UNITED STATES OF AMERICA
BEFORE THE NATIONAL CREDIT UNION ADMINISTRATION

In the Matter of

Holy Love Ministries *Docket BD-27-10*

Insurance Claim

Decision and Order on Appeal

Decision

This matter comes before the National Credit Union Administration Board (Board) pursuant to 12 C.F.R. §745.202 as an administrative appeal of the determination by the Agent for the Liquidating Agent of St. Paul Croatian Federal Credit Union denying the insurance claim submitted by Holy Love Ministries.

Background

NCUA placed St. Paul Croatian FCU (FCU) into conservatorship on April 23, 2010, following the discovery of fraud, in the form of fictitious loans and other manipulation of the records, allegedly perpetrated by the FCU's CEO. On April 30th, one week later, the Board determined, given the scope of fraud, that conservatorship was not a viable option and placed the FCU into involuntary liquidation.

Through a letter, NCUA notified members of the conservatorship and imposed a share withdrawal limit of $5,000 per week, with a proviso for exceptions on a case-by-case basis. This letter, signed by the Region III Director and Agent for the Conservator (Agent), dated April 26, 2010, was posted in the FCU's lobby and on its website, and versions in English and Croatian were distributed to members who visited the FCU's two locations. The Agent determined it was necessary to institute a share withdrawal restriction because the fraud extended to the FCU's deposit records, such as forged share pledge documents used in lending. In addition, law enforcement suspected that accounts had been used for money laundering. The letter stated, in part, as follows:

> As conservator, our first task is to gain control of the business, including sorting out the share and loan records and conducting an investigation into the circumstances that led up to the appointment of the conservator. Accordingly, beginning immediately and extending for an indefinite time, the conservator has imposed a limit of $5,000 per week on the amount that may be withdrawn from member share accounts. On a case by case

basis, the conservator will consider requests for an exception to this policy, for example in the event of an emergency or to meet a previously established commitment such as a home purchase. Members should also note that the application of this policy will not have any impact on the amount of share insurance that is available from the *[National Credit Union Share Insurance Fund]* NCUSIF to cover the funds in the account.

Claim

Holy Love Ministries (Appellant) is a nonprofit organization, located in Elyria, Ohio. As of the liquidation date, Appellant held $1,752,148.82 in five accounts with several subaccounts (share account 26139-00 with share certificate 26139-20 and share draft account 26139-30; share account 26143-00; share account 26147-00 with share certificates 26147-20 and -21; share account 26161-00 with share certificate 26161-20 and share draft account 26161-30; and share account 26160-00 with share draft account 26160-30).

On September 8, 2010, NCUA's Asset Management and Assistance Center (AMAC)[1] made an initial payout to Appellant in the amount of $1,001.73. On October 18, 2010, AMAC mailed a check in the amount of $248,998.27 to Appellant and notified it by letter that the remaining unpaid balance of $1,502,148.82 exceeded the $250,000 share insurance limit and therefore was uninsured. On December 16, 2010, Appellant filed an appeal to the Board of AMAC's initial insurance determination.

Argument

Appellant stated that due to the wrongdoing of the FCU and NCUA, Appellant is entitled to recover the full balance of its accounts as of the FCU's liquidation date. Appellant argued NCUA failed to properly monitor the FCU and alleged NCUA committed fraud in the days before and after the conservatorship. Appellant alleged NCUA and FCU staff discouraged a signer on Appellant's accounts from withdrawing Appellant's funds until the week of April 26, 2010. In addition, Appellant alleged the Agent: 1) instructed employees to contact members with balances in excess of $250,000 to restructure accounts to ensure full share insurance coverage, but failed to contact Appellant; 2) permitted withdrawals of funds in excess of insurance coverage, and; 3) allowed withdrawals over the $5000 limit under the share withdrawal restriction policy. Appellant further argued that it is entitled to an additional $250,000 in insured shares under the joint account insurance rule because there were multiple signers on its accounts.

Discussion

NCUA's rules governing share insurance provide that accounts of a corporation, partnership, or unincorporated association engaged in any independent activity shall be insured up to $250,000 in the aggregate. 12 C.F.R. §745.6. Appellant is a nonprofit

[1] References to AMAC throughout this decision refer to AMAC staff acting in their capacity as agents for the liquidating agent.

corporation registered in the State of Ohio, Entity Number 774482. AMAC correctly determined that Appellant's accounts were insured up to $250,000 in the aggregate and that, upon the FCU's liquidation, the remaining balance of $1,502,148.82 in its accounts was uninsured.

Duty of NCUA as a Regulator to Detect Fraud

NCUA does not bear liability to Appellant for failing to detect the fraud that led to the FCU's insolvency. The FCU Act states unambiguously that an FCU is under the supervision of the Board and shall make financial reports to the agency as well as make its books and records accessible to NCUA for purposes of examination. 12 U.S.C. §1756. Federal law provides similar authority for the other banking regulators, including the OCC and Federal Reserve. "These examinations, including examinations of credit unions by the Bureau [of Federal Credit Unions], are made for the purpose of supplying the Comptroller or the Director . . . with information necessary to perform his regulatory function. They are not made as a service to the bank or the credit union. The detection of fraud is not a primary function of the examinations . . . ." *Soc. Sec. Admin. Baltimore Fed. Credit Union v. United States,* 138 F. Supp. 639, 646 (D. Md. 1959). While the FCU plaintiff in *Social Security Administration Baltimore FCU v. United States* alleged that examiners were negligent in performing examinations and failing to discover embezzlements, the district court found that the FCU Act did not impose upon the government a duty to the FCU to verify its accounts and records. "Of course, if a defalcation is discovered or suspected in the course of a Comptroller's or Bureau examination, the facts should be communicated to the proper officials . . .unless . . .the Director decides that more drastic action is necessary, such as closing the credit union altogether. . . . Such communication is made in the exercise of the regulatory function, not because the statute imposes any duty" to do so. *Id.*

In a bank fraud case, an appellate court determined that nothing in the Federal Deposit Insurance Act establishes a duty that the FDIC warn a bank of the unlawful banking practices of its officials. *First State Bank of Hudson County v. United States*, 599 F.2d 558 (3rd Cir. 1979). "If bank examinations by the FDIC reveal any irregularities or fraud, such examinations, though they may inure incidentally to the benefit of a bank, are intended primarily for the protection of the insurance fund." *Id. at* 563. "As long as the FDIC did no more than carry out its statutory responsibility to examine the Bank for insurance purposes, neither the FDIC nor the Bank could reasonably have believed that the agency assumed a duty to warn the Bank's board of the derelictions of their president and employee." *Id. at* 565. *See also Harmsen v. Smith,* 586 F. 2d 156 (9th Cir. 1978) *and In re Franklin Nat'l Bank Sec. Litigation,* 478 F. Supp 210 ("the Comptroller's primary duty is to supervise the banking system for the protection of the public and the national economy as a whole and not for the protection of an individual banking institution.").

In *Sisters of the Presentation of the Blessed Virgin Mary of Aberdeen v. NCUA,* a nonmember charity obtained shares in a low-income credit union well in excess of the applicable insurance limits when it was induced by credit union officials who were

engaged in a fraudulent share certificate operation. 961 F.2d 733 (8th Cir. 1992). The officials fraudulently represented the share certificates were collateralized by government securities and engaged in the fraud for several years. When NCUA liquidated the FCU, the charity held certificates totaling $2.45 million dollars. The charity argued it was entitled to priority preference by virtue of equitable trust principles because it was "induced by fraud to purchase the share certificates in Franklin [FCU] and because NCUA was negligent in performing its duty to discover that fraud." *Id. at* 737. The charity also asserted it suffered unique harm in comparison to the other depositors by virtue of the amount of its loss. The court determined the charity was properly classified to the amount of its uninsured shares and not entitled to a constructive trust.

> First, it has been held that the regulatory activities of a government agency do not give rise to a duty to discover and report possible fraud or wrongdoing. . . . The NCUA was under no duty to discover or warn Franklin shareholders of fraudulent activities, and the Petitioner has no equitable claim based on regulatory negligence.
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> Second, the Petitioner fails to establish that it was the only accountholder of the credit union that was fraudulently induced to purchase share certificates in excess of applicable insurance coverage. Nor did Petitioner suffer a fraud unique from other accountholders by Franklin's assurances that its certificates would be collateralized. . . .
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> Finally, there is no equitable basis for the Petitioner's argument that it deserves priority over other accountholders because it stands to suffer the most substantial loss. We simply can find no basis in equity for giving the Petitioner a disproportionate advantage over other Franklin shareholders who also suffered losses.

Id. at 737-738.

Under the law, therefore, the regulatory authority that conducts examinations of insured depository institutions owes no legal duty to the institution or to its officers, directors, depositors or creditors. Accordingly, NCUA's alleged failure to discover the fraud at the FCU does not create a legal obligation on the part of NCUA to indemnify the Appellant against its loss.

Withdrawal Restriction or "Share Freeze" Imposed by Conservator's Agent

Section 206(h)(1)(A) of the FCU Act, 12 U.S.C. §1786(h)(1)(A), grants the Board the right to appoint a conservator and to take possession and control of the business and assets of an insured credit union if the Board determines that such action is necessary to conserve the assets of such insured credit union or to protect the NCUSIF or the interests of the credit union's members. 12 U.S.C. §1786(h)(1)(A); *See In Re Conservatorship of the Polish & Slavic Fed. Credit Union,* No. 99 CV 2406, 1999 U.S.

Dist. LEXIS 10762 (E.D.N.Y. July 9, 1999). Once the Board becomes conservator, it succeeds to "all rights, titles, powers, and privileges of the credit union" and its directors with respect to the credit union. 12 U.S.C. §1787(b)(2)(A)(i). The Board is then authorized to exercise all powers and authorities specifically granted to conservators and take any action authorized by the FCU Act in the best interests of the credit union, its accountholders, or the Board. 12 U.S.C. §1787(b)(2)(J).

Under conservatorship authority, the Agent was permitted to establish a share withdrawal restriction from April 23, 2010 until the liquidation date, April 30, 2010. NCUA, stepping into the FCU's shoes, assumed all of the powers of the credit union and its board of directors and was empowered under the FCU Act and the FCU's bylaws to take such action as was necessary to put the FCU in a sound and solvent condition and appropriate to preserve and conserve its assets.[2]

NCUA, as conservator, has imposed share freezes in other cases, in which accountholders were ultimately left with uninsured shares because they were unable to remove funds in excess of the share insurance limits before liquidation. When Midwood FCU was placed into conservatorship, the conservator placed a 60-day freeze on share withdrawals in excess of $250 pursuant to the FCU's bylaws due to the recordkeeping problems determined at the onset of the conservatorship. One member, the Hebrew Institute for the Deaf and Exceptional Children (HIDEC), a not-for-profit educational corporation, held ten share certificates for a total of $919,541, which it invested based on misrepresentations made by a credit union official. HIDEC attempted to withdraw all of its deposits during the conservatorship, but the conservator denied the request in accordance with the withdrawal restriction. Upon Midwood's liquidation, HIDEC had $819,541 in uninsured funds pursuant to the insurance rule for corporate account coverage, 12 C.F.R. §745.6. After losing an insurance appeal before the Board (NCUA BD-06-05), HIDEC sued the agency for its uninsured balance. The appellate court upheld the agency's decision to deny coverage and noted the doctrine of equitable estoppel is not available against the government. *Friends of Hebrew Inst. for the Deaf and Exceptional Children v. NCUA,* No. 06-0424-ag, 2007 U.S. App. LEXIS 6275 (2nd Cir. March 16, 2007).

Due to the fact-specific nature of conservatorships, NCUA does not have regulations or policies that dictate step-by-step procedures for operating a conserved institution. The decision-making for the day-to-day management of a credit union in conservatorship is largely left to the discretion of the conservator's agent. In this instance, the Agent determined a share freeze policy was necessary to conserve the assets in the FCU, protect the NCUSIF, and protect the interests of the FCU's members. The Agent's management of the FCU during the conservatorship and use of a withdrawal restriction policy, even if negligently implemented, was an exercise of discretion in furtherance of public policy goals.

[2] Article III, Section 5 of St. Paul's bylaws authorized the board of directors to impose a withdrawal restriction as necessary by requiring "members to give 60 days' notice of intention to withdraw the whole or any part of the amounts so paid in by them."

Appellant argues NCUA's fraud and wrongdoing includes statements made to a signer on Appellant's accounts, during the week of April 18, 2010, by an NCUA problem case officer (PCO) and the FCU's interim manager. Although the individual may have discussed making a withdrawal of $1,000,000 of Appellant's funds with the PCO, the PCO had no authority to pay on behalf of St. Paul. The issue of whether Appellant made an attempt to withdraw funds from the FCU and was denied by the FCU's management is beyond the scope or authority of this administrative appeal and is not relevant to determination of share insurance coverage.

Insurance Limits

As stated above, Section 745.6 of the NCUA Rules and Regulations provides that "[a]ccounts of a corporation, partnership, or unincorporated association engaged in any independent activity shall be insured up to the SMSIA," the standard maximum share insurance amount of $250,000, in the aggregate. 12 C.F.R. §745.6. Legal entities, including non-profit corporations, are not eligible for joint account coverage, as joint accounts are only available to natural persons. "A joint account is a qualifying joint account if each of the co-owners has personally signed" a membership or account card. 12 C.F.R. §745.8(c). While some of the Appellant's account cards may have had multiple signers on the accounts, these individuals are not co-owners of the accounts. NCUA's insurance rules require that all of the shares owned by the Appellant, a non-profit corporation, be combined and insured up to $250,000.

Credit union members are responsible for determining whether their accounts are adequately insured. Furthermore, statements made by NCUA staff and credit union employees are not binding on the liquidating agent or the Board and do not obligate either to provide coverage in excess of coverage provided by the NCUA Regulations.

NCUA's publication "Your Insured Funds" clarifies the coverage by Part 745:

> NCUA's rules on insurance control how accounts will be insured. Members are advised that no persons may, by representations or interpretations, effect the extent of insurance coverage provided by the Federal Credit Union Act as amended and the rules and regulations for insurance of share accounts. Also, members are advised to review their accounts periodically and whenever they open new accounts or modify existing accounts to ensure that all of their funds continue to be insured.

Your Insured Funds, NCUA publication 8046.

Consistency with Previous Board Insurance Appeal Decisions

The Board has considered applicable case law, as well as previous Board decisions on insurance claims. The facts in *HIDEC* and *Sisters of the Presentation* are similar to the present claim in terms of the pervasive fraud that caused the FCU's insolvency. In particular, HIDEC endured a very restrictive share freeze during the conservatorship.

Both accountholders lost significant amounts in uninsured deposits; decisions that were upheld in court.

In addition, the Board has recently denied appeals from other St. Paul members who likewise asserted agency responsibility for its failure to identify the fraud perpetrated by the FCU's CEO. See *In the Matter of Cascade Federal Credit Union,* NCUA Docket BD-06-10; *In the Matter of Acme Federal Credit Union,* NCUA Docket BD-23-10.

Conclusion

As discussed above, an account of a nonprofit corporation may be insured up to no more than $250,000 under Section 745.6.[3] AMAC correctly determined that Appellant's corporation accounts are entitled to the standard maximum share insurance amount of $250,000. Appellant has not demonstrated it is entitled to any funds as insured shares beyond AMAC's share insurance determination. Accordingly, Appellant's claim for payment of $1,502,148.82 is denied. This decision does not affect Appellant's certificate of claim for $1,502,148.82 in uninsured shares.

Order

For the reasons set forth above, it is ORDERED as follows:

The Board upholds the agent for the liquidating agent's decision and denies the appeal of Holy Love Ministries.

The Board's decision constitutes a final agency determination. Pursuant to 12 CFR §745.203(c), this final determination is reviewable in accordance with the provisions of Chapter 7, Title 5, United States Code, by the United States district court for the federal judicial district where the credit union's principal place of business was located. Such action must be filed not later than 60 days after the date of this final determination.

So **ORDERED** this 21st day of April 2011 by the National Credit Union Administration Board.

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Mary Rupp
Secretary of the Board

[3] We note section 343(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, providing for unlimited share insurance for "noninterest-bearing transaction accounts," which took effect July 22, 2010, is inapplicable here.