

Open Board Meeting

October 15, 2015

**Board Member J. Mark McWatters
Statement on the Final Risk-Based Net Worth Rule**

Stop and Study Bill (H.R. 2769)

On January 15, 2015, the NCUA Board, by a 2-1 vote, issued a proposed Risk-Based Net Worth (RBNW) rule. I dissented from that action and issued a written statement that remains relevant today. I will reference the substance of that statement in these remarks and note that such statement is currently available on the NCUA website.¹ My comments and observations today will be available on the NCUA website this afternoon.

Before proceeding with a discussion of the final RBNW rule, it is worth noting that the House Financial Services Committee by an overwhelming, bipartisan vote of 50-9 recently passed the Risk-Based Capital Study Act (H.R. 2769). The Stop and Study Bill would require the NCUA to review its proposed RBNW rule and report to Congress on the impact the rule would have on credit unions and their members. It would also require the agency to conduct additional research regarding whether it possesses the legal authority to adopt and enforce the RBNW rule.

By letter of October 6, 2015, Congressmen Stephen Fincher (R-TN), Denny Heck (D-WA), and Bill Posey (R-FL), co-sponsors of the Stop and Study Bill, wrote to NCUA Chair Debbie Matz requesting that the agency “voluntarily undertake the study outlined in our bill, and communicate your findings and recommendations to Congress, before moving forward and finalizing the risk-based capital rule.” On October 8, 2015, Chair Matz responded by stating that the agency has, in effect, already complied with the basic tenets of the Stop and Study Bill. By letter of October 13, 2015, House Financial Services Committee Chair Jeb Hensarling (R-TX) replied to Chair Matz where he stated:

It is deeply troubling that you would utterly disregard the express will of this Committee and rush to adopt a misguided rule that risks undermining the safety and soundness of credit unions in contravention of the NCUA’s statutory mandate.

...

I urge you to listen to the collective wisdom of the 50 members of the Committee on Financial Services who voted in favor of H.R. 2769 and comply in full with the provisions of this bipartisan legislation prior to adoption of a final risk-based capital rule.

¹ Board Member J. Mark McWatters, Statement on the Proposed Risk-Based Capital Rule, January 15, 2015, at <http://www.ncua.gov/News/Pages/SP20150115McWattersStatementRBC.aspx>.

I appreciate that the NCUA is an independent federal agency and, consistent with the separate branches of our federal government, is not required to tailor its actions in response to every letter and request from a member of Congress or the introduction of every bill that purports to challenge an action proposed by the agency. However, when members of Congress question the agency’s legal authority to pursue a particular course of action, it seems entirely appropriate, reasonable, and responsible as a gesture of good faith and transparency towards Congress for the agency to reflect and reconsider in a thoughtful and diligent manner its actions, as the Stop and Study Bill directs the NCUA to do for the RBNW rule. After all, it is Congress that created the NCUA and only Congress that can grant or deny legal authority to the agency.

The final RBNW rule is based on the premises that the NCUA Board must adopt a rule that takes into consideration any material risks presented to the credit union community and that the existing RBNW rule is out of date, is not “comparable” to the rule adopted by the FDIC, and fails to adequately ensure the safety and soundness of the National Credit Union Share Insurance Fund (NCUSIF).² While the agency should certainly consider these arguments, they principally serve as a distraction—a red herring—from the broader issues caused by the agency’s critical misinterpretation of the Federal Credit Union Act (FCUA). Yes, the NCUA is charged with protecting the NCUSIF; yes, capital requirements represent a critical component in the agency’s discharge of this mandate; yes, Congress directed the agency to implement a RBNW requirement; but, no, in implementing a RBNW regulation the agency may not disregard the rules of the road and clear directives prescribed by Congress in the FCUA.

Simply put, the NCUA is not required to adopt a new RBNW rule at this time, and may not adopt a rule that contravenes the unambiguous language of the FCUA at any time.

No Legal Authority for a Two-Tier Risk-Based Net Worth Rule

The fundamental issue presented before the Board today is whether the NCUA has the legal authority to establish a separate RBNW requirement for each category of “well capitalized” and “adequately capitalized” credit unions that are designated as “complex.” Section 216(d) of the FCUA addresses the RBNW requirement for “complex” credit unions and its plain language creates a single-tier RBNW component.

Section 216(d)(2) provides:

The Board shall designate the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union *to be adequately capitalized* may not provide adequate protection. (Emphasis added.)

² See, Larry Fazio, NCUA Director of Examination and Insurance, “Why Does the NCUA Need to Update Risk-Based Capital Rules?,” Credit Union Times, February 16, 2014.

As this unequivocal, plain language states, Congress did not authorize the Board to adopt a two-tier RBNW standard. If Congress had intended a two-tier system, it would not have included the words “to be adequately capitalized” in the section. The inclusion of this phrase demonstrates that Congress created a single RBNW standard. Any attempt by the Board to read section 216(d)(2) as a “baseline” or “minimum” standard contradicts the plain meaning of the text. If Congress had sought to design a two-tier RBNW system for credit unions, it would not have undertaken to accomplish this goal by *only* referencing the “adequately capitalized” category in section 216(d)(2). Instead, Congress would have included a reference to both the “adequately capitalized” and “well capitalized” levels in section 216(d)(2) so as to reflect a two-tier RBNW system in a clear and transparent manner.³

Congress could have also granted the NCUA Board authority to implement a two-tier RBNW rule by simply placing a “.” after the phrase “any material risks” or by, perhaps, adding language such as “to the credit union system or the NCUSIF” after that phrase.⁴ Congress could have used any one of these several options that would have resulted in authority for a two-tier RBNW system. Instead, by using the actual statutory language following the phrase “any material risks,” Congress clearly *limited* the authority of the NCUA Board to design and implement an RBNW rule. In fact, the only conceivable purpose for the additional language referencing the phrase “to be adequately capitalized” was to serve as a check on the authority of the Board, since *without* such language the Board would have had greatly enhanced discretion to craft an RBNW rule, including a two-tier approach.

By omitting a reference to the “well capitalized” standard in section 216(d)(2) or by not ending the section after the phrase “any material risks,” Congress created an unambiguous single-tier RBNW standard. For the reasons I have addressed, the NCUA Board must adopt a single-tier RBNW system so as to comply with the unambiguous language of the FCUA.

Some have confused opposition to a two-tier system with the position that well capitalized credit unions should not be subject to any RBNW requirement. The FCUA is clear on that point as well. Well-capitalized credit unions *are subject* to an RBNW

³ For example, Congress could have created a two-tier RBNW system by incorporating a reference to “well capitalized” credit unions, where section 216(d)(2) would have read:

The Board shall designate the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be well capitalized or adequately capitalized may not provide adequate protection.

⁴ For example, Congress could have granted the NCUA Board broad latitude in crafting a RBNW rule (i) by placing a “.” after the phrase “any material risks,” where section 216(d)(2) would have read: “The Board shall designate the risk-based net worth requirement to take account of any material risks.” or (ii) by placing a “.” after the phrase “any material risks” and adding “to the credit union system or the NCUSIF,” where section 216(d)(2) would have read: “The Board shall designate the risk-based net worth requirement to take account of any material risks to the credit union system or the NCUSIF.”

requirement, but unlike under the final rule pending before the Board today, the FCUA directs that such standard may not be higher than the RBNW requirement that applies to adequately capitalized credit unions.

FCUA Sections 216(c)(1)(A) and (B) provide:

(A) Well capitalized.—An insured credit union is “well capitalized” if –

- (i) it has a net worth ratio of not less than 7 percent; and
- (ii) it meets any applicable risk-based net worth requirement under *subsection (d) of this section*.

(B) Adequately capitalized.—An insured credit union is “adequately capitalized” if

- (i) it has a net worth ratio of not less than 6 percent; and
 - (ii) it meets any applicable risk-based net worth requirement under *subsection (d) of this section*.
- (Emphasis added.)

Just because the “net worth ratio” (Leverage Ratio) requirement differs for “well capitalized” and “adequately capitalized” credit unions, it does not necessitate a different RBNW requirement for well capitalized and adequately capitalized credit unions. Also, the statute provides that the net worth classification for well and adequately capitalized credit unions must satisfy the RBNW requirement established under section 216(d). However, this language contains no indication that the RBNW standard for well versus adequately capitalized credit unions is different. Since the RBNW requirement for well and adequately capitalized credit unions references section 216(d), it could not be clearer that Congress intended the same RBNW component to apply to both categories. In addition, because the Leverage Ratio requirements for credit unions provided in sections 216(c)(1)(A)(i) and (B)(i) exceed the Leverage Ratio requirements for banks, it is entirely rational and reasonable that Congress would have sought to offset the enhanced Leverage Ratio burden placed on credit unions by adopting a single-tier RBNW system based upon the “adequately capitalized” standard.

I appreciate that some may argue that the NCUA’s RBNW rules should follow a two-tier system comparable to that of the FDIC. Section 216(b)(1)(A) of the FCUA provides that the NCUA Board shall, by regulation, prescribe a system of prompt corrective action (PCA) for insured credit unions that is (i) “consistent” with section 216 of the FCUA and (ii) “comparable” to the rules adopted by the FDIC. Yet, under basic principles of statutory construction, a general provision must give way to a specific provision. As such, the specific RBNW rules tailored by Congress for credit unions in section 216(d) of the FCUA must trump the general mandate that the NCUA formulate its rules in a manner comparable to the rules adopted by the FDIC. Congress did not

intend that the NCUA Board utilize the FDIC rule and ignore the statutory provisions specifically prescribed by Congress for credit unions.

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.)⁵ 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.”⁶

Yet, in the development of this final RBNW rule, the NCUA inexplicably has taken a 180-degree pivot away from a correct 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.⁷

It is worth noting that Paul Hastings LLP, a well-known law firm, has rendered an opinion to the NCUA Board stating that a court “could” conclude that the NCUA has the legal authority under the *Chevron* doctrine⁸ to establish a two-tier RBNW standard.⁹ 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.¹⁰ In the obscure, arcane and highly technical and nuanced world of legal

⁵ National Credit Union Administration, Revisions: Prompt Corrective Action Reform Proposal, April 2007, Appendix 2.

⁶ Open Board Meeting Transcript 22-23 (June 21, 2007).

⁷ It is entirely possible that the 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.

⁸ *Chevron, USA, Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984). In a nutshell, the *Chevron* doctrine holds, in part, 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 *Chevron* doctrine will not protect NCUA since, in my view, the FCUA is not ambiguous or silent regarding a two-tier versus a one-tier structure.

⁹ Paul Hastings LLP concluded on page 12 of its opinion letter addressed to the NCUA Board, dated December 30, 2014, under the heading “4. Conclusion,” as follows:

Based on the foregoing facts and a reasoned analysis of *Chevron* and Section 216 of the FCUA, we are of the opinion that, under current principles of applicable law and existing case law, a court of appropriate jurisdiction, in a litigated matter or proceeding, *could* conclude that the NCUA’s statutory authority pursuant to Section 216 of the FCUA permits the NCUA to establish the proposed two-tier RBNW requirement set forth in the Proposed Rule. (Emphasis added.)

Although other sections of the opinion letter incorporate different standards of comfort, the key “Conclusion” section of the opinion uses the “could” standard and, as such, would appear to trump any inconsistency reflected in other sections of the opinion.

¹⁰ I certainly do not fault Paul Hastings for not rendering a more favorable legal opinion to the agency because as a practicing lawyer for many years I fully appreciate that attorneys are ethically charged with informing their clients in a forthright, transparent manner as to the legal consequences of a proposed action and not merely to act as aiders and abettors or facilitators of dubious legal positions. I have little doubt that the firm rendered the most favorable opinion

opinions, key words such as “could,” “would,” “should,” and “more likely than not” truly matter.¹¹ 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.¹² NCUA and, as such, the credit union community, paid Paul Hastings \$150,000 for the opinion letter.

It is also worth considering that Venable LLP, another well-known law firm, retained by CUNA has questioned the legal authority of the NCUA Board to propose a two-tier RBNW regulatory system under the *Chevron* doctrine.¹³ According to CUNA’s then Senior Vice President of Regulatory Advocacy, the law firm was asked to advise CUNA solely on what the FCUA requires regarding a RBNW system; that is, the Venable attorneys were not directed to develop arguments to support any predetermined perspective. This Venable opinion 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.¹⁴

Although not dispositive, but clearly indicative of Congressional intent, 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 NCUA Board to issue two-tier RBNW regulations. Speaker Gingrich stated in a letter to NCUA:

possible after reviewing the facts and circumstances and applicable law. Unfortunately, for those who support the final RBNW rule, the legal opinion provides modest support at best.

¹¹ There are no hard and fast rules regarding these (and other) legal opinion “standards,” except to note that a “would” (or “will”) opinion denotes a very high level of confidence (in the order of 90-plus percent) by the opining attorney that a court would concur with the opinion recipient’s legal action. A “should” opinion implies less confidence than a “would” opinion (say, 70-percent), and a “more likely than not” opinion indicates a confidence level of probably greater than 50-percent (better than a coin flip). Conversely, a “could” opinion reflects a confidence level of less than 50-percent, yet indicates that the proposed legal action by the opinion recipient is not “frivolous.” Attorneys are by no means limited to these standards and are generally free to (and often do) opine at different comfort levels.

¹² It is remarkable that the NCUA Board majority would proceed to finalize the RBNW rule based upon only a “could” level of comfort from its own handpicked law firm. It seems unreasonable to burden the credit union community with a 400-plus-page RBNW rule absent a firm understanding (that is, a “would” comfort level) that the rule complies with the FCUA.

¹³ Yet another well-known law firm retained by NAFCU has questioned the legal authority of the NCUA Board to prescribe an “individual minimum capital requirement” (IMCR) protocol under section 216 of the FCUA. Although, after receipt of the NAFCU commissioned opinion letter, the NCUA removed the IMCR provision from the proposed RBNW rule that was before the Board in January 2015, any attempt by the NCUA to “back-door” an IMCR or substantially similar standard during the examination process may very well run the same risk of violating the FCUA as would a formal IMCR rule.

¹⁴ I encourage CUNA to release this opinion letter to the public.

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.¹⁵

Based upon my 30-plus years of experience as an attorney who has worked on many intricate issues of statutory and regulatory interpretation, I am of the view that the NCUA does not possess the legal authority under the FCUA to adopt a two-tier RBNW regulatory standard. Section 216 of the FCUA is not ambiguous on its face and, accordingly, the *Chevron* doctrine regarding deference to agency decisions should not apply, as a holistic, plain language reading of the statute in support of a single-tier RBNW standard should prevail over any regulatory interpretation or wishful thinking to the contrary. While some may argue that the NCUA Board *should* have the authority to issue a two-tier RBNW regulation as a matter of prudent public policy, those debates are best left to Congress as the source of the Board’s regulatory authority. If Congress acts, the NCUA Board may follow, but without modification of the FCUA, the Board lacks the legal authority to issue a two-tier RBNW rule and will not be shielded by the *Chevron* doctrine so as to resolve in its favor a forced or strained ambiguity in the statute.

I respect those who actively challenge and debate well reasoned, principled arguments, but after review and consideration, I cannot reach a different conclusion that the better interpretation of section 216 of the FCUA clearly precludes a two-tier RBNW standard.

“Complex” Credit Unions

The issue of how a RBNW system is applied to “well capitalized” credit unions is not the only concern I have with the final rule. Section 216(d)(1) of the FCUA provides that the NCUA Board may only adopt a RBNW rule for “insured credit unions that are *complex*, as defined by the Board *based upon the portfolios of assets and liabilities of credit unions.*” (Emphasis added.) However, instead of following the clear and unambiguous language of the statute, the final RBNW rule defines “complex” by reference to a credit union’s gross asset size only. In fact, the final rule uses asset size as a “proxy” for “the portfolios of assets and liabilities of credit unions.” Although such an approach is not unhelpful from an administrative and rule implementation perspective, the RBNW regulation must follow the express language of the FCUA. As such, the NCUA Board must designate credit unions as “complex” only based on a definition of that term that encompasses credit unions’ “portfolios of assets and liabilities” as specifically required by the FCUA.

Supplemental Capital

¹⁵ Letter dated May 23, 2014 from former Speaker of the House Newt Gingrich to the NCUA commenting on the NCUA’s proposed RBNW rule.

I am also concerned that the Board would adopt a rigorous RBNW regulation without also providing—at that time—members of the credit union community with the option of at least partially satisfying the requirements of the rule through the issuance of properly structured supplemental capital.

It is clear from section 216(o)(2) of the FCUA that, other than for Low-income credit unions, a credit union’s “net worth” may not include secondary capital for purposes of satisfying the Leverage Ratio of section 216(c) of the FCUA. I am not aware, however, of any similar limitation that applies to the determination of “net worth” for purposes of the RBNW requirement.¹⁶ Provided the supplemental capital is structured in such a manner as to “take account of any material risks” under section 216(d)(2) of the FCUA, otherwise complies with applicable law, and does not threaten the safety and soundness of the NCUSIF, NCUA should proceed with authorizing its use.¹⁷

Accordingly, I urge the Board to continue the process that will lead to the promulgation of rules permitting properly structured supplemental capital to qualify as “net worth” under the RBNW regulations as ultimately enacted. I appreciate that such an undertaking is not without its unique challenges regarding an array of vexing issues, including, but not limited to, (i) the ability of supplemental capital to absorb credit union losses, (ii) the “permanence” of supplemental capital, (iii) member versus non-member supplemental capital, (iv) the availability of supplemental capital for state versus federal chartered credit unions, (v) consumer protection for purchasers of and investors in supplemental capital, (vi) securities regulation of supplemental capital issuances, (vii) NCUSIF payout priorities and subordination of supplemental capital, (viii) capital contribution limitations of supplemental capital as “net worth” for RBNW purposes, and (ix) the contractual terms of, the market demand for, and the cost of supplemental capital.

Even so, these issues should not have a chilling effect on the willingness of the NCUA Board to grant to the credit union community a workable methodology under which properly structured supplemental capital may be used for purposes of partially satisfying the RBNW requirement.¹⁸ Like long overdue modifications to the field-of-

¹⁶ The definition of “risk-based net worth” used in the numerator of the final RBNW rule differs materially from the definition of “net worth” employed in the numerator of the Leverage Ratio. The NCUA Board, pursuant to section 216(d)(2) of the FCUA, establishes the former, and the latter is defined in section 216(o)(2) of the FCUA.

¹⁷ In an NCUA White Paper on Supplemental Capital, dated November 18, 2014, NCUA’s OGC concluded on page 2, “While the Board cannot redefine the statutory definition of Net Worth, OGC did determine the Board has broad authority in establishing what can be included in the numerator when defining Risk Based Capital (RBC). This could include expanding the inclusion of secondary capital by all FICUs, and not solely the LID FICUs, into the numerator of RBC.” It is also worth noting that a well-known law firm retained by CUNA has issued a memorandum concluding, subject to certain caveats, that there are “strong legal arguments” in support of including secondary capital in the numerator of the RBNW ratio.

¹⁸ A few months ago I read an article in *CU Insight* by Brian Branch, President and CEO of the World Council of Credit Unions, describing an array of supplemental capital initiatives employed in the international credit union community. Instead of fretting and hand wringing, the NCUA, like its international counterparts, should take the leadership role in solving the supplemental capital conundrum.

membership and member business lending rules that are presently under consideration by the NCUA Board, the agency should actively endeavor to craft supplemental capital regulations that will benefit the credit union community while maintaining the safety and soundness of the NCUSIF. A thoughtful, prudently constructed supplemental capital rule would afford the credit union community with a heightened opportunity to extend job creating small business loans thereby strengthening the economic viability of the Main Street business community.

So as to assist the agency in the development of a viable, market oriented supplemental capital rule, I encourage the Chair to establish a formal Advisory Committee and seek input from the credit union community regarding the structure and scope of the rule.

Interest Rate Risk Rule

I am pleased that the final RBNW rule does not incorporate an interest rate risk (IRR) component. Hopefully, the agency will address IRR through the examination process and not through a separate IRR rule.

If a majority of the NCUA Board decides to pursue an IRR rule, I urge the Board to seek input from the credit union community regarding any proposed IRR rule by issuing an Advance Notice of Proposed Rulemaking prior to any rulemaking on this subject. It is absolutely critical that the Board receive timely comments from those who will incorporate the IRR 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 IRR rule.

Cost of the Risk-Based Net Worth Rule

It is also worth noting that in accordance with the requirements of the Paperwork Reduction Act of 1995, NCUA staff estimates that the total non-recurring compliance cost of the final RBNW regulations (i) for both “complex” and “non-complex” credit unions totals approximately \$5.1 million,¹⁹ and (ii) for the NCUA totals approximately \$3.8 million.²⁰ I anticipate that some, if not many, credit unions may argue that these projections materially underestimate the actual cost of complying with the final RBNW regulations. I also do not believe that the NCUA undertook a sufficient estimate of the recurring compliance costs of the final RBNW regulations. Regrettably, these additional costs will fall on a financial services sector that is not too-big-to-fail and was in no manner responsible for the recent financial crisis.

¹⁹ NCUA Final Risk-Based Capital Rule, October 15, 2015, pages 329 - 330.

²⁰ \$3,759,000 equals the sum of: (i) Non-Recurring Incremental Costs (2016-2018) of \$1,699,000, (ii) Revise Other Affected Data Systems (2016-2018) of \$316,000, (iii) Updating Policies and Guidance (2016-2018) of \$144,000, and (iv) Training (2016-2018) of \$1,600,000. NCUA Board Action Memorandum, Final Risk-Based Capital Rule, September 29, 2015 for Board action of October 15, 2015, pages 1-2.

The NCUA has dedicated a significant portion of its institutional resources over the past two years to drafting and vetting the final RBNW regulations with the ultimate goal of ensuring the safety and soundness of the NCUSIF. While I certainly concur with this objective as it relates to the NCUSIF, I disagree with the approach the majority has taken and intends to pursue in order to achieve that objective.

If the NCUA had issued an Advance Notice of Proposed Rulemaking regarding the anticipated rewrite of the RBNW regulations, there is little doubt that the overall vetting process of the proposed regulations would have progressed in a much more efficient, effective and transparent manner. The allocation by the NCUA of the cost savings generated from an expedited RBNW rulemaking process to fighting fraudulent activity within a limited number of credit unions and assisting the management of credit unions with the development of rigorous and resilient internal control systems and procedures, instead, would have further enhanced the safety and soundness of the NCUSIF without increasing the NCUA's overall budget or placing any additional financial burden on an already overstressed credit union community and its members.²¹

Small is Small, A New Approach to Credit Union Regulation

I recently published an op-ed in the *Credit Union Times* entitled, "Small is Small, A New Approach to Credit Union Regulation."²² I am pleased that the editorial has been well received. In the op-ed I state:

It is significant to note that the NCUA generally adopts a two-tier regulatory structure when designing the implementation of its rules and regulations. Under a two-tier system, for example, credit unions with assets of \$100 million or fewer would be exempt from a rule or regulation, but credit unions with assets of greater than \$100 million would most likely be subjected to the full force of the rule or regulation.

This means that the NCUA would afford no regulatory relief to credit unions with assets between \$100 million and \$550 million, even though banks with an identical asset base would most likely benefit from a regulatory protocol more astutely structured to incorporate and reflect the small entity status.

To address this regrettable imbalance, the NCUA should increase the small entity asset threshold under the [Regulatory Flexibility Act] to \$550 million, like the FDIC, and endeavor to implement a three-tier regulatory structure. For example, credit unions with assets of \$100 million or fewer would be fully exempt from a rule or regulation (regulatory relief), credit unions with assets of greater than \$100 million but less than \$550 million would be subject to a rule or regulation specifically tailored to their small entity status (regulatory relief), and credit unions with assets totaling more than \$550 million would be subject to a rule or regulation that properly assesses and thoughtfully targets their relative threat to the safety and soundness of the

²¹ The NCUA has determined that fraud was a key contributor to (i) 45-percent of the losses to the NCUSIF over the past five years, and (ii) 43-percent of the losses to the NCUSIF over the past ten years.

²² J. Mark McWatters, *Credit Union Times*, October 6, 2015, "Small is Small, A New Approach to Credit Union Regulation," at http://www.ncua.gov/about/Leadership/Pages/mcwatters_publications.aspx.

NCUSIF.

If despite overarching legal concerns, a majority of the NCUA Board adopts the final RBNW today, I encourage the Board to revise the rule as soon as possible to incorporate such a three-tier regulatory approach under which (i) credit unions with assets of \$100 million or less would be fully exempt from the rule (regulatory relief), (ii) credit unions with assets of greater than \$100 million but less than \$550 million would be subject to a RBNW rule specifically tailored to their small entity status and the actual risk presented by such credit unions to the NCUSIF (regulatory relief), and (iii) credit unions with assets totaling more than \$550 million would be subject to a more fulsome rule, which would include supplemental capital (resulting in a measure of regulatory relief).

The incorporation of a three-tier regulatory approach into this exceedingly complex, overwrought, and flawed RBNW rule would help level the playing field with other financial institutions and grant much needed regulatory relief to credit unions with assets below \$550 million and not just those under the \$100 million threshold as currently contemplated.²³ The increasing number, scope and costs associated with regulatory requirements, not just from the NCUA but from all agencies, that credit unions must manage is a concern that the NCUA must take more seriously and devote more resources toward addressing in a meaningful way. The adoption of a three-tier regulatory approach for the RBNW rule would serve as an initial step in the right direction.

Dissenting Vote on Proposed Risk-Based Net Worth Rule

Since I am of the view that the NCUA Board does not possess the legal authority under the FCUA to adopt a two-tier RBNW standard, and based upon other major concerns with the rule I have addressed in this statement, I will not support the RBNW regulations as currently drafted. Further, I would find it problematic to support a single-tier RBNW standard unless the rule permits the inclusion—or at least acknowledges a good faith undertaking to investigate the viability—of properly structured supplemental capital in the calculation of the RBNW ratio to the fullest extent permitted by applicable law.

Thank you.

²³ As previously discussed, the RBNW rule should certainly follow the express statutory requirement of the FCUA on the definition of “complex” credit unions. For ease of description, however, the three-tier regulatory structure noted above parallels the approach to the definition of “complex” incorporated in the final RBNW rule.