

Cooperative Credit Union Association

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NATIONAL CREDIT UNION ADMINISTRATION October 27, 2016

STATEMENT RELATIVE TO 2017-2018 BUDGET PROPOSAL

The Cooperative Credit Union Association, Inc. (“Association”) is the state credit union trade association, representing credit unions collectively 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. On behalf of member credit unions, the Association expresses significant concerns on the National Credit Union Administration’s (“NCUA”) 2017-2018 draft Budget Proposal.

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union suggestions on reducing the regulatory burden, providing flexibility to credit unions, and eliminating unfair or outdated regulations, all within the bounds of safety and soundness.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 Board’s voluntary decision to open the budget public comment process in advance beginning with the Budget Briefing, on-line comment process and November comment deadline.

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Increase Budget Transparency

According to a recent survey, members noted that credit unions are subject to extensive regulatory input, oversight and accountability for all budgeting, expenses, and actions through supervisory examinations and reporting as custodians for consumer members' funds. Thus, at a minimum, as NCUA serves in a position of public trust of deposits and shares nationwide, a similar process and standard of review and reporting should also apply to the federal regulator and insurer.

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 further a better working relationship between the NCUA and its regulated and insured entities.

The Association is also in agreement with Board Member McWatters' public statements that the NCUA should prioritize their explanation of the budget process to the entities they supervise, incorporate reasonable public comment into final deliberations, and ensure that it is abundantly clear as to why the budget is set at a certain level. While the NCUA did release its 2017-2018 Budget Proposal and supporting documents to the public prior to the open briefing and requested comments, it did so on October 14, a mere 13 days before the briefing. The Budget Justification is comprised of 53 pages, the Line Item Budget is comprised of 24 pages, and documents underlying the proposed budget,

such as the 2017-2021 Strategic Plan and 2016-2017 Annual Performance Plan, combine for an additional 84 pages. The brief period of time does not adequately provide interested stakeholders sufficient opportunity to examine in detail, not only the volume of supporting materials, but also the finer points of the budget, and make reasonable comparisons to past years' budgets and other similar regulatory agencies' budgets. It is recommended that for each future years' budget proposal, that the NCUA open the proposal to a public comment period and release its supporting documents at least 60, if not 90, days prior to any briefing or hearing in order for stakeholders to have appropriate time to review.

Perform Formal Public Review of Budget and Overhead Transfer Rate

The Association urges the NCUA to establish a methodology and parameters now that reflect transparency, public comment and concern, which will serve as a benchmark to be reviewed on an annual basis.

In past comments to the NCUA, the Association has addressed the agency's voluntary participation in the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA") process, and has suggested that as the NCUA has adopted the EGRPRA review in its discretion, the agency should consider the benefits in transparency and accountability it will gain by opening both the budget more broadly, and the Overhead Transfer Rate ("OTR") specifically, in a formal annual review subject to public comment. The Association again offers that suggestion relative to the current budget process. It will ensure that all stakeholders are afforded the opportunity to review the budget and OTR

methodology for fairness, better understanding, and ensure that the budget reflects any appropriate increases or decreases and that the methodology and related OTR definitions are appropriately connected to the NCUSIF.

Readdress Overhead Transfer Rate Methodology

The Association has long advocated for the NCUA to be more transparent regarding its calculation of the OTR. A public comment period represents the first of many necessary steps to remain transparent on this issue. It is strongly urged that the NCUA permanently adopt a regular cycle of review as well as advance notice and comment prior to amending or changing the OTR methodology in the future.

Furthermore, member credit unions are of the position that decisions regarding the methodology behind the OTR and the Operating Fee Schedule impact both state and federally-insured credit unions and therefore should, at the very least, be within the purview of the NCUA Board only. The recent change to permit staff to have a greater role in setting the OTR is rejected. In addition, the methodologies should be subject to a public hearing and comment period.

Maintain Board Discretion in OTR

In approving the OTR for 2016, the NCUA delegated to senior staff the authority going forward to set the OTR, even though the agency said it would seek comments on changes in the OTR methodology periodically with its Strategic Plan. This approach would entail that there would no longer be a need for staff to bring the rate resulting from the OTR

calculation to the NCUA Board annually for approval. Instead, through approval of the Board Action Memorandum, the Board will delegate to staff the authority to administer the Board-approved OTR methodology, and to set the OTR as calculated per the approved methodology each annual budget cycle beginning with the rate for 2016. In addition, this would entail that the OTR will be published and available to the public only after it is already final.

The decision to remove the Board from future OTR rate decisions should be revisited and the decision changed to return the authority to the NCUA Board to set the OTR, which should be accomplished as part of the annual budget process. Issues identified in the Price Waterhouse Cooper 2013 report to the NCUA on OTR examination time support this approach. This delegation, while shielding the Board from potential criticism, requires agency staff to assume authority over a substantive issue that should remain with the Board. The NCUA Board should retain rulemaking authority over the OTR, and a Board-mandated rulemaking period must be completed prior to the setting of the OTR. Any 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.

Relate OTR to Safety and Soundness

In addition, the Association requests that a reallocation of the safety and soundness function of the OTR should be conducted and attributed to the NCUA's role as regulator and Title I responsibilities, resulting in a more realistic and fair assessment to federally-chartered credit unions for direct work performed. The Association believes that the shift

in costs that has occurred to state-chartered credit unions has created industry confusion and has adversely impacted the attractiveness of the state charter and therefore the dual chartering system of regulation. A reallocation of the safety and soundness function is necessary as the NCUA's definition of insurance-related costs as procedures addressing safety and soundness issues lacks specific standards and is far too broad. The definition appears to equate insurance-related activities with safety and soundness, when the two concepts are uniquely different. Lack of clarity blurs the line that NCUA has routinely and clearly stated must be drawn between itself as a regulator and itself as an insurer.

Adjust OTR Model

The Association suggests specific changes are needed to be made to the OTR model. Although examination and supervision support the insurance function, they are primarily the responsibility of the chartering authority, the prudential regulator: NCUA for federal credit unions ("FCUs") and the various state supervisory agencies ("SSAs") for federally-insured state credit unions ("FISCUs"). In theory, if the NCUSIF could reimburse both NCUA and the SSAs for the cost of examinations, it could be appropriate for it to do so, to NCUA through the OTR and to SSAs by means of a direct reimbursement. However, for a number of reasons, making such payments to SSAs is not practicable. Therefore, equity requires that routine examinations of both FCUs by NCUA and FISCUs by SSAs be paid by the respective credit unions through operating fees, and that the OTR cover only NCUA examination of FISCUs, NCUA examination of potentially troubled FCUs, and the FISCU share of other examination-related costs.

Using this approach, the amount of NCUA's 2016 \$292.2 million budget to be borne by FISCUs would have been around the range of \$85 million to \$93 million as opposed to \$101.5 million using NCUA's approach. The resulting OTR is estimated to have been in the range of 62% to 67%, instead of NCUA's 73.1%. Using a similar approach, the \$299.2 million 2017-2018 budget, and the as yet unreleased OTR, could be further reduced.

Provide Public Policy Rationale

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 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.

Increase Reliance on State Supervisory Authorities

The Association urges the NCUA to more fully rely on and seek further efficiencies from its relationship with state supervisory authorities ("SSAs"). The dual-examination system necessitates a close relationship between the NCUA and SSAs. The Association acknowledges and supports the longstanding, positive, working relationship of all credit union regulators within Region I and Region II.

There is, however, a significant overlap in state and federal share insurance examinations.

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 Association notes that the credit union regulators in Delaware, Massachusetts, New Hampshire and Rhode Island each regulate other financial service providers and strive to administer a high quality, risk based, system of supervision. Moreover, many state regulators, such as Massachusetts, have undergone the rigorous process and obtained accreditation from both the National Association of State Credit Union Supervisors and the Conference of State Bank Supervisors. Finally, each of the credit union regulators supervising Association members receive regular training, education and other resources directly from the NCUA.

The Association urges the NCUA 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 rely 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.

For example, the Massachusetts Division of Banks and Loan Agencies played a key role in the development of the Federal Financial Institutions Examination Council's ("FFIEC") Cybersecurity Assessment Tool. NCUA has begun to incorporate the Cybersecurity Assessment Tool into its examination process in 2016. The NCUA's adoption of this tool is a meaningful demonstration of how the NCUA can rely on the expertise of local regulatory bodies, and decrease its own expenses.

In addition, the Association's unwavering support for a return to the 18-month extended exam cycle continues. It should be noted that returning to an extended exam cycle, under appropriate parameters and in coordination with a deeper relationship with local SSAs, is an important tool readily available to the NCUA which may lower the budget as appropriate.

Finally, NCUA should develop 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 NCUA is currently deliberating on its Exam Flexibility Initiative Report, and the Board will consider the ten recommendations contained in the Report made by the Working Group during its November 17 meeting. The Association notes that the Exam

Flexibility Initiative Report echoes many of the Association's suggestions made relative to SSAs that will impact the NCUA's budget. For example, the Report recommends enhanced coordination with state supervisors on scheduling practices for credit union examinations.

Additionally, the Report recommends the establishment of a joint NCUA-state supervisor Working Group in order to evaluate and recommend further changes to the NCUA's examination program. The Association strongly urges that this Working Group be adopted and also remain a permanent advisory tool. Issues relative to coordination and scheduling of joint exams, scheduling flexibility, and reduced redundancy and burden are ongoing and require regular review. This Working Group should work in collaboration with the NCUA Board to note key areas for change and further reliance on SSAs, which will ultimately reduce the NCUA's overall budget going forward.

Provide Credit Unions With More Information Regarding Contracted Services

Contracted services represent the largest increase in expenditures for 2017, and more than double that increase for 2018 for the NCUA. It is expected that these expenditures will grow as NCUA seeks outside experience in areas where the agency lacks staff expertise. Credit unions have little way to evaluate these third-party business relationships so stakeholders can evaluate whether the contracts are awarded appropriately and the fees are reasonable. The Association requests that the NCUA provide more detailed information and justification for the expenses regarding contracted services.

Improve Capital Budget and Information Technology Expenditure Transparency

The 2017-2018 notes an increase in capital budget costs. According to the budget, this is primarily due to the estimated \$5.3 million of operations and maintenance costs associated with the 2017 capital budget projects, which include systems that support the modernization of NCUA's information technology ("IT") tools including the Automated Integrated Regulatory Examination System ("AIRES") and Credit Union Online. Additionally, NCUA's capital budget is zero-based to identify the new investment needs for information technology and building improvements and repairs.

While we note with approval the enhancements to the NCUA's information security program in order to effectively safeguard against cyber threats, it is recommended that the NCUA develop efficiency standards for its IT plan and programs. Stating that IT investments include ongoing enhancements and upgrades to decades old legacy systems is not an explanation of anticipated IT costs. The NCUA must establish a nexus between capital budget and IT cost increases, stated goals, effectiveness standards, and provide an accounting of any exit plans. The agency should develop and state in its budget its goals for the implementation and operation of a revamped Call Report and AIRES software. For example, stating that software is due to be in service by a certain time is one of many operational goals that should be included in the budget. The agency should state efficiency goals for each IT enhancement, as well as a cost-benefit analysis of the justification for any such enhancement. Again, these goals should require efficiency and be measurable.

Staffing Levels

The Association notes that the 2017-2018 budget reflects a decrease in staffing levels from both the 2015-2016 budget as well as the original 2017-2018 budget. While this decrease reflects the fact that the agency is regulating fewer, healthier entities and therefore should not see increases in staff, the Association notes that agency appears to maintain its position that the NCUA needs to maintain a higher staff level than is necessary out of concern regarding its ability to staff up during crisis times. The Association rejects this argument as the approach is flawed. An efficient government agency should staff for its current needs and develop a contingency plan for additional staffing if needed. A better and less costly approach would be for the NCUA to develop a contingency plan with an outside auditing firm for additional emergency staffing should another severe financial crisis present itself. Similarly, the agency could develop and use retired credit union and bank examiners on a contract basis when additional resources are needed. These are two of many potential alternative ways to staff for emergencies as opposed to maintaining excessive and costly staff during the lengthy periods when it is not needed.

Address Open Budget Related Questions

The Association has various other questions which remain unanswered, and requests that the NCUA respond to these open questions prior to approving the 2017-2018 budget:

- Since 2010, the increase in the NCUA's budget has been justified based on the failure of the agency to identify problems soon enough before losses occurred after the agency's

staff decreases in 2002-2008. Other than the 2010 “capping report” on credit union failures prepared by the NCUA Office of Inspector General, individual material loss reviews from NCUA’s OIG generally state that examiners did identify problems on a timely basis. Moreover, NCUA examiners on a routine basis were in the largest corporate credit unions that failed. The Association has several questions about the 2010 capping report, in light of its use to justify agency budget increases. What was the purpose of the capping report? It seems to simply summarize the earlier reports but adds some conclusory statements indicating examiners did not identify problems soon enough. Does the FDIC produce such capping reports? Did NCUA board members or staff direct the report? Did they discuss, review or edit it before it was released?

- The NCUA has indicated several times that the complexity of credit unions necessitates increases in the agency’s budget. Please provide the agency’s detailed analysis that demonstrates how the complexity of credit unions means the agency’s budget must continue to grow. Under this theory, the FDIC’s budget would be growing each year, which has not been the case.
- How do you anticipate that RBC2 will impact the agency’s 2017-2018 budget and subsequent budgets?
- What comprehensive steps is the agency undertaking to address fraud and what part of the agency’s budget is going to fund such efforts?

- Please provide insight and budgeting for establishing and maintaining the: Office of Consumer Protection; Office of Small Credit Union Initiatives; and the Office of National Examination Supervision. Can their functions be performed by other offices and/or in concert with other activities?
- Cybersecurity is a critical issue for everyone, yet it is unclear from the NCUA's budget how it is addressing this concern in a comprehensive manner. How is NCUA managing cybersecurity and making appropriate resource allocations to handle cybersecurity issues?
- The agency's process for credit unions to appeal examination findings and directives is unclear. Please explain the agency's appeals process in detail and what part of the budget is allocated to address credit union appeals.

Conclusion

The Association encourages the NCUA to continue to seek credit union input on its budget. Credit unions deserve a regulatory and supervisory environment that will allow them to best serve their members, which includes input into the way costs are budgeted and allocated.

The Association appreciates the opportunity to offer comments to the NCUA on this important issue and respectfully requests your favorable consideration of such comments.