The DOR should specifically state the corrective action needed to solve the problem, the individual responsible for correcting the problem, and the time frame in which the problem should be resolved. If the problems can not be resolved through the DOR and extensive supervision then there are numerous actions that can be taken based on management and official's abilities, effectiveness, and willingness to make the necessary changes.

In deciding what action to take the examiner, along with their supervisor, should consider the following:

- Financial condition of the credit union;
- Interests of the membership;
- Interest of management and officials in the continuation of the credit union;
- Ability of management and the officials to manage the credit union effectively; and
- Local economic conditions.

Letter of Understanding and Agreement – The Letter of Understanding and Agreement (LUA) is the least serious of the actions that can be taken and is used when the DOR proves ineffective. The LUA, similar to the DOR, should describe all of the corrections to be made, who is responsible for making the corrections, and the time frames in which the corrections are to be made. If a credit union has a serious loan delinquency problem, an LUA item to address the delinquency might read this way:

- Reduce the delinquent loan to total loan ratio to:
    - 8% by 12/31/02
    - 6% by 3/31/03
    - 5% by 6/30/03
    - Maintain the ratio at no more than 5% for the long term.
    - Responsible party – Head of Lending/Head of Collections.

The LUA, unlike the DOR, will be addressed to the board of directors of the credit union. It will be drafted and signed by the head of the credit union regulatory body and the examiner in charge of the credit union's supervision. Upon presentation and review of the LUA, the board of directors and credit union manager should sign and date the

document. The LUA should clearly state that if the necessary corrections are not made then the regulatory authority can take a more forceful action to safeguard the credit union's assets.

Examiners should make regular on-site supervision contacts to all credit unions with an LUA. During each supervision contact, the examiners shall determine and document credit union compliance with the LUA. Compliance should be assessed by discussing each LUA item with management and the officials. They should have a definitive plan in place to address each problem identified. The LUA should be removed only upon correction of all material issues addressed in the document. Removal of the document should be approved by the head of the credit union regulatory body.

Cease and Desist Order – The Cease and Desist Order (C&D) is more serious in nature than the LUA. A C&D allows resolution of problems in a solvent credit union while preserving and strengthening the credit union's managerial and financial integrity. A C&D is usually effective in compelling the credit union to take the needed action. If, however, examiners believe that issuance of a C&D order would not affect compliance, they should consider an alternative administrative action.

C&Ds are frequently used if a credit union is:

- Engaging in or has engaged in, or the examiner has reasonable cause to believe that the credit union or the persons involved are about to engage in, an unsafe or an unsound practice in conducting the business of the credit union; or
- Violating or has violated, or the examiner has reasonable cause to believe that the credit union or persons involved are about to violate a law, a bylaw, or a rule or regulation issued by the regulatory authority.

A C&D is useful and effective because it allows the regulatory authority to stop a current harmful practice or anticipate and prevent harmful practices from occurring. Although a C&D normally resolves a persisting or recurring problem, the regulatory authority may use a C&D for a first time problem that could seriously affect the credit union's operations and where the officials have indicated they will not take corrective action.

The C&D will state the specific action that shall be ceased, the individual(s) that is to cease from doing the action, and identify the time frame in which the action is be ceased. The C&D is more negative in tone than the LUA. If the credit union has a serious agricultural loan delinquency problem, the C&D item to address the delinquency problem might read in this way:

- Cease making loans for agricultural purposes and/or secured by agricultural collateral immediately and until further notice.
- Responsible party – General Manager/Head of Lending

The C&D should be drafted and signed by the head of the credit union's supervisory body and the examiner in charge of the credit union's supervision. The C&D will be addressed to the credit union's board of directors. Upon presentation and review of the document, the board of directors and general manager should be required to sign and date

the document. The C&D becomes effective upon delivery and signing by the officials and remains effective until all actions addressed in the document have been resolved or a more forceful action is taken because of noncompliance. The C&D should clearly state that the regulatory authority may at any time take a more forceful action to safeguard the credit union assets.

Examiners should make regular on-site supervision contacts to all credit unions with a C&D. During each supervision contact, the examiners shall determine and document credit union compliance with the C&D. Compliance should be assessed by discussing each C&D item with management and the officials. It should be clear by management's actions that all required actions have been ceased. The C&D should be removed only upon compliance with all material issues addressed in the document. Removal of the document should be approved by the head of the credit union regulatory body.

Monetary Penalties – The credit union law should grant the regulatory authority the right to assess monetary penalties. Usually there are different penalty amounts depending on the severity of the action committed. For example:

- Level One – Any credit union that violates a law or regulation, an LUA, a C&D, submits late or substantially incorrect reports to the regulatory authority can be fined no more than ______________________.
- Level Two – If a credit union commits any of the violations described in level one, exhibits reckless conduct or a breach of fiduciary duty and the violation, practice, or breach is part of a pattern of misconduct, or causes more than an minimal loss to the credit union the regulatory authority may assess a penalty not greater than ________________________.
- Level Three – Any credit union that knowingly commits any of the violations described in level one, knowingly engages in unsafe or unsound practices, breaches any fiduciary duty or knowingly or recklessly causes a substantial loss to the credit union may be assessed a penalty by the regulatory authority not greater than ________________________.

The Monetary Penalty Order should be addressed to the board of directors of the credit union and drafted and signed by the head of the credit union supervisory body and his/her superior. It should specifically state the reason for the penalty, the amount of the penalty, when and where the penalty is to be paid, and the actions the credit union may take if they do not agree with the penalty.

Removal of Officials – The credit union law should grant the regulatory authority the right to remove members of the board of directors, credit committee, and supervisory committee. The removal of an official by the regulatory authority is used when the official will not voluntarily resign. Any party who has been removed or suspended from office is also automatically removed, suspended, and prohibited from participating in the affairs of any financial institution without the written consent of the regulatory authority.

The regulatory authority can remove an official from office when they have:

- Directly or indirectly violated the law, bylaws, or rules and regulations;

- Engaged or participated in any unsafe or unsound practice in connection with the credit union, or
- Committed or engaged in any act, omission, or practice which constitutes a breach of fiduciary responsibility, and

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

- The credit union has or will suffer financial loss or other damage;
- The interest of the members have or could be prejudiced, or
- The party receives financial gain or other benefits because of the violation, practice, or breach, and

Such violation, practice, or breach:

- Involves personal dishonesty by the party, or
- Demonstrates the party's unfitness to serve the credit union or to participate in its affairs.

The notice to remove an official from office should be addressed to the credit union and the official to be removed. The notice should be signed by the head of the credit union supervisory body and his/her superior. It should contain a specific statement of facts constituting the grounds for removal and that this removal is immediate. The official to be removed may, if allowed by local law, have the right to bring the matter before the court if they do not agree with their removal by the supervisory authority.

Prohibitions – A prohibition action is similar to, but broader in scope than a removal action. A removal action removes a person from a specified official position in a credit union, while a prohibition action stops any institution-affiliated party from participating in the affairs of a credit union. Because credit union affiliated parties are not always elected or appointed officials, they may not always be removed as officials. Instead, the regulatory authority must prohibit them from further participation in the affairs of a credit union.

If permitted in the credit union law, the regulatory authority may prohibit any individual seeking to be an official from participating in credit union activity and affairs if it is found that the individual has been charged with a crime involving monetary loss, fraud, breach of contract, or a crime that may pose a threat to the interest of the credit union members or threaten to impair public confidence in the credit union.

The regulatory authority may also recommend to all credit unions that they not do business or discontinue doing business with any individual or legal entity that has been charged with any of the crimes discussed above. If the credit union wants to do business or continue to do business with such prohibited parties, they must provide the regulatory authority with written justification and receive approval from the supervisory authority prior to transacting business or continuing to do business with the prohibited party.

The Prohibition Order should be addressed to the credit union and the prohibited party and drafted and signed by the head of the credit union regulatory body and his/her superior. It should state specifically the reason(s) for the prohibition and that it is

immediate. If the prohibited party does not agree with the action taken against them, they may bring the matter before a court if allowed by local law.

Establishment of Special Reserves – The regulatory authority, if permitted by law, may require a credit union to establish special reserves to protect the interest of credit union members. The special reserves are designed to prevent further deterioration of a credit union's financial condition.

Special reserves may be necessary:

- when the established reserves do not provide sufficient protection against a condition that threatens the credit union's soundness; or
- when the regulatory authority believes that the credit union may avoid establishing sufficient reserves by refinancing or extending loans or intentionally misrepresenting facts that, if properly disclosed, would have a material effect.

The order should be addressed to the credit union's board of directors and drafted and signed by the head of the credit union supervisory body and his/her superior. It should state the specific reason for the reserve, how the reserve is to be established and maintained in the accounting records, the amount of the reserve, and that the reserve should be established immediately. The reserve may only be removed from the accounting records upon approval by the head of the credit union regulatory body and his/her superior.

Conservatorship – Conservatorship is the procedure whereby the regulatory authority takes immediate possession and control of a credit union's business and assets and may operate the credit union until:

- the regulatory authority permits it to resume business on its own, subject to any terms and conditions the regulatory authority may impose; or
- the regulatory authority merges or liquidates the credit union.

When deciding to establish conservatorship the regulatory authority should consider the probability of improving the financial condition of the credit union to a level that is sustainable without outside assistance and the possibility of retaining a large part of the membership, assets, and liabilities of the credit union.

A conservatorship allows the regulatory authority to influence more actively the operations of a credit union to reduce any further dissipation of assets. Conservatorship is a useful tool when:

- the credit union violates legislation or rules and regulations of the regulatory authority;
- unsafe or unsound business practices exist;
- there is willful and continuous failure to comply with requirements or instructions issued by the regulatory authority;
- credit union management refuses to submit required or requested reporting documents to the regulatory authority;

- management has abandoned the credit union or is totally incapable of coping with severe financial problems that should be immediately brought under control;
- evidence exists of illegal or unsafe practices but the activities can not be readily identified;
- the credit union member's interests need protection;
- the credit union has willingly violated previous orders or actions taken against it by the regulatory authority;
- management conceals or refuses to make available the books and records for an examination; or
- deposit insurance funds are at risk (if a fund exists).

Ideally, a conservatorship will result in the credit union being returned to the member's control.

The Statement of Conservatorship should be addressed to the credit union's board of directors and drafted and signed by the head of the credit union regulatory body and his/her superior. The statement should state:

- grounds for conservatorship;
- the name of the individual or custodian that will be in charge of managing the daily affairs of the credit union until the conservatorship is terminated;
- the starting date and duration of the conservatorship; and
- any restrictions on the custodian's powers.

Effective from the moment the conservatorship is ordered by the regulatory authority the powers of executive management, the board of directors, and the general meeting of members are suspended and transferred to the custodian. In addition, the credit union should be required to suspend all transactions and business until the custodian is in charge of operations. Management of the credit union should be obliged to hand over all forms, seals, stamps, items of value, keys, as well as any other credit union property and documents.

Depending on local law, the regulatory authority's conservatorship may be able to be appealed before a court.

Mergers – Mergers can be both voluntary and involuntary. A voluntary merger is performed in a solvent credit union and initiated by an affirmative vote of the membership. A voluntary merger is completed by credit union management and officials without "hands on" assistance from the regulatory authority. However, final approval by the regulatory authority is usually required. An involuntary merger is carried out by the regulatory authority without a membership vote. The merger is usually due to insolvency, loss of the credit union's field of membership or sponsor, or loss of interest in the credit union by the field of membership.

A merger occurs when two or more credit unions join together and operate as one financial institution for the purpose of continuing and improving service to members and in some cases to reduce or avoid a loss to the deposit insurance fund. Mergers are a viable alternative when a credit union can not feasibly continue operations.

In a merger, the continuing credit union absorbs the members and creditors and all of the credit union's assets, liabilities, and equity. In other words, the merging credit union is simply made a part of the continuing credit union. Accordingly, the continuing credit union must honor all legal commitments of the merging credit union. Crucial in every merger is management's ability to successfully resolve the problems in the merging credit union. Their ability to cope with the merging credit union's problems should be carefully analyzed along with the effect of the merger on the financial condition of the continuing credit union. This documentation should be in writing and included in the permanent credit union file.

Prompt action is especially important in cases where financial stability, membership confidence, and service are in jeopardy. The supervisory authority must be aware of the negative consequences involved with the merger and work to ensure that the merger is completed quickly and without interruption of member service.

For involuntary mergers, the process begins as of the date of the merger order issued by the regulatory authority. The order should be addressed to the credit union's board of directors and drafted and signed by the head of the credit union regulatory body and his/her superior. The order should be delivered to the credit union immediately after the merger decision is made.

The credit union will continue to be supervised by the regulatory authority until the merger is complete. The regulatory authority has the right to conduct examinations or on-site contacts as desired. If allowed by local law, the merger order may be contested in the court system.

Liquidation– The objective of the liquidation process is to reduce the loss to the deposit insurance fund, if applicable and to satisfy all demands made by the creditors of the credit union. Liquidation can be voluntary or involuntary. It can occur by a revocation of the credit union's license by the regulatory authority or by a decision or vote at a general membership meeting to voluntarily liquidate the credit union, if subsequently approved by the supervisory authority. Voluntary liquidation occurs when a credit union has the ability to meet its obligations to creditors and members. If the liquidation is voluntary, credit union management and the officials are responsible for the liquidation upon approval by the regulatory authority.

For involuntary liquidations, the process begins as of the date of the liquidation order issued by the regulatory authority. The order should be addressed to the credit union's board of directors and signed by the head of the credit union regulatory body and his/her superior. The order should be delivered to the credit union immediately after the liquidation decision is made.

The involuntary liquidation process usually consists of the following steps:

- Taking control and making an inventory of assets;
- Examination and valuation of assets;
- Sale of assets;

- Allocation of the sales proceeds; and
- Completion of liquidation process.

If there are any proceeds or assets remaining after the payment of the credit union's creditors, operational expenses, member savings and deposit accounts, and ownership shares (payments made in that order) then the proceeds should be distributed to the credit union's members proportionally to the size of their membership shares.

The credit union will continue to be supervised by the regulatory authority until the liquidation is complete. The regulatory authority has the right to conduct examinations or on-site contacts as desired. Depending on the law, the involuntary liquidation order may be able to be appealed in the court system.

Revocation of Deposit Insurance, License, or Charter – The credit union law should allow the regulatory authority to suspend or revoke deposit insurance and/or the license of a credit union that has violated any provision of the law, bylaws, or rules and regulations. A revocation order may be issued for:

- Abandonment by the officials of the credit union operations and affairs;
- If the officials refuse to liquidate the credit union voluntarily;
- Serious operational deficiencies that the officials have not acted to correct and which, if allowed to continued, may cause insolvency; and
- Other serious violations of the law, bylaws, and rules and regulations that cannot be reversed and that may cause insolvency.

The revocation order should be addressed to the credit union's board of directors and should be drafted and signed by the head of the credit union supervisory body and his/her superior. It should contain: a statement that explains the reason(s) for the revocation of the deposit insurance and/or license, that the revocation is immediate, and the steps the officials may take if they do not agree with the order. Upon issuance of the order, the assets, books, and records of the credit union immediately become the property of the regulatory authority.

Any official at a credit union in which the deposit insurance and/or license is revoked is prohibited from participating in the affairs of any financial institution without the written consent of the regulatory authority.

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