

April 26, 2016

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

Re: Comments on OTR Methodology and Operating Fee Schedule

Dear Mr. Poliquin:

The Credit Union National Association (CUNA) appreciates the opportunity to submit comments concerning the National Credit Union Administration's (NCUA) Request for Comments on the Administration Operating Fee Schedule Methodology and the Overhead Transfer Rate (OTR) Methodology. CUNA represents America's credit unions and their more than 100 million members.

As an initial matter, CUNA has long advocated for and requested full transparency and open communication regarding the overhead transfer rate with the credit union community. We commend the NCUA for opening up for comment the OTR and the Operating Fee Schedule and further urge the NCUA to continue allowing for notice and comment prior to amending or changing the OTR methodology in the future. It is also not our intent, nor should it be that of the NCUA, to benefit a Federal credit union over a State-chartered credit union or a State-chartered over a Federal credit union.<sup>1</sup> CUNA represents both Federal and State credit unions. Our goal is to ensure a fair distribution of the charges for the supervision of credit unions consistent with the Federal Credit Union Act (FCUA).

The NCUA's Operating Budget is funded through two primary mechanisms: 1. The OTR, funded by federally insured credit unions, both federally and state chartered; and 2. Operating Fees, funded only by Federal credit unions (FCUs). As such, CUNA has chosen to combine its comments on both funding mechanisms into a single letter. CUNA has consistently opposed any overhead transfer of agency expenses to the National Credit Union Share Insurance Fund (NCUSIF) that are not legitimate, substantiated "insurance-related" costs, consistent with fairness to state and federal credit unions and the FCUA.

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<sup>1</sup> 12 U.S.C. 1790 states: "It is not the purpose of this subchapter to discriminate in any manner against State-chartered credit unions and in favor of Federal credit unions, but it is the purpose of this subchapter to provide all credit unions with the same opportunity to obtain and enjoy the benefits of this subchapter."

The Federal Register notice requests specific comments on the OTR’s allocation of insurance and non-insurance related activities to the Operating Budget and the methodology used to determine the value of the work performed in Federally-Insured credit unions (FISCU) by State Supervisory Authorities (SSA).

***NCUA Definition of “Insurance Related Activities”:***

*Federal Register:*

In the Federal Register notice, the NCUA states that the definition of “insurance related examination procedures” that falls under Title II includes “examination or supervision contact procedures [that] address safety and soundness issues.” “Insurance regulatory related examination procedures” are defined in the OTR methodology as those that assess compliance with regulations that “address safety and soundness issues”. NCUA states this definition narrows, rather than expands, the procedures that the OTR includes under Title II since some consumer protection regulations may also be directed at safety and soundness.

***FCUA Construct of the OTR and Operating Fee:***

*Title I (12 U.S.C. §1756 and §§1751 - 1782 generally):*

Title I of the FCUA generally provides for the authority to regulate Federal credit unions, and assess an operating fee for regulatory and supervisory activities, as well as enumerating other powers. Section 1756 also provides in pertinent part:

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.

*Title II (12 U.S.C. §1781):*

Title II as it relates to charges in connection with Share Insurance related activities in 12 U.S.C. §1781(b) provides in pertinent part:

(1) to pay the reasonable cost of such examinations as the Board may deem necessary in connection with determining the eligibility of the applicant for insurance:  
**Provided, That examinations required under subchapter I of this chapter shall be so conducted that the information derived therefrom may be utilized for share insurance purposes, and examinations conducted by State regulatory agencies shall be utilized by the Board for such purposes to the maximum extent feasible;**

(emphasis added)

***“Safety and Soundness” does not equal “Insurance Related Activities”:***

NCUA’s definition of “Insurance Related Activities” essentially equates anything that is “safety and soundness” with being insurance related. This necessarily assumes that there will be no safety and soundness oversight in connection with its role as a prudential regulator under Title I. In short, “Insurance Related” does not equal “Safety and Soundness”. NCUA even acknowledges this, in part, noting that “some consumer protection regulations may also be directed at safety and soundness.”<sup>2</sup> Yet safety and soundness is only carved out of overhead transfers as they relate to consumer protection regulations.

The problem with this definition is that it shifts charges to the NCUSIF for **all** safety and soundness functions (other than those related to consumer protection), where some of the safety and soundness function should be clearly allocated to the proper Title I function and assessed only to federally chartered credit unions. Safety and soundness should not be a catch-all by which NCUA can allocate all of its activities for purposes of having the NCUSIF fund the agency.

To that end, Title I spells out many of the powers of a Federal credit union including the ability to make loans (personal, residential and business), the power to invest its funds, to make contracts, to sue and be sued, and to purchase and hold property, among many others. Further, Title I expressly requires the submission of financial reports, examinations, access to books and records, and overall supervision by the NCUA of Federal credit unions. Arguably all of these functions, including those delegated to Federal credit unions under Title I, and those related to the reviewing of financial reports, examinations and overall supervision should correspond to the funding mechanism for FCUs under Title I. Much of these Title I functions involve issues of safety and soundness yet are not allocated to the operating fee for Federal credit unions, but instead are funded by the OTR. The plain reading of the Title II statutory language states that examinations required under Title I shall be conducted such that the information can be utilized for share insurance purposes, not the other way around. It stands to reason that the current OTR method therefore does not allocate expenses according to their respective statutory titular function (i.e. Title I vs. Title II).

A startling indication that indeed the methodology is not properly capturing “insurance related activities” can be discerned from NCUA data. For the years 2008 to 2015, the OTR has been set at the rates shown in the following table:

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<sup>2</sup> See Request for Comment Regarding Overhead Transfer Rate Methodology, 81 Federal Register 4804 - 4805 (January 27, 2016).

<b>YEAR</b>	<b>OTR</b>
2008	52.0%
2009	53.8%
2010	57.2%
2011	58.9%
2012	59.3%
2013	59.1%
2014	69.2%
2015	71.8%
2016	73.1%

Per the NCUA, the number of troubled credit unions with rating of Camel 4/5 has decreased from a peak of 409 in 2011 to a low of 220 as of December 31, 2015.<sup>3</sup> If indeed the OTR is designed to capture what the NCUA is characterizing as “insurance related activities,” one would logically expect the OTR to correspondingly decrease. While there are other factors that might have bearing on those activities related to insurance activities, such as the conversion of a federal charter to state-chartered institutions, with the improving economy and the strengthening of credit union balance sheets, the dramatic increase in the transfer rate is still staggering and highlights the potential flaw in the fairness of the current methodology.

***Reliance on State Regulatory Agencies:***

CUNA has long advocated that the NCUA should seek efficiencies under the dual examination system and work more closely with state regulators to implement efficiency measures. Our member state-chartered credit unions often report that there is significant overlap of state and federal examinations. Both the FCUA and NCUA’s own rule contain the express directive to utilize other examinations to the maximum extent possible. Not only does Title II contain the express directive, but 12 CFR 741.1 also provides in pertinent part:

To the maximum extent feasible, the NCUA Board will utilize examinations conducted by state regulatory agencies.

NCUA should go much further in utilizing and relying on other regulators’ work product than it currently does. Not only will this benefit credit unions directly, but it should result in savings to the overall charges under both the OTR and Operating Fee.

It has often been cited by our member credit unions with state charters that a full complement of examiners from the SSA and NCUA will sometimes show up for what should be a routine examination of a non-troubled credit union. Efficiencies that could be gained by better coordination should result in an overall reduction in the NCUA’s budget. Further, the NCUA should make serious strides towards moving to an extended examination cycle and consider the Federal Deposit Insurance Corporation (FDIC) model of alternating examinations with state regulators on an 18-month cycle. All of these efforts can lead to budget efficiencies that will

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<sup>3</sup> NCUSIF Fourth Quarter Statistics (December 31, 2015), presented at the February 18, 2016 NCUA Board Meeting.

reduce the Operating Fee and ultimately the OTR for credit unions. Staffing levels have not been reduced at the NCUA even though we are well past the financial crisis.

What is notable is that the actual amounts of the total Operating Fee for Federal credit unions actually decreased over the past few years, although the overall total budget for the NCUA has increased and the OTR has dramatically increased. From 2009 to 2016, the total NCUA budget has risen by over 70%, from \$168 million to \$290 million while the OTR has risen from 53.8% to 73.1%. Because of this, the total amount of NCUA's operating budget funded by FCU Operating Fees is about the same today as it was in 2008, just over \$80 million, even though FCU assets have risen by 30% over the period. As a result, the operating fee rate to FCUs has declined from a dollar weighted average of 1.7 basis points of assets in 2009 to 1.3 basis points in 2016. This indicates that true budget increases are somewhat hidden from credit unions as federal charters are seeing the amounts directly charged to them decrease, but have no meaningful way to discern how much is being transferred from the NCUSIF. "Accountability" and "Transparency" were two of the values stressed in NCUA's Strategic Plan. In that spirit, the NCUA should adjust its funding of the OTR and the Operating fee accordingly and discontinue the practice of hiding growth in the agency's budget vis-à-vis the OTR.

#### ***Alternate OTR model:***

Having analyzed the statutory constructs and the relationship between Federal and State regulators, it is clear the NCUA should revise the OTR methodology. Although examination and supervision support the insurance function, they are **primarily** the responsibility of the chartering authority, the prudential regulator: NCUA for FCUs and the various SSAs for FISCUs. In theory, if the NCUSIF could reimburse both NCUA and the SSAs for the cost of examinations, it could be appropriate for it to do so, to NCUA through the OTR and to SSAs by means of a direct reimbursement. However, for a number of reasons, making such payments to SSAs is not practicable. Therefore, equity requires that routine examinations of both FCUs by NCUA and FISCUs by SSAs be paid by the respective credit unions through operating fees, and that the OTR cover only NCUA examination of FISCUs, NCUA examination of potentially troubled FCUs, and the FISCU share of other examination-related costs.

Under this approach, the following principles would apply [data based on November 19, 2015 Board Action Memorandum (BAM) on the OTR]. Similar to NCUA's own calculation, this approach identifies the total costs to be paid by FISCUs, and calculates the implied OTR.

- Costs to be borne by FISCUs should be based on the data of the Workload Program in the following way (see Step 1 of Attachment 1 in the BAM):
  - 100% of Core Program time directly devoted to FISCUs. This includes State Examination and Supervision, State Examination Review, and the 5300 Program—FISCU;
  - The pro-rata share (47.7% based on the percentage of insured shares) of the extra examination and supervision time NCUA devotes to CAMEL code 3, 4, and 5 FCUs beyond what would be required if they were CAMEL 1s or 2s. Considering that Code 3, 4, and 5 FISCUs account for less than 10% of the assets of all FISCUs, assuming this is roughly the case for FCUs alone, and assuming

the extra exam and supervision time is about double that required for Code 1 and 2 FCUs, the FISCUs share of the time spent on these Code 3, 4, and 5 FCUs would be about 5% of total FCUs examination and supervision time;

- We estimate that under this approach, FISCUs share of Core Program time would be slightly less than one third;
  - The pro-rata share (47.7%) of Special Program insurance hours. Since insurance hours account for 92.4% of Special Program hours, FISCUs share of that time is 44.1%; and
  - Combining FISCU's roughly one third of Core Program and 44.1% of Special Program hours yields a FISCU share of the Workload Program hours of still slightly less than a third (likely in the range of 30% to 33%) since Special Program time is only 5% of Core Program time.
- All identified insurance costs in the Financial Budget (Step 2 in the BAM) to be borne on a pro-rata basis (47.7%) by FISCUs.
  - That portion of the budget not identified as insurance costs in Step 2 to be allocated to FISCU's based on the FISCU share of the Workload Program (slightly less than a third). This applies to All Regional Costs and Other Internal Offices.

Using this approach, the amount of NCUA's \$292.2 million Financial Budget to be borne by FISCUs would be around the range of \$85 million to \$93 million as opposed to \$101.5 million using NCUA's approach. The resulting OTR would be about in the range of 62% to 67% instead of NCUA's 73.1%.

This rough estimate is based on the current level of NCUA examination of FISCUs. If, as we have urged elsewhere in this letter, NCUA would make better use of SSA examination results by examining healthy State-chartered credit unions on an alternating basis on an 18-month cycle, the OTR would likely fall below 60% and NCUA's total budget would also be reduced.

***PriceWaterhouseCoopers LLP Study (January 20, 2011):***

The PriceWaterhouseCoopers January 20, 2011 Study has often been cited by the NCUA as justifying the fairness of the OTR methodology. While we appreciate the NCUA having the methodology studied by an outside accounting firm, what is clear from the audit itself is that the role of a CPA audit firm is not a substitute for the policy that should be established by the NCUA. While the CPA review focused on the reasonableness and soundness of the methodology, given NCUA's policies and legal interpretations, it did not express any opinion on issues regarding NCUA's dual role as a regulator and insurer, its oversight or lack thereof, or NCUA's budget or an interpretation of Congressional intent behind the FCUA. In short, it was not an opinion that the current OTR was fair to both State and Federal credit unions, nor was it an opinion that the methodology was the best or only formula for implementing the statute. These policy issues are the province and the responsibility of the NCUA Board.

***Federal Register Questions:***

The NCUA has requested comments on the following items concerning 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;

The NCUA should continue to use a formula-driven approach to the OTR, however, the methodology should be revised by the Board, via notice and comment, to provide only legitimate, substantiated, “insurance-related” costs, pursuant to the respective FCUA Title, and consistent with fairness to State and Federal credit unions and the FCUA.

2. The definition NCUA uses for insurance-related activities;

The definition should not equate “Safety and Soundness” with “Insurance-related” and should be revised to correspond to the respective statutory Title.

3. Adjustments or changes to the current calculation; and

Adjustments should be made to properly allocate Title I and Title II costs as indicated above.

4. Alternate methodologies to arrive at an accurate and fair allocation of costs.

Adjustments should be made to properly allocate Title I and Title II costs as indicated above.

For the Operating Fee Schedule Methodology, the NCUA requests comments on the following:

1. Are the asset determination thresholds reasonable; and

The asset determination thresholds appear to be within a reasonable limit, however, the NCUA should continue to review them annually, subject to notice and comment by the public.

2. Is the method for forecasting projected asset growth for the credit union system reasonable?

While the current method for forecasting growth appears somewhat reasonable, again, the methodology should be reviewed annually, subject to notice and comment by the public.

Thank you for the opportunity to express these views to the NCUA. If you have further questions or would like to discuss CUNA's comments in more detail, please feel free to contact me at 202-508-3630.

Sincerely,

A handwritten signature in black ink, appearing to read 'A. T. Price', with a stylized flourish at the end.

Andrew T. Price  
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