



National Credit Union Administration

May 24, 2019

U.S. MAIL and E-MAIL

XXXXXX XXXXXXXX, President/CEO
XXXXXXX Federal Credit Union
XXXX XXXXXXX XX
XXXXXX,XX XXXX

RE: XXXXXXXX FCU, Supervisory Review
Committee Appeal Decision (SRC-03-19)

Dear XX. XXXXXXXXXXXX:

On January 25, 2019, the NCUA Secretary of the Board received your notice of appeal, pursuant to 12 CFR §746.107, of the material supervisory determination embodied in a letter from NCUA Regional Director XXXXX XXXXXXXXs to XXXXXXXX Federal Credit Union dated December 19, 2018. The December 19, 2018 letter conditionally approved XXXXXXXX's reconsideration request to accept \$XX million of secondary capital, but at a lesser amount than requested. The conditional approval also required XXXXXXXX to adhere to certain other safety and soundness conditions enumerated in the letter. As stated in your appeal, XXXXXXXX objects to and seeks clarification and modification of the following three (3) specific features of the Reconsideration Decision:

1. The Reconsideration Decision deferred approval of XXXXXXXX's authority to accept the balance of the \$XX million of secondary capital accounts (i.e., authority to accept more than \$XX million of capital accounts) pursuant to the Plan until sometime after December 31, 2019, but does not include a clear and predictable procedure whereby XXXXXXXX can demonstrate its ability to achieve the real estate loan concentration reduction and NEV limits specified in the Plan, and follow section 3.4.3 of its ALM policy for corrective action on any breach limit.
2. The Reconsideration Decision imposed a condition that XXXXXXXX reduce its real estate concentration by the end of 2019 to the level that the Plan proposed, but the Plan was premised on XXXXXXXX having authority to accept \$XX million of secondary capital accounts during 2019. Therefore, the 2019 real estate concentration standard should be adjusted to reflect that XXXXXXXXe only has authority to accept \$XX million of secondary capital accounts during 2019.
3. The Reconsideration Decision requires that XXXXXXXX may not change its ALM model assumptions without prior approval of the Director. This unduly restricts XXXXXXXX's ability to respond promptly as market conditions and other circumstances change.

I am writing to inform you that the NCUA's Supervisory Review Committee (SRC) has made a final decision to uphold the Regional Director's reconsideration decision to conditionally approve XXXXXXX's secondary capital plan to accept \$XX million in secondary capital.

Timeline

A chronology of major activities relating to XXXXXXX's request for approval to accept secondary capital is as follows:

| Date | Activity |
|--------------------|---|
| October 27, 2017 | XXXXXXX submitted a secondary capital plan to the NCUA Regional Director requesting authority to issue \$XX million in secondary capital (First SC Plan) |
| November 29, 2017 | NCUA Regional Director denied XXXXXXX's First SC Plan, citing inadequate liquidity risk assessment, no exit or stop-loss strategy, incomplete low income analysis and potential loan participation regulatory compliance concerns |
| January 2, 2018 | XXXXXXX requested a meeting with NCUA regional representatives to discuss NCUA's underlying concerns with their secondary capital plan |
| January 10, 2018 | NCUA Regional Director acknowledged receiving XXXXXXX's request for a meeting and a meeting was scheduled with the field supervisor to be held on February 15, 2018 |
| February 15, 2018 | NCUA field staff meet with XXXXXXX management in their main office to discuss the secondary capital plan |
| May 18, 2018 | XXXXXXX submitted a revised secondary capital plan to the NCUA Regional Director requesting authority to issue \$XX million in secondary capital (Second SC Plan) |
| July 2, 2018 | NCUA Regional Director denied XXXXXXX's Second SC Plan, citing inadequate liquidity risk assessment, inadequate exit/stop-loss strategy, and concerns with the credit union's high concentration of real estate loans to net worth |
| August 3, 2018 | NCUA field staff meet with XXXXXXX management in their main office to discuss the secondary capital plan |
| September 11, 2018 | XXXXXXX submitted a revised secondary capital plan to the NCUA Regional Director requesting authority to issue \$XX million in secondary capital (Third SC Plan) |
| October 26, 2018 | NCUA Regional Director denied XXXXXXX's Third SC Plan, citing safety and soundness concerns related to the credit union's high concentration of real estate assets to net worth, insufficient policies and controls to manage the risk, and inadequate enforcement of policy limits |
| November 5, 2018 | NCUA field staff met via conference call with XXXXXXX management to discuss the secondary capital plan |

| Date | Activity |
|-------------------|--|
| November 19, 2018 | XXXXXXXX requested the Regional Director reconsider the denial of the Third SC Plan |
| December 19, 2018 | NCUA Regional Director conditionally approved XXXXXXX's request for reconsideration limiting the approval to \$XX million in secondary capital and citing conditional approval is contingent upon XXXXXXX's correction of all previously identified deficiencies with the plan, a formal update to ALM policy limits with respect to real estate concentration to net worth limits, and restriction from making unsecured secondary capital loans to other credit unions |
| January 17, 2019 | XXXXXXXX appealed the NCUA Regional Director's conditional approval of the revised secondary capital plan to the NCUA Supervisory Review Committee pursuant to 12 CFR §746.107 |
| January 25, 2019 | NCUA SRC requested XXXXXXX's board resolution authorizing the appeal, which was delivered on February 1, 2019 |
| February 1, 2019 | NCUA SRC determined XXXXXXX's appeal request was complete |
| February 22, 2019 | XXXXXXXX emailed additional information requested by the NCUA SRC |
| April 24, 2019 | XXXXXXXX and NCUA presented their cases before the NCUA SRC in an oral hearing at the NCUA headquarters in Alexandria, VA, in accordance with 12 CFR §746.107(c)(2) |

Authority to Conditionally Accept Secondary Capital Accounts

The NCUA evaluated XXXXXXX's membership database for the 12/31/2015 examination to determine if XXXXXXX was eligible for NCUA's low-income designation. XXXXXXX met the eligibility requirements and requested approval of the designation, which NCUA approved on February 13, 2017. As a low-income designated credit union, XXXXXXX is eligible to request secondary capital authority from the NCUA pursuant to 12 CFR §701.34.

Authority to Request SRC Review

NCUA Rules and Regulations allow a credit union to request SRC review after receiving a written decision issued by a program office in response to a request for reconsideration pursuant to 12 CFR §746.105. The SRC must receive the request for review within 30 days of the credit union receiving the written decision by the appropriate program office on reconsideration, and the matter for review must be a "material supervisory determination." According to 12 CFR §746.103, a material supervisory determination means any written decision by a program office that may significantly affect the capital, earnings, operating flexibility, or that may otherwise affect the nature or level of supervisory oversight of an insured credit union. 12 CFR §746.103 (a)(5) further defines the term to include a determination on a waiver request or an application for additional authority where independent appeal procedures have not been specified in other NCUA regulations.

The Regional Director's denial of XXXXXXXX's request for authority to accept secondary capital accounts meets the definition of a material supervisory determination as the decision has a significant impact on capital, earnings and operating flexibility. As reflected in the timeline above, XXXXXXXX appropriately requested reconsideration of the Regional Director's denial of the Third SC Plan from the program office before requesting reconsideration from the SRC. After reviewing the reconsideration request, the Regional Director conditionally approved XXXXXXXX's secondary capital request. However, the terms of the conditional approval still have a significant impact on XXXXXXXX's capital, earnings and operating flexibility. Thus, XXXXXXXX submitted the reconsideration request to the Secretary of the Board for review by the SRC and did so within the timeframe required by the regulation.

By filing an appeal to the SRC, XXXXXXXX seeks clarity on three specific aspects of the reconsideration decision.

Supervisory Review Committee Decision

For the reasons noted below, the SRC has decided to uphold the Regional Director's reconsideration decision to conditionally approve XXXXXXXX's secondary capital plan to accept \$XX million in secondary capital. The Region's reconsideration decision was based on certain conditions for which XXXXXXXX is seeking clarity. The following items outline the decisions of the SRC:

1. The reconsideration decision reduced the amount of uninsured secondary capital XXXXXXXX may accept because the Regional Director remained concerned with the increased risk from XXXXXXXX's balance sheet concentration in real estate secured assets combined with the amount of leverage in the Third SC Plan. XXXXXXXX previously held an excess concentration of real estate loans and created unsafe and unsound interest rate and liquidity risks. In addition, the examination revealed weaknesses with policy limit transparency resulting in a lack of enforcement by management to adequately control risk. The Regional Director's approval of the lesser amount of \$XX million in secondary capital was intended to reduce the proposed leverage on XXXXXXXX's balance sheet in the short-term. The Regional Director specified that XXXXXXXX may seek additional secondary capital after December 31, 2019. The Regional Director expects XXXXXXXX to achieve the real estate loan concentration reduction and NEV limits specified in your request for reconsideration, and follow section 3.4.3 of your ALM policy for corrective action on any breached limit.

XXXXXXX contends the response is ambiguous and seeks a clear and predictable procedure whereby the credit union can demonstrate its ability to achieve the real estate loan concentration reduction and NEV limits specified in the Plan. The SRC agrees that the approval of the lesser amount for 2019 will allow XXXXXXXX to demonstrate an ability to reduce the concentration limits and abide by policy. In seeking an additional \$XX million in secondary capital, the SRC expects XXXXXXXX to follow the procedures outlined in 12 CFR §701.34. Further, XXXXXXXX must adhere to the Third SC Plan by not making unsecured secondary capital loans to other credit unions.

2. The Reconsideration Decision imposed a condition that XXXXXX reduce its real estate concentration by the end of 2019 to the level that the Third SC Plan proposed. XXXXXX contends that because the Third SC Plan was premised on XXXXXX having authority to accept \$XX million of secondary capital accounts during 2019, and the reconsideration decision reduced the approval to \$XX million, the 2019 real estate concentration standard should be adjusted accordingly. The SRC agrees with the Regional Director that establishing, monitoring, and adhering to board approved limits is an important internal control practice necessary to mitigate risk. To address safety and soundness concerns, it is necessary for the credit union to adhere to hard limits. The SRC agrees that XXXXXX's board of directors should be able to logically modify the 2019 real estate concentration limit based upon their authority to accept \$XX million rather than \$XX million. XXXXXX should seek mutual agreement from the Region on the reduced limits for 2019.
3. The Reconsideration Decision requires that XXXXXX may not change its ALM model assumptions without prior approval of the Director. XXXXXX contends this condition unduly restricts XXXXXX's ability to respond promptly as market conditions and other circumstances change. The Region required a higher level oversight and monitoring based on prior exam history with real estate loan concentrations and the credit union exceeding policy limits. Risk management and consistency is required to assess the credit union's compliance with risk tolerances and contingency plans. If assumptions are changed from period to period without reasonable cause, comparison between periods will not be meaningful. There is a difference between a refinement to improve the underlying quality of an assumption versus changing the source, index or methodology for key assumptions. For example, changing non-maturity share assumptions should be rare and reviewed by NCUA for reasonableness. The SRC agrees that refinements to policy are expected in the normal course of business. In modifying ALM assumptions that have a material impact and involve changing the source, index, or methodology for key assumptions, the SRC expects XXXXXX to notify the Regional Director in writing within 30 days of approving such modifications. As usual, the Region retains the right to assess risk on an ongoing basis and require corrective action for unacceptable risks.

XXXXXXX may reapply for approval to accept additional secondary capital provided that XXXXXX achieves the real estate loan concentration reduction and NEV limits specified in their request for reconsideration, and follow section 3.4.3 of their ALM policy for corrective action on any breached limit. In reapplying for additional secondary capital, XXXXXX should follow the procedures outlined in 12 CFR §701.34. XXXXXX may adjust the real estate concentration limit to be achieved in 2019, based upon their authority to accept \$XX million rather than \$XX million in 2019. XXXXXX should seek mutual agreement from the Region on the modified 2019 real estate loan concentration limit. Finally, if XXXXXX modifies ALM assumptions that have a material impact and involve changing the source, index, or methodology for key assumptions, the SRC expects XXXXXX to notify the Regional Director in writing within 30 days of approving such modifications.

XX. XXXXXX XXXXXXXX

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Pursuant to NCUA's regulations, 12 CFR §746.109, you may appeal this decision to the NCUA Board within 30 calendar days of receiving this letter.¹ Such appeals must follow the requirements established in the regulation, and must be filed in writing with the Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428. Please refer to the regulation for additional guidance.

Sincerely,

Anthony N. Cappetta, Chairman
NCUA Supervisory Review Committee

cc: NCUA Board Secretary Gerard Poliquin
SRC Member Timothy O'Quinn
SRC Member Debra Tobin
Regional Director XXXXX XXXXXX
Senior Staff Attorney Justin Anderson

¹ Alternatively, to the extent you intend to reapply instead of appealing this decision to the NCUA Board, the SRC recommends you address the deficiencies discussed in this letter and submit a new secondary capital plan to your Region. The committee also encourages ongoing dialogue with the Region to identify the necessary aspects of supporting due diligence most relevant to the underlying safety and soundness issues that were the basis for previous resubmissions.