



The National Voice of the State Credit Union System

**PREPARED REMARKS OF
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2020 BUDGET BRIEFING OF THE NCUA BOARD

November 20, 2019

On behalf of NASCUS—including its regulator members who represent all states that issue charters for state credit unions and state-chartered credit unions from around the country—thank you Chairman Hood, Board Member McWatters, and Board Member Harper for conducting today’s briefing. NASCUS applauds the NCUA Board for continuing to hold these public briefings which reflect your commitment to transparency, accountability, and providing stakeholders with a role in NCUA’s budgeting process.

By way of background, NASCUS is the primary resource and voice of the state governmental agencies that charter, regulate, and examine the nation’s state-chartered credit unions. Our membership is comprised of state regulators and other credit union system stakeholders that support a robust dual charter system including state-chartered credit unions, federal credit unions, and system organizations. NASCUS is the only organization dedicated to the defense and promotion of the state credit union charter and the autonomy of state credit union regulatory agencies.

NASCUS and its members continue to monitor NCUA’s management of budget funding sources and NCUA’s management of its complex role as both chartering authority for federal credit unions (FCUs) and as the insurer of both state chartered and federally chartered credit unions through administration of the National Credit Union Share Insurance Fund (NCUSIF). The overhead transfer rate (OTR)—which determines how much of NCUA’s operating expenses are covered by the NCUSIF—is inextricably tied to NCUA’s implementation of its budget.

Two years ago, in a bold departure from past practice, NCUA re-conceptualized the OTR and approved a completely different and substantially improved overhead transfer rate methodology. The OTR formula is based on four underlying principles for allocating agency operating costs:

	Activity Allocated as Insurance Related	% Allocation
1	NCUA time spent examining & supervising federal credit unions.	50%
2	All time and costs the NCUA spends supervising or evaluating the risks posed by federally insured state-chartered credit unions or other entities that the NCUA does not charter or regulate (e.g., third party vendors & CUSOs).	100%
3	Time & costs related to the NCUA's role as charter and enforcer of consumer protection and other non-insurance based laws governing the operation of credit unions (e.g., field of membership requirements).	0%
4	Time and costs related to NCUA's role in administering federal share insurance and the Share Insurance Fund.	100%

Re-inventing the OTR was not an easy lift. Cost allocation models are inherently difficult to design—with the OTR being no exception. We recognize the unprecedented level of effort that was undertaken by NCUA to conceive of an entirely different approach—a very elegant solution that is rational and easy to comprehend. The far easier path would have been to merely tweak the previous methodology. NASCUS and the state credit union system applaud the Board and staff for your boldness, the open dialogue with various stakeholders, and your commitment to ongoing transparency and fairness.

The commonsense nature of the new “principles-based” approach and the decision to open the OTR to public notice and comment are commendable departures from past practice—bringing to relative rest 20 years of often contentious debate between the state credit union system and NCUA.

As we have stated previously, NASCUS has historically held the position that a regulatory agency is in the best position to know the resources it needs to maintain a safe and sound supervisory program. Accordingly, we do not reflect on specific budgetary elements, but we do have a few observations to share with respect to NCUA's budget justification for 2020-21 mostly with respect to OTR.

- (1) Understanding what drove the OTR down in 2018, down in 2019, and up in 2020.
- (2) OTR consistency with credit union system distribution.
- (3) Re-visiting the cost allocation of NCUA's supervision of CUSOs and third parties.

Understanding What Drove OTR in 2018, 2019, and 2020 under New Methodology

Following NCUA's seminal re-casting of the OTR methodology in November 2017, the OTR has fluctuated as follows:

Year	OTR	Δ	Explanation for Δ
2017	67.7%	-5.4%	Previous OTR methodology – Reduction of state exam hours 20,000 of which reallocated to compliance & training → greater reliance on SSAs.
2018	61.5%	-5.2%	New OTR methodology – Principle 1 allocates 50% of FCU exam costs to Title I and 50% to NCUSIF.
2019	60.5%	-1.0%	New OTR methodology – Reduction in time for examination & supervision of federally insured state-chartered CUs.
2020	61.3%	+0.8%	Reduction in time for FCU exam & supervision? Increase in time for state exam & supervision? Both? SCU-related NCUSIF Losses? MERIT development? (Not MERIT Training for SSAs because these costs are more than off-set by \$2.5m decrease in large credit union stress-testing costs of NCUSIF Administration.)

The notable decrease in the OTR of -5.2% from 2017 (67.7%) to 2018 (61.5%) is clearly due to the migration to the new OTR methodology beginning in 2018 when NCUA began allocating federal credit union examination costs equally 50% as Title I-related and 50% as insurance-related.

The -1.0% decrease from 2018 (61.5%) to 2019 (60.4%) is explained in NCUA's 2019 Overhead Transfer Rate Summary as largely driven by a reduction in time spent on the examination and supervision of federally insured state-chartered credit unions. (But, why and in which states?)

The +0.8% increase from 2019 (60.5%) to 2020 (61.3%) is *presumably* due to an increase in time spent on the examination and supervision of federally insured state-chartered credit unions or a decrease in time spent on federal credit union examination and supervision. Perhaps the extended 18-month exam cycle for well-managed credit unions up to \$1 billion is a factor. In any case, the reason for first increase in the OTR since 2017 cannot be determined by the "2020-2021 Budget Justification: Staff Draft" and the NCUA's 2020 OTR Summary is not yet available. Even if the 2020 OTR Summary were available, it may still be difficult to ascertain the specific explanation for the increase.

In NCUA's third year of implementing the new OTR methodology, NASCUS has arrived at two realizations and attendant requests. The first realization is that it would be helpful and constructive to publish NCUA's annual OTR summary in conjunction with NCUA's annual budget justification document. We ask that the NCUA Board consider issuing the two documents in tandem. Secondly, it has become clear to us that we do not understand how federal examiner hours are calculated and to what extent state examiner hours are calculated and valued. In the interest of transparency and federal-state interdependency, NASCUS would welcome the opportunity to review with NCUA's its valuation process of federal examiner and state examiner hours. NASCUS

is prepared to cooperate with NCUA on the valuation method so that NASCUS and other stakeholders can appreciate the circumstances that contribute to NCUA examiner hours spent on federal versus state charters which in turn drive the OTR up in some years and down in others. It is reasonable that in some years NCUA would spend relatively more time on state-chartered credit unions' supervision or assessment of risk. It would be helpful to understand the swings in either direction. Open sharing and mutual appreciation can only foster greater federal-state trust and collaboration.

OTR Consistency with Credit Union System Distribution

In determining how much of the OTR should be distributed between federal and state credit unions, “percent of insured shares” is certainly a simple proxy for estimating relative burden and it may also be a reasonable proxy.

	OTR Insured Shares			# (%) of Credit Unions	
	FCUs	FISCUs		FCUs	FISCUs
2018	51.1%	48.9%	2017	3,499 (63%)	2,074 (37%)
2019	51.3%	48.7%	2018	3,376 (63%)	1,999 (37%)
2020	51.1%	48.9%	2019	3,335 (63%)	1,973 (37%)

For the last few years, federal credit union and state credit union insured shares have hovered around 51% and 49%, respectively. At the same time the percentage of federal and state credit unions has consistently remained at 63% and 37%. Arguably, for NCUA, as the insurer for both federal and state credit unions, there may be a greater supervisory burden represented by the significantly larger number of insured federal credit unions relative to state credit unions.

NASCUS values the simplicity of implementing the current OTR methodology and has, accordingly, accepted the simple proxy of insured shares in the allocation of OTR between federal and state credit unions. We call attention to the distribution between the number federal and state credit unions simply as a factor to review going forward in evaluating the equity of the OTR methodology.

Re-Visiting the Cost Allocation of NCUA’s Supervision of CUSOs and Third Parties

Under Principle 2 of the current OTR methodology, all the time and costs NCUA spends supervising or evaluating the risks posed by FISCUs or other entities NCUA does not charter or regulate is allocated as 100% of insurance related. We do agree that NCUA oversight of FISCUs is 100% insurance related, but question whether other entities are justifiably allocated as 100%.

NCUA gives CUSOs and third party service providers as examples of non-regulated entities. While it is true that NCUA does not charter or supervise those entities, NCUA has taken steps to assert supervisory authority over such entities out of concern for the

safety and soundness of its federal charters as well as the FISCUs it insures. Indeed, state supervisory agencies with third party vendor authority *selectively* exercise supervisory authority over third party providers utilized by their state charters, *when warranted*.

It would follow that *some* of NCUA's workload hours in CUSOs and third parties reflect NCUA's safety and soundness responsibility as charterer/prudential regulator of federal credit unions. Additionally, NCUA's chartering rules limit the services that a federal credit union's CUSO may provide and to whom it may provide them. These are not material safety and soundness issues; they are compliance issues. As NCUA further explores third party vendor authority, we remind NCUA that we do not agree that 100% of the time and costs associated with NCUA's supervision of CUSOs and third parties is insurance-related. We recommend that NCUA allocate at least 25% of its CUSO and third party workload hours to its Title I function.

Closing Thoughts

Let me take this opportunity to repeat NASCUS' appreciation for the yeoman's work that NCUA completed in 2017 to develop a much more sustainable and equitable approach to implementing the overhead transfer rate.

Thanks to all three members of the NCUA Board, NCUA staff, and state supervisory agencies, the relationship between NCUA, state regulators, and NASCUS is the most productive and collaborative that it has been in recent memory. We acknowledge all three board members for treating state regulators and NASCUS as partners with shared objectives and we thank each of you for recognizing the value that a robust dual charter framework brings to state and federal credit unions alike.

In closing, we thank Chairman Hood, in particular, for publicly committing to and signing the NASCUS-NCUA Document of Cooperation in August of this year. The agreement recognizes the distinct roles that state regulators and NCUA have in supervising credit unions while also embracing the cooperation between state regulators and NCUA that is critical to ensuring safety and soundness and fostering an environment of innovation, prosperity, and success.