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Remarks of J. Mark McWatters
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Prepared Remarks

Regulatory Relief for Credit Unions: Essential and Achievable¹

Thank you, Paul, for the kind introduction and to the Credit Union National Association for inviting me to speak this afternoon. I welcome the opportunity to share with you some of my thoughts on regulatory relief for the credit union community.

Regrettably, the day-to-day regulatory burdens of the credit union system appear unprecedented and steadily growing. The irony of this statement is not lost on a community that was neither a perpetrator nor an aider and abettor of the recent financial crisis. In fact, given the significant settlement recoveries and lawsuit collections received with respect to the reorganization of the corporate credit unions, it appears that the community was to a material extent a victim of those who packaged and sold dubiously underwritten mortgage-backed and other securities.

Although credit unions were certainly not without a measure of meaningful culpability, how odd it seems that the NCUA has continued to pummel a financial services community that stayed on message and continued to operate substantially unimpaired while extending consumer and small business credit to the middle class, the underserved and the unserved during the darkest days of the financial crisis. The dilemma you face, however, is that the NCUA is the source of both your regulatory burden and any offsetting relief.

As an NCUA Board member, I make it a point to spend a substantial amount of time listening to members of the credit union community, thinking about your regulatory burdens and considering how well-managed institutions can achieve meaningful and measurable relief from the endless waves of compliance requirements, without threatening the safety and soundness of the National Credit Union Share Insurance Fund or the community itself.

Many of you tell me that no single rule serves as your biggest worry, and I appreciate the sophistication of your insight. While several individual rules and proposals have created much anxiety, such as the Current Expected Credit Loss (CECL) proposal from Financial Accounting Standards Board, the NCUA's risk-based capital rule, and the CFPB's TILA-RESPA Integrated

¹ Due to time constraints, I was unable to read the entire speech from the podium on Monday, February 22, 2016.

Disclosure (TRID) requirements, it is the totality of the regulatory burden that presents the most problematic issue for the community.

Yet, despite the high cost of the regulatory burden visited upon credit unions in terms of distracting management and the expense of attorneys, accountants, and compliance experts, credit unions tell me they have not benefited from measurable regulatory relief. Although there were some positive regulatory steps and proposals taken in 2015, the essential question remains: Where is the true regulatory relief for credit unions that is in proportion to the total burden you feel and the risk your institution objectively presents to the Share Insurance Fund?

Credit unions should not, in essence, be sentenced to increasing burdens without prospects for less intrusive regulations. We must do better than maintaining the status quo.

How Did Credit Unions Become So Highly Regulated?

It is puzzling that credit unions are so highly regulated. I have reflected on this issue and considered the following questions:

- Is it because the credit union system is so large and interconnected that many rules are needed to contain it?
- Is it because the credit union system is so inherently risky that many rules are required to control those risks?
- Is it because credit unions have created major problems in the economy and for the taxpayers?
- Is it because on a consistent and regular basis credit unions abuse their members?
- Is it because the credit union community is too big to fail and presents a systemic risk to the financial services community, the economy and the taxpayers?

Of course, 'No' is the answer to all of these questions.

Causes of Credit Union Regulatory Burdens

In my view, there are six key factors that have contributed to the high level of regulation that the credit union system faces today:

- The advocacy effectiveness of other financial services institutions;
- Non-targeted reaction to examination issues from the NCUA;
- Isolated, but significant problems within a limited number of credit unions at critical times;
- Problems, not prosperity, drive policy;
- The credit union system has not always communicated what ‘regulatory relief’ means; and
- Credit unions have many regulators, but there are few who champion regulatory relief that matches the level of your regulatory burden and the risk your institution objectively presents to the Share Insurance Fund.

I would like to elaborate on these factors.

Probably the easiest examples that reflect the advocacy of other financial institutions are the restrictions on member business lending) and field of membership that were included in the Federal Credit Union Act in 1998. Such limitations are difficult to address by the NCUA, as the agency must always comply with the letter as well as the spirit of the act. The NCUA has recently updated the MBL rule and is considering improvements to the field-of-membership rule that are within the confines of the Federal Credit Union Act.

Although the comment period on the proposed field-of-membership rule has closed, I would welcome the opportunity to learn your reactions, suggestions for improvement and concerns regarding the proposed rule.

The second factor is that regulators tend to address problems with broad based solutions, often overlooking less intrusive and elegant approaches that are more targeted and specifically directed to the outliers that present the actual risk to the Share Insurance Fund. Policymakers, including

the NCUA, responded to the financial crisis and the credit union community as a whole shared the burden. Although the issues affecting many of the corporate credit unions and a relatively small number of the natural-person credit unions during the financial crisis should have been identified earlier by the NCUA and other financial regulators, was it truly necessary for most credit unions to be included in many of the provisions that now affect the operations of the credit union system?

That said, I fully appreciate that in a crisis, there is often little time for a tailored approach. Yet, after the crisis has calmed, it is entirely appropriate to convert the one-size-fits-all crisis-based response to a more thoughtful and targeted approach.

Further, reports issued over the past few years from the Government Accountability Office and the NCUA Office of Inspector General have cited examination inadequacies at the NCUA.² Yet, I am not aware the NCUA has addressed these internal deficiencies sufficiently. Moreover, rather than tailoring an examination finding to a discrete subset of relevant credit unions, the agency often seeks to develop a new rule or supervisory directive that applies to many, if not most credit unions.

Messaging is another important factor. I commend your efforts to educate members of Congress and agency officials about the level of your regulatory burden. Also, the Senate Banking Committee, as well as, the House Financial Services Committee and other members of Congress have sought to address regulatory relief. We operate in a political environment, and I appreciate that sometimes grabbing a slice of a legislative agenda rather than bringing home the whole pie is all that one may reasonably achieve. Even so, a clear and consistent message from the credit union system on specific changes to the Federal Credit Union Act that will bring the most relief to the greatest number of credit unions is of critical and fundamental significance.

In my view, the most important factor contributing to regulatory burden is the absence of a critical mass on Capitol Hill. By that I mean, the key to achieving true regulatory relief resides in the ability of the community to turn to a solid and sizeable number of policymakers who understand the role of credit unions, support your issues and champion your causes.

² U.S. Government Accountability Office, "*National Credit Union Administration: Earlier Actions Are Needed to Better Address Troubled Credit Unions*," GAO 12-247. Washington, D.C. 2012. See, <http://www.gao.gov/assets/590/587409.pdf>. National Credit Union Administration Office Of Inspector General, "*Material Loss Review Of Telesis Community Credit Union*," Report #OIG-13-05 March 15, 2013. See, <https://www.ncua.gov/About/leadership/CO/OIG/Documents/OIG-13-05MLRTelesis.pdf>. Other OIG reports that reached similar conclusions about NCUA exam deficiencies may be found at <https://www.ncua.gov/About/pages/inspector-general/material-loss-reviews.aspx>

The need for more policymakers to understand the extent of your regulatory burden and to come together for credit unions has never been greater. Strong and numerous allies can also ensure the ongoing oversight of agencies, including the NCUA. The Senate Banking and House Financial Services Committee hearings last year were important steps, and I encourage more oversight in 2016 and beyond.

Is Regulatory ‘Overburden’ the New Normal?

In another time, perhaps we could have used the approach to rules and regulations that a major retailer, Nordstrom, used in the past and now says is its number one rule—“at all times use your good judgment—no other rules are needed.”³ But, in our current economic environment, rules and regulations are certainly needed and desirable, as long as they are fair, effective, targeted and transparently administered. However, returning to a reasonable level of such rules and safety and soundness standards for the credit union community is needed today.

I think most of us would agree that the Goldilocks’ approach—not too few nor too many rules, but rules that are “just right” in addressing specific problems without undermining credit unions’ ability to execute on their business models and manage their operations—is an appropriate solution to this vexing issue.

Yet, in the wake of the financial crisis, there has not been such a balanced approach and overregulation has resulted. Overregulation is not just too many rules, it is also the NCUA looking beyond the Federal Credit Union Act to justify the RBC rule and excessive CUSO oversight, as well as actions to:

- Eliminate rather than manage risk;
- Impose supervisory practices without articulating a nexus to either the Federal Credit Union Act or agency regulations;
- Continue a broken exam appeals process, substantially devoid of even modest tenets of due process;
- Refuse to allow flexible approaches to compliance;

³ See, <http://www.klariti.com/employee-handbook/Nordstrom-Employee-Handbook.shtml>

- Increase reporting burdens;
- Ignore market innovations; and
- Adopt regulatory requirements premised on too much examiner discretion and the reliance on ill-defined and poorly communicated concepts of “best practices.”

Overregulation creates adverse and immediate economic consequences as it needlessly drives up the costs of operation for the NCUA, for state regulators that must administer the NCUA rules, for credit unions and, most importantly, for credit union members. Yet, overregulation will remain the normal operating procedure into the future unless your perspective is accepted by Congress and other policymakers and the resulting costs to consumers from the excess regulation of the credit union community is effectively communicated on a timely basis.

Principles of Appropriate Credit Union Regulation

While too much regulation is unsustainable, a more balanced approach can only result if the NCUA adopts a more enlightened perspective of its regulatory mandate. Instead of the current approach, right-sized regulation that focuses on risk management, identifying material problem areas, correcting deficiencies and containing outliers, while staying out of the way of well-managed credit unions, should serve as the guiding objective of the NCUA. Not every examination issue should serve as the justification for a rule and the agency should tailor new rules to address systemic issues and not the occasional, one-off concern that is best addressed during the examination process.

Rules are not immutable and the NCUA should diligently undertake to remove or lessen the impact of outdated, ineffective or inappropriate rules on the credit union community.

Moreover, the NCUA does not always know best, and working with and replacing specific rules with increased examiner discretion very likely does not yield regulatory relief. Credit unions should feel unencumbered to challenge examiner directives in a meaningful, unambiguous manner, replete with due process rights, that does not preordain the outcome for the benefit of the NCUA or present issues of retaliation or bad faith. And, the NCUA should remain mindful that the agency has no more power than what Congress provides and that the agency exceeds its statutory authority at its peril.

Of course CUNA, NAFCU, NASCUS, NACUSO, and others support regulatory relief measures and I welcome their efforts. For example, if you haven't heard of the SCRUB Act, H.R. 1155, I urge you to take a look. It has already passed the House and, if enacted, would set up a regulatory review commission as well as establish a process to repeal regulations under certain circumstances. Although it would stop its operations after five years, the framework appears promising. Notably, H.R. 1941, the Financial Institutions Examination Fairness and Reform Act, which has passed the House Financial Services Committee, would set up a new office at the Federal Financial Institutions Examination Council to hear examination appeals outside of the examiner's chain of command, including those of credit unions.

These Congressional and other steps would provide welcome regulatory relief to the credit union community.

More Relief is Needed—What Should the Regulatory Relief Package Look Like?

Additional regulatory relief—that is, in full proportion to the regulatory burden you carry and the actual risk presented by the credit union community to the Share Insurance Fund and the taxpayers—is essential to avoid a perpetual drag on the operations of the credit union community.

Only you can say for certain what you need in terms of regulatory relief, but please allow me to highlight a few issues that may serve as a basis for a more comprehensive approach to regulatory relief that, in my view, will not impair the safety and soundness of the Share Insurance Fund or the credit union system.

Although I did not originate all of these ideas, I wish to identify 21 thoughts and combine others to achieve a broad based proposal of regulatory relief as it relates to the NCUA.

- 1) We must remember that this is 2016, and not 2008, and it is counterproductive to refight the last battle—that is, the financial crisis battles of 2008 and 2009. Instead, we should engage in forward thinking to address new challenges and threats to the Share Insurance Fund and the credit union community. This approach should include corporate, as well as natural-person, credit unions.
- 2) Absent documented significant, systemic supervisory problems, the NCUA should declare a moratorium on the issuance of any new material rules that limit credit

union activities or impose new restrictions system wide, at least for a reasonable period of time as we assess the totality of credit unions' regulatory burdens.

In my view, as long as the credit union system continues to perform well, as it is today, the NCUA should, to the greatest extent possible, deal with individual problem issues through the supervisory process and, except as noted, not by imposing new requirements on the remainder of the credit union community.

That said—and this is of critical importance—the agency should remain vigilant against unanticipated, contrarian, Black-swan threats to the Share Insurance Fund and not hesitate to act in a professional and unequivocal manner to address any such threats. And, of course, as I have noted, any such actions must follow the letter and spirit of the Federal Credit Union Act.

- 3) The NCUA should utilize the moratorium period to scrutinize all of its rules, policies, and guidance and remove or improve those that are out of date. The agency should not needlessly draw out this process and should avoid replicating the current review of rules on a three-year cycle that many in the credit union community view as merely pro forma, if not unhelpful.

Going forward, the agency should undertake to issue new rules on a targeted basis after thoughtfully considering the actual risks presented by the credit union community to the safety and soundness of the Share Insurance Fund and the community itself.

- 4) The NCUA should respect the due process rights of the credit union community by implementing an examination-appeals process where each party is represented by counsel before an impartial tribunal. The agency's examination process should allow credit unions to challenge examiner findings and directives in an open and fully accountable manner without fear of retaliation or retribution.
- 5) The NCUA should establish a credit union advisory group charged with making—in a transparent manner that follows objective governance and reporting standards—recommendations regarding the removal or modification of outdated rules. The advisory group should also offer recommendations regarding regulatory action that could facilitate more effective and efficient credit union operations.

The NCUA should also engage more with the credit union system and learn from the community itself concerning such matters as fraud prevention, supplemental capital, the regulatory and economic challenges of small credit unions and a fair-minded appeals process.

- 6) The NCUA should conduct onsite examinations as infrequently as prudently possible (for example, every 18 months for certain well-capitalized and well-managed credit unions). The agency should also respect the dual charter system and rely on examinations conducted by state supervisory authorities to the extent it is reasonable to do so.

Further, the NCUA should respect the ability of state supervisory authorities to contribute to the regulation of federally insured state chartered credit unions in a meaningful and competent manner. Regulatory wisdom does not reside exclusively within 1775 Duke Street in Alexandria. Instead, it should emanate from the collaborative good faith efforts of federal and state regulators.

- 7) The NCUA should ensure that examiners conduct their operations in a manifest and accountable manner by avoiding the "because I say so" mentality that seldom works even with two-year olds.
- 8) The NCUA should disclose in writing to credit unions the legal, financial, accounting, and regulatory basis of their examination findings and actions. Likewise, examiners should rely, to the least extent possible, on 'best practices' justifications for their actions unless they are clearly supported by statute or regulation and are communicated in an objective and transparent manner to the credit union community on a timely basis.
- 9) The NCUA should expand its hotline to the NCUA Inspector General so credit unions may specifically report, on an anonymous basis, instances of intimidation, retaliation, retribution, or inappropriate behavior by examiners, other employees or independent contractors of the NCUA.
- 10) While, as previously noted, the NCUA should hold off on new credit union limitations, the agency should publish market-based rules permitting credit unions

to access supplemental capital for RBC purposes, because the NCUA should encourage credit unions to maintain and grow their capital.

- 11) The NCUA should respect the business models and plans of credit unions, except where they fall objectively out-of-bounds.
- 12) The NCUA should not meddle in the day-to-day operations and internal affairs of credit unions, except as required to address a viable threat.
- 13) The NCUA should modernize many of the restrictive rules that are oppressing the growth and development of the corporate credit union system today. As noted, the agency should acknowledge that what was appropriate in 2008 and 2009 should not burden a reorganized corporate credit union system in 2016. After all, what may have reasonably registered to many as gross mismanagement by the corporates a few years ago, appears at least somewhat less so today after the stunning inflow of settlement and lawsuit recoveries on the sketchy investment securities sold to the corporates.
- 14) The NCUA should work to preserve minority- and women-owned credit unions because it is the right thing to do, and these institutions often provide financial services to the underserved and unserved at competitive rates, helping to address the troublesome issue of income inequality.
- 15) The NCUA should disclose, in a transparent manner, the ongoing resolution of the administrative actions taken by the agency during the corporate crisis; the proceeds received from the settlement or other resolution of the corporate crisis-related lawsuits, including the amount of legal fees and other expenses paid; and the ongoing changes to the fair market value of the assets securing the agency's Guaranteed Notes program.
- 16) The NCUA should disclose, in a transparent manner, the stress-test methodology the agency relies upon, particularly when the methodology is challenged by credit union internal or third-party analysis. It is inappropriate to inform a credit union that it is deficient under some metric without also addressing, in an open manner, credit union analysis to the contrary. Reasonable minds may differ on these matters and the agency should welcome the debate.

- 17) There are issues of fraud that plague a limited number of credit unions, and the NCUA should immediately redouble its efforts to address this problematic and thorny issue. It is distressing that over 40-percent of the losses to the Share Insurance Fund are attributable to fraudulent activity within credit unions. With enhanced examiner training, the adoption of appropriate internal controls and employee intake and supervision protocols, and meaningful input and counsel from members of the credit union community who have developed and implemented successful anti-fraud systems, I remain optimistic that the agency can identify and manage instances of fraud within the credit union system.
- 18) If necessary and appropriate, the NCUA should work with the FDIC and Comptroller of the Currency to minimize, in a thoughtful manner, any ill-considered and adverse effects of FASB's efforts to change reporting of possible credit losses at credit unions and community banks under the CECL proposal.

In my view, it is helpful that FASB has agreed to consider the comments of credit unions and community banks regarding the potential unintended consequences of the proposed rule.
- 19) I encourage credit unions to work together promptly in good faith to develop and implement consumer-driven principals that guide programs such as overdraft protection, student lending, debt collection and other similar issues.
- 20) Absent economic and regulatory circumstances the NCUA cannot handle within its current operating budget, the agency should use its best efforts to decrease or, at a minimum, materially reduce the rate of growth in future operating budgets.
- 21) While the NCUA should, without hesitation, address cybersecurity threats within the credit union community, the agency should not use cybersecurity issues as a justification in support of a request for broad based vendor authority or the issuance of new rules in non-cybersecurity areas. Thoughtfully targeted, designed and implemented vendor authority in the cybersecurity area, however, appears reasonable and prudent.

How Can We Initiate this Approach?

What I propose today should offer assistance to the credit union community. Quite frankly, it is relatively easy to develop the “ideal concept” of regulatory relief as the burdens on the credit union community appear quite obvious, from my perspective. The challenging part is to achieve the implementation of actual regulatory relief in the near to intermediate term.

Most of what I am suggesting will not require a new law, yet without insistence from Congress, I fear business as usual will continue at the NCUA and more rules will follow. In your meetings with members of Congress, consider raising these points and urge your Senators and Representatives to offer their support. If you have already met with your members, follow up and urge them to champion regulatory relief for the credit union community. Some of you are also meeting with regulators, including me, this week, which I encourage. Discussing the deployment of a more positive approach to regulatory relief for well-managed, consumer-oriented institutions is certainly appropriate.

As I have noted during my speaking engagements throughout the country, in an age of burgeoning income inequality, credit unions have a compelling story to tell Congress, the financial services community and the taxpayers. Remarkably, credit unions have developed business models and plans that specifically target their members, through which they serve the middle class as well as the underserved and otherwise unserved—without the motivation of the Community Reinvestment Act—and in most instances, while earning income in a safe and sound manner.

I encourage you to continue your efforts and tell this story on Capitol Hill.

Conclusion

Please allow me to conclude with this. Credit unions of every size and charter type have too many regulatory burdens. I am not suggesting I have all of the solutions, but I hear your frustrations and have tried to put forth some ideas that will provide true regulatory relief without impairing the safety and soundness of the Share Insurance Fund or the credit union community.

You may have read that the president has announced his intention to nominate me for another federal post. I am honored. You may also be aware that the Senate directs the process and will

make the final decision regarding my confirmation, a process that usually takes time—perhaps, a substantial period of time.

Throughout my tenure at the NCUA, I will continue to advocate for regulatory relief and the agency’s proper approach to the supervision of the credit union community. Regulatory relief is not merely useful. It is among the most fundamentally important concerns facing the credit union system today. I welcome your efforts to assist the community, either along the lines I have addressed today or in another manner you and your colleagues consider appropriate.

Since coming to the NCUA, I have met many wonderful credit union people and have learned to appreciate the outstanding service credit unions provide to their members, communities and to our nation.

I wish you all the very best—you deserve it as the heroes of the credit union community.⁴

Live long and prosper.

Thank you.

⁴ See, Op-Ed by J. Mark McWatters, *Credit Union Times*, January 29, 2016, at <http://www.cutimes.com/2016/01/29/credit-union-heroes-should-step-up-to-the-mic>.