Cooperative Credit Union Association
Delaware • Massachusetts • New Hampshire • Rhode Island
Creating Cooperative Power

August 29, 2017

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Cooperative Credit Union Association, Inc. Comments on Request for Comment Regarding Revised Overhead Transfer Rate Methodology

BY EMAIL ONLY

Dear Secretary Poliquin:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. ("Association"), please accept this letter relative to the National Credit Union Administration's ("NCUA") Request for Comments Regarding Revised Overhead Transfer Rate ("OTR") Methodology. The Association is the state trade association representing credit unions located in the states of Delaware, Massachusetts, New Hampshire and Rhode Island, serving approximately 195 credit unions which further serve approximately 3.8 million consumer members.

In preparation for the development of the present comment letter and to foster a local consensus, the Association conducted a survey of all credit union members in order to assess the impact the OTR has on our local credit unions. All respondents indicated that the OTR is a substantive issue that credit unions should be concerned about. The theme of respondents' answers focused on the lack of transparency and lack of clarity in the current process, despite the significant impact on both state and federal chartered credit unions and their own budgeting process.

The Association supports the NCUA's proposed OTR methodology as a marked improvement from the current methodology. However, the Association continues to have concerns regarding the continued transparency and simplicity of the OTR and its impact on both federally and state chartered credit unions, and also advocates for regular public review of the OTR methodology.

Cooperative Credit Union Association, Inc.
845 Donald Lynch Blvd., Marlborough, MA 01752-4704 • Tel. 508.481.6755 • 800.842.1242 • Fax. 508.481.3586

I. Equal Treatment of Charters is Necessary

The OTR is one of two mechanisms funding the NCUA's Operating Budget. The OTR is funded by both federal credit unions and federally-insured, state-chartered credit unions. The overhead transfer of agency expenses to the NCUSIF must be legitimate "insurance-related" costs, consistent with fairness to state and federal credit unions.

The Association is committed to the equal treatment of charters, and strongly supports the dual-chartering system. A robust and strong dual-chartering system benefits both credit unions and most importantly, consumers. The Association represents the full and complete interests of both federally-chartered credit unions and state-chartered credit unions, and does not support beneficial treatment of one charter over the other. On the contrary, the Association is committed to the fair distribution of costs for the supervision of credit unions.

It is the clear language of the law that funding of the OTR and funding of Operating Fees are to operate distinctly. The Association strives for equity and fairness between the charters and believes that any possible realignment of costs reflects this goal.

Most importantly, the Association does not believe that the OTR calculation and Operating Fee processes only represent cost transfers or increases. The Association expressly requests that in future rulemaking, the NCUA provide the public policy rationale that underlies OTR increases so that a more clear understanding of the budget impact for both federally-chartered and federally-insured state chartered credit unions is the result.

Therefore, the Association supports the Board's proposal to formally adopt the OTR-related process of indicating for any proposed regulation whether the regulation is based on Title I, Title II, and/or Title III of the Act and seeking comment on this determination. The Association supports the increased clarity regarding the purpose of and authority for any new or updated regulations and preservation of future flexibility with respect to any desired changes to the OTR methodology.

II. Increased Transparency of Proposed Methodology Is Supported

NCUA is responsible for ensuring federally insured credit unions operate safely and soundly and comply with all applicable laws and regulations within NCUA's jurisdiction. In so doing, the agency mitigates risk to the Share Insurance Fund and prevents taxpayer- funded bailouts.

To achieve its mission of ensuring that federally insured credit unions operate safely and soundly and in compliance with all applicable laws and regulations, the agency incurs various expenses, including those involved in examining and supervising federally insured credit unions. An Operating Budget funds the majority of the costs of operating the agency. The Budget is comprised of two sources: (1) Requisitions from the Share Insurance Fund; and (2) Operating Fees charged to federal credit unions.

NCUA has used an allocation methodology, known as the OTR, to determine how much of the Operating Budget to fund with a requisition from the Share Insurance Fund since 1972. NCUA has employed various allocation methods over the years, with the current methodology adopted in 2003. The NCUA is currently proposing to revise its methodology to three steps, from the current eight-step calculation. The proposal also eliminates the examination time survey. If the proposed methodology had been used in setting the 2017 OTR, the rate would have been set at 60%, compared with the current 67.7%.

Two statutory provisions directly limit the Board's discretion with respect to Share Insurance Fund requisitions for NCUA's Operating Budget and, hence, the OTR. First, expenses funded from the Share Insurance Fund must carry out the purposes of Title II of the Act, which relate to share insurance. Second, NCUA may not fund its entire Operating Budget through charges to the Share Insurance Fund.

Generally, member credit unions do not object to the formula-based approach to calculating the OTR. Respondents indicated that a formula-based approach is non-subjective, rational, and can be explained and justified, and are therefore supportive. In addition, respondents all agreed that the methodology is generally sound. However, there is consensus among members that the OTR methodology is simply too complicated, and no justification has been provided for the significant increases in the OTR in past years.

The Association supports the proposed simplification of the OTR formula as it is a step towards facilitating greater understanding of the methodology. Equally as important, it will decrease the agency resources necessary to administer the OTR.

The simplified formula applies certain principles to the allocation of agency operating costs. First, time spent examining and supervising federal credit unions is allocated as 50 percent insurance related. The 50 percent allocation mathematically emulates an examination and supervision program design where NCUA would alternate examinations, and/or conduct joint examinations, between its insurance function and its prudential regulator function if they were separate units within NCUA. This is consistent with the alternating examinations FDIC and state regulators conduct for insured state-chartered banks as mandated by Congress. In addition, it reflects that NCUA is responsible for managing risk to the Share Insurance Fund and therefore should not rely solely on examinations and supervision conducted by the prudential regulator. Association member respondents largely agreed that NCUA's examination and supervision focus should remain on managing risk to the Share Insurance Fund. An important point remains, though, that the Overhead Transfer Rate and the Share Insurance Fund transfer should not mask how well or how poorly the Share Insurance Fund is managed

The second principle states that all time and costs NCUA spends supervising or evaluating the risks posed by federally insured state-chartered credit unions or other entities not regulated by NCUA is allocated as 100 percent insurance related. This is appropriate as NCUA does not charter state-chartered credit unions nor serve as their prudential regulator.

The third principle states that time and costs related to NCUA's role as charterer and enforcer of consumer protection and other non-insurance based laws governing the operation of credit unions are allocated as 0 percent insurance related. The Association agrees that NCUA resources allocated to these functions are properly assigned to its role as charterer and prudential regulator.

The final principle states that time and costs related to NCUA's role in administering federal share insurance and the Share Insurance Fund are allocated as 100 percent insurance related. All such activities are a function of NCUA's role as insurer.

The Association appreciates the NCUA's detailed chart showing the allocation of these four principles to the activities and costs of the agency to arrive at the portion of the agency's Operating Budget to be charged to the Share Insurance Fund, and largely supports the proposed allocation. The Association reminds the NCUA that such calculations should not remain stagnant, and must be reviewed to ensure allocations remain properly divided. It is suggested that regular reviews of the proposed expense allocations for computing the OTR are necessary, and some may even require further scrutiny currently. The changes in the proposal make significant improvement in the allocation of costs, but further refinements could be made. For example, the expenses (expressed as a percentage) of NCUA's CUSO and third-party workload hours for safety and soundness of FCUs should be lowered to 25%.

In addition, the Association believes NCUA must continue its efforts to work more effectively and efficiently with state regulators to minimize any duplication of examination efforts on state-chartered credit unions that may unnecessarily add expense to the exam process and increase the OTR. Member credit unions believe there are cases when the agency and state regulator are not effectively coordinated on the examination process, adding time to the exam process. Better coordination between the agency and state regulators benefits the agency, the state regulator and the regulated entity.

The agency has requested that commenters provide alternatives for calculating the OTR. Survey respondents provided the following suggestions:

- Further exploration of how other insurance industries allocate expenses;
- A 5-year rolling average of actual costs will provide a better method of assessing future fees;
- Utilization of a historical perspective. Review a 5-year average of actual costs as allocated to the two expense streams and utilize those figures to calculate the OTR and budget for the following year.

The concern expressed by member credit unions with providing specific alternatives is the risk of becoming too granular, thereby further complicating the methodology rather than simplifying it.

Member credit unions were asked to rank their support alternatives to the current OTR methodology. The alternatives offered were: NCUA-internal segregation of the functions of chartering supervision of federal credit unions from its share insurance supervisory functions; rather than reduce the OTR by the amount of imputed value of state examination work, NCUA should refund that money to federally-insured state-chartered credit unions; rather than reduce the OTR by the amount of the imputed value of state examination work, pay out those funds for the benefit of state agencies; and eliminate a formal overhead transfer calculation and establish the OTR at 50% of the agency's budget.

One hundred percent of respondents agreed that the most desirable alternative is for NCUA to internally segregate the functions of chartering supervision of federal credit unions from its share insurance supervisory functions.

Similarly, 75% of respondents indicated that they would not support the elimination of a formal OTR calculation nor the establishment of the OTR at 50% of the agency's budget. Such responses speak to the complexity of the current methodology.

A persistent concern amongst member credit unions it that the OTR calculation is simply too complicated and has continued to rise without justification. The Association supports the agency's proposed methodology as it attempts to further simplify a complicated process, while also reflecting member credit union opinion that the NCUA should internally segregate its chartering supervision functions from its share insurance supervisory functions. However, because of the possibility that other alternatives exist that have not yet been suggested or analyzed, the Association further urges the NCUA to continue to review the methodology regularly.

III. Public Comment Is Necessary for Changes to Methodology

The OTR is at an all-time high level, and has been increasing since 2000, after remaining at a constant 50% for 14 years. As a mechanism by NCUA to fund itself by transferring money from the Share Insurance Fund that is contributed by both state and federal charters, the OTR level is very important to the entire credit union system. Most recently, the OTR increased from 52% in 2009, to 73.1% in the agency's 2016 budget, a 21% increase. Such significant and regular increases have necessitated the agency's response to industry comments on the transparency and utility of the current OTR methodology, resulting in the current proposal.

Without question, the Association welcomes the Board's voluntary decision to open the OTR methodology for public comment. The Association has long advocated for the NCUA to be more transparent regarding its calculation of the OTR. A public comment period represents one of many necessary steps to remain transparent on this issue.

The Association urges the NCUA to permanently adopt a regular cycle of review as well as advance notice and comment prior to substantively amending or changing the OTR methodology in the future. Any substantive changes to the OTR should be subject to a board action so that the discussion is conducted at a board meeting or hearing and on the public record.

The Association commends the NCUA on its commitment to its safety and soundness responsibilities as the prudential regulator of federal credit unions, and the insurer for all federally insured credit unions. Such recognition is central to a principles-based approach allocating the NCUA's examination time and costs evenly between its chartering and insurance-related responsibilities.

A common criticism amongst our local credit unions relative to this issue concerns the idea that credit unions are subject to oversight and accountability for all budgeting, expenses, and actions in examinations and elsewhere. It is the belief of our member credit unions that the NCUA should be required to control and account for its expenses in as similar a manner as possible. As credit unions have a vested interested in what the NCUA spends and how it operates, it should remain accountable and as transparent as possible, through the use of public hearings and comment periods. Such accountability will only further a better working relationship between the NCUA and its regulated entities.

The Association notes and supports Acting Chairman J. Mark McWatters' comments made both at Board meetings and publicly acknowledging the OTR as an example of non-sensitive information that should be subject to public comment. The Association is in agreement with him that the NCUA should prioritize their explanation to the entities they supervise, incorporate reasonable public comment into final deliberations, and ensure that it is abundantly clear as to how the OTR is set at a certain level.

The Association also strongly supports the agency's recent efforts to more effectively deploy examiner resources by implementing an extended exam cycle for well-run credit unions, as well as Chairman McWatters' focus on implementing virtual exam tools that could minimize on-site examiner hours. Such efforts reduce examination costs and speak to the agency's efforts to evolve as a regulator in recognition that more data and information can be shared virtually. These efforts lead to reduced agency costs, positively impacting both the OTR and the federal credit union operating fee. The Association believes the agency should revisit the $1 billion cap on the extended exam cycle for well-run credit unions as a further tool to manage OTR and operating fee costs.

Based on industry input during this current comment period, the Association urges the NCUA that at the very least the OTR methodology be reviewed and open for public comment on a rotating, dedicated basis, such as every three years, and also when a substantive change is proposed. The Association suggests that OTR review could be incorporated into the NCUA's regular regulatory review through EGRPRA, which currently occurs on a three-year rotating basis.

IV. Conclusion

The Association expresses its appreciation to the NCUA for seeking stakeholder input into this subject, and requests that the NCUA consider the Association's suggestions regarding regular public comment.

Thank you for your consideration of these views. The Association appreciates the opportunity to provide input and I remain available to address any questions or concerns at pgentile@ccua.org that you or your staff may have at your convenience.

Sincerely,

Paul Gentile

Paul C. Gentile
President/CEO

PCG/mabc/kb