



Client Update - Thursday, June 20, 2019

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NCUA BOARD EXTENDS RISK-BASED CAPITAL EFFECTIVE DATE UNTIL 2022, VIRTUALLY ENSURING IT WILL NEVER GO INTO EFFECT AS DRAFTED

The NCUA Board, by the first but likely not the last 2-1 vote of the Hood-Harper-McWatters three-member board, today pushed back the effective date for the agency's Risk-Based Capital (RBC) rule to January 2022.

Since this issue was first proposed seriously in 2012 and several iterations later became a final rule in 2015, this essential means that RBC as currently structured is unlikely to ever go into effect in its present form.

With ten years of market changes, two NCUA Chairman ascensions and at least one serious congressional effort to delay RBC from going into effect as scheduled, it is our view that this action - by far the most significant indicator of what to expect from the NCUA Board under new Chairman Rodney Hood - will require the RBC rule to be re-written dramatically if it is to ever become effective.

Supplemental capital through subordinated debt, confirmed again today as remaining on the agency's priority list for regulatory action over the next year or so, will absolutely have to be incorporated into a revised RBC formula for risk-weighting and calculation into a credit union's RBC ratio.

The longstanding concern about how marketplace changes can alter the basics upon which the one-size-fits-all risk weights were calculated in both the initial RBC proposal (affectionately known as RBC1) and the subsequent RBC final rule (called RBC2) has certainly been brought to the forefront by the taxi medallion credit union losses that came about due to serious disrupters like Uber and Lyft changing the dynamics of what had been some of the safest and soundest credit unions in the country up until that point.

RBC must become more credit union by credit union flexible and less prescriptive in its risk-weighting regime. Supplemental capital must be incorporated, even if a rule never comes on subordinated debt for all credit unions, because over 2600 low-income credit unions are eligible to issue supplemental capital today.

RBC is going to have to change if it is to ever become an implemented final rule. The NCUA Board majority (Board Member Todd Harper, closely aligned with former Chairman Debbie Matz who was the leading proponent of RBC during her tenure at NCUA, voted against it, thus showing his continued adherence to the Matz position he once represented as a staffer to her) has wisely chosen to delay this rule in order for a more complete examination of what should actually be in a 2022 RBC rule with a 2022

market - rather than a 2015 rule in a 2022 market.

They will be accused of surrendering to the industry they regulate. That comes with the territory. But the NCUA Board, under Chairman Hood and with former Chairman McWatters as a solid second vote, is obviously not afraid to address the inadequacies of a capital rule controversially put in place by their predecessor board.

This action reflects the ongoing ebb and flow of regulatory actions and changes to those regulations over time as boards and circumstances change.

Chairman D'Amours passed the Community Action Program as a type of CRA for credit unions until the Dollar administration reversed it before it went into effect. D'Amours strongly supported exclusionary clauses in a federal credit union's FOM until the Dollar majority board opened up FOM to the marketplace within the newly enacted at that time 1998 Credit Union Membership Access Act.

The Dollar administration passed and implemented RegFlex until the Matz administration undid it. Same with some of the Dollar approach to FOM, dramatically restricted by subsequent 2010 FOM rule changes under the Matz administration.

And, as it happens, the Matz administration was totally in on RBC as absolutely essential in their view, but now the McWatters and Hood administrations are essentially delaying it into a timeline that will make it difficult to implement with any real impact.

Again, it is the swinging pendulum of federal regulation.

There will always be future boards with future priorities dealing with future circumstances. It happens in every industry and with every regulatory agency.

This action today is the never-ending regulatory pendulum swinging election to election, chairman to chairman, board to board and circumstance to circumstance.

For those who are still in credit union leadership roles in 2032, they will have seen this pendulum shift a couple of more times. It is inevitable.

WHAT DOES THIS SAY ABOUT THE HOOD CHAIRMANSHIP?

For those who knew Board Member Rodney Hood in his previous tenure on the NCUA Board from 2005-09 and felt he was not as aggressive in his leadership position as some would have liked, I have said for years that one underestimates Rodney Hood at their own peril.

I can tell you first-hand that there is a distinct difference in the leadership role a person can play as one member of a three-member NCUA Board and the impact he or she can have when bestowed with the gavel and the chairmanship at the agency.

In my view, Rodney was an effective NCUA Board Member. He actually took my former seat on the board and was a leader on some progressive issues at the agency in the arena of promoting reasoned capital reform and moving credit unions into the next decade when it came to the agency's view of technology.

From the time he was designated NCUA Chairman (even though I was and remain very high on former Chairman McWatters), I felt and have shared with you that he is likely to surprise observers with his progressive approach to regulation and his understanding of the marketplace.

Chairman Rodney Hood is bright and experienced. Today's action shows that he does not feel himself bound to refusing to reconsider agency precedent and that he is not going to be controlled by the permanent NCUA staff - who were the primary architects of RBC when Chairman Matz gave them marching orders to draft it and put it in place.

The action by the NCUA Board today, at least for as long as Board Member McWatters hangs around, indicates several things.

First, there will be an increase in 2-1 votes. Board Member Harper, a brilliant person in his own right, is more likely to oppose the Hood-McWatters majority verbally and increasingly as he gets his feet on the ground as a NCUA Board Member.

His ties to the Matz administration give him some equity position to oppose some of the Hood-McWatters initiatives to reverse some of the Matz actions at NCUA. This is almost certainly to continue as he positions himself to be considered for the NCUA chairmanship in 2021 if a Democrat wins the White House in the 2020 elections.

Secondly, we will see a more activist NCUA board under Chairman Hood than many expected.

Supplemental capital with subordinated debt options, in some form, is much more likely to become a reality under the Hood chairmanship now with having to incorporate it into an already implemented RBC regulation.

It is very possible that you may see a considerable movement forward on a supplemental capital rule within the next 12-18 months under Chairman Hood. As capital modernization is crucial to long-term credit union viability and is essential if some future RBC regulation is actually going to work for credit unions, action on a supplemental capital rule is crucial.

Thirdly, from his past positions, we know that Chairman Hood is very progressive on field of membership. He recognizes that the federal charter has fallen well behind the state charter in being competitive from a credit union growth perspective.

We would expect Chairman Hood, as long as he has a majority of like-minded Board Members, to continue to look for ways to not only enhance the federal FOM rules - but also to return the agency staff to a position of trying to help credit unions get to "yes" on a field of membership expansion rather than delaying them into virtual "no" territory for fear the bankers may challenge the action.

Chairman Hood is very likely to say to the bankers, bring it on. He would probably say that we at NCUA must do what it takes to enable credit unions to have a regulatory environment whereby they can compete, grow sufficiently to develop scale and maintain themselves as safe and sound institutions.

We would not be surprised to see him begin exploring a more updated and modernized definition of what constitutes "reasonable proximity" for a member to be able to access

credit union services.

The longstanding interpretation, although not written in statute, regulation or guidance, has been by NCUA that a SEG - either employer or associational - must be located within 25 miles of a credit union branch before the agency will approve the credit union to serve that SEG.

In this era where members carry their branches around with them in their pockets with a smart phone or tablet, this is tremendously outdated thinking. Nothing short of eliminating FOM restrictions at all (which cannot be done because it is specified in federal law that a credit union must have an approved FOM) would go further to modernize FOM and the delivery of member service than to address this antiquated view of "reasonable proximity."

Based upon his previous support of technology as a driving force in the delivery of credit union services to persons from all walks of life and with him being a Trump appointee put in position to expand and not restrict access to credit in order to protect a federal agency's historical interpretations or expansive grabs for additional authority, Chairman Hood may just be the NCUA leader that can move the agency out of the 1980s in this regard.

Today's action certainly shows that he and Board Member McWatters are not afraid to team up for substantive action that makes sense in today's marketplace.

It is a good indicator that, should it continue, may be a harbinger for a very effective chairmanship at NCUA under Chairman Hood.

Until next time.

Dennis Dollar