

NATIONAL CREDIT UNION ADMINISTRATION
WASHINGTON, D.C. 20456
LETTER TO CREDIT UNIONS

NCUA LETTER NO 84

DATE: AUGUST 6, 1986

TO THE BOARD OF DIRECTORS OF THE FEDERALLY-INSURED CREDIT UNIONS ADDRESSED:

Much has been said recently within the credit union movement about an unpleasant subject for credit unions - insider dealing and conflicts of interest. We are addressing this subject now for two reasons: first, to set the record straight on the nature of this problem; and second, to tell you what NCUA is doing about it.

NCUA recently completed a comprehensive report, including case reviews of insider dealing and conflicts of interest in federally-insured credit unions over the last two years, and of the laws, rules and procedures in place to prevent these cases and to resolve them when they do occur. (A copy of this report is available upon request through the NCUA's Office of Public and Congressional Affairs, 1776 G Street, N.W., Washington, D.C. 20456; 202-357-1050.)

The first thing you should know is that the number of such cases, as a percentage of the 15,000 federally-insured credit unions in the United States, is very small. Thus, the existence of a limited number of cases does not impart a bad name to the credit union movement, or to the vast majority of honest, hard-working volunteers and employees in credit unions.

It is true, however, that a limited number of cases have resulted in millions of dollars in financial costs to your insurance fund. A review of ten of the major cases over the last two years, for example, indicates potential aggregate costs to the Insurance Fund from these cases alone in the range of \$50-\$75 million. The problems include the following: embezzlement, preferential and substandard loans to officials and employees, substandard commercial loans to management officials and their business interests, refinancing of nonperforming loans to cover up past-due principal and interest, conversion of credit unions' assets (businesses, and real and personal property) to personal use and benefit, ownership by management officials of fixed assets that are leased by the credit union on less than arms-length terms, and receipt by credit union officials and employees of commission and fee income in connection with the business transactions of the credit union and its members.

Obviously, these practices have no place in the credit union movement, and it is incumbent upon NCUA to consider every reasonable means of prevention. Remember, every dollar in financial costs to the Insurance Fund reduces by one dollar the amount available to pay dividends on your deposit in the Fund.

In our review of these cases, we determined that virtually every problem we encountered was a violation of a law or regulation already on the books, ranging from provisions of the U.S. Criminal Code to the rules of NCUA and the State Supervisors, to the Common Law doctrine of fiduciary responsibility. We concluded, therefore, that the solution does not lie in promulgating new restrictions, but rather in improving our efforts at education, investigation and enforcement.

In that connection, we are taking a number of positive steps at NCUA that we want you to be aware of:

- We have adopted new criminal referral forms and procedures that will improve the ability of the U.S. Department of Justice to investigate and prosecute criminal activity in federally-insured credit unions.

We are reinstating an examiner workpaper on "insider transactions" that will improve our ability to detect conflicts of interest.

- We have recently hired one litigation specialist and authorized hiring another to deal primarily with enforcement actions and recovering claims in problem-case credit unions.
- We are working with the National Association of State Credit Union Supervisors (NASCUS) to develop a so-called "model exam" - a core set of examination forms and procedures to be used by NCUA and the state regulators.
- We have reached agreement with NASCUS on the circumstances under which NCUA will participate in the examination of problem-case state credit unions. (We believe that NCUA, the state regulators and all credit unions are bound to benefit from improved coordination of examinations.)
- We are reviewing NCUA's statutory enforcement powers (cease and desist, prohibition, removal, etc.) and may develop proposed legislation enhancing our ability to use those powers.
- Finally, we are developing a chapter for inclusion in a forthcoming officials' handbook providing comprehensive guidelines on the subjects of conflict of interest and the responsibilities of credit union officials and employees.

In the interim, this letter should remind everyone of the responsibility we all bear in maintaining the integrity and the reputation of the credit union movement.

In closing, we would suggest, as a basic rule of thumb, that all officials and employees of federally-insured credit unions avoid situations where they would derive personal gain from the business of the credit union, other than normal salary, benefits and permissible, nonpreferential loans. Finally, all officials and employees should be mindful of their responsibility to report all suspected criminal activities to the NCUA Regional Office. If you have questions about a particular situation, do not hesitate to call upon your Regional Office or State Supervisor, as the case may be.

Sincerely,

ROGER W. JEPSEN
Chairman
National credit Union Administration Board