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National Association of Federally-Insured Credit Unions

August 25, 2017

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

RE: Overhead Transfer Rate Methodology

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the National Credit Union Administration's (NCUA) proposed revision to the Overhead Transfer Rate (OTR) methodology. NAFCU strongly believes that the proposed methodology is a radical restructuring that would create a subjective principles-based model. Instead, NAFCU urges NCUA to retain the current methodology. NAFCU believes that it is an objective formula-based model that uses measurable data inputs, which prioritizes fairness, accuracy, and equity.

Background

Because of its dual-roles, NCUA charters and regulates federal credit unions (FCU), and insures shares and deposits in all federally insured credit unions (FICU) through the National Credit Union Share Insurance Fund (NCUSIF of SIF). The OTR is the agency's mechanism to determine how the agency's "insurance related" costs, under Title II of the *Federal Credit Union Act* (the Act or FCUA), and regulatory related (ie., non-insurance related) costs, under Title I, are allocated between the NCUSIF and operating fees charged to FCUs. Although various methodologies have been used since the OTR's initial implementation, the current methodology was first developed in 2003, and refined further in subsequent years. The current formula uses data inputs based on NCUA's Annual Budget, agency staff estimates, and budgeted workloads.

In January 2016, NCUA requested comments on the current OTR methodology. NCUA received approximately 40 comments and is now seeking comments on a proposed revision. Namely, the Board seeks to decrease the number of steps from the current level of eight to three, and base the methodology on principles and assumptions rather than measurable data inputs. According to NCUA, the primary goals of the proposed changes are to simplify the methodology, and to reduce the administrative cost of implementing it.

The proposed methodology would apply four underlying principles:

1. Assume that time spent examining FCUs is 50 percent insurance related.
2. Allocate all time and costs NCUA spends supervising federally insured state-chartered credit unions (FISCUs) as 100 percent insurance related.
3. Allocate time and costs spent as charterer and enforcer of consumer protection and other non-insurance laws as 0 percent insurance related.
4. Allocate time and costs spent administering federal share insurance and the SIF as 100 percent insurance related.

General Comments

First, NAFCU has long held that NCUA should prioritize fairness, accuracy, and equity. In matters that can be perceived as partial, it is of the utmost importance to ensure that these goals are achieved. Unfortunately, the proposed methodology supplants these goals with ease of implementation and simplicity.

Second, and more importantly, a substantial portion of the proposed methodology is not based on observable and measurable data inputs, like hours spent, but is rather roughly based on the principle and belief that NCUA examiners should split their time evenly between Title I and Title II activities. NCUA's rationale for the 50-50 allocation is that it evaluates programs in which NCUA would alternate exams between its insurer and prudential regulator function.

However, NAFCU does not believe that NCUA should calculate the OTR based on a principled stance of "how things should be." A fairer and more accurate approach is the one currently employed, where NCUA uses measures time actually spent.

The current issue should not be a question of whether the current methodology is objective; it is. The issue is more properly framed as whether the current formula inputs are accurately defined, which is what the majority of stakeholders called into question in response to NCUA's 2016 call for comments.

The current methodology is based on objective and observable data

As stated above, the current methodology has been used for nearly two decades, honed and improved over the course of that time. Several third-party reviews have led to important innovations that have increased the accuracy and utility of the OTR methodology. One of the most critical innovations was the creation of the Examination Time Survey (ETS).

ETS is an important tool which was designed to capture examiner time spent on insurance related matters versus non-insurance related. NCUA has mapped over 300 regulations to determine which is insurance or non-insurance related. Using current definitions of "insurance related," the ETS reports show that examiners spend approximately 88 percent of their examination and supervision time on insurance-related activities at FCUs.

Unfortunately, by eliminating the ETS, NCUA would allocate 50 percent of examiners' time spent at FCUs as non-insurance, based merely on principle. While the ETS attempts to accurately track how much time examiners actually spend on insurance-related activities, NCUA's proposal prioritizes principles and assumptions over observable fact. This results in a calculation that does not reflect reality.

Despite some stakeholders' principled belief that NCUA examiners should not spend more than half their time on insurance related activities, the fact remains that examiners *do* spend more than half their time on insurance-related activities. If the Board wants to change this reality, then it should revisit its definition of "insurance related activities," or change the annual priorities of examiners so they focus less on insurance-related matters.

If the agency is to remain objective, then it should prioritize reality over principle. Indeed, if NCUA adopts the proposed methodology, it would tacitly introduce subjectivity into the process. NAFCU strongly cautions against this, as it sets a worrisome precedent.

The proposed methodology would introduce subjectivity to the process

The fallacy with a principles-based model, such as the one presently proposed, is that it uses inputs based on concepts rather than observable and measurable data inputs. By rough-guessing the amount of insurance-related time spent at FCUs, the proposed methodology opens NCUA to criticism about equitable treatment of one charter type over the other. PwC, an un-interested third-party, found that there is no reasonable basis to conclude that the current OTR methodology, ex-ante and for reasons beyond the control of credit unions, favors or disadvantages any one type of credit union over another.

In stark contrast, the proposed revision would create a principles-based methodology, hinged on the central construct that NCUA serves dual-roles as both prudential regulator for federal credit unions and insurer for all federally-insured credit unions.

Although a principles-based methodology is flexible and less burdensome for NCUA to administer, NAFCU believes that a formula- or rules-based methodology would lead to more accurate and true assessments of NCUA's delineation of time spent between insurance and non-insurance related activities.

The majority of commenters did not call for a wholesale rebuke of the current methodology

The overwhelming number of commenters supported a formula based on data, and merely requested NCUA to revisit and reconsider certain defined inputs.

Although many commenters expressed dissatisfaction with the current state of affairs, NCUA's definitions of data inputs were the target of their discontent, not the methodology itself. With scant exception, commenters called for a finer distinction between "insurance" and "safety and soundness" categorizations.

Of the 40 comment letters that NCUA received in response to its 2016 request for comments, the most common complaint lodged was that the agency conflated "insurance-related" activities with "safety and soundness" activities. Other commenters urged NCUA to re-evaluate which examination costs are "insurance-related" and therefore properly attributable to its role as insurer rather than prudential regulator and charterer. Many felt that the definition of "insurance-related" was too broad.

Despite the fact that NAFCU does not agree or subscribe to the contention that NCUA is conflating its insurance and safety & soundness missions, NAFCU notes that the primary contention put forth by stakeholder feedback was that the *inputs* to the methodology need to be tweaked, not that the *method* needs to be scrapped.

Rather than eliminating the current methodology, NAFCU recommends that NCUA be responsive to the comments put forth, and address which activities are related to "insurance" versus "safety and soundness." This would recalibrate the agency's cost allocations accordingly, and satisfy the main thrust of the majority of comments.

Reevaluation of SSA imputed value

In addition to revisiting defined inputs, NAFCU agrees with many commenters that NCUA could find cost-savings by collaborating closely with state examiners. Relatedly, many commenters asked NCUA for a recalculation of the imputed value of state supervisory authorities (SSAs).

NCUA uses the "SSA imputed value" component of the current methodology to determine how much time and money NCUA saved by relying on SSA examiners. In recognition of that time-savings, NCUA imputes a certain avoided-cost to SSAs under the current methodology. Rather than overhaul the current methodology and eliminate the SSA imputed value function, NAFCU recommends that NCUA focus its time ensuring that cost-savings are accurately reflected in the SSA component of the current methodology.

Further ETS refinement

A few detailed comment letters raised an issue that NAFCU believes is worth further review. These commenters raised the possibility of basing the OTR calculation on the number of hours spent per institution, rather than hours spent per insured share. As these commenters noted, NCUA examines credit unions, not shares. This would be another way to respond to stakeholder comment without the need to completely upend a formula-based system.

NCUA should convene a Credit Union Advisory Council

NAFCU anticipates that this round of comments will elicit a mixed response from stakeholders with various perspectives and incentives. Much like previous iterations of the OTR methodology, whether the Board elects to maintain the current formula or move to a principles-based option, complete satisfaction is unlikely to be achieved.

Although universal praise will not likely be achieved, it stands to reason that NCUA should do everything in its power to solicit feedback from the industry. So far, NAFCU commends the Board for publishing the OTR methodology and seeking feedback multiple times.

However, such debate and exchange of ideas is difficult to facilitate via a staid notice and comment process. As a way to leverage the work already accomplished, NAFCU proposes that NCUA establish a Credit Union Advisory Council, and to take up the OTR methodology as one if its first topics of conversation.

The OTR methodology is a perennially divisive issue in the credit union industry. Rather than adopt a methodology that will inflict irreparable changes, NAFCU asks NCUA to institute a Council that can study this issue further and engage in a real-time exchange of ideas.

NCUA should state Title I or II authority when promulgating new rules

Already, NCUA is already moving in the right direction to address concerns raised by commenters. Both in last year's and this year's request for comments, NCUA stated its intention to cite whether a rulemaking is promulgated under either Title I or II when it proposes new rules. NAFCU supports this idea.

NAFCU urges NCUA to refine the current methodology with this improvement implemented. Furthering this goal, NCUA could state whether existing regulations are authorized under Title I or II during its annual regulatory review.

Legal authority

Finally, regarding legal matters, NAFCU agrees that NCUA has the legal authority to transfer insurance-related expenses from the SIF to the Operating Budget. As NCUA explains in the preamble, the Act clearly permits expenses related to insurance to be funded by the Share Insurance Fund regardless of charter. Specifically, 12 U.S.C. 1783(a) expressly allows expenses ‘‘incurred in carrying out the purposes of [Title II]’’ to be allocated to the Share Insurance Fund. The costs NCUA incurs in safeguarding the Share Insurance Fund relate to the risks in federal credit unions and federally insured state-chartered credit unions.

At the end of the day, the Board has the option of retaining an objective formula that captures observable data points, or to migrate to a system that substitutes data for principles.

The current methodology is objective and fair. It should be built upon to increase equity, not scrapped for the sake of simplicity. Should you have any questions or would like to discuss these issues further, please contact me at (703) 842-2249 or memancipator@nafcu.org.

Sincerely,

Michael Emancipator
Senior Regulatory Affairs Counsel