April 26, 2016

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

RE: NCUA Request for Comment Regarding Overhead Transfer Rate Methodology

Dear Mr. Poliquin:

Boeing Employees' Credit Union ("BECU") respectfully submits these comments in response to the National Credit Union Administration's ("NCUA" or the "Agency") Request for Comment Regarding the Overhead Transfer Rate ("OTR") Methodology ("Request for Comment"), published in the *Federal Register* on January 27, 2016 (81 Fed. Reg. 4804).

These comments discuss: (1) why the OTR methodology and determination are subject to full notice and comment rulemaking requirements of the Administrative Procedure Act ("APA"), (2) why the current OTR methodology which improperly shifts Title I examination and supervisory expenses onto federally insured state credit unions ("FISCUs") is contrary to the language, structure, and purpose of the Federal Credit Union Act ("FCUA" or "Act"), (3) why both the current OTR and the proposed OTR, which disproportionately and unlawfully burden FISCUs, are in violation of the antidiscrimination provisions of the Act and NCUA's stated policy of developing an OTR methodology that is "neutral and equitable with respect to credit union charter types," (4) why the current OTR methodology, and OTR determinations based on it, would be deemed arbitrary and capricious by a reviewing court, and (5) several proposals to ensure an open and accountable decision process for establishing the OTR in the future.

I. Introduction

The NCUA's current practice of classifying all safety and soundness related costs as *exclusively* "insurance-related" costs is inconsistent with the language, structure, and purpose of the FCUA, the Agency's own history of regulating federal credit unions prior to 1970, and the regulatory practice of other federal financial regulators.[1] The related practice of transferring all expenses NCUA determines to be insurance-related from the National Credit Union Insurance Fund ("NCUSIF" or "Fund") has resulted in an ever-increasing share of the NCUA budget being covered by the OTR.

The dramatic increase in the OTR over the past few years represents a concerted effort by the Agency to shift additional costs to the Fund and, by extension, to FISCUs. For the first thirty years of the Fund's existence, the OTR never exceeded 50 percent. In 2000, the OTR increased from 50 to 66.7 percent. Following a brief period of retrenchment in the early 2000s, the NCUA has steadily increased the OTR every year since 2009.

The increases in the OTR have spiked dramatically in the past several years following the Agency's adoption of a new methodology for classifying insurance and non-insurance-related costs. Since the new methodology was adopted in 2014 the amount of examiner time NCUA now deems insurance-related has increased from 67 percent to approximately 90 percent. As a result, the OTR has increased from 59.1 percent in 2013 to 73.14 percent in 2016 - an increase of 24 percent.

The current OTR methodology also highlights the conflict of interest inherent in NCUA's dual role as the regulator of federal credit unions ("FCUs") and the administrator of the Fund for both FCUs and FISCUs. This inherent conflict of interest works to the specific disadvantage of FISCUs. The funds being withdrawn from the Fund to meet an ever-growing OTR would otherwise be available for dividends to be paid to all federally insured credit unions. FISCUs are uniquely disadvantaged because increases in the OTR are matched by corresponding decreases in the operating (examination) fees charged to FCUs. This in turn creates a competitive advantage

[1] The Request for Comment concedes that the mission and duties of the other federal prudential financial regulators, the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, include regulations to ensure the safety and soundness of the institutions they supervise. Neither of those agencies acts as a deposit insurer. NCUA has and had, prior to the enactment of Title II of the FCUA, the very same mission and duties in its capacity as the regulator of FCUs.

for FCUs, as the increase in the OTR operates like a tax on all federally insured credit unions but only the FCUs receive an off-setting benefit in the form of reduced annual Operating Fees.

Worse, under the current OTR methodology FISCUs pay a disproportionate share of the funds withdrawn from the Fund. As detailed in the attached economic and costing analysis prepared by SLS Consulting Inc. ("SLS Analysis"),[2] the current OTR methodology allocates the costs NCUA determines to be insurance-related on the basis of insured shares, rather than the costs of performing the insurance-related work by charter type. NCUA's own budgeted work hours / cost estimates show that less than 31 percent of the insurance-related costs are incurred by FISCUs, yet FISCUs are responsible for 48 percent of the OTR. In contrast, 69 percent of the insurance-related costs are incurred by FCUs, but FCUs are responsible for only 52 percent of the OTR.

The competitive disadvantage faced by FISCUs under the current OTR methodology also threatens to undermine the viability of the dual chartering system that has benefited federal and state credit unions and consumers for over 80 years.

NCUA's operating budget has dramatically increased with the increases in the OTR; confirming the concern that access to the Fund would diminish restraint and accountability in the NCUA budget process. NCUA's operating budget in 2013 was $241.8 million. In 2016, after three years of dramatically increased assessments to the Fund, the operating budget had increased to $290.92 million - an increase of over 20 percent. The lack of budget discipline is a reflection of the lack of effective oversight. The NCUA budget is not subject to review by OMB or Congress, and the Agency has taken the position that its OTR methodology and determination are not subject to formal notice and comment rulemaking requirements under the APA.

The current OTR methodology and determination cannot be justified. A more open and transparent process for establishing the OTR methodology and determination is necessary.

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[2] *See* Analysis of the National Credit Union Administration's Overhead Transfer Rate Methodology, prepared by SLS Consulting, Inc., April 26, 2016.

II. Discussion

A. The OTR Methodology and Determination are Subject to Full Notice and Comment Rulemaking Requirements

The Request for Comment is styled as a "voluntary effort to invite input from stakeholders." Request for Comment at 4804. The Agency asserts that notice and comment rulemaking is not required because "the OTR is not a legislative rule under the Administrative Procedure Act (APA) and is, therefore, exempt from notice and comment rulemaking processes." *Id*., at 4805.

The NCUA is incorrect that notice and comment rulemaking is not required. The OTR methodology and determination are legislative rules that are not subject to any exception to the use of notice and comment procedures. Accordingly, the NCUA must comply with all the requirements for notice and comment rulemaking, and cannot dispense with them on the basis that it has sought comments on a "voluntary" basis. Moreover, as discussed more fully in the next section of these comments, and as the Agency acknowledges, even if adoption of the OTR methodology and determination of the OTR did not require notice and comment rulemaking, it would still be subject to judicial review under the APA, requiring the Agency to act consistently with law and to engage in a reasoned decision-making process.

1. The OTR Methodology and Determination Are Legislative Rules

The APA broadly defines a rule as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy . . ." 5 U.S.C. § 551(a)(4). The APA provides a limited exception to the general requirement that agency rulemakings be published in the *Federal Register* and subject to public comment for "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice…" 5 U.S.C. § 553(b)(3).

The OTR methodology is not merely a statement of policy or guidance; rather it sets out the criteria by which OTR determinations will be made. Unlike interpretive rules that are merely explanatory in nature, *see CUNA v. NCUA*, 573 F. Supp. 586, 591 (D.D.C. 1983), legislative rules "grant rights, impose obligations, or effect a change in existing policy." *Elec. Privacy Info. Ctr. v. DHS*, 653 F.3d 1, 6-7 (D.C. Cir. 2011). As stated in *Mendoza v. Perez*, 754 F.3d 1008, 1021 (D.C. Cir, 2014), a legislative rule is one that "effects a substantive regulatory change to the statutory or regulatory regime," and a rule is legislative and not interpretive when it goes beyond simply describing the agency's view of the meaning of an existing statute or regulation. Here, as in *Mendoza*, the OTR rule does not purport to "clarify a statutory or regulatory term, remind parties of existing statutory or regulatory duties, or merely track pre-existing requirements and explain something the statute or regulation already required." *Id.* (internal quotation omitted). *See Nat'l Family Planning & Reprod. Health Ass'n, Inc. v. Sullivan*, 979 F.2d 227, 236-37 (D.C. Cir. 1992) (legislative rule is "one that does more than simply clarify or explain a statutory term, or confirm a regulatory requirement, or maintain a consistent agency policy."). Credit unions are not being "reminded" of anything; nor is any statutory term being "clarified or "tracked." The OTR methodology imposes on BECU and other state-chartered credit unions the costs associated with activities deemed insurance-related, and those payment obligations are made binding through the OTR determination.

The dramatic increase in costs assigned to state-chartered credit unions under the methodology also represents a significant change in policy. The Agency asserts that the OTR process does not eliminate judgment as to what examination procedures to perform or how examiners record their time, *see* NCUA, Legal Analysis of Overhead Transfer Rate ("NCUA Legal Analysis") at 5 (Aug, 18, 2015), available at https://www.ncua.gov/Legal/Documents/Opinion/OL2015-0818.pdf, but this is a *non sequitur* because the OTR methodology and determination do not address how examiners are assigned or how they record their time. Rather, the OTR establishes a binding obligation as to how these duties established by the Agency will be funded. The Agency may have discretion to deploy its examiners as a matter of internal Agency procedure not subject to notice and comment requirements, but that in no way means that it can make determinations as to how the costs for those examinations will be allocated among third parties without using notice and comment rulemaking procedures. *See, e.g., St. Lawrence Seaway Pilots Ass'n v. U.S. Coast Guard*, 85 F. Supp. 3d 197 (D.D.C. 2015) (noting that the agency's methodology to establish pilotage rates, and the application of that methodology to set rates in each given year, are each subject to notice and comment rulemaking procedures).

The NCUA's assertion that the connection between the OTR and NCUSIF assessments or distributions is "tenuous and diluted," NCUA Legal Analysis at 5, is also incorrect. The NCUA's current OTR methodology increases the percentage of costs attributable to state-chartered credit unions and, thus, takes money out of the pockets of state-chartered credit unions and puts it into the pockets of federal credit unions. That there may be other factors that also affect assessments to, or distributions from, the Fund does not alter this basic fact. Finally, the argument that this is not a legislative rule because "NCUA has made adjustments to the matrix and reviews allocation factors annually, demonstrating its view that the OTR is a policy, subject to alteration outside of rulemaking procedures" is of course entirely circular. The fact that the Agency may have previously violated the APA does not excuse a current violation, and as the Agency well knows state-chartered credit unions have asserted for at least 15 years that OTR determinations are required to follow notice and comment rulemaking procedures.[3]

Because the OTR determination is of binding effect in determining how costs are allocated to the Fund and thus charged to state-chartered credit unions, the NCUA's argument that the OTR rule is merely a precatory "statement of policy" is likewise without merit. The Agency's action here is nothing like *New Jersey Department of Human Services v. HHS,* 748 F. Supp. 1120, 1127 (D.N.J. 1990), where the rule at issue did not "oblige the State to assume any obligations or duties." Here, BECU and other state-chartered credit unions are required to assume additional payment obligations as a direct result of the changes to the OTR methodology and determination.

In determining whether an agency action requires notice and comment, the courts have routinely looked to actual legal effect (or lack thereof) on regulated entities. For example, *Nat'l Mining Ass'n v. McCarthy*, 758 F.3d 243, 250 (D.C. Cir. 2014) held that an agency pronouncement requires public notice and comment if it has the force and effect of law. The OTR rule does not merely set out guidelines for a future discretionary determination; it is the determination itself. A closely analogous example is found in *Texas Children's Hosp. v. Burwell*, 76 F. Supp. 3d 224 (D.D.C. 2014), a case in which a number of hospitals alleged that the relevant agency had improperly modified its method of calculating hospital-specific supplemental Medicaid payment limits without following APA notice and comment procedures. The court held that, because the agency action made substantive changes to the formula that bound state Medicaid agencies, notice and comment procedures were required. The same principle applies here.

[3] *See e.g., Overhead Transfer: The Authority of the National Credit Union Administration to Allocate Costs to the National Credit Union Share Insurance Fund*, Study Commissioned by National Association of State Credit Union Supervisors, October 21, 2001.

2. *The OTR Methodology and Determination are Not "Committed to Agency Discretion by Law"*

The NCUA has also stated that the OTR methodology and calculation are a "means of explaining a function committed to agency discretion by the [Act]." NCUA Legal Analysis, at 5. To the extent this statement is intended to advance the argument that these matters are not subject to APA requirements because they are "committed to agency discretion by law" under 5 U.S.C. § 701(a)(2) of the APA, that argument is incorrect. A matter is committed to agency discretion for these purposes only when there is lack of judicially manageable standards to guide meaningful review. *See Steenholdt v. FAA*, 314 F.3d 633, 638 (D.C. Cir.2003). This is a very narrow exception generally confined to matters of prosecutorial discretion, as were involved in the leading case of *Heckler v. Chaney*, 470 U.S. 821, 828 (1985)(finding "no meaningful standard against which to judge the agency's exercise of discretion" in deciding whether to bring an enforcement action), or matters of national security and defense. *See, e.g., District No. 1, Pacific Coast District, Marine Engineers' Beneficial Association v. Maritime Administration,* 215 F.3d 37 (D.C. Cir. 2000) (rejecting APA challenge to decision to allow vessels to be reflagged overseas where the "primary factors driving the . . . decision are national defense, the adequacy of the merchant marine, foreign policy, and the national interest"); *National Federation of Federal Employees v. United States*, 905 F.2d 400 (D.C. Cir. 1990) (rejecting APA challenge to the closure of certain military bases where review would require "second guessing the Secretary's assessment of the nation's military force structure and the military value of the bases within that structure," and courts are "ill-equipped to conduct reviews of the nation's military policy.").

The issues presented here are whether the allocations of costs between insurance and non-insurance purposes are reasonably supported in the record and consistent with the governing statute. They do not involve matters of national security or prosecutorial discretion to which this exception has applied. The NCUA itself asserts that it is applying a cost-accounting methodology that "by design is both neutral and equitable with respect to credit union charter type," which provides a meaningful standard. And Agency ratemaking and cost-allocation decisions are routinely subject to judicial review. *See, e.g., Illinois Commerce Comm'n v. FERC*, 576 F.3d 470 (7th Cir. 2009) (reviewing, and reversing, an agency decision allocating the cost of transmission facilities); *Midwest ISO Transmission Owners v. FERC*,, 373 F.3d 1367, 1368 (D.C. Cir. 2004) (reviewing challenge brought by utilities as to the allocation of certain regional transmission planning costs; court applies the "cost causation" principle that rates must "reflect to some degree the costs actually caused by the customer who must pay them." (quoting *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992)). Accordingly, the reasonableness of the OTR methodology and determination turn on questions of law and fact that allow for notice and comment and that a reviewing court could meaningfully review.

3. The OTR is Not a Matter of Agency Management, Organization, Procedure, or Practice

The NCUA has also asserted that its OTR determinations are not subject to notice and comment rulemaking procedures because they are matters of internal Agency management, organization, and practice. NCUA Legal Analysis, at 7-8. This assertion is also incorrect.

As noted above, the OTR methodology and determinations do not affect how the Agency establishes its regulatory, supervisory, and examination program, or how it allocates its resources to these tasks. Rather it addresses the question of who must pay the costs of those activities by determining the proportion of the costs that will be chargeable to the Fund and thus imposed on state-chartered credit unions. These determinations are binding on the parties who must pay the amounts assessed, as opposed to being Agency budgeting documents or internal allocations. The Agency's reliance on *Lincoln v. Vigil*, 508 U.S. 182 (1993), for the proposition that budgeting and enforcement priorities set by the agencies are not subject to notice and comment rulemaking is thus misplaced. NCUA Legal Analysis, at 7. *Lincoln* involved an agency's "decisions to expend otherwise unrestricted funds," 508 U.S. at 198, but the question here is a different one of who is required to bear the cost for the budget priorities the Agency sets.

Because the NCUA's action directly affects third parties it is, by definition, not an internal rule of Agency management, organization, or practice. *See, e.g.*, *Batterton v. Marshall*, 648 F.2d 694, 700 (D.C. Cir. 1980) (regulation that interferes with "substantial private rights and interests"); *Pickus v U.S. Board of Parole*, 507 F.2d 1107,113 (D.C. Cir. 1974) (D.C. Cir. 1974) (exemption for rules relating to agency procedure and practice "should not be deemed to include any action which goes beyond formality and substantially affects the rights of those over whom the agency exercises authority."). The OTR methodology and determination interfere with the substantial rights and interests of state-chartered credit unions because state-chartered credit unions are forced to bear the significant costs imposed by the Agency's classification and allocation of its budgeted resources. The effects on state-charted credit unions are substantial enough to implicate the policy interests that underpin the requirement for notice and comment rulemaking. *Elec. Privacy Info. Ctr.*, 653 F.3d at 6-7 (D.C. Cir. 2011).

For the above reasons, the NCUA's request for comment on its OTR methodology and determinations is not properly construed as a "voluntary" action or a matter of grace. Full notice and comment are required by the APA and the NCUA must comply fully with its requirements.

B. <u>The Proposed OTR Determinations Would Not Survive Judicial Review</u>

The Request for Comment acknowledges that even where an agency action is not subject to notice and comment procedures, if it is final agency action for which there is no other adequate remedy in a court, it is subject to judicial review. *See* Request for Comment, at 7 n.7, citing 5 U.S.C. §§ 704, 706. These provisions of the APA authorize a reviewing court to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," or action that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right . . . ." 5 U.S.C. § 706(2)(C)-(D). "[A]gencies are required to engage in "reasoned decision making." A*llentown Mack Sales & Service, Inc. v. NLRB*, 522 U. S. 359, 374 (1998). "Not only must an agency's decreed result be within the scope of its lawful authority, but the process by which it reaches that result must be logical and rational." *Id*.

The allocation methodology set forth in the Request for Comment, and the determination to dramatically increase the allocation of costs to state-chartered credit unions pursuant to the OTR, do not meet these required standards. The OTR methodology and determination are contrary to law because they attempt to assess, as insurance-related expenses recoverable from the Title II insurance funds, expenses that are not insurance-related, and expenses incurred in connection with the supervisory responsibilities of the Agency over federal credit unions under Title I, and because they discriminate against state-chartered credit unions. They are also arbitrary and capricious because they are not based on a rational allocation methodology and do not accurately implement the methodology they purport to adopt. As a result, they are invalid and would be set aside by a reviewing court.

1. The Proposed Methodology and Allocation are Contrary to Law

The Request for Comment proceeds on the assumption that the NCUA is subject to virtually no legal constraint in its adoption of an allocation methodology and in its allocation of insurance-related costs to the Fund. The Request for Comment reaches this conclusion by asserting that only a few provisions of the Act are relevant to the issue, and that these provisions do not meaningfully constrain NCUA's discretion. *See* Request for Comment at 4806. This position misconstrues the significance of the provisions on which it relies, and ignores both the non-discrimination provision in the statute and the history, structure and purpose of the FCUA as a whole.

An agency assessing the meaning of a statute must "exhaust the traditional tools of statutory construction," *Natural Resources Defense Council, Inc. v. Browner*, 57 F.3d 1122, 1125 (D.C.Cir.1995), including the "particular statutory language at issue, as well as the language and design of the statute as a whole." *K Mart Corp. v. Cartier, Inc.,* 486 U.S. 281, 291 (1988). As the Supreme Court stated in *FDA v. Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 133 (2000),

> it is a "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Michigan Dept. of Treasury*, 489 U. S. 803, 809 (1989). A court must therefore interpret the statute "as a symmetrical and coherent regulatory scheme," *Gustafson v. Alloyd Co*., 513 U. S. 561, 569 (1995), and "fit, if possible, all parts into an harmonious whole," *FTC v. Mandel Brothers, Inc*., 359 U. S. 385, 389 (1959).

In ascertaining Congressional intent, an agency, like a reviewing court, "should not confine itself to examining a particular statutory provision in isolation." *Id.* at 132. Here, the Request for Comment, in assuming away any meaningful statutory limitation on its allocation of costs, ignores these principles.

2. The OTR Methodology and Determination Improperly Imposes Costs of Title I Regulation and Supervision of Federal Credit Unions onto the NCUSIF and, by Extension, State-chartered Credit Unions

From 1934 to 1970 the Act provided for the regulation of federal credit unions, and did not include an insurance function. The Agency's supervisory powers over federal credit unions included, and still include, the power to require financial reports from each federal credit union at least annually, and to examine them and inspect their books and records. Federal credit unions were required under Section 105 of the Act to pay supervisory fees on a graduated scale in order to "defray [administrative, supervisory, and other expenses incurred by the Agency in carrying out the Act] as far as possible." *See* H. Rep. No. 91-1457, Federal Share Insurance for Credit Unions, at 26 (setting out Section 105 as it appeared as Section 6 of the original Act in 1970). Federal credit unions were also required to pay examination fees set by the Agency "giving due consideration to the time and expense incident to such examinations, and to the ability of federal credit unions to pay such fees." *Id.* (setting out section 106 as it appeared as Section 7 of the original Act in 1970).

The 1970 legislation designated the then-existing Act as Title I and added a new Title II to establish the credit union share insurance program. *See* Cong. Rec. H9562 (daily ed. Oct. 5, 1970). Title II expressly recognized that the new insurance program was not being created in a vacuum, but rather was building on the existing Act, under which much or all of the supervisory and examination work relevant to the insurance program was already being done as part of the NCUA's pre-existing supervisory duties. The new legislation thus provided, and the Act still provides, that "[r]eports required under Title I of this Act shall be so prepared that they can be used for share insurance purposes." Section 202(a)(5) of the Act, codified at 12 U.S.C. § 1782 (a)(5). The Act likewise provided, and still provides, that reports of state-chartered credit unions to their regulators should also be used for insurance purposes to the "maximum extent feasible." *Id.*

The matter was, if anything, even clearer in the bill as introduced, which provided that each existing federal credit union would automatically be issued a certificate of insurance within three months of the enactment of the bill, with a provisional certification process for federal credit unions with impaired capital, and that examinations of insured credit unions and applicants for insurance "shall utilize examinations of Federal credit unions conducted by the [NCUA] in accordance with section 7 [now Section 106] of the [Act]." *See* Sections 202(a) and 206(b) of H.R. 18870, reprinted in To Provide Insurance for Accounts in State and Federally Chartered Credit Unions, Hearings before the House Banking and Currency Comm. ("Hearing"), at 2, 5 (1970). These provisions recognized that the existing oversight and examination of federal credit unions was sufficient to allow them to be insured, and the NCUA expressed no concern over these provisions as applied to credit unions without capital impairment. *See* Hearing, at 12-15, 20-21. The move to the present language requiring federal credit unions to apply was not the result of any conclusion that the existing supervision and examination was inadequate to support insurance, but rather a concern that requiring state but not federal credit unions to apply might be viewed as discriminatory. *See* Hearings, at 66 (statement of the President of the National Association of Federal Credit Unions "rais[ing] the question whether this might constitute discrimination in favor of federal credit unions."). The provision was moved to Section 202(a)(5), where it remains now, so that it requires the use of Title I reports for "insurance purposes" generally and not just with respect to examinations.

The 1970 legislation also added Section 203(a) of the Act, which has remained unchanged since and is codified at 12 U.S.C. § 1783(a). That section created the NCUSIF to be used for "making payments of insurance," "providing assistance and making expenditures . . . in connection with the liquidation or threatened liquidation of insured credit unions," and "for such administrative and other expenses incurred in carrying out the purposes of this title as it may determine to be proper." This provision thus does not allow the Fund to be charged for *any* expenses incurred in carrying out Title I, but *only* those that are newly required with respect to Title II, to which the provision is expressly limited.

In addition to its plain words, this conclusion is also consistent with the placement of this administrative expenses provision as secondary to the insurance and liquidation purposes of the Fund, and the fact that it was not the subject of significant discussion when enacted. *See, e.g.*, Hearings at 23 (statement of NCUA Acting Administrator that the primary purpose of the Fund is to protect credit unions members from loss in the case of insolvency of the credit union). Nothing in the legislative history suggests that this provision was ever intended to be used as a vehicle to allow the Agency to shift large portions of regulatory and supervisory costs from FCUs under Title I, where they had resided at the time the provision was enacted, onto the Fund so that they could be imposed on FISCUs. *See, e.g., Whitman v. American Trucking Associations*, 531 US 457, 468 (2001) ("Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouse holes."). The NCUA's effort to use this innocuous and secondary provision to justify an ongoing effort to transfer tens of millions in costs from FCUs to FISCUs is just such an attempt to push an elephant through a mouse hole.

Because the OTR methodology and determination purports to charge the Fund for safety and soundness regulation and other activities that it is authorized to undertake under Title I, and thus to try to push nearly 90 percent of its operating budget into the Title II category, it is contrary to law. This is further demonstrated by the hypothetical set out in the SLS Analysis. Under the current OTR methodology $257.29 million of a total operating budget of $290.92 million are deemed insurance-related costs. This means that if the NCUA did not have any insurance-related function it would need only $35.19 million to fulfill its obligations to regulate, charter and supervise all FCUs. As the SLS Analysis points out, that figure is entirely implausible given the regulatory complexities of current financial institution regulation. *See* Request for Comment at 4808 (noting that "credit unions have become larger and more complex").

3. The Request Violates the Statutory Prohibition on Discrimination Against State-Chartered Credit Unions

The FCUA, as amended in 1970 to add the share insurance function, imposes a separate legal requirement not to "discriminate in any manner against State-chartered credit unions and in favor of Federal credit unions." 12 U.S.C. § 1790. Instead, the purpose of Title II is "to provide all credit unions with the same opportunity to obtain and enjoy the benefits" of the Title. The provision recognizes the value of the dual chartering system, which ensures that credit unions have a choice between federal or state chartering, that they can change their charter from federal to state or vice versa, and that the insurance provisions should not be applied to interfere with that process by discriminating against FISCUs.

The legislative history does not explain why the provision is directed specifically at discrimination against state-chartered credit unions, as opposed to discrimination against either type of charter. But a fair inference is that Congress was aware of and sensitive to the inherent conflict of interest that NCUA would face acting as both the administrator of the NCUSIF and the regulator with chartering and general supervisory responsibility for FCUs. It is further reasonable to infer the concern that the Agency would be inclined to discriminate in favor of federal credit unions, with which it has had the longer and closer relationship, and against state-chartered credit unions. The need for an express direction not to discriminate against state-chartered credit unions makes sense in this context.

The Request for Comment overlooks the nondiscrimination provision entirely in erroneously stating that "only two statutory provisions limit the Board's discretion with respect to [Fund] requisitions," citing the requirement of 12 U.S.C. § 1783(a) that Fund requisitions carry out the purposes of the share insurance program under Title II, and the requirement of 12 U.S.C. § 1766(j)(3) that some of the Agency's operating budget must be funded by Operating Fees on FCUs. Request for Comment, at 4804.[4] This is an important omission. The NCUA is required by the express command of 12 U.S.C. § 1790 to administer the Fund, including the allocation of expenses to the Fund, so as not to discriminate against state-chartered credit unions.

The Request for Comment is thus also in error when it states that the NCUA's use of a cost accounting methodology that "by design is both neutral and equitable with respect to credit union charter types" is a matter of "current Board policy" but not a "legal requirement." *Id*. A neutral and equitable allocation method is expressly required by the statutory non-discrimination provision. Indeed, the NCUA's suggestion that being "neutral and equitable" is merely a matter of "current" policy, and that the Agency is free as a legal matter to adopt a non-neutral and inequitable policy is revealing, and underscores Congress' wisdom in including a statutory non-discrimination provision.

The non-discrimination provision also constrains the NCUA's discretion under other provisions of the Act. For example, as noted above, at the time the insurance fund was established in 1970, the Act contained a provision requiring FCUs to pay operating fees that defrayed "as far as possible" administrative, supervisory, and other expenses incurred in carrying out the functions now in Title I, along with a provision requiring them to pay examination fees. *See* H. Rep. 91-1457, at 26. Those provisions were combined and reorganized in 1988 to the current form of 12 U.S.C. § 1755. The current provision requires fees to be set giving "due consideration to the expenses of the Administration in carrying out its responsibilities under [the Act] and to the ability of Federal credit unions to pay the fee." *Id.* at § 1755(b). It also provides that the fees be used "to defray the expenses incurred in carrying out the provisions of [the Act] including the examination and supervision of Federal credit unions," but eliminates the express

[4] The Request for Comment, also provides an "*accord*" cite to 12 U.S.C. § 1755(a), which requires federal credit unions to pay an annual operating fee "composed of one or more charges identified as to the function or functions for which assessed." *Id.* at 4 n.5. This is apparently intended to convey the implausible contention that as long as the federal credit unions pay at least some operating fee, this provision does not otherwise limit the agency's discretion as to the level of the fee. The history of this provision is set out at p. 11, *supra* and pp. 14-15 *infra.*

requirement that the fee defray administrative and supervisory expenses "as far as possible," and merely states that the fee "may be composed of one or more charges identified as to the function or functions for which assessed." *Id* § 1755(a), (b). It is not clear from the legislative history whether this revision was intended to have significant substantive effect. Even if it were intended to give the Agency additional discretion in setting federal operating fees, however, under the non-discrimination provision the NCUA cannot exercise that discretion if the result would be to discriminate against state-chartered credit unions.[5]

The expansive definition of "insurance-related" costs - which now cover virtually all federal regulatory and supervisory expenses - does in fact have a discriminatory effect on FISCUs. Because FISCUs cannot charge the regulatory and supervisory expenses incurred by state regulators to the Fund, allowing FCUs to do so provides them a benefit that is not provided to state-chartered credit unions, and thus is discriminatory against state-chartered credit unions in violation of 12 U.S.C. § 1790. The non-discrimination provision, consistent with the text, history, and structure of the Act as a whole, requires that the Fund be charged only for those insurance-related expenses that do not overlap with regulatory and supervisory expenses the Agency would otherwise be incurring with respect to FCUs. The Agency's current practice of classifying all safety and soundness related costs as *exclusively* "insurance-related" costs and the related practice of transferring all expenses it determines to be insurance-related to the Fund is thus contrary to law.

The costing and economic study performed by SLS Consulting also confirms that even accepting the NCUA's overly expansive and subjective classification of insurance-related costs, the current OTR methodology and determination discriminates against FISCUs. The costing and economic analysis shows that at least 69 percent of the time that the Agency spends on activities it classifies as insurance-related are spent with FCUs. *See* SLS Analysis at 13. Yet, FCUs pay only 52 percent of the total costs assessed against the Fund for insurance-related costs. *See id*. In contrast, less than 31 percent of the Agency's time on insurance-related matters is spent with FISCUs, yet FISCUs pay 48 percent of the total costs assessed against the Fund. *See id*. This

[5] 12 U.S.C. § 1766(j)(3), which requires that "salaries and expenses" of the Board and its employees are to be paid from fees and assessments on insured credit unions, was added in 1978 as part of an effort, which also applied to the Office of Comptroller of the Currency, to allow flexibility in the hiring of financial regulatory personnel, including as to salary levels. *See* Pub. L. 101-73 §§ 1203-04, 103 Stat. 520. There is no indication in either the text of the provision or its legislative history that Congress sought to authorize any kind of disparity or inequity by charter type in funding such salaries and expenses, or to authorize the Agency to impose costs on state-chartered credit unions that are in fact attributable to federal credit unions.

disproportionately higher share of payments by FISCUs, based on cost-allocation rules that deviate from normal cost accounting practices because they bear no relationship to the asserted insurance-related costs imposed by FCUs and FISCUs, is neither neutral nor equitable. The current OTR methodology and determination discriminate against FISCUs in violation of 12 U.S.C. § 1790.

As shown more fully below, this discriminatory result flows from many subjective, arbitrary, and flawed determinations, nearly all of which result in an over-recovery from state-chartered credit unions and a corresponding under-recovery from federal credit unions. The result is thus arbitrary and capricious as well as contrary to law.

C. The Proposed Methodology and Allocation are Arbitrary and Capricious

An agency decision is arbitrary and capricious "if the agency . . . entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). The agency must "examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made." *Id*. *See American Mining Congress v. EPA*, 907 F.2d 1179 (D.C. Cir. 1990) (agency's rule invalidated where it failed to articulate a rational connection between the data on which it relied and its decision). To assure this was done, any court reviewing the agency's actions must make a "searching and careful inquiry" into the facts. *Am. Trucking Ass'n v. EPA*, 283 F.3d 355, 362 (D.C. Cir. 2002).

The proposal in the Request for Comments does not meet these requirements. First, as set out in the SLS costing and economic study, the OTR methodology fails to consider what proportion of the total insurance-related costs to be covered by funds transferred from the Fund are traceable to FCUs as opposed to FISCUs. *See* SLS Analysis, at 12-13. The Agency thus fails to deal in any way with the inequitable result that FISCUs are charged disproportionately for the costs for which they are actually responsible.

By ignoring the cost incidence by charter type, the methodology abandons any appropriate cost-based or cost-reflective system of pricing. Instead, as the SLS costing and economic study shows, the "price" charged each charter type is based on the relative proportion of insured shares. *See* SLS Analysis, at 12. The Agency fails to articulate a reasonable explanation for equating insured shares with incurred costs, or to show a rational connection between insured shares and cost incidence, particularly when the evidence before the Agency shows that the actual cost incidence is far different from the result the Agency posits using insured shares. As the SLS costing and economic study concludes, the "misalignment between the incidence of the cost and the prices charged for those costs violates plain cost accounting rules and basic notions of fairness and equity." SLS Analysis, at 13.

An "agency action is lawful only if it rests 'on a consideration of the relevant factors.'" *Michigan v. EPA*, 576 U.S.___, 135 S. Ct. 2699, 2706 (2015) (quoting *Allentown Mack Sales & Serv.*, 522 U.S. at 374, *State Farm*, 463 U.S. at 43. As noted above, the agency in this case entirely ignored cost incidence by charter type, as well as the actual costs of regulating and chartering federal credit unions. As noted above, this principle, also known as "cost causation," is a fundamental principle of agency decisions to set rates or charges that allocate costs among regulated entities. *See, e.g., K N Energy, Inc.*, 968 F.2d 1295, 1300 (principle requires that rates must "reflect to some degree the costs actually caused by the customer who must pay them.").

The Agency collects specific data on insurance-related workload hours by charter type, and thus has the information necessary to make the cost causation determination, as again shown by the economic study submitted with these comments. The Agency's failure to consider this factor further renders its proposal arbitrary and capricious.

Second, the arbitrary nature of the current OTR methodology and determination is further demonstrated by their fundamental dependence on the subjective classification of activities as insurance or non-insurance-related, and the lack of any explanation or understanding as to how certain activities ought to be classified and as to the Agency's decisional criteria in making its assignments. *See* SLS Analysis, at 16, citing a 2011 PricewaterhouseCoopers report at 5, 26. The SLS costing and economic study shows that there are in fact a number of errors in the classification and cost-allocation decisions even if the overall logic of the classifications is assumed. For example, certain centralized expenses in the category of "All Other Offices" are simply allocated on the same basis as regional offices even though they are applicable to the entire Agency and not just those offices. *Id.* at 17. The study identifies several other allocations that are suspect on their face and wholly unexplained. *Id.* at19-21; s*ee also Lakeland Bus Lines v. NLRB*, 347 F.3d 955, 962 (D.C. Cir. 2003) (agency cannot look only to evidence that supports its conclusion without considering evidence contrary to its result and must base its decision on the "whole record" before the agency) (quoting *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 487-88 (1951)).

The NCUA's cumbersome effort in the Request for Comment to catalogue how various functions have been classified as insurance or non-insurance-related gives a false appearance of rigor but misses the ultimate point. The detail on process does nothing to cure the fact that the classification determinations that serve as the critical input to the current OTR methodology are opaque, highly-subjective, and premised on the implausible assumption that any activity that has even a remote nexus to safety and soundness ought to be classified as exclusively insurance-related. The detailed accounting also cannot overcome the fact that the classification scheme is independent of the allocation of burden by charter type which, as the SLS costing and economic analysis points out, has nothing to do with the fair allocation of the actual costs incurred by the NCUA.

III. Conclusion

Because the OTR methodology and determination are highly inequitable, improperly charge the NCUSIF with regulatory and examination expenses of federal credit unions, and impermissibly discriminate against FISCUs, they are arbitrary and capricious and contrary to law. BECU respectfully urges that NCUA: (1) develop an alternative OTR methodology, including the underlying assumptions regarding the definition of insurance-related activities and related cost-allocation rules, through a formal notice and comment procedure, (2) ensure that any alternative OTR methodology is redesigned to collect revenues by charter type proportionate with the insurance-related costs that they impose on the system, and (3) ensure that any alternative OTR methodology complies with the statutory non-discrimination provisions by eliminating all but routine administrative costs from the OTR.

These actions are necessary to ensure that the OTR methodology and the underlying processes are open and transparent, and that any alternative OTR methodology is equitable and fully complies with the requirements of the FCUA. An equitable and fair OTR methodology is necessary to ensure the continued vitality of the dual chartering system.

Until such a methodology can be developed, BECU respectfully submits that NCUA should immediately adopt, consistent with the legal requirements governing the agency, a provisional OTR of at most 55.8 percent. As discussed in the SLS accounting and economic analysis, a 55.8 percent OTR corrects readily-identifiable cost-allocation flaws and makes adjustments to the costs to be absorbed by the NCUISF through the OTR by more closely aligning the NCUSIF costs borne by FCUs and FISCUs with the incidence of the cost by charter-type.[6]

Thank you for your consideration of these comments.

Sincerely,

Parker T. Cann
Senior Vice President and General Counsel
Boeing Employees' Credit Union

[6] *See* SLS Analysis at 12-15. Showing that under an alternative OTR methodology that corrects select cost-allocation errors and that collects revenues by charter type proportionate with the insurance-related costs, the costs to be absorbed by the NCUSIF through the OTR total $162.28 million which represents 55.8 percent of the NCUA Operating Budget. This compares to $212.78 million, which represents 73.1 percent, under the NCUA's current OTR methodology. Of the $162.28 million of costs to be absorbed by the NCUSIF through the OTR, $49.98 million should be recovered from FISCUs, and the remaining $112.40 million should be recovered from FCUs. Because the portion of the NCUA Operating Budget covered by FCU Operating Fees is derivative of the OTR calculation, a decrease in the OTR would result in a corresponding increase the portion of the Operating Budget covered by FCU Operating Fees.

ANALYSIS OF THE NATIONAL CREDIT UNION ADMINISTRATION'S OVERHEAD TRANSFER RATE METHODOLOGY

Prepared by: Lawrence G. Buc, President, SLS Consulting, Inc.

Prepared for: BECU

Date: April 26, 2016

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Qualifications

My name is Lawrence G. Buc. I am the President and co-founder of SLS Consulting, Inc. (SLS), a consulting firm in Washington, D.C. focusing on price and cost analysis. For over 40 years of my professional career, I have specialized in multiple aspects of budget development and analysis as well as costing, pricing, and economic analyses spanning a wide variety of contexts across numerous industries and types of organizations, including federal government agencies, non-profits, and the private sector.

I was awarded an MA in Economics from the George Washington University of America in 1978. I also was awarded an AB in Mathematics and Economics (with Honors) from Brown University in 1968.

A detailed biographic narrative appears in Attachment 1.

Assignment

I was engaged by BECU to evaluate the National Credit Union Administration's (NCUA) Overhead Transfer Rate (OTR) methodology[1] and to prepare a report that assesses that methodology and recommends improvements to it.

[1] As described in the Request for Comment Regarding the Overhead Transfer Rate Methodology published in the Federal Register on January 27, 2016 (Request).

Summary of Findings

At a high level of generality, the OTR is fundamentally a pricing methodology for recovering part of the NCUA's operating costs. NCUA acts as both the regulator of federally charted credit unions (FCUs) and administrator of the National Credit Union Share Insurance Fund (NCUSIF). The NCUSIF insures the deposits of both FCUs and federally insured state chartered credit unions (FISCUs). Of the $935 billion in insured shares, FCUs have 52.3 percent of the insured shares and FISCUs have 47.7 percent of the insured shares. (Request at 57).

The costs determined by NCUA to be related to the regulation and chartering of FCUs are collected through direct assessments (Operating Fees) on FCUs. The OTR serves as the mechanism by which NCUA transfers from the NCUSIF the funds necessary to cover specific costs determined by the NCUA to be "insurance-related."

The stated policy of the NCUA is to develop an OTR "cost-accounting methodology that by design is both neutral and equitable with respect to credit union charter types." (Request at 5). My assessment is that the OTR methodology fails to achieve this stated goal.

The initial step in the current OTR methodology is the disaggregation of NCUA's total costs into costs NCUA determines to be insurance and non-insurance related based on the accounting costs of performing those activities.[2] This allows the NCUA to identify what it deems to be the total insurance-related costs to be covered by funds

[2] An obvious concern in assessing the OTR methodology is that the integrity of the methodology is fundamentally dependent on the NCUA's classification of costs as insurance-related or non-insurance related. For purposes of this analysis I have accepted the aggregated cost totals that are dependent on NCUA's classification of costs with the exception of several discrete areas where I suggest refinements because the classification is internally inconsistent or obviously wrong.

transferred from the NCUSIF. The OTR methodology does not, however, attempt to separate the total insurance-related costs traceable to FCUs and the total insurance-related costs traceable to FISCUs. As a consequence, the OTR methodology ignores the cost incidence by charter type and, thus, abandons what would be an appropriate cost-based or cost-reflective system of pricing. That is because the "prices" charged to FCUs and FISCUs via the transfer from the NCUSIF do not reflect the revenues necessary to fund the costs of insurance-related work by charter type. Rather, the "price" charged FCUs and FISCUs is based on the relative share of FCU and FISCU assets in the NCUSIF. The misalignment between the incidence of the cost and the prices charged for those costs violates plain cost accounting rules and basic notions of fairness and equity.

Even assuming NCUA's assignment of insurance-related costs is correct, an OTR methodology that "charged" each charter type based on the costs incurred for the work performed would recover *at least* 69.2 percent of the OTR amount from FCUs and *at most* 30.8 percent of the OTR amount from FISCUs. A fair and equitable OTR methodology would allocate insurance-related costs by charter type in proportion to the costs incurred by charter type. The same distribution key - pro rata allocation among individual credit unions based on insured shares - could be applied separately to FCUs and FISCUs. This could be accomplished through an accounting device without any changes to the structure of the Fund itself.

Further, as noted in the PricewaterhouseCoopers report, the entire OTR methodology is "fundamentally dependent"[3] on NCUA's subjective classification of activities as insurance or non-insurance related. A wholesale re-examination of those classification and cost allocation decisions is beyond the scope of this report. *See* n.2

[3] PWC Report at 26.

supra. Nevertheless, as explained later in my report, there are several apparent errors in the cost allocations that result in an under-collection from FCUs for non-insurance expenses and a corresponding over-collection from FISCUs. These errors can and should be immediately corrected.

While cost accounting provides one way of viewing costs, economics provides another perspective. And for some purposes, economics provides the superior lens because economic costs are grounded in causality. Economic costs can be used to test whether the revenues from products or services (or charter types) are equal to or greater than the costs of providing the work. If the revenues collected from a given product or service in a multiproduct firm are not covering the incremental cost of providing that product or service the product or service may be being subsidized. Selling products or services below costs is disfavored from an economics and public policy perspective because of the distortionary effect on the market. From an economics perspective, the question is whether the NCUA is providing its non-insurance examination and supervisory services for FCUs below cost and, if so, whether that results in a cross-subsidy from FISCUs in the form of a higher OTR than would otherwise be justified. This type of cross subsidy would have a distortionary effect on the credit union market place. The larger the OTR, the less NCUA needs to charge FCUs for its operating expenses. Artificially reducing FCU examination fees creates an unfair competitive advantage for FCUs relative to FISCUs, thus, impairing the future viability of the dual chartering system.

Finally, a thought experiment isolating the decremental costs of NCUA's regulatory, chartering, and supervisory responsibilities for FCUs highlights the implausibility of NCUA's current practice of classifying all safety and soundness costs as exclusively insurance-related costs.

Discussion

A. <u>The Current OTR Methodology is Not Neutral or Equitable as to Charter Type Because the Relative Burden Imposed on FISCUs and FCUs does Not Reflect the Insurance-Related Costs Imposed by Charter Type</u>

The OTR methodology reflects both (1) the costs NCUA determines to be insurance-related, and (2) the relative burden of those insurance-related costs imposed on FCUs and FISCUs. Both aspects of the current methodology are deficient. As discussed below, there are fundamental problems with the methodology and obvious flaws with many of the cost allocation assumptions. But even accepting the current OTR determination for purposes of discussion, the current OTR methodology must also be rejected because it fails to align the implicit "price" of the insurance-related work with the cost of providing it by charter type. Rather, total insurance-related costs are apportioned based on insured shares by charter type. Accordingly, FCUs bear 52.3 percent of the burden and FISCUs bear 47.7 percent of the costs of the OTR (*see* TABLE 11). As a result the current OTR methodology is not fair or equitable; FISCUs are disproportionately burdened.

TABLE 5 – ALLOCATION OF BUDGETED PROGRAM HOURS, is reproduced from the Request below. This table shows the allocation of FY 2016 budgeted work hours for both Core and Special Programs that NCUA has determined should be classified as non-insurance related activities. The table also shows the allocation basis.

TABLE 5 - ALLOCATION OF BUDGETED PROGRAM HOURS

	2016 budgeted workload hours	Non-insurance percent	Non-insurance hours	Allocation basis
Core Programs	**728,556**	**na**	**70,691**	**Sum of Core Programs**
Federal Examination	454,115	13.2%	59,807	Examiner time survey
Fed Supervision	53,687	12.8%	6,867	Examiner time survey
State Exam & Supervision	175,722	0.0%	-	FISCU is insurance-related
State Exam Review	5,321	0.0%	-	FISCU is insurance-related
5300 Program - FCU	30,503	13.2%	4,017	Examiner time survey
5300 Programs - FISCU	9,208	0.0%	-	FISCU is insurance-related
Special Programs	**35,637**	**na**	**2,607**	**Sum of Special Programs**
Regional Lending	4,190	13.2%	552	Examiner time survey
Regional Capital	4,130	0.0%	-	NCUSIF risk management program
Regional IT	3,320	13.2%	437	Examiner time survey
Field Membership and Chartering	500	100.0%	500	Regulatory program
Small Credit Unions	18,633	6.0%	1,118	OSCUI's time reporting results
CUSO Exams	4,864	0.0%	-	NCUSIF risk management program
Total Core & Special Programs	**764,193**	**na**	**73,298**	

The budgeted workhours shown in TABLE 5 can be further disaggregated by charter type and for activities classified as both insurance-related and non-insurance related. For the “Core Programs” TABLE 5 shows which programs are FCU-related (Federal Examination, Federal Supervision, and 5300 Program-FCU) and which are FISCU-related (State Exam & Supervision, State Exam Review, and 5300 Program – FISCU.) For the “Special Programs” according to the Request, Regional Lending, Regional Capital, and Regional IT “perform focused reviews” on FCUs. (Request at 39.) Where there was insufficient information to disaggregate the budgeted workhours by charter type (e.g., Small Credit Unions and CUSO Exams), I conservatively assumed that all time should be allocated to FISCUs.[4]

[4] If this assumption is incorrect, NCUA should provide additional data or make the appropriate correction.

TABLE 5 - REALLOCATED TO FCU, FISCU, AND NON-INSURANCE PROGRAM HOURS				
	FCU	FISCU	Non-insurance hours	Total
Core Programs	**467,614**	**190,251**	**70,691**	**728,556**
Federal Examination	394,308		59,807	454,115
Fed Supervision	46,820		6,867	53,687
State Exam & Supervision		175,722	-	175,722
State Exam Review		5,321	-	5,321
5300 Program - FCU	26,486		4,017	30,503
5300 Progrmas - FISCU		9,208	-	9,208
Special Programs	**10,651**	**22,379**	**2,607**	**35,637**
Regional Lending	3,638		552	4,190
Regional Capital	4,130			4,130
Regional IT	2,883		437	3,320
Field Membership and Chartering			500	500
Small Credit Unions		17515	1,118	18,633
CUSO Exams		4,864		4,864
Total Core & Special Programs	**478,265**	**212,630**	**73,298**	**764,193**
Percent	**62.6%**	**27.8%**	**9.6%**	

The disaggregated workhours can be used to calculate the estimated workhours by charter type for all work classified as insurance-related. This can be accomplished by summing total workhours by charter type across all Core and Special Programs. The total insurance-related workhours by charter type are reflected in the following table.

SLS TABLE 1 - NCUA INSURANCE-RELATED WORK DISTRIBUTION		
	Hours	**Percent**
FCU	478,265	69.2%
FISCU	212,630	30.8%
TOTAL	690,895	

As SLS TABLE 1 shows, 69.2 percent of the time NCUA spends on activities it classifies as insurance-related is time spent on FCUs. Similarly, the table shows that 30.8 percent of the time NCUA spends on activities it classifies as insurance-related are time spent on FISCUs. This allocation of work effort is presumably well thought out, rational, and risk-based. It is a reflection of NCUA's reasoned decision as to how its resources should be spent to satisfy its duties as the administrator of the NCUSIF.

Despite the stated goal of creating an OTR methodology that is neutral as to charter type, and despite the fact that the information is readily available, the current OTR methodology completely ignores the cost incidence by charter type in allocating the OTR burden among FCUs and FISCUs. As a consequence, the "prices" charged to FCUs and FISCUs via the transfer from the NCUSIF do not reflect the revenues necessary to fund the costs of insurance-related work by charter type.

Rather than adopt a cost-based or cost-reflective OTR methodology, NCUA states that it "considers that the most fair and appropriate basis to allocate the cost of providing NCUSIF insurance between FCUs and FISCUs is the distribution of insured shares." (Request at 56). Yet, NCUA never explains how insured shares tie back to the costs incurred on FCUs and FISCUs; consequently, costs and prices are not aligned with respect to credit union charter types. Although a pro rata allocation based on insured shares could be facially neutral in theory, as applied, it is prejudicial to FISCUs. NCUA incurs more costs on insurance-related work for FCUs than is covered by the revenue transferred from FCUs (via the NCUSIF) under the current OTR methodology. NCUA incurs fewer costs on insurance-related work for FISCUs than it collects in revenue transferred from FISCUs (via the NCUSIF) under the current OTR methodology. As a result, FISCUs are paying a disproportionate share under the current OTR methodology, a result that is neither neutral nor equitable.

Specifically, as shown by the allocation of budgeted program hours, even assuming NCUA's assignment of insurance-related costs is correct, *at least* 69.2 percent of those costs are spent on activities pertaining to insuring FCUs. Yet the FCUs "pay" for only 52.3 percent of the total revenue transferred from the NCUSIF via the OTR methodology. In contrast, *at most* 30.8 percent of the insurance-related costs are spent on activities pertaining to the FISCUs, yet the FISCUs "pay" for 47.7 percent of the total insurance-related costs under the current OTR methodology. The misalignment between the incidence of the cost and the prices charged for those costs violates plain cost accounting rules and basic notions of fairness and equity.

Allocating the insurance-related costs on the basis of the respective proportions of insured shares of FCUs and FISCUs might be justified if NCUA could not identify insurance-related costs by charter type. But NCUA can disaggregate these costs by charter type. In fact, it has already done so. As shown in TABLE 5 Allocation, NCUA collects specific data on insurance-related workload hours by charter type. NCUA projects that in 2016 it will spend at least 478,265 insurance-related work hours for FCUs, and at most 212,630 insurance-related work hours at FISCUs. Thus, even assuming NCUA's assignment of insurance-related costs is correct; an OTR methodology that "charged" each charter type based on the costs incurred for the work performed would recover at least 69.2 percent of the OTR amount from FCUs and at most 30.8 percent of the OTR amount from FISCUs. Because the current methodology for the OTR does not align the implicit price of the work with the cost of providing it FISCUs pay a disproportionate share of the burden.

Allocating the insurance-related costs based on the incidence of the cost as measured by the budgeted work hours for FCUs and FISCUs rather than their insured shares is consistent with cost accounting principles and is a fair and equitable solution.

The OTR methodology should be redesigned to collect revenues by charter type proportionate with the insurance-related costs that they impose on the system. As shown in the following calculations, this can be accomplished by substituting corrected values under the existing methodology.[5] Specifically, I have reproduced and then recalculated TABLES 11, 12, 13, and 14 from the Request with the corrected values. TABLE 11, as reproduced from the Request, shows the allocation of the total insurance-related costs based on insured shares.

TABLE 11 - ALLOCATION OF TOTAL COSTS OF PROVIDING NCUSIF INSURANCE

	FCUs	FISCUs
Total Cost of Providing NCUSIF Insurance (millions)	$297.89	
Proportion of insured shares	52.3%	47.7%
Alloacated total insurance costs (millions)	$155.80	$142.09

TABLE 11 CORRECTED, below, shows the allocation of the total insurance-related costs based on the costs of the work that each charter type imposed (as shown in SLS TABLE 1, above).

TABLE 11 CORRECTED - ALLOCATION OF TOTAL COSTS OF PROVIDING NCUSIF INSURANCE

	FCUs	FISCUs
Total Cost of Providing NCUSIF Insurance (millions)	$294.10	
Proportion of insured shares	69.2%	30.8%
Alloacated total insurance costs (millions)	$203.52	$90.58

Under the NCUA's current OTR methodology, which allocates NCUSIF costs to charter type based on insured shares, the allocated total insurance cost for FISCUs is $142.09 million (TABLE 11). Under an alternative methodology that collects revenues by charter type proportionate with the insurance-related costs that they impose on the system, the allocated total insurance cost for FISCUs is $90.58 million (TABLE 11 CORRECTED).

[5] The recalculated amounts presented here assume the correction to the All Other Offices allocation discussed below and shown in corrected TABLES 6 and 9. The other allocation issues discussed below are not included because it is not possible to quantify them accurately with the information available.

TABLE 12, as reproduced from the Request, shows the net insurance-related cost on FISCUs (FISCU portion of total insurance-related costs (based on insured shares) less the offset for the imputed value of the state supervisory authority (SSA) work).

TABLE 12 - NET COST OF NCUSIF INSURANCE FOR FISCUs (MILLIONS)

FISCU Portion of Total Insurance Costs	$142.09	TABLE 11
SSA Imputed Value	-$40.60	Table 32
Net Cost	$101.49	

TABLE 12 CORRECTED, below, corrects the amount of the FISCU portion of the total insurance costs, a reduction from $142.09 million to $90.58 million per the correction in TABLE 11. TABLE 12 CORRECTED then produces the corrected cost of the FISCU portion of those Insurance costs. The SSA imputed value remains unchanged at $40.60 million.

TABLE 12 CORRECTED - NET COST OF NCUSIF INSURANCE FOR FISCUs (MILLIONS)

FISCU Portion of Total Insurance Costs	$90.58	TABLE 11 CORRECTED
SSA Imputed Value	-$40.60	
Net Cost	$49.98	

Under the NCUA's current OTR methodology the net cost of NCUSIF insurance for FISCUs is $101.49 million (TABLE 12). Under an alternative methodology that collects revenues by charter type proportionate with the insurance-related costs that they impose on the system, the net cost of NCUSIF insurance for FISCUs is $49.98 million.

TABLE 13, as reproduced from the Request, shows the total insurance-related costs to be absorbed by the NCUSIF through the OTR. Under the current methodology this is accomplished by dividing the net cost of NCUSIF insurance for FISCUs ($101.49 million) by the percentage of total insured shares held by FISCUs (47.7 percent).

TABLE 13 - COSTS TO BE ABSORBED BY THE NCUSIF, THROUGH THE OTR

Net Cost of NCUSIF Insurance for FISCUs (millions)	$101.49	TABLE 12
FISCU Proportion	47.7%	TABLE 11
Costs to be Absorbed by the NCUSIF, through the OTR (millions)	$212.78	

TABLE 13 CORRECTED, performs the same calculation but divides the corrected net cost of NCUSIF insurance for FISCUs ($49.98 million) by the percentage of insurance related costs imposed by FISCUs (30.8 percent) to calculate the total cost that must be collected from the NCUSIF.

TABLE 13 CORRECTED - COSTS TO BE ABSORBED BY THE NCUSIF, THROUGH THE OTR

Net Cost of NCUSIF Insurance for FISCUs (millions)	$49.98	TABLE 12 CORRECTED
FISCU Proportion	30.8%	TABLE 11 CORRECTED
Costs to be Absorbed by the NCUSIF, through the OTR (millions)	$162.28	

Under the NCUA's current OTR methodology the total costs to be absorbed by the NCUSIF through the OTR totals $212.78 million (TABLE 13). Under an alternative methodology that collects revenues by charter type proportionate with the insurance-related costs the total costs to be absorbed by the NCUSIF through the OTR totals $162.28 million (TABLE 13 CORRECTED).

Finally, TABLE 14, as reproduced from the Request, calculates the OTR itself, as a percentage, by dividing the total costs to be absorbed by the NCUSIF by the total NCUA budget. Under the current methodology this is accomplished by dividing $212.78 million by $290.92 million which equals 73.1 percent - the OTR under the current methodology.

TABLE 14 - OVERHEAD TRANSFER RATE

Costs to be Absorbed by the NCUSIF, through the OTR (millions)	$212.78	TABLE 13
NCUA Operating Budget	$290.92	TABLE 9
Overhead Transfer Rate	73.1%	

TABLE 14 CORRECTED performs the same calculation using the corrected figures for the total costs to be absorbed by the NCUSIF ($162.28 million) to calculate the adjusted OTR.

TABLE 14 CORRECTED - OVERHEAD TRANSFER RATE

Costs to be Absorbed by the NCUSIF, through the OTR (millions)	$162.38	TABLE 13 CORRECTED
NCUA Operating Budget	$290.92	TABLE 9 CORRECTED
Overhead Transfer Rate	55.8%	

Under the NCUA's current OTR methodology the OTR is 73.1 percent (TABLE 14). Under an alternative methodology that collects revenues by charter type proportionate with the insurance-related costs the adjusted OTR would be *at most* 55.8 percent (TABLE 14 CORRECTED).

As shown in the tables above, assuming $162.28 million is the correct amount of insurance-related costs that need to be recovered through the OTR (for the reasons discussed below this amount is likely significantly overstated) - $49.98 million of it should be recovered from FISCUs, and the remaining $112.40 million should be recovered from FCUs. This recalculation is superior from a cost accounting standpoint because it collects revenues by charter type proportionate with the insurance-related costs that they impose on the system. This approach is fair and equitable. It would produce an OTR that would be at most 55.8 percent. For the reasons discussed below, the recalculated 55.8 percent figure can and should be reduced even further.

It would not be difficult to administer a more fair and equitable OTR methodology which allocated insurance-related costs by charter type in proportion to the costs incurred by charter type. It could be accomplished through accounting rules without any changes to the structure of the Fund itself. NCUSIF capitalization adjustments from individual credit unions would be invoiced or refunded in the same manner as they are today. From an accounting standpoint the NCUSIF capitalization deposits would be segmented by charter type into two "pots," one for FCUs, one for FISCUs. Under an alternative methodology that collects revenues by charter type proportionate with the insurance-related costs imposed by charter type, insurance-related costs traceable to FCUs and FISCUs would be allocated accordingly, as demonstrated above in TABLE 11 CORRECTED and TABLE 12 CORRECTED. Within each "pot" the sum total from individual credit unions could be collected based on insured shares.

B. <u>The Current OTR Methodology is Deficient because it is Dependent on NCUA's Subjective Cost Allocation Determinations, Many of Which are Flawed</u>

A fundamental design flaw in the current OTR methodology is that it is critically dependent on subjective determinations by the NCUA with respect to the classification of various activities as insurance or non-insurance related and subjective cost allocations within certain activities. This flaw was clearly identified in the PricewaterhouseCoopers 2011 report, which noted that the computation of the OTR was fundamentally dependent on NCUA's classification decisions.[6] PWC further noted that there was a lack of any consensual knowledge base among stakeholders as to how certain activities ought to be classified and a lack of transparency with respect to NCUA's decisional criteria in making its assignments.[7]

Wholesale changes to the NCUA's classification and allocation decisions are beyond the scope of this report. I have limited my focus to several clear errors. Each of these errors produces an under-collection from FCUs for non-insurance expenses and a corresponding over-collection from FISCUs. These errors and others should be revisited. The most significant of these is that the allocation of "All Other Offices" costs.

By way of background, a necessary step in developing the OTR entails allocating the NCUA Operating Budget between insurance and non-insurance related costs.

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[6] *See* PWC Report at 5 and 26.

[7] *See id*. We recognize that the NCUA has undertaken a number of efforts in the past five years to refine the scope and content of its Examiner Time Survey (ETS), but critical reliance of the OTR on NCUA's subjective classification of insurance-related activities remains.

TABLE 6 of the Request shows how that allocation is performed. As TABLE 6 shows, costs for seven categories areas are split between insurance-related and non-insurance related costs. The dollar budget in each category is multiplied by the non-insurance percent of work in that category to produce a total Non-Insurance cost for each category. Those amounts are added together and the resulting sum is the total Non-Insurance Cost. The total insurance-related costs can be derived by subtracting the Non-Insurance Costs from the total NCUA budget. TABLE 6 is reproduced below.[8]

TABLE 6 - ALLOCATION OF NCUA OPERATING BUDGET

	Dollar budget $M)	Non-insurance percent	Non-insurance cost ($M)
All Regional Costs	$155.49	9.6%	$14.93
Asset Management Assistance Center and Assistance Program	$6.92	0.0%	$0.00
Office of Consumer Protection	$9.54	82.3%	$7.85
Office of Small Credit Union Initiatives	$6.37	6.0%	$0.38
Office of National Examinations and Support	$10.48	0.0%	$0.00
Office of Minority and Women Inclusion	$2.94	86.0%	$2.53
All Other Offices	$99.18	9.6%	$9.52
TOTAL	$290.92		$35.21
TOTAL w/o All Other	$191.74		$25.69
Non-insurance % w/o All Other			13.4%

Narrative explanations for the percent allocations assigned to different categories are provided in the Request. (Request at 45-53). With respect to the percentage allocation for the "All Other Offices" category, NCUA states:

> NCUA's remaining offices do not provide estimates on their insurance and non-insurance related activities. Rather, because these offices are support functions for NCUA's main program – the examination and supervision of credit unions – the same allocation basis used for the regional offices is used to determine the costs of insurance and non-insurance related activities for these support functions. The budgeted costs of the offices of the NCUA Board, Executive Director, General Counsel, Chief Financial Officer, Chief Information Officer and Chief Economist as well as Human Resources, Examination and Insurance, Public and

[8] Minor discrepancies in the second decimal place for several entries are presumably due to rounding conventions used by the NCUA. The differences are not material to this analysis.

> Congressional Affairs, and Continuity and Security Management are allocated at 9.6 percent non-insurance related activities for purposes of calculating the OTR.

Request at 53.

This logic for allocating the $99 million expense for All Other Offices, even within the context of cost accounting, is clearly faulty. Based on the description provided, it would almost certainly not be accepted in any governmental or commercial cost accounting that I have reviewed or participated in.

The listed support areas in All Other Offices comprise slightly over one-third of NCUA's total operating budget of $290.92 million. All of enumerated executive and administrative support functions support the operations of the entire agency, not just the regional work. The NCUA Board provides policy direction to the entire NCUA, not just the regions. The Executive Director directs the entire agency, not just the regions. The General Counsel provides legal advice to the entire agency, not just the regions. The Chief Financial Office provides accounting and budgeting services to the entire agency, not just the regions. The Chief Information Officer supports information technology for the entire agency, not just the regions. Human Resources provide services to the entire agency not just the regions. All of the enumerated overhead functions presumably support the entire agency, not just the regions. Consequently, the insurance and non-insurance related costs for “All Other Offices” should be allocated on the basis of the dollar-weighted allocation of all of the categories, not solely on the basis of the allocation of the regional work.

TABLE 6 CORRECTED, below, implements that approach. It uses the percentage of the non-insurance related work of the total operating budget with the costs for All Other Offices excluded – 13.4 percent, as shown in TABLE 6 above – to distribute the cost of All Other Offices. The corrected results produce total NCUA Non-Insurance costs of $38.98 million, an increase of $3.77 million. Because the non-insurance related costs are excluded from the OTR, the correction would also reduce the OTR.

TABLE 6 CORRECTED - ALLOCATION OF NCUA OPERATING BUDGET

	Dollar budget ($M)	Non-insurance percent	Non-insurance cost ($M)
All Regional Costs	$155.49	9.6%	$14.93
Asset Management Assistance Center and Assistance Program	$6.92	0.0%	$0.00
Office of Consumer Protection	$9.54	82.3%	$7.85
Office of Small Credit Union Initiatives	$6.37	6.0%	$0.38
Office of National Examinations and Support	$10.48	0.0%	$0.00
Office of Minority and Women Inclusion	$2.94	86.0%	$2.53
All Other Offices	$99.18	13.4%	$13.29
TOTAL CORRECTED	$290.92		$38.98

TABLE 9, as reproduced from the Request, calculates the total budgeted insurance-related costs, by subtracting the non-insurance related costs from the total operating budget figure and adding direct operational charges to the NCUSIF.

TABLE 9 - NCUSIF COSTS

[millions]

2016 NCUA Operating Budget	$290.92	
Non-Insurance Related Costs	- 35.19	Table 6
Direct Operational Charges to NCUSIF	+ 1.56	Budgeted costs for SSA training, travel, and equipment
Total 2016 Budgeted Insurance Related Costs	$257.29	

TABLE 9 CORRECTED shows the adjustment to the NCUSIF costs.

TABLE 9 CORRECTED - NCUSIF COSTS

[millions]

2016 NCUA Operating Budget	$290.92	
Non-Insurance Related Costs	- 38.98	Table 6 Corrected
Direct Operational Charges to NCUSIF	+ 1.56	Budgeted costs for SSA training, travel, and equipment
Total 2016 Budgeted Insurance Related Costs	$253.50	

Under the NCUA's current OTR methodology the total 2016 budgeted insurance related costs are $257.29 million (TABLE 9). Under an alternative methodology that corrects for obvious cost allocation errors in the "All Other Costs" category the total 2016 budgeted insurance related costs are $253.50 million (TABLE 9 CORRECTED).

Several additional allocations of budgeted program hours to Special Programs workhours and allocations with respect to the NCUA operating budget also appear to be suspect.

For example, NCUA uses the results of the ETS as a proxy for the allocation of insurance and non-insurance related hours / costs within Special Programs. This may be appropriate for certain activities, such as the regional lending specialists, but no explanation is given for using the same allocation for other functions with less obvious nexus to insurance-related work. For example, no explanation is provided as to why allocating only 13.17 percent of the time of the regional information technology specialist to non-insurance related activities is appropriate. (Request at 39).

NCUA allocates only 6 percent of the time of the Office of Small Credit Union Initiatives (OSCUI) to non-insurance related activities. (Request at 40, 49). OSCUI did not participate in ETS and minimal scrutiny of the OSCUI's assumptions reveals that allocating 94 percent of its time to insurance-related activities is unjustified. For example, OSCUI assumes that 90 percent of the consulting work regarding marketing and training and 100 percent of FOM expansion consultations are insurance-related. No rationale is provided to support these assumptions.

NCUA has also deemed 100 percent of its time in CUSO examinations as insurance-related on the basis that NCUA "does not charter and has no regulatory authority over CUSOs." (Request at 40). It is correct that NCUA does not charter CUSO's, but NCUA does not insure CUSOs either. And NCUA may not have express authority to examine CUSOs and other third-party vendors, but since 2014 NCUA regulations (referred to as NCUA's "CUSO regulations") have governed not only what services FCU CUSOs can provide, but also FCU loan and investment limits with CUSOs, the legal structure of FCU CUSOs, and NCUA has had complete access to CUSOs' books and records.[9]

Similar issues plague the NCUA operating budget allocations. In addition to the OSCUI issue mentioned above, with respect to the Office of Consumer Protection (OCP) NCUA simply assumes without any supporting time study, that 35 percent of the time spent by its Consumer Access divisions on chartering and field of membership and membership and bylaws disputes is insurance-related. (Request at 45).

NCUA allocates 100 percent of the ONES' work as insurance-related time on the basis that all of the ONES' work in connection with its examination of corporate credit unions is insurance-related. (Request at 50-51). Even accepting this as true, ONES' also examines and supervises credit unions with assets greater than $10 billion; because there are three FCUs currently above this asset threshold the non-insurance related costs must be greater than zero.

Finally, NCUA concedes that the Office of Women and Minority Inclusion (OMWI) does not monitor its time; nevertheless NCUA asserts without any additional support that 14 percent of the time of the OMWI is deemed insurance-related in connection with time spent preparing reports to Congress. (Request at 52-53).

The cost allocations for these and other issues should be corrected to produce a more accurate estimate of the total 2016 budgeted insurance related costs.

[9] *See* 12 C.F.R. § 712 and 741.

C. Economic Costing Should be Used to Investigate Potential Cross Subsidies and to Assess the Reasonableness of Cost Allocations

Accountants and economists have fundamentally different ways of thinking about and defining costs. To an economist, costs are grounded in causality. When an economist thinks about cost, particularly in an organization (a firm or a government entity) that produces a number of different goods or services, the economist starts by separating out distinct goods or services and finding the cost caused by each. NCUA "charters, regulates and insures deposits in federal credit unions (FCUs) and insures deposits in state-chartered credit unions that have their shares insured through the NCUSIF."[10] (NCUA Request at 3). The cost to NCUA caused by each of these activities and charter types is called its incremental cost.

The incremental cost of regulating and chartering FCUs is the current total cost of NCUA minus what it would cost if NCUA no longer regulated and chartered FCUs. The two other incremental costs (insuring FCUs and insuring FISCUs) would be defined and measured in similar fashion. NCUA should construct the budgets for these three scenarios (regulating and chartering FCUs, insuring FCUs, and insuring FISCUs) to estimate the incremental cost of each of the three services or products it provides.

Developing incremental cost estimates for each of the functions would also help ensure that the OTR is not being used to subsidize the insurance and non-insurance related costs of FCUs. The question is whether the NCUA provides its FCU insurance-

[10] The Request notes that "Congress envisioned efficiencies" from NCUA's dual role as the regulator of FCUs and the insurer of both FCUs and FISCUs. NCUA Request at 11. To the extent that these efficiencies actually exist, it means that it is less expensive to operate the combined operations of the NCUA than it would be to operate two separate agencies with distinct missions. It would also be less expensive to operate the NCUA than to operate two separate agencies with the same mission, one for FCUs, one for FISCUs. Economists refer to these as efficiencies as "increasing returns to scope." Where they exist, it is less expensive to run a combined operation than to run two separate ones.

related and non-insurance related examination and supervisory services below cost and, if so, whether that results in a cross-subsidy from FISCUs in the form of a higher OTR than would otherwise be justified. A cross subsidy would distort the credit union market place because the larger the OTR, the less NCUA needs to charge FCUs for its operating expenses. Artificially reducing FCU examination fees creates an unfair competitive advantage for FCUs relative to FISCUs, thus, impairing the future viability of the dual chartering system.

Cross-subsidy concerns are especially pronounced here because we have already established that the costs borne (or the prices paid) by FCUs under the current OTR methodology are less than the accounting costs of providing the insurance-related service to FCUs. We also know that the costs (or the prices paid) borne by FISCUs under the current OTR methodology are greater than the accounting costs of providing insurance-related services to FISCUs. These facts are highly suggestive of a cross-subsidy that would disadvantage FISCUs relative to FCUs and distort the credit union dual chartering system.

A thought-experiment further highlights the likely overstatement of insurance-related costs. NCUA estimates that its total operating budget for 2016 is $290.92 million and that its total non-insurance related costs are only $35.19 million (see TABLE 6). Therefore, if NCUA did not offer any insurance-related products, NCUA estimates that it would need only $35.19 million to fulfill its obligations to regulate, charter and supervise all FCUs. That figure in constant dollars matches the NCUA budget in the early 1980s, notwithstanding the dramatic increases in regulatory complexity experienced in the intervening decades. The figure is implausible and highlights the fact that NCUA's classification of all safety and soundness related costs as *exclusively* insurance-related costs cannot be justified.

Conclusion

The stated policy of the NCUA is to develop an OTR "cost-accounting methodology that by design is both neutral and equitable with respect to credit union charter types." My assessment is that the current OTR methodology is neither neutral nor equitable.

The current OTR methodology is not equitable because it fails to collect revenues by charter type proportionate with the insurance-related costs that they impose on the system. Apportioning assessments based on assets under supervision is only facially neutral by charter type. As I have shown above, as applied, that practice works to the significant detriment of FISCUs because FISCUs are forced to pay a disproportionate share of the costs classified as insurance-related.

The current OTR methodology also fails because it is critically dependent on NCUA's classification of insurance and non-related costs and other subjective cost allocation determinations. Many of those determinations are flawed. And nearly all of the flaws result in an over-recovery from FISCUs and an under-recovery from FCUs. Those are not the indicia of a neutral and equitable system. Additionally, NCUA should develop estimates of the incremental cost of each of the services it provides so that a more rigorous examination of potential cross-subsidies from FISCUs to FCUs can be undertaken. It is not possible to have a "neutral and equitable" OTR methodology with cross-subsidies.

Finally, the recalculated 55.8 percent OTR included above is illustrative of the improvements that can be made to the current methodology by: (1) correcting certain obvious flaws in the cost allocation assumptions, and (2) aligning the costs borne by FCUs and FISCUs with the incidence of the cost by charter type - a straight-forward cost accounting rule that comports with basic notions of fairness and equity. A more searching review and assessment of the reasonableness of NCUA's cost allocation assumptions and its classification of its activities as insurance or non-insurance related would likely yield additional improvements and additional reductions in the appropriate OTR.

Attachment 1: Biographic Narrative

My work in budget development and analysis dates to 1978 when I was a budget analyst in the Office of Management at the Environmental Protection Agency (EPA). I developed workload models for EPA's management accounts used to allocate resources for these activities across the 10 EPA regions based on the workload in each region and also developed methods, policy, and guidance for workload models for all EPA program areas. I also developed and implemented methods for estimating the costs of remediating abandoned hazardous waste management sites; these estimates formed the basis of EPA's supplemental budget request to the Office of Management and Budget (OMB) for the program area that eventually became Super Fund.

I founded Buc & Associates (BAI) in 1985 and merged BAI with ICF, Inc. in 1986. At BAI, among other activities, I performed background budget work for EPA's Office of Solid Waste (OSW) that it used in preparing its budget for submission to OMB.

I was President of Project Performance Corporation (PPC), a Virginia firm specializing in project management, cost estimating, scheduling, and information technology, from 1994 to 2001. Among my administrative duties I was responsible for developing the annual operating budget. That budget was then incorporated into the forward pricing estimates submitted to the Defense Contract Audit Agency (DCAA) and used for preparing cost and pricing proposals for all PPC's Federal contracting. Budgets were built by identifying the relevant cost drivers, projecting work levels, and estimating costs as a function of these drivers; they were fully compliant with the Federal Acquisition Regulation (FAR) and based on Generally Accepted Accounting Principles (GAAP). I was also responsible for coordinating PPC's incurred cost audits with DCAA, during which it reviewed and then approved our Labor, Overhead, Fringe, and G&A rates developed for our forward pricing submissions. Finally, the firm's Chief Financial Officer reported to me and I was ultimately responsible for the firm's annual audit prepared by our outside auditor.

While at PPC, I directed the firm's work on the Baseline Management Environmental Report (BEMR) for the Department of Energy (DOE), a project for which, using DOE site budgets and out year workload estimates, we conceptualized and then implemented methods to estimate the multi-billion dollar, multi-year cost of remediating the Nuclear Weapon Complex. Given the almost-fixed nature of the overhead costs of the work, I also developed and implemented a model showing that increasing budget to allow additional immediate work on the project scope would reduce the net present value (NPV) of the cleanup, since overhead costs would be incurred for a shorter time span. BEMR results were submitted to OMB and then used in DOE's Congressional budget requests. I also directed cost, budget, and contract reviews of projects at DOE sites.

I have also served as an expert witness, presenting testimony to the Postal Rate Commission (PRC) regarding the Postal Service's revenue requirement used to develop out-year budget estimates for product pricing purposes and the Postal Service's treatment of cost reduction programs, contingency costs, and asymmetry in how supervisors' costs changes as the costs of those they supervise change.

I have developed and implemented budget systems for both a private and a charter school in Washington, DC to estimate their out year costs using activity based cost principles and reflecting the relevant cost drivers and the degree of economies of scale in schools.

In addition to budgeting, I have extensive experience in cost and economic analysis encompassing both economic and accounting-based costs of activities, projects, programs, and product. As Chief of the Economic and Policy Analysis Branch at EPA's OSW (1979 - 1983), I was responsible for all cost, benefit, and economic impact analyses supporting regulatory development as EPA designed and implemented hazardous and solid waste regulations under the Resource Conservation and Recovery Act (RCRA). I introduced costing approaches that comport with economic theory while still allowing the calculation of firm economic impacts that are based on accounting cost constructs. I was also co-chair of the Agency's cost work group that developed EPA's methods and approach for estimating costs as required by the Executive Order that mandated the performance of Regulatory Impact Analyses (RIAs).

I have continued my interest and work in the economic and accounting cost of regulations and their relationship since leaving EPA. For example, for the Agency, I performed a study and prepared a report describing why it often overestimated the costs of environmental regulations. The report showed that it very frequently ignores productivity increases and learning curves in its cost estimates. Further, to the extent that regulated industries buy factor inputs in non-competitive markets, expenditures will be greater than social cost, an example of the divergence of economic and accounting costs. Finally, it discussed how expenditures are based on accounting notions of cost, and thus allocates fixed costs, where marginal costs are the proper cost construct for a benefit/cost analysis. EPA used the study in discussions with Congress in support of Clean Air Act regulations on particulates.

For a trade group, I reviewed EPA's cost estimates for the MACT combustion rule under RCRA and the Clean Air Act. I prepared and filed comments to EPA suggesting that it likely overestimated the costs of compliance with the MACT rule. And for the Institute of Scrap Recycling Industries I reviewed the cost analysis of a proposed rule that would have expanded the definition of hazardous waste, bringing new material under regulation.

I have applied similar methods in analyzing regulations and legislation in other industries. For example, for the Association of Magazine Media (MPA), I reviewed the Federal Trade Commission's cost estimates of the Telemarketing Sales Rule; and for the Cigar Rights of America I reviewed the Preliminary RIA, Initial Regulatory Flexibility Analysis (IRFA), and Unfunded Mandates Reform Act Analysis in support of proposed regulations, Deeming Tobacco Products to be Subject to the Food, Drug, and Cosmetic Act, as Amended by the Family Smoking Prevention and Tobacco Control Act; Regulations Restricting the Sale and Distribution of Tobacco Products and Required Warning Statements for Tobacco Product Packages and Advertisements prepared by the Food and Drug Administration. For MPA I analyzed balance sheet implications of legislation that would effect tax treatment of advertising expenses and depreciation schedules. For MPA I prepared a report on activity based costing which served as the basis for a section of its comments to the President's Commission on the United States Postal Service.

The costs of the Postal Service and its products and their pricing are another area of deep expertise. I began my professional work in cost analysis as a Cost Systems

Analyst at the United States Postal Service (1975-1978). While there, among other projects, I presented testimony at the Postal Rate Commission on the cost of local mail and the cost of non-local mail. And on many occasions since, I have provided expert witness testimony at the Postal Regulatory Commission (PRC) on improvements to the Postal Service's product costing system and the costs of postal products and written the costing section of comments in rule makings considering changes to analytic principals for costing. Work has covered peak load costs and pricing, costs avoided by worksharing, access pricing and efficient component pricing, price subsidization, and costing of Negotiated Service Agreements between clients and the Postal Service. The PRC has adopted several of my improved approaches for product costing. I am regularly invited to speak at industry conferences on Postal costing and pricing and have contributed chapters to books relating to postal issues. I also routinely work with clients and with the Postal Service to estimate cost savings that would result from customer operational changes.