

Summary of Comments on Refined Overhead Transfer Rate Methodology

CUNA's Comments

States is a significant step forward. Improvements mentioned are:

- Recognizes perceived inequity between FCU exams funded by OTR and FISCO exams that are not.
- Continuous survey process.
- Annual review and setting of rate.

Recommendation: Believe the application of overhead is purely arbitrary. Thus NCUA could consider an alternative application, like 50/50, in lieu of applying the Workload program allocation factor (which is based on what examiners do) of 25%.

NCUA Response: In cost accounting, the allocation of overhead is not arbitrary. Logically, it follows that if an organization devotes differing levels of effort to producing products, or providing services, the allocation of overhead costs should be based on a pro-rata basis. To do otherwise would be arbitrary. Also, not all overhead is independent of what is produced or provided. If one of the multiple products or services were no longer provided, there would be some commensurate decrease in overhead costs (e.g., OHR staff would decline as total agency staff declined, at least until you reached some minimum baseline).

Recommendation: The imputed SSA value does not include the work conducted by SSAs for insurance-related work in jointly examined FISCOs.

NCUA Response: This recommendation was based on misunderstanding of the calculation of the imputed SSA value. We clarified that the work NCUA examiners conduct during joint examinations reduced the insurance-related work SSAs needed to do in those institutions, thus a proper reduction to the imputed value.

Recommendation: The time NCUA examiners spend reviewing state examination reports to conduct due diligence and NCUSIF risk management should not reduce the imputed SSA value, since this is not an examination or supervision time-savings (like the joint exam work) for SSAs and is already factored into NCUA's OTR calculation at 100% insurance.

NCUA Response: We agree and will adjust the formula accordingly.

Recommendation: Share the examination time survey guidance and definitions with CUNA.

NCUA Response: This is already accessible via FOIA, so we provided CUNA with a copy, are making the survey an attachment to the BAM, and will post it to the Internet.

Recommendation: Would like to have draft versions of the budget and OTR available prior to the annual budget briefing to enable the industry to better comment on them.

NCUA Response: Not directly related to the refined method. Under consideration.

NASCUS' Comments

States is an improvement in that:

- Recognizes the value of the work done by SSAs.
- Demonstration of the depth of NCUA's efforts to address this issue.

NASCUS cannot support, however, since they believe the legal basis is unsupported by the FCUA. Also believe that safety and soundness work is also regulatory, thus not appropriate to fund from the NCUSIF. Further, view the OTR as a symptom of the lack of segregation between NCUA's regulatory and insurance roles. NASCUS believes these functions should be separated to provide for direct allocation of costs.

NAFCU's Comments

States is a demonstration of the time and effort NCUA devoted to this issue, and that NCUA is committed to dealing with this issue in an equitable and straightforward manner.

Recommendation: They question the need for and advisability of changing the method so soon after the Deloitte and Touche study. Further, they suggest the recent GAO report, though suggesting the OTR be continually improved, does not indicate a need for an entirely new method.

NCUA Response: The method proposed is a refinement (or improvement) of the current method. It is not new in the sense it is still fundamentally based on the existing method and still utilizes the examination time survey. Thus, D&T's review still has validity. The major change is the adjustment for the value of the SSA work, which is a policy decision not a cost allocation methodology issue. In terms of the GAO report, it is reasonable to interpret their comments as supportive of enhancements that bring greater equity, transparency, and accuracy to the process.

Recommendation: They suggest that the direct charges to the NCUSIF for SSA staff training and equipment not be added to the insurance-related costs but rather deducted from the imputed SSA value. NAFCU also suggests NCUA should have a policy governing the extent to which NCUA will pay for these costs (not a "blank check"), and address the fact that the SSAs utilize this training and equipment for examining privately insured credit unions.

NCUA Response: This recommendation is based on a misunderstanding of the formula. The costs associated with SSA staff training and equipment are actual insurance-related costs incurred as part of the overall NCUSIF risk management program, and thus need to be factored in. Even as direct charges to the NCUSIF, FCUs and FISCUs both are indirectly paying for these costs on a pro-rata basis. Further, the formula does deduct these costs from the imputed SSA value since these costs would not be incurred if NCUA were conducting all of the insurance-related work. Though not specific to the OTR, whether or not a formal policy governing the level of expenditures for SSA staff training and equipment needs to be developed is under consideration. There are some controls already in place on the extent to which NCUA provides equipment to SSA staff. In regard to privately-insured credit unions, the impact is minimal and there is a derivative benefit to the NCUSIF in terms of system risk implications.

Recommendation: They suggest that it is improper for NCUA to pay the costs for a NASCUS employee, especially now that NASCUS is a hybrid organization involving credit union personnel. NAFCU also suggests this cost should be factored into the OTR calculation.

NCUA Response: The NASCUS employee does provide valuable service in coordinating the training and other joint efforts related to SSA staff. However, the propriety of having this person as a NASCUS employee as opposed to an NCUA employee needs to be considered. The costs associated with the NASCUS employee are factored in at 100% insurance-related with the new formula by adjusting the allocation factor for the budget center accordingly.

Recommendation: NCUA should reconsider how the cost (principal) of the building is funded since much of the central office's functions are insurance-related. Currently FCUs absorb the entire cost of the principal, though the interest portion is split between the NCUA and NCUSIF.

NCUA Response: The expense portions of the building costs, the depreciation and the interest on the loan, are factored into the OTR calculation. The only remaining issue is, in the event NCUA were to realize a profit on the building (e.g., via a sale), the NCUSIF would be entitled to a portion of the proceeds since it funded its portion of the interest and depreciation expenses.

Recommendation: NAFCU is concerned the sample used for the examination time survey may not reflect the distribution present in all examinations and supervision contacts, resulting in sample bias.

NCUA Response: The examination time survey is statistically valid, and any sample bias inherent in a random sample process would not be material. We will be increasing the sample size for the June 2004 to June 2005 cycle given the reduction in one region, going from 3 examiners in 6 regions (18 in total) to 6 examiners in 5 regions (30 total).

Recommendation: NAFCU suggested we provide further breakdown of the cost centers.

NCUA Response: We agree and will revise the refined method to further breakdown central office costs.