


Approved by the NCUA  
Board on 11/20/03

BOARD ACTION MEMORANDUM

  
Secretary of the Board

TO: NCUA Board

DATE: November 14, 2003

FROM: J. Leonard Skiles, Executive Director

SUBJ: Overhead Transfer Rate



**ACTION REQUESTED:** Approve the recommended Overhead Transfer Rate for 2004.

**DATE ACTION REQUESTED:** November 20, 2003

**OTHER OFFICES CONSULTED:** Examination and Insurance, Chief Financial Officer,  
General Counsel

**VIEWS OF OTHER OFFICES CONSULTED:** Concur.

**BUDGET IMPACT:** None. The overhead transfer rate is one of the funding sources for the budget, but does not affect the amount of the budget. The NCUA Board approves the budget separately and without regard to the overhead transfer rate. The overhead transfer rate is applied to actual expenses incurred each month.

**RESPONSIBLE STAFF MEMBER:** J. Leonard Skiles, David M. Marquis, Larry D. Fazio

**SUMMARY:** The *Federal Credit Union Act* authorizes NCUA to expend funds from the NCUSIF for administrative and other expenses related to federal share insurance (12 U.S.C. §1783). An overhead transfer from the NCUSIF covers the expenses associated with insurance-related functions of NCUA's operations. The NCUA Board last approved an overhead transfer rate for 2002 and 2003 of 62%.

In the past, the overhead transfer rate has been set for varying periods, usually two to three years, and the rate was based primarily upon results of examination time surveys collected from examiners. E&I gathered data by surveying examiners about examinations of federal credit unions completed during a specified period. An analysis of examination time served as the basis for prior recommendations because of the following factors:

- NCUA primarily carries out its mission as an insurer and as a federal credit union supervisor through the examination process; and
- Examinations and supervision are the primary catalysts for other agency functions.

The independent study of the overhead transfer rate process conducted by Deloitte and Touche concluded the survey process was a reasonable basis upon which to allocate costs. NCUA implemented Deloitte and Touche's recommendations to improve the survey process in June 2002 by automating the examination time survey system, training participating staff on the process, and collecting surveys on a flow basis throughout the year.

**Due to the risk-focused examination program, there has been a substantial increase in the amount of time examiners are reporting spent on insurance-related activities.** Examiners now report spending 71% and 74% of their examination and supervision time respectively on insurance-related procedures. Based on the method used in 2001, this would result in an overhead transfer rate range of 68% to 76%.

Per the recommendations of an internal working group established in late 2002 to study the overhead transfer rate, we are recommending the NCUA Board approve an overhead transfer rate based upon refinements to the method for allocating costs to the NCUSIF. **The data collected from the time surveys continues to be a key factor in determining the overhead transfer rate.** However, the calculation method has been refined by factoring in the following:

- **The value to the NCUSIF of the insurance-related work performed by state supervisory authorities.**
- **The cost of NCUA resources and programs with different allocation factors from the examination and supervision program.**
- **The distribution of insured shares between federal credit unions and federally insured state-chartered credit unions.**
- **Operational costs charged directly to the NCUSIF.**

The refined method, by considering additional information, results in a more comprehensive and equitable calculation and allocation of costs to the NCUSIF. With the refined method and ongoing time survey process, NCUA can set the OTR annually. The framework for the refined method is not unduly complex and thus NCUA will not incur additional costs to administer it. The refined method results in an overhead transfer rate of 59.8% for 2004.

The refined method first determines the portion of NCUA's core and special workload programs<sup>1</sup> devoted to regulatory-related activities. The time survey results are applied to federal examination and supervision time, with other program hours allocated based on analyses of the individual programs.

---

<sup>1</sup> The work examiner and specialized examiner staff does to supervise federally-insured credit unions and manage risk to the insurance fund.

| Core Programs  | 2004 Workload Hours | Regulatory Percent | Regulatory Hours       | Allocation Basis   |
|--|---------------------|--------------------|------------------------|--|
| Federal Examination  | 360,000             | 29%                | 104,400                | Examiner time survey.  |
| Federal Supervision  | 103,000             | 26%                | 26,780                 | Examiner time survey.  |
| State Exam & Supv  | 65,000              | 0%                 | 0                      | FISCU work is insurance-related.   |
| State Exam Review  | 10,500              | 0%                 | 0                      | FISCU work is insurance-related.   |
| 5300 Program – FCU   | 34,000              | 29%                | 9,860                  | Related to examinations, uses examiner time survey.  |
| 5300 Program – FISCU   | 28,000              | 0%                 | 0                      | FISCU work is insurance-related.   |
| <b>Total Core Program</b>                                      | <b>600,500</b>      | <b>n/a</b>         | <b>141,040</b>         |  |
| Special Programs   |                     |                    |                        |  |
| Fair Lending Exams   | 2,500               | 100%               | 2,500                  | Regulatory program.  |
| Subject Matter Examiners                                       | 3,000               | 29%                | 870                    | Related to examinations, uses examiner time survey.  |
| Agricultural Lending   | 2,000               | 0%                 | 0                      | NCUSIF risk management program.  |
| FOM & Chartering   | 1,500               | 100%               | 1,500                  | Regulatory program.  |
| RCMS   | 11,500              | 0%                 | 0                      | NCUSIF risk management program.  |
| Small Credit Unions  | 21,000              | 85%                | 17,850                 | For FCUs is a regulatory program. However, approximately 15% of the time in this program is related to work in FISCUs. |
| CUSO Exams   | 1,000               | 0%                 | 0                      | NCUSIF risk management program.  |
| <b>Total Special Program</b>                                   | <b>42,500</b>       | <b>n/a</b>         | <b>22,720</b>          |  |
| <b>Total Core &amp; Special Programs</b>                       | <b>643,000</b>      | <b>n/a</b>         | <b>163,760</b>         |  |
| Percent of Workload Programs devoted to NCUA's Regulatory Role |                     |                    | <b>25%<sup>2</sup></b> |  |

<sup>2</sup> There may be some instances where the "math" shown here is off by a point due to rounding.

The regulatory portion of NCUA's core and special workload programs is then applied to NCUA's budget. However, some offices devote different levels of effort to regulatory-related activities than examiner and specialized examiner staff, for which different allocation factors are applied as follows:

| <b>Cost Area</b>  | <b>Dollar Budget (\$M)</b> | <b>Regulatory Percent</b> | <b>Regulatory Cost (\$M)</b> |
|---|----------------------------|---------------------------|------------------------------|
| <b>2004 Financial Budget</b>  |                            |                           |                              |
| <b>Divisions of Insurance:</b><br>Primarily regulatory function involving chartering and fields of membership, net of work related to share insurance coverage for members and FISCUs.  | \$5.8                      | 87%                       | \$5.0                        |
| <b>All Other Region Costs:</b><br>Based on regulatory portion of core and special workload programs.  | \$83.2                     | 25%                       | \$20.8                       |
| <b>Asset Management Assistance Center:</b><br>NCUSIF function that handles liquidation payouts, manages assets acquired from liquidations and assistance programs, and manages recoveries for the National Credit Union Share Insurance Fund. | \$2.2                      | 0%                        | \$0.0                        |
| <b>Office of Credit Union Development:</b><br>Regulatory function to facilitate the expansion of credit union services.   | \$0.8                      | 100%                      | \$0.8                        |
| <b>Office of Corporate Credit Unions:</b><br>NCUSIF risk management function, net of operating fee paid by corporate credit unions for regulatory (e.g., chartering) activities.  | \$6.1                      | 18%                       | \$1.1                        |
| <b>Office of Chief Financial Officer:</b><br>Based on regulatory program percent, net of staff time associated with NCUSIF accounting.  | \$5.0                      | 20%                       | \$1.0                        |
| <b>Office of Chief Information Officer:</b><br>Combination of support for state and federal examiners and staff related to hardware and software, as well as efforts for program development driven by Examination and Insurance.             | \$9.1                      | 20%                       | \$1.8                        |
| <b>Office of Human Resources:</b><br>Based on regulatory program percent, adjusted for Division of Training and Development time related to training for state examiners and staff.   | \$6.8                      | 20%                       | \$1.4                        |
| <b>All Other Costs:</b><br>Based on regulatory portion of core and special workload programs. Includes NCUA board, Office of Inspector General, etc.  | \$30.9                     | 25%                       | \$7.7                        |
| <b>Total 2004 NCUA Budget</b>   | <b>\$149.9</b>             |                           | <b>\$39.6</b>                |

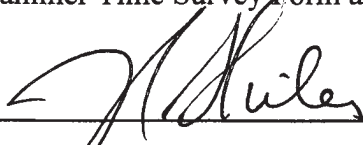
With \$39.6 million in regulatory costs and \$2.1 in insurance-related direct charges to the NCUSIF, the total insurance-related expenses equal \$112.4 million. However, considering the insurance-related work done by state supervisory authorities (valued at \$18.7M, referred to below as the state supervisory authority imputed value), the total imputed insurance-related costs are \$131.1 million. Allocating this cost proportionally based on insured shares (as of December 31, 2002, federal credit unions held 55% of insured shares and federally-insured state-chartered credit unions held 45%) results in federal credit unions being responsible for \$72.1 million and federally-insured state chartered credit unions for \$59 million.

However, state supervisory authorities are already providing \$18.7 million worth of imputed value to the NCUSIF. Therefore, federally-insured state chartered credit unions are only responsible for supporting \$40.3 million through the overhead transfer rate. Thus, the overhead transfer rate in total would cover \$89.6 million of all NCUA costs, which is calculated by dividing \$40.3 million by the 45% proportional allocation basis for which federally-insured state chartered credit unions are responsible. As a percentage of the NCUA budget, \$89.6 million represents 59.8%.

The state supervisory authority imputed value is calculated by determining what it would cost NCUA to do the insurance-related work currently being provided by state supervisory authorities. To treat all federally-insured credit unions equitably, this calculation is based on the NCUSIF risk management standards applied to federal credit unions. To determine the cost, we first determine the size of the workload such a program would represent. We use the actual examination and supervision hours spent for FCUs by asset size and CAMEL rating and apply this to the population of federally-insured state chartered credit unions. Adjustments are then made for the risk-based scheduling program federal credit unions are under, as well as for insurance-related work in state-chartered credit unions NCUA is already conducting during joint examinations. This results in 152,732 additional workload hours. Using NCUA's staffing model and productivity levels (e.g., ratio of examiners to supervisory examiners, regional office staff, etc.), this level of workload equates to 159 additional staff positions. Using the average cost of these positions, as well as adjusting for the related overhead and affected central offices, would result in a net increase in costs of \$18.7 million. This represents the imputed value of the insurance-related work of state supervisory authorities.

**RECOMMENDED ACTION:** Authorize the use of the refined overhead transfer rate method for calculating the overhead transfer rate annually and establish an overhead transfer rate of 59.8% for 2004.

**ATTACHMENT(S):** Examiner Time Survey Form and Instructions.

  
\_\_\_\_\_  
J. Leonard Skiles, Executive Director

**General Information about Examination:**

|                                    |                                   |
|------------------------------------|-----------------------------------|
| <b>Name:</b>                       | _____ <b>FEDERAL Credit Union</b> |
| <b>Charter Number:</b>             | # _____                           |
| <b>Assets (no decimal places):</b> | \$ _____                          |
| <b>Effective Date of Contact:</b>  | ____ / ____ /200x                 |
| <b>Contact Type (WCC):</b>         | _____                             |
| <b>CAMEL Rating:</b>               | <b>COMPOSITE RATING</b> _____     |
|                                    | <b>Capital Adequacy</b> _____     |
|                                    | <b>Asset Quality</b> _____        |
|                                    | <b>Management</b> _____           |
|                                    | <b>Earnings</b> _____             |
|                                    | <b>Liquidity</b> _____            |

**Survey Form Time Detail**

| <b>Time Categories</b>          | <b>Total Hours</b> | <b>Insurance Related</b> | <b>Non-Insurance Related</b> |
|---------------------------------|--------------------|--------------------------|------------------------------|
| Planning / Scope Development    |                    |                          |                              |
| Call Report Review              |                    |                          |                              |
| Supervisory Committee           |                    |                          |                              |
| Financial Analysis              |                    |                          |                              |
| Loan Analysis                   |                    |                          |                              |
| Investment Analysis             |                    |                          |                              |
| Liquidity Analysis              |                    |                          |                              |
| Asset Liability Management      |                    |                          |                              |
| Compliance                      |                    |                          |                              |
| Information Systems Technology  |                    |                          |                              |
| Management                      |                    |                          |                              |
| Examination Report/JC/Follow-Up |                    |                          |                              |
| <b>Total Exam Hours</b>         |                    |                          |                              |

**Survey Form Instructions/Guidelines:** The survey is an excel workbook that includes pop-up guidance along with the complete set of general definitions and specific instructions for the users. The following is a copy of what is included in the form:

## GENERAL DEFINITIONS

### **Insurance Related Examination Procedures:**

Insurance Related examination or supervision contact procedures address safety and soundness issues. On the time survey forms, respondents should classify the time used to evaluate safety and soundness as “Insurance Related.” “Insurance Related” time involves efforts to review, report, or document areas that include, but are not limited to, the following:

- Evaluating financial trends and Call Report data.
- Determining the credit union’s solvency position.
- Evaluating risks, and potential costs, the credit union presents to the NCUSIF (when appropriate).
- Assessing management’s efforts to protect earnings and net worth by identifying, evaluating, controlling, and monitoring internal and external risks.
- Assessing management’s abilities to develop strong policies and a reliable internal control structure.

### **Non-Insurance Related Examination Procedures:**

Non-Insurance Related examination or supervision contact procedures address compliance with the laws and regulations that NCUA enforces. On the survey forms, respondents should classify the time used to evaluate issues not related to safety and soundness as “Non-Insurance Related.” “Non-Insurance Related” time involves efforts to review, report, or document areas that include, but are not limited to, the following:

- Compliance with consumer protection laws, NCUA Rules and Regulations, the FCU Act, and Bylaws
- Review of previously cited regulatory violations, areas of concern, and corrective actions taken
- Call report accuracy and timeliness

## SPECIFIC INSTRUCTIONS ABOUT INDIVIDUAL SCOPE CATEGORIES

**NOTE:** The procedures referenced within each time category of the survey are not all encompassing. These guidelines merely provide *examples* respondents should consider when estimating the allocation of their time.

## **A. Planning / Scope Development**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Reviewing prior contact reports to identify historical safety and soundness concerns;
- Reviewing scope workbook to become familiar with potential safety and soundness concerns;
- Reviewing correspondence between contacts that address safety and soundness issues;
- Reviewing recent financial trends;
- Evaluating changes to the credit union's product and service mix that could present new safety and soundness concerns;
- Determining whether a Subject Matter Examiner could assist during the supervision process in addressing safety and soundness concerns;
- Considering whether additional resources (i.e., grants, technical assistance, low-income designation) are available to assist management in addressing safety and soundness concerns;
- Evaluating prevailing economic conditions;
- Reviewing risk management reports;
- Interviewing key officials to learn status of action taken to correct previously identified safety and soundness concerns;
- Developing on-site procedures for evaluating safety and soundness concerns;
- Completing portions of scope workbook that pertain to safety and soundness concerns; and
- Updating scope workbook to document new information about safety and soundness issues.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Reviewing prior contact reports for previously cited noncompliance issues and regulatory violations;
- Reviewing scope workbook to become familiar with potential regulatory concerns;
- Reviewing correspondence between contacts that address compliance and regulatory concerns;
- Determining the potential applicability of new regulatory requirements;
- Determining whether a Subject Matter Examiner could assist during the supervision process in addressing compliance and regulatory concerns;
- Considering whether additional resources (i.e., grants, technical assistance, low-income designation) are available to assist management in addressing regulatory and compliance concerns;
- Evaluating changes to the credit union's product and service mix that could require an expanded review of regulatory compliance;
- Interviewing key officials to determine management's level of expertise regarding, and attitude toward, regulatory compliance;
- Developing on-site procedures for evaluating regulatory concerns;
- Completing portions of scope workbook that pertain to regulatory concerns; and
- Updating scope workbook to document new information about regulatory issues.



## **B. Call Report Review**

- 1) Time related to Insurance Issues includes the time required for tasks such as:
  - Determining if factors causing inaccuracies in Call Reports are symptoms of internal control weaknesses.
  - Reviewing Call Report trends for potential risk indicators.
- 2) Time related to Non-Insurance Issues includes the time for tasks such as:
  - Verifying the accuracy and timeliness of Call Reports filed by management.

## **C. Supervisory Committee Review**

- 1) Time related to Insurance Issues includes the time required for tasks such as:
  - Reviewing general internal controls and segregation of duties;
  - Evaluating if the supervisory committee serves as a legitimate “check” upon management activity; and
  - Determining whether supervisory committee is effective in correcting identified internal control weaknesses.
- 2) Time related to Non-Insurance Issues includes the time for tasks such as:
  - Ensuring the supervisory committee is carrying out its fiduciary responsibility to ensure member account verifications and annual audits are complete and timely and meeting the supervisory committee’s regulatory requirements.
  - Reviewing the actual documentation from the supervisory committee audit and member account verification.

## **D. Financial Analysis**

- 1) Time related to Insurance Issues includes the time required for tasks such as:
  - Reviewing the current financial trends; and
  - Determining whether management has adequate controls and risk management systems in place.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Reviewing general accounting procedures to ensure compliance with the *Accounting Manual for Federal Credit Unions*;
- Verifying that current financial statements reflect the balances in the general ledger;
- Determining that management is maintaining adequate subsidiary ledgers; and
- Testing the validity of delinquency computation and income accrual procedures.

## **E. Loan Analysis**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Reviewing loan underwriting procedures;
- Determining the risk associated with the product mix;
- Evaluating loan policies to determine if sound practices exist;
- Reviewing collection efforts for timeliness;
- Evaluating whether the level of the credit union's reserves is consistent with the loan products offered by the credit union.
- Assessing the controls management has over loan losses.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Evaluating compliance with the limitations promulgated within the Federal Credit Union Act, NCUA Rules and Regulations, and consumer compliance laws and regulations;
- Ensuring the written policies comply with all applicable lending regulations; and
- Evaluating the accuracy and funding methodology of the allowance for loan loss account.

## **F. Investment Analysis**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Reviewing appropriateness of the investment portfolio and overall practices;
- Determining the adequacy of the internal controls related to investments;
- Assessing investment trends;
- Ensuring adequate safekeeping procedures are in place; and
- Evaluating management's effectiveness in addressing investment risks.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Reviewing the permissibility of the investments included in the portfolio; and
- Reviewing the written investment policy to ensure the policy includes all elements discussed in the regulations.

## **G. Liquidity Analysis**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Determining whether the credit union has sufficient liquidity to cash needs for loan and share transactions;
- Evaluating whether management has sound contingency plans for addressing unanticipated liquidity needs; and
- Ensuring risk management processes (measuring, monitoring, controlling, and reporting) are appropriate for credit union.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Ensuring management is complying with statutory borrowing limitations.

## **H. Asset Liability Management**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Determining if management has adequate controls in place and assigns clear responsibilities to address the credit union's overall exposure to interest rate risk;
- Reviewing the adequacy of the credit union's modeling and risk monitoring procedures; and
- Ensuring that management initiates corrective action when internal analysis identifies concerns relative to interest rate risk.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Ensuring written asset liability management policies do not contain provisions that are inconsistent with regulations that apply to loans, investments, or shares.

## **I. Compliance**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Determining whether any identified regulatory violations could cause the credit union to have financial risk exposure.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Assessing management's compliance with the Bank Secrecy Act;
- Reviewing compliance with consumer regulations that pertain to lending and savings programs; and
- Evaluating other regulatory compliance issues such as records preservation, security devices, regulatory fees, membership eligibility, and other applicable state and federal laws and regulations.

## **J. Information Systems Technology**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Ensuring that the credit union's written policies contribute toward the establishment and maintenance of a system of sound internal controls; and
- Determining if weaknesses in the control structure presents any exposure to financial risks.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Ensuring that all agreements with outside parties meet applicable legal requirements; and
- Evaluating controls the credit union has in place to ensure compliance with Privacy Act requirements.

## **K. Management Analysis**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Reviewing planning and general business practices for overall soundness;
- Reviewing income/expense budget process and controls; and
- Assessing management's capabilities in implementing strategies to address risks.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Reviewing compliance with Federal Credit Union Bylaws;
- Reviewing Board minutes to ensure meetings take place in accordance with the Federal Credit Union Act and Bylaws; and
- Ensuring that all written policies are consistent with applicable laws and regulations.

## **L. Contact Report / Joint Conference / Follow-Up Procedures**

1) Time related to Insurance Issues includes the time required for tasks such as:

- Communicating safety and soundness or risk management issues to credit union officials and employees during the exit interview process;
- Documenting supervision plans for monitoring safety and soundness concerns noted during an on-site contact;
- Discussing safety and soundness or risk management concerns with management during the joint conference;
- Preparing written reports that provide guidelines for correcting safety and soundness concerns;
- Drafting correspondence for the Regional Director's signature that discuss safety and soundness concerns;
- Preparing internal monitoring reports that assess management's progress in addressing safety and soundness or risk management issues;
- Assisting management in obtaining outside mentor assistance to address safety and soundness concerns; and
- Implementing administrative remedies designed to correct safety and soundness or risk management concerns.

2) Time related to Non-Insurance Issues includes the time for tasks such as:

- Communicating regulatory violations that do not present safety and soundness concerns to credit union officials and employees during the exit interview process;
- Documenting supervision plans for monitoring regulatory violations noted during an on-site contact;
- Discussing regulatory concerns with management during the joint conference;
- Preparing written reports that provide guidelines for complying with regulations that do not specifically pertain to insurance-related concerns;
- Assisting management in obtaining outside mentor assistance to address regulatory and compliance issues; and
- Drafting correspondence for the Regional Director's signature that discusses regulatory concerns.