

Open Board Meeting

July 23, 2015

Board Member J. Mark McWatters
Statement on Continuing Concerns with NCUA's Budget and Budget Process

These comments on the agency's budget acknowledge that steps have been taken to provide information about NCUA's resource allocation. At the same time, I want to urge more meaningful transparency for the credit union system, in the context of our democratic system of government and the Federal Credit Union Act.

As I stated at the November 2014 Board meeting when I dissented from the adoption of the 2015 operating budget, I am dismayed by the increase in the budget, the historic climb in the Overhead Transfer Rate (OTR) over the past several years, and certain aspects of the budgetary process employed by NCUA, including the failure of the agency to submit the OTR methodology for public comment under the Administrative Procedure Act (APA).¹ As a Board, we should remain mindful that we are spending other peoples' money – that is, the scarce resources of federal and state chartered credit unions and their members. Any allocation of these funds should occur only after thoughtful reflection as to the necessity of the expenditures and whether the costs have been undertaken in the most efficient, effective, transparent, and fully accountable manner.²

¹ NCUA should draft and submit a formal OTR regulation for a 90-day public comment period in accordance with the APA. There is little doubt that the determination of the OTR is of material consequence to both federal and state chartered credit unions and it is surprising that NCUA has drafted and implemented the rule based upon advice from two accounting firms, yet without comment from the credit union community. While I have maintained a CPA license since 1979 and hold the accounting profession in the utmost esteem, it is important to note that accounting firms generally do not render legal advice, provide legal services, or otherwise operate as law firms in the United States. The determination of the OTR is essentially a legal construct and requires the sophisticated analysis of statutes, regulations, and case law which lies beyond the operational mandate of accounting firms, even highly regarded, top-tier firms. Further, NCUA is a federal regulator and should develop and implement policies in an impartial manner, yet the inexorable increase in the OTR over the past several years generally favors federally chartered credit unions. This creates the appearance of a conflict of interest between a federal regulator and federally chartered credit unions to the particular detriment of state chartered credit unions. I also think further consideration needs to be given to how funds from mid-year budget reductions are allocated and whether they should be used, at least in part, to address OTR issues directly, rather than routinely applied to reduce operating fees to benefit just one group of credit unions. In any event, in order to negate the appearance of a conflict of interest, follow the letter and spirit of the APA, and respect the dual charter system, I encourage NCUA to submit, without hesitation, the OTR as a proposed rule for public comment under the APA.

It is interesting to note that the National Association of State Credit Union Supervisors (NASCUS) recently received a legal opinion from a third-party *law firm* concluding that the determination of the OTR is subject to a notice and comment requirement under the APA. See http://www.nascus.org/press_release/2015-press-releases/06.23.15%20Legal%20analysis%20on%20OTR.php

² As a timely example of the need for enhanced transparency in the budgetary process, I was told approximately two weeks ago about the planned "Data Center Collocation." Under the plan (according to my briefings), NCUA would relocate its data center so as to, according to the explanation, "align with industry best practices for securing and protecting NCUA's critical infrastructure and data" and to "sustain industry standard for data center 'availability'" at a "one-time cost" of approximately \$1.3 million and an annual cost of approximately \$865,000. According to NCUA staff these costs are "rough order of magnitude (ROM) estimates and are intended for budget planning purposes." It is

The Board’s job, in my view, is not merely to follow the script set by other financial regulators, but to lead and to set the standard of transparency and accountability for all such regulators. Over the past several months I have argued for enhanced budgetary transparency and welcome the additional disclosure noted in the November 2014 and July 2015 Board Action Memoranda and on the NCUA website. That said, I strongly encourage the Board to enhance the transparency of the budgetary process and NCUA’s operations by disclosing, at a minimum, each of the items outlined in my November 2014 dissent to the current operating budget.³

In addition to matters of transparency, I encourage the Board to deliver the proposed 2016 budget, the calculation of the proposed OTR, and proposed budget-component estimates and related analyses to the credit union community and general public at least two weeks prior to a formal budget hearing that will be part of the administrative record.⁴ At that hearing NCUA staff should formally present the proposed budget and OTR to the public in a detailed, understandable and transparent manner supported by written analysis posted on the NCUA website. The agency should also afford the public the opportunity to submit written comments concerning the proposed budget and OTR prior to the hearing and to make presentations to the Board at the public hearing. The Board should not formally act on the proposed budget or OTR until it has reflected upon and given due consideration to the comments received.⁵ This approach, while somewhat cumbersome, will materially enhance the transparency and inclusiveness of the budgetary process.⁶

regrettable that NCUA has beaten the cybersecurity drum as a means to argue for unneeded vendor authority over *all* third-party vendors in addition to those few data processing vendors that may actually present a cybersecurity risk to the credit union community, and it is doubly unfortunate that the agency continues to invoke cybersecurity as a means to fund the Data Center Collocation without fully disclosing to the credit union community – those who will pay for any collocation – and the Board a comprehensive and objective analysis of the proposed project. [NCUA may directly and indirectly examine data processing vendors through its CUSO and due diligence rules. Since credit union data processing vendors may also serve other financial institutions, NCUA may have the opportunity to access exam reports through the Federal Financial Institutions Examination Council (FFIEC).] Although I am quite sympathetic to the need for upgraded cybersecurity systems and protocols at NCUA, I am disinclined to spend other peoples’ money without a thorough appreciation of the costs and benefits of the perceived risks and threats to NCUA and the credit union community presented by not collocating the data center.

³ See “NCUA Board Member J. Mark McWatters Statement on the 2015 Operating Budget,” at <http://www.ncua.gov/News/Pages/SP20141121McWatters2015BudgetStatement.aspx>.

⁴Some have argued that public hearings on the NCUA budget will result in the credit union community “capturing” or perhaps, more directly, corrupting or compromising the integrity of the Board and the individual Board members’ sworn duty to uphold the Constitution and laws of the United States. Such logic escapes me. If a Board member meets in his or her office or over lunch with a member of the credit union community, no one seriously considers that action to constitute regulatory capture even if the operating budget is discussed. How a similar presentation at a public meeting of the NCUA Board – in front of the cameras, microphones, and media – could somehow morph into regulatory capture remains beyond my imagination. If members of the credit union community wish to discuss the budget with the NCUA Board, we should have that dialogue in public and on the record for all to witness and for the media to report.

⁵ The ultimate determination of the NCUA budget, of course, resides within the sole discretion of the Board.

⁶Although it appears that NCUA will not hold a public hearing on the operating budget, I wish to thank those bipartisan members of the U.S. Senate and House who have introduced and sponsored bills to require enhanced budgetary transparency and for the agency to conduct formal public hearings on the budget. I welcome their thoughtful and prudent oversight.

Over the past several months I have continued my outreach to the credit union community by holding a series of town hall meetings throughout the country where I have discussed and debated, among other matters, NCUA's operating budget. I have learned much from these interactions and hope to orchestrate other de facto budget hearings in the relatively near future. Along these lines and in anticipation of the 2016 budgetary cycle, I continue to invite interested parties to communicate their issues and concerns directly to my office and to the other Board members. I particularly welcome specific, concrete observations regarding the budget and the budgetary process. For example, and certainly without limitation, I welcome your definitive, detailed comments regarding the agenda and mechanics of a public hearing on the budget, the overall transparency of the budget and budgetary process, and the methodology employed in calculating the OTR. I very much appreciate your assistance in this endeavor.⁷

Having expressed my views regarding the 2015 budget, I cannot in good faith vote to approve the changes to the 2015 budget pending before the Board today.

As I stated at the November 2014 Board meeting and reiterate here today, I will find it challenging to vote in favor of another NCUA operating budget unless the transparency of the budget and the budgetary process is materially enhanced and the credit union community and general public are afforded sufficient opportunity to comment on the proposed budget and OTR prior to action by the Board.

In closing, please allow me to note that although my comments reflect a good faith analysis of the 2015 budget and NCUA's budgetary process, I fully appreciate that reasonable minds may differ on these issues. To the extent the Chair and Vice Chair have different perspectives on these matters, I welcome their views. My differences with the Chair and Vice Chair are professional, never personal, and I look forward to working with them in a collegial manner.⁸

⁷ As I stated in my remarks at the recent Governmental Affairs Conference (GAC), I recommend that NCUA establish a formal Advisory Committee on the budget and budgetary process. See, <http://www.ncua.gov/News/Pages/SP20150310McWattersGAC.aspx>.

⁸ See my recent GAC speech at <http://www.ncua.gov/News/Pages/SP20150310McWattersGAC.aspx>, where I remarked:

As I have stated many times during my town hall meetings, it is not possible to regulate credit unions without hearing from actual members of the system on a consistent basis, in an environment that promotes the free and honest exchange of ideas. To the greatest extent possible, regulation should emanate from a collaborative and collegial process with the goal of building trust and inclusiveness between the regulator and the regulated. I enthusiastically welcome the opportunity to work with the Chair and the Vice Chair on an ongoing basis in such a manner.

Some have argued that I have not been sufficiently engaged in my work at NCUA because I often work from Texas and while traveling to speak and hold town hall meetings with the members of the credit union community. May I suggest that the true problem is that I am *too engaged* in my work at NCUA as I have chosen to speak out against and highlight the lack of transparency and accountability in the NCUA budget and budgetary process as well as the failure of the proposed Risk-Based Capital rules (RBC2) to comply with the Federal Credit Union Act (FCUA). If I had simply agreed to rubber stamp the budget and RBC2 by looking the other way, by raising a series of non-

Thank you.

substantive, busy-work, comments, or by treating cryptic emails as appropriate briefings under any reasonable governance standard, I feel confident that nary a peep regarding my engagement in the process would have emanated from Duke Street. Instead, by diligently and thoughtfully discharging my duties as a member of the NCUA Board, I have elicited a series of unprofessional ad hominem attacks. Although this response belittles the attacker, I appreciate that I work in an environment where some prefer to shoot the messenger because they are ill-prepared to address fundamental issues of transparency, accountability, compliance with the FCUA, governance, and best practices standards on the merits and on the record.