Credit Union National Association

Good afternoon. I'm CUNA Economist Mike Schenk – and I appreciate the opportunity to share some high-level observations on the NCUA budget. As you know, CUNA represents America's credit unions and their 110 million members.

NCUA's budget process under the leadership of Chairman McWatters and Board Member Metsger has been more transparent over the past few years. Providing budget details and justifications in advance, holding an open briefing session, and soliciting feedback as the NCUA has done is good public policy and a strong step in the direction of government transparency. We thank NCUA leadership for continuing to improve the budget process and for making it more inclusive.

While we still have critical concerns, our analysis of the Budget Justification and related documents makes it clear that NCUA is headed in the right direction with consolidating offices and streamlining operations which require fewer staff resources. We have long advocated for and supported NCUA in taking these actions.

During last year's NCUA Budget Briefing, CUNA focused on a handful of critically important issues – each of which were addressed in constructive ways in the current budget process. These include:

- **Reigning in budget increases and right-sizing overall outlays.** The NCUA's proposed 2018 budget totals $298.2 million, which represents a $6.1 million (2.1%) increase over the 2017 restated budget. The proposed budget increase compares favorably to both increases in headline inflation (reflected in a 2.1% increase in the consumer price index in the year ending September 2017) and to increases in credit union operating expenses (reflected in a median increase of approximately 3.5% in year ending June, 2017).

  Furthermore, the request continues what we believe is both a welcome and necessary trend of reduced growth in the NCUA operating budget. Operating Fund budget increases were 4.2% in 2015, 4.1% in 2016, and 2.5% in 2017 with increases in 2018 and 2019 set to be 2.1% and 1.5% respectively.

  Against this backdrop of slowing expenditures recently, proposed spending levels in the aggregate remain a concern. Our updated analysis, comparing changes in NCUA's budget to the changes in the banking industry's comparable spending, reveals that NCUA's budget remains approximately 95% higher than pre-recession levels whereas banking industry outlays are up 75% over that period.[1]

While we conclude NCUA's total outlays are elevated from a comparative historical perspective, it is obvious – both in the budget justification's numbers and its accompanying narrative - that NCUA is attempting to increase efficiency while improving operations and interactions with credit unions. The NCUA's capital budget for 2018 is $15.4 million and reflects a continued modernization of NCUA software and hardware, which is needed to meet the agency's efficiency goals.

CUNA generally agrees with the NCUA's claim that the budget "reflects necessary expenditures to ensure successful execution of the agency's mission and strategic plan under the Board-approved Agency Reform Plan." We fully expect the current proposed investments in capital, systems, and technology to lead to further improvements in efficiency, lower staffing levels, and additional relief for thousands of credit unions under NCUA supervision.

- **Reducing staffing levels and controlling compensation costs.** Not surprisingly, last year we urged the NCUA to decrease staffing and to reign-in fast-growing compensation outlays. Employee pay and benefits account for nearly three-quarters of the agency's proposed budget and individually they are the two largest groups of expenditures.

  The NCUA Board has been receptive to CUNA's view and has proposed many changes that impact the budget through reorganization and needed updates to the examination process. These changes will lower the agency's authorized staffing level from 1,247 full-time equivalents (FTE) in the 2016 approved budget, down to 1,174 in the 2019 budget, a decline of 73 FTEs or nearly 6%. This is also a cumulative reduction of 95 positions, or 7% from a peak of 1,269 authorized FTEs in 2015.

  Nevertheless, the cost per full-time employee continues to increase substantially faster than inflation and marginally faster than the increases bestowed on credit union employees: While the agency proposes a 5.7% increase in salary per FTE, CUNA's 2017-2018 Staff Compensation survey reports budgeted salary increases of 2.9% for management (2.8% for non-management) during the upcoming year. Once again, we note this difference isn't large over a one-year period, but if

[1] Our analysis compares 2007 expenditures to the most recent budget data. We use data for NCUA [net of Asset Management and Assistance Center (AMAC)] against the aggregated data for the Office of the Comptroller of the Currency (OCC) supervision, regulation and chartering activity, Federal Reserve supervision and regulation activity, and the Federal Deposit Insurance Corporation (FDIC) ongoing operations.

maintained over time, the cumulative effect will produce significant differences in pay between the regulator and the regulated.

We understand that union contracts and health care costs are key drivers of these trends. Beyond this, while some employees may be entitled to merit raises, the standards for such raises or other pay increases are not readily available. The agency's *Employee Handbook* does list merit increases, promotions, location changes, location adjustments, and equity increases as ways that an employee's compensation may be increased, but it does not discuss factors to be considered in providing increased compensation under these categories.

In a similar vein, we believe credit unions can play a more distinct and important role in this process. Examiners spend a large percentage of their time interacting with the credit unions they supervise. However, feedback from credit unions on the performance of individual examiners – to the extent it is collected at all - is obtained in a generally random fashion. The only formal feedback mechanism available is through the examination appeals process - but credit unions are loath to use that process mostly due to fear of retribution and a perception that the process is largely ineffective.

CUNA, therefore, again strongly urges the NCUA to develop and conduct ongoing, confidential, examination staff satisfaction surveys – distributed to credit unions after each examination. Of course, these surveys ought to be processed and compiled outside the purview of the agency staff, and by an outside third party with each examiner's average rating shared with the regions to assist in both the merit pay process and in filling education and training gaps. Nearly all the nation's largest credit unions have adopted similar approaches to assist in evaluating service quality and enhancing staff evaluations (both in the aggregate and on an individual basis).

- **Reconfiguration of the Regions.** CUNA previously urged the NCUA to study the composition of the Regions to explore possibilities for significant cost savings. The current configuration, we felt, indicated that efficiency gains were possible.

  The NCUA's willingness to consider this proposal and ultimately flesh out a concrete plan of action is commendable.

  The proposed changes, a restructuring and reconfiguration of the Regions to include the elimination of two Regional offices, will help to fuel an 80% reduction in leased office space.

- **Exam Efficiency and Innovation.** Although closely related to reconfiguring Regions and employee costs, we wanted to specifically address the agency's ongoing efforts modernize the exam process. We think that investments in time and money are well spent in modernizing NCUA's exam process as this makes for a more efficient NCUA staff. NCUA has already made progress by implementing the 18-month exam cycle and planning for exams with remote components. Our hope is that NCUA staff will be able to perform thorough exams with a minimum staff present in credit unions, which will save travel costs, ensure that NCUA staff dedicate more time to examination per hour worked and are less disruptive to credit unions' staff. We encourage NCUA to dedicate the proper resources to fulfilling this vision.

- **Distribution of Cost Burdens/Overhead Transfer Rate.** As part of the review process last year, CUNA took the opportunity to once again object to the fact that the National Credit Union Share Insurance Fund (NCUSIF) Overhead Transfer Rate (OTR) was at an all-time high. We also expressed concern that the actual amounts of the total Operating Fee for Federal credit unions decreased over the previous few years, although the overall total budget for the NCUA has increased and the OTR has dramatically increased.

  We noted, from 2009 to 2016, the total NCUA budget rose by over 70%, from $168 million to $290 million while the OTR rose from 53.8% to 73.1%. Because of this, the total amount of NCUA's operating budget funded by Federal credit union (FCU) operating fees was about the same then as it was in 2008, just over $80 million, even though FCU assets had risen by 30% over the period. As a result, we noted that the operating fee rate to FCUs had declined from a dollar weighted average of 1.7 basis points of assets in 2009, to 1.3 basis points in 2016 – indicating that true budget increases were somewhat hidden from credit unions as federal charters were seeing the amounts directly charged to them decrease, but had no meaningful way to discern how much was being transferred from the NCUSIF. Since accountability and transparency are two of the values stressed in NCUA's Strategic Plan, CUNA urged the agency to adjust its funding of the OTR and the Operating Fee accordingly and address the fact that growth in the agency's budget is often obscured through changes the OTR.

  We further argued the NCUA should provide greater detail to help the public evaluate functional allocations to "insurance-related costs" or to Operating Fees. Moreover, we suggested the NCUA should continue to use a formula-driven approach to the OTR, and that the methodology should be revised by the Board, via notice and comment, to provide only legitimate, substantiated, "insurance-related" costs, pursuant to the respective Federal Credit Union Act (FCUA) Title, and consistent with fairness to State and Federal credit unions and the FCUA.

In our April 2016 comment letter, CUNA proposed an alternate OTR model that would have led to an OTR of 56.3% instead of the 67.7% in place for 2017, under the then-current method. More recently, the NCUA proposed a 60% OTR – suggesting the agency's proposed model yields similar results to CUNA's proposed model driving the OTR to 60%. That's still higher than years 2008 through 2013, but more in line with historical averages. Although the proposed 60% OTR represents a large increase for Federal credit unions, we note the portion of the percent of budget funded by the OTR and operating fee is lower than the years 2008-2013.

We think that NCUA's recently-proposed approach is reasonable if it doesn't lead to spikes or frequent large changes in the OTR.

- **Asset Management and Assistance Center (AMAC).** We applaud the NCUA for responding to our request to reduce AMAC spending. In our comments last year, we noted operations and expenses of the AMAC were unnecessarily difficult to evaluate via publicly available documents. However, we argued that in the absence of compelling data to the contrary, the agency ought to dramatically reduce or eliminate the AMAC.

  The agency, we noted, appeared to be keeping the office open at what we surmised was a very low usage rate, simply to have the function available for the next recession. Since there is little to no chance the next recession will require anything as the prior one in terms of asset liquidation, we saw little reason to maintain the resources at anything but substantially lower levels. In fact, we stated it would likely be substantially more cost effective to outsource asset sales on an as needed basis compared to keeping a fully staffed AMAC open all the time.

  With this in mind, CUNA fully supports *both* the Agency's proposed reduction in the size of AMAC and the associated realignment of supporting functions to their central office counterparts.

The budget proposal creates an office focused on chartering and credit union expansion and it eliminates Economic Development Specialist (EDS) consulting. Many of the nation's small credit unions have benefited from the Office of Small Credit Union Initiatives (OSCUI) and from the EDS program. The latter service is frequently praised for its emphasis on meaningful personal contact, customized strategic and operational solutions, and (more recently) service provision aimed at those most likely to benefit from the services. NCUA's internal research showed that EDS consulting was one of the most impactful activities in the OSCUI office and that those impacts were most obvious among the smallest credit unions – many of which are institutions in the greatest need of such services. There is little discussion on the details of the significant changes being proposed.

CUNA urges the NCUA to carefully consider the approach taken on this front. While the focus on cost savings is laudable, it is clear a significant number of smaller institutions remain stressed in the current low-rate, hyper-competitive environment, and access to OSCUI resources can be a game-changer and a critical resource for the survival of many credit unions.

In conclusion, CUNA recognizes and applauds NCUA's improved budget process as well as most of the details of the budget proposal. Together, they represent a clear, positive, and significant step in the right direction as the agency works to become a leader and innovator in the financial services industry. We hope to see more innovation and modernization, more material reductions in the budget, and a continued focus on slowing the growth rate of expenditures.

On behalf of CUNA, thank you for the opportunity to speak to you today. I'd be happy to address any questions you may have.