CUNA
Credit Union National Association

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The Honorable Rick Metsger
Chairman
National Credit Union Administration Board
1775 Duke Street
Alexandria, VA 22314

Dear Chairman Metsger:

On behalf of America's credit unions and their more than 100 million members, thank you for opening the National Credit Union Administration's (NCUA) budget process to credit unions and credit union stakeholders. Providing budget items in advance, holding an open briefing where stakeholders were able to comment and soliciting written comments is good public policy and a strong step in the direction of government transparency. We commend you for your efforts.

This letter presents the views of America's credit unions on the agency's budget and responds to questions you addressed to Mr. Mike Schenk, CUNA's Vice President for Economics and Research, at the recent budget briefing. Attached to this letter is an analysis of NCUA's budget. During and following the Board briefing, you and your staff questioned the analysis we presented. Given the concern you raised, we have recast our analysis using the time period and data set suggested by you and your staff during and following the board briefing. The numbers have changed but the conclusion has not: NCUA's budget continues to increase substantially in the face of post-crisis improvements in credit unions, and at a rate that significantly outpaces changes in credit union operation costs and the budgets of other banking regulators. NCUA staffing levels increased substantially in response to the greatest financial crisis in modern history; however, the agency's FTE count is virtually unchanged since the peak of the crisis. We find these trends concerning given the improvement in credit unions' financial conditions over the past six years and this is something on which we intend to continue to press the agency.

Credit unions and their members need and deserve a world class regulator. We believe the budget is a critical driver of the agency's effectiveness and efficiency in regulating credit unions and maintaining public trust in the financial system. That is our goal in this budget process and we know it is a shared goal with the agency. To that end, as NCUA implements its budget, we encourage the agency to make responsiveness, efficiency, and responsible use of credit union members' money its highest priorities, giving full consideration of the fact that the economy and credit unions are especially strong and that in addressing these priorities right-sizing the agency is essential. Furthermore, we encourage the NCUA to measure itself against other regulators so it can proudly demonstrate how its operations and ideas are world class.

In recent months, the NCUA has demonstrated responsiveness to credit unions' needs and to stakeholder input. The open budget process is a step forward in demonstrating that the agency wants to operate in an open manner for the good of all credit unions and credit union members. Further, NCUA's ongoing efforts to revamp regulations to provide credit unions relief from unnecessary, duplicative and unduly burdensome requirements and processes further builds trust that NCUA is committed to an improved and efficient regulatory scheme. We commend you and the agency for these efforts.

We further commend the agency for the efficiencies it seeks in the supervisory process. Implementation of extended examination cycles will not only reduce burden on healthy credit unions but it will also allow NCUA to devote resources to problem areas. We are eager for NCUA to proceed with additional supervisory improvements, with the expectation that budget efficiencies will be achieved over the long-term. Unlike the other financial regulatory agencies, NCUA has considerable flexibility on the timing and manner in which the agency conducts examinations. We see little reason that the agency cannot step far in front of the other regulators by creating an examination process that is conducted almost entirely by virtual examination. NCUA should treat the move to this process as a critical goal to achieve maximum agency efficiency, limit costs, and provide relief to credit unions.

The efficiency of NCUA's operation are paramount to responsibly using credit union members' resources as NCUA seeks to become a world class regulator. We know it takes real skill and management excellence to be effective and efficient, and this is our expectation of the NCUA. In recent years, CUNA itself has seen how addressing inefficiency and making better use of our members' resources leads to better results overall. We believe there is immense capacity for NCUA to reduce its footprint, right-size the organization and come out of the resulting transition as a nimbler, stronger, more efficient and more effective regulator. That is the path to becoming a world class regulator.

On behalf of America's credit unions and their more than 100 million members, thank you very much for your consideration of our views.

Sincerely,

Jim Nussle
President & CEO

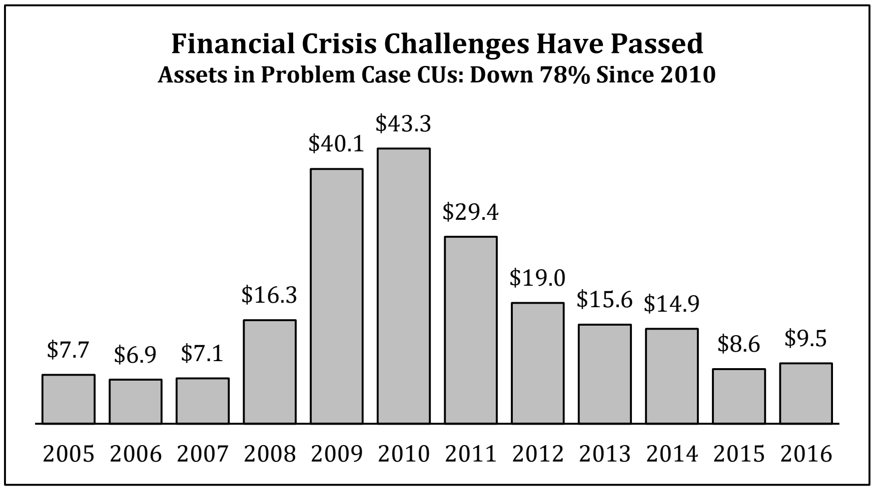
CUNA Analysis of NCUA's Budget

The NCUA's Proposed Budget Increase Represents a Continuation of Alarming Trends

NCUA Budget Trends

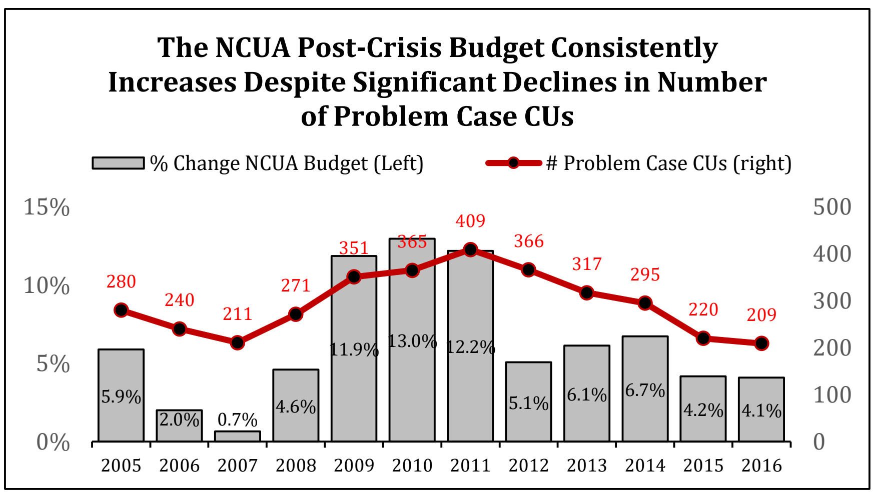
NCUA's post-crisis budget trends have been – and continue to be - deeply concerning.

The agency's budget was significantly affected by the financial crisis and its immediate aftermath: The insurance fund experienced increases in troubled institutions, failures, insurance fund losses, and in annual operating expenses during the crisis.



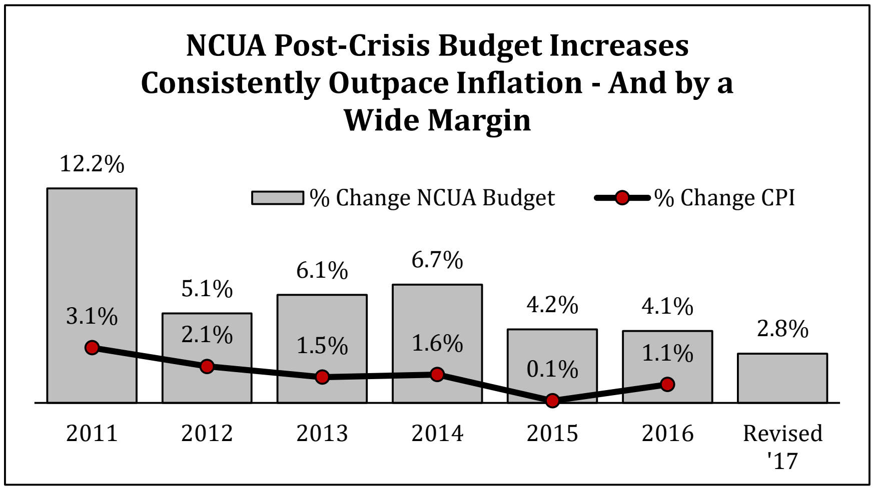
It is reasonable, of course, to expect the operating expenses of a federal deposit insurance fund to rise in periods of economic stress. Greater supervision and monitoring are necessary to control insurance losses in such an environment.

However, the crisis and the overwhelming majority of the difficulties it created are squarely behind us – and have been for several years: Assets in problem-case credit unions reflect a six-fold increase between 2007 and their $43.3 billion peak in 2010 but have declined by nearly 80% since that time.



The total number of problem case credit unions fell by 49% in approximate straight-line fashion - from 409 in 2011 to 209 at mid-year 2016. The current number of problem case credit unions is below the level seen at year-end 2007, when 207 problem case credit unions were reported.

Still, NCUA's post-crisis budget continues to increase substantially in the face of these improvements. In 2010, the NCUA's total budget was $200 million – a sum that has ballooned to nearly $300 million in just six years. That's an all-in, six-year budget increase of 45% since 2010 and an annual average jump of 6.4%. Overall, the NCUA budget has increased by 91% since pre-crisis levels.

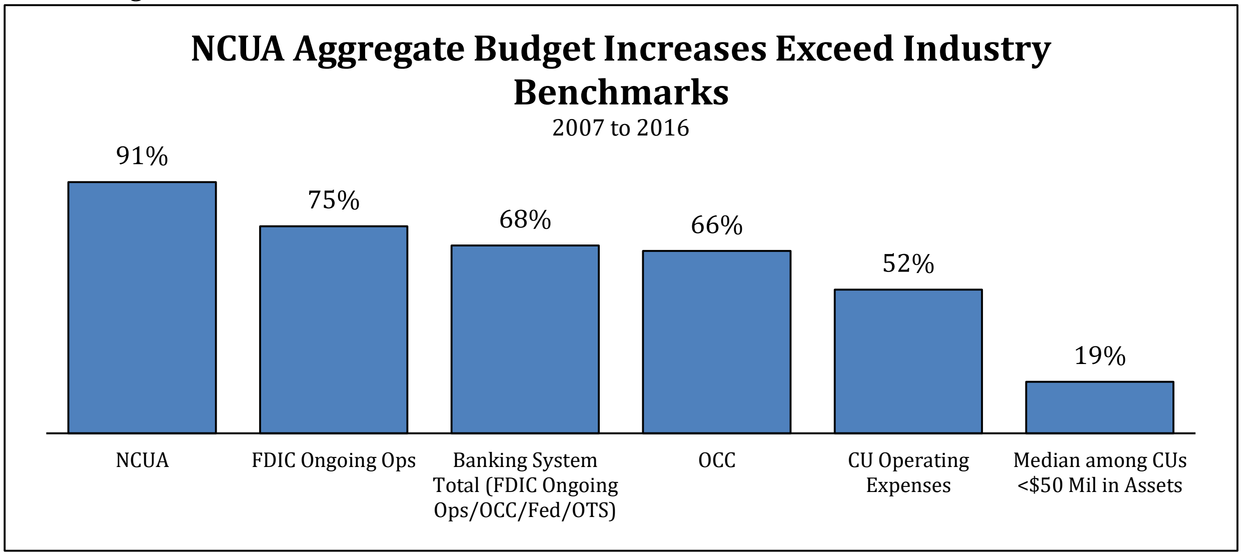


The agency's budget increases have significantly outpaced inflation year-in and year-out for over a decade. While the NCUA budget reflects a 45% increase compared to 2010, inflation (measured by changes in the CPI) increased by only 10% over the same period. In other words, since 2010, NCUA budgets have increased more than four times faster than inflation during a period when most of the effects of the financial crisis quickly faded.

Looking more broadly and comparing the 2016 budget to pre-crisis levels tells a similar tale. NCUA's budget is up by 91% since 2007, while inflation increased by only 16% during that period. This means the NCUA budget has increased nearly six times faster than inflation over the cycle.

One of the most obvious and important benchmarks is natural person credit unions and the operating expenses those institutions incur. Among credit union professionals, their own credit union's operating expenses typically are a first point of reference when assessing effective expense management. Of course, NCUA operations are not similar to credit union operations so differences in the comparative growth of total expenses are bound to exist and most observers expect to see differences. Still, credit union operating expenses increased by only 52% since 2007 – roughly half the increase seen in NCUA's budget. Most CUNA members are shocked and (understandably) upset when they discover the magnitude of that difference.

Importantly, the 52% credit union aggregate increase is NOT typical – it is a dollar-weighted average, pulled up by results at the nation's largest credit unions. As a point of comparison, the increase in the median level of operating expenses among credit unions with $50 million or less in assets since 2007 is 19% - not 50%. We choose $50 million as a point of reference because roughly two-thirds of credit unions have $50 million or less in total assets today. This means that a significant portion of the constituency that NCUA interacts with is apt to view the agency's increases as "out of control" and in need of reigning-in. It should come as no surprise that credit unions want much more detailed explanations of the rationale for increases, as well as reasons behind the current and proposed spending and staffing levels.



It is admittedly difficult to come up with strict apples-to apples comparisons for the NCUA budget. However, NCUA's spending over the period of 2007 to 2016 exceeds every banking benchmark we examined – by a wide margin. These benchmarks include the Federal Deposit Insurance Corporation's (FDIC) Ongoing Operations budget, the Office of the Comptroller of the Currency (OCC) budget and the banking system total budget [including FDIC Ongoing Ops, OCC, Federal Reserve and Office of Thrift Supervision (OTS) budgets]. NCUA spending increases greatly outpaced those in the banking arena even though only 26% of the institutions supervised by NCUA are complex. In comparison, roughly 70% of banks are complex – defining complex as was defined in the agency's recent risk-based capital regulation.

NCUA often cites the trend to larger and more complex credit unions as the rationale for consistently large budget increases. However, NCUA both insures and supervises much smaller and much less complex institutions than those in the banking sector.

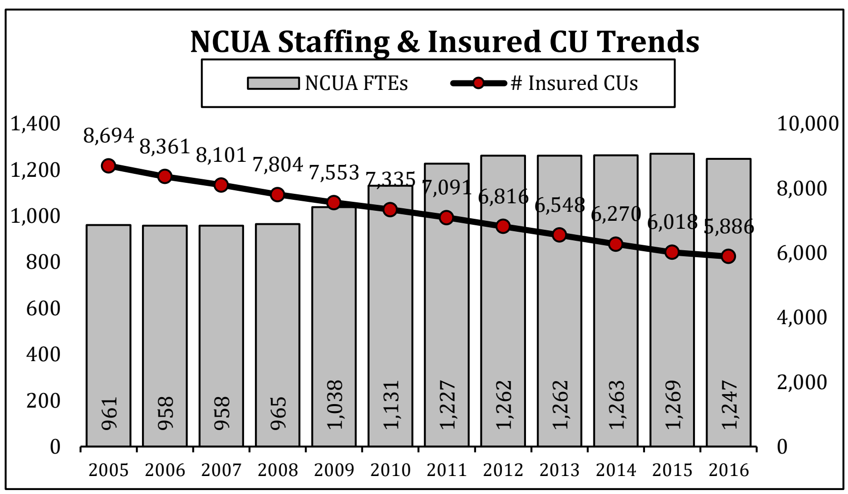
As shown in the table below, there are a total of 5,886 insured credit unions reporting $1.27 trillion in total assets. In contrast, FDIC reports a total of 6,058 insured banks with $16.5 trillion in total assets and a total of 3,827 FDIC-regulated banks with $2.8 trillion in assets.

The average asset size of insured credit unions is thus $216 million, while the average asset size of FDIC-regulated and FDIC-insured banks is $1.0 billion and $1.7 billion respectively. The average credit union size is less than one-quarter the size among FDIC-regulated institutions and about one-eighth the size of FDIC-insured banks.

Additionally, NCUA data reflects 1,542 complex[1] credit unions accounting for roughly one-quarter of total credit unions. In contrast, roughly three-quarter of FDIC-regulated and FDIC-insured banks are complex.

NCUA/FDIC INDUSTRY SIZE/COMPLEXITY PROFILE	NCUA	FDIC Regulated	FDIC Insured
Number of institutions	5,886	3,827	6,058
Total assets (Bil)	$1,270	$2,760	$16,530
Average assets (Mil)	$216	$997	$1,700
Number "complex"	1,542	2,703	4,378
% of total "complex"	26%	71%	72%
Assets in complex (Bil)	$1,149	$2,695	$16,477
% of total assets in "complex"	90.0%	97.6%	99.7%

Most credit union observers seem sympathetic to the idea that NCUA was not adequately staffed to effectively handle the greatest financial catastrophe since the Great Depression. However, today the crisis is quickly becoming a historical footnote. The rationale for the agency's current staffing levels is simply perplexing to most outside observers.



It's certainly not unusual to hear credit union managers complain about NCUA staffing levels in light of industry consolidation trends: the number of insured credit unions has declined by 2,215 - from a total of 8,101 immediately prior to the start of the Great Recession to only 5,886 at mid-year 2016. That's a 27% drop.

[1] As a proxy, we here use the NCUA's risk-based capital rule definition of "complex" – $100 million or more in total assets. The NCUA's complexity index cannot be easily applied to banks due to lack of comparable call report operational data.

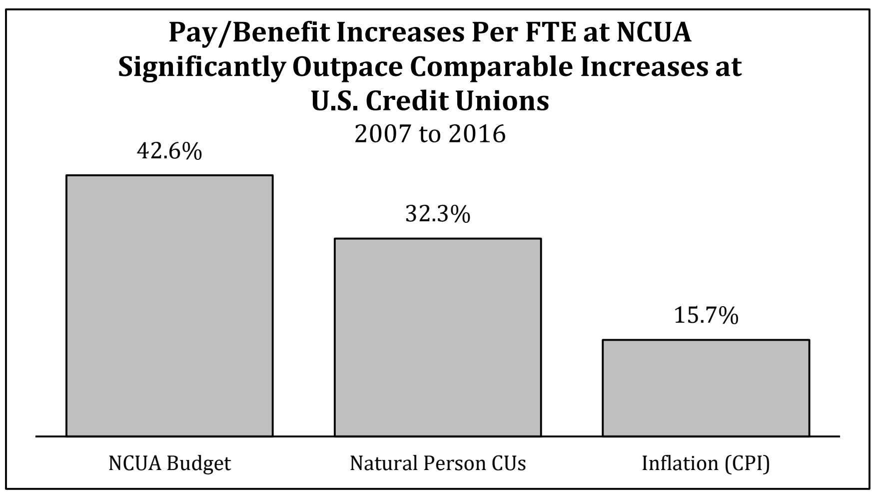
In contrast, the number of NCUA full time examiners (FTEs) increased dramatically as the fall-out from the collapse of the housing bubble grew. Those staffing levels are essentially unchanged at crisis levels despite widespread improvement in economic conditions and in credit union financial health. At the start of the financial crisis, NCUA reported 958 FTEs – a number that increased by 289 - peaking at 1,269 in 2015. The 2016 total is only 22 off the previous-year all-time high.

NCUA is correct in pointing out that it is simplistic and can be misleading to attempt to right-size staffing by comparing FTE trends to trends in the number of insured institutions. Credit unions are larger and more complex than they were prior to the start of the crisis and it requires more resources to adequately supervise those institutions. However, it is just as simplistic and misleading for the agency to attempt to justify current staffing levels simply by claiming that institutions are bigger and more complex.

While we applaud and embrace the agency's plans to reduce staffing significantly through extended examination cycles and advances in technology, we request much more transparency on the rationale for current staffing levels. NCUA must be more forthcoming and describe in detail the rubric it uses in determining appropriate staffing levels.

NCUA Personnel Costs

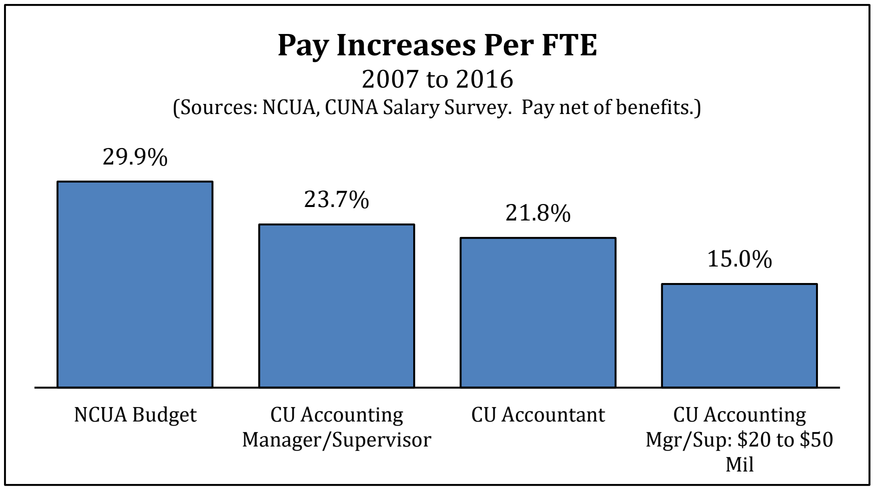
During the agency's recent budget briefing, NCUA staff noted that comparison of the NCUA budget to inflation is misleading because nearly three-quarters of the agency's expenses are personnel-related. In addition, they noted that a large number of agency employees are college educated and thus tend to require salary increases that significantly outpace inflation averages.



That may be true, but our independent analysis suggests that NCUA personnel expenses rise substantially faster than similar expenses at natural person credit unions.

Indeed, over the 2007 to 2016 period we find that NCUA's budgeted staff pay and benefits per full-time equivalent employee has increased by roughly 43%, while natural person credit union pay and benefit expenditures rose by only 32% during that nine-year period. We use annualized first-half credit union expenses as an approximation for full-year pay/benefit expense at credit unions.

We likewise find that NCUA pay increases (net of benefits) substantially outpace credit union pay increases over the 2007-2016 horizon for many categories of credit union pay – including for credit union jobs that require college degrees. For example, while the NCUA budgets reflect an approximate 30% increase in staff pay per full-time equivalent employee, credit union Accounting Manager/Supervisor average pay reflects less than a 24% increase over the period according to CUNA's annual Salary Report. Credit union accountants experienced a 22% increase in pay over the period.



Moreover, as would be expected, average credit union pay increases for employees that work at smaller institutions tend to be substantially lower than the national averages for all credit union employees (including those that work at large institutions). For example, the Accounting Manager/Supervisor position average pay at credit unions in the $20 million to $50 million asset category reflects only a 15% increase over the 2007-2016 period.

This helps to explain why many credit union professionals might view NCUA budgeted increases unfavorably and suggests the Agency ought to look for additional ways to rein-in costs and (at the very least) do much more to rationalize average staff pay increases and illuminate the drivers of pay and benefit changes. A better summary of contractual obligations and other non-discretionary drivers of these trends would be desirable, for example.

While the optics of pay and benefit increases tend to generate significant concern, more general, aggregated comparisons to banking increases also are unfavorable: The agency's total budgeted outlays over the long-term budget increases greatly exceed nearly every industry benchmark.

Relating Goals to Budget

Over the past few Januarys, NCUA has sent a Letter to Credit Unions itemizing the agency's supervisory goals for the upcoming year. This document does not provide suitable detailed information to credit unions on how examination resources are allocated to achieve the agency's goals. The agency now provides public information on how its budget expenditures dovetail with strategic or annual performance plans. However, the level of detail and the exact connections between the budget and strategies are insufficient, making it impossible to see how budget expenditures specifically correlate with the achievement of NCUA's strategic goals. The agency should provide additional analysis of how budget allocations more specifically support the achievement of the agency's goals.

Efficiency in Operations

NCUA should review its structure and use of remote location. For example, NCUA needs to evaluate the necessity of maintaining the Asset Management and Assistance Center (AMAC). Due to the lack of public information, CUNA cannot effectively evaluate the necessity of this office or the efficiency of this office. In the absence of compelling data to the contrary, we propose dramatically reducing the AMAC and moving its operation to Alexandria. The agency is keeping the office open at what we can only guess is a very low usage rate, simply to have it available for the next recession. There is little to no chance the next recession will not require anything like the last one in terms of asset liquidation, so there is little reason to maintain the resources at anything but substantially lower levels. In fact, it would likely be substantially more cost effective to outsource asset sales on an as needed basis compared to keeping a fully staffed AMAC open all the time.

Travel Expenses

Travel expenses are the fourth highest budget expenditure, at roughly 10% of the budget. Overall travel expense appears 1.1% lower than the 2016 budgeted amount – due primarily to a reduction in examiner positions. Travel per FTE is up, but only marginally, from $23,491 in 2016 to $23,459 in the revised budget (a 0.2% increase).

With the potential to secure meetings via the Internet and mobile communications, it seems the agency could find some savings by reducing the travel budgeted for examiners and other agency officials. We also question whether most staff should be on site at the agency's national conference, particularly since the conference seems to result in NCUA employee absences of up to two weeks.

Staff Reduction

The Exam Flexibility Initiative pushes the examination cycle out from twelve to eighteen months. This suggests that, all equal, when fully implemented, EFI should result in a need for roughly one-third fewer examiners overall. Since not all credit unions are (or will be) healthy in the future, this decrease admittedly overstates potential reductions. The need for examination and agency improvements, including technology upgrades and ongoing examiner training, may offset a bit of this. Still, the declines should be more significant than is discussed in material distributed to date. Reductions in the neighborhood of 25% overall seem realistic. A more detailed and robust exploration of the magnitude of possible reductions should be shared with stakeholders.

Industry Feedback

Part of operating a world class organization is maintaining a scorecard from all stakeholders and striving to excel and to exceed expectations. Credit unions, as a stakeholder, can play a distinct and important role in this process. Examiners spend a large percentage of their time interacting with the credit unions they supervise. But feedback from credit unions on the performance of individual examiners – to the extent it is collected at all - is obtained haphazardly.

The only formal feedback mechanism available is the examination appeals process - but credit unions are loath to use that process mostly due to fear of retribution and a *perception* that the process is largely ineffective. NCUA should consider developing and conducting ongoing, confidential examination staff satisfaction surveys, distributed to credit unions at the conclusion of each exam. These surveys should be processed and compiled outside the purview of the agency staff, by an outside third party with each examiner's average rating shared with the regions. This could be used as a component of the merit pay process for each region. Nearly all of the nation's largest credit unions have adopted similar approaches to assist in evaluating service quality and enhance staff evaluations (both in the aggregate and on an individual basis).

Technology

NCUA will spend more this year on technology related expenses (ARIES, Exam Reform, Call Report, CU Online) for purposes of obtaining efficiencies, but that should result later in a decrease in the budget. Again, additional narrative on the possible range of reductions would be helpful.
Finally, I urge the agency to study the composition of the Regions to explore any possibilities for significant cost savings. The current configuration implies that efficiencies may be possible.

Contracted Services

Contracted services are the third largest expenditure for the agency, yet there does not seem to be much public information on those specific costs or the process for selecting contractors. As a result, stakeholders cannot evaluate whether the contracts are awarded appropriately and the fees paid are reasonable. We urge the agency to provide more information on expenses for contracted services. However, the agency's categorization of activities is not clear and more information should be provided to credit unions regarding the supporting data for overheard transfer rate decisions.

Overhead Transfer Rate (OTR)

It is notable that the actual amounts of the total Operating Fee for federal credit unions have 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 National Credit Union Share Insurance Fund (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.

Therefore, we believe that the NCUA should continue to use a formula-driven approach to the OTR. However, the current methodology is flawed and should be revised by the Board, via notice and comment, to provide that only legitimate, substantiated, "insurance-related" costs are charged to the NCUSIF, pursuant to the respective FCUA Title, and consistent with fairness to state and federal credit unions and the FCUA.

Appendix A

NCUA's Stark Contrast with Banking Agencies

NCUA expressed concern over CUNA's use of FDIC's total budget in the comparative analysis we provided during the agency's recent budget briefing. Agency staff suggested that the FDIC Ongoing Operations Budget (excluding receivership costs) and selected budgeted expenses of various other banking agencies is closer to an apples-to-apples comparison point.

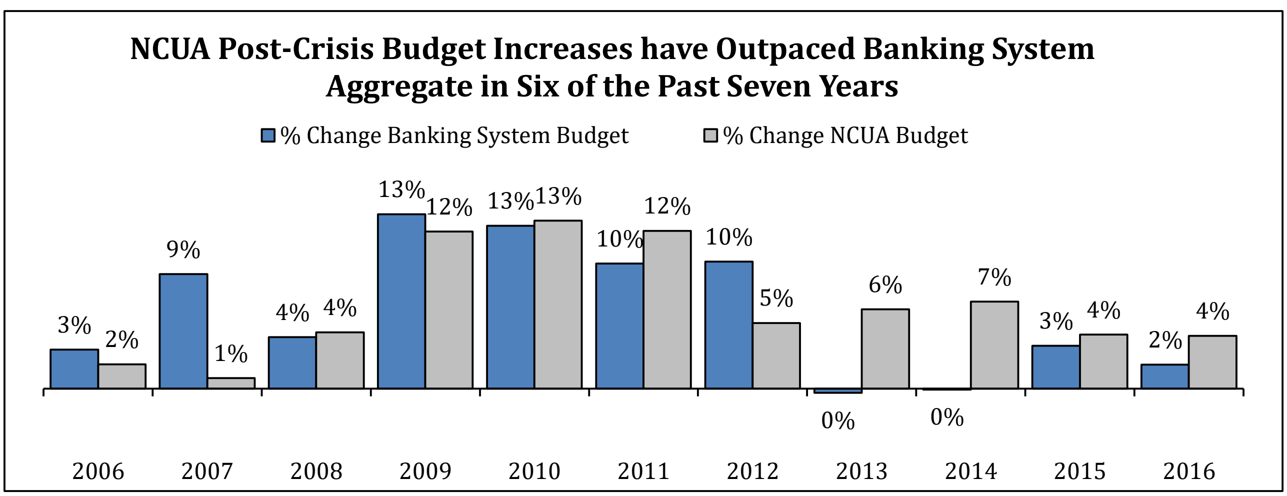
In light of this concern, we have re-cast our analysis, comparing NCUA's budget increase to aggregated "Banking System" increases defined as changes in the budgeted outlays for FDIC Ongoing Operations, Federal Reserve supervision, OTS supervision, and OCC supervision, regulation and chartering.

Having done so, we find the magnitude of the differences in budget growth rates is not as great as we reported during the briefing. That's not surprising – FDIC receivership costs skyrocketed and removing these from the equation has a dramatic effect on the numeric changes. Notwithstanding these changes, we also find that the fundamental conclusion is unchanged: NCUA's budget increases significantly outpace those in the banking industry: Following the crisis, NCUA's budget increased by 45% - nearly double the 26% increase in the aggregated Banking System budget during the same period.

NCUA further expressed concern over our comparison of the NCUA and FDIC budgets over the 2010-2016 period – suggesting that our choice of a 2010 start-date for the analysis was misleading and indicating a pre-recession start-date would be more appropriate. Again, recasting the analysis using pre-recession budgeted expenses as a start date changes the numbers but confirms our basic conclusion: The 2007-2016 budget increase at NCUA is 91% - a substantially higher rate of growth than seen in aggregated Banking System budgets, which increased 68% over the same period.

Our updated, detailed analysis follows:

First and foremost, it is important to note that the budgets of *both* NCUA for credit unions and Banking Industry totals for commercial banks, increased during the financial crisis. However, because of their



cooperative ownership structure and resulting less risky operations, the stresses of the financial crisis among credit unions paled to those in the banking industry.

More recently following the peak of the crisis, as financial pressures on the share insurance fund have abated, NCUA's annual spending has continued to increase while Banking System spending has declined each year. As noted above, since 2010, the NCUA's budget increased by 45% - nearly double the 26% increase in the FDIC budget over the same period of time.

The table below provides updated information on budgets and assets in troubled institutions for NCUA and FDIC over three periods: Averages from 2005 to 2007, a baseline prior to the crisis; averages from 2009 to 2011, the peak of the effects of the crisis on FDIC and NCUSIF; and 2014-2016, the post-crisis norm. The analysis thus smooths out the data, evaluating three-period norms rather than annual data for one specific year.

Troubled Institutions and Budgets: NCUA vs FDIC/Banking				
Assets in Troubled Institutions	**NCUA**		**FDIC**	
	$ Billions	% Change	$ Billions	% Change
Pre-Crisis (2005-2007)	$7.2		$15.7	
Peak of Crisis (2009-2011)	$37.6	420%	$370.7	2,261%
Post Crisis (2014-2016)	$11.0	-71%	$75.4	-80%
Percent Change Pre-Crisis to Post-Crisis		52%		480%
Budgets	**NCUA**		**Banking System Totals***	
	$ Millions	% Change	$ Billions	% Change
Pre-Crisis (2005-2007)	$150.3		$2.4	

Peak of Crisis (2009-2011)	$201.4	34%	$3.3	41%
Post Crisis (2014-2016)	$279.6	39%	$4.1	24%
Percent Change Pre-Crisis to Post-Crisis		86%		75%
***Banking totals are budgeted outlays for FDIC Ongoing Operations, Federal Reserve supervision, OTS supervision, and OCC supervision, regulation and chartering.**				

The data reveals the following:

- Assets at troubled institutions insured by the FDIC increased much more severely than did assets in troubled NCUSIF-insured credit unions. While troubled assets rose for both NCUA and FDIC from before the crisis to its peak, the approximate 23-fold increase at FDIC (2,261%) dwarfed the less than five-fold increase at NCUA (420%).
- Since the peak of the crisis, troubled assets declined by almost three-quarters for NCUA (-71%) and by a similar magnitude for FDIC (-80%).
- From before the crisis to the post-crisis period, troubled assets for NCUA are less than double, $7.2 billion compared to $11.0 billion. Troubled assets for FDIC are still roughly five times greater now than they were before the crisis, growing from $15.7 billion to $75.4 billion.
- In response to the increases in assets in troubled institutions, both NCUA and FDIC increased spending. Despite its much smaller increase in troubled assets, NCUA nevertheless did increase spending from pre-crisis to its peak by 34%. With its dramatically greater increase in troubled assets, FDIC increased its budget by 41% over the same period.
- Since the peak of the crisis, as troubled assets fell at both NCUA and FDIC, FDIC increased its budget by 24%, while NCUA increased spending at a substantially faster rate of 39%.
- Compared to the three-year average prior to the crisis, NCUA's budget has risen by slightly less than double, or 86%; while FDIC's is up by only 75%. However, during this period, the 480% increase in troubled assets under FDIC supervision dwarfs the 52% increase in such assets under NCUA's supervision.
- The number of problem case banks at year-end 2016 is 93% higher than at the start of the downturn whereas the number of problem case credit unions declined by 1% over the same period.