have that would have provided the transparency that you're requesting, other than having the trade associations to actually come here and sign our budget for us and --

**Board Member McWatters:** Well, wait a minute. I did not say that, and you know I didn't say that, so please don't say that I said that.

**Chairman Matz:** Basically, that's what the bottom line is, by just turning over all of our documents to the industry. I don't know what documents we have that we can turn over that we haven't made available. We are extremely transparent, and if you go through all of the documents that we have on the table outside, I don't know what additional information could be useful to stakeholders that we're not providing to them, as long as they're not the decision makers. They need to know what our policies are, how we're basing our decisions, and what indices we use to determine what it takes to protect the system. We are very, very transparent about that. Is there a motion?

**Vice Chairman Metsger:** I move the Board approve: (1) the fiscal year 2015 budget of $279,477,779 and 1,268.7 FTEs, as presented in the Attachment 1 of the Board Action Memorandum; and (2) the 2015 capital acquisitions of $8,872,500, as presented in Attachment 2 of the Board Action Memorandum.

**Chairman Matz:** Is there a second? I will second. All in favor say aye. Aye.

**Vice Chairman Metsger:** Aye.

**Chairman Matz:** Is there any opposition?

**Board Member McWatters:** No.

**Chairman Matz:** The motion carries. Please let the record show that the motion carries 2 to 1.

The next item on our agenda is the 2015 Overhead Transfer Rate. We will hear from: Larry Fazio, Director of the Office of Examination and Insurance; Robert Parrish, Acting Director of Risk Management; and Russell Moore, our Loss Risk Analyst Officer. Good morning, again.

**Larry Fazio:** Good morning again, Chairman Matz, Vice Chairman Metsger, and Board Member McWatters. Acting Director of Risk Management, Robert Parrish, along with Loss Risk Analysis Officer Russell Moore, and I are here to present the overhead transfer rate recommendation for 2015. This recommendation is based on established methodology. Based on that methodology, the overhead transfer rate computes to 71.8 percent. Robert is now going to provide an overview of the methodology used to compute the overhead transfer rate. Then Russell is going to talk about the primary components of the rate calculation. Robert?

**Robert Parrish:** As both the regulator for federal credit unions and insurer for federal and state credit unions, NCUA allocates funding for operations consistent with our dual role. One portion of the activities is geared towards managing risk to the insurance fund, while the other portion of our activities is related to consumer protection for federal credit unions. As a result, the NCUA operating budget is financed through two sources. Federal credit unions are assessed an operating fee for the regulatory portion of our operations, and an overhead transfer rate occurs from the Share Insurance Fund to cover the cost of insurance-related activities in all federally-insured credit unions. NCUA continues to use the method approved by the Board in 2003, which includes annual setting of the overhead transfer rate consistent with this methodology.

NCUA's validated overhead transfer methodology is a data-driven process based on an imputed value, or replacement cost approach toward insurance activities. It uses up-to-date information on the examination and supervision program to ensure the process reflects current practice. The methodology incorporates key factors, including an annual time survey completed by examiners from June to May each year, NCUA's resource workload budget and financial budget, the distribution of insured shares between federal credit unions and federally-insured state-chartered credit unions, and the value of the insurance-related work conducted by state regulators. Using those factors, we determine the portion of the NCUA budget that should be funded through an insurance-related overhead transfer and the portion that should be funded through regulatory-related operating assessments to federal credit unions.

For 2015, we recommend an overhead transfer rate of 71.8 percent, based on the results of our methodology. Applying this to the NCUA Operating Budget of $279.5 million results in $200.7 million funded through the insurance-related overhead transfer rate. The remaining $78.78 million, or 28.2 percent, is funded through the federal credit union operating fee. In total, 33.6 percent of the budget will be attributed to federally-insured state chartered credit unions and 66.4 percent to federal credit unions.

In comparison, the overhead transfer rate for 2014 was 69.2 percent. Applied to the 2014 operating budget, 32.0 percent of the operating budget was attributed to federally-insured state chartered credit unions and 68.0 percent towards federal credit unions.

At this time, Russell will discuss the items that went into the formula.

**Russell Moore:** Thank you. As previously discussed, the overhead transfer rate is calculated using the results of the examination time survey, the operating and workload budgets, the distribution of insured shares between federal credit unions and federally insured state-chartered credit unions, and the value to the Share Insurance Fund of work performed by the state supervisory authorities.

For the survey, we use principal examiners in randomly selected supervisory groups from each of our five regions. For the time survey ending May 2014, the examiners reported spending 86.6 percent of examination time on insurance-related procedures, compared to the May 2013 results of 87.2 percent. Examiners also reported spending 94.3 percent of supervision time on insurance-related procedures, an increase from the May 2013 results of 92.4 percent.

For 2015, the workload budget includes a net decrease in budgeted examination and supervision hours for work in all credit unions, compared to 2014. The budgeted exam and supervision hours for federal credit unions increased by 6,474 hours, but decreased by 12,692 hours in federally-insured state-chartered credit unions.

The operating budget, just approved by the Board, for the cost of NCUA resources and programs increased from the prior year from $268.3 million to $279.5 million.

The distribution of insured shares shifted with federally insured state-chartered credit unions holding a slightly higher percentage of insured shares than they did last year, and the value of the work of state supervisory authorities decreased from $46.12 million to $41.56 million. With that, I'll turn it back over to Larry.

**Larry Fazio:** Before I conclude, I'd like to take this opportunity to just put on the record and remind everybody the process we went through in developing this overhead transfer rate. I think, as you recall, Chairman in 2003, or at least leading up to 2003, we had gotten a lot of stakeholder input over the years about concerns about how the overhead transfer rate worked, and we took that very seriously and we came up with this new relatively complicated formula in an attempt to be as comprehensive as is equitable and is fair as possible. In fact, that was also the time period when we were having budget hearings, and that was part of the discussion.

In developing this new methodology based on stakeholder input, before we adopted it, we actually met with several constituency groups and walked through it and got input and actually made some refinements as a result of that before the final new methodology was presented to the Board and adopted. I don't know if you recall the somewhat torturous Board meeting we had when we actually spent an entire hour walking through every single element of the new formula on the public record and then made that available publically, the actual methodology, so extensive disclosure and briefing on it.

We've also had ongoing stakeholder input. While we have admittedly not have had an annual formal forum for it, we have continued to receive input. In fact, the stakeholder input that we received led to the 2013, the last year of the refinement. One of the ongoing input we had gotten was they believed we could do a better job refining the definitions that went into this time survey, and we took that seriously and instituted a review and developed that refinement and then had an independent study on that. We have taken the stakeholder input that we've received over the years seriously, and we continue to welcome stakeholder input that they can submit at any time.

It's a standing formula. There is no subjective judgment that goes into the calculation. The calculation is completely formulaic, and so the result that we present to you is based on that all-inclusive methodology.

**Chairman Matz:** That's available on our website?

**Larry Fazio:** It is available on our website, and it's part of the BAM. One of the things I would point out is also that we've realized, since 2003, 11 years ago, there's been various changes to the website. I think maybe some of that historical information was lost in the shuffle along the way, and we've taken this opportunity, based on the input we've received from the Board officers, to go back and make sure that we had a good comprehensive history on that overhead transfer rate for our stakeholders. We'll be repopulating that section. There is a section on the website for it, and we're going to be repopulating that with a lot more background information that may have gotten lost along the way, but was already made public.

With that, I would note that the methodology has not changed. We continue to use the same overall methodology as last approved by the Board. We'd be happy to answer any others questions you have at this time.

**Chairman Matz:** Thank you. You mentioned that there was an independent contractor that validated the results. Can you elaborate on that?

**Larry Fazio:** Sure, and I'll actually let Robert talk a little bit about that. We've had several, actually, independent validations along the way, the most recent one being 2013.

**Robert Parrish:** Right. In 2013, PricewaterhouseCoopers performed a study of the examiner time survey process and the mapping of the exam procedures in the field by the examiners to the actual regulations. There were a few suggestions in the study in regards to providing training to the examiner staff that participated in the exam time survey, and those recommendations were put in place. Overall, the study indicated that the agency, if I could just quote from the study?

**Chairman Matz:** Sure.

**Robert Parrish:** "The NCUA rules and regulations matrix aligns consistently with the insurance and regulatory activities and provides a documented basis supporting the allocation of examiner time between insurance and in regulatory activities."

**Chairman Matz:** Is that also available on our website?

**Larry Fazio:** Yes. It was, in fact, part of the BAM last year, and so it was made public as part of the BAM. It's in the BAM section now, but we're going to actually add it to the overhead transfer rate section, so that the stakeholders can go to one place that's labeled “overhead transfer rate” and see all of the different information.

**Chairman Matz:** I'd admit it is sometimes difficult to find things on our website.

**Larry Fazio:** Yes, and we're working to improve that.

**Chairman Matz:** Yes. Board Member McWatters?

**Board Member McWatters:** Yes. I've looked at the PwC studies. One is on January 2011. The other one, I guess, is the one you just referred to in October, 2013. These are studies made by an accounting firm that, by definition in the U.S., cannot practice law. It seems to me what PwC is saying in these studies is that the methodology in the approach that you use in computing the overhead transfer rate works. Okay.

My question is more of a legal question as to what constitutes safety and soundness? How do you get the mechanism in place to define what's safety and soundness, which strikes me as a legal determination, to put into the Share Insurance Fund bucket that you then go through the mechanical process that PwC has blessed? I assume there's been a legal determination that these particular regulations deal with safety and soundness and they go into the Share Insurance Fund bucket for analysis.

**Chairman Matz:** Would it help if we brought John Ianno up, since he's a lawyer?

**Board Member McWatters:** Yeah, sure. It would be great.

**Chairman Matz:** Do you want to?

**Larry Fazio:** Sure.

**John Ianno:** I guess I could sit over here.

**Chairman Matz:** He might be able to better address that. I don't know.

**John Ianno:** Thanks. Yes. Good morning to all of you. I think if you're asking, with respect to any regulations that the NCUA Board may have passed pursuit to its Title II authority under 209, has there been a determination that they are relevant to safe and sound operation.

**Board Member McWatters:** Yes.

**John Ianno:** In connection with each of those regulations, when they're passed there's an analysis that allows application of the regulation to a state chartered federally-insured credit union under Title II, so within the preambles and the explanation for the rule, there would be that. Now, I can't go through each one specifically and tell you what it is, but that would be how it would be done.

**Board Member McWatters:** Okay, so there is no legal determination otherwise, with respect to that, just from the statute, the legislative history of the statute and the like, this is clearly a safety and soundness issue that goes into the Share Insurance Fund bucket?

**John Ianno:** I'm not sure about that, but if you look at the statute, the Board has broad discretion, as I read it in 203, to charge the Insurance Fund directly for matters related to the purposes of carrying out Title II. It doesn't even talk specifically about safety and soundness. I think, if you look at whatever is in Title II, which is a broad statutory and regulatory scheme that outlines oversight and all, anything, in my view, this is just my personal view, but I think the statute supports the notion that anything that even indirectly relates to that, whether it's time expensed looking at a federal credit union in regards to that or a state chartered credit union can be charged to the Fund directly. I'm not sure that the notion of safety and soundness is the critical question.

**Board Member McWatters:** Well, I'm trying to understand how the application of these statutes are bifurcated between safety and soundness and the regulatory function between the insurance function and the non-insurance function, because it seems to me that's what drives the bottom line or the increase in the overhead transfer rate over the years. It's not so much the mechanics of the methodology that PwC has approved. Their answer falls through. The key question is, when you have a statute and in enforcing that statute, which bucket does it go in and who makes that determination in how it's been made? Does that make sense?

**John Ianno:** It does, and I think Larry can probably speak to this more than I, but I think the analysis proceeds along the lines of are what we're doing, in connection with the particular oversight, is that matter involved in trying to protect a loss to the fund? Could it have an impact of some significance, for example, to the bottom line of the credit union and cost of the fund, as opposed to a purely regulatory function? For instance, arguably, let's say whether or not the credit union is serving people that are outside of their field of membership, for example. I think that's the kind of analysis --

**Larry Fazio:** I think that's right. It's really a function of what's the primary motivation behind the regulation and our activity. Are we doing it because we're trying to manage risks to the fund, or are we doing it because we're trying to enforce the laws of the country that aren't really about protecting risk? They're about protecting against risks to the fund. They're really about a consumer compliance or just governing commerce. We don't want certain things going on in commerce that don't really have a nexuses to risk to the Fund.

I think the closest analog to think about would be FDIC is only an insurer. They are not the charter or regulator for state banks or any federal banks. Their whole exam program, their whole function is insurance-based, yet they do examine federally-chartered banks, and they're doing those exams and they're doing the work and the overhead to protect against risk to the Insurance Fund. That's the simplest way to think about it.

**Board Member McWatters:** Okay. When you make this analysis, do you ever bifurcate, let's say, a reg between safety and soundness, share insurance fund and regulatory, that it really kind of touches both areas, and maybe 80 percent of it is safety and soundness Share Insurance Fund and 20 percent of it is regulatory?

**Larry Fazio:** It was interesting. When we went through that 2013 analysis, that was one of the things I thought that would be the biggest sticking points was what happens when you've have this reg that's really wearing two hats.

**Board Member McWatters:** Sure.

**Larry Fazio:** We didn't really, and I don't have every single line-item imprinted on my memory, but as I recall, we actually didn't come across many, if any, of those that really sort of a tossup between what's the primary motivation, because we went in a very granular way through the rules and regs. That's what we had then PwC look at is to make sure we didn't miss anything, make sure that the decisions we made, made sense.

As you could appreciate, you can take anything and turn it into a financial risk, right. You could say you've got such an extreme consumer compliance violation that you're at threat of getting lawsuits, which could create a financial risk, but really the main reason we examine for truth in lending is not that extreme tail black swan risk. It's because we're enforcing the laws of the land, in terms of protecting consumers, versus another regulation where, like we have a regulation that requires certain credit unions to have an interest rate risk management written policy. We require that because of the risk of interest risk to the failure of the credit union and the cost to the Insurance Fund.

**Board Member McWatters:** Okay. Well, I'm just trying to understand this inexorable increase, it seems, every year in the overhead transfer rate, if there --

**Larry Fazio:** It hasn't. I mean, that's been a slightly recent phenomenon, but when we first rolled the formula out, we actually saw a slight uptick, a downtick, and then an uptick. There was a period where we had some renewed focus on Bank Secrecy Act and some new compliance regulations. Actually, the survey went down and the whole share went down a little bit. It floats based on what we're focusing on in the examine program year-to-year. That's a bottoms-up analysis that examiners do of what's going on in a particular credit union, what activities are they involved on and how well are they managing them or not and what do I need to be focusing on this year under the risk-focused exam process. There is some variation from year-to-year, and that's what the formula is actually designed to capture.

**Board Member McWatters:** Okay. Thank you.

**Chairman Matz:** Anything else?

**Board Member McWatters:** No.

**Vice Chairman Metsger:** Just one comment. I remember last year when we were going through the changes – I think maybe it would be helpful to reiterate what we talked about last year, and this goes to some of the comments I made earlier today about the input we've received from some credit unions. I know NASCUS was very helpful on this, in terms of trying to get to that specific question of how we break this time down, and one of the issues we worked to address, your office worked to address, was consistency among the regions of how individual examiners would report this. That's how, in the last couple of years, some of these changes are trying to bring consistency to that.

I think if you would speak to that process, in terms of as Board Member McWatters pointed out, how do you do this scale? Maybe it's 80 percent or 20 percent? With input from stakeholders and with NASCUS help, has really helped change that number last year and make it more accurate by doing that. Maybe just a brief summary of that, the rise of that, and why we think this is more granular than it was before?

**Larry Fazio:** You're exactly right. It's more granular and consistent. One of the things we pointed out last year after we made the change was it didn't change in principle had we had approached this. We were still evaluating it through the lens of what's the primary reason we're doing that activity? Is it to protect against risk to the fund or is it to enforce compliance and commerce laws? That principle didn't change, but what we found was, despite our training and despite the way we had sort of laid it out, examiners still were sort of misinterpreting that.

Instead of relying on them to sort of apply consistently the broader principles behind each of these determinations, we actually took the full set of activities and regulations and mapped them out for them so that when they examined it for the rule on interest rate risk policy, they knew that however much time they spent in that went in this bucket on the time survey, so that we created that consistency and clarity for that.

**Vice Chairman Metsger:** Thank you. That was all.

**Chairman Matz:** Anything else?

**Vice Chairman Metsger:** I pass.

**Chairman Matz:** Is there a motion?

**Vice Chairman Metsger:** Yes. I move the Board authorize an overhead transfer rate of 71.8 percent for 2015, as attached to the Board Action Memorandum.

**Chairman Matz:** Is there a second? I will second it. All in favor say aye.

**Vice Chairman Metsger:** Aye.

**Chairman Matz:** Aye. Those who oppose, nay.

**Board Member McWatters:** No.

**Chairman Matz:** The motion carries by a vote of 2 to 1. Thank you very much, and thanks, John, for coming up at the last minute.

**John Ianno:** Sure.

**Chairman Matz:** Next we'll be briefed on our 2015 operating fee scale. Staff presenting is Susan Douglas, Budget Officer, Office of the Chief Financial Officer. Hi, Susan.

**Susan Douglas:** Good morning. Chairman Matz, Board Member Metsger, Board Member McWatters. I'm here to request Board approval for the final piece of the 2015 budget, the operating fee assessment to federal credit unions. The Board's last action approved funding 71.8 percent of NCUA's budget for the Share Insurance Fund. The remaining 28.2 percent will come from the operating fee assessments. The Board action before you shows our method for turning this 28.2 percent into our cash needs of $78,990,000, and then into the assessment scale to collect the $78.9 million. We have determined that the assessment scale rates will decrease by 0.9 percent. This calculation is based on the 2015 budget and expected 2014 growth of credit union assets of 3.8 percent.

Please turn to Attachment 1 of the Board Action Memorandum. This Schedule D tells the steps to determine the rate adjustment. Starting at the top, line one shows the approved 2015 budget