April 26, 2016

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

RE: Comments on NCUA Overhead Transfer Rate Methodology and Operating Fee Schedule

Via e-mail: boardcomments@ncua.gov

Dear Mr. Poliquin,

The Michigan Credit Union League (MCUL), the statewide trade association representing 100% of the credit unions located in Michigan and their nearly 4.9 million members, appreciates the opportunity to comment on the National Credit Union Administration's (NCUA) Overhead Transfer Rate (OTR) Methodology. As the NCUA knows, the credit union industry is continuing to see a reduction in the number of credit unions operating nationally due to consolidation through mergers and closures. The state of Michigan has seen similar experience with the number of credit unions operating statewide reduce over the past 10 years from 399 to 254.

The MCUL believes in the importance of a strong dual chartering system as it creates incentives for the NCUA and state regulators to continually improve their charter, to the ultimate benefit of credit unions. While the industry has seen a reduction in the number of credit unions, Michigan credit unions remain strong. Of the 254 Michigan based credit unions, 160 are state chartered and 94 are federally chartered.

As with any matter impacting credit unions, the MCUL believes in full transparency and open communication. We commend the NCUA for opening the Overhead Transfer Rate and Operating Fee Schedule for comment and further encourage the Agency to continue allowing for notice and comment prior to amending or changing the OTR Methodology in the future.

Additionally, it is not our intent, nor should it be that of the NCUA, to benefit a Federal credit union over a State-chartered credit union or vice versa. [1] The MCUL represents both State and Federal credit unions. Our goal is to ensure fair distribution of the charges for supervision of credit unions consistent with the Federal Credit Union Act (FCUA). To that end, we would discourage any NCUA action which would create a competitive advantage for one charter over the other. This issue was identified in a 2011 PricewaterhouseCoopers report that found: "[a] lower federal operating fee makes the federal charter more attractive" and "extends a competitive edge to the federal charter over the state charter."

With this background in mind, the MCUL submits the following comments.

[1] 12 U.S.C. 1790 states: "It is not the purpose of this subchapter to discriminate in any manner against State-chartered credit unions and in favor of Federal credit unions, but it is the purpose of this subchapter to provide all credit unions with the same opportunity to obtain and enjoy the benefits of this subchapter.

OTR & Operating Fee Methodology

The NCUA's Operating Budget is funded through two primary funding mechanisms: 1. The OTR, funded by both federal credit unions and federally insured state-chartered credit unions (FISCU); and 2. Operating Fees, funded only by federal credit unions (FCU). Due to the interrelatedness of these funding sources, the MCUL has chosen to provide comments on both funding mechanisms into a single comment letter.

The MCUL opposes any overhead transfer of agency expenses to the NCUSIF that are not legitimate, substantiated "insurance-related" costs for the following reasons.

NCUA Definition of "Insurance Related Activities":

In the Federal Register notice for comment, the NCUA states the definition of "insurance-related examination procedures" that fall under Title II includes; "examination and supervision contact procedures that address safety and soundness issues." Further, Title II also states; "insurance regulatory related examination procedures" are defined in the OTR methodology as those that assess compliance with regulations that "address safety and soundness issues." The NCUA states that this definition narrows, rather than expands, the procedures that the OTR includes under Title II since some consumer protection regulations may also be directed at safety and soundness.

FCUA Construct of the OTR and Operating Fee:

Title I (12 U.S.C. §1756 and §§1751 - 1782 generally):

Title I of the FCUA generally provides for the authority to regulate federal credit unions, assess an operating fee for regulatory and supervisory activities, as well as enumerating other powers. Section 1756 also provides in pertinent part:

> Federal credit unions shall be under the supervision of the Board, and shall make financial reports to it as and when it may require, but at least annually. Each federal credit union shall be subject to examination by, and for this purpose shall make its books and records accessible to, any person designated by the Board.

Title II (12 U.S.C. §1781):

Title II as it relates to charges in connection with Share Insurance related activities in 12 U.S.C §1781(b) provides in pertinent part:

> (1) to pay the reasonable cost of such examinations as the Board may deem necessary in connection with determining the eligibility of the applicant for insurance: **Provided, that examinations required under subchapter I of this chapter shall be so conducted that the information derived therefrom may be utilized for share insurance purposes, and examinations conducted by State regulatory agencies shall be utilized by the Board for such purposes to the maximum extent feasible;**
>
> (emphasis added)

"Insurance Related Activities" equating to "Safety and Soundness"

The responsibility of the NCUA to conduct safety and soundness examinations of Federal credit unions, is consistent with other banking regulators. The Office of Comptroller of Currency (OCC) for the supervision of national charters, the Federal Reserve Bank for the supervision of member banks, and the state regulators for the supervision of state chartered credit unions and banks all share similar responsibilities.

Under the present formula, the NCUA appears to consider that "everything" is insurance related. The present OTR calculation, through the mapping of procedures and regulations, presumes virtually all safety and soundness related examination costs are assumed to be an insurance related cost. This definition provides the unnecessary assumption that there will be no safety and soundness oversight in connection with its role as a prudential regulator under Title I of the FCUA. Ultimately conflating "Insurance Related Activities" into "Safety and Soundness" activities, warps the formula by under-emphasizing costs for federally chartered entities and over-emphasizing costs for state chartered entities. NCUA acknowledges this in part noting, "some consumer protection regulations may also be directed at safety and soundness".[2]

The problem with this definition is the shift of charges to the NCUSIF for all safety and soundness functions (other than those related to consumer protection), where some of the safety and soundness function should be clearly allocated to the proper Title I function and assessed only to federally chartered credit unions. The guise of safety and soundness should not be a "catch-all" by which the NCUA can allocate all of its activities for purposes of having the NCUSIF fund the agency.

A plain reading of the FCUA runs contrary to the NCUA's present process of allocating the cost of all safety and soundness examinations to the NCUSIF. Under Title I of the FCUA, the NCUA should be conducting safety and soundness examinations on Federal credit unions as part of its charter supervision. When operating under Title II of the FCUA, the NCUA should be relying on the safety and soundness examinations conducted under Title I for responsibilities as insurer. If the NCUA is charging 100% of the cost of safety and soundness examinations to the NCUSIF what does the federal credit union operating fee pay for?

The funding of safety and soundness examinations of FCUs should come fully from the FCU operating fees, not the insurance fund. FCU safety and soundness examinations conducted under Title I could represent cost savings to the NCUA for insurance purposes[3]. Under a similar premise, the NCUA is expected to accept safety and soundness reports made by state credit union regulators as cost savings to the insurance fund. [4]

NCUA data clearly indicates the current methodology is not properly capturing "insurance related activities." Since 2008 the OTR has significantly increased. Before the year 2000 the OTR was consistently set at 50% for 14 consecutive years.

Year	**OTR**
2008	52.0%
2009	53.8%
2010	57.2%
2011	58.9%
2012	59.3%
2013	59.1%
2014	69.2%
2015	71.8%
2016	73.1%

The number of troubled credit unions with a rating of CAMEL 4/5 has decreased from a peak of 409 in 2011 to a low of 220 as of December 31, 2015.[5] If indeed the OTR is designed to capture what the NCUA is characterizing as "insurance related activities" one would logically expect the OTR to correspondingly decrease. While there are other factors that might have bearing on those activities related to insurance activities, such as the conversion of a federal charter to state charter, with the improving economy and the strengthening of credit union balance sheets, the dramatic increase in the transfer rate is still staggering and highlights the potential flaw in the fairness of the current methodology.

[2] See Request for Comment Regarding Overhead Transfer Rate Methodology, 81 FR 4804 – 4805 (January 27, 2016)

[3] 12 U.S.C. 1782(a) (5) "Reports required under Title I of this Act shall be prepared that they can be used for share insurance purposes."

[4] 12 U.S.C. 1782 (a)(4) and (5) in Title II states (4) "The NCUA Board may accept any report of condition made to any commission, board, or authority having supervision of a State-chartered credit union and furnish to any such commission, board or authority reports of conditions made to the Board."

[5] NCUSIF Fourth Quarter Statistics (December 31, 2015), presented at the February 18, 2016 NCUA Board Meeting.

Reliance on State Regulatory Agencies

To further increase efficiencies and reduce costs, the NCUA should utilize the resources available under the dual examination system and work more closely with the state regulators to identify and implement new and existing efficiency measures.

The MCUL conducts a survey of Michigan's credit union community on a semi-annual basis. Our state-chartered member credit unions are asked in the survey what additional feedback they have if they are subject to a joint examination by the NCUA and the state regulator. The MCUL's member state-chartered credit unions often report of a significant overlap of state and federal examinations. Some of the comments from MCUL member credit unions include:

> *There needs to be better coordination and communication between the two agencies;*
>
> *It was a very frustrating exam since it felt as though the two teams were adversarial;*
>
> *At times there seems to be a disconnect in communication between NCUA/DIFS examiners onsite. The relevant materiality of issues can be viewed differently as well as the interpretation of testing. Also, there can be ambiguity as to who is really in charge of the examination.* [6]

In order to achieve greater efficiency the NCUA should consider looking to the Federal Deposit Insurance Corporation (FDIC). The FDIC is the insurer for all insured depository banks in the United States. It is also the prudential federal regulator for state-chartered banks and state-chartered savings institutions that are not members of the Federal Reserve System. Most state banking agencies participate in an examination program under which certain examinations are performed on an alternating basis by the state agency and the FDIC. Under the alternating examination program, certain examinations are conducted in alternating periods by the state supervisory authority and federal regulators. [7]

The use of cooperative examination agreements between state banking agencies and the Federal regulators provide efficiencies for state banks by establishing that they will have only one regulatory examination on either a 12 or 18 month cycle. This interagency cooperation is made possible since each agency relies on an alternating examination agreement.

The MCUL, together with CUNA, has long advocated to the NCUA to seek such efficiencies. Both the FCUA and the NCUA's own rules contain the express directive to utilize other examinations to the maximum extent possible, as is previously mentioned in footnote 5. Not only does Title III contain the express directive, but 12 CFR 741.1 also provides:

> To the maximum extent feasible, the NCUA Board will utilize examinations conducted by state regulatory agencies.

The NCUA should go much further in relying on the state supervisory authorities' work product and utilizing that work product in insurance examinations. Not only will this benefit credit unions directly, but it should result in savings to the overall charges under both the OTR and the Operating Fee. It could also lead to workforce efficiencies within the NCUA as well.

PricewaterhouseCoopers LLP Study (January 20, 2011)

The 2011 PricewaterhouseCoopers study has often been cited by the NCUA as justification of the current OTR methodology. The MCUL appreciates the NCUA having the methodology studied by an outside accounting firm. However, what is clear from the audit is that PwC's role as a CPA firm is not a substitute for a policy that should be established by the NCUA. An NCUA policy is a legal construct warranting full legal review as well as review and comment from the credit union community it directly impacts. While the PwC review focused on the

[6] MCUL Examination Survey, Q4, 2015.
[7] FDIC Supervision Program 2015-2019

reasonableness and soundness of the methodology, given the NCUA's policies and legal interpretations it did not express any opinion on the issues regarding NCUA's dual role as regulator and insurer. The study also failed to provide insight into NCUA oversight, NCUA's budget, or an interpretation of Congressional intent behind the FCUA. In short, it was not an opinion that the current OTR was fair to both state and federal credit unions, nor was it an opinion that the methodology was the best or only formula for implementing the statute. These policy issues are the responsibility of the NCUA Board.

Conclusion

The MCUL believes the NCUA is in the best position to determine its budget necessary to fulfill its responsibilities. We believe the NCUA budget process and the methodology utilized to develop and administer the OTR could be improved and we continue to call on the NCUA for transparency in its budget process overall. Credit unions of both charter type expend resources to fund the NCUA under the current methodology. It has been several years since the financial crisis, yet the NCUA's budget continues to grow when credit unions remain very safe and sound. In contrast, at the same time the FDIC is reducing its budget.

We respectfully ask the NCUA to evaluate the operating fee methodology to fully fund the supervision and safety and soundness examinations of FCUs from operating fees rather than the NCUSIF. As previously discussed the rationale to revise the methodology is based on a plain reading of the FCUA that looks to the NCUA to examine FCUs as the charter supervisor and utilize FCU examinations and state supervisory authority examinations as a cost savings to the insurance fund. The current methodology hinges everything upon "safety and soundness" which is not appropriate.

The MCUL appreciates the opportunity to comment.

Respectfully,

Ken Ross
Executive Vice President & Chief Operating Officer