Cooperative
Credit Union Association

Creating Cooperative Power

October 26, 2018

Rendell Jones
Chief Financial Officer
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

Cooperative Credit Union Association, Inc. Comments on the NCUA Draft 2019–2020 Budget Justification

BY EMAIL ONLY

Dear Mr. Jones:

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") Draft 2019-2020 Budget Justification. The Association is the state trade association representing credit unions located in the states of Delaware, Massachusetts, New Hampshire, New Jersey and Rhode Island, serving approximately 180 credit unions which further serve approximately 3.9 million consumer members.

The Association notes and supports the NCUA's continued commitment to regulatory relief and transparency. The agency has remained open to credit union suggestions on reducing the regulatory burden, providing flexibility to credit unions, and eliminating unfair or outdated regulations, all within the bounds of safety and soundness.

Without question, the Association welcomes the budget public comment process. The NCUA's voluntary decision to open the budget to public comment for the past two years prior to passage of *Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018*, also known as S. 2155, was a demonstration of the agency's commitment to transparency. Since the inception of the expanded public hearing process, the Association has participated in the process at every opportunity and believes that it is useful to the entire industry. The Association is encouraged by the continuation of this process as a result of passage of S. 2155, and is in agreement with Chairman McWatters' public statements that opening up the budget process is part of the NCUA's commitment to maintaining the public trust. Not only does the NCUA provide its budget, but further, has published over 100 pages of a detailed, careful, and extensive justification. Importantly, direct linkage to the agency's strategic plan is more clearly communicated and rationalization more obvious.

It is the belief of our member credit unions that the NCUA should be required to control and account for its expenses in a comprehensive manner. As credit unions have a vested interest in what the NCUA spends and how it operates, it should remain accountable and as transparent as possible, through the permanent and standard use of budget public briefings, hearings and comment periods. Such accountability will only

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further a better working relationship between the NCUA and its regulated and insured entities, and also serves as an example of good public policy and government transparency. The Association appreciates the NCUA's initiative and leadership in this area of improving the budget process.

The current budget proposal and public hearing process is reflective of the sensitivity with which the NCUA pursues their goals of transparency, and has been the most improved budget review process to date.

The Association is encouraged by the many proactive changes the agency has made over the past year and to its budget, including:

- Decline in facilities costs;
- Savings in rent benefits from lease terminations due to ongoing consolidation of physical space and offices;
- Continued reduction in full time employees;
- Links between capital expenditures and strategic goals.

The remainder of this statement will focus on suggestions for additional areas of improvement relative to the 2019-2020 Budget.

1. Operating Fee and Overhead Transfer Rate

Controlling insurance fund operating expenses continues to remain important, especially in context of the budget. Over the past few years, the total operating fee for federal credit unions has decreased, while the total NCUA budget has increased along with dramatic increases to the OTR 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. The OTR increased from 52% in 2009, to 73.1% in the agency's 2016 budget, a 21% increase.

The NCUA Board approved the current methodology for calculating the OTR at its November 2017 open meeting, which is principles-based, more equitable and transparent, and good for all federally insured credit unions. For 2019, the OTR proposed by NCUA will be an estimated 60.4 percent, which is down from last year's 61.5 percent. The Association acknowledges this principles-based approach and looks forward to the OTR review in 2020.

The Association represents the interests of a fairly balanced distribution of both charters, serving 140 federal credit unions, and 85 state-chartered credit unions. A regular consensus amongst all members is that the OTR methodology is too complicated. Such significant and regular increases necessitated the agency's response to industry comments on the transparency and utility of the OTR methodology, resulting in the agency's finalization of a change to OTR methodology. The Association is of the position that further enhancements can be made.

Simultaneously, the operating fee rate to federal credit unions declined, revealing that budget increases are unclear to credit unions, as federal credit unions witness decreased charges without any meaningful way to determine the amount transferred from the NCUSIF.

The important point remains that the Overhead Transfer Rate and the Share Insurance Fund transfer should not deflect how well or how poorly the Share Insurance Fund is managed. The Association does not believe that the OTR calculation and Operating Fee processes only represent cost transfers or increases. Through the use of the agency's categorization of insurance versus non-insurance related costs, the NCUA is able to use NCUSIF funds to pay for agency expenses with broad discretion. Accountability and transparency are values contained within the NCUA's Strategic Plan, and the Association continues to have concerns regarding the transparency of the OTR and operating fee in relation to the budget.

As such, the Association encourages the agency to adjust its funding of the OTR and the Operating Fee accordingly and remediate confusion resulting from growth in the budget through the OTR. The Association expressly requests that in future rulemaking, the NCUA provide the public policy rationale that underlies OTR increases so that a clearer understanding of the budget impact for both federally-chartered and federally-insured state chartered credit unions is the result, as well as endeavor to contain overall costs and manage resources which come from federally insured credit unions. Importantly, the Association is not suggesting that NCUA simply transfer costs that are currently included in the OTR calculation, and fund these costs through increased federal credit union operating fees. The impact of the agency's budget decrease for federal and state chartered federally insured credit unions should be consistent.

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.

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 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.

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. Credit unions should have access to information that will allow them to determine whether the NCUA is allocating its resources in an efficient, appropriate, and well-balanced way, particularly in consideration of fairness between charters.

2. Staff Reduction and Composition

The Association is encouraged that the 2019-2020 budget reflects a decrease in staffing levels. This decrease reflects the fact that the agency is regulating fewer, healthier entities and therefore the decrease reflects steps that the agency has taken for a more efficient use of staff and future staffing.

In addition, the Association notes the agency's position that assets are growing faster than staff. While it is a fact that the number of credit unions is going down, and the number of larger, more complex credit unions is rising, it is a questionable conclusion to say that all credit unions as they grow are engaging in more complex transactions, and that these trends are raising the risks to the Share Insurance Fund. The Association encourages NCUA to continue to manage, not eliminate, all risks.

Additionally, while larger credit unions may be more complex than smaller ones, there are economies of scale in supervising fewer, larger credit unions. The reduced number of credit unions means there are fewer to supervise, reducing the overall level of staff work. As such, the Association encourages NCUA to moderate supervision based on objective indicators, thereby avoiding undocumented future challenges.

As the industry continues to see larger credit unions, more of a focus should be placed on exam specialists. The Association suggests that as credit unions grow, the agency continue to focus on exam specialists, which larger credit unions appreciate for their expertise in areas such as capital markets, member business loans, among others. Often the specialists are cited for giving exceptional insight into their particular areas of focus. As credit unions continue to grow, NCUA may be able to further reduce the budget with a more focused exam staff honed on specialty areas that carry the most risk to the NCUSIF, rather than a large general exam team. The Association suggests that the agency could further reduce its general practitioners, and move towards developing more specialists. While this suggestion likely would not result in budget savings, the Association is of the position that such a change would be a positive use of funds as assets continue to grow.

Finally, as members share their experiences from examinations conducted by NCUA, the Association often hears of a large number of examiners on-site at credit unions for significant periods of time, often up to 14 days. The Association requests that the NCUA provide more visibility and data on average exam hours spent at credit unions by asset size and by region. While not a direct Budget issue, such data would help the industry better understand the agency's budget expenditures on staffing and other related items.

3. Reliance on State Supervisory Authorities

The Association has commented in the past on the need for NCUA to more fully rely on and seek efficiencies from its relationships with state supervisory authorities ("SSAs"), and we incorporate those comments herein.

The NCUA presently receives a detailed assessment of the financial and operational conditions of federally-insured, state-chartered credit unions through the sharing of examination reports, coordinated examinations and off-site monitoring. This is further supplemented by the national, regional and local dialogue sessions engaged in by all credit union regulators throughout the year.

The NCUA should increase goals and metrics for improving the dual examination process for state-chartered credit unions. The Association's state-chartered members have reported that there is often significant overlap of state and federal examinations. NCUA should set efficiency goals for dual examination and work with state regulators to implement efficiency measures. Any efficiency gained from these examinations could easily be measured and reported.

The Association urges the NCUA to increase its confidence in the local regulatory scheme to which it contributes and often drives, and to substantively increase reliance on the agreed upon reports, efficient procedures established between the agency and local SSAs, and other areas in which local SSAs maintain an expertise. The NCUA is strongly encouraged to enhance its reliance upon state supervisory agencies to the fullest extent possible, and account for the efficiencies the joint examination process affords the NCUA. By doing so, the Association believes that the NCUA may further reduce its budget.

Many state regulatory staff serve on interagency committees that specialize in information technology and cyber security and develop expertise not only for training examiners, but for industry examination procedures. For example, Massachusetts employs regional field managers who have these types of expertise. The Association suggests that NCUA capitalize on such local resources where possible to increase efficiencies and avoid duplicative efforts.

Finally, the Association encourages the NCUA to further leverage its coordination with state regulators where possible to reduce on-site exam time, which will assist in lowering the sizeable travel budget which is a major focus of the Budget. In addition, the Association suggests that the NCUA adopt a clearer delineation between off-site and on-site exam hours, as well as further a more comprehensive use of technology for exams, such as through Skype or other remote video software.

4. Information Technology Expenditure Accountability

The Association encourages the NCUA to expand accountability on Information Technology ("IT") investments, especially in terms of progress with the agency's virtual exam goal. Stakeholders would benefit from a more transparent and detailed explanation of how the significant $15 million IT capital budget is moving the industry closer to virtual exams, which will in turn positively impact the budget by saving on on-site examiner time. While the 2019-2020 Budget Justification includes the specific numbers of expenditures for IT improvements, it does not clearly specify how these IT expenditures are connected to virtual exam efforts.

In prior comments on the budget, the Association requested the formation of working groups to collaborate and develop further efficiencies in the budget. In 2017, the NCUA created the Joint NCUA-State Supervisor Working Group. The NCUA's movement forward on this concept is appreciated. The Association suggests that this Working Group could be harnessed for specialty topics, such as information technology and cyber security, which represent highly technical areas and where enhanced collaboration with state regulators could further assist NCUA in its goals.

Additionally, the Association suggests that it would be helpful to the agency to utilize an independent third-party review of IT expenditures, both as an unbiased method to provide data on how such expenses are moving the agency towards it goals, as well as to help identify areas of success and improvement, which would help direct efficient use of agency resources.

With such significant expenses in this area, the industry should be able to see and understand how such expenditures at this point in time will accelerate the agency's progress towards virtual exams in coming years. The Association would welcome more detail on how significant IT expenditures are moving the industry closer to virtual exams, and a clearer nexus between such expenditures and progress in the virtual exam area.

5. Accounting of Future Authorities

The Association raises the NCUA's pursuit of third-party vendor authority and the increased costs such authority would entail. Such costs may significantly derail the goal of minimizing budget increases. The Association encourages an ongoing commitment to an efficient budget than is sustainable and can be maintained long-term without relying on annual increases, and suggests that it is unclear how pursuit of third-party vendor authority, and, if and when granted, an implementation plan, will be accounted for in the budget. The Association suggests more detailed information on the agency's pursuits in this area.

The Association encourages the NCUA to continue to seek credit union input on its budget. Credit unions have earned and support a regulatory and supervisory environment that will allow them to best serve their members, which includes insight into the way costs are budgeted and allocated. Furthermore, the Association acknowledges and applauds the delicate balance that the NCUA strikes, similar to that faced by member credit unions, in minimizing budget costs while managing risk, building an educated work force and staying ahead of technology and its security challenges. While some recommendations of the Association may appear to increase cost, the path for regulatory transparency and efficiency remains the goal and the Association stands ready to assist with member input, working groups, pilot programs or any other tool to assist the agency.

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 eford@peoplescu.com or (401) 846-8930 that you or your staff may have at your convenience.

Sincerely,

Ellen Ford

Ellen Ford
Board Chairman

EF/kb/mabc