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Remarks of J. Mark McWatters  
Board Member  
National Credit Union Administration

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Credit Union National Association's  
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Washington, D.C.



## Remarks

Good morning. Thank you, Paul, for the kind introduction, and thank you, Jim, for inviting me to speak before the CUNA Governmental Affairs Conference, the largest gathering of credit union leaders of its kind. Just as I regard my service on the NCUA Board as an honor, I also take this opportunity to address you as an honor.<sup>1</sup>

Please allow me to introduce myself to you and discuss how my professional experience affects my regulatory philosophy, as well as my appreciation of and enthusiasm for the mission of the cooperative, not-for-profit credit union community.

I am an attorney and a Certified Public Accountant and have practiced law at large, international law firms for the majority of the past 30 years. During my practice, I have represented many financial institutions and, trust me, I appreciate the challenges you face on a day-to-day basis as you endeavor to execute on your business plans. What you do is neither theoretical nor hypothetical to me. As such, I will not vote to approve any regulation of the credit union community unless I sincerely believe—based upon my multi-decade, real-world professional experience—that the proposed rule appropriately targets in the least intrusive and most transparent manner the actual risks posed by the credit union community to the taxpayers, the economy and the Share Insurance Fund.

In addition to practicing law, I have taught at a law school and a business school, a process that has ratified my faith and confidence in the next generation of young men and women who, with a little work and guidance on your part, will seek to join the credit union community. I encourage you, as credit union leaders, to incorporate their enthusiasm and entrepreneurial spirit into your strategic plans. The future of the credit union community is surely passing to their stewardship, and I urge you to champion their needs and their preferences for the structure and delivery of financial services. I will undertake to offer a regulatory environment that embraces the next generation by not undermining the sustainability of the cooperative, not-for-profit business organization.

Other than practicing law and teaching, I also have had the great honor and privilege of serving my fellow Texans on two public sector boards as well as the U.S. taxpayers as a member of the Troubled Asset Relief Program, Congressional Oversight Panel. While I have learned much from these opportunities, one lesson from the TARP Panel should clearly resonate with you today. That is: no credit union is too-big-to-fail, the credit union community as a whole is not too-big-to-fail, and the credit union community did not cause the recent financial crisis.

<sup>1</sup> Due to time constraints, I was unable to read the entire speech from the podium on Tuesday, March 10, 2015.

With that fundamental perspective underlying my regulatory philosophy, it is objectively clear that NCUA should not regulate credit unions as if they are, indeed, too-big-to-fail or that they present a systemic risk to the U.S. economy and taxpayers similar to that presented by the large money-center, too-big-to-fail, financial institutions. The credit union cooperative, not-for-profit structure is radically different from the shareholder, for-profit model, and I will endeavor to reflect that distinction in all rules and regulations promulgated by NCUA during my tenure on the Board. Instead of piling additional rules and regulations on non-TARP recipient, non-systemically significant credit unions, NCUA should endeavor to offer the credit union community true regulatory relief.

Based upon my legal, accounting, academic, and public service experience, I have learned that 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 of you who head to your offices each morning and undertake to execute on a business plan in today's uber competitive financial services marketplace. Those of you in the audience today—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 your organizations by NCUA and other regulators.

NCUA should 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. Anything 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. For example, instead of allocating its limited resources and political capital on yet another quixotic search for enhanced vendor authority, I encourage NCUA to undertake true regulatory relief, including, incorporating supplemental (secondary) capital into the final risk-based capital rule, and modernizing the antiquated member business lending regulations that place unnecessary limits on the ability of credit unions to extend job creating, small business loans to Main Street enterprises.

NCUA should thoughtfully investigate the feasibility of exempting from the member business lending cap each credit union with "a history of primarily making, member business loans to its members." It's entirely possible that NCUA has interpreted this key exemption too narrowly.

And while we're at it, NCUA should undertake a top-to-bottom review of its field-of-membership regulations that needlessly restrict the ability of credit unions to serve consumers. There is a natural, organic growth that should characterize the credit union presence in the

financial services marketplace. Consumers want what you have to offer, and NCUA should not unnecessarily stand in the way of credit union access to the fullest extent under the law. I'd like for NCUA to identify and implement more proactive and positive measures to assist consumers, business persons and entrepreneurs, and the credit unions that strive to satisfy their financial services needs.

My professional experience has taught me that the management teams of credit unions and other financial institutions are stressed and stretched thin. The retention of the advisors, consultants, and employees necessary to navigate the thousands of pages of obtuse and abstruse regulations promulgated by NCUA and other regulators 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 services.

From a broad-based public policy and course of dealing perspective, NCUA should undertake to minimize the economic impact of its rules and regulations on all credit unions regardless of their size. NCUA must strive to appreciate that meaningful regulatory relief should assist credit unions in competing with the financial services community as a whole and not solely against other 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 programs accordingly.

Before moving to another matter, please allow me to make two additional observations. First, I have no interest—no interest, and NCUA should have no interest—in directly or indirectly running your business operations or influencing the development or execution of your business strategy. You run legal, legitimate businesses, and judging from your success in the marketplace, you do it quite well. NCUA is charged with securing the safety and soundness of the Share Insurance Fund pursuant to the Federal Credit Union Act, NCUA's rules, regulations and guidance, and other applicable law.

I am absolutely committed to that mandate, but you—not me, not NCUA—should develop and execute your business plan for the benefit of your members. I appreciate that a fine line often exists between a safety and soundness issue and your ability to operate your financial institution in accordance with your business policy. In my view, NCUA should not cross that line and meddle in the internal affairs of your institution without clearly articulating the demonstrable safety and soundness issue raised by the allegedly offending action.

Second, today—and rightly so—there is much emphasis on the economic well-being of the middle class, those who are struggling to join the middle class, those who wish to nurture and cultivate small business operations, and those who are underserved by traditional financial services institutions. It is fascinating to me that the credit union community represented by each of you in this audience works tirelessly every day to serve these constituencies as your primary business model. You don't focus on multi-billion dollar, international merger and acquisition

transactions with the occasional wink and nod to Middle America, but instead you invest the full energy of your institutions in serving Main Street consumers and small businesses day-in and day-out.

So, if Middle America needs financial services and if credit unions are ready, willing and able to provide those financial services at an affordable price, why should regulators inappropriately impede that process?

With nearly 100 million account holders it appears abundantly clear to me that American consumers and small business persons value the services provided by the credit union community. As such, NCUA and other credit union regulators should diligently strive to eliminate all unnecessary regulations that thwart credit unions from serving the needs of Middle America. True regulatory relief and protecting the safety and soundness of the Share Insurance Fund, in my view, are not mutually exclusive goals.

My principal job as an NCUA Board Member is to exercise autonomous and unencumbered analysis and judgment regarding credit union regulatory and public policy matters. In discharging these duties and responsibilities I solicit input from representatives of the credit union community, such as you, and from NCUA staff, among others. I then use my 30-plus years of professional experience as a prism to further refine my analysis and conclusions, and I endeavor to reach independent, principled, and fair-minded decisions regarding the issues presented.

I also strive for thorough and thoughtful engagement in this process, and it's worth noting that such engagement has led to vigorous and rigorous dissents in several high-profile instances, including:

- The absence of transparency in and public comment regarding NCUA's budgetary process;
- NCUA's failure to adequately address fraud and inadequate internal control systems as substantial causes for ongoing losses to the Share Insurance Fund; and
- The problematic legal authority for the recently re-proposed risk-based capital regulations.

I want to provide a bit more background about the rationale for these rather public disagreements, because the significance of the issues presented and the seriousness of the underlying public policies carry with them an importance that goes beyond today's headlines.

Regarding the transparency of the NCUA budget, the Board's job is not merely to follow the script set by other financial regulators such as the Federal Reserve Board, the FDIC and the OCC, but instead is to lead and to set the standard of transparency and accountability for all such regulators to consider. NCUA is an independent regulatory agency and should display the

confidence and competence to act accordingly. While, at my request, NCUA has recently enhanced the transparency of the budgetary process, much work remains. The Board should not forget that NCUA is funded with “other people’s money”—that is, the money of your members—and that the operations of the agency should remain absolutely transparent and fully accountable to those members at all times.

At the November NCUA Board Meeting, I strongly encouraged the Board to deliver the proposed 2016 budget and calculation of the Overhead Transfer Rate to the general public and to the credit union community—that is, to you and your colleagues—at least two-weeks prior to a public budget hearing before the Board. In accordance with my recommendation, at that hearing NCUA staff would formally present the proposed budget and Overhead Transfer Rate to the public in a detailed, understandable, and transparent manner supported by written analysis posted on the NCUA website. The agency would also afford the public the opportunity to submit written comments regarding the proposed budget and Overhead Transfer Rate and to make presentations to the Board in an open meeting. The Board would not formally act on the proposed budget or Overhead Transfer Rate until it had reflected upon and given due consideration to the public comments. This approach, while somewhat cumbersome, would in my view materially enhance the transparency, accountability, and inclusiveness of the budgetary process.

Regrettably, my recommendation for a public hearing on the budget—that is, receiving input from those of you who actually write the checks that fund the agency—was summarily rejected. I will continue to advocate for an open budgetary process, because more transparency is better than less, more analysis is better than less and more critical thinking and honest debate is always better than less.

With respect to the proper allocation of NCUA’s limited resources under its budget, I remain concerned regarding what I consider to constitute an upside-down approach by the agency. Given that, according to NCUA statistics, approximately 58 percent of Share Insurance Fund losses over the past five years were attributable to fraud, I question why more energy and supervisory effort are not focused on preventing fraud, rather than directed to more, and often onerous new rules and regulations for credit unions to follow. NCUA must take a more thoughtful and diligent approach to combating fraud and inadequate internal control systems at credit unions. This is a supervisory responsibility of the agency and NCUA should not seek to write new regulations unless the rules in place are clearly inadequate. I’d like to see the agency enforce what’s already on the books before piling on more paperwork that may not address the actual, most realistic threats posed to the Share Insurance Fund.

As I stated at the November Board Meeting on the 2015 budget and in anticipation of the next budgetary cycle, I invite interested parties to communicate their issues and concerns regarding the NCUA budget directly to my office. I particularly welcome specific, concrete observations regarding the budget and the budgetary process as opposed to general, vague comments that

often offer little in the way of meaningful guidance. For example, and certainly without limitation, I welcome your specific, 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 Overhead Transfer Rate. I very much appreciate your assistance in this endeavor.

On the matter of risk-based capital, I cast the sole dissenting vote on the re-proposed rule at the January Board Meeting. In doing so I wasn't voting against an effective capital regime. Nor was my "no" vote meant to simply stand apart from this already controversial rulemaking process. Instead, I voted against the proposed rule because, in my view based upon over 30 years of legal experience, a plain-English reading of the Federal Credit Union Act prohibits the NCUA Board from adopting a two-tier risk-based capital standard.

If Congress had intended a two-tier risk-based capital system, the drafters would not have included the words "to be adequately capitalized" in the applicable section of the Federal Credit Union Act. The inclusion of this phrase indicates that Congress intended to limit the risk-based capital standard to a single-tier system, and any attempt by the NCUA Board to create a two-tier risk-based capital system simply contradicts what is written in the law. Congress could have easily accomplished a two-tier risk-based capital system for credit unions by including a reference to both the "adequately capitalized" and "well capitalized" standards. This would have created a two-tier risk-based capital system, and would have done so in a straightforward manner.

Unlike the Lewis Carroll story where Humpty Dumpty says, "words mean just what I choose them to mean—neither more nor less," NCUA should stick to following the clear and unambiguous language of the Federal Credit Union Act. It's not only the smart thing to do, it's the right thing to do, and it complies with the law.

I want to re-emphasize: I am not opposed to a sensibly crafted, well-designed risk-based capital system. Strong capital is a fundamental component of safe and sound financial institutions. In the case of risk-based capital for credit unions, NCUA should take a serious look at going back to the drawing board to ensure that the rule is practical, useful, prudent, and legal.

Yet, reasonable minds may differ. Regardless of whether a one-tier or a two-tier rule is ultimately adopted by the NCUA Board, it is truly ironic and disconcerting that the Board would seek to raise the risk-based capital requirements for credit unions without also affording the system with a workable means by which to raise supplemental capital for risk-based capital purposes. A thoughtful, prudently constructed supplemental capital rule would afford the credit union community with the heightened opportunity to extend additional credit to their members on affordable terms, including job creating, small business loans that strengthen the economic viability of Main Street. NCUA should actively endeavor to craft supplemental capital regulations that will benefit the credit union community while maintaining the safety and

soundness of the Share Insurance Fund. This endeavor will not require the reinvention of the regulatory wheel as talented leaders of the credit union community—like those of you in the audience today—have over the years offered viable, market-based approaches to supplemental capital for risk-based capital purposes and, regarding low-income credit unions, for leverage ratio purposes.

The agency should remain mindful that low-income credit unions, as specifically permitted by the Federal Credit Union Act, have employed supplemental capital for many years. NCUA should welcome and learn from their experiences and not seek to obscure this critical issue in the bureaucratic machinations of yet another internal NCUA committee. After numerous false starts, it's time—today—for NCUA to get to work and actually propose a set of rules regarding the implementation of a supplemental capital regime for risk-based capital purposes.

I am pleased that the proposed risk-based capital rule no longer confusingly incorporates an interest rate risk component. Although it is my understanding that the NCUA Board may consider a separate and distinct interest rate risk rule, I encourage the Board to seek input from the credit union community regarding any proposed rule by issuing an Advance Notice of Proposed Rulemaking. It is absolutely critical that the Board receive timely comments from those who will incorporate any proposed interest rate risk rule into their business plans and econometric models. Such input will enhance the efficiency, effectiveness, and transparency of the regulatory drafting process and speed the implementation of any fully vetted interest rate risk rule. Similar to my observations about more vigorous and thorough supervision in place of new regulations, it is my sincere hope that the NCUA Board will choose to address the interest rate risk issue in a targeted manner through the supervisory process and not with a separate, one-size-fits-all interest rate risk rule.

Just last month the NCUA Board proposed to raise the asset threshold incorporated into the definition of small credit union from \$50 million to \$100 million. Even though I supported the proposed regulatory change as in the overall best interest of the credit union community, the modest increase in the asset threshold does not constitute, in my view, meaningful regulatory relief for credit unions.

At the Board Meeting I advocated for an increase in the asset threshold to not less than \$250 million and noted that a principled argument exists for increasing the asset threshold to \$550 million. By comparison, the FDIC, the OCC and the Federal Reserve Board each use the Small Business Administration's asset threshold of \$550 million for determining small entity status. Credit unions with assets of less than \$250 million and, preferably \$550 million, also merit the regulatory relief that follows a small entity designation. Because credit unions swim in the same marketplace waters as do banks, and regulatory compliance presents the same, if not a greater, compliance burden on credit unions, I will keep pushing in the right direction on this issue.

In my first seven months on the NCUA Board, I have met with over a dozen leagues, plus the leadership of national trade organizations such as CUNA, NAFCU, NASCUS, and NACUSO, among others. When visiting credit unions and leagues I don't read speeches—like I am today—but, instead, I clip on a microphone and wade into the crowd with a red pen and a yellow note pad. I ask questions, and I take notes. I challenge answers and conduct town-hall style meetings more like graduate seminars than simple question and answer sessions. This dialogue is absolutely critical for me, principally because the input I receive is honest, unencumbered, well-intentioned, and derived from real-world experience. I don't need to hear, and I don't want to hear, Washington-ese doublespeak.

Outside the Beltway communication reinforces my belief that analysis and sound decision-making may be conducted in Alexandria, Dallas, Boston, Phoenix or in any other place where I travel as a member of the NCUA Board. There is no monopoly on wisdom or judgment here in Washington. I appreciate a wide-variety of perspectives regarding the fundamental challenges facing the credit union community today, and I welcome interactions with those volunteers and professionals who have a hands-on understanding of the unique nature of the cooperative financial services model.

That's why I value my time away from Washington as much as I value my time here. My commitment to you is to remain available and accessible wherever serious and informed dialogue awaits me. That's the hallmark of a healthy relationship between a regulator and a regulated industry, and I welcome it.

Let me close with these thoughts: Credit unions, as cooperative, not-for-profit financial institutions, exist to serve their members, not shareholders. You are not operating your financial institutions so as to manage a share price or your stock option portfolio, and—as I have previously noted—your institutions are not too-big-to-fail and their demise would not present a systemic risk to the U.S. economy. NCUA should craft and precisely target its rules and regulations accordingly.

As a safety and soundness regulator, I am very conscious of the need for an objective, forward-looking balance between the free marketplace and protecting the Share Insurance Fund. I am frankly concerned that such a balance is not in place today. I sense a disequilibrium, where the degree of regulatory zealotry and overreach is regrettably out of proportion when measured against the actual risk presented by the credit union community to the Share Insurance Fund.

NCUA cannot and should not use the chorus of “safety and soundness” as a catch-all justification for every rule and regulation promulgated by the agency. That's not accurate, and its overuse, like anything, renders it pedestrian and ineffective. That said, as well-articulated, objective threats to the safety and soundness of the Share Insurance Fund develop—and they surely will arise—NCUA should react promptly and without hesitation or apology to address the actual risk presented in an efficient, effective, transparent, and thoughtfully directed manner.

Further, NCUA should have the confidence, courage and conviction to chart a regulatory path for the credit union community that is based upon a transparent and fully accountable appreciation of the unique structure and attributes of the cooperative, not-for-profit business model that is not held hostage to a regulatory standard designed for the shareholder owned, for-profit bank model or the systemically important—too-big-to-fail—financial institutions model. I hope to play a role in charting that course, in working with you—not against you—jointly in the service of the credit union community and the taxpayers.

With these thoughts in mind, I ask the NCUA Board to establish not less than three formal advisory committees with the mandate to advise the Board about:

- NCUA’s budget and the budgetary process;
- NCUA’s examination programs and the appeals process; and
- Areas where NCUA may expedite regulatory relief for the credit union community without compromising the safety and soundness of the Share Insurance Fund.

Regarding the latter point, and as I have previously noted, these areas of regulatory relief should include at a minimum, supplemental capital for risk-based capital purposes, and a complete rewrite of the member business lending and field-of-membership regulations. The advisory committees should report their finding to the NCUA Board on a regular basis and the Board and NCUA staff should transparently and thoroughly vet the recommendations offered by the advisory committees.

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.

Please understand, however, that I am not a new convert to the mantra of deregulation. I am not a new convert to the transformative power of free market economics, I am not a new convert to the job-creating juggernaut of Main Street small business operations, and I am not a new convert to the financial services needs of the middle class and the underserved. Instead, I explicitly appreciate and have respected and adhered to these economic, social and political principles and philosophies throughout my professional and academic life. In other words, matters of regulatory relief, the economic power of the marketplace, and support for Middle American consumers, small businesspersons, and the economically disenfranchised have always been embedded as an integral part of my DNA and will continue to serve as the foundation of all actions I take as a member of the NCUA Board.

In a financial services world dominated by interconnected, systemically important, too-big-to-fail, financial institutions, it is truly refreshing and remarkable that the locally owned and managed, cooperative, not-for-profit business model exists and thrives today. The continuing success of the credit union system is directly attributable to the tireless, diligent efforts of you and your colleagues, and I pledge that I will endeavor to formulate a regulatory protocol that respects these contributions and accomplishments while maintaining the sustainability and viability of the credit union financial services model and securing the safety and soundness of the Share Insurance Fund.

As I conclude, please allow me to paraphrase our recently departed friend, Mr. Spock, “May the credit union community ‘Live long and prosper.’”

Thank you.