

operating under good faith under that agreement while their competitors who, as the Chair mentioned, we're obligated to have parity, have continued to rise and the sound people of NCUA have not. Now that Congress has lifted that and the CBA is back into effect, I think that is a much-earned reprieve from a sacrifice they made that others did not.

And then as we look at all the rest of the things in the budget, it is just absolutely I think a real tribute to everyone who has worked very, very hard to be efficient, to be targeted with our resources, to redeploy resources as necessary, so I want to commend you and your staff. I've worked off a lot of budgets with a lot of different agencies in the past and I think that this is one that has really met the mission of the organization in a very wide stewardship of dollars, so my commendation to you and the staff and my fellow Board members. We've worked very, very hard to come up to this process. Thank you, Madam Chair.

**Chairman Debbie Matz:** Thank you. Is there a motion?

**Rick Metsger:** Yes. I'm happy to make a motion. I move that the Board approve one, the fiscal year 2014 budget of \$268,290,296 and 1,262.5 million -- or, excuse me, 1,262.5 FTEs -- could be a slip of the tongue -- on Attachment 1 -- don't write that down, Heather -- of the Board Action Memorandum, and two, the 2014 capital acquisition budget as presented in Attachment 2 of the Board Action Memorandum.

**Chairman Debbie Matz:** Is there a second?

**Michael Fryzel:** Senator, I'll be happy to second your motion as you made to pass the biggest NCUA budget.

**Rick Metsger:** Yeah. You'd think we were in Chicago with a deficit like that.

**Chairman Debbie Matz:** Okay, boys.

**Michael Fryzel:** Yes.

**Rick Metsger:** Right.

**Chairman Debbie Matz:** All in favor?

**Michael Fryzel:** Aye.

**Rick Metsger:** Aye.

**Chairman Debbie Matz:** Aye. Okay, the motion carries.

**Mary Ann Woodson:** Thank you, everyone.

**Chairman Debbie Matz:** Thank you. We will now get a presentation on the 2014 Overhead Transfer Rate by Larry Fazio, Director; JeanMarie Komyathy, Director of Risk Management;

and Brian McDonough, Loss Risk Analyst Officer. They're all with the Office of Examination and Supervision -- Examination and Insurance.

**Larry Fazio:** Hello, again, Chairman, Board Member Fryzel, Board Member Metzger. JeanMarie, Brian and I are here to present the Overhead Transfer Rate recommendation for 2014.

As you are aware, the exam time survey is used to determine the amount of time NCUA examiners spend on insurance versus non-insurance matters. This determination is an important component of the Overhead Transfer Rate.

At the November 2012 open Board meeting we announced that in January 2012 NCUA had begun collecting time survey results based on a refined time survey definition due to informal feedback from the industry as well as examination staff that greater clarity and consistency was needed in terms of how the examination time was defined. Accordingly, NCUA has clarified these definitions for insurance versus non-insurance activities within the Examination Time Survey.

To assist our examination staff in completing the survey and to ensure consistency in application of these clarified definitions, NCUA has modified its training and created a matrix which mapped all of the regulations to the applicable time survey category. In order to further validate these clarifications, NCUA obtained an independent review of the clarified definitions and the accompanying matrix. NCUA utilized PricewaterhouseCoopers to conduct this review. They delivered their report in October and I'm happy to report that they concluded that, quote, the NCUA rules and regulations matrix aligns consistently with the insurance regulatory activities and provides a documented basis supporting the allocation of examiner time between insurance and regulatory activity. End quote.

JeanMarie will now provide a brief overview of the methodology used to compute the Overhead Transfer Rate and then Brian will discuss the primary components of the rate calculation.

**JeanMarie Komyathy:** Good morning. As both regulator for federal credit unions and insurer for federal and state credit unions, NCUA allocates funding for operations consistent with our dual role. One portion of our activities is geared towards managing risk to the insurance fund while the other portion of our activities is related to consumer protection for federal credit unions. As a result, the NCUA operating budget is financed through two sources. One, federal credit unions are assessed an operating fee for the regulatory portion of our operations and two, an Overhead Transfer occurs from the Share Insurance Fund to cover the cost of insurance-related activities.

NCUA continues to use the method approved by the Board in 2003, which includes annually setting of the Overhead Transfer Rate. NCUA's overhead transfer methodology is a data-driven process based on an imputed value or replacement cost approach toward insurance activities. It used up-to-date information on the examination and supervision program to ensure the process reflects current practice. The methodology incorporates key factors, including an annual time survey completed by examiners from June to May of each year, NCUA's resource workload budget and financial budget, the distribution of insured shares between federal credit unions and

federally insured state chartered credit unions, and the value of the insurance-related work conducted by state regulators. Using those factors, we determine the portion of the NCUA budget that should be funded through an insurance-related overhead transfer and the portion that should be funded through regulatory-related operating assessments to federal credit unions.

For 2014 we recommend an Overhead Transfer Rate of 69.2% based on the latest results of our methodology. Applying this to the NCUA operating budget of \$268.3 million results in \$185.7 million funded through the insurance-related overhead transfer. The remaining \$82.6 million or 30.8% of the budget is funded through the federal credit union operating fees. That means that in total 32% of the budget will be attributed to federally insured state chartered credit unions and 68% of the budget to federal credit unions.

In comparison, the Overhead Transfer Rate for 2013 was 59.1%. Applied to the 2013 operating budget, 27% of that operating budget was attributed to federally insured state chartered credit unions and 73% was towards the federal credit unions.

Brian will now discuss the items that went into the formula.

**Brian McDonough:** Thank you. Good morning.

**Chairman Debbie Matz:** Good morning.

**Michael Fryzel:** Morning.

**Brian McDonough:** As Larry previously discussed, the Overhead Transfer Rate is calculated using the results of the Examination Time Survey, the operating and workload budgets, the distribution of insured shares between federal credit unions and federally insured state chartered credit unions, and the value to the Share Insurance Fund of the work of the state supervisory authorities.

For the survey we used principal examiners and randomly selected supervisory groups from each of our five regions. For the time survey ending May 2013, utilizing the clarified definitions that Larry mentioned earlier, examiners reported spending 87.2% of examination time on insurance-related procedures compared to the May 2012 results of 63.2%. Examiners also reported spending 92% of supervision time on insurance-related procedures, an increase from the May 2012 results of 78.2%.

For 2014 the workload budget includes a net decrease of budgeted examination and supervision hours for work in all credit unions; however, budgeted examination and supervision hours in federally insured state-chartered credit unions increased by over 11,000 from the prior year. As the chart indicates, NCUA staff is spending an increasing amount of time in state chartered credit unions, approximately 29%, and less time in federal credit unions, down to 71% of their time.

The operating budget just approved by the Board for the cost of NCUA resources and programs increased from the prior year from \$255 million to \$268.3 million. The distribution of insured shares remained largely unchanged from the prior year and the value of the work of the state

supervisory authorities increased to \$46.1 million.

I will now hand it back over to Larry for some concluding remarks.

**Larry Fazio:** Thank you, Brian. The Overhead Transfer Rate methodology has not changed. The clarifications of the definitions within the survey are not a change in policy. We continue to use the same Overhead Transfer Rate methodology approved by the NCUA Board in 2003. The purpose of undertaking the clarification of the definitions within the 2013 Examination Time Survey was to promote clarity and consistency in the classification of examination hours and to ensure the Overhead Transfer Rate is applied accurately.

At this point we'd be happy to answer any questions you have.

**Chairman Debbie Matz:** Thank you. I just want to emphasize as you have that the Overhead Transfer Rate is based purely on data. There is nothing subjective about it. We just go with the data we have. But it is extremely complicated -- and as a result, the Board asked you to bring in an independent consultant to validate the way we were going about doing this. And you brought in PricewaterhouseCoopers and they did an analysis which is being made public -- and it's I believe attached to the BAM, is that correct?

**Larry Fazio:** That's correct; it's an enclosure to the BAM.

**Chairman Debbie Matz:** It's an enclosure to the BAM, and it will be on our website after this meeting. But they did validate that the methodology that's being used is in fact accurate.

The independent report documents all of the regulations that are insurance-related compared to the regulations that are not counted toward the Overhead Transfer Rate. And the time surveys demonstrate that we are spending a greater percentage of our time on insurance-related work. And as the insurer of all federal credit unions and most state-chartered credit unions, protecting the Insurance Fund and the credit union members' deposits is the most important part of our job.

And I just want to emphasize a point that you made in your closing remarks, Larry, that the methodology for calculating the Overhead Transfer Rate has not changed. And in fact we continue to use the same methodology approved during my first time on the Board in 2003, which is I think when I first met you and you came in and tried to explain all of this to me for the first time.

**Larry Fazio:** Yes. That was lots of fun.

**Chairman Debbie Matz:** Yes. You've been doing it annually ever since. So I do have a couple of questions.

The distinction between federal and state credit unions is very important, and I would like you to once again talk us through how the Overhead Transfer and budget dollars are attributed to each.

**Larry Fazio:** Sure. If we could actually go back to the prior slide, I'm going to have JeanMarie

actually kind of walk us through again the allocation here.

**JeanMarie Komyathy:** Sure. The overhead transfer is divided between federally and state chartered credit unions based on their percentage of insured shares. Currently 54% of the insured shares are held in federally-chartered credit unions and 46% are held in state chartered credit unions.

Unlike the operating fee, the overhead transfer is not billed to credit unions. It's simply a transfer from the Share Insurance Fund to the operating fund.

So for 2014 we start with the overhead transfer and we take the total amount and, of that, 54% is attributed to federal credit unions and 46% is attributed to state credit unions. So the only portion of the budget that is attributed to the state credit unions is that 46% of the overhead transfer, which is 32% of the overall budget. The remainder, 68% of the budget, is attributed to federal credit unions, a portion of which comes from the Share Insurance Fund, the remainder of which comes from the operating fees that they are charged.

**Chairman Debbie Matz:** Okay, perfectly clear. And how are we implementing the recommendations from the independent report? Have they all been implemented?

**Larry Fazio:** Yes. I'll have Brian answer that.

**Brian McDonough:** PricewaterhouseCoopers made three recommendations in their report, one regarding training, one regarding an update to our classification matrix, and another regarding updating the matrix to include two regulations that were inadvertently omitted.

As the report notes, we immediately corrected the omissions from the matrix, so that recommendation has already been implemented.

We are currently updating our training materials consistent with their recommendation.

And finally, we will issue a revised matrix that aligns with the Examination Time Survey tool that is used by examiners and we expect those recommendations to be fully implemented prior to the beginning of the next time survey cycle, which begins next June.

**Chairman Debbie Matz:** Thank you. Do you have any questions?

**Michael Fryzel:** Thanks. Mr. Fazio, the Overhead Transfer Rate relates to the \$268.3 million that the Board approved for the operating budget, correct?

**Larry Fazio:** Yes. The Overhead Transfer Rate is expressed as a percentage and that's because it's a percentage of the total budget that is transferred from the Share Insurance Fund to pay for the cost of operating the agency.

**Michael Fryzel:** And why don't we include the capital budget in that?

**Larry Fazio:** The capital budget is historically under accounting not an expense like the operating budget; it's a capital improvement typically and so we haven't historically included it in the Overhead Transfer Rate.

**Michael Fryzel:** And how is that paid for?

**Larry Fazio:** That's paid for out of the cash that we have through the operating fee and the funds that we have on hand.

**Michael Fryzel:** The cash that we have on hand?

**Larry Fazio:** Yes, as we collect it.

**Michael Fryzel:** I guess my question is where does that come into play in regards to the credit unions and the amount they are required to pay? Where does the capital budget fall so that we can collect the money for that? Where do we get it from? How does it come into this fund?

**Larry Fazio:** It's part of the overall funds that we have as an agency.

**Michael Fryzel:** Where do we get those funds?

**Larry Fazio:** We get them from a variety of sources -- the Share Insurance Fund and other collections we have sometimes, including the federal operating fee.

**Michael Fryzel:** So how do we pay for capital expenditures, out of what fund?

**Larry Fazio:** I believe it's out of the operating fund right now.

**Michael Fryzel:** If it's out of the operating fund, why isn't it included in the operating budget and not included in the \$268 million?

**Larry Fazio:** Because again, those historic -- capital improvements are generally something that get capitalized; that's why it's called the capital budget.

**Michael Fryzel:** I understand, but they're an expenditure. We're spending money to make improvements to our building.

**Larry Fazio:** Yes, but then they get depreciated.

**Michael Fryzel:** I understand that. But where do the funds come from to make those expenditures that we depreciate over time?

**Larry Fazio:** They come out of --

**Michael Fryzel:** Where do they appear? Where are they? We've got \$7 million that we're going to spend; why isn't it reflected in that budget? How do we get that \$7 million?

**Larry Fazio:** We collect it as part of the operating fee.

**Michael Fryzel:** But it's not reflected in the OTR?

**Larry Fazio:** Right because it's not considered an expense; it's a capital acquisition.

**Michael Fryzel:** So the operating fee being --

**Larry Fazio:** Historically the Overhead Transfer Rate has been to pay for expenses.

**Michael Fryzel:** So when we talk about this operating fee scale next, that's where we're going to be talking about it?

**Larry Fazio:** Correct.

**Michael Fryzel:** Okay, good. We'll talk about it then.

**Larry Fazio:** Thank you.

**Chairman Debbie Matz:** Good?

**Michael Fryzel:** I'm good.

**Rick Metsger:** Larry, as you mentioned, the methodology hasn't changed in putting together the Overhead Transfer Rate but you're trying to focus in, as you did, to a greater sense of uniformity among the call sheets, I mean the report sheets out in the field. Are there any particular changes that you noticed as a result of that or where is maybe the greatest variance that was now narrowed as a result of refining this? Are there any particular areas that you notice that in?

**JeanMarie Komyathy:** It's difficult to compare one year's survey to the next year's survey because we use a different group of examiners each year to do the survey. So in this case when we went back to look at last year compared to this year we got more surveys this year so there's more time to start with.

When we looked at it as a percentage of the total surveys for the year, most of what we noticed is that the overall amount that was to non-insurance, so the regulatory portion, had not changed all that much. What had changed was the part that was in the insurance regulatory section. So what examiners had been calling regulatory before or insurance before, now they're classifying as insurance regulatory. It's things that they do that are safety and soundness related but also relate directly to our rules and regulations, for example, reviewing an audit or reviewing bond coverage; things that are designated and dictated by our regulations that are really insurance-related things. And we saw the greatest change from just straight insurance related to insurance regulatory regulated.

But the percentages really, the total amount changed for both the clarified definitions and

because of the greater number of surveys we got.

**Larry Fazio:** Okay. And I would just add to that that we have a risk-focused examination process and the examiners are the one, based on the various policies and guidance that we have, that on a case-by-case basis design the scope of the examination consistent with the risk profile of the credit union and the products and services it's entered into. And so what they choose to focus on as part of the exam process is a risk-based judgment decision that they make; the time survey is just a reflection of that. Then they record that time based on what they chose, based again on the risk profile of the credit union, to examine for. And so all we did is clarify which buckets on the survey those activities go.

So when you're comparing one time period to the next, there is some natural variation that happens based on what examiners were focusing on in a particular time period, which is affected by the risk profiles of the credit unions, the overall economy, the local economy the credit union operates on and so forth.

**Rick Metsger:** Okay. And then when we come up with these percentages and ultimately the Overhead Transfer Rate we also have our state partners who are involved in this as well and in calculating their contribution to this. So as we have refined this going forward for this year, can you tell me a little bit about, in terms of the allocation for the state supervisors, in terms of how we have used that formula in the credits that we give them and has that been carried, the formula that we use for the federally insured credit unions, been carried over to the same allocation for the state-regulated credit unions?

**Larry Fazio:** Yes. One of the key inputs to the Overhead Transfer Rate formula is a credit or a value that we assign to the work that the state regulators do in helping us manage risks to the Share Insurance Fund. We rely, as the Act provides, to the greatest extent possible on the work of the state regulators and in partnership with them.

And so one of the changes we made when the Board approved the new methodology back in 2003 was to reflect that as an adjustment in the calculation and we make that adjustment or that credit, if you will, on the exact same cost basis and the exact same programmatic basis that we apply to ourselves. For example, we use our exam hours, so if you took the state charter and you said based on the size of the state charter and the CAMEL rating on average how many hours we would spend examining that credit union if it were a federal credit union, those are the exam hours we assign to that. How much of a percentage of the time of that exam time is insurance related, which goes back to the examiner time survey, is also applied to that. So the same time survey results we apply to the work of our federal examiners is applied in this computation of the imputed value for the state regulators' work.

So all the cost bases, our cost per hour of exam, all that is used, so it's identical; so it's a pure apples-to-apples credit.

**Rick Metsger:** So then for the state ones then as you were putting together the final numbers, did this result in an increased credit for the states?



**Larry Fazio:** Yes. Brian, if you would?

**Brian McDonough:** It increased actually. Last year's credit was \$34.1 million. This year, due to our increased costs and the time survey results, it's gone up significantly to \$46.1 million.

**Rick Metsger:** All right, so that's the credit that they --

**Larry Fazio:** Correct.

**Rick Metsger:** More credit for the state. Okay, thank you.

**Chairman Debbie Matz:** Thank you. Is there a motion?

**Michael Fryzel:** Yes. I move that the Board authorize an Overhead Transfer Rate of 69.2% for 2014 as attached to the Board Action Memorandum.

**Chairman Debbie Matz:** Is there a second?

**Rick Metsger:** Second.

**Chairman Debbie Matz:** All in favor say "Aye."

**Michael Fryzel:** Aye.

**Rick Metsger:** Aye.

**Chairman Debbie Matz:** Aye. The ayes have it; the motion carries. Thank you.

The final item on our agenda is the 2014 operating fee scale. We will hear from Susan Douglas, Budget Officer, Office of the Chief Financial Officer; and Mary Ann Woodson is back again. Thank you.

**Susan Douglas:** Good morning, Chairman Matz.

**Chairman Debbie Matz:** Good morning.

**Susan Douglas:** Board Member Fryzel, Board Member Metsger.

I'm here to request Board approval for the final piece of the 2014 budget, the operating fee assessment to federal credit unions.

In the Board's last action, you approved funding 69.2% of NCUA's budget by the Share Insurance Fund; the remaining 30.8% will come from operating fee assessments.

The Board action before you shows our method for turning this 30.8% into our cash needs, \$79 million, and then into the assessment scale to collect the \$79 million. We have determined