GAO Report Reveals the NCUA's Inability to Accurately Assess the Full Extent of the Corporate Credit Union Crisis

Overview

On January 4, 2012, the Government Accountability Office (the "GAO") issued a report entitled "Earlier Actions Are Needed to Better Address Troubled Credit Unions" (the "Report"). The Report focused on the credit union industry during the financial crisis of 2008 through 2011 and evaluated the National Credit Union Administration's ("NCUA") efforts to mitigate and prevent failing corporate credit unions and natural person credit unions through the Prompt Corrective Action ("PCA") framework and other enforcement tools. The completion of the Report coincided with the preparation of the 2010 audit of the Temporary Corporate Credit Union Stabilization Fund ("TCCUSF").

Deficiencies Noted by the GAO

The Report contained a number of concerns that should be important to credit unions when analyzing their exposure to future TCCUSF assessments:

- During its examination, the GAO requested documentation that would support the NCUA's loss estimates due to the corporate failures; however, the **"NCUA was not able to provide the documentation."**
- Without well-documented information, **"it is not possible to determine the full extent of the losses resulting from the corporate credit union failures."**
- Without well-documented information, the NCUA faces questions about its **"ability to effectively estimate the total costs of the failures."**
- Without well-documented information, the NCUA faces questions about its determination whether credit unions **"will be able to pay for these losses."**

Since 2009, the NCUA has assessed credit unions approximately $5 billion ($1.7 billion for the NCUSIF and $3.3 billion for the TCCUSF). The entire credit union industry is in agreement that there are many more assessments still to come. If the credit union system is unable to repay the United States Treasury through future assessments, the American taxpayers will have to absorb the cost. The political repercussions of such an event could trigger results that would no doubt be very unfavorable to the credit union industry. The dramatic findings by the GAO Report have caused a number of prominent commentators from the credit union industry to publicly question the ability of the NCUA to have a firm grip on what the ultimate cost will be for all credit unions.

In order to mitigate the losses to the industry, the NCUA has initiated litigation against various investment banking firms that sold certain investment securities to the corporate credit unions. Even if these lawsuits are somewhat successful, the recoveries are estimated to be small in comparison to the overall exposure to the industry. Furthermore, at least one trial court has issued a tentative ruling that the

NCUA's lawsuit should be dismissed due to the statute of limitations, which brings into question the viability of future litigation.

GAO Recommendations

Due to (i) the NCUA's inability to provide the GAO with adequate documentation in support of the NCUA loss estimates and (ii) the identified shortcomings in the PCA framework, the GAO Report contained the following two recommendations:

- That the NCUA should provide "verifiable" documentation as soon as possible relative to the loss estimates.

- That in order to improve the effectiveness of the PCA framework, the NCUA should consider implementing additional triggers that would require early and forceful regulatory action and, if necessary, that the NCUA make recommendations to the Congress for appropriate legislative action.

Protecting Capital from Future Assessments

The NCUA's inability to provide adequate and verifiable support for corporate credit union failure cost estimates leaves all credit unions exposed to future threats to their members' equity and severely hampers strategic planning efforts. Consistent with a Board's fiduciary duty to protect the credit union and the equity owned by its members, many credit unions, including a number of credit unions working with our law firm, are proactively conducting extensive due diligence regarding their exposure to future TCCUSF assessments. These credit unions are considering their strategic alternatives while they are still in a position to control their own individual corporate identity and destiny. The certainty of future assessments coupled with economic and regulatory forces that negatively affect sources of income and growth may eliminate strategic options that a credit union may otherwise have had while in a stronger financial posture.

Future assessments are a complete certainty. The amount of such future assessments, however, is a complete unknown. Our attorneys are assisting credit unions in making an informed decision as to whether the institution can best serve the interests of their members and protect their members' equity by remaining a credit union, merging with another financial institution (credit union or bank) or converting to an independent mutual savings bank. As a law firm that is experienced in representing both credit unions and mutual savings banks, we can provide effective counsel as to the strategic alternatives that can best serve the institution and the interests of its members.

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We are available at your convenience to discuss these and other important issues facing credit unions. Please feel free to contact any of the attorneys listed below if you have questions or would like further information.

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