NATIONAL CREDIT UNION ADMINISTRATION

OFFICE OF INSPECTOR GENERAL

REVIEW OF NCUA'S DOCUMENT OF RESOLUTION FOLLOW-UP PROCESS

Report #OIG-11-11

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EXECUTIVE SUMMARY

The National Credit Union Administration (NCUA) Office of Inspector General (OIG) conducted a self-initiated audit of NCUA's Document of Resolution (DOR) follow-up process. Our objectives for this review were to determine (1) the process for resolution/closure of DORs; and (2) the effectiveness of the current resolution process. To accomplish these objectives, we analyzed unresolved (open) and resolved (closed) DOR items[1] as reported in NCUA's DOR Report database as of December 31, 2010. We also (1) judgmentally sampled from each of NCUA's five regional offices ten credit unions with unresolved DOR items;[2] (2) reviewed credit unions which NCUA closed from 2008 through 2010, and that had outstanding DOR items at the time of closure; (3) interviewed NCUA management and regional staff; and (4) reviewed NCUA national and regional guidance, policies and procedures.

We determined that neither NCUA's Office of Examination nor Insurance (E&I) nor the five regional offices effectively monitored or followed up on unresolved DOR items. Specifically, we found that E&I performed limited DOR monitoring and that monitoring in each region varied based on their individual policy. Accordingly, NCUA is establishing a uniform credit union supervision process for all regions. The National Supervision Policy Manual (NSPM)[3] will replace the individual regional supervision manuals and policies and will help improve the overall DOR follow-up process. However, under this new policy it would be optional for examiners to require a written response to all DOR items in CAMEL 2 credit unions[4] with unresolved DORs. Conversely, during recent OIG material loss reviews (MLRs), we identified five credit unions that historically received composite CAMEL 1 or 2 ratings but had repeat DOR items that examiners did not properly follow up on through stronger supervisory actions, which we believe helped contribute to the credit unions failure. In addition, after receiving a draft of this report, E&I management amended the draft NSPM and will require a written response to the examiner for all DOR items not completed within the prescribed timeframe, regardless of the credit union's composite CAMEL rating.

We found that of the 74 credit unions closed and/or merged from 2008 through 2010, 45 percent had been regularly rated a composite CAMEL 1 or 2. The problems were so insurmountable that 18 of these credit unions closed or merged about a year after the initial downgrade. We also found that for 14 of these credit unions examiners noted a total of 55 unresolved DOR items during the last examinations where the credit union received a composite CAMEL 1 or 2 rating. We believe NCUA examiners considered these credit unions a low risk and therefore did not aggressively pursue timely

[1] For purposes of this report, the OIG considers unresolved DOR items as issues or problems repeated over several examination contacts and/or not completed within the prescribed timeframe.
[2] We sampled 50 credit unions with unresolved DORs.
[3] As of the date of this report, the NSPM is draft form.
[4] The acronym CAMEL is derived from the following components: [C]apital Adequacy, [A]sset Quality, [M]anagement, [E]arnings, and [L]iquidity/Asset/Liability Management. The CAMEL ratings disclosed in this report refer to the overall CAMEL composite rating examiners assign a credit union and not the individual component ratings.

resolutions for the unresolved DOR items. Consequently, NCUA missed opportunities to mitigate losses to the National Credit Union Share Insurance Fund (NCUSIF).

Furthermore, we determined that as of December 31, 2010, NCUA had over 26,000 unresolved DOR items. These DORs encompassed 63 percent of all federally insured credit unions, of which 23 percent had unresolved DOR items related to management issues which were cited as a cause of credit union failures in every OIG MLR issued to date. We also determined that as of December 31, 2010, examiners reduced identified areas of unacceptable risk by resolving over 106,000 DOR items.[5] Moreover, examiners resolved over 91,000 (86 percent) of these DORs in two years or less.

In the November 2010, *OIG Capping Report on Material Loss Reviews* ("Capping Report"),[6] we stated that had examiners acted more aggressively in their supervision actions, the looming safety and soundness concerns could have been identified sooner and the eventual losses to the NCUSIF could have been stopped or mitigated. We reported in the Capping Report and determined again during this review that examiners did not take timely corrective actions on DOR items or elevate the supervisory response.

Given the results of our review, viewed in tandem with the findings set forth in our Capping Report, we believe opportunities continue to exist for improvement of the DOR monitoring and follow-up processes.

To ensure future DORs are properly monitored and addressed in a timely manner, we recommend that NCUA management:

1. Develop a standardized DOR monitoring process requiring E&I and the regions to generate and analyze DOR database reports on a regularly defined basis including, but not limited to the DOR Aging Months of Unresolved Report.

2. Require written responses from credit union management, regardless of the composite CAMEL rating, for all DOR items not resolved within the established timeframes.

3. Ensure regional staff takes stronger supervisory actions when a credit union fails to correct DOR items.

We also suggest NCUA management consider establishing specific time limits for examiners to resolve and close DOR items to help ensure DORs do not remain open indefinitely.

NCUA management agreed with our findings and recommendations, and has already or is in the process of taking corrective action. Specifically, in conjunction with the additional guidance incorporated into the current draft of the National Supervision Policy

[5] Examiners resolved these DOR items from 2005 through 2010.
[6] http://www.ncua.gov/Resources/OIG/Files/Reports/2010/OIG-10-20OIGCappingReportMLRs_11.23.10.pdf

Manual (NSPM), management stated that NCUA's Office of Examination and Insurance and Office of the Chief Information Officer will work together to improve the DOR reports, thereby strengthening the regions ongoing monitoring and reporting of DOR items. As previously stated, management revised the draft NSPM and plans to require written responses for all DORs not completed within the prescribed timeframe, regardless of the credit union's composite CAMEL rating. Moreover, management plans to provide training on the proper use of the DOR during NCUA's 2012 National Conference. In addition, management stated the current draft of the NSPM requires more stringent administrative actions when credit unions do not resolve the DORs with the agreed timeframe, and when administrative action is not taken, the examiner must document the reason for not taking more stringent action. Furthermore, management stated they would continue to stress the importance of taking stronger supervisory actions as needed to ensure the safety of the National Credit Union Share Insurance Fund. Finally, management plans to implement the NSPM following the 2012 National Conference.

In regards to our suggestion, NCUA management does not believe it is feasible to establish specific time limits for examiners to resolve and close DOR items given the innumerable circumstances examiners must consider when determining the appropriate needed action. The OIG defers to management‘s decision to continue to allow examiners to exercise judgment when determining the most effective corrective action for issues identified during the examination. However, we believe management should continue to look for ways to reduce the time to close DORs during any future reviews or changes to the program. We have included management‘s comments in their entirety in Appendix A.

We appreciate the courtesies and cooperation NCUA management and staff provided to us during this review.

BACKGROUND

Document of Resolution

Examiners use the Document of Resolution (DOR) to outline plans and agreements reached with credit union officials to reduce identified areas of unacceptable risk. The DOR identifies persons responsible and timeframes for correction.[7] A DOR may contain one or more DOR action items, which (1) is the corrective action credit union management needs to perform and (2) address the examiner's concerns related to a specific risk area and risk factor. According to E&I management, for some of the unresolved DOR items, the specific corrective action may change over examinations depending on changing circumstances and/or the improvements credit union management made to address the original DOR issues. Furthermore, E&I management indicated that although the original corrective action may not be the same, the DOR item retains the original date the examiner identified the problem to maintain a history of recurring problems related to the same risk area and risk factor.

Conversely, recent NCUA Office of Inspector General (OIG) material loss reviews (MLRs) indicated that credit unions had not timely addressed requirements NCUA examiners set forth in DORs to correct significant deficiencies. For example, in five of ten MLRs[8] conducted by the OIG, we found instances where the same DOR issues were repeated over several examination contacts at the same credit union. We also observed during our MLR work that unaddressed DOR requirements were relevant to the issue(s) that led to the failure of credit unions. For instance, we determined that Ensign Federal Credit Union failed because its Board of Directors and management did not implement appropriate risk management practices related to concentration risk, a repeated DOR item. In addition, examiners issued repeated DORs related to High Desert Federal Credit Union's construction loan portfolio. A high concentration of real estate construction loans coupled with the dramatic decline in nationwide real estate values caused by the credit crisis contributed to High Desert's failure.

Document of Resolution Reports Database[9]

The DOR database[10] provides a means to monitor resolution items identified during credit union examinations and allows for the extraction of a summary report and five detail reports. The DOR reports gather data from NCUA's Automated Integrated Regulatory Examination Software (AIRES) examination uploads to identify outstanding problems and monitor the resolution process. The reports are updated daily with data from the most recent AIRES report uploads and changes to other data sources may also result in updated fields in the DOR reports. The reports monitor outstanding

[7] NCUA Examiner's Guide, Chapter 20, page 20-4.
[8] The ten credit unions were Ensign, High Desert, Center Valley, New London and St. Paul Federal Credit Unions, and Beehive, Cal State 9, Clearstar Financial, Eastern Financial Florida and Norlarco Credit Unions. These credit unions closed from 2008 through 2010 and resulted in MLRs.
[9] Source: *NCUA Central Report Service Users Guide Accessing Online Reports,* Office of Examination and Insurance dated March 24, 2010, pgs 17-22 and Appendix C.
[10] NCUA established the DOR database and the corresponding reports in 2008.

resolution items for each NCUA regional office, and within each region, for each Supervisory examiner (SE) group, district, or state and on a national level. The benefits of the DOR reports include allowing for quality control of problem resolution and gathering data to identify concentrations of risk for workload, resource, and dollar budgeting.

Specifically, NCUA staff can use the:

- Summary of DOR Items Report to focus attention upon those credit unions with the greatest number of unresolved problems and to help prioritize supervision plans. This report lists each risk area and specific risk factors for all unresolved DOR items.

- DOR Aging Months of Unresolved Report to identify outstanding plans for corrective action and to identify DORs in specific risk areas or factors. This report displays unresolved risk areas, risk factors, and plans for corrective action as well as the number of months since the corrective action was first identified.

- DOR Items with Plans for Corrective Action Report to filter and prioritize areas of concern. This report displays either resolved or unresolved DOR items and provides detailed plans for corrective action for each DOR item. The report allows the user to select a specific risk area or risk factor.

- DOR Resolved Number of Months Report to review the credit union's problem resolution history to determine management's competency and the probability that similar problems may arise in the future.

- DOR by Date Range Report to determine what issues have arisen during a certain time period. This report displays either resolved or unresolved DORs permitting the user to see only those problem areas identified within a user-specified time period.

- Projected Number of Months to Resolve Report to identify credit unions where problem resolution is expected to take a significant length of time. Examiners can schedule follow-up contacts or phone calls based on the DOR due dates.

NCUA Examination Process

NCUA uses a total analysis process that includes: collecting, reviewing, and interpreting data; reaching conclusions; making recommendations; and developing action plans. The objectives of the total analysis process include evaluating CAMEL components, and reviewing qualitative and quantitative measures.

NCUA uses the CAMEL Rating System in examining credit unions to provide an accurate and consistent assessment of a credit union's financial condition and operations. The CAMEL rating includes consideration of key ratios, supporting ratios, and trends. Generally, the examiner uses the key ratios to evaluate and appraise the credit union's overall financial condition. During an examination, examiners assign a CAMEL rating, which completes the examination process.

Examiner judgment affects the overall analytical process. An examiner's review of data includes structural analysis,[11] trend analysis,[12] reasonableness analysis,[13] variable data analysis,[14] and qualitative data analysis.[15] Numerous ratios measuring a variety of credit union functions provide the basis for analysis. Examiners must understand these ratios both individually and as a group because some individual ratios may not provide an accurate picture without a review of the related trends.

Financial indicators such as adverse trends, unusual growth patterns, or concentration activities can serve as triggers of changing risk and possible causes for future problems. NCUA also instructs examiners to look behind the numbers to determine the significance of the supporting ratios and trends. Furthermore, NCUA requires examiners to determine whether material negative trends exist; ascertain the action needed to reverse unfavorable trends; and formulate, with credit union management, recommendations and plans to ensure implementation of these actions.

According to NCUA training guidance, the greater the credit union's problems, usually reflected by CAMEL codes, the more extensive, detailed, and specific the DOR will be. Similarly, the less sophisticated the management team, the more detailed the DOR will be. Examiners tailor the DOR to the credit union's types of weaknesses and the competence of the management team.

OBJECTIVE, SCOPE AND METHODOLOGY

The objectives of this audit were to determine (1) the process for resolution/closure of DORs; and (2) the effectiveness of the current resolution process. To accomplish our objectives, we (1) analyzed unresolved (open) and resolved (closed) DOR items[16] contained in NCUA's DOR Report database as of December 31, 2010, and (2) judgmentally sampled from each of NCUA's five regional offices ten credit unions with unresolved DOR items. For the unresolved DOR items, we eliminated DORs with completion dates later than December 31, 2010.[17] Our scope included credit unions

[11] Structural analysis includes the review of the component parts of a financial statement in relation to the complete financial statement.
[12] Trend analysis involves comparing the component parts of a structural ratio to itself over several periods.
[13] As needed, the examiner performs reasonableness tests to ensure the accuracy of financial performance ratios.
[14] Examiners can often analyze an examination area in many different ways. NCUA's total analysis process enables examiners to look beyond the "static" balance sheet figures to assess the financial condition, quality of service, and risk potential.
[15] Qualitative data includes information and conditions that are not measurable in dollars and cents, percentages, numbers, etc., which have an important bearing on the credit union's current condition, and its future. Qualitative data analysis may include assessing lending policies and practices, internal controls, attitude and ability of the officials, risk measurement tools, risk management, and economic conditions.
[16] We queried unresolved and resolved DOR items from active credit unions.
[17] We pulled the unresolved DOR reports after December 31, 2010, and captured DOR items not resolved by the assigned completion date. Unresolved DOR items include DOR issues repeated or recurring over several examination contacts and/or not completed by the assigned due date.

closed from 2008 through 2010 with outstanding DOR items at the time of closure. Further, we reviewed and analyzed NCUA examination and supervision work papers, examination reports, and related correspondence for the selected credit unions. Finally, we reviewed NCUA national and regional guidance, policies and procedures, and interviewed NCUA management and regional staff.

We used computer-processed data from NCUA's AIRES and Credit Union Online systems. We did not the test controls over these systems. However, we relied on our analysis of information from management reports, correspondence files, and interviews to corroborate data obtained from these systems to support our audit conclusions.

We conducted this performance audit from February 2011 through September 2011 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management officials and incorporated their suggested changes where appropriate.

PRIOR AUDIT COVERAGE

We identified one NCUA OIG audit conducted within the past 5 years related to the subject of this audit.

OIG Capping Report on Material Loss Reviews, Report Number OIG-10-20, dated November 23, 2010 ("Capping Report").[18]

In this report, the NCUA OIG identified several shortcomings related to NCUA and State Supervisory Authority (SSA) supervision efforts, including examiner deficiencies in quality control efforts and examination procedures. Specifically, the OIG stated that had examiners acted more aggressively in their supervision actions, the looming safety and soundness concerns could have been identified sooner and the eventual losses to the NCUSIF could have been stopped or mitigated. The OIG recommended that NCUA management determine whether credit unions with repeat DORs have taken appropriate corrective action. In the event that corrective action had not been taken, the OIG recommended that examiners should be instructed to elevate the supervisory response, including the taking of enforcement action when necessary. NCUA management agreed with the recommendation, indicating the identification of repeat DOR items and appropriate examiner response was already part of the regional quality control review process and would continue to be emphasized in the new national supervision manual. Management also indicated they were currently evaluating other methods to better capture repeat DOR items.

[18] http://www.ncua.gov/Resources/OIG/Files/Reports/2010/OIG-10-20OIGCappingReportMLRs_11.23.10.pdf

We also identified two additional reviews NCUA OIG completed within the past 5 years related to the subject of this audit:

NCUA's Risk-Focused Examinations Tracking Identified Documents of Resolution (DOR) Survey Report, Report Number OIG-07-06, dated July 10, 2007.[19]

NCUA's Risk-Focused Examination Process for Federal Credit Unions, Report Number OIG-06-08, dated October 16, 2006.[20]

[19] http://www.ncua.gov/Resources/OIG/Files/Reports/2007/OIG-07-06TrackingDORsSurveyReport.pdf
[20] http://www.ncua.gov/Resources/OIG/Files/Reports/2006/OIG0608.pdf

RESULTS IN DETAIL

We determined NCUA's DOR follow-up process needs improvement. Specifically, we determined that neither NCUA's Office of Examination & Insurance (E&I) nor the five regional offices effectively monitored or followed up on unresolved DOR items. In addition, we determined that E&I staff performed limited DOR monitoring and that monitoring at each regional office varied based on their individual policy. We also learned NCUA is establishing a uniform credit union supervision process for all regions. The National Supervision Policy Manual (NSPM) will replace the individual regional supervision manuals and policies and help improve the overall DOR follow-up process. However, under this new policy for composite CAMEL 2 credit unions with unresolved DOR items, it would be optional for examiners to require that management provide a written response to all DOR items. Conversely, during OIG MLRs we found that five of ten credit unions were both routinely rated composite CAMEL 1 or 2 and had repeat DOR items that were not properly followed up on by examiners through stronger supervisory actions. The result of the non-action related to these repeat issues helped contribute to the credit unions failure. After we provided NCUA management with a draft of this report, E&I management amended the draft NSPM and plans to require written responses for all DORs not completed within the prescribed timeframe, regardless of the credit union's composite CAMEL rating.

Additionally, we found that of the 74 credit unions closed and/or merged from 2008 through 2010, 45 percent historically received composite CAMEL 1 or 2 ratings. The problems were so insurmountable that 18 of these credit unions closed or merged approximately one year after the initial downgrade. We also found that for 14 of these credit unions, examiners noted a total of 55 unresolved DOR items during the last examinations where the credit union regularly received a composite CAMEL 1 or 2 rating. We believe NCUA missed opportunities to mitigate losses to the NCUSIF.

As of December 31, 2010, NCUA had over 26,000 unresolved DOR items. These DOR items encompassed 63 percent of all federally insured credit unions, of which 23 percent had unresolved DOR items related to management issues which were cited as a cause of credit union failures in OIG MLRs. Regional management stated that actions to resolve outstanding DORs included downgrading a credit union's CAMEL rating and taking stronger supervisory actions; however, we determined examiners did not take timely corrective actions such as downgrading a credit union's CAMEL rating or taking stronger supervisory actions. Conversely, we further determined that as of December 31, 2010, the DOR database showed that examiners had resolved over 106,000 DOR items; thereby reducing identified areas of unacceptable risk. The average time to resolve these DOR items was 13 months.

Given the results of our review, viewed in tandem with the findings set forth in our Capping Report, we believe opportunities continue to exist for improvement of the DOR monitoring and follow-up processes.

A. Document of Resolution Monitoring and Follow-up

NCUA's DOR Monitoring and Follow-up Processes Need Improvement

We determined NCUA's DOR monitoring and follow-up processes need improvement. Specifically, we determined that during 2010, E&I staff performed limited DOR monitoring through a newly implemented national quality control review (QCR) process. In addition, E&I management stated that the regions were responsible for ensuring unresolved DOR items were addressed. We found that DOR monitoring and follow-up varied among the regions, with each region office relying on the examiners and/or their supervisors to ensure unresolved DORs were properly addressed. As a result, there is no consistency in the agency with how to monitor, follow up on or resolve open DOR items. This has the potential to lead to additional failures for credit unions that do not act on critical recommendations related to the safety and soundness of the credit unions.

DOR Monitoring

In addition to the regional QCRs, E&I management implemented a new national examination and supervision QCR process in June 2009. The new QCR process also superseded E&I's previous national QCR process. Under this new process, E&I staff periodically sample examination and supervision reports from each region and review the most recent examination report, the administrative record, and the risk profile of each selected credit union. In addition, the reviewer determines (1) the frequency of repeat DOR items, (2) if effective and timely resolution has occurred, and (3) whether a weakness existed in the construction of the DOR such as lack of measureable results, inappropriate completion time frames, etc. E&I staff began this new QCR process in May 2010 and performed 100 QCRs during 2010. E&I staff based the sample on emerging trends, identified concentrations, credit risk, risk to net worth, and lessons learned from OIG MLRs.

The E&I's QCR process focused on eight assessment areas to determine whether examiners:

1. Addressed negative trends and included effective recommendations to resolve significant problems within acceptable timeframes.

2. Completed the exam utilizing the proper use of AIRES and the DOR module and included plans for timely resolution of DOR items.

3. Reviewed new programs, services, and/or significant concentrations.

4. Documented supervision plans consistent with the risk profile, Financial Performance Report (FPR), and risk report data.

5. Used appropriate administrative action commensurate with the risk profile and CAMEL code.

In addition, the E&I QCR process ensures examination reports:

6. Identify a weakness where one or more CAMEL component ratings should have been rated differently or were inconsistent with related risk ratings.

7. Identify a weakness where national examination expectations and standards were not adequately met including DOR development and follow-up, administrative record documentation, and scoping development or documentation weaknesses.

8. Identify a weakness where one or more risk ratings should have been rated differently including reconciling with CAMEL or risk areas not identified, discussed or factored into the rating.

While E&I's preliminary results showed that overall 82 percent of the reviewed areas satisfied national expectations and reflected positively on NCUA's examination and supervision program, E&I management identified areas for improvement within the program. Specifically, E&I management determined that 25 percent of the reports reviewed contained a weakness where examiners did not adequately meet national examination expectations and standards. This included DOR development and follow-up, administrative record documentation, and scoping development or documentation. Although E&I management indicated that the vast majority of its findings did not identify a systemic weakness, officials stated that the results of the QCR process reflected the need to continue to improve national guidance and expectations.

We determined that the process for DOR monitoring and follow-up was not consistent among the regional offices. Specifically, we found that two of the five regional offices used monthly reports to monitor unresolved DOR items. In one of these regional offices, a monthly management report highlighted outstanding DOR items for record keeping issues. In another regional office, regional officials provided Supervisory Examiners with a monthly report detailing the outstanding DOR items with instructions to have their staff review all outstanding problem areas and note whether examiners corrected the issues or the issues were no longer applicable. According to regional management, this was completed in 2010 and again during the first quarter of 2011. In addition, two other regional offices used the Division of Supervision (DOS) QCR process and/or the annual Supervisory Examiner evaluations of selected examinations to review unresolved DOR items. Since both of these processes involve only a sampling of examinations, neither one captures all of the unresolved DOR items. Finally, the remaining Region depended on the examiners to conduct the overall tracking and monitoring of unresolved DOR items.

DOR Follow-up

According to E&I management, each regional office is responsible for ensuring unresolved issues are addressed. However, we found DOR follow-up was not consistent among the regions. We determine DOR follow-up methods at each of the five regional offices included:

- The Region I DOS director reminding Supervisory Examiners, during a 2010 presentation, of the need to regularly review reports in the DOR database to ascertain the level of problem resolution.

- Region II tracking and requiring follow up on credit unions with a composite CAMEL code 3, 4, and 5 rating, and credit unions with administrative actions such as Preliminary Warning Letters and Letters of Understanding and Agreement.

- Region III relying on the examiners and Supervisory Examiners to take proper follow-up actions.

- Region IV using DOS QCRs and/or the Supervisory Examiner evaluations to identify unresolved DOR items requiring further administrative action.

- Region V advising staff through DOS QCRs and/or the Supervisory Examiner evaluations to follow up on repeat DOR items and implement increasingly more stringent administrative remedies.

According to the NCUA Examiner's Guide,[21] when credit union management does not agree with the DOR, offer alternate plans or fails to meet the timeframe, the examiner should discuss the course of action with the supervisory examiner following regional policy. The examiner may consider drafting a Regional Director Letter[22] urging credit union officials to formulate an acceptable plan that recognizes and resolves the problems. However, when the overall risk to the credit union so warrants, the examiner and supervisory examiner may find it necessary to recommend taking administrative action,[23] again following regional policy.[24]

Additionally, we found the NCUA Examiner's Guide and current regional manuals and guidelines only require follow-up on credit unions rated composite CAMEL 3, 4, or 5. However, we learned that the NSPM, currently in draft form, will eventually supplant the

[21] NCUA Examiner's Guide, Chapter 20, page 20-5.
[22] Regions attempt to correct noted problems by sending Regional Director Letters to the credit union in question. In severe cases, the letters indicate that unless the credit union takes corrective action or makes reasonable progress, NCUA may pursue administrative action.
[23] Administrative actions represent the strongest supervisory tool available to NCUA. The actions generally used to correct problems and to ensure the continued existence of credit unions include: Cease and Desist; Civil Money Penalties; Removal of Officials; Prohibition; Conservatorship; Termination of Share Insurance (limited to federally insured state-chartered credit unions); Liquidation; and revocation of Charter.
[24] NCUA Examiner's Guide, Chapter 20, pages 20-4 & 20-5.

individual regional manuals and guidelines. We believe this policy will also help improve the DOR follow-up process and establish a uniform credit union supervision process for all regions. While the NSPM states that for composite CAMEL 2 credit unions with ongoing unresolved DORs field staff should consider whether the CAMEL rating is correct. If the credit union does warrant a composite CAMEL 2 rating, it would nevertheless be optional for examiners to require management at these credit unions to submit written responses.[25] The NSPM states written responses will be required for credit unions rated a composite CAMEL 3, 4, or 5 for all DORs issued. It should be noted that after we provided NCUA E&I management with a draft of this report, they amended the draft NSPM and plan to require written responses for DORs not resolved within the established timeframe from credit union management regardless of the composite CAMEL rating.

Credit Union Closures and CAMEL Ratings

We determined that from 2008 through 2010, 74 credit union closures and/or mergers resulted in approximately $649 million in losses to the NCUSIF.[26] Of these, 33 or 45 percent historically received a composite CAMEL 1 or 2 rating and resulted in $559 million in losses to the NCUSIF. All but one of these credit unions closed or merged within two years of being downgraded to a composite CAMEL 3, 4, or 5 rating.[27] Additionally, the problems were so insurmountable that 18 of the 33 credit unions closed or merged approximately one year after the initial composite CAMEL downgrade. Furthermore, in 14 of the 33 closed credit unions, examiners noted a total of 55 unresolved DOR items during the last examinations where the credit union received a composite CAMEL 1 or 2 rating. The composite CAMEL 1 or 2 rating were assigned immediately prior to the examination where the CAMEL ratings were lowered. Moreover, examiners regularly rated eight of the ten credit unions,[28] which were the subject of recent OIG MLRs, composite CAMEL 1 or 2 prior to the credit union failure.

We believe that since these credit unions were rated a composite CAMEL 1 or 2, NCUA examiners considered them a low risk and therefore did not aggressively pursue timely resolutions for the unresolved DOR items. In addition, for composite CAMEL 1 and 2 credit unions with unresolved DORs, NCUA policy did not require credit union management provide written responses for the DORs not completed within the assigned timeframe. Consequently, the examiners missed opportunities to mitigate losses to the NCUSIF.

[25] Draft NSPM Chapter 1, section 6A.
[26] Two of the 74 credit union closures resulted in a gain to the NCUSIF.
[27] Some credit unions were downgraded to composite CAMEL 3 then 4 then 5 and some went straight from CAMEL 1 or 2 to 4 or 5. The one exception went from a composite CAMEL 2 to merger.
[28] Ensign, High Desert, Center Valley, New London and St. Paul Federal Credit Unions and Beehive, Cal State 9, Clearstar Financial Credit Unions were regularly rated composite CAMEL 1 or 2 prior to the failures. Eastern Financial Florida Credit Union and Norlarco Credit Union completed the list of ten credit unions closed from 2008 through 2010 that resulted in MLRs.

Recommendations

We recommend NCUA management:

1. Develop a standardized DOR monitoring process requiring E&I and the regions to generate and analyze DOR database reports on a regularly defined basis including, but not limited to the DOR Aging Months of Unresolved Report.

2. Require written responses from credit union management, regardless of the composite CAMEL rating, for all DOR items not resolved within the established timeframes.

Management Response

Management agreed with the recommendations and has taken corrective action. Specifically, NCUA incorporated additional guidance into the current draft of the National Supervision Policy Manual (NSPM), which will replace regional policies with consolidated national guidance. In addition to the actions already taken, management plans to take the following corrective action. For recommendation 1, management stated that E&I and NCUA's Office of the Chief Information Officer will work together to improve the DOR reports thereby strengthening the regions ongoing monitoring and reporting of DOR items. In addition, management plans to provide training on the proper use of the DOR during NCUA's 2012 National Conference. For Recommendation 2, management revised the draft NSPM and plans to require written responses for all DORs not completed within the prescribed timeframe, regardless of the credit union's composite CAMEL rating. Furthermore, management expects to implement the NSPM after the 2012 National Conference.

OIG Response

We concur with the actions taken to date and the actions planned by management.

B. Document of Resolution Sampling Results

NCUA's Unresolved DOR Process Needs Improvement

We determined that as of December 31, 2010, NCUA had over 26,000 unresolved DOR items at 63 percent of all federally insured credit unions (FICUs). Fifty-seven percent of these credit unions received composite CAMEL 2 ratings. We also determined that 23 percent of the credit unions with unresolved DORs had unresolved DOR items related to management, which was one of the causes cited in the OIG's Capping Report as leading to recent credit union failures. We further determined that examiners did not take timely corrective actions such as downgrading a credit union' s composite CAMEL rating or taking stronger supervisory actions even though regional management stated that actions to resolve outstanding DORs included downgrading a credit union's CAMEL rating and taking stronger supervisory actions. Finally, we also determined that as of December 31, 2010, the DOR database showed that examiners had resolved over 106,000 DOR items.

Unresolved DOR Results

As of December 31, 2010, we determined NCUA had over 26,000 unresolved DOR items at 4,653 of the 7,339 FICUs. Therefore approximately 63 percent of the credit unions had unresolved DOR items. Of this 63 percent, over half (57 percent) of these credit unions received composite CAMEL 2 ratings during their last examination. See Table 1 (below) for the number of credit unions with unresolved DOR items by composite CAMEL rating:

COMPOSITE CAMEL	Region					Total	Percentage of DOR Items by CAMEL
	1	2	3	4	5		
1	41	42	52	77	19	231	4.96%
2	575	539	612	688	239	2,653	57.02%
3	266	363	280	391	172	1,472	31.64%
4	49	62	54	68	45	278	5.97%
5	1	6	2	4	6	19	0.41%
Total	932	1,012	1,000	1,228	481	4,653	100%

Table 1

While Table 1 shows over half of the unresolved DOR items were at credit unions with composite CAMEL 2 ratings, it should be noted that NCUA examiners rated over fifty percent of the credit unions as composite CAMEL 2. This is significant because, as previously stated in this report, we believe examiners considered composite CAMEL 2 credit unions a lower risk and did not aggressively pursue timely resolutions for unresolved DOR items. Furthermore, NCUA Examiner's Guide and the current regional manuals and guidelines only require follow-up on credit unions rated composite CAMEL 3, 4, or 5. Additionally, since over 57 percent of the unresolved DOR items were at credit unions with a composite CAMEL 2 rating, we believe opportunities exist to mitigate losses to the NCUSIF.

Table 2 (below) shows the number of FICUs by composite CAMEL rating:

COMPOSITE CAMEL	Number of FICUs	Percentage of Total FICU
1	1,079	14.62%
2	4,141	56.11%
3	1,793	24.30%
4	349	4.73%
5	16	0.22%
Not Rated	2	0.03%
Total FICUs	7,380[29]	100.00%

Table 2

Unresolved Management DORs

We found that 23 percent of credit unions with unresolved DORs had DOR items related to management risk.[30] Of these, the "Management Understanding/Response" and "Management Practices" risk factors accounted for 88 percent of the management-related DOR issues reported. We believe this is noteworthy because ineffective management was one of the causes of credit union failures cited in NCUA's Post Mortem Capping Report, as well as the OIG's Capping Report and MLRs.

[29] This was number of credit unions as of November 30, 2010, which fluctuates on a regular basis.
[30] The management risk factors were Board of Director Oversight, Management, Management Practices, Management Understanding/Response and Supervisory Committee.

Chart 1 below shows the unresolved DOR items by management risk factor:

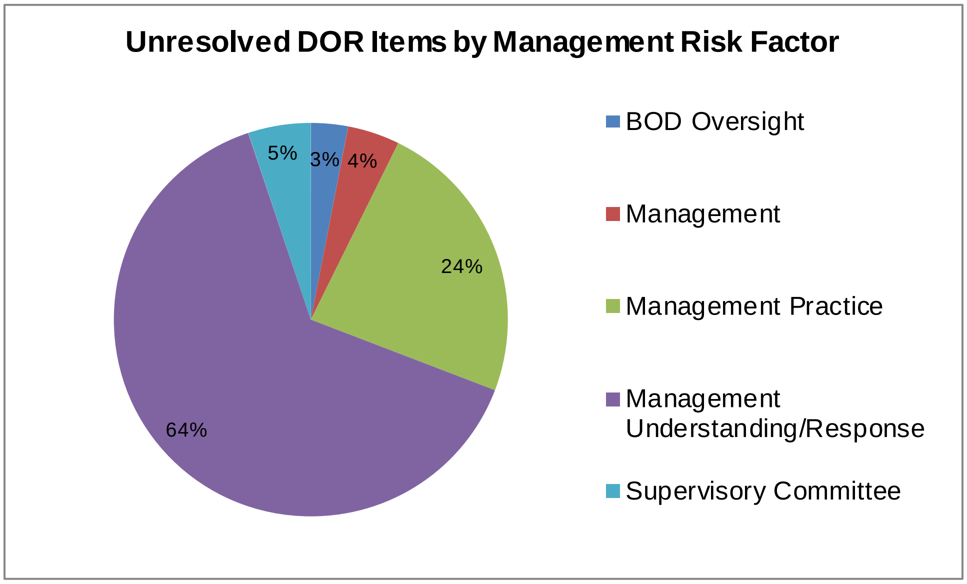

Chart 1

Lack of Timely Corrective Actions

We found that the establishment of timeframes for DOR completion was left to the examiner's judgment, and that examiners took into account the credit union's CAMEL rating and assets. Furthermore, neither E&I management nor regional officials had established specific completion timeframes for resolution of non-regulatory violations.[31] We also found examiners did not take timely corrective actions. Specifically, there were 331 unresolved DOR items at the 50 credit unions sampled. While 41 of 50 credit unions had unresolved DOR items, NCUA only took stronger supervisory actions[32] at eight credit unions and lowered composite CAMEL ratings at twelve credit unions. See Table 3 (below) for the details:

Region	Stronger Actions		CAMEL Lowered		Unresolved DORs		Number of Unresolved DOR Items
	Y	N	Y	N	Y	N	
1	1	9	2	8	9	1	95
2	1	9	2	8	7	3	25
3	2	8	5	5	7	3	101
4	2	8	1	9	10	0	67
5	2	8	2	8	8	2	43
Total	8	42	12	38	41	9	331

Table 3

[31] Only regulatory issues, such as Bank Secrecy Act violations, had specific timeframes for compliance.
[32] Stronger supervisory actions include items such as Net Worth Restoration Plan, Regional Director Letter, Preliminary Warning Letter, and Letter of Understanding and Agreement.

DOR Item Aging

As previously mentioned, NCUA had over 26,000 unresolved DOR items. Of these, 57 were over 10 years old; 776 were 5-10 years old; 2,305 were 3-5 years old; 3,098 were 2-3 years old, 9,055 were 1-2 years old, and 10,870 were less than one year old. Based on the documentation received from regional management, we determined that 42 of the 57 or 74 percent of unresolved DOR items over 10 years old were still valid. Planned corrective actions by regional management to resolve outstanding DORs include:

- Reviewing the unresolved DOR items and downgrading the composite CAMEL rating and/or taking stronger administrative actions.
- Reminding the examiners to follow up on unresolved DORs.
- Considering the routine dissemination of DORs summary to the Supervisory Examiners.

Table 4 (below) shows the number of credit unions with unresolved DOR items by Region:

Age	Region					Total Unresolved DOR Items
	1	2	3	4	5	
>10 years	10	11	18	13	5	57
5-10 years	139	216	115	265	41	776
3-5 years	361	787	329	676	152	2,305
2-3 years	716	905	584	621	272	3,098
1-2 years	2,052	2,718	1,795	1,655	835	9,055
<1 years	2,377	2,589	2,568	2,181	1,155	10,870
Total	5,655	7,226	5,409	5,411	2,460	26,161

Table 4

Chart 2 (below) indicates how long the DOR items have been unresolved:

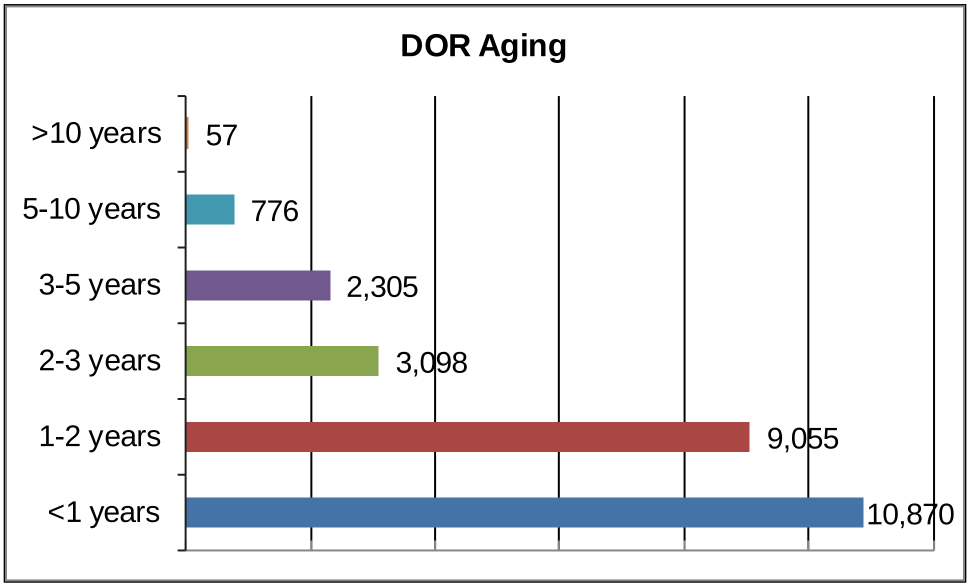

Chart 2

Recommendation

We recommend NCUA management:

3. Ensure regional staff takes stronger supervisory actions when a credit union fails to correct DOR items.

Management Response

Management agreed with the recommendation and has taken corrective action. Specifically, management believes NCUA has taken stronger supervisory actions since the economic downturn in 2008 by increasing enforcement actions 175 percent from December 31, 2008 through June 30, 2011. In addition, management plans to take additional corrective action as follows. Management stated the current draft of the NSPM requires more stringent administrative actions when credit unions do not resolve the DORs with the agreed timeframe, and when administrative action is not taken, the examiner must document the reason for not taking more stringent action. Management further stated they would continue to stress the importance of taking stronger supervisory actions as needed to ensure the safety of the National Credit Union Share Insurance Fund.

OIG Response

We concur with the actions taken to date and the actions planned by management.

We are also making the following suggestion to NCUA management:

1. Consider establishing specific time limits for examiners to resolve and close DOR items to help ensure DORs do not remain open indefinitely.

Management Response

NCUA management does not believe it is feasible to establish specific time limits for examiners to resolve and close DOR items given the innumerable circumstances examiners must consider when determining the appropriate needed action.

OIG Response

The OIG defers to management's decision to continue to allow examiners to exercise judgment when determining the most effective corrective action for issues identified during the examination. However, we believe management should continue to look for ways to reduce the time to close DORs during any future reviews or changes to the program.

Resolved DOR Results

We determined that as of December 31, 2010, examiners helped reduce identified areas of unacceptable risk by resolving a significant number of DOR items since 2005. Specifically, examiners recorded over 106,000 resolved DOR items in the DOR database. Moreover, examiners resolved over 91,000 (86 percent) of the DORs in two years or less. Table 5 (below) is a breakdown of DORs resolution by time period:

Age	Region					Total Resolved DOR Items
	1	2	3	4	5	
>10 years	12	30	49	17	13	121
5-10 years	111	235	228	131	30	735
3-5 years	963	1,203	714	1,050	340	4,270
2-3 years	2,335	2,539	1,877	2,457	733	9,941
1-2 years	9,798	9,305	8,840	12,101	4,540	44,584
<1 years	8,257	10,128	11,025	11,892	5,225	46,527
Total	21,476	23,440	22,733	27,648	10,881	106,178

Table 5

The overall average time to resolve these DOR items was 13 months. As noted in Table 6 below:

Region	Average Time to Resolve
1	14.21
2	14.20
3	13.10
4	12.92
5	12.23
Overall Average Time	13.33

Table 6

Appendix A: NCUA Management Response

National Credit Union Administration

EI/AJS:as
SSIC 1920

VIA E-Mail

TO: William DeSarno, Inspector General
Office of Inspector General (OIG)

FROM: Executive Director David M. Marquis
Office of Executive Director

SUBJ: Comments on "Review of NCUA's Document of Resolution Follow-Up Process"

DATE: September 23, 2011

This memorandum responds to your request for review and comments of the OIG report titled *Review of NCUA's Document of Resolution Follow-Up Process.*

I agree with the report's assessment that improvement is needed in relation to the current document of resolution (DOR) follow-up process. NCUA has already begun to take action to address the issues outlined in the report. Below is a summary of the actions or planned actions regarding each recommendation provided in the report.

- Recommendation #1 "Standardized DOR Monitoring Process" – NCUA is currently in the process of developing a National Supervision Policy Manual (NSPM). The NSPM will replace regional policies with consolidated national guidance. While the NSPM does include information regarding the proper use of the DOR module within AIRES, the NSPM working group determined the DOR reports require improvement. The Office of Examination and Insurance (E&I) will work with the Office of the Chief Information Officer to develop better DOR reports that allow the regions to strengthen their ongoing monitoring and reporting of DOR items. E&I also plans to include training on the proper use of the DOR during the 2012 National Conference. I expect the NSPM to be implemented after the 2012 National Conference.

- Recommendation #2 "Written Responses from Credit Union Management" – NCUA has included this recommendation as a requirement in the draft NSPM. I expect the guidance to be implemented with the approval of the NSPM, which will occur after the 2012 National Conference.

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- Recommendation #3 "Stronger Supervisory Actions" – Since the economic downturn began in 2008, NCUA has taken stronger supervisory actions as evidenced by the number of outstanding enforcement actions increasing 175 percent from December 31, 2008 to June 30, 2011.[1] In June 2010, NCUA issued Supervisory Letter 10-04 "Administrative Remedies," which provides guidance on administrative actions and the framework for maintaining an administrative record. In addition, the current draft of the NSPM provides additional guidance regarding credit unions failing to address previously agreed upon DORs. The guidance states failure to address previous agreements is grounds for more stringent administrative action, and if administrative action is not taken in these instances, the examiner must document the reason. NCUA will continue to emphasize the importance of taking strong supervisory action as needed to ensure the safety of the National Credit Union Share Insurance Fund.

The report also provides a suggestion regarding establishing specific time limits for examiners to resolve and close DOR items. Due to the innumerable circumstances that are considered when defining the appropriate action needed to address a specific issue, this is not feasible to implement. NCUA must allow examiners to exercise judgment in determining the most effective corrective action to minimize risks identified during the examination.

In conclusion, I would like to draw attention to the report's discussion regarding "Resolved DOR Results." The average time to resolve a DOR item is 13 months. When considered with the fact that the average time between full examinations for federal credit unions is approximately 15 months, this is a significant accomplishment displaying that examiners are able to significantly mitigate risks in credit unions on a continuing basis. Based on these numbers, examiners are actively working with credit unions to resolve issues found during examinations.

Thank you for the opportunity to comment.

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[1] Enforcement actions include Preliminary Warning Letters, Letters of Understanding and Agreement (published and non-published), Cease and Desist Orders, and Conservatorships.