

BOARD ACTION MEMORANDUM

TO: NCUA Board

DATE: November 19, 2015

FROM: Office of Examination & Insurance

SUBJ: Overhead Transfer Rate Delegation

ACTION REQUESTED: Delegate to the Director of the Office of Examination and Insurance authority to administer the methodology approved by the Board for calculating the overhead transfer rate and setting the rate each budget cycle, beginning with the rate for 2016.

DATE ACTION REQUESTED: November 19, 2015.

OTHER OFFICES CONSULTED: Office of the Chief Financial Officer.

VIEWS OF OTHER OFFICES CONSULTED: Concur

BUDGET IMPACT, IF ANY: None. The overhead transfer rate is one of the funding sources for the budget, but does not affect the amount of the budget. The NCUA Board approves the budget separately and without regard to the overhead transfer rate. The overhead transfer rate is applied to actual expenses incurred each month.

SUBMITTED TO INSPECTOR GENERAL FOR REVIEW: N/A

RESPONSIBLE STAFF MEMBERS: Larry Fazio, Director Office of Examination & Insurance, JeanMarie Komyathy, Director of Risk Management and Loss/Risk Analysis Officer Russell Moore.

SUMMARY: The *Federal Credit Union Act* authorizes NCUA to expend funds from the National Credit Union Share Insurance Fund (NCUSIF) for administrative and other expenses related to federal share insurance (12 U.S.C. §1783). An overhead transfer from the NCUSIF covers the expenses associated with insurance-related functions of NCUA's operations. The NCUA Board approved the current overhead transfer rate of 71.8 percent for fiscal year 2015 in November 2014.

At the November 20, 2003, board meeting, the NCUA Board approved a refined method for calculating the recommended overhead transfer rate. The overhead transfer methodology incorporates the following key factors:

- The value to the NCUSIF of the insurance-related work performed by state supervisory authorities (SSAs).
- The cost of NCUA resources and programs with different allocation factors from the examination and supervision program. Allocation factors are reviewed annually.
- The distribution of insured shares between federal credit unions and federally insured state-chartered credit unions.

- Operational costs charged directly to the NCUSIF.
- The results of the annual Examination Time Survey (ETS). The ETS captures the time NCUA spends in federal credit unions carrying out its dual mission as an insurer and a regulator. NCUA primarily achieves its mission through the examination and supervision process, and examinations and supervision are the primary catalysts for other agency functions.¹

Request for Comments on the OTR Methodology

Chairman Matz has publicly indicated she plans to ask the NCUA Board to vote at its January 2016 open meeting to publish the current OTR methodology in the *Federal Register* for public comment, and periodically thereafter in conjunction with NCUA's Strategic Plan. Under the anticipated comment process, the NCUA Board would analyze the comments and determine whether or not to adjust the methodology. With this process, NCUA would also seek prior public comment on any future changes to the OTR methodology. Any such changes to the OTR methodology would require a vote of the NCUA Board.

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

OTR Results for 2016

For the 2014-2015 ETS results, examiners devoted an average of 86.8 percent of their exam time and 87.2 percent of their supervision time to insurance related activities. This was an increase over the 2013-2014 ETS results for insurance-related exam time of 0.2 percentage points, and a decrease for insurance-related supervision time of 7.1 percentage points.

Based on the current Board-approved OTR methodology, the overhead transfer rate for 2016 calculates as 73.1 percent. The OTR for 2015 was 71.8 percent. The primary driver of the increase in the 2016 OTR was an increase in the percentage of insured shares held by state chartered credit unions (up 0.9 percentage points to 47.7 percent).

¹ In 2012, NCUA clarified the application of the insurance-related and non-insurance related definitions in the ETS in response to feedback from stakeholders and examiners. Specifically, the NCUA rules and regulations were individually mapped to each ETS category based on the extent to which a regulation was designed to protect the NCUSIF (a new sub-category of insurance related labeled "insurance-regulatory") or to govern commerce and/or provide consumer protection (labeled "non-insurance or consumer regulatory"). The primary definitions did not change; the regulations were merely explicitly mapped based on the existing overarching definitions of insurance-related and non-insurance related. While examiners continue to use their judgment as to what exam procedures to perform during an examination or supervision contact based on the risks and product-service mix of the credit union, this clarification created more consistency as to where examiners recorded their time on the ETS. In 2013, PricewaterhouseCoopers, LLP, reviewed the mapping of NCUA regulations to the categories on the ETS. The PricewaterhouseCoopers, LLP review concluded: "*The NCUA rules and regulations matrix aligns consistently with the insurance and regulatory activities and provides a documented basis supporting the allocation of examiner time between insurance and regulatory activities.*"

Distribution of Operating Budget Costs

The overhead transfer rate represents insurance-related costs in the NCUA Operating Budget to be paid for out of the NCUSIF; thus, 73.1 percent of the total operating budget will be paid out of the NCUSIF. The remaining 26.9 percent of the Operating Budget will be paid for through the federal credit union (FCU) operating fee.

Thus, the explicit and implicit distribution of total Operating Budget costs for FCUs and federally insured, state-chartered credit unions (FISCUs) is as follows:

Portion of Operating Budget covered by:	FCUs	FISCUs
FCU Operating Fee	26.9%	0.0%
OTR x Percent of Insured Shares	38.2% (73.1% x 52.3%)	34.9% (73.1% x 47.7%)
Total	65.1%	34.9%

RECOMMENDED ACTION: Delegate authority to the Director of the Office of Examination and Insurance to administer the methodology approved by the Board for calculating the overhead transfer rate, and to set the rate as calculated per the approved methodology and validated by the Chief Financial Officer each budget cycle, beginning with the rate for 2016.

ATTACHMENTS:

- (1) Calculation of the 2016 Overhead Transfer Rate

Attachment 1

Calculation of the 2016 Overhead Transfer Rate

STEP 1 – Workload Program (2016)

Core Programs	2016 Workload Hours	Non-Insurance Percent	Non-Insurance Hours	Allocation Basis
Federal Examination	454,115	13.2%	59,807	Examiner time survey.
Federal Supervision	53,687	12.8%	6,867	Examiner time survey.
State Exam & Supv	175,722	0%	0	FISCU work is insurance-related.
State Exam Review	5,321	0%	0	FISCU work is insurance-related.
5300 Program - FCU	30,503	13.2%	4,017	FCU time uses examiner time survey.
5300 Program – FISCU	9,208	0%	0	FISCU portion considered insurance-related.
Total Core Program	728,556	n/a	70,691	
Special Programs				
Fair Lending Exams		100.0%		Regulatory program now completed by OCP.
RLS	4,190	13.2%	552	Based on insurance but includes a portion of regulatory.
FOM & Chartering	500	100.0%	500	Regulatory program.
RCMS	4,130	0%	0	NCUSIF risk management program.
RISOs	3,320	13.2%	437	Allocation based on % from time surveys.
Small Credit Unions	18,633	6.0%	1,118	Allocation based on types of assistance provided by Time Reporting categories.
CUSO Exams	4,864	0%	0	NCUSIF risk management program.
Total Special Program	35,637	n/a	2,607	
Total Core & Special Programs	764,193	n/a	73,298	
Percent of Workload Programs devoted to NCUA's Non-Insurance Role			9.6%	

NOTE: The totals may not reconcile exactly due to rounding.

STEP 2 – Financial Budget (2016)

Cost Area 2016 Financial Budget	Dollar Budget (\$M)	Non- Insurance Percent	Non- Insurance Cost (\$M)
All Regional Costs: Based on regulatory related portion of core and special programs.	\$155.49	9.6%	\$14.91
Office of Consumer Protection: Primarily non-insurance (regulatory) function i.e. chartering/FOM - net of work related to share insurance coverage for members and FISCUs.	\$9.54	82.3%	\$7.86
Asset Management Assistance Center and Assistance Program: Manages liquidation payouts, assets acquired from liquidations and assistance programs, and recoveries for the NCUSIF.	\$6.92	0%	\$0
Office of Small Credit Unions: Ensures small credit unions operate in safe and sound manner through its consulting program. However, it also addresses consumer regulatory issues.	\$6.37	6.0%	\$0.38
Office of National Examinations and Supervision: NCUSIF risk management function other than chartering, FOM, and mergers.	\$10.48	0%	\$0
Office of Minority and Women Inclusion	\$2.94	86.0%	\$2.53
Other Internal Offices: Based on non-insurance percent.	\$99.18	9.6%	\$9.51
Total 2016 NCUA Budget	\$290.92		\$35.19

NOTE: The totals may not reconcile exactly due to rounding.

STEP 3 – Calculate NCUSIF Costs (2016)

Imputed NCUSIF Costs

	Millions
2016 Financial Budget	\$290.92
Non-Insurance Costs (see Step 2)	(\$35.19)
SSA imputed Value	\$40.60
Direct Operational Charges to NCUSIF	\$1.56
Total NCUSIF Imputed Costs	\$297.89

STEP 4 – Allocation of NCUSIF Costs (2016)

Insured Shares Allocation

	FCU	FISCU
Total Cost of Providing NCUSIF Insurance	\$297.89	\$297.89
Times Proportional Allocation Basis	52.3%	47.7%
Equals Allocated Insurance Costs	\$155.80	\$142.09

Net of Imputed SSA Value

	Millions
Total Allocated Insurance Costs - FISCUs	\$142.09
Minus SSA Insurance Work Imputed Value	(\$40.60)
Equals Net Cost of NCUSIF Insurance – FISCUs	\$101.49

Dollar Amount of OTR

	FISCUs	FCUs	Dollar Amt.
FISCU Portion of NCUA Insurance Cost	\$101.49	\$111.28	\$212.78
Divided by Percentage of Insured Shares	47.7%	52.3%	

OTR as a Percent of Budget

Dollar Amount of OTR	\$212.78
Divided by NCUA Budget	\$290.92
Equals OTR	73.1%

NOTE: The totals may not reconcile exactly due to rounding.

Imputed SSA Value Step 1 – 2016

Gross Workload

Table 1

Average Exam Time (Hours) FCU (Dec. 2014)	Assets < \$10M	\$10M - \$100M	\$100M - \$250M	\$250M - \$500M	> \$500M
CAMEL 1	39	80	162	192	408
CAMEL 2	41	88	186	234	445
CAMEL 3	45	100	223	279	407
CAMEL 4	65	142	312	225	438
CAMEL 5	109	219	0	0	0

Table 2

FISCUs (#) in Each Category (as of Dec 2014)	Assets < \$10M	\$10M - \$100M	\$100M - \$250M	\$250M - \$500M	> \$500M
CAMEL 1	54	99	45	30	83
CAMEL 2	342	664	205	102	147
CAMEL 3	188	230	46	16	12
CAMEL 4	40	32	5	2	4
CAMEL 5	0	0	0	0	0

Table 3

Total Hours (Table 1 cells x Table 2 cells)	Assets < \$10M	\$10M - \$100M	\$100M - \$250M	\$250M - \$500M	> \$500M
CAMEL 1	2,116	7,911	7,295	5,766	33,898
CAMEL 2	13,982	58,225	38,232	23,845	65,408
CAMEL 3	8,499	22,889	10,256	4,465	4,882
CAMEL 4	2,616	4,530	1,558	449	1,750
CAMEL 5	0	0	0	0	0
Total	27,213	93,555	57,340	34,526	105,938
Total Gross Exam Hours					318,573

Imputed SSA Value Step 2 - 2016

Net Workload

Net of Insurance-Related Time

FISCUs	Hours
Gross FISCU Exam Hours	318,573
x Insurance Factor Based on Exam Time Survey	86.8%
(1) = Total Insurance Hours	276,617
Current Budgeted State Exam Hours	149,914
x 2 (Assuming 50/50 Joint)	2
(2) = Total Calculated Annual FISCU Exam Insurance Hours	299,828

Net of NCUA Time in FISCUs

	Hours
Total FISCU Hours - Greater of (1) or (2) Above *	299,828
+ 2016 Budgeted Supervision Hours	25,808
- 2016 Budgeted Insurance Review Hours	149,914
Total Additional FISCU Insurance Hours Needed	175,722
Less State Exam Review Time (no need to perform)	5,321
Net Additional FISCU Hours Needed	170,401

*Uses the larger of two calculations – current budgeted state exam insurance hours or projected FISCU exam insurance hours based on ETS.

Imputed SSA Value Step 3 - 2016

Additional Staff Needed

Examiner Productive Time

2016 Core and Special Workload Program Hours	764,193
/ Total 2016 Workload Program Hours	1,448,716
= Productivity Ratio	52.7%
Total Work Hours in a Year Per Full Time Equivalent (FTE)	2,080
x Productivity Ratio	52.7%
= Productive Hours per FTE Examiner	1,097

Number of Examiners Needed

Net Additional FISCU Hours Needed	170,401
/ Productive Hours per FTE Examiner	1,097
= Number of Additional FTE Examiners Needed	155.3

Total Additional Staff Needed

Additional Staff Needed	Ratio Examiners to Position	FTEs Per Position
Examiners	1/1	155.3
Supervisory Examiners	1/9	17.3
Analysts	1/15	10.4
Directors	1/25	6.2
Other Regional Staff	1/20	7.8
= Number of Additional FTEs Needed		196.9

**Imputed SSA Value Step 4 - 2016
Imputed Cost**

Gross Cost

Total Cost of Regions (2016 Budget)	\$155.49M
/ FTEs in Regions (2016 Budget)	838.2
= Per Regional FTE Cost	\$185,508
x Number of Additional FTEs Needed	196.9
= Cost of Additional Regional Positions	\$36.53M

Net Cost

	Millions
Cost of Additional Regional Positions	\$36.53M
+ Additional Central Office Costs (15.6% of budget)	\$5.63M
- SSA Training and Equipment Cost	(\$1.56M)
= Imputed SSA Value	\$40.60M