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Nathan Deal
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April 26, 2016

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

Re: Comments on OTR Methodology

Dear Mr. Poliquin:

The Georgia Department of Banking and Finance (“the Department”), the chartering authority for credit unions in the State of Georgia, submits this letter 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”). The objective of this letter is to obtain a revised approach to administering the National Credit Union Share Insurance Fund (“NCUSIF”) that is equitable to all federally insured credit unions, including Georgia state-chartered credit unions, that is consistent with the Federal Credit Union Act (“the Act”).¹ This letter highlights the conflict of interest inherent in the NCUA’s dual role as chartering authority for federal credit unions and administrator of the NCUSIF as well as the inequity to Georgia state chartered credit unions under the NCUA’s OTR approach, and proposes simpler and more transparent alternatives.

Value of the Dual Charter System

The Department is charged by the Georgia General Assembly with promoting safe, sound, competitive financial services in Georgia through innovative and responsive regulation and supervision.² A diverse system of financial service providers competing to serve Georgians has favorable impacts on choice, pricing, and innovation in the offerings of products and services, which benefit Georgians and Georgia’s economy. The Department is committed to a healthy

¹ 12 U.S.C. Chapter 14.

² O.C.G.A. § 7-1-3.

dual charter system in which the Department, as the chartering authority for credit unions in the State of Georgia, engages in a healthy competition with the NCUA and other federal banking regulators to ensure that the business and delivery models for financial services in Georgia are able to be delivered by a federally-insured credit union charter tailored to the unique needs and desires of Georgians. As compared to one size fits all federal charter alternatives, the Department strives to design Georgia's charter to meet the unique geographic, demographic, and cultural characteristics of Georgia and its various submarkets, which may vary substantially in comparison to other markets across the United States. A healthy dual charter system allows for a distinctly Georgian charter that supports a financial services business model designed to best serve Georgians. Another very tangible value of a healthy dual charter system is that it allows the financial service provider to decide which charter option best suits its business model and target market, which provides as a meaningful check-and-balance on excesses in either the state or federal regulatory models. Similar to the manner in which competition among financial service providers promotes choice and benefits to Georgians, competition among state and federal chartering agencies provides choice and benefits to the financial service providers that seek to serve Georgians. Imbalances that undermine competition diminish the many benefits to Georgians of a healthy dual charter system.

Roles of Chartering Agencies

The Department charters, regulates, and supervises Georgia state-chartered credit unions, funding its operations solely from appropriated funds, including assessments of Georgia state-chartered credit unions, by the General Assembly. All Georgia state-chartered credit unions are federally-insured by the NCUSIF, which benefits from the Department's safety and soundness regulation, supervision, and examination by the sharing of reports of examination and supervisory materials with the NCUA as administrator of the NCUSIF. The Department is required by State law³ to examine all Georgia state-chartered credit unions at least once each year and may examine or investigate more frequently at any time it deems such action necessary or desirable, although the Department is authorized to alter the examination frequency and scope to, among other things, achieve coordination with other agencies and assure that appropriate time and attention are devoted to the supervision and examination of credit unions in a problem status.

The NCUA was established in 1934 and charged by Congress with chartering federal credit unions as well as supervising and examining federal credit unions for safety and soundness. In this respect, the NCUA is to federal credit unions what the Department is to Georgia state-chartered credit unions, their chartering authority and primary regulator. Title II of the Act was enacted by Congress in 1970, establishing the NCUSIF and placing it within the NCUA so that the federal share insurance fund could be efficiently administered by the NCUA Board. In doing so, Congress directed the NCUA to rely, in its capacity as federal share insurer, upon examinations conducted by State authorities, such as the Department, "to the maximum extent

³ O.C.G.A. § 7-1-64.

feasible.”⁴ A plain reading of the Act effectively limits the NCUA’s role at Georgia state-chartered credit unions to that of insurer and back-up supervisor.⁵

Inherent Conflict of Interest

The NCUA is the Department’s chartering competitor in addition to being the Department’s invaluable partner in its capacity as the federal insurer of all Georgia state-chartered credit unions. The NCUA has a fiduciary responsibility in its administration of the NCUSIF to ensure that both state and federal chartered credit unions are treated equitably, without advantage to either charter resulting from the manner in which the NCUA administers the fund. To mitigate this clear conflict of interest in its dual role as chartering competitor and fund administrator, NCUA should implement compensating safeguards to ensure that state chartered credit unions are treated equitably. An initial step taken by the NCUA to provide for a compensating safeguard is the publication of its OTR methodology for review and comment, now and periodically in the future. The Department greatly appreciates the NCUA recognizing the weaknesses with its previous approach and taking this first step to remedy the conflict. However, this lone action in itself is far from sufficient to provide meaningful mitigation of the conflict of interest. In fact, the NCUA Board’s recent delegation of its responsibility for administering the OTR to the NCUA’s Director of the Office of Examination and Insurance, who is responsible for NCUA’s supervision programs that ensure safety and soundness of all federally insured credit unions, is, on its face, inconsistent with increasing transparency of the OTR process.

The Department’s recommendations to mitigate the NCUA’s inherent conflict of interest as chartering competitor and administrator of the NCUSIF include, but are not limited to, acknowledging that the OTR is a rule subject to the Administrative Procedures Act (“APA”), separating internally within the NCUA the supervisory function from the administration of the NCUSIF and creating an internal firewall to promote independence and impartiality in administration of the NCUSIF, and working with the state credit union system to promote a change in the Act requiring at least one seat on the NCUA Board be dedicated to an individual with state credit union regulatory experience. This permanent commitment to state system representation on the NCUA Board helps to ensure that an understanding and appreciation of the state credit union and dual charter systems are reflected in the deliberations and decisions undertaken by the NCUA Board, especially those determinations regarding the NCUSIF.

Inequity of the OTR

⁴ 12 U.S.C. § 1781(b)(1).

⁵ The Federal Deposit Insurance Corporation’s (“FDIC’s”) 2015-2019 Strategic Plan, which is available at <https://www.fdic.gov/about/strategic/strategic/supervision.html>, discusses in Strategic Objective 2.1 its back-up supervisory role with national banks that are chartered, regulated, and supervised by the Office of the Comptroller of the Currency (“OCC”).

A plain reading of the Act, standard practice in financial services regulation, and a common understanding of the role of a regulator requires that the NCUA has a responsibility, as the chartering authority for federal credit unions, to supervise and examine for safety and soundness the federal credit unions that it charters, just as the Department does for Georgia state chartered credit unions. The language in Title I of the Act supports this assertion. Notwithstanding this fact, the NCUA, by offsetting virtually all of its costs for supervision and examination of federal credit unions, clearly believes that it has no responsibility as chartering authority for the safety and soundness of the federal credit unions that it charters but, instead, is only involved in a safety and soundness capacity at federal credit unions in its dual capacity as federal insurer. This interpretation is flawed on its face and fundamentally challenges the very essence of financial regulation. Further, as a practical matter, it results in an inequitable administration of the NCUSIF, which is funded by all federally insured credit unions, because distributions from the fund only serve to reduce the operating fees imposed by the NCUA on federal credit unions. There are no such distributions made by the NCUA, in its capacity as administrator of the NCUSIF, to offset fees charged by state regulatory agencies to state chartered credit unions for the supervision and examination activities conducted by state regulators to the benefit of the NCUSIF. Accordingly, the cost of the NCUA's safety and soundness responsibilities for federal credit unions is subsidized by the NCUSIF at the expense of state credit unions, which is a clear inequity in the administration of the NCUSIF by the NCUA. This is akin to a state chartered credit union and a federal credit union joining together in partnership to form a credit union service organization ("CUSO") that offers insurance services where both benefit from the insurance services provided, but the operator of the CUSO distributes special dividend payments only to the federal credit union to partially offset its costs of ownership. Such an arrangement is on its face inequitable and the Department only assumes that the NCUA in its regulatory capacity would not authorize such a structure. The Department asserts that the clear inequity in the administration of the NCUSIF would not be accepted by an impartial administrator of the NCUSIF, thus necessitating the recommendations outlined in the previous section of this letter to mitigate the NCUA's inherent conflict of interest.

Alternatives Approaches to the OTR

One simple alternative approach is for the NCUA to stop distributing funds from the NCUSIF to offset its costs of performing its safety and soundness responsibilities as the chartering authority for federal credit unions. This simplest of approaches is most effectively and transparently implemented in an NCUA organizational structure that is designed to mitigate its inherent conflict of interest, as outlined in an earlier section of this letter. However, the Department acknowledges that the Act does allow the NCUA to use funds from the NCUSIF to offset the cost of insurance related activities, which are admittedly difficult to separate from safety and soundness activities.

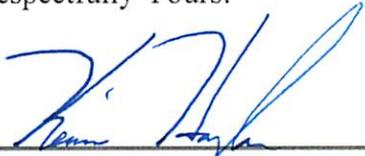
If the NCUA, in its capacity as administrator of the NCUSIF, continues to make distributions from the NCUSIF to offset its costs of performing its safety and soundness responsibilities as the

chartering authority for federal credit unions, then the same proportionate amount should be distributed to the state system to offset the costs of state regulators for performing their safety and soundness responsibilities for federally insured state chartered credit unions. This would result in the equitable treatment of all federally insured credit unions. It is reasonable to expect that the administrator of the NCUSIF should make adjustments to the distribution, as appropriate, to account for relative differences in credit union assets subject to supervision and examination within state and federal systems, respectively. It would also be reasonable to expect adjustments to the distribution for insurance activities performed by the NCUA in its capacity as back-up regulator as well as in its capacities as receiver and conservator of federally insured credit unions, whether state or federal chartered. The hours involved in these activities would be easily tracked and reported on as part of a separate, firewalled insurance division within the NCUA. Any general overhead of the insurance division may be likewise allocated to adjust the distributions to the state and federal credit union systems, accordingly. The result would be a simple, equitable, transparent administration of the NCUSIF for the benefit of both state and federal chartered credit unions. Distribution to the state credit union system could be provided through various mechanism, to include a direct rebate to state chartered credit unions that fund the NCUSIF, a direct distribution to state credit union regulatory agencies that perform safety and soundness responsibilities at the federally insured credit unions chartered by that state, or preferably, a distribution to a fund dedicated to the safety and soundness of the state credit union system, to be administered by representatives of the state credit union system for the benefit of the NCUSIF. Such a dedicated fund could be used to promote education and awareness of safety and soundness matters and made available to the employees of state credit union regulatory agencies as well as employees of federally insured state chartered credit unions. These alternative approaches provide simple, equitable, transparent alternatives to the NCUA's convoluted and opaque OTR methodology.

Conclusion

The Department greatly appreciates the NCUA's willingness to review and address these important concerns on inequities in the OTR and the inherent conflict of interest in the NCUA's dual role as chartering competitor and administrator of the NCUSIF. These long standing concerns have been communicated on behalf of the Department and the broader state credit union system by the National Association of State Credit Union Supervisors ("NASCUS"), the organization formed to represent the state credit union system at the national level on matters of importance to the state system. The Department greatly values its critically important partnership with the NCUA in its capacity as administrator of the NCUSIF as well as respects and appreciates the value of healthy competition offered by the NCUA as the chartering authority for federal credit unions. These comments are respectfully submitted and the Department looks forward to actions taken by NCUA in response to the issues outlined herein.

Respectfully Yours:



Kevin B. Hagler
Commissioner
Department of Banking and Finance
State of Georgia