

Q&A ABOUT NCUA'S 2013 BUDGET AND RECENT BUDGET PROCESS

The NCUA Board is committed to running the agency as efficiently and prudently as possible to fulfill the agency's mission to protect the safety and soundness of the credit union system. Here are answers to questions NCUA has received about the 2013 budget and general budget process, to help clarify the "why" behind the agency's budget decisions.

The NCUA Board takes its oversight role very seriously, and constantly pushes the agency to become more efficient in its stewardship of credit union funds. The 2013 budget meets that test.

Q. Why have NCUA's recent annual budgets increased?

At the outset of the financial crisis, the NCUA Board made several responsible policy changes, each of which affected NCUA's budget needs. The two most significant policy changes impacting the budget were:

- 1) Eliminating the 18-month exam cycle and replacing it with an annual exam cycle (with CAMEL 3, 4, and 5 credit unions receiving even more frequent supervisory attention), and
- 2) Conducting insurance exams for state-chartered credit unions with assets over \$250 million in assets (rather than the previous \$500 million asset threshold).

These new policies responded to Material Loss Reviews by NCUA's independent Inspector General. These postmortem analyses of credit union failures found serious threats had developed at credit unions between examinations under the previous 18-month exam cycle. Failures could have been prevented and losses would have been significantly reduced with timelier onsite visits to detect and address material issues earlier. Averting just one \$120 million credit union failure covers the salary and benefits of virtually the entire 2012 NCUA examiner force.

Of course, these new policies required increased examiner hours, an expanded workforce needed to execute the necessary supervision tasks, and higher travel costs. However, the policy decisions worked as intended: to minimize credit union failures and associated losses to the National Credit Union Share Insurance Fund (NCUSIF). *In doing so, NCUA protected credit unions and their members from paying for higher losses; the total 2009-2012 budget increase amount of \$59.0 million prevented up to \$1.1 billion in further losses credit unions would have had to pay for credit unions that were on the brink of failure.*

The share of assets held in credit unions with CAMEL ratings of 3, 4 or 5 *nearly quadrupled* during the height of the crisis from historical norms. At the same time, the need to provide increased supervision of troubled credit unions increased NCUA budgets and outlays. Specifically, during the crisis the share of natural-person credit union assets associated with troubled CAMEL 4 and 5 ratings *more than quadrupled* over historical norms, to a high point of over 5% of assets – over \$50 billion held in troubled credit unions.

Such combined failures could have overwhelmed the NCUSIF and devastated the entire industry had NCUA not immediately dealt with them. NCUA enhanced supervision, and struggling credit unions stepped up and worked hard to improve their operating efficiencies.

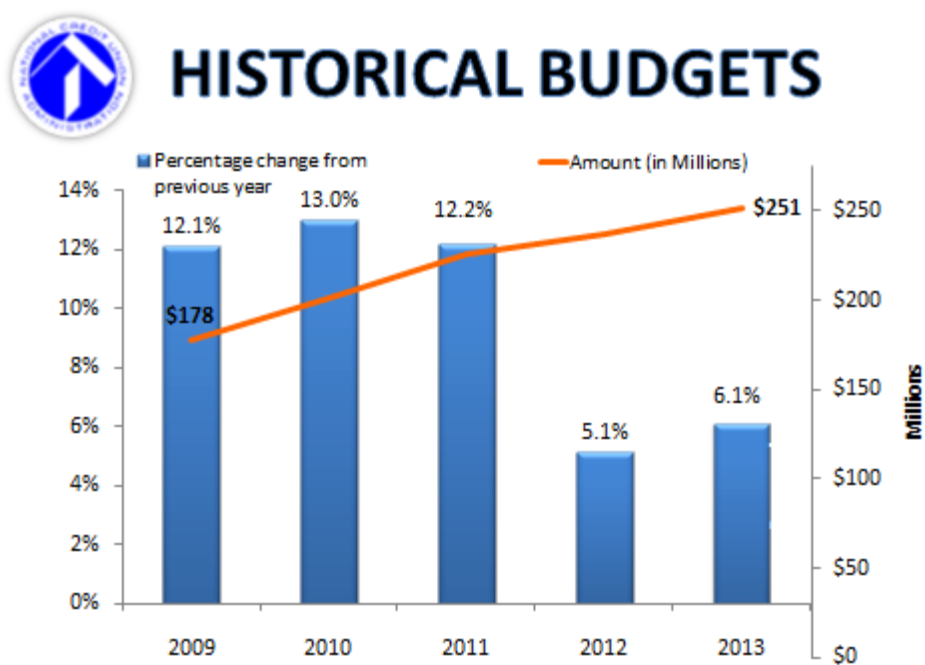
As a result of collective action by both the industry and regulators, coupled with a slow but steady economic recovery, overall credit union metrics are improving today. However, in the second half of 2012 there were still 382 credit unions in troubled condition (rated CAMEL code 4 or 5), with six larger than \$1 billion. Altogether these 382 credit unions still hold over \$23 billion in combined assets.

Comparing that \$23 billion remaining risk exposure level to \$11.9 billion invested by the NCUSIF, continued vigilance and supervision is necessary to help return as many troubled credit unions to higher CAMEL ratings as possible, and prevent future losses to the NCUSIF. NCUA's 2013 budget and those of recent years were a necessary means to accomplish the agency's statutory mission and ensure continued consumer confidence in the credit union system.

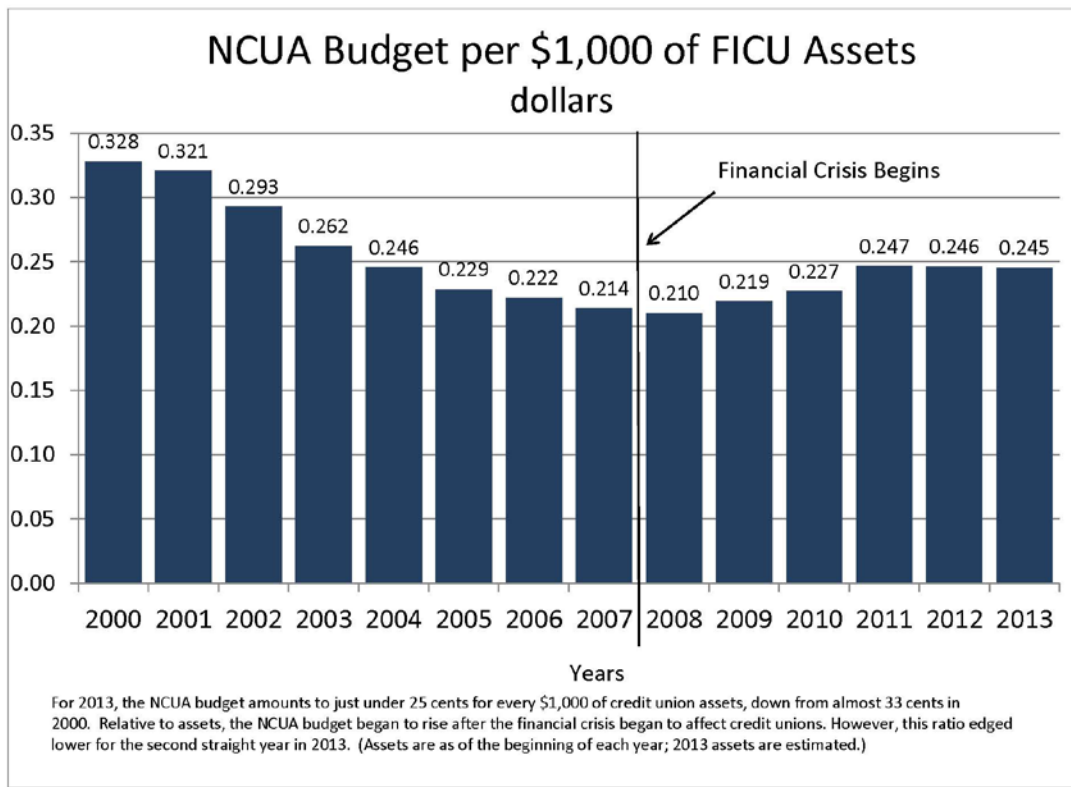
NCUA's budgets reflect core strategic goals which are consistent year over year (see NCUA Strategic Plan 2011-2014 at www.ncua.gov/Legal/Documents/Reports/Plan2011-2014Amend12-11.pdf), with the primary focus on maintaining a healthy credit union system and NCUSIF to accomplish the agency's statutory mission and ensure continued consumer confidence in the credit union system.

Q. How do recent NCUA budgets stack up against past years' budgets?

During the expansionary economic cycle that occurred just before the recent recession, NCUA staff was being *reduced*, even as the credit unions were growing in both size and complexity; the NCUA budget essentially remained flat from 2001 to 2007. As the recession began and the number of troubled credit unions grew alarmingly, NCUA increased its budget. It's worth noting that any budget savings credit unions derived from those pre-recessionary years were dwarfed by more than \$900 million in actual natural-person credit union losses which credit unions paid for through the National Credit Union Share Insurance Fund from 2008 to 2012.



Over the past three years, NCUA's budget expressed as a share of industry assets has been essentially flat. As the following chart indicates, the NCUA budget per \$1,000 of FICU assets fell dramatically, from 33 cents per \$1,000 in 2000 to a low point of 21 cents per \$1,000 in 2008.



NCUA was asking examiners to do more work and be accountable for more areas of review without corresponding increases in budgeted exam hours. As has become apparent in reviewing the Material Loss Reviews for failed credit unions prepared by NCUA's independent Inspector General, examiner staff in some cases simply did not have sufficient time to explore areas of concern.

When the Great Recession began, NCUA increased its budget beyond prior flat historical budget levels. NCUA actually had *fewer* examiners in 2009 than were serving during 1999. The agency did not have sufficient resources to fully address the loss threats facing the entire system. For example, in 2009, NCUA had to shift existing examiner resources and expertise away from Region I into Nevada, and away from Region II into California to deal with rising numbers of troubled credit unions.

Because of the dire situation, and similar to FDIC and other financial institution regulators, NCUA was forced to increase its budget to deal with these critical issues. Financial regulatory budgets have tended to be counter-cyclical. That is, when the economic cycle turned down, financial regulators staffed up. These increases, although necessary, also compounded the financial burden on many credit unions as they were facing mounting charge-off losses and weak earnings. So rather than implementing immediate large budget increases similar to actions taken by other financial regulators (some over 80% per year), NCUA strategically spread out necessary budget increases over multiple years. This approach steadily rebuilt NCUA resources at a measured pace to help minimize the funding burden on credit unions during the recession.

In addition, the NCUA Board has taken the approach that the budget is not intended to be strictly counter to economic cycles (thus only rising when crises occur). The NCUA Board is focused now on building optimum capacity when the economy and the industry is performing relatively well, in order to ensure long-term safety and soundness, and to keep pace with growing credit union complexity. By contrast, the counter-cyclical approach to reducing the budget during times of improved credit union performance would be akin to laying off firefighters between fires. The NCUA Board's approach is intended to ensure the necessary resources are in place before the next crisis, which puts NCUA in the best position to reduce the risk of major losses in the future.

Q. What factors drove the 6.1% increase for the 2013 budget?

Infrastructure Needs

A key lesson learned from the last crisis is to prepare well for the eventuality of the next one. During the last several years, NCUA went into triage mode, working on the hundreds of new problem credit union cases, which in turn delayed some necessary changes and improvements to the core needs of NCUA operations as the industry evolves. Today, the industry overall continues to swiftly grow in both asset size and complexity. NCUA's infrastructure must keep pace, and the knowledge requirements for examiners continue to expand.

As a result, current budget levels of staffing and contract dollars are needed to continue project management and the modernization of core systems and processes. Some improvements will be maximizing efficiencies in data storage and retrieval systems; updating the examination system; and enhancing credit union monitoring capabilities.

Staff Levels

Despite needed infrastructure improvements, and projected 2013 total exam time increasing by over 12,000 hours, the NCUA Board continues to be very mindful of achieving operational efficiencies at the agency. For example, the Board held the line on overall staffing levels in 2013. The 2013 staffing level of 1,261.5 full-time employees or their equivalents is unchanged from the 2012 level.

Additionally, NCUA's proposed overall 2013 budget growth of 6.1% is slower than the credit union industry's projected 2013 asset growth rate of 6.5%. If contingent funding matters are removed, the overall budget increase is even smaller, at 2.3%.

As in 2012, NCUA started the budget cycle with a zero-based budgeting approach. Staff justifies each line item, building from the bottom up based on the agency's strategic plan goals. In this budget, NCUA also re-allocated examination resources internally. Rather than allocating exam hours based on the number of credit unions, NCUA is allocating exam hours based on asset size. Examiners will spend fewer exam hours in smaller credit unions, and more hours in larger credit unions that would pose more potential risk to the NCUSIF if they were to fail.

Travel and Other Items

NCUA has implemented a number of travel, communication, and information technology initiatives to cut waste and promote efficient and effective spending. For example, NCUA trimmed the travel line item so that the rate of growth for 2013 is only 2.9%, compared to double-digit increases that were necessary in recent past years.

Travel is driven by many factors outside NCUA's control. It includes airline and hotel costs, as well as the federal rate on mileage reimbursement (which the Internal Revenue Service tends to increase each year because of gas prices). NCUA continues to maximize the use of virtual meeting tools and other technology solutions to control travel costs, but NCUA cannot control non-discretionary travel costs.

Given the structure of NCUA's field operations, travel is a core necessity to performing examinations. Travel is integral to the job description of examiners who are based from their homes. NCUA's business model saves the cost of office space that would be required to house more than 800 field staff.

Additionally, NCUA also decreased other expenses internally, such as postage, by moving to electronic publishing and distribution of most information, as part of the agency's "green" initiative to help protect the environment.

Q. Since the overall number of credit unions is decreasing, why is NCUA's budget increasing instead of shrinking?

Some have suggested that because the number of credit unions is declining, NCUA staffing should also be falling. This does not paint the whole picture and ignores a key lesson of the financial crisis.

It is the NCUA Board's view that examiner resource allocation decisions should not be based simply on the number of credit unions (units), but more focused on assets and total dollar exposure to help protect the NCUSIF, consistency with the agency's statutory mission.

As the financial services sector and institutions become larger and more complex, minimizing future losses requires appropriate levels of staffing and resources. As a result, it is not expected that NCUA budgets will return to pre-crisis levels.

An effective and efficient operating budget translates into a sound and reasonable annual investment by credit unions to protect the \$11.9 billion NCUSIF and credit union bottom lines from any preventable losses.

Q. Explain the budgeted 7.5% pay and benefits increase -- is this all for salary? What about the federal pay freeze currently in place?

Like credit unions, the majority of NCUA's budget costs consist of staff payroll and benefits. There has been some confusion about the 7.5% increase in the budget line item of "pay and benefits." This is not an across-the-board 7.5% *salary* increase for NCUA employees. There are three distinct components to the 7.5% pay and benefits line item increase over the 2012 budget:

- 1) 1.0% represents the net adjustment needed to account for attrition, promotions and other mandatory inflationary adjustments including health insurance premiums and retirement expenses;
- 2) 1.1% represents the incremental costs to fully fund new full-time NCUA positions that were added during 2012; and
- 3) 5.4% represents the budget increase to cover a contingent pay adjustment that is indexed to the General Service pay scale for federal employees. The costs of a contingent pay increase are further divided between merit pay increases and locality pay adjustments indexed to cost of living.

It is important to note that during 2012, NCUA provided no merit or locality pay adjustment to staff. NCUA voluntarily instituted the pay freeze for the past year for all employees.

However, just as credit unions seek to attract and retain capable staff, NCUA has to be able to retain qualified staff in a competitive marketplace with other federal employees as well as the private sector. Warranted pay increases are a factor in employee retention.

Credit unions deserve well-qualified and capable examiners. Likewise, NCUA also strives to attract and retain the most qualified and capable examiners. An inability to provide merit pay increases or keep up with the cost of living detracts from that goal.

Q. What happened to the money that the NCUA Board gave back in mid-year 2012?

The NCUA Board voted unanimously in July 2012 to give back \$2 million in money that will not be spent from the 2012 budget. Cash needs for the 2013 operating budget were reduced by \$2.5 million, which included the \$2 million in savings from the 2012 Mid-Session Budget Review plus another \$500,000 identified by the Chief Financial Officer based on an analysis of cash needs through NCUA's current cash cycle ending March 2014, just before the next operating fee assessment.

These budget issues were discussed during the November 2012 open NCUA Board meeting. A video and audio recording of the meeting, accompanied by a written transcript, is posted [on this website](#).
