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Sent via email only: regcomments@ncua.gov

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Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Marvin Umholtz Comments on Notice of Proposed Rulemaking (CUSO)

Dear Ms. Rupp:

I appreciate having the opportunity to present these comments to the members of the National Credit Union Administration (NCUA) Board about the proposed rulemaking regarding credit union service organizations (CUSOs). The opinions in this letter represent my point of view and are not necessarily the views held by any of my clients or by any organization with which I may be affiliated. At the time of this writing, I do not have any CUSOs as direct clients, but do serve credit unions that have investments in wholly-owned or shared-ownership CUSOs.

There are others who can and will extol the value of CUSOs much better than me and from deeper direct experience – as well as explain in more detail how the NCUA Board's proposed rule might impair credit union operations. Nonetheless, I believe that this proposed rule should not build a firewall around credit union-owned CUSOs that is so high that it cuts off all of the oxygen fueling the industry's future growth and success. The credit union industry needs companies and people willing to take innovative risks. The NCUA Board's proposed CUSO rule will create more anxiety and uncertainty than confidence going forward.

For the reasons outlined later in my comment letter, I encourage the NCUA Board to postpone indefinitely any action on the proposed CUSO rule. This call for delayed consideration is rooted in my overarching concern that the rule represents yet another interventionist micro-managing assault on credit unions' strategic options that adds to the regulatory drag on our industry's and our nation's economic recovery. I urge the NCUA Board to instead call a moratorium on all new rules at least until 2013. The NCUA Board should instead now focus on streamlining and repealing many of its strategic business plan-impairing existing rules. For that endeavor, I would welcome the opportunity to provide my very lengthy list of recommendations about reforming credit union deposit insurance funding, governance options, ownership structures, and operating authorities, among others.

Umholtz's Key Concerns About the NCUA Board's Proposed CUSO Rule

- **Labeling CUSOs to be "Systemic Risk" is Ill-Advised.** The adoption of this proposed rule would be ill-advised since it will not by itself effectively address systemic risk concerns as identified by the NCUA Board as the prime motivator necessitating this proposal.
- **NCUA Board Should Focus Instead on Specific Problem CU Supervision.** The apparent safety and soundness objective of the proposed CUSO rule would be better addressed by the NCUA Board through enhanced supervision at specific problem institutions.
- **Rule Promises Chilling Effect on CUSO Development.** The proposed rule represents a piecemeal approach to rulemaking rather than an all-encompassing vision of how the NCUA Board intends to intervene in the business affairs of credit union-owned CUSOs.

- **CUSO Rule Adds to Cumulative Regulatory Burden.** The application of this proposed rule at a strategic tipping point when the cumulative regulatory burden on credit unions from the NCUA Board, from the Consumer Financial Protection Bureau (CFPB), and from the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* has reached extreme levels is ill-timed.

Overview of NCUA Board's Proposed CUSO Rule

On July 21st the NCUA Board proposed a new rule regulating CUSOs. The summary included in the introduction to the proposed rule that amends 12 CFR § 712 and § 741 stated, "NCUA proposes to amend its credit union service organization (CUSO) regulation to address certain safety and soundness concerns. Specifically, this proposal expands the requirements of the CUSO regulation that apply to federally insured state-chartered credit unions (FISCUs) to include investment limits for FISCUs that are 'less than adequately capitalized' and requirements related to accounting and reporting by CUSOs owned by FISCUs. This proposal also adds two new requirements related to accounting and reporting by CUSOs owned by FISCUs. This proposal adds two new requirements that would apply to both federal credit unions (FCUs) and FISCUs. These new items would include requiring CUSOs to file financial reports directly with NCUA and the appropriate state supervisory authority and requiring subsidiary CUSOs to follow all applicable laws and regulations. Finally, this proposal makes conforming amendments to NCUA's regulation on the requirements for insurance to address the items discussed above that apply to FISCUs."

Essentially the NCUA Board plans to leverage the National Credit Union Share Insurance Fund (NCUSIF) statutes to extend its regulatory reach to FISCUs and require all CUSOs to file reports so that the federal agency can monitor systemic risk. In the proposal's background section it was pointed out that, "The Board also believes it is imperative to have complete and accurate financial information about CUSOs and the nature of their services to ensure protection of the NCUSIF and to identify emerging systemic risk posed by CUSOs within the credit union industry."

The NCUA Board later elaborated on the rationale for the proposed rule. "Currently, the information NCUA has been able to compile on CUSOs is incomplete and flawed, as the agency is attempting to gather pertinent information from customer credit unions rather than directly from the CUSO. The Board notes that without further reporting directly from CUSOs, it is impossible for NCUA to determine which CUSOs maintain relationships with credit unions, the financial condition of CUSOs, and the full range of services those entities are offering. This lack of information restricts NCUA's ability to conduct offsite monitoring and evaluate the systemic risks posed by CUSOs. The new requirement will allow NCUA to collect uniform information directly from all CUSOs, which will allow the agency to adequately evaluate the relationships between CUSOs and credit unions and the systemic risk posed by those relationships. As discussed below, the information required in the reports will be comprehensive to allow NCUA to obtain a clear picture of, not only relationships between CUSOs and credit unions, but also the structure of CUSOs, the services they offer, and their financial condition." To be included in the reports to NCUA are structural and operational information about the CUSO, its board and management, its services, its complete customer list, and its comprehensive financial information.

Labeling CUSOs to be "Systemic Risk" is Ill-Advised

The adoption of this proposed rule would be ill-advised since it will not by itself effectively address systemic risk concerns as identified by the NCUA Board as the prime motivator necessitating this proposal. Whether this proposed CUSO rule would be an effective systemic risk-mitigating firewall or not remains to be proved and to my mind the label "systemic risk" has been misapplied. There exists significant doubt that CUSO investments or operations rise to the same level of systemic risk to the industry as did the corporate credit union crisis or the 2008 financial system meltdown. By NCUA Board Chairman Debbie Matz's own definition in the *Bridge Corporate Consolidation Policy Statement*, "Systemic risk is the risk that the failure of a single entity could significantly impair the NCUSIF directly, or indirectly, through the disruption of service to credit unions and their members." Despite this statement, there is an unresolved debate among the broader financial services regulators about what exactly a systemically important institution looks like. Frankly, I don't think that any credit union organizations would qualify in that larger context.

Using NCUA Board Chairman Matz's more narrow definition the label "systemic risk" can be readily abused to rationalize just about any rule affecting credit unions due to their being structurally interconnected via deposit insurance. And this is despite the fact that credit unions are after all in the business of taking calculated risks. It is not CUSOs in and of themselves that are the source of potential systemic risk for the credit union industry. It is the dynamic interaction between institutions, markets, and products that becomes the source of systemic risk. Not even the U.S. Treasury Secretary-led Financial Stability Oversight Council (FSOC) has demonstrated that it is capable of successfully defining and mitigating that interactive "systemic risk." Neither FSOC nor the NCUA Board can guarantee that its interventionist regulatory regime, including this and subsequent CUSO rules, can prevent another systemic crisis at either the credit union industry level or the macro-economic level.

NCUA Board Should Focus Instead on Specific Problem CU Supervision

The apparent safety and soundness objective of the proposed CUSO rule would be better addressed by the NCUA Board through enhanced supervision at specific problem institutions. Those specific problems that have been cited as the driving force behind the promulgation of this proposed CUSO rule were more about isolated patterns of mismanagement and embedded moral hazard than fundamental structural or financial flaws in industry-wide relationships between CUSOs and credit unions. It is doubtful that the NCUA Board's call for more complete and less-flawed data about CUSOs would have made a material difference in this and similar potential loss situations.

The NCUA Board has not been forthcoming with details about the specific problems that motivated proposing this CUSO rule other than to allude to "risky CUSOs" in industry conference speeches. Hopefully the NCUA Board is not suppressing alarming information about problems at large multi-user CUSOs engaged in shared branching, payment systems, technology infrastructure, indirect auto lending, or business lending about which the industry should be made aware. Until the NCUA Inspector General publically releases the material loss review on the Texans Credit Union conservatorship, the credit union industry lacks a sufficient level of information with which to determine that the problem that needs addressing is the mere existence of CUSOs rather than the NCUA's or state agency's supervisory failures. The NCUA Board should narrow its focus to fixing the real problem rising from individual credit union mismanagement and agency supervisory mistakes rather than rushing to apply this proposed rule's burdensome CUSO reporting requirements on the innocent as well as the guilty.

According to the NCUA Inspector General, the primary causes of credit union failures in 2010 were 1.) poor strategic planning and decision-making, 2.) inadequate oversight, policies, and internal controls, 3.) criminal fraud, 4.) credit, liquidity, and concentration risks, and of course, 5.) examiner deficiencies. Perhaps the NCUA Inspector General should add a sixth category of failure causes that includes: 6.) hubris, arrogance, greed, and moral hazard.

Rule Promises Chilling Effect on CUSO Development

The proposed rule represents a piecemeal approach to rulemaking rather than an all-encompassing vision of how the NCUA Board intends to intervene in the business affairs of credit union-owned CUSOs. While on the surface the CUSO reporting requirements might appear innocuous albeit time-consuming and potentially costly, the fear is that the proposed rule represents the first step in an ultimately counterproductive NCUA Board multi-step effort to drive all risk-taking, no matter how calculated, from CUSOs and similar credit union operations. The proposed rule has the potential of placing a chilling effect on CUSO development and the accompanying CUSO-generated income at a time when the credit union industry is suffering from protracted margin compression – with no relief in sight.

Additionally, the potentially net-negative economic effect on the credit union industry from the proposed CUSO rule does not appear to have been thoroughly vetted by the NCUA's Office of Chief Economist – at least not to the point where the Chief Economist's assessment about the rule's economic impact has been transparently disclosed. The NCUA Chief Economist should at the very least publicly rate this CUSO rule as to its cumulative burden on credit unions and on the economy. The NCUA Board's own

2011 Annual Performance Budget submitted to the executive branch Office of Management and Budget (OMB) committed the agency to include the Chief Economist in the policy-development process.

I also encourage the NCUA Board to embrace the recommendations made to financial regulatory agencies on May 4th by the ten Republican members of the U.S. Senate Banking, Housing and Urban Affairs Committee to ensure adequate economic analysis of the agencies' rules. The Senators said that regulators should disclose: 1) a description of any statutory or other requirements to perform economic analysis, 2) a description of any internal policies, procedures, and economic guidance that the agency uses to ensure rigor and consistency in the economic analysis of its proposed rules, 3) an assessment of the degree to which the relevant staff of the agency understand and follow statutory and the agency's own requirements, 4) an assessment of the degree to which the agency complies with these requirements, 5) a description of any discretionary economic analysis that the agency voluntarily undertakes on a regular or *ad hoc* basis in order to ensure that its rulemaking is effective and efficient, 6) an assessment of the relevant qualifications of the staff who conduct economic analysis, and 7) a review of the economic analysis, if any, conducted in connection with the agency's rulemakings.

CUSO Rule Adds to Cumulative Regulatory Burden

The application of this proposed rule at a strategic tipping point when the cumulative regulatory burden on credit unions from the NCUA Board, from the Consumer Financial Protection Bureau (CFPB), and from the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* has reached extreme levels is ill-timed. The NCUA Board should not add to these crushing burdens, especially with a CUSO rule that appears to be wrongly targeted on an unsubstantiated problem and that is economically counterproductive in its universal application. If there are a handful of potentially systemically risky CUSOs of sufficient size and interconnectivity, the NCUA Board should deal directly with them and leave the rest alone.

The rule's cost vs. benefit analysis has not been convincingly articulated by the NCUA Board and appears to fall short of the expectations of President Barack Obama's July 11th Executive Order 13579 that among other provisions called for cost-benefit analyses on the NCUA Board's regulatory rule-making. As other comment letters have already suggested, "The analysis must not be merely cursory, but substantive and meaningful, and have both quantitative and qualitative components." As others have observed before me, the sheer volume of rules has weighted down credit unions' ability to assist their consumer members to recover from the economic predicament in which they find themselves.

In summary, I recommend that the NCUA Board postpone indefinitely any action on the proposed CUSO rule and I urge the NCUA Board to instead call a moratorium on promulgating any new rules at least until 2013. The NCUA Board should now instead launch an initiative to streamline and repeal many of its economic recovery-inhibiting existing rules. Thank you for the opportunity to comment and please feel free to contact me for additional information about or elaboration on my recommendations.

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