Open Board Meeting Feb. 19, 2015

Board Member J. Mark McWatters
Statement on the Proposed IRPS and Rule on the RFA Definition of a Small Entity

The Regulatory Flexibility Act of 1980, as amended (RFA), generally requires federal agencies to determine whether a proposed or final rule will have a "significant economic impact on a substantial number of small entities" and, if so, prepare an analysis that describes the proposed or final rule's impact on small entities, including any significant alternatives that minimize the impact.[1]

If an agency determines that a proposed or final rule will not have a "significant economic impact on a substantial number of small entities," the agency may so certify and forgo the "initial regulatory flexibility analysis" (IRFA) and the "final regulatory flexibility analysis" (FRFA).[2] Otherwise, the IRFA must, among other items, "contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives…and which minimize any significant economic impact of the proposed rule on small entities."[3] The IRFA must also include alternatives such as allowing "differing compliance or reporting requirements or timetables," "the clarification, consolidation, or simplification of compliance and reporting requirements," "the use of performance rather than design standards," and a *full or partial exemption for small entities*.[4]

The FRFA must also respond to public comments and describe "the steps the agency has taken to minimize the significant economic impact on "small entities"…, including a statement of factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule…was rejected."[5] This process, in theory, should encourage NCUA and other federal agencies to afford special consideration to the ability of smaller entities to absorb the compliance burdens imposed by new rules and regulations.

The RFA permits NCUA and other federal regulators to define the term "small entity" for purposes of the Act, although an agency must publish the proposed definition in the Federal Register for public comment.[6] In 1981, the NCUA Board initially defined "small entity" as any federally insured credit union with less than $1 million in assets.[7] In 2003, the NCUA Board revised the definition to include federally insured credit

[1] See NCUA Board Action Memorandum, dated January 28, 2015, and NCUA Staff Memorandum prepared for the Board. In describing the RFA, I have quoted, in part, from these sources.
[2] 5 U.S.C. 605(b).
[3] 5 U.S.C. 605(c).
[4] Id.
[5] 5 U.S.C. 605(a).
[6] 5 U.S.C. 601(4).
[7] Interpretative Ruling and Policy Statement (IRPS) 81-4, 46 FR 29248 (June 1, 1981).

unions with less than $10 million in assets and, in 2013, the NCUA Board further increased the threshold to include federally insured credit unions with less than $50 million in assets.[8]

Today, the NCUA Board will consider raising the asset threshold incorporated in the definition of the term "small entity" under the RFA from $50 million to $100 million. NCUA staff advocates that raising the asset threshold to $100 million will account for and benefit federally insured credit unions that generally face significant challenges from their relatively small asset base, membership, and economies of scale. In addition, NCUA staff focuses on the concept of "competitive disadvantage" and advocates that federally insured credit unions with assets of less than $100 million are "not dominant" in their field regarding deposit growth rate, membership growth rate, loan origination growth rate, rate of operating costs to assets, merger and acquisition trends, and non-interest expense per dollar loaned, among other items, and, as such, should receive the "small entity" designation. I won't quibble with this analysis except to note that, in my view, it misses the key point.

To me, the modest increase in the asset threshold from $50 million to $100 million does not constitute meaningful regulatory relief for federally insured credit unions. Instead, I wish to advocate for an increase in the asset threshold to not less than $250 million and believe that a principled argument also exists for designating each federally insured credit union with assets of less than $550 million as a "small entity" for RFA purposes. By comparison, the FDIC, OCC and Federal Reserve Board each use the Small Business Administration's asset threshold of $550 million for determining "small entity" status under the RFA. Credit unions with assets of less than $250 million—and, preferably, $550 million—also merit the regulatory relief noted above that follows a "small entity" designation under the RFA.[9]

A federally insured credit union with assets of less than $100 million may appear to some at NCUA as a "small entity" *relative to other federally insured credit unions*, but a federally insured credit union with assets of less than $250 million—if not $550 million—would no doubt constitute a "small entity" *relative to the universe of financial services institutions in which it competes*.[10] Meaningful regulatory relief should assist

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[8] 68 FR 31949 (May 29, 2003) and 78 FR 4032 (January 18, 2013).

[9] As previously noted, the RFA requires NCUA to describe the steps the agency will take or has taken to minimize the "significant economic impact" on "small entities" of proposed and final regulations with the goal of encouraging NCUA to afford special consideration to the ability of smaller entities to absorb the compliance burdens imposed by new rules and regulations. In addition, the RFA requires NCUA to consider full or partial exemptions from its rules and regulations for "small entities."

[10] To place a $550 million asset threshold v. a $100 million asset threshold in context:
(i) Banks – (a) 80-percent of banks have assets less than $550 million, those banks account for six-percent of assets (insured depositories only); and (b) 29-percent of banks have assets less than $100 million, those banks account for one-percent of assets (insured depositories only).

federally insured credit unions in competing with the financial services community as a whole and not solely against other federally insured credit unions. In this analysis, it is critical to compare apples to apples and not to forget the obvious—credit unions compete against all providers of financial services and NCUA should structure its regulatory protocols accordingly.

True regulatory relief is not achieved through the issuance of press releases or the ticking of deregulation boxes in Congressional testimony. Instead, it emanates from a thoughtfully targeted reconsideration of NCUA's regulatory philosophy directed so as to assist a broad swath of credit unions in better serving their members and enhancing the cooperative financial services model while maintaining the safety and soundness of the Share Insurance Fund. Regulatory relief in "name only" offers little to those who head to their offices each morning and endeavor to execute on a business plan in the uber competitive financial services marketplace. These people—the credit union directors, officers, employees and members who actually make the credit union world turn—deserve fair-minded regulatory relief and a rethinking of the relentless barrage of rules and regulations visited upon their organizations by NCUA and other regulators.[11] To many, NCUA often operates under a pre-Copernican view where the credit union community revolves around the agency. In reality, the strength of the credit union community is founded upon and exists because of the diligent and dedicated work of the people who comprise the community itself within an organizational structure where NCUA should serve a far more modest, distant and less intrusive role.

NCUA would best serve the credit union community by adding a focused perspective and rigorous analysis regarding the *actual threat* posed by the credit union community to the taxpayers, the broader economy, and the Share Insurance Fund. As we all recognize, no credit union is too-big-to-fail, the credit union community as a whole is not too-big-to-fail, and credit unions did not cause the recent financial crisis. NCUA should strive to reflect in its rules and regulations an appreciation and transparent acknowledgement that virtually all credit unions are small, locally owned and operated businesses managed pursuant to the time-tested cooperative business model.[12] Anything

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(ii) Credit unions – (a) 93-percent of credit unions have assets less than $550 million, those credit unions account for 33-percent of assets; and (b) 77-percent of credit unions have assets less than $100 million, those credit unions account for 10-percent of assets. Source: NCUA Office of the Chief Economist.

[11] The management teams of credit unions are stressed and stretched thin and the retention of the advisors, consultants and employees necessary to navigate the thousands of pages of obtuse and abstruse regulations promulgated by NCUA presents a formidable drain on cash flow that should, instead, serve the needs of each institution's members through higher yields on share deposits, lower interest rates and fees on loans, and enhanced customer service. From a broad-based policy and course of dealing perspective, NCUA should undertake to "minimize the significant economic impact" of its rules and regulations on all credit unions and not just the subset designated as "small entities" – regardless of the asset threshold – under the RFA.

[12] As I have stated, NCUA should also establish advisory committees and employ advanced notice of proposed rulemaking procedures regarding new regulations.

less offers little in the way of meaningful regulatory relief to a credit union community struggling to cope with today's largely misdirected and resource taxing regulatory environment.[13]

Although a slight nudge in the RFA asset threshold from $50 million to $100 million offers, at best, modest regulatory relief, I will support the motion offered today, as I believe it is in the overall best interest of the credit union community. That said, it is my sincere hope that the Board will increase the "small entity" asset threshold in the final rule to not less than $250 million and, preferably, to not less than $550 million.[14]

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[13] For example, instead of allocating its limited resources and political capital on yet another search for enhanced vendor authority, I encourage the Agency to undertake true regulatory relief, including, incorporating secondary (supplemental) capital into the final Risk-Based Net Worth rule, and modernizing the antiquated Member Business Lending and Field of Membership regulations.

[14] Consistent with today's regulatory relief theme and the overarching public policy underlying the RFA, I note that an NCUA senior officer testified before the Senate Banking Committee on September 16, 2014, and that another NCUA senior officer testified before the House Financial Services Committee on April 8, 2014, that, when promulgating new rules and regulations, the NCUA Board considers the potential benefits, as well as the direct and indirect potential costs, of the proposed rules and regulations.

In a hearing before the Senate Banking Committee on September 16, 2014, Mr. Larry Fazio, Director, Office of Examinations and Insurance of NCUA, stated:

> When promulgating new rules, the **NCUA Board considers the potential benefits, as well as the direct and indirect potential costs**. **Direct costs** include any expenses credit unions are likely to incur in complying with the rule. These costs might include the additional time spent collecting data, reporting, and training staff, as well as the need to acquire new software or services. **Indirect costs** might include higher lending rates or fees, lower rates on share deposits, or other constraints on a credit union's activities. (Emphasis added.) See page 7, http://www.ncua.gov/News/Press/CL20140916Fazio.pdf.

In a hearing before the House Financial Services Committee on April 8, 2014, Mr. Michael J. McKenna, General Counsel of NCUA, stated:

> Before engaging in formal rulemaking under the Administrative Procedure Act, **NCUA conducts an analysis about the need for and impact of a potential rule and the associated costs and benefits**. NCUA also gathers information from stakeholders, including comments received as part of NCUA's rolling regulatory review and interactions with credit unions, trade associations, state regulators, and other interested parties. **NCUA additionally performs extensive research** on applicable topics related to a potential rule. (Emphasis added.) See page 4, http://www.ncua.gov/News/Press/CL20140408McKenna.pdf.

In a hearing before the Senate Banking Committee on February 10, 2015, Mr. Larry Fazio, Director, Office of Examinations and Insurance of NCUA, stated:

> **NCUA scales our regulatory and supervisory expectations** for smaller credit unions. NCUA also seeks to provide broader regulatory relief when it is sensible and within the agency's authority to do so. Over the past three years, we have taken many actions to cut red tape and provide lasting benefits to credit unions. This includes relaxing eight regulations and

Thank you.

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streamlining three processes. (Emphasis added.) See page 1, http://www.ncua.gov/News/Documents/CT20150210Fazio.pdf.

In order to highlight the transparency (or lack of transparency, as appropriate) of the cost-benefit analysis (CBA) process conducted by NCUA, I request that the agency promptly post on its website the following items with respect to each CBA prepared by the agency in each of the past five (5) calendar years, (i) a discussion of the methodology employed by NCUA in conducting each CBA, (ii) a discussion of how each CBA was vetted and documented, in a consistent, objective and transparent manner, (iii) a discussion of the "direct costs" and "indirect costs" analyzed with respect to each CBA, (iv) a discussion of the "extensive research" undertaken with respect to each CBA, and (v) a copy of each CBA (with supporting documentation) prepared by the agency. I should acknowledge that I requested these items from the agency several months ago after learning of the representations noted in the above-cited Congressional testimony, but I have not yet received a satisfactory response.