

Chapter 31

LIQUIDATIONS

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Chapter 31

LIQUIDATIONS

Liquidations Objective

- Determine the liquidation types available
- Determine the procedures of the various types of liquidations

Associated Risks

- Reputation risk can occur when the credit union sustains losses sufficient to result in liquidation. Although reputation risk is the primary risk, the liquidation process most likely results from high risk in any or all of the remaining six risk areas.

Overview

In order to carry out that part of district responsibility relating to liquidations, the examiner must have a thorough knowledge of the types of liquidations and the procedures governing each. Liquidations are classified as follows:

- **Voluntary.** Part 710 of the *NCUA Rules and Regulations* provides guidance for the voluntary liquidation of a solvent federal credit union. The credit union's board of directors or a duly appointed liquidating agent conducts voluntary liquidations. The board or liquidating agent fully disburses members' shares in a voluntary liquidation only after selling or collecting the assets and satisfying any liabilities. Also, in most cases the members receive a liquidating dividend. For these reasons, the board or liquidating agent should expedite the liquidation process.
- **Title I Involuntary.** Under §120 of the *FCU Act*, the NCUA Board can place a solvent federal credit union into involuntary liquidation for violations of its charter, its bylaws, the *FCU Act*, and the *NCUA Rules and Regulations*. Also, under §120, the NCUA Board can place a federal credit union into involuntary liquidation upon finding that the board or liquidating agent did not conduct a voluntary liquidation in an orderly or efficient manner or in the best interests of the members.

- Title II Involuntary. §207 of the *FCU Act* requires the NCUA Board to close for liquidation any federal credit union it deems bankrupt or insolvent. In these cases, the NCUA Board must also appoint itself as liquidating agent. In addition, the NCUA Board can accept appointment as liquidating agent of a bankrupt or insolvent federally insured state-chartered credit union.
- Purchase and Assumption. A purchase and assumption (P&A) is an action similar to a merger, but unlike a merger the NCUA Board places the credit union into involuntary liquidation. In a P&A, another credit union or another financial institution assumes all or part of the assets, liabilities, and shares.

Responsibility

The NCUA Board has delegated to the Asset Management and Assistance Center (AMAC) the responsibility of managing all involuntary liquidations of federally insured credit unions in all NCUA regions. AMAC processes in an orderly manner the payment of insured shares, sale or collection of loan portfolios, the liquidation of other assets, and the cancellation of charters or insurance certificates. In addition to the liquidation responsibility, AMAC can assist the examiner, if the regional director so requests, with evaluating real estate assets, bond claims, other major assets, records reconstruction, and management. These evaluations of operating credit unions can help develop alternatives to liquidation or help support the insolvency calculation.

When AMAC staff is onsite during an involuntary liquidation, the region retains full responsibility for a federal credit union up to the point of delivery of the Notice of Liquidation to the credit union officials. In the case of a federally insured state-chartered credit union, the state regulator retains full responsibility until NCUA has accepted the appointment as liquidating agent. Once delivery of the Notice of Liquidation takes place, or NCUA has accepted appointment as liquidating agent, the liquidation becomes the responsibility of AMAC. When AMAC staff is not onsite, the region retains full responsibility until the region ships and AMAC receives the records. At that time AMAC assumes responsibility.

The region is responsible for purchase and assumptions. AMAC usually performs the administrative activity necessary to complete the P&A. For example, AMAC can become involved in those cases in which expense payments are necessary (not including 208 Assistance to facilitate the action), when the continuing institution does not receive all assets and liabilities, and when NCUA retains bond claims. In these cases, AMAC takes responsibility for the remaining assets, liabilities, expense payments, and bond claims on the effective date of the purchase and assumption. The region must involve AMAC during the planning stages of the P&A, so that AMAC can promptly publish notices and AMAC can assume responsibility for any remaining assets and liabilities.

The region must also supervise voluntary liquidations. AMAC, if requested by the region, can provide assistance in the liquidation of assets or the payment of liabilities. AMAC can also accept appointment as liquidating agent and complete the entire voluntary liquidation. The region and AMAC determine the degree of AMAC involvement case by case.

The regional office and AMAC must closely coordinate liquidations. In most cases, staff from both the region and AMAC conducts involuntary liquidations. Generally, after the planning stage, regional staff performs much of the onsite phase and ship the records to AMAC. AMAC then conducts the share payout, prepares loan registers, arranges for the sale or collection of the loans, and concludes the affairs.

Voluntary Liquidation

AMAC or other designated liquidating agents or the credit union officials conduct a voluntary liquidation. Once credit union notifies the regional office of a voluntary liquidation, the examiner should contact the credit union to determine the current financial situation and to provide guidance on voluntary liquidation procedures. The examiner should ensure that the officials or liquidating agent understand and comply with Part 710 of *NCUA Rules and Regulations* and the *Voluntary Liquidation Procedures for Federal Credit Unions* (NCUA 8040).

**Considering
Voluntary
Liquidation**

Frequently, credit union officials will consult with the examiner regarding the advisability of liquidation. Examiners must carefully analyze all pertinent conditions to learn the true reason the officials are considering liquidation.

Some problems for which practical solutions short of liquidation may exist include: withdrawal of support by the parent organization, delinquent loans, lack of interest, or disputes between officials or factions within the credit union. Resolution of existing problems will depend on the examiner's ability to make use of the facts uncovered in the investigation.

The examiner may suggest reorganizing the officials, restructuring the operating procedures, and reviving interest among the officials and members as viable alternatives to liquidation. To accomplish this, the members or representatives of other local credit unions may decide to meet. The examiner should inform the supervisory examiner of the progress made.

The examiner or regional office provides a copy of the *Voluntary Liquidation Procedures for Federal Credit Unions* to the board of directors. The examiner should urge the officials to take all necessary steps to protect the members' interests and to complete the liquidation as rapidly as possible.

**Alternatives to
Voluntary
Liquidation**

The credit union and examiner should explore all alternatives to liquidation. In addition to reorganization of the officials, alternatives include changes to the field of membership and merger. An extension of the basic field of membership could result in a more viable group. For example, conversion from an occupational to a community or associational charter provides a broader membership base. (For further guidance, see NCUA's *Chartering and Field of Membership Manual*, NCUA 8007.)

Both NCUA and the credit union may prefer a merger option to liquidation since credit union service can continue. Regional and field staff must weigh continued credit union service against other factors, such as the costs to the NCUSIF. The examiner should investigate the

possibility of a merger and include all pertinent findings in a memorandum to the regional office.

**Solvency
Evaluation**

The examiner's memorandum regarding the voluntary liquidation proposal must document the credit union's solvency and support the solvency determination with current financial statements, a delinquent loan list, and a solvency evaluation workpaper. The examiner can use the Probable Asset/Share Ratio form as a solvency evaluation workpaper. The Credit Union Merger Procedures and Merger Forms Manual, (NCUA 8056) includes a copy of the Probable Asset/Share Ratio form. The examiner should determine the actual cash value of each asset and discuss in the memorandum any asset assigned a value less than book value with the reasons for the valuation. Examiners should report current loans that are probable losses, such as bankruptcies, on the list as classified. If the credit union is insolvent, the examiner should recommend that the regional director place the credit union into involuntary liquidation under §207 of the *FCU Act*. §700.1 of the *NCUA Rules and Regulations* defines insolvency. Insolvent credit unions cannot choose voluntary liquidation.

Commencement

The commencement date of the liquidation is the date the board of directors votes to submit the question of liquidation to the members. If, for some reason, the examiner feels this date would not result in an equitable distribution to the members, the examiner should contact the supervisory examiner to decide on appropriate action. The regional director has the authority to change the date of liquidation to provide equitable treatment of all members.

An example of inequity is a situation where the officials induce borrowers to transfer shares to current loans just prior to the board's announcement of the voluntary liquidation. By reducing the amount of shares at the commencement date, a select number of shareholders would receive a larger liquidating dividend. Inequity would also apply in a case where, just prior to the liquidation date, the officials pressure members with large share balances to close their accounts under the misconception of a prolonged period awaiting final distribution.

The examiner should instruct the liquidating agent to use the cash basis rather than the accrual basis of accounting during liquidation. The liquidating agent should follow procedures outlined in the *Accounting Manual for Federal Credit Unions*, except that the liquidating agent should not close income and expense accounts at year-end.

The examiner should determine that the liquidating agent closed the books and prepared commencement reports as of the liquidation commencement date in compliance with the *Voluntary Liquidation Procedures Manual*. If the liquidating agent cannot prepare and mail the reports and schedules to the regional office during the contact, the examiner should obtain a firm date from the liquidating agent for completion of these requirements. The examiner will follow up by telephone or other means to determine that the liquidating agent keeps the agreements.

The examiner may suggest that the board of directors authorize late charges on inactive accounts under par value, as provided by the bylaws, prior to closing the books. Also, staff should resolve out-of-balance conditions at this time, where possible.

Financial Assistance

In some cases, the credit union cannot convert assets to cash to facilitate a prompt share distribution. This may occur when the credit union cannot arrange a bulk sale of loans or when surety delays settlement of a bond claim. The examiner may consider requesting assistance under §208 of the *FCU Act*. In these cases, the NCUSIF can purchase the assets to expedite the share distribution. Before discussing such assistance with the officials, the examiner should contact the supervisory examiner.

When the NCUSIF acquires assets as a result of voluntary liquidations, AMAC is responsible for the sale, collection, or settlement of the assets.

Sale/Collection of Assets

Since the duration of the liquidation usually depends on the collection of loans, the examiner should emphasize that a bulk sale of loans will shorten the liquidation period and that the credit union might negotiate a more favorable price early in the liquidation. If the sale of loans or

other major assets will not produce sufficient funds to pay the shareholders at par (100 percent), the credit union may not consummate a sale without the written approval of the regional director.

Credit unions needing assistance in selling loan portfolios may contact AMAC through the regional office for marketing assistance. While the bulk sale of loans will, in most cases, be the practical way to provide a quick distribution to the shareholders, the examiner should not encourage the officials to sell at an excessive discount, especially if the credit union is financially sound. Under these conditions the officials may want to continue to collect the loans in order to provide the members a liquidating dividend.

**Partial
Distribution**

The examiner will occasionally receive inquiries concerning partial distributions. Current policy discourages partial distributions if the credit union will most likely fully liquidate within six months. However, in cases where conversion of all assets to cash will extend beyond six months, the examiner should encourage a partial distribution. A partial distribution generally is at least 25 percent of total shares, and any subsequent partial distribution normally is not less than 25 percent of commencement shares. Before payment of a partial distribution, the credit union must request and obtain the approval of the regional director. The voluntary liquidation procedures specify the reports, which should accompany this request.

Other Priorities

Auditing responsibilities of the supervisory committee do not cease because the credit union enters liquidation. Rather, internal controls take on greater importance with the conversion of the credit union's assets to cash and the responsibility for the liquidation frequently delegated to one individual.

Part 710 of the *NCUA Rules and Regulations* requires bond coverage for at least four months beyond the date of final distribution. The importance of surety coverage increases because of the accumulation of cash.

When the examiner or liquidating agent determines that the credit union can return members' shares at par, the credit union returns the NCUSIF capitalization deposit. Credit unions that do not start final distribution of the members' checks by December 31 must pay the annual operating fee for that year. For the purpose of assessing operating fees, NCUA considers the final distribution made when the liquidating agent mails the members' checks.

**Supervision
during
Voluntary
Liquidation**

A voluntary liquidation remains the district examiner's responsibility until cancellation of the charter. Voluntary liquidations normally conclude in one year or less, and examiners normally do not conduct examinations during liquidation. In rare cases, the regional office will assign necessary examinations. While examiners will ordinarily follow regular examination techniques, the regional director will determine the scope of the examination. Regional instructions will guide the examiner.

The examiner will make supervision contacts monthly throughout the liquidation unless the board appoints AMAC as liquidating agent. Onsite contacts will occur if the examiner cannot obtain sufficient information by mail and by telephone to properly monitor the liquidation. The examiner's duties will extend into such areas as:

- Determining that the records are current and in balance;
- Determining that prescribed procedures are being followed;
- Coordinating the sale of loans and other assets;
- Monitoring solvency;
- Submitting prompt and accurate reports to the regional office; and
- Bringing the liquidation to a prompt conclusion.

Immaterial differences between the individual share and loan ledgers and their control accounts should not delay distribution. If material differences exist, the examiner should obtain guidance from the supervisory examiner.

The examiner should conduct a joint conference at the conclusion of onsite contacts if the officials continue to run the credit union. Examiners should discuss any exceptions or irregularities with the responsible officials and take appropriate steps to ensure necessary

corrections. If unsatisfactory practices jeopardize the interests of the shareholders and NCUSIF, the examiner should ensure that the officials discontinue these practices immediately.

Examiners will report by memorandum to the regional office on each supervisory contact for a liquidation. The memorandum should briefly state:

- The conditions found;
- Instructions given to and agreements reached with the liquidating agent and the officials;
- Any information specifically requested by the supervisory examiner; and
- The anticipated date of distribution.

The examiner should continue to contact the credit union even after the final distribution. NCUA finalizes the liquidation only after receiving the final reports and canceling the charter.

Involuntary Liquidations

The Administrative Action chapter explains the procedures for placing an operating federal credit union into involuntary liquidation.

When the NCUA Board places a federal credit union into involuntary liquidation or NCUA accepts appointment as liquidating agent/receiver for a federally insured state credit union, the regional office notifies AMAC. The regional director and president of the AMAC should decide early in the planning process if AMAC staff must be onsite at commencement of liquidation. The *Field Examiners Liquidation Guide to On-Site Involuntary Liquidation Procedures*, (NCUA 9700) provides detailed guidance on the liquidation procedures.

Title I Involuntary Liquidations

Although Title I of the *FCU Act* provides that the NCUA Board may place a federal credit union into involuntary liquidation because of insolvency, Title I does not provide for the related payout. Therefore, NCUA conducts all liquidations of insolvent federal credit unions under the authority of §207 of the *FCU Act*, and uses Title I for liquidations involving violations of the charter, bylaws, *FCU Act*, and

NCUA Rules and Regulations. AMAC, as liquidating agent, conducts Title I involuntary liquidations.

Since Title I liquidation is not a commonly used administrative action, examiner involvement will differ from case to case. For this reason, the regional office will issue any needed assignments to examiners for each case. The examiner will discuss with the supervisory examiner the decision to recommend involuntary liquidation of a solvent federal credit union.

**Title II
Involuntary
Liquidations**

The examiner will submit to the regional director a recommendation to place an insolvent federal credit union into involuntary liquidation, who will request concurrence from the Office of General Counsel. The following data should support the recommendation:

- Summary of the credit union's history and background;
- Summary of the field of membership;
- Economic conditions of the local area;
- Merger feasibility;
- Officials' involvement; and
- Previous examination information such as, CAMEL, solvency evaluation ratio, delinquency, etc.

The recommendation should include the following current reports:

- Balance sheet;
- Income statement;
- Delinquency report;
- Classified loans;
- Solvency evaluation workpaper;
- Any outstanding Letter of Understanding and Agreement;
- All Preliminary Warning Letters; and
- Other administrative actions.

Current financial statements, the delinquent loan list, and a solvency evaluation workpaper should support the credit union's insolvency. The examiner should: (1) determine the actual cash value for each asset; (2) discuss in the memorandum any assets assigned a cash value less than book value and the reasons for the valuation; (3) mark the delinquent loan list to indicate the classified loans; and (4) report

current loans which are probable losses, such as bankruptcies, on the list as classified.

Basically, the instructions in the Administrative Actions chapter of this Guide dealing with an operating, solvent credit union will apply to a liquidating, insolvent credit union.

In the case of a liquidating credit union, it is not necessary to cite any other charges other than insolvency in the recommendation to the regional director. If the regional director so requests, AMAC can assist the examiner in evaluating complex assets, bond claims, and records reconstruction to make the solvency determination.

**Payout of
Federally
Insured State
Credit Unions**

When the appropriate state authorities declare an insured state credit union insolvent or bankrupt, the state usually appoints NCUA or the NCUA Board as liquidating agent, receiver, or conservator. Under delegated authority the president of AMAC, becomes the liquidating agent in these cases.

NCUA does not have the authority to place a state-chartered credit union into liquidation. NCUA cannot make the formal determination of insolvency. The regional director will make any examiner assignments in these liquidations. Examiners will follow NCUA's procedures to the extent that they do not conflict with state law.

**Preparing Credit
Unions for
Involuntary
Liquidation**

The primary goals of an involuntary liquidation are the prompt return of members' shares, payment to the creditors, and disposition of the remaining assets to the NCUSIF. Once the regional director has decided to liquidate the credit union, the examiner must ensure that the records are current and in balance. The regional director determines the examiner's role during the liquidation case by case. If the examiner is to conduct the onsite phase of the liquidation, he or she should use the *Examiners Liquidation Guide to On-Site Involuntary Liquidation Procedures* for detailed guidance.

**Failure to
Commence
Operations**

When the regional office receives notice that a new credit union will not start operations as scheduled, it will assign an examiner to determine if the region should liquidate the credit union. If the

examiner's efforts to commence operations are unsuccessful, the examiner should submit the following to the regional office:

- The original charter and share insurance certificate; and
- A letter or statement signed by a majority of the directors which includes:
 - Request for revocation of charter;
 - Reason for not beginning operations;
 - Information as to the disposition of the initial supplies.

**Workpapers
and
References**

- Workpapers
 - Solvency Evaluation Workpaper
- References
 - *Federal Credit Union Act*
 - Title I - General Provisions
 - Title II - Share Insurance
 - 120 - Powers of the Board and Administration
 - 207 - Payment of Insurance
 - 208 - Special Assistance to Avoid Liquidation
 - *NCUA Rules and Regulations*
 - 700.2(e)(1) - Insolvency
 - 709 - Involuntary Liquidations
 - 710 - Voluntary Liquidation of Federal Credit Unions
 - 745 Subpart B - Payment of Share Insurance
 - *Voluntary Liquidation Procedure for Federal Credit Unions (NCUA 8040)*
 - *Field Examiners Liquidation Guide to On-Site Involuntary Liquidation Procedures*
 - *Credit Union Merger Procedures and Merger Forms Manual*