

April 26, 2016

National Credit Union Administration
1775 Duke St.
Board Secretary
Alexandria, VA 22314

RE: Comments on NCUA's OTR and Operating Fee Schedule Methodologies

Dear Mr. Gerard Poliquin,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), one of the largest state trade associations for credit unions in the United States, representing the interests of more than 350 credit unions and their more than 10 million members/consumers. There are 134 federally insured state-chartered credit unions (FISCUS) in California and Nevada with more than six million members, representing 12 percent of all members belonging to state chartered credit unions in the United States.

The National Credit Union Administration (NCUA) operating budget has two primary funding mechanisms: (1) An Overhead Transfer, which is funded by both FISCUs and federal credit unions (FCUs); and (2) annual Operating Fees, which are charged only to FCUs.

The Leagues welcome the opportunity to provide comments to the NCUA on the OTR Methodology and the FCU Operating Fee Schedule Methodology. Since these topics are interrelated, this letter will serve as comment for both methodologies. In commenting, it is our goal that NCUA will utilize methodologies that ensure a fair allocation of costs to both state and federally chartered credit unions.

OVERHEAD TRANSFER RATE METHODOLOGY

The NCUA applies the Overhead Transfer Rate (OTR) to the agency's operating budget to determine the portion of the budget that will be funded from the National Credit Union Share Insurance Fund (NCUSIF).

Safety and Soundness versus Insurability

Title I of the Federal Credit Union Act (Act) – General Provisions provides for examinations, oversight by the Board, and the provision of financial statements, all of which cover “safety and soundness” issues. Those “safety and soundness” issues arising from Title I activities should rightfully be charged under the Operating Fee.

Title II of the Act – Share Insurance requires that federally insured credit unions agree to pay the reasonable costs of exams necessary to determine insurability and protection of the NCUSIF. In relevant part, Title II states, “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.”

Under a plain reading of the Act, NCUA’s duties as a regulator and supervisor of federal credit unions are different than its duties as the administrator of the NCUSIF. It is also clear that safety and soundness is the responsibility of the chartering authority – whether the NCUA or a state supervisory authority. Accordingly, the safety and soundness costs related to federal credit union exams cannot also be insurance related costs.

NCUA’s current methodology, in place since 2003 and refined in 2013, determines the OTR using the results of an examiner time survey (ETS). In 2012, the Office of Exam and Insurance (E&I) clarified the application of insurance related and non-insurance related definitions in the ETS, specifically by mapping certain regulations to insurance related. The NCUA made the determination of which rules are insurance or non-insurance related. Additionally, rules were allocated as solely insurance related. We suggest some rules can be both insurance and non-insurance related, and the NCUA should identify and divide the costs associated with those rules accordingly.

Based on the 2012 mapping of regulations, the average examiner time survey results for insurance related activities increased by 21% and the OTR increased from 59.1% in 2013 to 69.2% for 2014. The OTR has continued to increase every year since 2013.

YEAR	OTR	% Year/Year	% Since 2008
2008	52.0%		
2009	53.8%	1.8%	1.8%
2010	57.2%	3.4%	5.2%
2011	58.9%	1.7%	6.9%
2012	59.3%	0.4%	7.3%
2013	59.1%	<0.2%>	7.1%
2014	69.2%	10.1%	17.2%
2015	71.8%	2.6%	19.8%
2016	73.1%	1.3%	21.1%

Increases in the OTR during the financial crisis, from 2008-2013 may make sense. However, they do not make sense in this post crisis, recovery environment. The number of troubled credit unions with CAMEL ratings of 4 or 5 has decreased from a high of 409 in 2011 to a low of 220 as of December 31, 2015.

The Leagues recommend the NCUA correct the assumption that all safety and soundness rules and related activities are solely insurance related. We recommend NCUA publish which rules are deemed insurance or non-insurance related, with an explanation for each determination, and solicit comments on whether the current mapping and classification of these rules are appropriate.

The Leagues agree with the use of the ETS in setting out objective costs allocation for insurance and non-insurance related activities. However, it is our understanding that other cost centers within NCUA do not track their time and simply estimate their time spent on insurance related activities. The Leagues strongly recommend the NCUA require all cost centers to employ a more objective and documented method of accounting of time spent on insurance and non-insurance related activities.

Improved Examination Efficiency

Reliance on State Regulatory Agencies

The NCUA should respect and rely on competent state supervisory agencies (SSAs) to regulate and ensure the safety and soundness of FISCUS. The SSAs are the primary regulators for FISCUS, while NCUA's role is that of insurer.

The Leagues suggest the NCUA better follow its mandate to rely on SSAs "to the maximum extent feasible." We continue to strenuously recommend the NCUA leverage the safety and soundness exams completed by SSAs and not complete duplicative examinations at FISCUS.

The Leagues also recommend the NCUA enter into agreements with SSAs to alternate examination cycles. The NCUA should enter into agreements with SSAs under which examinations of well-managed, low-risk FISCUS are performed on an alternating basis by the SSA and NCUA. Such agreements already exist between other federal insurers and SSAs, such as the one employed by the Federal Deposit Insurance Corporation for state-chartered banks.

Examination Cycles

The Leagues support an expanded examination cycle of 18 months for well-managed, low-risk FCUs and FISCUS. We recommend the NCUA adopt an expanded exam cycle sooner rather than later.

Improved Technology and Expertise

The Leagues commend the NCUA for its plans to develop and implement new technology that will support an exam portal and reduce the amount of on-site examination time. We also support NCUA hiring specialized staff knowledgeable and experienced in the areas they examine.

We believe taking these actions will directly benefit credit unions and better utilize NCUA's resources, resulting in a reduced operating budget for examinations, thus reducing both the OTR and Operating Fee.

OPERATING FEE METHODOLOGY

Operating Fees are fees which may be expended by the NCUA to defray the expenses incurred in carrying out the provisions of the FCU Act, including the examination and supervision of FCUs.

Methodology

There are two primary steps used to determine the adjustments to the Operating Fee schedule for the upcoming year. They are:

1. Updating the prior year asset tiers using the projected asset growth rate; and

2. Updating the prior year assessment rates for each asset tier by determining the average assessment rate adjustment (the percentage difference between the projected operating fees and the required operating fees).

Currently three tiers are used and FCUs with \$1 million or less in assets pay no Operating Fee. Each asset tier is increased annually by the projected asset growth rate. NCUA's Office of Chief Economist (OCE) uses three different methods to forecast the asset growth and combines them to generate an overall asset growth rate forecast.

The Leagues believe the three tiers seem reasonable, and that FCUs with assets less than \$1 million should pay no Operating Fee. The Leagues also appreciate the use of objective methods to forecast the asset growth rate; however, we recommend the NCUA conduct a third-party review of the forecasting models. This independent review will help ensure the validity of the methods.

CONCLUSION

The Leagues strongly believe that FISCUS and FCUs should be treated equitably. If the OTR benefits FCUs more than FISCUS, or vice-versa, it weakens the dual chartering system. We trust the NCUA will utilize methodologies that ensure a fair allocation of costs to both state and federally chartered credit unions.

The Leagues thank the NCUA for their transparency in making the OTR and Operating Fee Schedule Methodologies available for comment and for considering our views.

Sincerely,

Diana R. Dykstra
President and CEO
California and Nevada Credit Union Leagues

cc: CUNA, CCUL