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April 26, 2016

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: NCUA's Request for Comments on the Overhead Transfer
Rate Methodology

Dear Mr. Poliquin:

On behalf of the interests of CU Counsel, PLLC's credit union clients, I am pleased to respond to the National Credit Union Administration Board's request for comments on its Overhead Transfer Rate (OTR) Methodology, which was published in 81 *Fed Reg* 4822 January 27, 2016. These comments are generally organized in response to NCUA's four questions in the request's *Supplementary Information*.

The letter also addresses NCUA's legal authority to use the OTR as a funding mechanism for agency costs and whether material decisions regarding the OTR belong under the Administrative Procedure Act. In addition, the letter discusses other relevant issues relating to the agency's budget, which affect the use of the OTR.

Questions continue within the credit union community regarding the basic fairness of the use of the OTR, why it has increased about 20% in just eight years, and whether there are feasible alternatives to the current approach acceptable to the NCUA that credit unions can have confidence will result in equity to them as stakeholders while allowing the agency to pay for costs that are appropriately funded through a transfer from the National Credit Union Share Insurance Fund (NCUSIF). We urge the agency to address these and other concerns as part of its review of the OTR methodology.

**1. Whether the OTR Should Continue to be Determined Using a
Formula-Driven Approach or Instead Be Set Largely at the Discretion
of the Board**

In our view, neither of these options presented by the request for comments captures the correct approach for setting the OTR. Rather than a "formula-driven" process, which

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while using some quantitative analyses and benchmarks nonetheless contains key elements of subjectivity, the OTR would better serve the agency's budget process in terms of transparency and equity to all stakeholders if it were more formula-based. Some thoughts on how to achieve that result are addressed under question number 4.

In terms of the Board's discretion, in approving the OTR for 2016 in November of last year, the agency delegated to senior staff the authority going forward to set the OTR, even though the agency said it would seek comments on changes in the OTR methodology periodically with its Strategic Plan.

Under the anticipated comment process, the NCUA Board would analyze the comments and determine whether or not to adjust the methodology. With this process, NCUA would also seek prior public comment on any future changes to the OTR methodology. Any such changes to the OTR methodology would require a vote of the NCUA Board.

However, there would no longer be a need for staff to bring the rate resulting from the OTR calculation to the NCUA Board annually for approval. Instead, through approval of this Board Action Memorandum, the Board will delegate to the Director of the Office of Examination and Insurance the authority to administer the Board-approved OTR methodology, and to set the overhead transfer rate as calculated per the approved methodology, and validated by the Chief Financial Officer, each annual budget cycle beginning with the rate for 2016. Each year NCUA will post on its website the OTR calculation. (NCUA Board Action Memorandum, "*Overhead Transfer Rate Delegation*," November 19, 2015.)

Based on this description, the Board will not be exercising discretion because it has removed itself from future OTR rate decisions. This approach should be revisited and the decision changed to return the authority to the NCUA Board to set the OTR, which should be as part of the annual budget process. The PwC 2013 report to NCUA on OTR examination time and regulation mapping was generally positive but identified several issues with the agency's OTR setting approach. For example, on page 13 the report noted an inconsistency at the time between how the agency classified its rules for OTR purposes and the survey categories examiners used to report their agency work time. PwC concluded:

This inconsistency between the NCUA Rules and Regulations Reclassification matrix categories and the actual ETS categories could result in potential misunderstanding or inconsistent application of time to the refined categories. (NCUA *Analysis of Examination Time Survey Modifications*, PwC, October 2, 2013.)

The Board made the PwC report available to credit unions in part to help explain OTR issue, and that was a positive step. Yet, the release of such reports, to the extent they would be undertaken, would be far less certain if staff are making the OTR decisions. Also, while the issue regarding the discrepancy PwC flagged has apparently been addressed, there would be no way for credit unions to know the issue -- which could

have affected the OTR-- existed or to raise questions if staff routinely decide the OTR. This delegation, while shielding the Board from potential criticism, requires agency staff to assume authority over a substantive issue that should remain with the Board.

2. The Definition NCUA Uses for Insurance-Related Activities

A principal area of concern regarding the OTR remains the agency's classification of issues as "insurance" or "non-insurance"-related, which lays the foundation for the ability of the agency to increase the OTR on a discretionary basis. Moreover, as reflected in the request for comments and other agency documents, concern remains that although the agency describes and provides direction to examiners regarding these terms, NCUA does not clearly "define" what is "insurance related." This heightens the subjectivity associated with the OTR process. The use of "Insurance Regulatory" categories for OTR purposes such as the Examination Time Survey (ETS) further complicates the agency's approach.

We think as long as the issue of insurance versus non-insurance costs remains unsatisfactorily addressed, the OTR will be a concern, at least for some credit unions. In that connection, we believe NCUA should reconsider whether costs should be allocated in another way, not on an insurance or non-insurance related basis but on the basis of whether the costs are associated with supervision of a federal or state credit union. This is discussed in more detail under question 4.

3. Adjustments to the Current Calculation

Rather than making changes at the margins in the current methodology, we respectfully request the Board to revisit it with the objective of changing the current approach. This would include altering basic assumptions that weight insurance priorities too heavily, increase the OTR calculation's complexity and do not produce a result that is fair for all concerned.

However, if the Board determines it should keep the current system, we recommend the following be considered, in addition to providing a clearer definition of "insurance related":

- Change the Examination Time Survey to include a fourth category: "Non-insurance federal credit union operations" and move rules such as 701.21, loans, 713, bond coverage, and a number of other operational federal credit union regulations into that category.
- Call report review time for federal credit unions that is associated with compliance with operational rules, such as lending, should also be included under "Non-insurance federal credit union operations."
- The NCUA used a 9.6 percent budget allocation of non-insurance related costs for the regional offices in the 2016 budget, the same allocation as for the overall core and special programs. It is not clear whether the allocation was automatically applied to the regions or whether further analysis should be undertaken for the regional offices' allocation.

4. Alternative Methodologies

The agency has asked for comments on different approaches that would result in a fair allocation of costs for the NCUA and the NCUSIF. As discussed above, one approach is to pay for most costs relating to federal credit union examinations and supervision generally through their operating fees. The OTR would be utilized to address agency costs relating to state chartered federally insured credit unions and other direct costs such as the AMAC and others mentioned above in this letter.

Simply stated, the regulation of federally insured credit unions is conducted either by the NCUA for a federal credit union or a state regulator for a state credit union, and the NCUSIF supplements their efforts to ensure safety and soundness. The regulatory role of NCUA as the federal regulator is distinct from the role of the NCUSIF, just as the role of the NCUSIF is distinct from state regulators. With a clear and consistent recognition of the roles each of the three parties plays in the regulation or supervision of credit unions, allocating costs to ensure adequate resources are available for those functions should follow.

While safety and soundness is essential, as part of the OTR methodology review we think NCUA should consider whether too much emphasis is being placed on protecting the NCUSIF, which has led to overregulation, overfunding of the agency's budget and over reliance on the NCUSIF to fund NCUA costs.

The *Supplementary Information* in the request for comments notes that NCUA has increasingly placed more emphasis on share insurance since the NCUSIF'S creation in 1970.

As credit unions have become larger and more complex, the potential risk to the NCUSIF has increased. As a result, NCUA's operations have adapted. This has resulted in an increased focus on insurance-related activities, and this focus remains in place today. (81 Fed Reg. at 4808)

The NCUA also cites changes in the Federal Credit Union Act (FCU Act) and its rules that have required the agency to undertake "new obligations" to protect the NCUSIF, such as the Credit Union Membership Access Act. Yet there is concern that because the agency justifies increases in the OTR based on the need to protect the NCUSIF, the agency goes too far in prioritizing the interests of the NCUSIF and regulating to eliminate risk, rather than balancing its role between regulator for federal credit unions and insurer for federally insured credit unions.

If Title II of the FCU Act and the NCUSIF did not exist, would NCUA's role as regulator of federal credit unions be any less than it is today? Likely not because as the regulator, NCUA is charged with examining and supervising federal credit unions under Title I of the FCU Act.

Reports and examinations.—Federal credit unions shall be under the supervision of the Board, and shall make financial reports to it as and when it may require, but at least annually. Each Federal credit union shall be subject to examination by, and for this purpose shall make its books and records accessible to, any person designated by the Board. (12 USC 1756)

We believe more consideration should be placed on the use of the OTR for costs to the NCUA that are generally related to: the supervision of state federally insured credit unions (taking into account the value of state regulator assistance), significant systemic issues such as cybersecurity issues affecting federal and state credit unions alike, handling problem cases through assistance or mergers, the Asset Management and Assistance Center, training, and other appropriate costs. As discussed below in this letter, we believe that result is required by the FCU Act.

The categories of agency costs, basically state versus federal, could still be determined as a formula relying in part on examiner surveys. We do not think an elaborate methodology, however, is required to divide costs but rather the entire process could be simplified and improved. Examiners would not be confused (as PwC indicated in the 2013 report that some were in terms of how to categorize their time) and credit unions would be able to more clearly determine how costs are being allocated.

We are not suggesting the costs to federals be substantially increased, particularly in recognition of the funds they also pay to the NCUSIF. Rather, the NCUA budget should be contained, which will help manage costs to state and federal credit unions alike. Greater use of technology, expanding the examination cycle, particularly for well managed credit unions, and greater management efficiencies, including reducing how much time examiners spend at a credit union should all be undertaken.

Another approach some have suggested is to return to a lower OTR level, of say 50%, under which half of the agency's budget would be funded by a transfer from the NCUSIF. While arguably a better approach than the current process for some credit unions, this nonetheless retains some of the disadvantages of the current method in that it still provides a mechanism under which costs are not transparent and the OTR can readily be used to fund NCUA budget increases.

5. The NCUA's Legal Authority

We do not want to belabor this but we have concerns that the agency interprets Title II too broadly to give it discretion to fund too much of the NCUA's operations through the NCUSIF. The relevant provision of the FCU Act is 12 USC 1783, with which of course the agency is very familiar but for reference states:

National Credit Union Share Insurance Fund.—(a) Creation; use of fund.—There is created in the Treasury of the United States a National Credit Union Share Insurance Fund which shall be used by the Board as a revolving fund for carrying out the purposes of this subchapter. Money in the fund shall be available upon requisition by the Board, without fiscal year limitation, for making payments of

insurance under section 1787 of this title, for providing assistance and making expenditures under section 1788 of this title in connection with the liquidation or threatened liquidation of insured credit unions, and for such administrative and other expenses incurred in carrying out the purposes of this subchapter as it may determine to be proper.

In our view, this language does not grant the agency broad authority to fund agency budget increases by increasing the OTR. Instead, we view this language as directing NCUA to use NCUSIF funding judiciously for costs that are clearly related to the authorities delineated. Also, this language, as we know, must be considered in the context of Title I which established the NCUA to charter and regulate federal credit unions as well as authorized the NCUA to assess federal credit unions for agency costs associated with their supervision, under 12 USC 1755. We urge the agency to reconsider how Title I and Title II provisions work together and to revisit its legal authority for using the OTR as it reviews its OTR methodology.

6. The Administrative Procedure Act (APA) applies to OTR decisions

The agency developed a very well written memorandum to NASCUS (August 18, 2015) regarding its view that decisions concerning the OTR are not subject to the APA. Under the APA, changes in the OTR and decisions as to how it is calculated would be subject to notice and comments from stakeholders.

We do not agree with the agency's conclusions regarding the APA for the simple reason that the OTR is not merely a "matter of agency management" as the NCUA states. The issues regarding how the OTR is determined and the level at which it is set are substantive matters that affects the agency's examination and supervisory priorities and expenditures, which in turn affect all federally insured credit unions. We believe this conclusion regarding the OTR brings it squarely under the purview of the APA, and the agency's review of the OTR methodology should also include the handling of this issue under the APA.

Conclusion

Thank you for the opportunity to comment on the NCUA's OTR methodology. This is a substantive matter, which should be subject to notice and comment and decided by the Board. Credit unions deserve a process that is equitable, reasonable and beyond suspicion that it does not facilitate agency budget increases. We urge the Board to utilize the comments it receives under the current request and adopt meaningful improvements in the OTR methodology under a rulemaking. Please feel free to contact me at 202 430 8058 if you have any questions about our letter.

Sincerely,

Mary Mitchell Dunn, Partner, CU Counsel, PLLC