

Jan. 30, 2015

Board Member J. Mark McWatters
Addendum to the Statement of Jan. 15, 2015, on the Proposed Risk-Based Net Worth Regulations

It has come to my attention that the Chair has accused me of breaching the non-disclosure letter sent from the Paul Hastings law firm to NCUA¹ when, in actuality, the Chair breached the non-disclosure agreement during her statement concerning the proposed Risk-Based Net Worth (RBNW) regulations at the January 15, 2015, meeting of the NCUA Board.² Specifically, the Chair advocates that the letter and spirit of the non-disclosure letter only covers the written legal opinion and not the oral legal opinion rendered by Paul Hastings. She argues that since she referenced the oral legal opinion at the Board meeting she did not breach the non-disclosure letter, but since I referenced the written legal opinion at the Board meeting I breached the non-disclosure agreement.

This, at best, is a dubious position that reflects the “form” over “substance” legal trap.

Let's suppose you arrange for a law firm to render an oral legal opinion. After you hear the oral opinion you ask the firm to deliver a written opinion letter. The written legal opinion reaches the same conclusion as the oral opinion and contains a non-disclosure undertaking. May you disclose the “oral opinion”? No, the oral opinion has merged into the written opinion, as the “substance” of the legal opinions remains identical even though there are two "forms" of legal opinions – one written and one oral.

When the Chair disclosed the “substance” of the oral legal opinion at the Board meeting she also disclosed the "substance" of the written legal opinion. She can't hide behind the “form” of the advice rendered. It's a difference without a legal distinction. The substance of each legal opinion is the same, and substance – not form – is covered by the non-disclosure agreement. Accordingly, the Chair violated the non-disclosure agreement with Paul Hastings. By the time I spoke at the Board meeting “the cat was out of the bag” as the key legal conclusion of both the oral legal opinion and the written legal opinion of Paul Hastings was already in the public domain. I merely commented on what had been disclosed by the Chair.

The Chair's accusatory statement directed at me is nothing more than an attempt to obscure the true issue at hand – she directed NCUA to waste \$150,000 of credit union funded resources to obtain an opinion that offers modest support for a two-tier RBNW system.

¹ NCUA Chairman Debbie Matz, “Statement on Newly Proposed Risk-based Capital Rule” (NCUA Board Meeting, Alexandria, Virginia, January 15, 2015).

² The written legal opinion of Paul Hastings was subsequently disclosed by NCUA under FOIA. Paul Hastings also subsequently consented to the release of the opinion.

As I have previously noted, Paul Hastings rendered an opinion to the Board stating that a court “could” conclude that NCUA has the legal authority under the *Chevron* doctrine³ to establish a two-tier RBNW standard. As a practicing attorney, I have served on the legal opinions committee of large cross-border law firms and note that a “could” opinion represents a relatively modest standard of assurance. In the obscure, arcane and highly technical and nuanced world of legal opinions, key words such as “could,” “would,” “should,” and “more likely than not” truly matter. The recipient of a legal opinion prefers to know that a court “will” or “should” or, at a minimum, “more likely than not will” uphold the legal actions of the recipient. An opinion letter merely noting that a court “could” uphold the actions of the recipient, although not entirely unhelpful, offers limited comfort to the recipient.⁴

³ *Chevron, USA, Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984). In a nutshell, the *Chevron* doctrine holds that a regulation is presumed valid if the underlying statute is ambiguous or silent on the matter presented, and the agency’s interpretation of the statute is reasonable. The second prong of the *Chevron* doctrine does not apply since, in my view, the FCUA is not ambiguous or silent regarding a two-tier v. one-tier structure.

⁴ Interestingly, an NCUA White Paper, dated April 2007, concludes in part, “In relation to the risk-based net worth requirement, the statute *precludes* a distinction between Well Capitalized and Adequately Capitalized...” (Emphasis added.)⁴ The Board also received testimony from a senior NCUA officer in June 2007 that “the statute specifically limits the application of the risk-based requirement to adequately capitalized and the undercapitalized PCA categories, which does not allow us to put more emphasis on the risk-based requirements since we can’t apply it to well-capitalized credit unions...So that also precludes [us] from mirroring how the FDIC PCA system works, as well.”⁴ Apparently, over the past year, NCUA had taken a 180-degree pivot away from a single-tier interpretation of section 216 of the FCUA in favor of a two-tier system of RBNW even though Congress has not acted to revise the statute. It is entirely possible that NCUA undertook to justify in a formal manner the legal basis for a two-tier RBNW standard only *after* receiving numerous written comments challenging the legal underpinnings of the RBNW regulations proposed by the Board and published in the Federal Register on February 27, 2014.

It is also worth considering that another well-known law firm retained by CUNA has questioned the legal authority of the Board to propose a two-tier RBNW regulatory system under the *Chevron* doctrine. This firm concluded:

NCUA’s approach is contrary to the express language of [section 216(d) of the FCUA]. Were NCUA so ill-advised as to adopt in its Final Rule the proposed dual-based capital standard approach that simply ignores the language of multiple parts of the statutory structure that Congress actually adopted, that provision would be highly vulnerable to being overturned as unlawful by a reviewing court.

Although not dispositive unto itself, but indicating the intent of Congress, it should be noted that former Speaker of the House Newt Gingrich and former Senate Banking Committee Chair Alfonse D’Amato, both of whom held their positions in Congress when the credit union RBNW rules were enacted, have stated that it was not the intent of Congress to permit the Board to issue two-tier RBNW regulations. Speaker Gingrich stated in a letter to NCUA:

Since the Chair must appreciate that the recently proposed RBNW rules are based upon a problematic legal provenance, she has attempted to redirect the attention of the credit union community away from the fundamental flaw of the proposed rulemaking – the lack of a statutory legal basis for a two-tier RBNW system. It is unfortunate that the Chair continues to engage in making accusations that are flawed and not based in fact or law. With so many critical issues facing the credit union community today, the ongoing attempt by the Chair to discredit my efforts to provide meaningful transparency and inform credit unions of what is taking place within NCUA demonstrates a sad state of affairs at the agency.

It was our intent to direct NCUA to apply risk-based requirements for a credit union's capital at the adequately capitalized level... If Congress wanted a different result, we would have indicated that. In fact, in other banking statutes, we did exactly that.

Letter dated May 23, 2014, from former Speaker of the House Newt Gingrich to the NCUA commenting on NCUA's proposed RBNW rules.