NASCUS
National Association of State Credit Union Supervisors

August 29, 2017

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

Re: NASCUS Comments on OTR Methodology

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS), the professional association of the state credit union regulatory agencies and the nation's state credit union system, submits the following comments in response to the National Credit Union Administration's (NCUA's) request for comments on the methodology used to establish the Overhead Transfer Rate (OTR). NASCUS and its members have long held concerns regarding the OTR methodology and NCUA's management of its complex role as both the chartering authority of federal credit unions (FCUs) and as the administrator of the National Credit Union Share Insurance Fund (NCUSIF). We commend NCUA for publishing a revised OTR methodology for formal notice and comment. The revised OTR methodology, as laid out in the current proposal, is a marked improvement over the flawed current methodology.[1]

There is a lot to commend in NCUA's proposed OTR methodology, and NASCUS supports many of the changes.

The proposed OTR methodology is an indication that NCUA gave serious consideration to the forty (40) comments the initial request for comments published in 2016. That NCUA received so many comments on such a complex and technical issue is testament to how important the OTR is to the credit union system in general and state system in particular. After all, NCUA is well aware of the credit union system's desire for regulatory relief, yet the agency received only 28 comment letters in response to four separate notices for comment related to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) process.[2]

While NASCUS supports the proposed changes to key components of the methodology, we have identified further refinements that would improve the proposal consistent with

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[1] See Appendix A NASCUS Comments OTR Methodology, (April 26, 2016). Also available at https://www.ncua.gov/Legal/CommentLetters/bc-otr-2016421LIto.pdf.

[2] Another benchmark might be NCUA's annual Regulatory Review process. Unfortunately, NCUA does not publish those comments so the number of comments submitted is unknown to the public although it would be safe to wager less than forty letters were filed this year.

the wording and spirit of the Federal Credit Union Act (FCUA). Our recommendations are discussed in more detail below.

Regrettably, NCUA's proposal is accompanied by a narrative that tempers our enthusiasm for the proposed changes and curtails our confidence that the proposed improvements to the methodology will be finalized in an equitable manner. Our comments address those issues as well.

## I. Background

NCUA is both the chartering authority for FCUs and the administrator of the NCUSIF. As it performs these two functions, (Title I and Title II) NCUA incurs costs that it allocates by charging operating fees to federal credit unions for expenses related to its chartering responsibilities and by allocating expenses to the NCUSIF for expenses related to the administration of the fund. It is the NCUSIF allocation (the OTR) that has been the subject of debate within the credit union system for many years. Specifically, many stakeholders observed that the current OTR methodology was inequitable and inconsistent with the FCUA because it imposed a disproportionate burden on state chartered credit unions and, thus, threatened the dual chartering system.

The NCUSIF was created by an act of Congress in 1970 and, as NCUA notes in the preamble of its proposal, the OTR methodology originated as a result of the 1972 Government Accountability Office (GAO) report recommendation that NCUA create a better system to match expenses to its Title I chartering and Title II NCUSIF activities.[3] For the first thirty (30) years of the NCUSIF's expense allocation, the OTR never exceeded 50%. In 2000, the OTR increased from 50 to 66.7%. Since 2009, the OTR has remained inequitably high, increasing nearly every year until 2017.

**Overhead Transfer Rate History (1986-2017)[4]**

| Year | OTR | |
|---|---|---|
| 1986-2000 | 50% | = |
| 2001 | 66.7% | ↑ |
| 2002 | 62% | ↓ |
| 2003 | 62% | = |
| 2004 | 59.8% | ↓ |
| 2005 | 57.0% | ↓ |
| 2006 | 57.0% | = |
| 2007 | 53.3% | ↓ |
| 2008 | 52.0% | ↓ |
| 2009 | 53.8% | ↑ |

[3] http://www.gao.gov/assets/210/203181.pdf
[4] Data based on NASCUS analysis of NCUA budget documents.

| | | |
|---|---|---|
| 2010 | 57.2% | ↑ |
| 2011 | 58.9% | ↑ |
| 2012 | 59.3% | ↑ |
| 2013 | 59.1% | = |
| 2014 | 69.2% | ↑ |
| 2015 | 71.8% | ↑ |
| 2016 | 73.1% | ↑ |
| 2017 | 67.7% | ↓ |

## II. NCUA's Safety and Soundness Responsibility as Chartering Authority of Federal Credit Unions

The primary source of contention for the state system with the prior OTR methodology was that it failed to recognize (and account for) NCUA's safety and soundness responsibility as the FCU chartering authority. The prevailing assumption under the prior methodology was that all safety and soundness related costs were *exclusively* "insurance-related." That assumption was inconsistent with the FCUA, the NCUA's own regulatory history, and with the regulatory practice of the other federal financial regulators.

As our previous comments filed in response to the 2016 ANPR on the OTR methodology discussed, and NCUA acknowledges in this proposal, other bank regulators that are not deposit insurers view their primary examination responsibilities to be that of safety and soundness. In fact, the GAO also shares this common understanding of the responsibility of the chartering authority.

The occasion for the 1972 GAO report was the completion of its first congressionally mandated audit of NCUA's financial statements. Throughout the report, GAO references NCUA's roles as both the chartering authority of FCUs and the administrator of the NCUSIF. On page 1, GAO characterizes NCUA's objectives to "to promote a national system of cooperative thrift and credit organizations which are financially sound" (chartering) and then distinctly to provide share insurance. GAO goes on to say in the next paragraph that NCUA "administers its insurance functions under a share insurance function" and then distinctly "administers its functions of chartering, supervising, and **examining credit unions** under an **operating fund**." On page 8 of its report, GAO states that the "regular examination is the principal method the Administration uses to supervise each Federal credit union. The information obtained **also helps** to determine if the credit union continues to qualify for share insurance." GAO is distinguishing examination as a chartering/supervisory function distinct from share insurance.

NCUA's repeated assertions that it has no Title I safety and soundness responsibilities and hence very few limitations on its discretion to shift FCU examination costs to the NCUSIF remain unconvincing. As has been stated many times, by many different stakeholders, to accept NCUA's proposition that ALL of its safety and soundness examination work is Title II is to accept the proposition that were the NCUSIF to be

folded into the Federal Deposit Insurance Corporation (FDIC) NCUA would not bother examine its charters for financial stability. It is even more dubious that any board exercising true fiduciary duty to the insurance fund would allow the chartering authority to shift all of its examination costs to the share insurer.

For all of these reasons, the NCUA is to be credited for acknowledging in the current proposal that it also has safety and soundness responsibilities for FCUs in its role as the prudential regulator. This is a major step forward in establishing an equitable and workable methodology.

That recognition is also central to the shift to a "principles-based" approach that allocates the NCUA's examination time and costs evenly between its chartering and insurance-related responsibilities. The adoption of a principles-based approach will help reduce the complexity of the OTR methodology and the 50 percent rule makes intuitive sense because it is modeled after and reflects the likely allocation using alternating examination schedule.

NASCUS accepts the adoption of this principles-based approach and the allocation of the examination time and costs of FCUs as 50 percent chartering and 50 percent NCUSIF-related as a workable approximation for purposes of the OTR.

Accepting as a working rule that 50 percent of the costs of FCU examinations is insurance-related is a compromise by the state system. The most accurate calculation of costs would be for the NCUSIF to accept Title I exams in their entirety for a majority of FCUs. The NCUSIF should cover only the resources needed to review those exams or conduct its own insurance reviews for due diligence or material risk - just as it does with respect to FISCUs. That is why the NCUA's budgeted workload hours for FISCUs is substantially lower than the workload hours attributable to FCUs. Nevertheless, the adoption of a principles-based rule that allocates 50 percent of the FCU examination time and cost to the NCUSIF is a significant improvement. We urge NCUA to hold fast to the proposal's acceptance of Title I responsibilities. Backsliding from this position would undermine the principles-based approach espoused by the Board and render the remainder of the proposal unacceptable.

## III. NCUA Program Offices and Elements of the Proposed Methodology

The new proposal is predicated on four underlying principles. Principle (1) is that 50% of NCUA's time spent examining federal credit unions is allocated as Title I chartering. As discussed above we support this new classification. We note that a case could easily be made that a 50% allocation to Title I is too modest, but for the sake of simplicity we can accept the 50% allocation.

Principle (2) is that all time and costs NCUA spends supervising or evaluating the risks posed by FISCUs or other entities NCUA does not charter or regulate is allocated as 100% insurance related. NCUA gives as examples of non-regulated entities CUSOs and

third party service providers. We agree that NCUA oversight of FISCUs is 100% insurance related. However, we do not agree that 100% of the time and costs associated with NCUA's supervision of CUSOs and third parties is insurance related.

NCUA justifies the 100% insurance allocation of its 5,000 hours for CUSO or service provider oversight by noting that it does not charter or supervise those entities.[5] While that is true, it is not entirely the point. NCUA has taken steps to assert supervisory authority over such entities out of concern for the safety and soundness of its federal charters as well as the FISCUs it insures. As we have established that safety and soundness concerns for FCUs is partially allocated to Title I, it would follow that *some* of NCUA's workload hours in CUSOs and third parties reflect NCUA's safety and soundness responsibility as charterer/prudential regulator. Additionally, NCUA's chartering rules limit the services that an FCU's CUSO may provide and to whom it may provide them. These are not materially safety and soundness issues, they are compliance issues. Likewise ensuring FCU CUSO mortgage loan originator registration in compliance with the SAFE Act is a regulatory, not supervisory issue.

- We recommend that NCUA allocate 25% of its CUSO and third party workload hours to Title I.

Principle (3) is that the time and costs related to NCUA's role as charterer and enforcer of consumer protection and other noninsurance based laws governing credit unions are allocated as 100% Title I. We agree.

Principle (4) is that NCUA's hours administering the NCUSIF is 100% insurance related. We agree.

NCUA's proposal allocates 13% of the office of Consumer Financial Protection and Access (OCFPA) to the NCUSIF. However, NCUA has recently proposed a reorganization that would change this office and its mission and create a new program office.[6]

- We request clarification on how changes to the OCFPA and the creation of the Office of Credit Union Resources and Expansion would affect the proposed methodology.

The proposed changes make significant improvements in the allocation of costs, but further refinements can and should be made. For example, the costs for "all other offices" still represent approximately one-third of NCUA's total operating budget - this includes the Board, the Executive Director, the General Counsel, the Chief Financial Officer, the Chief Information Officer, the Chief Economist, the Human Resources, the Office of Examination and Insurance, the Inspector General, the Office of Minority and

[5] Table 1, Allocation of Workload Hours, Request for Comments Regarding Revised Overhead Transfer Rate Methodology, 82 Fed. Reg. 29944 (June 30, 2017).
[6] NCUA Press Release (July 21, 2017). Available at https://www.ncua.gov/newsroom/Pages/news-2017-july-ncua-plans-restructuring.aspx.

Women Inclusion, the Public and Congressional Affairs Office, and the Office of Continuity and Security Management.

The current proposal uses a weighted-average of other cost centers to designate 60% of the costs as insurance-related. This is an improvement over the prior methodology which allocated approximately 90% of the costs as insurance-related, but the notice fails to justify the current allocation. The notice acknowledged that "improvements can be made in allocation methods involving non-field offices." Further review of allocation decisions for other cost centers (Regional costs, Small CU Office costs, etc.) is warranted.[7]

We understand NCUA's premise that leads it to the 60% threshold, but we question the logic from an enterprise wide perspective. Just because NCUA is willing to shift 50% of its examination costs of FCUs to the NCUSIF, it does not follow that 50% of everything else it does with FCUs is insurance related for purposes of calculating the expense allocation for each program office.

NCUA's Human Resources (HR) office is but one example. Were NCUA to be formally divided into its NCUSIF and chartering functions, the NCUSIF would need far **fewer** examiners for performance of its insurance functions because rather than performing 50% of FCU examinations, it would be accepting Title I examinations for review and only examining troubled institutions or sampling healthy institutions for due diligence. NCUA as chartering authority on the other hand would need to increase its funding to support a majority of its current existing examination force. Therefore to suggest that a majority of the HR function is NCUSIF is a flawed premise.

Likewise, we believe that at a minimum, the NCUA board's expenses be allocated as only 50% NCUSIF related.

- We recommend that NCUA use a 50% allocation for its HR and board functions. We are willing to accept the 60% allocation for the other program offices as a compromise designed to balance the OTR. NCUA should revisit these initial allocations in the future.

NCUA's proposal would eliminate calculating and crediting the imputed value of state regulator work and the related cost savings. For this year the imputed value of state regulator work is $50.8 million.[8] This is value paid for by FISCUs that accrues to the benefit of all insured credit unions by reducing the workload, and expenses, of the NCUSIF. Backing the imputed value out of the total OTR under the existing methodology was an understandable, if imperfect, means for the NCUSIF to recognize those costs borne directly by the state system. Within the context of this proposed OTR

[7] Request for Comments Regarding Revised Overhead Transfer Rate Methodology, 82 Fed. Reg. 29943 (June 30, 2017).
[8] Request for Comments Regarding Revised Overhead Transfer Rate Methodology, 82 Fed. Reg. 29941 (June 30, 2017).

methodology, eliminating the imputed value seems consistent with the underlying principles of the new formula. However, should NCUA decide to not finalize the proposed methodology changes, the imputed value should be returned to the state system. The most workable way to return the imputed value to the state system is not by backing it out of the OTR, but rather by paying the imputed value back to the state system.

In its proposal, NCUA details the complexities in attempting to determine the exact value provided by each individual state. We concede determining the precise value in any given year of a particular state's contribution to the OTR would be complex. However, calculating precise value is by no means the exclusive mechanism by which the NCUSIF can return the imputed value to the states. NASCUS is willing to discuss alternative means of recognizing the imputed the value should NCUA decline to move forward with the new methodology.

## IV. Future Notice and Comment for the OTR Methodology

The notice reiterates NCUA's position that the OTR methodology is not subject to notice and comment rulemaking requirements under the Administrative Procedure Act. We continue to think that NCUA is wrong as a matter of law on this issue.

Nevertheless, NASCUS commends the NCUA for committing to: (1) seek comment through the Federal Register on the OTR methodology every three years; (2) to hold annual public board meetings on the OTR and to post all related materials on the NCUA website; and (3) for all future rulemakings to identify and seek comment on whether the proposed regulation is being issued pursuant to NCUA's regulatory authority or its role as the administrator of the NCUSIF.[9]

These are important procedural safeguards that help ensure transparent and accountable processes, will result in increased stakeholder input and, ultimately, better informed decision making by the agency.

As we have previously written, NCUA is required to provide an opportunity for notice and comment for its rulemakings[10] unless otherwise exempted.[11] Because the OTR methodology is an NCUA Board statement of general applicability and future effect designed to implement and interpret FCUA it clearly falls within the scope of the APA.[12] In fact, it is telling that the NCUA Board itself characterized the OTR as a rule and

[9] Request for Comments Regarding Revised Overhead Transfer Rate Methodology, 82 Fed. Reg. 29948 (June 30, 2017).
[10] Under the APA, a rulemaking is defined as "an agency process for formulating, amending or repealing a rule, (5 U.S.C § 551(5).
[11] 5 U.S.C. § 553.
[12] *Legal Analysis of the Administrative Procedure Used By The National Credit Union Administration To Adopt The Overhead Transfer Rate (Report to the National Association of State Credit Union Supervisors)*, Schwartz & Ballen, LLP, page 16 (June 2015).

procedure at the very Board meeting where this proposal was approved for publication.[13]

Another issue to consider with respect to NCUA's proposed notice and comment is the criteria triggering *Federal Register* publication. As currently proposed, NCUA would seek comment at least every three years and whenever the methodology changed. Given that dramatic changes in interpretations, or organizational structure, could have a significant impact on the OTR, public comment should also be sought any time the OTR changes by more than 2% points in any given year. This recommendation accounts for the fact that the new methodology as proposed may not in fact be the methodology going forward. Under the old methodology where controversial categorization of rules as insurance or chartering can dramatically swing the OTR, it is prudent for NCUA to seek stakeholder input to ensure equitable allocation of agency expenses.

- We recommend that public comment on the OTR is sought at least every three years, whenever the methodology is changed, and any time the OTR changes by more than 2% (in either direction) in any given year.

## V. Absorbing the Costs of Losses to the NCUSIF

While NASCUS advocates on behalf of the state credit union system, we are also staunch defenders of the dual chartering system. NASCUS remains the only national credit union organization that explicitly recognizes the need for a strong dual chartering system in its mission statement. Our commitment to dual chartering was evidenced by our unwavering support for H.R 1151 in 1998, legislation that was critical to fix the federal charter's field of membership, while subjecting state chartered credit unions to member business lending restrictions and prompt corrective action.[14] We recognize the credit union system as a whole, regulators and industry, are stronger together.

Likewise, state regulators understand that task of balancing supervision with providing credit unions flexibility to manage their affairs necessitates that supervisory mistakes will be made, things will be missed, and credit unions (like all financial institutions) will suffer some failures among their ranks. Pointing fingers among regulators in such circumstances is rarely productive.

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[13] "NCUA's Overhead Transfer Rate methodology is probably the most misunderstood of all of our rules and procedures based on history." Comments of NCUA Board member Rick Metsger, NCUA Board meeting, June 23, 2017 (Online transcript at p. 13). Available at https://www.ncua.gov/Pages/exitdisclaimer.aspx?externalURL=http://tinyurl.com/NCUA1446771.

[14] Of course, HR 1151 gave those regulatory burdens to FCUs as well, but it did provide a needed fix to FCU FOM. State charters received only burden.

Over the course of the discussion of the OTR, certain memes continue to be repeated that disparage the state system and mischaracterize the mutual share insurance within the credit union system operates. This meme can best be summarized by the odd (and unfounded) notion that either state regulators have no "skin" in the game or that somehow the state system does not pay for losses. Both suggestions could not be further from the truth.

Of course the agency that charters a financial institution has a stake in the financial health and well-being of its charters. In particular, state regulators are not just supervising a corporate entity, they are supervising institutions in their communities entrusted with the financial means of their fellow citizens. The failure of a financial institution in a specific community is not reduced to the dispassionate calculation of a balance sheet at a far-away agency, but rather represents an economic blow with far reaching consequences to the lives of not just the depositors/members, but to the community as a whole. Those costs accumulate at the state level and are felt by state government, of which our state regulators are, obviously, a part. That state regulators maintain a robust examination of even their most modestly sized credit unions in the face of a curtailed small credit union examination program from the deposit insurer stands as further testament to this fact.

Even harder to reconcile is the suggestion that the state system should pick up the cost of the failure of any state chartered credit union in that state. In point of fact they already do.

The losses sustained in the failure of a federally insured credit union are borne by the NCUSIF and all related supervisory and share deposit costs are passed to the NCUSIF. This is reflected in NCUA's allocation of the entire costs of its Asset Management Assistance Center (AMAC) as 100% insurance related.[15] The cost of the actual losses in the failed credit union is charged to the NCSIF, of which FISCUs contribute nearly 50% of the assets although making up less than 40% of the "units." Whether a failed credit union is an FCU or SCU, the costs of that failure goes to the NCUSIF and is shared by the remaining credit unions by way of lost equity in the fund. Therefore state charters do cover the costs resulting in the failures of other state charters, just as they participate in the losses of FCUs. A review of NCUA's Office of Inspector General (OIG) Material Loss Reviews (MLRs), Semi Annual Reports to Congress, and news reports bears out that both FCUs and state charters have caused losses to the NCUSIF that are in turn shared

[15] Request for Comments Regarding Revised Overhead Transfer Rate Methodology, 82 Fed. Reg. 29945 (June 30, 2017).

by the remaining federally insured credit unions.[16] In fact, losses to the NCUSIF tend to be cyclical. Federally insured credit union failures from 2010 to the present have seen more losses attributable to FCUs. Were the timetable to be extended to 2006 to the present, then more losses are attributable to state charters.

The larger point is that it seems hardly productive, and less germane, to imply one charter, or one regulator, is responsible for more losses to the NCUSIF and the credit union system caused by natural person and corporate credit union failures. The question presented is not about losses, but rather about the responsibility of the chartering authority to examine its credit unions. Suggestions that the nearly 500 dedicated state regulatory personnel and the 2,153 FISCUs somehow don't contribute to the financial soundness of the credit union movement speaks less to the issue at hand of the proper OTR methodology and more to the state system's need to ensure the NCUSIF has state regulatory experience in its official governance.

## VI. The OTR Methodology's Inverse Impact on FCU Operating Fee

As a rule, NASCUS does not comment on NCUA's overall budget. We believe a regulatory agency is generally best suited to understand its funding needs. Therefore, we have historically limited our comments to the expense allocation of the OTR. However because the possible increase in FCU operating fees was emphasized at the June 23, 2017 NCUA board meeting, we offer the following comments on the matter.[17]

We recognize that there is an inverse relationship between the OTR and the FCU operating fee and understand that if the OTR is adjusted to become more equitable NCUA might have to increase its operating fee accordingly. But increasing the FCU operating fee is not NCUA's only option. Increases in the operating fees paid by FCUs could be tempered by reductions in NCUA's overall budget. In fact, in June of this year NCUA announced a 2% overall budget savings equaling over $5 million.

Another issue to note is that while the OTR has risen steadily in the past years, the opposite inverse reaction has been occurring. Over the past decade, the FCU operating fees decreased by nearly 30%. The only year it increased during that span was in 2013 when it increased by .24% to offset NCUA eliminating any operating fee for FCUs with less than $1 million in assets.

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[16] While publically available data is incomplete, in the past 10 years NASCUS identified approximately $822 million in losses to the NCUSIF with approximately 56% of those losses attributable to FISCUs. These losses do not include the over $5 billion in losses incurred by the failure of the 5 federal corporate credit unions.

[17] See transcript of June 23, 2017 NCUA board meeting. Available at https://www.ncua.gov/Pages/exitdisclaimer.aspx?externalURL=http://tinyurl.com/NCUA1446771.

**History of NCUA FCU Operating Fee (2009 – 2016)**

| | OTR | | Δ FCU Operating Fees | |
|---|---|---|---|---|
| 2009 | 53.8% | ↑ | -6.77% | ↓ |
| 2010 | 57.2% | ↑ | -1.58% | ↓ |
| 2011 | 58.9% | ↑ | -2.86% | ↓ |
| 2012 | 59.3% | ↑ | -0.90% | ↓ |
| 2013 | 59.1% | = | +0.24% | "↑" |
| 2014 | 69.2% | ↑ | -18.4% | ↓ |
| 2015 | 71.8% | ↑ | -0.90% | ↓ |
| 2016 | 73.1% | ↑ | -0.47% | ↓ |

## VII. Conclusion

We thank NCUA for the opportunity to provide formal comment on the methodology used to determine the Overhead Transfer Rate. The proposed revisions to the methodology evidence a commitment within NCUA to develop an equitable and understandable basis for allocating the combined expenses of the agency's dual mission. NASCUS, state regulators, and the state credit union system remain committed as well to forging a balanced partnership with NCUA that contributes to a vibrant credit union system into the future.

NCUA, and the work it does, is a vital component of that future. Neither NASCUS, nor its members, have ever suggested otherwise. Likewise, we have never downplayed the benefit to the state system provided by the NCUSIF's support of state examination programs. We have however insisted that the administration of the NCUSIF treat state charters and national charters the same in terms of recognizing the benefits it provides, as well as the benefits it receives. The state system works hard to safeguard the credit union system, and the NCUSIF. For example, while the states benefit from NCUSIF funded training, the state agencies budget to provide their own training to their examiners as well: the result of which benefits the NCUSIF at no cost to the fund. But the larger point is that whatever benefit the NCUSIF is providing states, it provides to the federal system as well.[18]

[18] For example, the proposal notes that NCUA budgeted $1.4 million for training of state examiners. However, the $1.4 million for state training is only part of $10 million training and development budget which presumably is benefitting the chartering authority as well.

We would welcome the opportunity to discuss our comments and recommendations in detail with NCUA. We also resubmit for the record and for further consideration of the revised methodology, our 2016 comment letter that addresses many of the fundamental underlying issues with the existing OTR process. That letter is incorporated as Appendix A to our comments.

Sincerely,

- signature redacted for electronic publication -

Lucy Ito
President & CEO

cc: SSAs
NCUA Chairman McWatters
NCUA Board Member Metsger

# Appendix

# NASCUS 2016 Comments on OTR Methodology

April 26, 2016

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

Re: NASCUS Comments on OTR Methodology

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS), the professional association of the state credit union regulatory agencies and represents the interests of the nation's state credit union system, submits the following comments in response to the National Credit Union Administration's (NCUA's) request for comments on the methodology used to establish the Overhead Transfer Rate (OTR). NASCUS and its members have long held concerns regarding the OTR Methodology, and NCUA's management of its complex role as both the chartering authority of federal credit unions (FCUs) and as the administrator of the National Credit Union Share Insurance Fund (NCUSIF). We commend NCUA for bringing the OTR Methodology forward for formal notice and comment. After careful consideration of the issues, we submit the following comments and recommendations to help ensure the funds in the NCUSIF are managed in an equitable manner consistent with the letter, and spirit, of the Federal Credit Union Act (FCUA).[19]

During the January 21, 2016 NCUA Board meeting where the OTR Methodology was approved for public comment, the NCUA Board also voted to publish the FCU Operating Fee for public comment.[20] As has always been the case, NASCUS does not comment on proposed rules exclusively affecting FCUs. Suffice to note that our views on the allocation of expenses to the NCUSIF, and equitable treatment of federally insured state chartered credit unions (FISCUs) speak to our views of NCUA's overall budget allocations. We also reiterate, as has consistently been NASCUS' position, that we express no opinion on NCUA's overall budget expenditures. NASCUS believes that a regulatory agency is best positioned to know the resources it needs to maintain a safe and sound supervisory program.[21]

Through numerous iterations of the OTR methodology, across decades of adjustments to the actual transfer rate, dozens of letters back and forth between NASCUS and NCUA, opinion editorials in the trade press, and now thirty-three pages of exposition in the *Federal Register*, the issues presented by the OTR have often seemed beguilingly complicated. However, formulas and

[19] 12 U.S.C. Chap. 14.
[20] 81 Fed. Reg. 4674 (January 27, 2016).
[21] We note that state agency budgets are subject to oversight through budget hearings, legislative allocations, boards of oversite and state executive branch oversight among other means.

accounting audits cannot obfuscate the fact that the questions presented are not complicated at all: ***How should the costs of NCUA's operations be distributed? Should the benefits of efficiencies created by NCUA's unique dual role accrue to the NCUSIF or to the NCUA as a chartering authority?***

It is self-evident that Congress never intended the share insurance fund to completely subsidize NCUA's Title I chartering responsibilities. Congress intended the NCUSIF to benefit from NCUA's Title I responsibilities, not the other way around.

This issue is important to NASCUS, to state regulators (alternately state supervisory authorities or SSAs), and to state credit unions because NCUA expenses improperly allocated to the NCUSIF artificially inflate the cost of credit union share insurance, threaten the dual chartering system by artificially disadvantaging the state system, and inhibit regulatory and supervisory innovation. Fundamentally, NCUA's current methodology that classifies all safety and soundness as solely an insurance fund concern runs contrary to both the plain language of the FCUA and the history of bank and credit union regulation in the United States.

In our comments that follow, NASCUS will demonstrate:

- NCUA's proposition that it has no safety and soundness examination obligations as a chartering authority is without support in statute or practice;
- NCUA's current OTR methodology threatens the dual chartering system;
- NCUA's unique role as both competing chartering authority and Administrator of the NCUSIF obligates it to treat FISCUs equitably;
- NCUA's three "independent" reviews of the OTR Methodology have been flawed;
- The OTR Methodology is subject to the Administrative Procedure Act (APA);
- NCUA's OTR Methodology is flawed even when accepting NCUA's classification of Insurance Fund responsibilities;
- The determination of the OTR must not be delegated to staff; and
- There are more equitable ways to allocate NCUA's operating costs consistent with Congress' intent.

## **As the Chartering Agency of Federal Credit Unions, NCUA has Safety and Soundness Examination Obligations Pursuant to Title I of the Federal Credit Union Act**

NCUA's entire OTR Methodology is premised on the idea that the NCUA, created in 1970 to charter and supervise FCUs, has absolutely no safety and soundness responsibilities for the entities it charters. According to NCUA's reasoning, the only reason it examines FCUs for safety and soundness is to protect the NCUSIF. Put another way, NCUA feels no obligation, as a federal agency empowered to grant credit union charters, to ensure those charters are safe and sound for the members entrusting the FCU with their savings. In a similar vein, NCUA's methodology means NCUA as a federal agency empowered to charter financial intuitions, feels no obligation to ensure their safe and sound operation for the protection of the U.S. financial system. That a chartering authority would hold such beliefs, abdicating its

responsibilities solely to the deposit insurer is a remarkable proposition. It is also unsupported by the FCUA, nor is it supported by a simple examination of the actions and missions of other regulators. Suffice to say, no other federal or state banking regulator shares NCUA's view of the division of duties between prudential supervision and share/deposit insurance supervision. It is curious that NCUA's notice for comment quotes from the mission statements of its sister federal banking regulators in a footnote, because those mission statements, as well as NCUA's own characterization of the historic role of the "regulator" as opposed to the "insurer" completely and unequivocally contradict NCUA's entire OTR Methodology premise. It is worth examining this opening portion of NCUA's preamble for its *Federal Register* notice in detail:

> There is a distinct overlap between the historical role of a regulator, concerned with enforcing laws and implementing public policy, and that of an insurer. Though not motivated by the associated financial liability that comes with the role of insurer, regulators address ***threats to the viability of their financial institutions*** to protect consumers and their jurisdiction's economy. ***This focus on viability benefits the insurer***. The primary roles of an insurer are to protect depositors and the taxpayer, and contribute to the stability of the financial system. Before the advent of federal deposit insurance, federal financial institution regulators were concerned with protecting the stability of the financial system by ''regulating'' it. Thus, financial institution examinations focused on ensuring (1) statutes and regulations were followed to protect consumers, and (2) ***institutions were viable to protect consumer deposits, preserve access to financial services, and safeguard the stability of the economy***.
>
> - Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4814 (January 27, 2016). (emphasis added)(NCUA's *Federal Register* Notice)

Examining to protect against "threats to the viability" of the financial institution ***is examining for safety and soundness***. Contrary to the NCUA's fundamental premise that all safety and soundness is insurance, the FCUA states that "regulators" (as in NCUA as chartering authority) are responsible for safety and soundness to protect the public and the economy. That is why the chartering authority for National Banks, the Office of the Comptroller of the Currency (OCC), examines national banks for safety and soundness. And yet, the OCC has no role as insurer of bank deposits. Neither does the Federal Reserve Board (FRB), yet it examines state chartered member banks for safety and soundness. And lest one be confused by NCUA's reference to "historic roles" pre-deposit insurance, a review of the current mission statements of the OCC and FRB confirm that remains the case today, despite the fact that the Federal Deposit Insurance Corporation (FDIC) has been in existence since 1933.[22]

The OCC lists its mission statement as "To ensure that national banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations."[23] For its part, the FRB "has

[22] Pub. L 73-66, 48 Stat. 162 (June 16, 1933).
[23] Available on the OCC website at http://www.occ.gov/about/what-we-do/mission/index-about.html.

primary supervisory authority for state banks that elect to become members of the Federal Reserve System (state member banks)."[24] The FRB defines this supervisory authority as "the monitoring, inspecting, and examining of banking organizations to assess their condition and their compliance with relevant laws and regulations…"[25] For 80 years, two federal banking regulators have performed safety and soundness supervision in the banking sector despite the existence of a deposit insurer.[26]

In order for the NCUA to justifiably ignore this long-standing precedent and paradigm evident at other federal banking agencies, one would expect a clear mandate or at the very least clear support in statute. There is no such support. In fact, a plain reading of the FCUA leads to the opposite conclusion.

NCUA's *Federal Register* notice, contains only a brief discussion of the statutory justification for allocating all safety and soundness expenses to the NCUSIF. That NCUA's legal justification for its extreme interpretation of the FCUA is afforded less than one page in its 33-page request for comments is disappointing given that NCUA's entire methodology turns on the legal question of NCUA's Title I obligations as a chartering authority.

NCUA's entire legal justification for the OTR Methodology is as follows:

> NCUA has a unique dual role in that it serves as both the regulator of FCUs and the insurer of FCUs and FISCUs. Given this dual role, it is appropriate to allocate examination and supervision costs between the NCUSIF and Operating Fees charged to FCUs. The policy rationale for this allocation is supported by various provisions of the FCU Act. In Title II of the FCU Act, Congress established the NCUSIF and housed it within NCUA for administration by the NCUA Board.
>
> Congress envisioned efficiencies from this arrangement, as well as NCUA's partnership with state regulators. Evidence of intent to streamline can be found in 12 U.S.C. 1782(a)(5), which requires reports FCUs must file under Title I of the FCU Act to be prepared so ''that they can be used for share insurance purposes.'' Similarly, this provision requires NCUA to use the reports filed by FISCUs with their state regulators ''for share insurance purposes . . . [t]o the maximum extent feasible. . . .''
>
> Congress also recognized that, in addition to losses related to credit union failures, the NCUSIF would incur expenses related to its administration, including examination staff and other employees. Title II empowers the NCUA Board to determine the proper allocation of ''administrative and other expenses incurred'' under Title II that may be funded by direct requisitions from the NCUSIF. Title II further subjects the resources expended for ''insurance purposes'' to the Board's discretion by empowering the Board to ''appoint examiners who shall have power, on its behalf, to examine any insured credit union, any credit union making application for insurance of its member accounts, or any

[24] Available on the FRB website at http://www.federalreserve.gov/pf/pdf/pf_5.pdf.
[25] Available at the FRB website http://www.federalreserve.gov/pf/pdf/pf_5.pdf.
[26] The FDIC was established in 1933. The OCC predates the FDIC and the FRB was established in 1935.

> closed insured credit union whenever in the judgment of the Board an examination is necessary to determine the condition of any such credit union. . . .'' Title I confirms this design by requiring that salaries and expenses of the Board and NCUA employees ''be paid from fees and assessments (including income earned on insurance deposits) levied on insured credit unions under [the FCU Act].'' In addition to assessments charged to all insured credit unions simply by nature of their NCUSIF insurance, Title I requires an annual Operating Fee charged to FCUs in recognition of the additional duties required of NCUA under Title I with respect to FCUs.
>
> NCUA also has the authority to promulgate rules and regulations to carry out the provisions of Title II. Accordingly, the NCUA Board has approved rules and regulations that specifically address safety and soundness and protect the NCUSIF. Under the discretion vested in it under the FCU Act, the NCUA Board's primary motivation for the agency's regulations and examination program has been managing risk to the NCUSIF posed by all insured credit unions, whether state chartered or federal. The Board notes that NCUA's role as insurer is best fulfilled by a proactive approach to preventing losses, in addition to paying the post-failure obligations that NCUSIF insurance coverage requires. Since the implementation of federal share insurance in 1970, the NCUA Board has instituted a much more proactive examination and supervision program geared toward safety and soundness, which focuses on insurance related issues. In 2002, the NCUA Board strengthened its commitment to fulfilling NCUA's role as insurer by implementing the Risk-Focused Examination Program. This program bases examination scope and timing to a large extent on the risks an institution poses to the NCUSIF. The OTR's portion of NCUA's Operating Budget, including its changes over time, reflects the Board's fulfillment of its insurance responsibilities under the FCU Act under evolving economic and legislative circumstances.
>
> \- NCUA's *Federal Register* notice[27]

NCUA begins its legal analysis by noting that Congress gave it authority over FCUs as a chartering agency and authority over FISCUs and FCUs as an insurer. No one disputes this. It is NCUA's supervisory obligations in those roles that are in dispute, and how Congress intended NCUA to carry out its dual missions.

Next, NCUA acknowledges that Congress envisioned the combined structure of NCUA to provide cost-saving efficiencies.[28] However, Congress intended the efficiencies to accrue to the benefit of the NCUSIF, not solely to NCUA as a chartering authority. NCUA cites the controlling provision, noting that the FCUA directs NCUA to structure its Title I examinations so they may be used by the NCUSIF.[29] This is also exactly what Congress had in mind for reliance on state exams, instructing the NCUSIF to rely on state exams to the maximum extent feasible.[30] In order to reduce the NCUSIF's expenses, and

[27] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4806 (January 27, 2016).
[28] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4806 (January 27, 2016).
[29] 12 U.S.C. 1783.
[30] 12 U.S.C. 1782(a)(5).

achieve these efficiencies, Congress directed the NCUSIF to use the examinations produced by others: in this case NCUA as chartering authority, and the states. The FCUA literally can be read no other way.

NCUA then notes that Title II, its insurance role, allows it to have examiners, to conduct exams, and to pay expenses related to its insurance mission. NCUA then also notes that Title I requires it to assess an operating fee for what NCUA calls "additional duties." It is important to note that the term "additional duties" is NCUA's construct, it is not the wording used in the statute.

In fact, Title I does contain very explicit instructions for NCUA. At this point it is worth noting that Title I safety and soundness supervisory responsibilities predate NCUA's NCUSIF administration by 36 years.[31] In fact, Title I, the chartering supervisory provisions unrelated to the NCUSIF, expressly call for FCUs to be under the supervision of the NCUA Board, make financial reports as required by NCUA, and be subject to examination by the Board.[32] If NCUA as a chartering authority is only concerned with consumer protection, why did Congress require FCUs to submit financial reports to NCUA as their chartering authority? Congress grants separate and distinct authority under Title II for the NCUSIF to obtain reports it might deem necessary for NCUSIF purposes. The two important points are that Congress envisioned NCUA supervising the financial conditions of their federal charters under Title I and created an affirmative obligation for FCUs to submit those reports under Title I. The second point is that the Title II authority is ***discretionary*** for the NCUSIF: it may command additional reports ***if it needs them***.

NCUA claims discretion to determine how to allocate costs however it sees fit. Generally speaking, it is true agencies are given broad deference to interpret their statutes.[33] However, this is not the case if Congress speaks to a matter in the statute. In this instance Congress clearly spoke to how NCUA should manage its funding. Therefore, there is no ambiguity as to how NCUA was to allocate costs, and NCUA is not free to interpret the FCUA as it sees fit.[34]

In order to carry out its Title I, non-NCUSIF duties, Congress instructed NCUA to charge an annual operating fee to be, in the wording of 12 U.S.C. 1755(d) of the FCUA, "expended by the Board to defray the expenses incurred in carrying out the provisions of this Act, including the examination and supervision of Federal Credit Unions." Congress is instructing NCUA to supervise the credit unions it charters, including their financial condition, and to charge an annual operating fee, all pursuant to Title I. And, Congress went further.

As NCUA notes in its discussion excerpted above, Congress instructed that "The salaries and expenses of the Board and employees…shall be paid from fees and assessments (including income earned on insurance deposits) levied on insured credit unions under this Act."[35] This

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[31] The FCUA was first promulgated in 1934. The NCUSIF was not created until 1970.
[32] 12 U.S.C. 1756.
[33] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984),
[34] *King v. Burwell*, 576 U.S. ___ (2015); and *Michigan v. Environmental Protection Agency*, 576 U.S. ___ (2015)
[35] 12 U.S.C. 1766(j)(3).

provision, cited approvingly by NCUA, means exactly the opposite of what NCUA believes. Rather than a carte blanche to allocate all of its Title I safety and soundness obligations to the

NCUSIF, Congress included the NCUSIF as a ***subordinate, not primary,*** source of funding. As NASCUS explained in a legal study we commissioned and provided NCUA in 2001:

> This provision deserves careful scrutiny. While directing the NCUA Board to use operating fees and assessments to pay for agency costs, it also opens the door for NCUA to allocate some costs to the NCUSIF. By stating that salaries and expenses must be paid for from fees and assessments, including the earnings on the NCUSIF, ***it is clear that such earnings may be used only to supplement what is collected from operating fees.*** According to *Webster's Dictionary*, to "include" means "to place, list or rate as a part or component of a whole or of a larger group, class or aggregate; to take in, enfold or comprise as a discrete or subordinate part or item of a larger aggregate group or principle." Thus, something that is "included" is not distinct, but is added on to a larger, existing group. Congress could have stated that salaries and expenses should be borne exclusively or significantly through the earnings on the NCUSIF, but it did not. Rather, it established a system under which earnings on the NCUSIF could be included or added to operating fees to cover agency costs.
>
> \- 2001 NASCUS Legal Study[36]

Congress did more than limit NCUA's discretion in Title I. Congress reiterated those constraints in Title II as well. While Congress granted NCUA authority to allocate NCUSIF costs to the insurance fund, it limited the NCUSIF's expenses only to Title II activities. The FCUA limits expenditures to "administrative and other expenses incurred in carrying out the purposes ***of this title*** as it may determine to be proper."[37] We have already established NCUA has safety and soundness supervisory obligations under Title I of the FCUA. This provision in Title II prohibits NCUA from shifting the cost of those Title I safety and soundness obligations to the NCUSIF.

Ultimately, NCUA's interpretation of the FCUA, and its methodology, that the NCUSIF shoulders the full cost of NCUA's safety and soundness examinations begs a simple question: ***What exactly is the NCUSIF using from NCUA's Title I examinations?*** If the answer to that question is nothing, and NCUA's methodology says nothing, then the entire OTR stands in conflict with the FCUA.

Congress intended the NCUA to balance its roles as a chartering supervisor and an insurer. It divided NCUA's roles between Title I, its chartering supervisory functions, and Title II, its administration of the NCUSIF. As a chartering authority, NCUA has the responsibility to examine its charters for safe and sound financial condition just as the OCC, the FRB, and state regulators do. As administrator of the NCUSIF, NCUA has an obligation to review the financial condition of its insured credit unions. In so doing, we agree NCUA, on behalf the NCUSIF,

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[36] Overhead Transfer: The Authority of the National Credit Union Administration to Allocate Costs to the National Credit Union Share Insurance Fund, CUNA Legal Department, Commissioned by NASCUS (October 2, 2001) page 19. Available at http://nascus.org/OTRresources/NASCUSLegalStudyofOverheadTransfer.pdf.
[37] 12 U.S.C. 1783(a).

would conduct some examinations of FCUs and FISCUs. However, to the "maximum extent feasible" the NCUSIF should be relying on exams conducted by the chartering authorities. This was a deliberate act by Congress to preserve the resources of the NCUSIF.

**Background: Dual Chartering and the Foundation of the Nation's Banking System**

Distinct from other countries, the banking system in the United States is a dual banking system, predicated upon the principle that a financial institution's owners may choose a state or federal charter. The dual system has resulted in the United States possessing the most innovative, resilient, and vibrant, financial services system in the world.

Dual chartering creates regulatory and supervisory diversity. Twenty-five years ago, the United States Department of the Treasury acknowledged the importance of regulatory diversity, writing that it "increases the chances that innovative approaches to policy problems will emerge…A sole regulator, not subject to challenge from other agencies, might tend to become entrenched, conservative, and shortsighted."[38] The Conference of State Bank Supervisors notes in their recent white paper on bank supervision that "For more than 150 years, the United States has gone to great lengths to promote the uniquely American dual banking system.." and that it promotes financial diversity and dynamism.[39] What is true for the banking system is also true for the credit union system.

The dual chartering system thrives on the ability of credit unions to choose a state or federal charter, and in some cases, federal or alternative insurance. Generally independent and autonomous chartering systems allow for differing supervisory views, in turn fostering innovation in regulation, efficiency in examination, and market discipline in controlling the cost of supervision. Two systems, evolving in parallel and challenging the presumptions of the other, is the healthy consequence of the credit union dual chartering system.[40]

The dual chartering system works because of the cooperative tension between charters. However, NCUA's current OTR Methodology undermines that system and weakens the credit union movement. By shifting all of its supervisory functions to the NCUSIF, NCUA minimizes the opportunity for innovation. Rather than benefit from vibrant differences between charters, the system risks homogenization.

In addition to weakening the dual chartering system, NCUA's methodology raises concerns about a possible conflict of interest within the agency in its role as both a charterer, and administrator of the NCUSIF with authority over FISCUs. In 1991, the General Accounting Office (GAO) stated "if the NCUSIF remains within the NCUA, we believe a clearer distinction

[38] U.S. Department of the Treasury, Modernizing the Financial System, February 1991, page XIX-6.
[39] The Public Benefit of State Financial Services Regulation, The Conference of State Bank Supervisors (January 2015). Available at https://www.csbs.org/news/csbswhitepapers/Documents/The%20Public%20Benefit%20of%20State%20Financial%20Services%20Regulation.pdf.
[40] Caught in a Regulatory Vise: The Peculiar Problem Faced by Federally Insured State-Chartered Credit Unions, Lawrence J. White, p. 7, (2001).

between the chartering, regulatory and supervisory functions ***and the insurance function*** [emphasis added] needs to be made. Separate positions for a Director of Supervision and a Director of Insurance should be established, each reporting separately to the Board."[41] The context for the GAO report was the Congressional dissatisfaction with another combined chartering and insuring regulator in the thrift industry. Those functions were separated in 1989 because:

> At the regulatory level, critics have observed a blatant **conflict of interest** between the FHLBB and the FSLIC. [emphasis added] A high priority of the FHLBB was the survival of the thrift industry. A high priority of the FSLIC was the survival of the FSLIC, which often required the speedy closing of ailing thrifts to reduce damages. The fact that Board members of the FHLBB are also required to be directors of FSLIC created a **fundamental conflict of interest**. FHLBB members, in effect **wore two hats, guardian of the thrift industry as well as guardian of the public trust.**[emphasis added][42]

At that time GAO was asked to review NCUA's structure, and recommend internal divisions within NCUA. Of interesting note, one of the factors driving concerns about possible internal division of the NCUA was a fear that the Title I supervisor would be slow to act on one of its charters which could hurt the NCUSIF. Of course, if the Title I supervisory has no safety and soundness concerns, as asserted by NCUA, this would never have been a Congressional concern.

**<u>The Overhead Transfer Rate Methodology is Subject to the Administrative Procedures Act</u>**

NCUA is required to provide an opportunity for notice and comment for its rulemakings[43] unless otherwise exempted.[44] The OTR is subject to the APA notice and comment requirements. As noted in the Schwartz & Ballen LLP legal analysis, the OTR and the methodology used by the NCUA Board to calculate the OTR is an NCUA Board statement of general applicability and future effect designed to implement and interpret the FCUA provisions pertaining to the OTR.[45] Additionally, we do not believe the OTR qualifies for any of the exemptions from notice and comment rulemaking provided for under the APA.[46]

The OTR apportioned to FISCUs, through the NCUSIF assessment, is a significant percentage (33.6% or $93.9 million) of NCUA's total budgeted costs for 2015.[47] While it should be noted that federal credit unions (FCUs) also pay a significant portion of NCUA's costs through the

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[41] *Credit Unions: Reforms for Ensuring Future Soundness*; General Accounting Office Report to Congress, July 1991, p.194.
[42] See <u>Congress, regulators, RAP, and the savings and loan debacle, (regulatory accounting principles)</u>, Ahmad W. Salam, The CPA Journal on Line, (January 1994).
[43] Under the APA, a rulemaking is defined as "an agency process for formulating, amending or repealing a rule, (5 U.S.C § 551(5).
[44] 5 U.S.C. § 553.
[45] *Legal Analysis of the Administrative Procedure Used By The National Credit Union Administration To Adopt The Overhead Transfer Rate (Report to the National Association of State Credit Union Supervisors)*, Schwartz & Ballen, LLP, page 16 (June 2015).
[46] *Id.* at page 17.
[47] *Id*.

OTR, increases in the OTR over the years have substantially reduced FCU operating fees due to the fact that NCUA's budget costs have been shifted from FCUs to the NCUSIF-- which is funded by all federally insured credit unions.[48] This results in a competitive disadvantage for FISCUs, adversely impacted by recent changes to the OTR methodology. FISCUs have absorbed an increased percentage of NCUA expenses following the change in methodology, while FCUs enjoyed a substantial reduction in their "out of pocket" operating fees.[49]

Taking into consideration the OTR's impact on FICUs and the adverse effect on the competitive position of FISCUs in relation to FCUs, the OTR (and its methodology) should be recognized as a legislative or substantive rule subject to notice and comment to provide FICUs an opportunity to contribute input into a process that fundamentally impacts them.[50] Case law has held that where an agency's rule has "substantially and directly" impacted the "substantive rights of persons" outside of that agency, the rule would not be considered an interpretative rule or general statement of policy under the APA and would not be entitled to exemption from notice and comment requirements.[51] NCUA's OGC argued in its August 2015 letter to NASCUS CEO, Lucy Ito, that courts have "rejected" the substantial impact test when deciding if a rule should be considered legislative as opposed to interpretative.[52] On the contrary, more recent case law suggests that courts have not outright rejected the substantial impact test but have tempered it such that substantial impact alone would not be a determining factor as to whether or not a rule is legislative or interpretative. However, substantial impact related to an agency's rule can be considered along with a number of other factors to determine if a rule has been properly exempted from notice and comment requirements.[53] Taken together, the substantial impact of the OTR, the inequity of treatment of charters, the conflict of interest within NCUA in setting the OTR and stakeholder interest in ensuring an adequately funded NCUSIF, the threshold for application of APA standards is met.

The OTR, and the resulting Operating Fee result in cost allocation determinations that are binding on federally insured credit unions. That the OTR binds third parties means that it is not an internal NCUA matter or policy, but rather a rulemaking subject to notice and comment.[54]

For a complete discussion of the applicability of the APA to the OTR Methodology, we have included the Schwartz and Ballen Legal Study in its entirety in Appendix A with this letter.

[48] *Id.* at page 18.
[49] *Id.*
[50] *Id.* at page 18 and 19.
[51] *Anderson v. Butz*, 428 F. Supp. 245, 249 (E.D. Cal. 1975).
[52] *National Credit Union Administration's Office of General Counsel's Letter Re: Legal Analysis of Overhead Transfer Rate*, page 11 (August 18, 2015).
[53] *Cabais v. Eggers*, 690 F. 2nd 234, 237 (D.C. Cir. 1982)
[54] *Elec. Privacy Info. Cir.*, 653 F.3d (DC Cir. 2011).

**As Administrator of the National Credit Union Share Insurance Fund NCUA has an Obligation to Treat Federally Insured State Chartered Credit Unions Equitably**

Section 1790 of the FCUA strictly prohibits NCUA from using Title II to discriminate against FISCUs. It reads:

> Nondiscriminatory provision.—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.
>
> - 12 U.S.C. 1790

NCUA has been directed by Congress to ensure it does not disadvantage FISCUs in its administration of the NCUSIF. However, the OTR Methodology does just that. It takes monies from the NCUSIF to subsidize its Title I obligations. This require FISCUs to nearly fully subsidize NCUA's chartering functions. Congress understood the potential for this outcome and strictly forbade it.

It is true that in a mutual system such as the credit union share insurance system, from time to time one class of credit unions may require an inordinate amount of attention from the NCUSIF. In these natural cycles, a localized economic downturn may result in disproportionate distribution of expenses. However, such a "natural" event, which ultimately ends with a normalizing correction, is far different than premeditated shifting of expenses represented by NCUA'S OTR Methodology.

**NCUA's Current Overhead Transfer Rate Methodology is Flawed on its Face**

Even were one inclined to accept the proposition that all FCU safety and soundness supervision is the purview of the deposit insurer alone, and not that of the chartering authority and prudential regulator,[55] NCUA's methodology is flawed on its face. For example, NCUA asserts that because corporate credit unions do not serve consumers, one hundred percent of the Office of National Examination and Supervision (ONES) examination and supervision time is allocated to the NCUSIF.[56] However, corporate credit unions are obligated to comply with both the Bank Secrecy Act (BSA) and the Office of Foreign Asset Control (OFAC).[57] And yet NCUA's own classification establishes that the BSA/OFAC ***is not*** a safety and soundness regulation.[58] Presumably, ONES examines corporate credit unions for BSA/OFAC compliance, but NCUA allocates those expenses to the NCUSIF in spite of the fact its own methodology indicates those are FCU chartering costs. It would seem odd if ONES did not examine for BSA/OFAC compliance, given that BSA has been included in NCUA's supervisory priorities for the past two

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[55] And NASCUS does not.
[56] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4816 (January 27, 2016).
[57] See 31 U.S.C 5311-5330; § 748.2; See also "Bank Secrecy Act (BSA) Compliance," Corporate Credit Union Guidance Letter No. 2004-02 (June 2004). Available at https://www.ncua.gov/Resources/Documents/LCCU/LCCU2004-02.pdf.
[58] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4807 (January 27, 2016).

years.[59] Of course, ONES is also responsible for the natural person credit unions with over $10 billion in assets. Those natural person credit unions also have BSA/OFAC compliance obligations as well as consumer protection compliance obligations. If the ONES is 100 percent safety and soundness, as NCUA asserts, it is unclear from NCUA's classification of its examination hours which office, if any, within NCUA supervises those obligations for the largest natural person credit union.

A similar inherent contradiction seems to exist when comparing how NCUA classifies the work of its Office of Consumer Protection (OCP) and its Office of Small Credit Union Initiatives (OSCUI).[60] Discussing OCP, NCUA notes that one division alone in that office spends nearly 90 percent of its time reviewing FOM questions, of which only 25 percent is time spent on safety and soundness analysis.[61] Overall, only 1 percent of the OCP time is spent on safety and soundness issues and hence allocated to the NCUSIF.[62] However, when discussing the OSCUI, NCUA appears to take a far more liberal interpretation of the nexus between FOM and safety and soundness. Without explanation, NCUA asserts that 100 percent of OSCUI work on FOM expansion is insurance related and allocated to the NCUSIF.[63] There is no explanation of how many hours of OSCUI's time is spent on this, nor any explanation as to why FOM is insurance related for OSCUI, but not so much for OCP. This insurance classification with regard to OSCUI also appears to run contrary to NCUA's own methodology definition of "Non-Insurance Related Examination Procedures" which it defines as "examination or supervision contact procedures that address compliance with the laws and regulations that NCUA enforces" and includes "[c]ompliance with consumer protection laws, NCUA Rules and Regulations, the FCU Act, and Bylaws."[64] Field of membership is clearly a chartering/bylaws/compliance issue far more than any safety and soundness issue. In fact, on page 4813 of NCUA's *Federal Register* notice, NCUA states that 100 percent of examiner time dedicated to OCP for such analysis is non-insurance related, again conflicting with the tables presented in the public notice.

## **Additional Flaws in NCUA's OTR Methodology**

There are additional flaws in NCUA's methodology. After weighting and statistical analysis of its examination time surveys, NCUA "reverse-engineers" the OTR from its pre-determined overall operating budget.

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[59] See "Supervisory Priorities for 2016," NCUA Letter to Credit Unions No. 16-CU-01 (January 2016). Available at https://www.ncua.gov/regulation-supervision/Pages/policy-compliance/communications/letters-to-credit-unions/2016/01.aspx. See also "Supervisory Priorities for 2015," NCUA Letter to Credit Unions 15-CU-01 (January 2015). Available at https://www.ncua.gov/regulation-supervision/Pages/policy-compliance/communications/letters-to-credit-unions/2015/01.aspx.
[60] Comparing the classification of NCUA's OCP and OSCUI requires a degree of supposition because the public notice lacks detailed breakouts for these offices.
[61] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4814 (January 27, 2016).
[62] Id.
[63] Id at 4815.
[64] Id at 4807.

The key element of this part of the OTR Methodology is NCUA's use of the "SSA Imputed Value" and the percentage of FCU and FISCU insured shares. After calculating the total cost of providing share insurance based on its mapping of regulations and its time surveys, NCUA adds in the costs savings of state regulator work and manipulates the data based on percentage of insured FCU and FISCU shares.[65] Both steps are problematic.

NCUA's methodology adds back into its actually budgeted expenses the "SSA Imputed Value" in order "to determine the total cost to the federally insured credit union system of providing NCUSIF insurance."[66] In 2011, PriceWaterhouseCoopers referred to this as the system-wide cost of share insurance.[67] Yet NCUA never convincingly explains why this ***should*** be factored into NCUA's expenses.

The purpose of the OTR Methodology is to determine what percentage of NCUA's annual budget is actually spent on administering the NCUSIF. While statistical arguments may be made regarding the factoring of system-wide costs, the fact remains that in this respect, the calculations are straightforward. NCUA needs to allocate a specific sum of money for the work done in administering the NCUSIF. NCUA also relies on state regulators whose work saves NCUA a calculated amount of money. Factoring in the "SSA Imputed Value" only to back it out later serves only to convolute the methodology. As discussed in detail later in these comments, NCUA should transfer the value of state regulator work directly to FISCUs or allocate it as an expense and pay it directly for the benefit of the state agencies.

PriceWaterhouseCoopers' validation notwithstanding, NCUA's allocation of share insurance costs between the state and federal systems based on percentage of insured shares is also flawed. NCUA presumes that FISCUs are responsible for 47 percent of its NCUSIF administration costs because FISCUs hold 47 percent of insured shares.[68] NCUA asserts that this presumption is fair because it is "is consistent with the mutual nature of the insurance provided by the NCUSIF, and the statutory allocation method for any NCUSIF premiums and dividends."[69] We disagree. NCUA conflates the mutual nature of the credit union system in terms of individual credit unions, and the measurable differences between the state and federal parts of that system. By relying on insured shares, NCUA overstates the size of the state system, and therefore over-allocates its costs to supervise the state system.

**<u>Out of Balance</u>**[70]

NCUA does not examine insured shares. It examines insured credit unions. While the size of a credit union determines a base of exam hours needed, the fact remains that NCUA, like any regulator, must budget for the number of "units" among which those shares are distributed. Put simply, it generally costs more to examine three, $100 million asset credit unions than it does to

[65] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4818 (January 27, 2016).
[66] Id.
[67] Overhead Transfer Rate Review, PriceWaterhouseCoopers (January 20, 2011) page 18.
[68] Id.
[69] Id.
[70] NASCUS does not suggest that insured shared equates with total assets. However, as a benchmark for examination supervision, assets has always been held as a benchmark. We note that NCUA's rules do not distinguish among credit unions by insured shares, but rather by assets.

examine a single $300 million credit union. And the federal system is far larger, by number of credit unions, than the state system.

As of December, 2015, there were 3,764 FCUs and only 2,257 FISCUs. While holding47 percent of insured shares. FISCUs only make up 37 percent (in numbers) of the credit union system, while FCUs make up 63 percent of the credit union system. That FCUs outnumber FISCUs by 1,507 credit unions must mean that NCUA spends measurably more on FCU safety and soundness than the insured share percentages would suggest.

Now of course, assets matter in that larger credit unions take more time to examine, sometimes substantially more, than more modest-sized credit unions. However, even by this metric it would seem that FCUs command substantially more NCUA safety and soundness time than FISCUs. Three of the five largest credit unions are FCUs, as are five of the top ten, and 28 of the top 50. In fact the six largest FCUs have nearly one-third of the combined $331 billion assets of the top 50 credit unions.[71]

The point of the OTR Methodology is to determine, by the best metric, how NCUA should allocate its expenses. It has nothing to do with mutuality, and everything to do with costs. The use of percentage of insured shares, rather than actual projected costs of supervision, obscures the entire point of the exercise. An example of the cognitive dissonance this result produces is demonstrated by the fact that in 2014, FISCUs contributed approximately $85.6 million to the OTR while FCUs contributed only $100.1 million to the OTR despite there being 1,508 ***more*** FCUs than FISCUs.[72] Put another way, the additional 1,507 FCUs only cost NCUA $9,622 per credit union to examine and supervise. In other words, NCUA is asserting that in 2014 it cost the NCUSIF $26,594 per FCU, but somehow $37,926 per FISCU. And this is with imputing value to SSA work! This makes little sense.

This discrepancy might be understandable if all the very largest credit unions were FISCUs requiring more exam time. They are not. Or if there were inordinately more troubled FISCUs than FCUs. There are not. According to NCUA's *Federal Register* notice on the OTR Methodology there were 83 CAMEL code 4 FISCUs in 2014 and no CAMEL Code 5 FISCUs.[73] There is no corresponding table for FCUs. However in February, 2015, the NCUSIF reported a total of 276 CAMEL Code 4 and 5 credit unions.[74] That seems to indicate 193 CAMEL 4 or 5 FCUs. Finally, if FISCUs failed at a greater pace than FCUs, higher NCUA exam costs could be explained. However, again the record does not bear this out. To date in 2016, 4 credit unions have been liquidated, 2 FISCUs and 2 FCUs. In 2015, of the 10 credit unions liquidated, 8 were FCUs.

[71] Top 50 Credit Unions by Assets, Credit Union Access, available at http://creditunionaccess.com/top50creditunions.htm.
[72] Source: NCUA Board estimates for 2014 as reported in Board Action Memorandum, dated November 20, 2013, from Office of Examination and Insurance to NCUA Board Re: Overhead Transfer Rate 2014.
[73] Request for Comments Regarding Overhead Transfer Rate Methodology, 81 Fed. Reg. 4819 (January 27, 2016).
[74] NCUSIF 4th Quarter Statistics December 2014. Published February 18, 2015, available at https://www.ncua.gov/About/Documents/Agenda%20Items/AG20150219Item3a.pdf.

Clearly, NCUA's methodology of allocating costs to FISCUs based on insured shares, without adjusting for the number of credit unions skews the OTR to the disadvantage of the state system. Taken together with the other shortcomings we discuss, the only reasonable conclusion is that the OTR Methodology is deeply flawed. At a minimum, NCUA should work with state regulators to develop a more equitable, and a more sound, methodology for allocating examination hours between chartering/prudential regulator and NCUSIF administration.

## The Various Reviews of the Overhead Transfer Rate Methodology Conducted over the Years Lacked a Legal Analysis

Since 2001, NCUA has retained outside accounting firms to conduct three reviews of its OTR Methodology.[75] However, none of these reviews is on point because none of these reviews addressed the legal question of how Congress intended the NCUSIF's funds to be used.[76] These reports are accounting reviews, and the heart of this issue is a legal question: What are NCUA's Title I responsibilities pursuant to the FCUA? To this critical discussion, Deloitte and Touche and PriceWaterhouseCoopers add nothing.

For its part, Deloitte and Touche stated unequivocally in 2001 that it makes "no representation regarding the sufficiency of the procedures [used by NCUA]" and notes that they "were not engaged to, and did not perform an audit, the subject of which would have been the expression of an opinion on the specified elements…"[77]

Likewise, PriceWaterhouseCoopers stated in its report that it "did not state an opinion related to any issue that may be perceived with regard to NCUA's dual role as regulator and insurer, oversight or lack thereof NCUA's budget, or an interpretation of Congressional intent behind Title II of the Federal Credit Union Act…"[78]

As already discussed, the intent of Congress in seeking efficiencies for the ***NCUSIF*** by having it rely on NCUA Title I, FCU operating expense funded, safety and soundness exam ***is the issue***. Short of that, the various studies of NCUA methodology serve merely to assess whether NCUA is collecting the data properly. Of that we had little doubt.

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[75] Deloitte & Touche in 2001; PriceWaterhouseCoopers in 2011 and 2013.

[76] Indeed, as much was publicly noted by NCUA Board Member Mark McWatters who stated during the November 19, 2015 NCUA board meeting that "The determination of the OTR methodology is essentially a legal construct and requires the sophisticated analysis of statutes, regulations, and case law, which lies beyond the operational mandate of accounting firms, even highly regarded, top-tier firms." See Board Member J. Mark McWatters Statement on Continuing Concerns with NCUA's Budget and Budget Process, November 19, 2015. Available at https://www.ncua.gov/newsroom/Pages/budget-statement-mcwatters-nov-2015.aspx.

[77] Deloitte & Touche report to NCUA (December 2001) page 1. Available at https://www.ncua.gov/About/Documents/Budget/Misc%20Documents/2001DeloitteReportonOTRProcess.pdf.

[78] PriceWaterhouseCoopers report to NCUA (January 20, 2011) page 1. Available at https://www.ncua.gov/About/Documents/Budget/Misc%20Documents/2011PwCOTRReview.pdf.

## The Authority to Set the OTR Must Not be Delegated to NCUA Staff

During its November 19, 2015 board meeting, the NCUA Board voted to approve a delegation to the NCUA Office of Examination and Insurance the authority to administer the methodology to calculate the Overhead Transfer Rate.[79] This was a mistake.

The NCUA Board's delegation of its final approval of the OTR to staff is an abdication of one of the most important functions of the Board: oversight of the agency's and the NCUSIF's budget. Without discussion and oversight of the actual OTR by the NCUA Board, there is no check, or accountability, for the equitable nature of the transfer. The OTR is important. The credit union system deserves better than for the leadership of the NCUSIF to delegate away important responsibility of budgetary oversight.

## Alternative Approaches to more Equitably Recognize the Costs of Examination

1) **The NCUSIF should treat federal credit unions, and federal credit union examinations, in the exact same manner as it treats federally insured state chartered credit unions and federally insured state chartered credit union examinations**

As explained above, NCUA has safety and soundness responsibilities for federal credit unions as the chartering entity pursuant to Title I of the FCUA. Consistent with Congress' intentions and the wording of the FCUA, NCUA should internally segregate the functions of its chartering supervision of FCUs from its share insurance supervisory functions. In this way, NCUA's cost allocations would be clear: FCUs would pay an operating fee to support NCUA's supervision, including safety and soundness, and NCUA would transfer from the NCUSIF the costs of overseeing the share insurance supervision of both FCUSs and FISCUs.

Put another way, under this approach, the NCUSIF would treat FCUs and FISCUs in the same manner. Currently, states, as the prudential regulator of FISCUs, examine every one of their charters for both compliance and safety and soundness. The cost of this examination program is borne by FISCUs in the form of the operating fees they pay to the state. Those examinations are then provided to the NCUA in its capacity as administrator of the NCUSIF. Those state exams are then reviewed for share insurance purposes. In addition to reviewing those state examinations, the NCUA, on behalf of the NCUSIF, examines some FISCUs in conjunction with

[79] See NCUA Board Action Bulletin: https://www.ncua.gov/About/Pages/board-actions/bulletins/2015/november/BAB20151119.aspx.

the states. However, the FISCU examinations conducted by NCUA for the benefit of the NCUSIF is minimized by the NCUSIF's reliance on state work.[80]

The NCUSIF should manage its FCUs in the same manner as it does its FISCUs. NCUA should examine all FCUs for compliance and safety and soundness in its capacity as chartering entity. Those exams should be used for NCUSIF purposes. To the extent additional supervision is required, then those additional costs should be borne by the NCUSIF. However, non-NCUSIF sources of funding should support a robust chartering safety and soundness examination program. As previously noted, this approach is consistent with NCUSIF treatment of FISCUs, consistent with the OCC's supervision of its national charters, and consistent with the FRB's supervision of its member banks.

2) **Rather than reduce the overhead transfer by the amount of the imputed value of state examination work, the NCUA should refund that money to federally insured state chartered credit unions**

Requiring FCUs to bear the cost of safety and soundness supervision by their chartering authority is the most equitable manner of managing the NCUSIF and the OTR. Should NCUA insist on retaining the current OTR methodology, NCUA should change its treatment of the "SSA Imputed Value."

To the agency's credit, NCUA began in 2003, as advocated by NASCUS, to recognize the work done by state regulators supervising FISCUs for safety and soundness.[81] NCUA reduces the OTR by this "SSA Imputed Value." The NCUSIF saves millions of dollars a year because its safety and soundness work is done by the FISCUs' prudential regulators: the states. In November, 2015, NCUA estimated the benefit of the "SSA Imputed Value" to the NCUSIF of the work done by state regulators in FISCUs to be $40.6 million.[82] Recognizing that the work of the state regulators reduces the NCUSIF's costs is the right thing to do. However, while the NCUSIF might save money, state chartered credit unions are funding those state regulatory activities. NCUA's treatment of the "SSA Imputed Value" in its formula does little to represent true costs savings to the FISCUs that pay for it.

In order to recognize the true benefit of the "SSA Imputed Value" and the expenditures of state credit unions that generate it, NCUA should return that value directly to FISCUs.

Each year after calculating the "SSA Imputed Value," NCUA should return that amount, $40.6 million in 2015, back to FISCUs in the form of a rebate. The rebate can be distributed either on an equal basis or a pro rata basis to each FISCU. In 2015, NCUA reported 2,257 FISCUs as the

[80] In fact, while NCUA relies on states for a majority of contacts and examinations in FISCUs, state regulators believe the agency can further increase reliance on states, reducing NCUA presence in FISCUs from current levels back to historic levels of 10-12% of FISCUs annually.
[81] Overhead Transfer Rate, NCUA Board Action Memorandum (November 14, 2003) page 2.
[82] Overhead Transfer Rate Methodology, NCUA Board Action Memorandum (November 19, 2005) page 10. Available at https://www.ncua.gov/About/Documents/Agenda%20Items/AG20151119Item5a.pdf.

fourth quarter.[83] Returning the "SSA Imputed Value" would have resulted in a rebate to each FISCU of approximately $17,988.48 on an equal basis, or on an insured-share proportional basis of approximately $8.79/insured share for each FISCU.

Of course, returning the imputed value of SSA work to FISCUs would necessitate a restructuring of NCUA's methodology. We think it is worthy of exploration, and would provide an opportunity to address other shortcomings in the current methodology we have identified.

NCUA has the authority to return to FISCUs the value of the state work those FISCUs have funded. Section 1782 of the FCUA specifically authorizes NCUA to distribute funds from the NCUSIF back to credit unions.[84] While the FCUA places limits on NCUA's ability to pay distributions from the funds, these limits apply to the statutory mandate to pay distributions if the funds in the NCUSIF exceed the established operating level. Our proposal here is not a dividend distribution subject to those provisions, rather it is in effect an operating expense to the NCUSIF, offsetting the cost of work performed by states, funded by FISCUs, and essential to the administration of the NCUSIF.

3) **Rather than reduce the overhead transfer by the amount of the imputed value of state examination work, the NCUA should pay out those funds for the benefit of the state agencies.**

Another option for NCUA is to treat the "SSA Imputed Value" as an expenditure from the fund in the same manner it would for a contract for services. In this case, the NCUA would dedicate an amount equal to the "SSA Imputed Value" for the benefit of the state agencies. Dedicating the amount for the benefit of the state agencies could take the form of increased training and technical assistance for the states, or transfer of the amount to a third party to manage on behalf of all of the states. This approach accomplishes several laudable goals.

First, it would result in a simplification of the OTR Methodology, lending greater transparency for stakeholders. This accomplishes one of the recommendations from NCUA's outside reviews of the methodology. Next, returning the value to state regulators provides more direct benefit to the state system. It is the state credit union system and state regulators that produce the work from which the imputed value arises. By recognizing this the NCUSIF can provide even more resources for states to use to continue to improve their supervisory capabilities. This in turn produces more value for the NCUSIF and enhances protection of the share insurance fund.

Some might be tempted to assert that state agencies, and hence their FISCUs, already "unfairly" benefit from NCUSIF funding in terms of training, hardware, and software. These same parties might also suggest that the NCUSIF may not always rely on specific state agencies based on unforeseen circumstance, for example state budget cuts that impede the ability of the state to conduct full scope examinations of its FISCUs. These assertions are misguided.

[83] Credit Union Data Summary 2015 Q4, National Credit Union Administration, available at https://www.ncua.gov/analysis/Pages/call-report-data/Reports/PACA-Facts/PACA-Facts-2015-12.pdf.
[84] 12 USC 1782(c)(3).

To the point regarding NCUSIF-provided training, software, and hardware, we note that the NCUSIF is also providing all of that, ***and more***, to the FCU examiners. In addition, not all states utilize NCUSIF provided software or hardware. In addition, virtually every state expends its own funds to provide its examiners training above and beyond what is provided by the NCUSIF.[85] All of that state-funded training, and state-funded software and hardware, benefit the NCUSIF, at no cost to the fund. Therefore, while NCUA allocates any expenses of its examiners related to the NCUSIF, the states are spending their own funds to provide benefits to the NCUSIF.

With respect to the hypothetical where the NCUSIF must provide primary examination coverage to a specific state's FISCUs for some reason, we note that this is an extremely rare occurrence. But more importantly, we reiterate that the NCUSIF is absorbing the entire safety and soundness expense for every single FCU everywhere. There is simply no equating a rare, isolated occurrence on the FISCU side with the day in, day out, occurrence for FCU safety and soundness supervision.

4) **The NCUA should eschew a formal overhead transfer calculation and establish the overhead transfer rate at 50% of its budget**

Once again, we concede that attempting to develop a methodology that tries to calculate the costs of administering the insurance fund without internally distinguishing the safety and soundness obligations of the chartering responsibilities from the safety and soundness responsibilities of administering the NCUSIF is a difficult task. Consequently, there might be merit in returning to a simple OTR of 50 percent of NCUA's annual operating budget. This would be consistent with the OTR for 30 of its 45 years.

The advantage of this approach is it balances simplicity with an acknowledgement that a restructuring of the OTR to truly reflect NCUA's Title I prudential supervisory responsibilities could possibly represent a steep rise in non-NCUSIF funding. Further, by tying the NCUSIF and non-NCUSIF expenses allocations to parity, NCUA can help ensure that some efficiencies of examination flow to the NCUSIF, contrary to the current approach which reverses the flow of efficiencies. Under this approach, NCUA could repurpose its methodology from calculating the OTR to tracking and managing NCUSIF examination hours as an efficiency metric.

With respect to the GAO studies that have instructed NCUA to hone its method of allocating costs between its Title I and Title II roles, we note that GAO's concerns were with regard to NCUA overcharging the NCUSIF. These reports were issued in the context of steady increases of the OTR from 50 percent to 60 percent and above.

## Conclusion

[85] For example, in 2016, states will providing state funded training to examiners provided by NASCUS in areas of information and cyber security, BSA, commercial lending, among others. As another example, NCUA in 2016 chose to cancel one of its two annual meetings with state regulators as a cost cutting measure while continuing to fund its nationwide meeting of NCUA examiners. In response, the states, at their own expense, held a national meeting of their own to work on important safety and soundness and other supervisory issues. The NCUSIF ultimately benefits from that.

One might assert (as NCUA does) that given NCUA's dual role, allocating the entire cost of FCU safety and soundness supervision to one centralized function (in this case the administration of the NCUSIF) is the most efficient means of organizing and operating the agency. Generally speaking, this might be true, however that is neither the question presented nor the point. Congress chose a specific structure for banking and credit union supervision, and that structure requires federal chartering authorities to supervise their charters for safe and sound operation while creating a redundant function in a deposit insurer to evaluate the safety and soundness of its insured institutions to mitigate risk to the deposit insurance fund.

NCUA's OTR Methodology is severely flawed. We sincerely believe our recommendations could improve the process in an equitable, and statutorily sound manner. As it now stands, NCUA's methodology is arbitrary, capricious, and inequitable to FISCUs.

We thank NCUA for the opportunity to provide formal comment on the methodology used to determine the Overhead Transfer Rate. As evidenced in this letter, we remain deeply concerned that the current allocation of NCUA's operating expenses is inequitable to the state credit union system and incompatible with the wording, and spirit, of the FCUA. However, we are confident that NCUA will careful consider these comments, and modify the methodology in a manner that is both fair and consistent with the construction of its statute.

We would be pleased to discuss these comments, in detail at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Lucy Ito
President & CEO

cc: SSAs
NCUA Chairman Matz
NCUA board member Metsger
NCUA board member McWatters