

GOVERNMENT ACCOUNTABILITY OFFICE REPORT ON NCUA BOARD INDEPENDENCE AND OBJECTIVITY

December 1, 2006

This report was requested by House Ways and Means Committee Chairman William Thomas because according to the report, statements from the NCUA Board Chairman and another board member raised issues about the agency's "overall vigilance" as a regulator and the "independence and objectivity of NCUA's board and senior staff from the industry being regulated." As a result of those statements, GAO was asked to review governance policies and procedures for NCUA's board and senior staff, and how the policies and procedures address independence and objectivity.

To accomplish that objective, GAO reviewed statutory criteria for the selection of NCUA board members and six other financial regulatory agencies, the Commodity Futures Trading Commission, the Farm Credit Administration, the Federal Deposit Insurance Corporation, the Federal Housing Finance Board, the Board of Governors of the Federal Reserve, and the Securities and Exchange Commission. These particular agencies were selected because they are all financial regulators with either a board or commission similar to NCUA. For each agency, GAO compared the statutory criteria for qualification of board membership, the background and experience of board members, statutory requirements for board structure, agency guidance and the agencies' use of Schedule C (political appointee) staff. GAO also analyzed academic and industry literature on recommended management practices, and compared controls and related procedures.

A summary of the report is below, beginning with the recommendation.

Recommendation

The report contains no legislative recommendations to Congress and confines its recommendation to NCUA, to address perception issues regarding the agency's independence from and objectivity about the industry it regulates.

- GAO recommends that the Chairman of NCUA consider adopting agency practices that other financial regulators use to enhance their independence and objectivity. These practices, GAO said, include drafting agency specific rules to maintain an arm's length relationship with its regulated institutions and including independence and objectivity as core values in the agency's strategic plan. (As an example, GAO notes that NCUA could adopt additional independence and objectivity guidance similar to the Federal Housing Finance Board's (FHFB's) Standards of Conduct that require FHFB employees, including its board, to maintain an arm's length relationship with the regulated industry. Similarly, NCUA could consider including

independence and objectivity as core values in the agency's strategic plan, similar to FHFB and the Federal Reserve Board.)

Findings

- NCUA follows the Office of Government Ethics rules regarding ethical standards for employees and the Federal Credit Union Act addresses independence through provisions such as fixed term limits for Board Members and the apportionment of the Board among political parties. However, most of the other financial regulatory agencies have additional controls and procedures that address independence and conflicts of interest.
- The qualifications for NCUA Board membership are similar to those of most of the other financial regulatory agencies. The professional backgrounds and qualifications of current and prior NCUA Board members are similar.
- The current size of the NCUA Board is not consistent with recommended practices, not consistent with the size of the boards at the other financial regulatory agencies, and may hinder communications among the members. Board members are limited in communicating with each other directly outside of board meetings, due to restrictions that limit nonpublic meetings of the majority of the board. GAO also noted lengthy board vacancies in which the board only included two members, which limits diversity of perspectives, experience, and political party representations.
- NCUA's use of Schedule C positions was generally similar to the practices at the other financial regulatory agencies. (Schedule C positions are those that determine policy or involve a close, confidential relationship with a board member or other key official at the agency). GAO noted that four of these positions are currently occupied by individuals who were formally affiliated with the same credit union trade group. GAO also acknowledged that there are Schedule C appointees at other agencies who were also formally affiliated with trade groups.

Conclusions

- NCUA has a number of controls and procedures in place to address independence and objectivity of board members that are similar to those at the other agencies it reviewed.
- To address political independence of board members and commissioners, NCUA and the six other agencies have multiple board or commission members, the members are subject to Senate confirmation and have fixed terms limits. Also, the agencies have restrictions on the number of members that can be of the same political party.

- NCUA Board and staff, like other federal employees are required to adhere to the Office of Government Ethics' *Standards of Ethical Conduct of Employees of the Executive Branch*, which sets standards for maintaining impartiality as well as avoiding conflicts of interest.
- However, opportunities exist for NCUA and policy makers to address perception issues regarding its impartiality as a regulator.
- NCUA could consider adopting, with appropriate modifications, one or more of the additional practices identified by officials of five of the six other agencies reviewed. By adopting one or more of the practices that the other regulators use, NCUA would reinforce the message that independence and objectivity are enduring and achievable values and goals for all staff.
- Consistent with the GAO's 1991 report on NCUA, GAO continues to believe that consideration should be given to exploring the potential benefits and costs associated with increasing the number of NCUA Board members. NCUA has sometimes experienced board vacancies, which resulted at times in fewer than three active members. Additionally, some NCUA board members have noted that the public meeting restrictions of the Government in the Sunshine Act effectively, at times, constrain communication and collaboration, since any meeting involving two of the board members to deliberate official agency business must be public.
- GAO notes several potential advantages that could accrue from having a larger board. They include helping to provide a broader perspective on financial market regulatory and insurance issues, offering opportunities to enhance continuity of expertise and decision making on the board, and improving communication among board members.
- GAO acknowledged that there would be some financial and potential efficiency costs associated with increasing the size of the board but believes it would be worthwhile to consider.
- Although Congress did not adopt GAO's 1991 recommendation, the size of the board should be periodically reviewed to ensure the agency has the most appropriate board size for its current resources.

NCUA's Response

- NCUA is not opposed to the recommendation to consider adopting agency's specific ethics guidance and said it will consider including the concepts of independence and objectivity as part of its values and mission in its future strategic plans and annual performance budget.

- However, NCUA said that such action may not result in more rigorous standards than those already imposed by the Office of Government Ethics rules.
- GAO responded that its recommendation is not limited to agency specific standards and the practices of other regulators, such as results that require an arm's length relationship with the regulated industry, could enhance NCUA's controls and help with perception issues associated with its impartiality.
- NCUA does not agree that the size of the board should be increased as it would cost at least \$1.1 million annually. NCUA said it was addressing the concern GAO has raised about impartiality by focusing on maintaining an adequate expert field staff.